# UNITED STATES SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended: September 30, 2006**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from __________ to __________.**

**Commission file number: 0-17972**

# DIGI INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

| **Delaware** | **41-1532464** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

**11001 Bren Road East**
**Minnetonka, Minnesota 55343**
(Address of principal executive offices) (Zip Code)

**(952) 912-3444**
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Common Stock, par value $.01 per share | The NASDAQ Global Select Market |

**Securities registered pursuant to Section 12(g) of the Act:**
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No ☑

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.
Yes ☑ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer ☑ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No ☑

The aggregate market value of voting stock held by non-affiliates of the Registrant as of the last business day of the Registrant's most recently completed second fiscal quarter was $268,876,777, based on a closing price of $11.67 per common share as reported on the NASDAQ Global Select Market (formerly the NASDAQ National Market).

Shares of common stock outstanding as of November 24, 2006: 25,085,451

# INDEX

DOCUMENTS INCORPORATED BY REFERENCE

The following table shows, except as otherwise noted, the location of information required in this Form 10-K, in the Registrant's Annual Report to Stockholders for the year ended September 30, 2006 and Proxy Statement for the Registrant's Annual Meeting of Stockholders scheduled for January 22, 2007, a definitive copy of which will be filed on or about December 6, 2006. All such information set forth below under the heading "Page/Reference" is incorporated herein by reference, or included in this Form 10-K on the pages indicated.

## PART I

### FORWARD-LOOKING STATEMENTS

This Annual Report contains certain statements that are "forward-looking statements" as that term is defined under the Private Securities Litigation Reform Act of 1995, and within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

The words "believe," "anticipate," "intend," "estimate," "target," "may," "will," "expect," "plan," "project," "should," or "continue" or the negative thereof or other expressions, which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. Such statements are based on information available to management as of the time of such statements and relate to, among other things, expectations of the business environment in which the Company operates, projections of future performance, perceived opportunities in the market and statements regarding the Company's mission and vision. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

The future operating results and performance trends of the Company may be affected by a number of factors, including, without limitation, those described in Item 1A, Risk Factors, of this Form 10-K. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in the Company's filings with the Securities and Exchange Commission, including without limitation, its quarterly reports on Form 10-Q and its registration statements, could cause the Company's actual future results to differ materially from those projected in the forward-looking statements as a result of the factors set forth in the Company's various filings with the Securities and Exchange Commission and of changes in general economic conditions, changes in interest rates and/or exchange rates and changes in the assumptions used in making such forward-looking statements.

### ITEM 1. BUSINESS

During fiscal 2005 and 2004, the Company operated in two reportable segments. Effective October 1, 2005, the Company changed its organizational structure to functional reporting to eliminate redundancies in management and infrastructure. In addition, certain intellectual property that was previously utilized primarily in products that comprised the Device Networking Solutions segment has now been integrated throughout the Company's products in order to provide more functionality and allow for ease of migration to next generation technologies for the Company's customers. As a result of these changes in organizational structure and use of the Company's product technology, the Chief Executive Officer, as the chief operating decision maker, now reviews and assesses financial information, operating results, and performance of the Company's business in the aggregate. Accordingly, effective October 1, 2005, the Company has a single operating and reporting segment and all periods presented have been reclassified to conform to the single reportable segment.

### COMPANY OVERVIEW

Digi International Inc. was formed in 1985 as a Minnesota corporation and reorganized as a Delaware corporation in 1989 in conjunction with its initial public offering. The common stock of Digi is traded on the NASDAQ Global Select Market under the symbol DGII. The Company has its worldwide headquarters in Minnetonka, Minnesota, with regional sales offices throughout North America, Europe, and Asia Pacific, and engineering offices in North America and Europe. The Company has sales offices located throughout North America, Europe and Asia Pacific. Digi products are available through approximately 225 distributors in more

**ITEM 1. BUSINESS (CONTINUED)**

**COMPANY OVERVIEW (CONTINUED)**

than 55 countries. The terms "Digi" or "the Company" mean Digi International Inc. and all of the subsidiaries included in the consolidated financial statements unless the context indicates otherwise.

As a leader in device networking for business, Digi develops reliable products and technologies to connect and securely manage local or remote electronic devices over the network or via the Internet. Businesses use Digi products to create, customize and control retail operations, industrial automation and other applications. Digi's products are sold globally through distributors, systems integrators, solution providers and direct marketers as well as direct to strategic OEMs, government and commercial partners.

Digi's revenues consist of products that are in embedded and non-embedded product groupings. Embedded products include microprocessors and development tools, which are used by customers' engineers to build electronic devices with fully integrated networking functionality, embedded modules, core modules and single board computers and MaxStream wireless products. The non-embedded (or external) products consist of network connected products for access to serial devices over Ethernet networks, multi-port serial adapters, Universal Serial Bus (USB) connected products and cellular gateways. Non-embedded products can be used to connect one or many standalone devices or to connect devices as part of a larger solution (e.g., self-checkout systems, ATMs, medical systems, factory equipment).

Digi's first products were box and board-level serial port adapters (sold under the DigiBoard® brand) that were used to directly connect multiple peripherals, such as standalone computer terminals, to personal computer servers or a host computer system. During the 1990s, Digi employed Ethernet technology to provide the connectivity infrastructure for businesses. This trend began in the head and branch offices of businesses and in the late 1990s began to extend to the factory, retail stores, restaurants, and many other environments such as medical, traffic control, and building controls. During the same time, the semiconductor industry was also advancing rapidly. Complete systems were being built on single integrated circuits (chips). These chips, as part of a box or board product, could be used to build a network interface for virtually any device for which network connectivity was required. Digi recognized the developing opportunities for device connectivity and in early 2000 implemented a strategy to leverage the brand strength that it had established with the DigiBoard product line by organically developing or acquiring next-generation connectivity products and technologies that would extend the value of the brand into an array of commercial-grade device networking applications. In the past several years, Digi has augmented the strategy with an increasing emphasis on wireless solutions. Since 2000, Digi has made several acquisitions that provide complimentary products and technologies.

- In October 2000, Digi acquired privately held Inside Out Networks Inc. (Inside Out Networks), a developer and marketer of "out of the box" external data connection technologies that utilize USB.
- In June 2001, Digi acquired INXTECH, a French designer and manufacturer of Ethernet connectivity solutions sold under the Xcell technology brand. This acquisition provided technology and market knowledge to accelerate Digi's introduction of its device server product line. Device servers are both embedded and non-embedded products and are intelligent, easy-to-use network devices that convert serial data into network data.
- In February 2002, Digi acquired NetSilicon®, Inc. (NetSilicon), a developer and marketer of network attached processors and device connectivity software. NetSilicon's advanced microprocessors and software allowed customers to build intelligent, network-enabled solutions for manufacturers, mostly original equipment manufacturers (OEMs). With the acquisition of NetSilicon, Digi began offering embedded networking solutions used by design engineers as building blocks in the creation of devices.

**ITEM 1. BUSINESS (CONTINUED)**

**COMPANY OVERVIEW (CONTINUED)**

- In April 1, 2005, Digi acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (FS Forth), leading providers of embedded modules based on Digi processors and Net+OS software as well as other microprocessors with supporting embedded software. The acquisition enhanced Digi's embedded portfolio and also added expertise in a wide range of popular operating systems such as Linux, Microsoft Windows CE and VxWorks.
- In May 2005, Digi acquired Rabbit Semiconductor® Inc. (formerly Z-World™, Inc. and hereinafter referred to as Rabbit). Rabbit manufactured the Rabbit line of microprocessors and microprocessor-based core modules and Z-World single board computers (now all sold under the Rabbit brand). Rabbit's products facilitate quick time-to-market for device manufacturers who need to add network connectivity to endpoint devices such as sensors, meters, vending machines, card readers, and scales. Similar to Digi, Rabbit bundles hardware and software together, creating an engineer-friendly development environment.
- In July 2006, Digi acquired MaxStream®, Inc. (MaxStream), a leader in the wireless device networking market. MaxStream supplies device manufacturers and integrators with reliable wireless modules and box products that are easy to use and allow customers to wirelessly monitor and control electronic devices. Typical applications include automated utility meter reading, oil and gas monitoring, remote control and monitoring of commercial heating and air conditioning systems, vehicle information access for fleet management, industrial controls, wireless sensors, and electronic signals. MaxStream wireless technologies and products significantly expand Digi's wireless offering — covering both short and medium range using embedded modules and boxed/packaged solutions. Additionally, MaxStream is a pioneer in the field of ZigBee™/802.15.4 wireless communications.

Digi continues to leverage a common core technology base to develop and provide innovative connectivity solutions to its customers. Core technology is being migrated across product lines to provide additional functionality for customers, allowing them to get to market with network-enabled devices faster and improve their return on capital spending investments. Digi has positioned itself in the growing market of integrated hardware and software connectivity solutions to network-enable the coming generation of intelligent devices in commercial applications.

**APPLICATION MARKETS AND PRODUCTS**

Digi believes it is a worldwide leader in commercial grade device connectivity, through network-enabling devices in stores, factories, office buildings, banks, gas stations, oil rigs, hospitals, and many other vertical environments. The Company's products are compatible with many computing platforms, including IBM, Hewlett Packard and Sun Microsystems, as well as popular operating systems, such as Microsoft Windows NT/98/2000/XP/2003/CE, Linux, and UNIX.

Application markets where these products are prominently used include industrial automation, retail/Point-of-Sale (POS), building automation/security, medical/healthcare, out-of-band management, and office networking.

The Company's products include multi-port serial cards, network connected products, USB connected products, cellular gateways, wireless non-embedded products, and wired and wireless embedded networking products, including microprocessors, embedded modules, core modules and single-board computers, and networking software.

**ITEM 1. BUSINESS (CONTINUED)**

**APPLICATION MARKETS AND PRODUCTS (CONTINUED)**

**Application Markets**

**Industrial Automation** — Digi offers solutions for common challenges found in virtually every manufacturing facility today. These challenges include productivity improvements, inventory management and quality control. Digi provides solutions for attaching essential devices, including process and quality control equipment, pump controllers, bar-code readers/scanners, scales and weighing stations, printers, machine vision systems, programmable logic controllers (PLCs) and many other types of manufacturing equipment.

**Retail/Point-of-Sale (POS)** — Digi products solve the challenges associated with enabling POS devices to effectively share information across the network. They can be used to easily connect network devices like card swipe readers, bar-code scanners, scales, receipt printers and cash register display poles.

**Building Automation/Security** — Digi products automate and control buildings' heating, ventilation and air conditioning (HVAC) and security systems, and solve the problem of standalone control systems that are unable to talk to each other and share important data. Digi solutions can be used to centrally manage equipment and improve the comfort, safety and productivity of building occupants.

**Medical/Healthcare** — Digi network-enables medical equipment and devices to receive, monitor and access patient information quickly, easily, and accurately, utilizing the hospital's existing Ethernet or wireless network to improve patient care and reduce operating costs.

**Out-of-Band Management** — Digi's out-of-band management solutions enable immediate response when a network fails or in other critical situations, providing connectivity to servers and network equipment when the primary network is down and eliminating costly travel to remote sites.

**Office Networking** — Each business day billions of images are created, moved and then output in some form over networks and the Internet in a process called image communication. This demanding process has driven the need for a new generation of network attached devices to manage the ever increasing load of network media. Digi provides core solutions for connecting, enabling and managing this process for office, industrial and POS printers, as well as MFP's, network cameras, network LCD's, information displays and network projectors.

**Products**

**Non-Embedded Products**

**Multi-Port Serial Adapters —** The Company is a market leader in this product category and offers one of the most comprehensive multi-port serial adapter product families in the market. The Company's products support a wide range of operating systems, port-densities, bus types, expansion options, and applications.

As Ethernet connections extend beyond current applications, the multi-port serial adapter products are gradually transitioning to network-attached and/or USB-attached devices. While the Company will continue to fully support this mature product line, it has strengthened its product offering to meet customer needs and is working to seamlessly transition customers to newer technologies.

**ITEM 1. BUSINESS (CONTINUED)**

**APPLICATION MARKETS AND PRODUCTS (CONTINUED)**

**Network Connected Products** — Digi offers flexible, powerful and easy solutions (wired and wireless) to provide access to serial, USB and display devices over Ethernet networks.

External Serial Servers (formerly called device servers and terminal servers) quickly and easily turn a previously isolated device with a serial port into a fully collaborative component of the network. Digi believes that External Serial Servers will continue to be an important product category as Ethernet-based serial connections continue to extend beyond their current applications into new markets such as building automation, healthcare, process control and secure console port management on servers, routers, switches, and other network equipment.

Digi's intelligent Console Servers are used in data center management applications, where companies need to access, monitor and manage network devices and servers across multiple sites, both over the network or via their console ports, even when the network is unavailable. Digi's Console Servers are compatible with virtually any network equipment with a serial port including Sun, Cisco, IBM, Hewlett Packard, UNIX, Linux and Microsoft Windows Server 2003 systems.

In 2005, Digi introduced the Zero-Client category, a next generation client architecture that redirects USB, serial and display data over Internet Protocol (IP). The ConnectPort Display™ eliminates locally-attached, dedicated PCs from restaurant kitchens, retail checkouts and digital signage, such as airport status displays and stadium scoreboards, allowing customers to connect peripheral devices and video displays at each service point, with all processing happening across the network for increased security and lower total cost of ownership.

**USB Connected Products —** The Company has one of the most comprehensive and sophisticated USB product lines in the industry. Furthermore, the Company's EPIC software provides seamless transition between legacy software/systems and next generation USB attached devices, supporting hardware and software flow control signaling. This software provides ease of use and integration while protecting technology investments.

**Cellular Gateways —** Digi introduced the first intelligent high-speed cellular gateways in 2005 and 2006 to address the growing need for customers to connect remote site and devices. These products utilize GSM (GPRS/EDGE/UMTS/HSDPA) or CDMA (1xRTT/EV-DO) cellular data networks as an alternative to landlines for cost-effective primary or backup connectivity to previously hard-to-reach sites and devices. The products have been certified by major wireless service providers in the U.S. and abroad, including Cingular Wireless, Verizon Wireless and Sprint. All of Digi's cellular gateway products include Digi Connectware® Manager, a unique enterprise software platform that provides secure management of devices across remote networks.

**Embedded Networking Products**

**Microprocessors and Development Tools —** Digi designs and manufactures integrated network centric silicon-based solutions for manufacturers who want to build intelligence and network connectivity into their products. The platforms integrate high performance microprocessors and advanced networking software to provide fully integrated networking solutions.

**Embedded Modules —** In 2003, Digi extended its line of embedded networking products to include the Digi Connect ME® and Digi Connect® EM embedded modules, which are ideal for network and web-enabling a device. In 2004, the Company expanded its product offering to include wireless embedded modules that are pin-compatible and interchangeable with the Digi Connect wired embedded modules- the Digi Connect® Wi-ME and Digi Connect® Wi-EM. These products enable customers to easily accommodate both wired and

## ITEM 1. BUSINESS (CONTINUED)

## APPLICATION MARKETS AND PRODUCTS (CONTINUED)

wireless functionality in one product design and are typically used as co-processors that manage a device's communications system.

**Core Modules and Single Board Computers —** In 2005, Digi extended its embedded product families into core modules by introducing the Digi ConnectCore™ line of products. Digi ConnectCore is the industry's first network-optimized series of 32-bit core modules targeted as the main processor for products including access control systems, POS systems, RFID readers, medical devices and instrumentation and networked displays.

Core modules provide customers with a networked platform for uses as the main processor in an embedded system and the flexibility to allow them to add features and functionality to get to market very quickly with a network-enabled device. In addition, the Rabbit acquisition also added a family of single board computers (SBCs). While SBCs offer the same benefits as core modules, they also obviate the need for additional interface circuitry because they include all of the key device interface components on one circuit board.

**MaxStream Wireless Products —** MaxStream provides wireless modem modules, standalone radio modems (now part of Digi's network connected products), RF design services, and supporting software. The products are easy-to-use and allow customers to wirelessly monitor and control electronic devices. Typical applications include automated utility meter reading, oil and gas monitoring, remote control and monitoring of commercial heating and air conditioning systems, vehicle information access for fleet management, industrial controls, wireless sensors, and electronic signals.

## DISTRIBUTION AND PARTNERSHIPS

Digi sells its products through a global network of distributors, systems integrators, value added resellers (VARs) and original equipment manufacturers (OEMs).

The Company's larger U.S. distributors include Tech Data Corporation, Arrow Distributing, Ingram Micro, Synnex, Future Electronics and NuHorizons. Digi also maintains relationships with many other distributors in the U.S., Canada, Europe, Asia Pacific, and Latin America. Additionally, Digi maintains strong relationships with catalog distributors CDW, Insight, Digi-Key and Mouser Electronics.

Digi maintains strategic alliances with other industry leaders to develop and market technology solutions. These include most major communications hardware and software vendors, operating system suppliers, computer hardware manufacturers, and cellular carriers. Key partners include: Microsoft, Citrix Systems, Hewlett Packard, IBM, Motorola, Dell, Santa Cruz Operation, Sun Microsystems, Toshiba, Atmel, Green Hills Software, Cingular, Sprint, Verizon, and several other cellular carriers. Furthermore, Digi maintains a worldwide network of authorized developers that extends the Company's reach into certain technology applications or geographical regions.

The Company's customer base includes many of the world's largest companies. The Company has strategic sales relationships with leading vendors, allowing them to ship the Company's board and network products as component parts of their overall networking solutions. These vendors include IBM, NCR, Sun Microsystems, Fujitsu Transaction Solutions, Abbott Labs and Hewlett Packard, among others. Many of the world's leading telecommunications companies and Internet service providers also rely on the Company's products, including Lucent, AT&T, Cingular, Sprint, Verizon and Siemens. The Company has also established relationships with customers such as Hirschmann, Sauter, Pro Control, Bizerba, AFT Atlas, Ikusi and Metso Automation and many authorized resellers and OEMs.

## ITEM 1. BUSINESS (CONTINUED)

### DISTRIBUTION AND PARTNERSHIPS (CONTINUED)

One distributor, Tech Data, comprised 5.8%, 12.9% and 15.6% of the Company's net sales for the years ended September 30, 2006, 2005 and 2004, respectively.

### COMPETITIVE CONDITIONS

The Company competes in the communications technology industry, which is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. The Company competes for customers on the basis of existing and planned product features, company reputation, brand recognition, technical support, relationships with partners, quality and reliability, product development capabilities, price and availability.

The Company is a global market leader in multi-port serial adapters. As this market continues to mature, the Company is focusing on key applications, customers, and markets to manage applications as they transition to other technologies such as Ethernet, USB, and wireless connectivity products. The Company also is a leader in connecting commercial devices to LANs with its terminal server and device server product lines, to PCs or servers via USB technology with its USB product line, and to WANs with its cellular product line. The complementary nature of its embedded product lines will provide an expanded range of products and technology. The recent acquisition of MaxStream makes it a market leader in North America for proprietary wireless and Zigbee/Mesh networking wireless products.

### OPERATIONS

The Company's manufacturing operations procure all parts and perform certain services involved in production. Most of the Company's product manufacturing is subcontracted to outside firms that specialize in such services. Digi relies on third party foundries for its semiconductor devices. This approach is beneficial because the Company can reduce its fixed costs, maintain production flexibility and maximize its profits.

The Company's products are manufactured to their designs with standard and semi-custom components. Most of these components are available from multiple vendors. The Company has several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to the Company. If these suppliers are unable to provide a timely and reliable supply of components, the Company could experience manufacturing delays that would adversely affect its consolidated results of operations.

During fiscal years 2006, 2005 and 2004, the Company's research and development expenditures were $20.9 million, $16.5 million and $17.2 million, respectively. Due to rapidly changing technology in the communications technology industry, the Company believes that its success depends primarily upon the engineering, marketing, manufacturing and support skills of its personnel. Digi's proprietary rights and technology are protected by a combination of copyrights, trademarks, trade secrets and patents. The Company has established common law and registered trademark rights on a family of marks for a number of its products.

As of September 30, 2006, the Company had backlog orders in the amount of $12.4 million. All of these orders are expected to be shipped in fiscal 2007. Backlog as of September 30, 2005 was $9.0 million and $7.0 million as of September 30, 2004. Backlog as of any particular date is not necessarily indicative of the Company's future sales trends.

The Company had 549 employees on September 30, 2006 compared to 481 on September 30, 2005. The increase in the number of employees in fiscal 2006 is primarily due to the addition of 47 employees as a result of the acquisition of MaxStream.

**ITEM 1. BUSINESS (CONTINUED)**

**DIGI INTERNATIONAL WEBSITE**

The Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the Company's website (www.digi.com) under the "About us — Investor Relations" caption or by writing to Digi International Inc. This information is available free of charge as soon as reasonably practicable after the Company electronically files such material with the Securities and Exchange Commission. These reports can also be accessed via the SEC website, www.sec.gov, or via the SEC's Public Reference Room located at 150 F Street, N.E., Room 1580, Washington, D.C. 20549. Information concerning the operation of the SEC's Public Reference Room can be obtained by calling 1-800-SEC-0330.

The Company is not including the information on its website as part of, or incorporating it by reference into, its Form 10-K.

**ITEM 1A. RISK FACTORS**

Multiple risk factors exist which could have a material effect on our operations, results of operations, profitability, financial position, liquidity, capital resources and common stock.

**Risks Relating to Our Business**

***Our dependence on new product development and the rapid technological change that characterizes our industry make us susceptible to loss of market share resulting from competitors' product introductions and similar risks.***

The communications technology industry is characterized by rapidly changing technologies, evolving industry standards, frequent new product introductions, short product life cycles and rapidly changing customer requirements. The introduction of products embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable. Our future success will depend on our ability to enhance our existing products, to introduce new products to meet changing customer requirements and emerging technologies, and to demonstrate the performance advantages and cost-effectiveness of our products over competing products. Failure by us to modify our products to support new alternative technologies or failure to achieve widespread customer acceptance of such modified products could cause us to lose market share and cause our revenues to decline.

We may experience delays in developing and marketing product enhancements or new products that respond to technological change, evolving industry standards and changing customer requirements. There can be no assurance that we will not experience difficulties that could delay or prevent the successful development, introduction, and marketing of these products or product enhancements, or that our new products and product enhancements will adequately meet the requirements of the marketplace and achieve any significant or sustainable degree of market acceptance in existing or additional markets. In addition, the future introductions or announcements of products by us or one of our competitors embodying new technologies or changes in industry standards or customer requirements could render our then-existing products obsolete or unmarketable. There can be no assurance that the introduction or announcement of new product offerings by us or one or more of our competitors will not cause customers to defer the purchase of our existing products, which could cause our revenues to decline.

**ITEM 1A. RISK FACTORS (CONTINUED)**

***We intend to continue to devote significant resources to our research and development, which, if not successful, could cause a decline in our revenues and harm our business.***

We intend to continue to devote significant resources to research and development in the coming years to enhance and develop additional products. For the fiscal years ended 2006, 2005 and 2004, our research and development expenses comprised 14.4%, 13.2% and 15.4%, respectively, of our net sales. If we are unable to develop new products as a result of our research and development efforts, or if the products we develop are not successful, our business could be harmed. Even if we develop new products that are accepted by our target markets, the net revenues from these products may not be sufficient to justify our investment in research and development.

A substantial portion of our recent development efforts have been directed toward the development of new products targeted to manufacturers of intelligent, network-enabled devices and other embedded systems in various markets, including markets in which networking solutions for embedded systems have not historically been sold, such as markets for industrial automation equipment, security equipment and medical equipment. Our financial performance is dependent upon the development of the intelligent device markets that we are targeting, and our ability to successfully compete and sell our products to manufacturers of these intelligent devices.

***Certain of our products are sold into mature markets, which could limit our ability to continue to generate revenue from these products.***

Certain of our products provide asynchronous and synchronous data transmissions via add-on cards. The market for add-on asynchronous and synchronous data communications cards is mature. Furthermore, certain applications of our embedded network interface cards are also considered mature. As the overall market for these products decreases due to the adoption of new technologies, we expect that our revenues from these products will continue to decline. As a result, our future prospects depend in large part on our ability to acquire or develop and successfully market additional products that address growth markets.

***Our failure to effectively manage product transitions could have a material adverse effect on our revenues and profitability.***

From time to time, we or our competitors may announce new products, capabilities, or technologies that may replace or shorten the life cycles of our existing products. Announcements of currently planned or other new products may cause customers to defer or stop purchasing our products until new products become available. Furthermore, the introduction of new or enhanced products requires us to manage the transition from older product inventories and ensure that adequate supplies of new products can be delivered to meet customer demand. Our failure to effectively manage transitions from older products could have a material adverse effect on our revenues and profitability.

***Our failure to compete successfully in our highly competitive market could result in reduced prices and loss of market share.***

The market in which we operate is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. We compete for customers on the basis of existing and planned product features, company reputation, brand recognition, technical support, relationships with partners, quality and reliability, product development capabilities, price, and availability. Certain of our competitors and potential competitors may have greater financial, technological, manufacturing, marketing, and personnel resources than us. Present and future competitors may be able to identify new markets and develop products more quickly, which are superior to those developed by us. They may also adapt new technologies faster, devote greater resources to research and development, promote products more aggressively, and price products more competitively than us. There are no assurances that competition will not intensify or that we will be able to compete effectively in the markets in which we compete.

***Our inability to obtain the appropriate telecommunications carrier certifications or approvals from other governmental regulatory bodies could impede our ability to grow revenues in our wireless products.***

The sale of our wireless products in certain geographical markets is sometimes dependent on the ability to gain telecommunications carrier certifications and/or approvals by certain governmental bodies. The inability of us to obtain these approvals, or delays in receiving the approvals, could impact our ability to enter our targeted markets or to compete effectively or at all in these markets and could have an adverse impact on our revenues.

***The cyclicality of the semiconductor industry may result in substantial period-to-period fluctuations in operating results.***

Our semiconductor products provide networking capabilities for intelligent, network-enabled devices and other embedded systems. The semiconductor industry is highly cyclical and subject to rapid technological change and has been subject to significant economic downturns at various times, characterized by diminished product demand, accelerated erosion of average selling prices and production overcapacity. The semiconductor industry also periodically experiences increased demand and production capacity constraints. As a result, we may experience substantial period-to-period fluctuations in operating results due to general semiconductor industry conditions.

***Loss of one or more of our key customers could have an adverse effect on our revenues.***

Our sales are primarily made on the basis of purchase orders rather than under long-term agreements, and therefore, any customer could cease purchasing our products at any time without penalty. The decision of any key customer, including our distributors, to cease using our products or a material decline in the number of units purchased by a significant customer could have a material adverse effect on our revenues.

***The long and variable sales cycle for certain of our products makes it more difficult for us to predict our operating results and manage our business.***

The sale of our products typically involves a significant technical evaluation and commitment of capital and other resources by potential customers and end users, as well as delays frequently associated with end users' internal procedures to deploy new technologies within their products and to test and accept new technologies. For these and other reasons, the sales cycle associated with certain of our products is typically lengthy and is subject to a number of significant risks, including end users' internal purchasing reviews, that are beyond our control. Because of the lengthy sales cycle and the large size of certain customer orders, if orders forecasted for a specific customer are not realized, our operating results could be materially adversely affected.

***We depend on manufacturing relationships and on limited-source suppliers, and any disruptions in these relationships may cause damage to our customer relationships.***

We procure all parts and certain services involved in the production of our products and subcontract most of our product manufacturing to outside firms that specialize in such services. Although most of the components of our products are available from multiple vendors, we have several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us. There can be no assurance that our suppliers will be able to meet our future requirements for products and components in a timely fashion. In addition, the availability of many of these components to us is dependent in part on our ability to provide our suppliers with accurate forecasts of our future requirements. Delays or lost sales could be

ITEM 1A. RISK FACTORS (CONTINUED)

caused by other factors beyond our control, including late deliveries by vendors of components. If we are required to identify alternative suppliers for any of our required components, qualification and pre-production periods could be lengthy and may cause an increase in component costs and delays in providing products to customers. Any extended interruption in the supply of any of the key components currently obtained from limited sources could disrupt our operations and have a material adverse effect on our customer relationships and profitability.

***Our use of suppliers in Southeast Asia involves risks that could negatively impact us.***

We use suppliers in Southeast Asia. Product delivery times may be extended due to the distances involved, requiring more lead time in ordering. In addition, ocean freight delays may occur as a result of labor problems, weather delays or expediting and customs issues. Any extended delay in receipt of the component parts could eliminate anticipated cost savings and have a material adverse effect on our customer relationships and profitability.

***Our ability to compete could be jeopardized if we are unable to protect our intellectual property rights.***

Our ability to compete depends in part on our proprietary rights and technology. Our proprietary rights and technology are protected by a combination of copyrights, trademarks, trade secrets and patents.

We enter into confidentiality agreements with all employees, and sometimes with our customers and potential customers, and limit access to the distribution of our proprietary information. There can be no assurance that the steps taken by us in this regard will be adequate to prevent the misappropriation of our technology. Our pending patent applications may be denied and any patents, once issued, may be circumvented by our competitors. Furthermore, there can be no assurance that others will not develop technologies that are superior to our technologies. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competing companies will not independently develop similar technology. Our failure to adequately protect our proprietary rights could have a material adverse effect on our competitive position and result in loss of revenue.

***From time to time, we are subject to claims and litigation regarding intellectual property rights or other claims, which could seriously harm us and require us to incur significant costs.***

The communications technology industry is characterized by frequent litigation regarding patent and other intellectual property rights. From time to time, we receive notification of a third-party claim that our products infringe other intellectual property rights. Any litigation to determine the validity of third-party infringement claims, whether or not determined in our favor or settled by us, may be costly and divert the efforts and attention of our management and technical personnel from productive tasks, which could have a material adverse effect on our ability to operate our business and service the needs of our customers. There can be no assurance that any infringement claims by third parties, if proven to have merit, will not materially adversely affect our business or financial condition. In the event of an adverse ruling in any such matter, we may be required to pay substantial damages, cease the manufacture, use and sale of infringing products, discontinue the use of certain processes or be required to obtain a license under the intellectual property rights of the third party claiming infringement. There can be no assurance that a license would be available on reasonable terms or at all. Any limitations on our ability to market our products, or delays and costs associated with redesigning our products or payments of license fees to third parties, or any failure by us to develop or license a substitute technology on commercially reasonable terms could have a material adverse effect on our business and financial condition.

**ITEM 1A. RISK FACTORS (CONTINUED)**

***We face risks associated with our international operations and expansion that could impair our ability to grow our revenues abroad.***

We believe that our future growth is dependent in part upon its ability to increase sales in international markets. These sales are subject to a variety of risks, including fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers, unexpected changes in regulatory requirements, longer accounts receivable payment cycles and potentially adverse tax consequences, and export license requirements. In addition, we are subject to the risks inherent in conducting business internationally, including political and economic instability and unexpected changes in diplomatic and trade relationships. There can be no assurance that one or more of these factors will not have a material adverse effect on our business strategy and financial condition.

***The loss of key personnel could prevent us from executing our business strategy.***

Our business and prospects depend to a significant degree upon the continuing contributions of our executive officers and our key technical personnel. Competition for such personnel is intense, and there can be no assurance that we will be successful in attracting and retaining qualified personnel. Failure to attract and retain key personnel could result in our failure to execute our business strategy.

***Unanticipated changes in our tax rates could affect our future results.***

Our future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or our interpretation. In addition, we may be subject to the examination of our income tax returns by the Internal Revenue Service and other U.S. and international tax authorities. We regularly assess the potential outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an effect on our consolidated operating results and financial condition.

***Any acquisitions we have made or will make could disrupt our business and seriously harm our financial condition.***

We will continue to consider acquisitions of complementary businesses, products or technologies. In the event of any future purchases, we could issue stock that would dilute our current stockholders' percentage ownership, incur debt, assume liabilities, or incur large and immediate write-offs.

Our operation of any acquired business may also involve numerous risks, including:

- problems combining the purchased operations, technologies, or products;
- unanticipated costs;
- diversion of management's attention from our core business;
- difficulties integrating businesses in different countries and cultures;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees, particularly those of the purchased organization.

We cannot assure that we will be able to successfully integrate any businesses, products, technologies, or personnel that we have acquired or that we might acquire in the future and any failure to do so could disrupt our business and have a material adverse effect on our financial condition and results of operations. Moreover, from time to time, we may enter into negotiations for a proposed acquisition, but be unable or unwilling to consummate the acquisition under consideration. This could cause significant diversion of management's attention and out-of-pocket expenses for us. We could also be exposed to litigation as a result of an

**ITEM 1A. RISK FACTORS (CONTINUED)**

unconsummated acquisition, including claims that we failed to negotiate in good faith or misappropriated confidential information.

***Our failure to effectively comply with the requirements of applicable environmental legislation and regulation could have a material adverse effect on our revenues and profitability.***

Production and marketing of products in certain states and countries may subject us to environmental and other regulations. In addition, certain states and countries may pass regulations requiring our products to meet certain requirements to use environmentally friendly components. Such laws and regulations have recently been passed in jurisdictions in which we operate. The European Union has issued two directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive (WEEE) makes producers of certain electrical and electronic equipment financially responsible for collection, reuse, recycling, treatment and disposal of equipment placed in the European Union market after August 13, 2005. The Restrictions of Hazardous Substances Directive (RoHS) bans the use of certain hazardous materials in electric and electrical equipment which are put on the market in the European Union after July 1, 2006. In the future, China and other countries including the United States are expected to adopt environmental compliance programs. If we fail to comply with these regulations, we may not be able to sell our products in jurisdictions where these regulations apply, which could have a material adverse effect on our revenues and profitability.

**Risks Related to Our Common Stock**

***The price of our common stock has been volatile and could continue to fluctuate in the future.***

The market price of our common stock, like that of many other high-technology companies, has fluctuated significantly and is likely to continue to fluctuate in the future. During fiscal year 2006, the closing price of our common stock on the NASDAQ Global Select Market ranged from $9.84 to $14.33 per share. Our closing sale price on November 24, 2006 was $13.85 per share. Announcements by us or others regarding the receipt of customer orders, quarterly variations in operating results, acquisitions or divestitures, additional equity or debt financings, results of customer field trials, scientific discoveries, technological innovations, litigation, product developments, patent or proprietary rights, government regulation and general market conditions may have a significant impact on the market price of our common stock.

***Certain provisions of the Delaware General Corporation Law and our charter documents have an anti-takeover effect.***

There exist certain mechanisms under the Delaware General Corporation Law and our charter documents that may delay, defer or prevent a change of control. For instance, under Delaware law, we are prohibited from engaging in certain business combinations with interested stockholders for a period of three years after the date of the transaction in which the person became an interested stockholder unless certain requirements are met, and majority stockholder approval is required for certain business combination transactions with interested parties. Our Certificate of Incorporation contains a “fair price” provision requiring majority stockholder approval for certain business combination transactions with interested parties, and this provision may not be changed without the vote of at least 80% of the outstanding shares of our voting stock. Other mechanisms in our charter documents may also delay, defer or prevent a change of control. For instance, our Certificate of Incorporation provides that our Board of Directors has authority to issue series of our preferred stock with such voting rights and other powers as the Board of Directors may determine. Furthermore, we have a classified board of directors, which means that our directors are divided into three classes that are elected to three-year terms on a staggered basis. Since the three-year terms of each class overlap the terms of the other classes of directors, the entire board of directors cannot be replaced in any one year. In addition, under Delaware law, directors serving on a classified board may not be removed by shareholders except for cause. Pursuant to the terms of a shareholder rights plan adopted in 1998, each outstanding share of common stock has one attached right. The rights will cause substantial dilution of the ownership of a person or group that attempts to acquire Digi on terms not approved by the Board of Directors and may have the effect of deterring hostile takeover attempts. The effect of these anti-takeover provisions may be to deter business combination transactions not approved by our Board of Directors, including acquisitions that may offer a premium over the market price to some or all stockholders.

***We have not paid cash dividends on our common stock and do not expect to do so.***

We have never declared or paid a cash dividend on our common stock. We do not anticipate paying any cash dividends on our common stock in the foreseeable future.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

The following table contains a listing of the Company's current property locations:

| Location of Property | Use of Facility | Approximate Square Footage | Ownership or Lease Expiration Date |
|---|---|---|---|
| Minnetonka, MN (Corporate headquarters) | Research & development, sales, sales support, marketing, and administration | 130,000 | Owned |
| Eden Prairie, MN | Manufacturing and warehousing | 58,000 | Owned |
| Waltham, MA | Research & development, sales and sales support | 21,759 | September 2007 |
| Austin, TX | Sales, sales support, marketing, and administration | 6,563 | February 2009 |
| Davis, CA | Sales, sales support, manufacturing and warehousing | 24,000 | December 2012 |
| Davis, CA | Marketing, research & development, and administration | 11,200 | September 2008 |
| Lindon, UT | Sales, marketing, research & development, and administration | 10,686 | December 2007 |
| Hong Kong, China | Sales, marketing, and administration | 3,413 | August 2007 |
| Beijing, China | Sales, marketing, and administration | 2,372 | December 2006 |
| Shanghai, China | Sales, marketing, and administration | 1,251 | June 2008 |
| Dortmund, Germany | Sales, sales support, marketing, and administration | 65,348 | Owned |
| Breisach, Germany | Sales, marketing, research & development, manufacturing, warehousing and administration | 8,748 | December 2008 |
| Logrono, Spain | Sales, research & development, and administration | 1,291 | September 2007 |

In addition to the above locations, the Company performs research and development activities in various other locations in the United States and sales activities in various other locations in Europe which are not deemed to be principal locations. Management believes that the Company's facilities are adequate for its needs. The Company is attempting to sell the Dortmund, Germany facility.

## ITEM 3. LEGAL PROCEEDINGS

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of NetSilicon and approximately 300 other public companies. The complaint names as defendants the Company, NetSilicon, certain of its officers and certain underwriters involved in NetSilicon's IPO, among numerous others, and asserts, among other things, that NetSilicon's IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon's IPO underwriters in allocating shares in NetSilicon's IPO to the underwriters' customers. The Company believes that the claims against the NetSilicon defendants are without merit and has defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

**ITEM 3. LEGAL PROCEEDINGS (CONTINUED)**

In June 2003, the Company elected to participate in a proposed settlement agreement with the plaintiffs in this litigation. If ultimately approved by the Court, this proposed settlement would result in a dismissal, with prejudice, of all claims in the litigation against the Company and against any of the other issuer defendants who elect to participate in the proposed settlement, together with the current or former officers and directors of participating issuers who were named as individual defendants.

Consummation of the proposed settlement remains conditioned upon obtaining approval by the Court. On September 1, 2005, the Court preliminarily approved the proposed settlement and directed that notice of the terms of the proposed settlement be provided to class members. Thereafter, the Court held a fairness hearing on April 24, 2006, at which objections to the proposed settlement were heard. After the fairness hearing, the Court took under advisement whether to grant final approval to the proposed settlement.

If the proposed settlement is not consummated, the Company intends to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, there can be no guarantee as to the ultimate outcome of this pending lawsuit. The Company maintains liability insurance for such matters and expects that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of September 30, 2006, the Company has accrued a liability for the deductible amount of $250,000 which the Company believes reflects the amount of loss that is probable. In the event the Company has losses that exceed the limits of the liability insurance, such losses could have a material effect on the business, or consolidated results of operations or financial condition of the Company.

In the normal course of business, the Company is subject to various claims and litigation, including patent infringement and intellectual property claims. Management of the Company expects that these various claims and litigation will not have a material adverse effect on the consolidated results of operations or financial condition of the Company.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to the vote of security holders during the fourth quarter of the fiscal year ended September 30, 2006.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

### Stock Listing

The Company's Common Stock trades under the symbol "DGII." Since July 3, 2006 the Company's Common Stock has traded on the NASDAQ Global Select Market tier of the NASDAQ Stock Market and prior to that time was traded on the NASDAQ National Market tier. On November 24, 2006, the number of holders of the Company's Common Stock was approximately 8,181, consisting of 240 record holders and approximately 7,941 stockholders whose stock is held by a bank, broker or other nominee.

High and low sale prices for each quarter during the years ended September 30, 2006 and 2005, as reported on the NASDAQ Stock Market, were as follows:

### Stock Prices

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| 2006 | | | | |
| High | $13.41 | $11.81 | $13.94 | $14.35 |
| Low | $ 9.63 | $10.18 | $10.91 | $10.11 |

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| 2005 | | | | |
| High | $17.53 | $17.25 | $13.89 | $14.79 |
| Low | $11.59 | $13.24 | $10.11 | $ 9.75 |

### Dividend Policy

The Company has never paid cash dividends on its Common Stock. The Board of Directors presently intends to retain all earnings for use in the Company's business and does not anticipate paying cash dividends in the foreseeable future.

The Company does not have a Dividend Reinvestment Plan or a Direct Stock Purchase Plan.

### Issuer Repurchases of Equity Securities

The Company did not repurchase any of its equity securities in the fourth quarter of the fiscal year ended September 30, 2006.

## ITEM 6. SELECTED FINANCIAL DATA

(In thousands except per common share amounts and number of employees)

| For the fiscal years ended September 30 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Net sales | $ 144,663 | $ 125,198 | $ 111,226 | $ 102,926 | $ 101,536 |
| Gross profit (1) | $ 77,505 | $ 71,491 | $ 63,469 | $ 55,766 | $ 50,632 |
| Sales and marketing (1) | 28,591 | 26,339 | 25,556 | 24,734 | 28,808 |
| Research and development (1) | 20,861 | 16,531 | 17,159 | 15,968 | 19,530 |
| General and administrative (1) | 12,830 | 11,364 | 8,973 | 9,944 | 14,664 |
| Restructuring | — | — | — | (600) | 2,696 |
| Acquired in-process research and development | 2,000 | 300 | — | — | 3,100 |
| Loss on sale of MiLAN assets | — | — | — | — | 3,617 |
| Gain from forgiveness of grant payable | — | — | — | (553) | (1,068) |
| Operating income (loss) | 13,223 | 16,957 | 11,781 | 6,273 | (20,715) |
| Total other income, net | 2,044 | 1,026 | 369 | 296 | 1,255 |
| Income (loss) before income taxes and cumulative effect of accounting change | 15,267 | 17,983 | 12,150 | 6,569 | (19,460) |
| Income tax provision (benefit) (2) | 4,154 | 318 | 3,487 | (23) | (6,675) |
| Income (loss) before cumulative effect of accounting change | 11,113 | 17,665 | 8,663 | 6,592 | (12,785) |
| Cumulative effect of accounting change (3) | — | — | — | (43,866) | — |
| Net income (loss) | $ 11,113 | $ 17,665 | $ 8,663 | $ (37,274) | $ (12,785) |
| Net income (loss) per common share, basic: | | | | | |
| Income (loss) before cumulative effect of accounting change | $ 0.48 | $ 0.79 | $ 0.41 | $ 0.31 | $ (0.65) |
| Cumulative effect of accounting change | — | — | — | (2.08) | — |
| Net income (loss) per common share | $ 0.48 | $ 0.79 | $ 0.41 | $ (1.77) | $ (0.65) |
| Net income (loss) per common share, diluted | | | | | |
| Income (loss) before cumulative effect of accounting change | $ 0.46 | $ 0.76 | $ 0.39 | $ 0.31 | $ (0.65) |
| Cumulative effect of accounting change | — | — | — | (2.07) | — |
| Net income (loss) per common share | $ 0.46 | $ 0.76 | $ 0.39 | $ (1.76) | $ (0.65) |
| Balance sheet data as of September 30: | | | | | |
| Working capital (total current assets less total current liabilities) | $ 83,341 | $ 69,995 | $ 82,090 | $ 57,793 | $ 62,662 |
| Total assets | $ 225,321 | $ 177,631 | $ 150,465 | $ 132,540 | $ 180,828 |
| Long-term debt and capital lease obligations | $ 725 | $ 1,181 | $ — | $ — | $ 4,989 |
| Stockholders' equity | $ 193,830 | $ 153,537 | $ 127,079 | $ 105,863 | $ 151,180 |
| Book value per common share | $ 7.74 | $ 6.78 | $ 5.83 | $ 5.23 | $ 6.80 |
| Number of employees as of September 30 | 549 | 481 | 341 | 358 | 407 |

(1) Effective October 1, 2005, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), using the modified prospective method of application. Total compensation cost for stock-based payment arrangements totaled $2.3 million ($1.5 million after tax) during fiscal year 2006. Prior to the adoption of this Statement, no compensation cost for stock-based payment arrangements was recognized in earnings. Refer to Note 9 to the Consolidated Financial Statements for further discussion.

(2) During 2006 and 2005, the Company reversed income tax reserves of $1.6 million and $5.7 million, respectively, which were no longer required primarily as a result of the settlement of tax audits with the French government in 2006 and the Internal Revenue Service in 2005. In 2003, the Company reversed a valuation allowance, resulting in an income tax benefit of $1.4 million, based on anticipated future taxable income generated by the Company's German operations.

(3) The Company adopted the provisions of FAS 142 as of October 1, 2002 at which time it was determined that there was a total goodwill impairment of $43.9 million. The charge was attributable primarily to an impairment of the carrying value of goodwill related to the acquisition of NetSilicon of $38.4 million and goodwill related to the CDC and INXTECH acquisitions of $3.5 million and $2.0 million, respectively.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OVERVIEW

During fiscal 2005 and 2004, the Company operated in two reportable segments. Effective October 1, 2005, the Company changed its organizational structure to functional reporting to eliminate redundancies in management and infrastructure. In addition, certain intellectual property that was previously utilized primarily in products that comprised the Device Networking Solutions segment has now been integrated throughout the Company's products in order to provide more functionality and allow for ease of migration to next generation technologies for the Company's customers. As a result of these changes in organizational structure and use of the Company's product technology, the Chief Executive Officer, as the chief operating decision maker, now reviews and assesses financial information, operating results, and performance of the Company's business in the aggregate. Accordingly, effective October 1, 2005, the Company has a single operating and reporting segment and all periods presented have been reclassified to conform to the single reportable segment (see Note 4 to the Company's Consolidated Financial Statements).

Digi operates in the communications technology industry, which is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. Digi provides device connectivity solutions by providing products that connect devices to networks in various commercial environments. Digi believes that its products and technologies are cost-effective and easy to use, and Digi places a high priority on development of innovative products that provide differentiated features and functions and allow for ease of integration with customers' applications. Core technology is being migrated across product lines to provide additional functionality for customers and allow them to get to market with networked-enabled devices faster. Digi's revenues consist of products that are in non-embedded and embedded product groupings. The non-embedded products include multi-port serial adapters, network connected products, USB connected products, and cellular gateway products. Embedded products include microprocessors and development tools, embedded modules, core modules and single-board computers and MaxStream wireless products. Digi's non-embedded multi-port serial adapter products and its embedded network interface cards are in the mature phase of their product life cycles. Digi's strategy is to focus on key applications, customers and markets to efficiently manage the migration from products that are in the mature phase of their product life cycles to other newer technologies.

During fiscal 2006, the Company released many new products, including cellular products, ConnectPort Display, and Rabbit-branded chips and core modules. Digi also acquired MaxStream in July 2006, providing an expanded wireless technology and product portfolio.

We anticipate that the Company's growth in the future will result from both products that are developed internally as well as from products that are acquired, and that the growth rate from products developed internally will increase as the multi-port serial adapters and the network interface cards near the end of their product life cycles. The Company intends to continue to extend its current product lines with next generation commercial grade device networking products and technologies targeted for selected vertical markets, including but not limited to point of sale, industrial automation, office automation, medical and building controls. The Company believes that there is a market trend of device connectivity in these vertical commercial applications that will require communications intelligence or connectivity to the network or the Internet. These devices will be used for basic data communications, management, monitoring and control, and maintenance. The Company believes that it is well positioned to leverage its current products and technologies to take advantage of this market trend.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**CONSOLIDATED RESULTS OF OPERATIONS**

The following table sets forth selected information from the Company's Consolidated Statements of Operations, expressed as a percentage of net sales and as a percentage of change from year-to-year for the years indicated.

($ in thousands)

| | Year ended September 30, 2006 | | 2005 | | 2004 | | % Increase (decrease) 2006 Compared to 2005 | 2005 Compared to 2004 |
|---|---|---|---|---|---|---|---|---|
| Net sales | $ 144,663 | 100.0% | $ 125,198 | 100.0% | $ 111,226 | 100.0% | 15.5% | 12.6% |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) (1) | 62,322 | 43.1 | 49,516 | 39.6 | 43,443 | 39.1 | 25.9 | 14.0 |
| Amortization of purchased and core technology | 4,836 | 3.3 | 4,191 | 3.3 | 4,314 | 3.8 | 15.4 | (2.9) |
| Gross profit | 77,505 | 53.6 | 71,491 | 57.1 | 63,469 | 57.1 | 8.4 | 12.6 |
| Operating expenses: | | | | | | | | |
| Sales and marketing (1) | 28,591 | 19.8 | 26,339 | 21.1 | 25,556 | 23.0 | 8.6 | 3.1 |
| Research and development (1) | 20,861 | 14.4 | 16,531 | 13.2 | 17,159 | 15.4 | 26.2 | (3.7) |
| General and administrative (1) | 12,830 | 8.9 | 11,364 | 9.1 | 8,973 | 8.1 | 12.9 | 26.6 |
| In-process research and development | 2,000 | 1.4 | 300 | 0.2 | — | — | N/M | N/M |
| Total operating expenses | 64,282 | 44.5 | 54,534 | 43.6 | 51,688 | 46.5 | 17.9 | 5.5 |
| Operating income | 13,223 | 9.1 | 16,957 | 13.5 | 11,781 | 10.6 | (22.0) | 43.9 |
| Total other income, net | 2,044 | 1.4 | 1,026 | 0.9 | 369 | 0.3 | 99.2 | 178.0 |
| Income before income taxes | 15,267 | 10.5 | 17,983 | 14.4 | 12,150 | 10.9 | (15.1) | 48.0 |
| Income tax provision | 4,154 | 2.8 | 318 | 0.3 | 3,487 | 3.1 | N/M | N/M |
| Net income | $ 11,113 | 7.7% | $ 17,665 | 14.1% | $ 8,663 | 7.8% | (37.1)% | 103.9% |

N/M means not meaningful

(1) As a result of adopting FAS No. 123R as of October 1, 2005 on a modified prospective basis, stock-based compensation expense (pre-tax) is included in the consolidated results of operations for the twelve months ended September 30, 2006 as follows (in thousands):

| | Twelve months ended September 30, 2006 |
|---|---|
| Cost of sales | $ 89 |
| Sales and marketing | 694 |
| Research and development | 530 |
| General and administrative | 976 |
| Total | $ 2,289 |

As of September 30, 2006 the total unrecognized compensation cost related to non-vested stock-based compensation arrangements net of expected forfeitures was $4.8 million and the related weighted average period over which it is expected to be recognized is approximately 2.6 years.

**NET SALES**

Net sales were $144.7 million in fiscal 2006 compared to $125.2 million in fiscal 2005, an increase in net sales of $19.5 million, or 15.5%. Net sales of products acquired as a result of the FS Forth, Rabbit, and MaxStream acquisitions, which are primarily embedded products, increased $27.5 million in fiscal 2006 compared to fiscal 2005. Net sales of products other than those acquired through acquisitions, comprised of both non-embedded and embedded products, resulted in a net sales increase of $7.8 million in fiscal 2006, offset by a decline in net sales of multi-port serial adapters and network interface cards of $15.8 million as they approach the ends of their respective product life cycles. Due to customer and product mix changes, the Company has experienced a slight decrease in the average selling price of its products. Fluctuation in foreign currency rates compared to the prior year's rates had an unfavorable impact on net sales of $0.6 million in fiscal 2006 and a favorable impact on net sales of $0.7 million in fiscal 2005. The net sales increase from 2004 to 2005 was $14.0 million, or 12.6%.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**NET SALES (CONTINUED)**

| | Net Sales | | | % of Net Sales | | |
|---|---|---|---|---|---|---|
| ($ in millions) | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| Non-embedded | $ 86.7 | $ 87.5 | $ 82.9 | 59.9% | 69.9% | 74.6% |
| Embedded | 58.0 | 37.7 | 28.3 | 40.1% | 30.1% | 25.4% |
| Total | $ 144.7 | $ 125.2 | $ 111.2 | 100.0% | 100.0% | 100.0% |

**2006 Compared to 2005**

The Company's non-embedded products net sales decreased $0.8 million in fiscal 2006 compared to fiscal 2005. Product introductions generated an increase in net sales of network connected products, USB and cellular gateways, partially offsetting the decline of the multi-port serial adapter products.

Embedded products net sales increased $20.3 million in fiscal 2006 compared to fiscal 2005. Net sales of the Rabbit, FS Forth, and MaxStream branded embedded products increased $25.9 million in fiscal 2006 compared to fiscal 2005. Introduction of new embedded modules and microprocessors, as well as new customers reaching production volumes, partially offset the continued decline of the NIC sales in fiscal 2006.

**2005 Compared to 2004**

Digi improved its competitive position in fiscal 2005 with two acquisitions and product introductions creating an increase in net sales of $14.0 million or 12.6% compared to fiscal 2004.

The Company's non-embedded products net sales increased $4.6 million in fiscal 2005 compared to fiscal 2004 due to an increase in sales of network connected products, USB and cellular gateways, offset by the continuing market decline of the multi-port serial adapter products.

Embedded products net sales increased $9.4 million in fiscal 2005 compared to fiscal 2004. Net sales of Rabbit-branded products, consisting primarily of microprocessors, embedded modules and single-board computers, were $10.6 million from the date of acquisition of May 26, 2005, through the end of fiscal 2005. OEM customers migrating from network interface cards to software only solutions, resulted in a net sales decline of the NIC sales during fiscal 2005 compared to fiscal 2004, partially offset by the introduction of new embedded modules and new customers reaching production volumes.

**Distribution Channels**

The Company's revenue is generated from these distribution channels: Direct / OEMs and distributors. The following tables present the Company's revenue by channel and by geographic location of the customers:

| | Net Sales | | | % of Net Sales | | |
|---|---|---|---|---|---|---|
| ($ in millions) | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| Direct / OEM Channel | $ 70.3 | $ 62.7 | $ 54.8 | 48.6% | 50.1% | 49.3% |
| Distribution Channel | 74.4 | 62.5 | 56.4 | 51.4% | 49.9% | 50.7% |
| Total Company | $ 144.7 | $ 125.2 | $ 111.2 | 100.0% | 100.0% | 100.0% |

The increase in Direct / OEM channel net sales during the last three fiscal years was primarily due to the Company's continued enhancement of its product offerings through the acquisitions of Rabbit and MaxStream, whose customers are primarily OEMs, and the Company's decision to sell directly to certain customers rather than through the distribution channel.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### NET SALES (CONTINUED)

The increase in the distribution channel net sales over the last three fiscal years was primarily due to the Company's continued focus on maintaining its channel strategy, which includes employing additional channel partners and releasing complimentary products.

**Net Sales by Geographic Area**

| ($ in millions) | Net Sales | | | % of Net Sales | | |
|---|---|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| International | $ 55.9 | $ 53.2 | $ 49.2 | 38.6% | 42.5% | 44.2% |
| Domestic | 88.8 | 72.0 | 62.0 | 61.4% | 57.5% | 55.8% |
| Total Company | $ 144.7 | $ 125.2 | $ 111.2 | 100.0% | 100.0% | 100.0% |

The increase in international net sales for the three years was primarily due to incremental international sales resulting from the acquisitions of Rabbit and FS Forth as well as a focus on expansion in the Asia Pacific market which offset the decline in international sales of NICs.

The increase in domestic net sales was primarily due to continued market penetration, new customers reaching production volumes and introduction of new products as a result of acquiring complementary product lines.

### GROSS PROFIT

**2006 Compared to 2005**

Gross profit margin for 2006 was 53.6% compared to 57.1% in 2005. The decrease in gross profit margin was primarily due to product mix changes among products within both the embedded and non-embedded product groups, as well as higher manufacturing expenses.

**2005 Compared to 2004**

Gross profit margin was 57.1% for both 2005 and 2004, as sales of Rabbit products with lower gross profit margins were offset by an increase in gross profit margin due to reduced amortization of core and purchased technology resulting from certain purchased technology becoming fully amortized during fiscal 2005.

### OPERATING EXPENSES

**2006 Compared to 2005**

Operating expenses were $64.3 million in 2006, an increase of $9.8 million or 17.9%, compared to operating expenses of $54.5 million in 2005. The acquisition of MaxStream resulted in $3.1 million of additional operating expenses of which $2.0 million is related to in-process research and development. Fiscal 2006 also includes twelve months of operating expenses for Rabbit and FS Forth, acquired in the third quarter of fiscal 2005, resulting in incremental operating expenses of $7.5 million (of which $0.7 million is related to identifiable intangibles amortization expense) in 2006. As a result of the adoption of FAS 123R on October 1, 2005, the Company recorded $2.2 million in stock-based compensation expense in fiscal 2006. Operating expense savings of $3.0 million were realized in fiscal 2006 compared to fiscal 2005, primarily due to savings in compensation-related expenses, contract labor and professional fees.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**OPERATING EXPENSES (CONTINUED)**

Sales and marketing expenses were $28.6 million in 2006, an increase of $2.3 million or 8.6%, compared to sales and marketing expenses of $26.3 million in 2005. Sales and marketing expenses increased by an incremental $2.9 million due to the acquisitions of MaxStream, Rabbit and FS Forth and by an incremental $0.7 million due to stock-based compensation expense. These increases were offset by an incremental decrease in compensation-related expenses of $1.1 million due to open positions and decreased commissions in fiscal 2006 compared to fiscal 2005.

Research and development expenses were $20.9 million in 2006, an increase of $4.4 million or 26.2%, compared to research and development expenses of $16.5 million in 2005. Research and development expenses increased in fiscal 2006 compared to fiscal 2005 primarily due to incremental research and development expenses of $3.8 million due to the acquisitions of MaxStream, Rabbit and FS Forth and by an incremental $0.5 million due to stock-based compensation expense.

General and administrative expenses were $12.8 million in 2006, an increase of $1.4 million or 12.9%, compared to general and administrative expenses of $11.4 million in 2005. The increase was due to incremental expenses of $1.9 million (of which $0.7 million is related to identifiable intangibles amortization expense) related to the acquisitions of MaxStream, Rabbit and FS Forth and by an incremental $1.0 million due to stock-based compensation expense. The aforementioned increases in expenses were offset by savings of $1.2 million in compensation related expenses, professional fees and depreciation expense due to certain assets becoming fully depreciated. Intellectual property associated with a prior acquisition was sold for $0.2 million and was recorded as a contra expense in general and administrative expenses in fiscal 2006.

In-process research and development expenses associated with the acquisition of MaxStream were $2.0 million in 2006, compared to in-process research and development expenses of $0.3 million in 2005 associated with the acquisition of Rabbit in 2005 (see Note 2 to the Company's Consolidated Financial Statements).

**2005 Compared to 2004**

Operating expenses were $54.5 million in 2005, an increase of $2.8 million or 5.5%, compared to operating expenses of $51.7 million in 2004. Incremental operating expenses of $4.9 million were incurred as a result of the acquisitions of Rabbit and FS Forth, during the third quarter of fiscal 2005, of which $0.3 million related to in-process research and development associated with the Rabbit 4000 microprocessor. These increases were offset in part by the Company's continued focus on general cost containment in an effort to lower operating expenses as a percent of net sales. Although operating expenses increased $4.9 million as a result of the acquisitions of Rabbit and FS Forth, operating expenses as a percent of net sales improved to 43.6% in fiscal 2005 from 46.5% in fiscal 2004.

Sales and marketing expenses were $26.3 million in 2005, an increase of $0.8 million or 3.1%, compared to sales and marketing expenses of $25.5 million in 2004. The acquisitions of Rabbit and FS Forth during the third quarter of fiscal 2005, resulted in incremental sales and marketing expenses of $1.6 million in 2005. This increase was partially offset by a decline in variable sales and marketing expense related to a decline in net sales in certain other product categories, primarily in the network interface card product line.

Research and development expenses were $16.5 million in 2005, a decrease of $0.6 million or 3.7%, compared to research and development expenses of $17.1 million in 2004. The acquisitions of Rabbit and FS Forth resulted in incremental research and development expenses of $1.9 million. This increase was offset by a decline in chip fabrication and testing expense due to the timing of chip development. During fiscal 2004, fabrication and testing expenses were incurred for chip projects that were in development. During fiscal 2005, the development phase of these chips ended and the chips were released into volume production.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### OPERATING EXPENSES (CONTINUED)

General and administrative expenses were $11.4 million in 2005, an increase of $2.4 million or 26.6%, compared to general and administrative expenses of $9.0 million in 2004. Incremental general and administrative expenses were $0.6 million (of which $0.5 million is related to identifiable intangibles amortization) as a result of the acquisitions of Rabbit and FS Forth. In addition, general and administrative expenses increased due to increased professional service expense including legal and Section 404 Sarbanes-Oxley related expenses.

### ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT

**MaxStream, Inc.**

On July 27, 2006, the Company acquired MaxStream, Inc. (MaxStream), a privately held corporation and a leader in the wireless device networking market. The total purchase price of $40.5 million included $19.8 million in cash (excluding cash acquired of $3.7 million) and $20.7 million in common stock, in exchange for all outstanding shares of MaxStream's preferred and common stock and outstanding stock options. The Company did not replace MaxStream's outstanding options with Digi options.

At the time of acquisition, MaxStream had development projects in process associated with the XStream Gen. 2, X. Eleven, Mesh Firmware, Xbee Zigbee Firmware and Xplore products. Management estimated that $2.0 million of the purchase price represented the fair value of acquired in-process research and development related to the products listed below (in thousands) that were under development, had a measurable percentage completed and a documented expected life, had not yet reached technological feasibility, and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

| | |
|---|---|
| XStream Gen. 2 | $ 900 |
| X. Eleven | 500 |
| Mesh Firmware | 400 |
| Xbee Zigbee Firmware | 100 |
| Xplore | 100 |
| Total in-process research and development | $ 2,000 |

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company's estimate of revenue growth for each of the products over the next five fiscal years, using the assumption that all revenue recorded after that date will be generated from future technologies.
- The estimated gross margin was based upon historical gross margin for MaxStream's products, with an increase over time attributable to production synergies.
- The estimated operating expenses were based on consideration of historical selling, general and administrative expenses as a percentage of sales and MaxStream's projected operating expenses.
- Maintenance research and development, defined as the research and development necessary to sustain the existing technology and its revenue stream, was also included as an operating expense. The estimated remaining cost to complete each in-process research and development technology was also included in operating expenses.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)**

- When applying the income valuation approach, the cash flows expected to be generated by an asset are discounted to their present value equivalent using a rate of return that reflects the relative risk of the investment, as well as the time value of money. This return, known as the weighted average cost of capital ("WACC"), is an overall rate based upon the individual rates of return for invested capital (equity and interest-bearing debt). The discount rate used in the income valuation approach was 25%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The Company used a 40% rate of return for the in-process research and development projects.

The Company anticipates that the XStream Gen. 2, X. Eleven, Mesh Firmware and Xbee Zigbee Firmware projects will be released in calendar year 2007 and the Xplore product will be completed at the end of calendar year 2006. These estimates described above are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur.

**Rabbit Semiconductor Inc.**

On May 26, 2005, the Company acquired Rabbit, formerly Z-World, Inc., a privately held corporation for a purchase price of $49.3 million in cash (excluding cash acquired of $0.4 million and assumption of $1.3 million in debt).

At the time of acquisition, Rabbit had a development project in process for the Rabbit 4000 microprocessor. The project involved the design and development of a next-generation microprocessor that would have increased code execution speed, reduced code size, added security features, and integrated Ethernet capabilities. Management estimated that $0.3 million of the purchase price represented the fair value of acquired in-process research and development related to the Rabbit 4000 microprocessor that had not yet reached technological feasibility and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company's estimate of revenue growth over the next six fiscal years, or the estimated life cycle of the Rabbit 4000 microprocessor, using the assumption that all revenue recorded after that date will be generated from future technologies.

- The estimated gross margin was based upon historical gross margin for Rabbit's products, with an increase over time attributable to production synergies.

- The estimated selling, general and administrative expenses were based on consideration of historical operating expenses as a percentage of sales and Rabbit's projected operating expenses.

  When applying the income valuation approach, the cash flows expected to be generated by an asset are discounted to their present value equivalent using a rate of return that reflects the relative risk of the investment, as well as the time value of money. This return, known as the WACC, is an overall rate based upon the individual rates of return for invested capital (equity and interest-bearing debt). The discount rate used in the income valuation approach was 23%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The Company used a 40% rate of return for the in-process research and development projects.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

The Company released the Rabbit 4000 microprocessor in March 2006. The Company anticipates that the projected revenue from the Rabbit 4000 microprocessor will be in line with original projections. These estimates are subject to change and no assurance can be given that deviations from these estimates will not occur.

### OTHER INCOME (EXPENSE)

Total other income, net was $2.0 million in fiscal 2006 compared to $1.0 million in fiscal 2005. The Company realized interest income on marketable securities and cash and cash equivalents of $2.4 million in fiscal 2006 compared to $1.6 million in fiscal 2005. The increase in interest income was primarily due to higher average interest rates in fiscal 2006 compared to fiscal 2005, which was partially offset by a decrease in the average investment balance. The Company earned an average interest rate of approximately 4.3% during fiscal 2006 compared to approximately 2.5% for fiscal 2005. The invested balance averaged $52.6 million during fiscal 2006 compared to $64.8 million during fiscal 2005. Interest expense was $0.2 million in fiscal 2006 primarily related to interest expense on the $5.0 million short-term loan that was used to finance the MaxStream acquisition and interest on capital leases. The short-term loan was paid in full in August 2006. Other expense was $0.2 million in fiscal 2006 and $0.5 million in fiscal 2005.

Total other income, net was $1.0 million in fiscal 2005 compared to $0.4 million in fiscal 2004. The Company realized interest income on marketable securities and cash and cash equivalents of $1.6 million in fiscal 2005 compared to $0.9 million in fiscal 2004. The increase in interest income was due to higher average interest rates in fiscal 2005 compared to fiscal 2004 and average cash and marketable securities balances were comparable between years. Interest expense was $0.1 million in fiscal 2005 related to interest expense on the $21.0 million short-term loan that was used to finance the Rabbit acquisition and interest on capital leases and a revolving line of credit held by Rabbit. The short-term loan was paid in full in July 2005. Other expense was $0.5 million in both fiscal 2005 and fiscal 2004.

### INCOME TAXES

The Company's effective income tax rate was 27.2% in fiscal 2006 compared to 1.8% in fiscal 2005. During fiscal 2006, the Company recorded $1.6 million in discrete tax benefits, primarily related to an audit of prior fiscal years which was settled with the French government in 2006. The Company had established tax reserves that were no longer required as a result of the settlement. The Company recorded an income tax benefit as a result of the reversal of the tax reserves related to this settlement. The aforementioned discrete income tax benefits reduced the effective tax rate by 10.4 percentage points in fiscal 2006. These tax benefits were partially offset by non-deductible MaxStream acquired in-process research and development expense, which increased the effective tax rate in fiscal 2006 by 4.6 percentage points (see reconciliation of the statutory income tax rate to the effective tax rate in Note 8 to the Company's Consolidated Financial Statements). In February 2005, the Congressional Joint Committee on Taxation approved a settlement with the Internal Revenue Service on an audit of certain of the Company's prior fiscal years income tax returns. The Company had established tax reserves in excess of the ultimate settled amounts. As a result, the Company recorded an income tax benefit of $5.7 million in fiscal 2005 representing the excess of its income tax reserves over the amount paid. The income tax benefit of $5.7 million reduced the effective tax rate by 31.6 percentage points in fiscal 2005. The effective tax rates for both fiscal 2006 and fiscal 2005 are lower than the U.S. statutory rate of 35.0% primarily due to the aforementioned income tax benefits and the utilization of income tax credits and exclusions for extraterritorial income in both years and the domestic production activities deduction in fiscal 2006.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**INCOME TAXES (CONTINUED)**

The Company's effective income tax rate was 28.7% in fiscal 2004. The effective tax rate for fiscal 2004 is lower than the U.S. statutory rate of 35.0% primarily due to the utilization of income tax credits and exclusions for extraterritorial income.

As of September 30, 2006, the Company had United States federal net operating loss carryforwards and tax credit carryforwards of $2.6 million and $2.9 million, respectively, which expire at various dates through 2026. The Company also had foreign net operating loss carryforwards and tax credit carryforwards at September 30, 2006, of $2.0 million and $0.2 million, respectively, the majority of which carry forward indefinitely.

The Company is required to assess the realizability of its deferred tax assets and the need for a valuation allowance against those assets in accordance with Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" (FAS 109). The Company has concluded that it is more likely than not that the remaining deferred tax assets will be realized based on future projected taxable income and the anticipated future reversal of deferred tax liabilities, and therefore no valuation allowance has been established at September 30, 2006. The amount of the net deferred tax assets realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If the Company's future taxable income projections are not realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in future taxable income is determined.

**INFLATION**

Management believes inflation has not had a material effect on the Company's operations or on its financial position.

**LIQUIDITY AND CAPITAL RESOURCES**

The Company has financed its operations principally with funds generated from operations. At September 30, 2006, the Company had cash, cash equivalents and short-term marketable securities of $58.9 million compared to $50.2 million at September 30, 2005. The Company's working capital increased $13.3 million to $83.3 million at September 30, 2006, compared to $70.0 million at September 30, 2005. Working capital decreased $12.1 million in fiscal 2005 from $82.1 million at September 30, 2004 to $70.0 million at September 30, 2005.

Net cash provided by operating activities was $20.4 million during fiscal 2006 compared to net cash provided by operating activities of $18.1 million during fiscal 2005, an increase of $2.3 million. Changes in working capital generated a $4.7 million increase in net cash provided by operating activities, resulting from changes in income taxes payable and accounts receivable, partially offset by reductions resulting from inventory and account payable. Changes in tax benefits related to stock-based compensation reduced cash provided by operating activities by $2.8 million. Net cash provided by operating activities was $18.1 million during fiscal 2005 compared to net cash provided by operating activities of $19.3 million during fiscal 2004. The decline in net cash provided by operating activities of $1.2 million between comparable fiscal years ended September 30, 2005 and 2004 is primarily the result of a payment of $3.2 million to the IRS in November 2004 due to the settlement on an audit of certain of the Company's income tax returns for prior fiscal years.

Fiscal 2004 net income of $8.7 million along with non-cash charges including depreciation and amortization expense of $8.6 million and a $2.3 million tax benefit related to stock option exercises were the primary factors that resulted in net cash provided by operating activities of $19.3 million.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)**

Fiscal 2004 net income of $8.7 million along with non-cash charges including depreciation and amortization expense of $8.6 million and a $2.3 million tax benefit related to stock option exercises were the primary factors that resulted in net cash provided by operating activities of $19.3 million.

Net cash used in investing activities was $23.2 million during fiscal 2006 compared to net cash used in investing activities of $30.1 million and $25.0 million during fiscal 2005 and fiscal 2004, respectively. During fiscal 2006, the Company paid $16.1 million in cash (net of cash acquired of $3.7 million) for the acquisition of MaxStream and during fiscal 2005, the Company paid $48.9 million (net of cash acquired of $0.4 million) and $4.8 million for the acquisitions of Rabbit and FS Forth, respectively. Purchases of marketable securities were $6.0 million in fiscal 2006. Proceeds from the sale of intellectual property were $0.2 million in fiscal 2006. Net settlements from marketable securities were $25.0 million in fiscal 2005 compared to net purchases of $21.7 million in fiscal 2004. Purchases of property, equipment, improvements and certain other intangible assets were $1.3 million in each of the fiscal years ended 2006, 2005 and 2004. The Company also used $2.0 million in fiscal 2004 for contingent purchase price payments related to acquisitions.

During fiscal 2006, the Company generated $5.6 million from financing activities primarily due to $6.1 million of cash received from the exercise of stock options and employee stock purchase plan transactions. This was offset by $0.5 million of cash used for capital lease obligations. The Company entered into a $5.0 million short-term loan agreement during the fourth quarter of fiscal 2006 to finance the MaxStream acquisition and repaid the loan in the same quarter. The Company generated $4.9 million from financing activities in fiscal 2005, compared to $7.1 million in fiscal 2004, primarily due to cash received from the exercise of stock options and employee stock purchase plans of $6.3 million and $9.3 million in fiscal 2005 and 2004, respectively. The Company entered into a $21.0 million short-term loan during the third quarter of fiscal 2005 to finance the Rabbit acquisition. The Company determined that it was more economical to borrow funds to finance the Rabbit acquisition than to liquidate marketable securities prior to their scheduled maturities. This short-term loan was repaid in fiscal 2005. In January 2004, the short-term borrowing agreement with Sparkasse Dortmund in the amount of $2.0 million was repaid.

The Company's management believes that current financial resources, cash generated from operations and the Company's potential capacity for debt and/or equity financing will be sufficient to fund its business operations for the foreseeable future.

The following summarizes the Company's contractual obligations at September 30, 2006. However, this table excludes a potential $1.2 million installment on October 1, 2007 if FS Forth achieves certain future milestones. The Company paid $0.8 million in October 2006 as contingent consideration related to the FS Forth transaction based on the achievement of the milestones identified in the merger agreement.

| | Payments due by fiscal period | | | | |
|---|---|---|---|---|---|
| (in thousands) | Total | Less than 1 year | 1-3 years | 3-5 years | Thereafter |
| Operating leases | $6,538 | $2,400 | $2,075 | $1,105 | $958 |
| Capital leases | 1,311 | 472 | 775 | 64 | — |
| Total contractual cash obligations | $7,849 | $2,872 | $2,850 | $1,169 | $958 |

The lease obligations summarized above relate to various operating lease agreements for office space and equipment and have not been reduced by minimum sublease rentals of $0.2 million due in the future under noncancellable subleases.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### FOREIGN CURRENCY

The majority of the Company's foreign currency transactions are executed in the U.S. Dollar, Euro or Japanese Yen. As a result, the Company is exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros or Japanese Yen and foreign currency translation risk as the financial position and operating results of the Company's foreign subsidiaries are translated into U.S. Dollars for consolidation. The Company has not implemented a hedging strategy to reduce foreign currency risk.

During 2006, the Company had approximately $55.9 million of net sales related to foreign customers including export sales, of which $23.3 million was denominated in foreign currency, predominately the Euro. During 2005 and 2004, the Company had approximately $53.2 million and $49.2 million, respectively, of net sales to foreign customers including export sales, of which $18.6 million and $15.8 million, respectively, were denominated in foreign currency, predominately the Euro. In future periods, a significant portion of sales will continue to be made in Euros.

### RECENT ACCOUNTING DEVELOPMENTS

In May 2005, the Financial Accounting Standards Board ("FASB") issued FAS No. 154, "Accounting Changes and Error Corrections: A Replacement of APB Opinion No. 20 and SFAS No. 3." This statement changes the requirements for the accounting for and reporting of a voluntary change in accounting principle, and also applies to instances when an accounting pronouncement does not include specific transition provisions. The statement replaces the previous requirement that voluntary changes be recognized by including the cumulative effect of the change in net income of the period of the change. The statement requires retrospective application of a new accounting principle to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The statement is effective for changes and corrections made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of the statement at October 1, 2006 to have a material effect on its consolidated financial statements.

In June 2006, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement." This standard allows companies to present in their statements of income any taxes assessed by a governmental authority that are directly imposed on revenue-producing transactions between a seller and a customer, such as sales, use, value-added and some excise taxes, on either a gross (included in revenue and costs) or a net (excluded from revenue) basis. This standard will be effective for the Company in interim periods and fiscal years beginning after December 15, 2006. The Company presents these transactions on a net basis, and therefore the adoption of this standard will have no impact on our consolidated financial statements.

In July, 2006 the FASB issued Interpretation No. 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109." FIN 48 prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning October 1, 2007. The Company is in the process of determining the effect, if any, that the adoption of FIN 48 will have on its consolidated financial statements. However, the Company does expect to reclassify a portion of its unrecognized tax benefits from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### RECENT ACCOUNTING DEVELOPMENTS (CONTINUED)

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 requires registrants to apply the new guidance for the first time that it identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006 by correcting those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The Company does not expect SAB 108 to have a material impact on its consolidated results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of FAS 157 are effective for the fiscal year beginning October 1, 2008. The Company is currently evaluating the impact of the provisions of FAS 157 on its consolidated financial statements and does not believe the impact of the adoption will be material.

In September 2006, the FASB issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)," ("FAS 158"). FAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit pension and other postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. FAS 158 is effective for fiscal years ending after December 15, 2006. Since the Company does not have a defined benefit or other postretirement plans, FAS 158 will not impact its consolidated financial statements.

### CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, the disclosure of contingent assets and liabilities and the values of purchased assets and assumed liabilities in acquisitions. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

#### REVENUE RECOGNITION

The Company's revenues are derived primarily from the sale of embedded and non-embedded products to its distributors and Direct (end-user) / OEM customers, and to a lesser extent from the sale of software licenses, fees associated with technical support, training, professional and engineering services, and royalties. The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**CRITICAL ACCOUNTING POLICIES (CONTINUED)**

REVENUE RECOGNITION (CONTINUED)

occurred, the sales price is fixed or determinable, collectibility is reasonably assured and there are no post-delivery obligations other than warranty. Under these criteria, product revenue is generally recognized upon shipment of product to customers. Sales to authorized domestic distributors and Direct / OEMs are made with certain rights of return and price adjustment provisions. Estimated reserves for future returns and pricing adjustments are established by the Company based on an analysis of historical patterns of returns and price adjustments as well as an analysis of authorized returns compared to received returns, current on-hand inventory at distributors, and distribution sales for the current period. Estimated reserves for future returns and price adjustments are charged against revenues in the same period as the corresponding sales are recorded. Material differences between the historical trends used to determine estimated reserves and actual returns and pricing adjustments could result in a material change to the Company's consolidated results of operations or financial position. The Company has applied consistent methodologies for estimating reserves for future returns and pricing adjustments for all years presented. The reserve for future returns and pricing adjustments was $1.8 million at September 30, 2006 compared to $1.8 million at September 30, 2005.

The Company also generates revenue from the sale of software licenses, post-contract customer support, fees associated with technical support, training, professional and engineering services, and royalties. Revenue recognized resulting from such non-product sales represented 1.3% of net sales in fiscal 2006, 1.3% of net sales in fiscal 2005, and 2.6% of net sales in fiscal 2004. The Company's software development tools and development boards often include multiple elements, including hardware, software licenses, post-contract customer support, limited training and basic hardware design review. The Company's customers purchase these products and services during their product development process in which they use the tools to build network connectivity into the devices they are manufacturing. Revenue for software licenses, professional and engineering services and training is recognized upon performance, which includes delivery of a final product version and acceptance by the customer. For post-contract customer support and fees associated with technical support, revenue is deferred and recognized over the life of the contract as service is performed. Royalty revenue is recognized when cash is received from the customer. Unearned post-contract customer support and unearned nonrecurring engineering services revenue is included in deferred revenue on the balance sheet.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company maintains an allowance for doubtful accounts, which reflects the estimate of losses that may result from the inability of some of the Company's customers to make required payments. The estimate for the allowance for doubtful accounts is based on known circumstances regarding collectibility of customer accounts and historical collections experience. If the financial condition of one or more of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Material differences between the historical trends used to estimate the allowance for doubtful accounts and actual collection experience could result in a material change to the Company's consolidated results of operations or financial position. As of September 30, 2006 the allowance for doubtful accounts was $0.5 million compared to $0.9 million at September 30, 2005.

INVENTORY

Inventories are stated at the lower of cost or fair market value, with cost determined using the first-in, first-out method. The Company reduces the carrying value of its inventories for estimated excess and obsolete inventories equal to the difference between the cost of inventory and its estimated realizable value based upon assumptions about future product demand and market conditions. If actual product demand or market

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

### CRITICAL ACCOUNTING POLICIES (CONTINUED)

INVENTORY (CONTINUED)

conditions are less favorable than those projected by management, additional inventory write-downs may be required that could result in a material change to the Company's consolidated results of operations or financial position. The Company has applied consistent methodologies for the net realizable value of inventories. The reserve for excess and obsolete inventory was $2.6 million and $1.6 million at September 30, 2006 and 2005, respectively.

IDENTIFIABLE INTANGIBLE ASSETS

Purchased proven technology, customer relationships, license agreements, covenants not to compete and other identifiable intangible assets are recorded at fair value when acquired in a business acquisition, or at cost when not purchased in a business combination. Purchased in-process research and development costs (IPR&D) are expensed upon consummation of the related business acquisition. All other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives of three to thirteen years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets. Methods of amortization reflect the pattern in which the asset is consumed. To date, all of the Company's identifiable intangible assets are being amortized on a straight-line basis. Amortization of purchased and core technology is presented as a separate component of cost of sales in the Consolidated Statement of Operations. Amortization of all other acquired identifiable intangible assets is charged to operating expenses as a component of general and administrative expense.

In accordance with FAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), identifiable intangible assets are reviewed at least annually for impairment, or whenever events or circumstances indicate that the asset's undiscounted expected future cash flows are not sufficient to recover the carrying value amount. The Company measures impairment loss by utilizing an undiscounted cash flow valuation technique using fair values indicated by the income approach. Impairment losses, if any, are recorded currently. To the extent that the Company's undiscounted future cash flows were to decline substantially, such an impairment charge could result. No impairment was identified during fiscal 2006. There are certain assumptions inherent in projecting the recoverability of the Company's identifiable intangible assets. If actual experience differs from the assumptions made, the consolidated results of operations or financial position of the Company could be materially impacted.

GOODWILL

Goodwill represents the excess of cost over the fair value of identifiable assets acquired and is not amortized. However, in accordance with FAS No. 142, goodwill is subject to an impairment assessment at least annually which may result in a charge to operations if the fair value of the reporting unit in which the goodwill is reported declines. There are certain assumptions inherent in projecting the fair value of goodwill. Significant assumptions include the Company's estimates of future cash flows and the cost of capital. These and other estimates are based upon information that the Company uses to prepare its annual and five year business plan projections. If actual experience differs from the assumptions made, the consolidated results of operations or financial position of the Company could be materially impacted.

The Company performed its annual goodwill impairment assessment as of June 30, 2006 utilizing a discounted cash flow technique and determined that there was no impairment. Goodwill of $65.8 million is recorded on the

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

**CRITICAL ACCOUNTING POLICIES (CONTINUED)**

GOODWILL (CONTINUED)

Company's consolidated balance sheet as of September 30, 2006. (See Note 3 to the Company's Consolidated Financial Statements).

INCOME TAXES

Deferred tax assets and liabilities are recorded based on FAS 109. The amount of deferred tax assets and liabilities actually realized could be impacted by differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If management determines that it is more likely than not that a deferred tax asset will not be realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in estimated future taxable income is determined. The Company has determined that a valuation allowance is not required as of September 30, 2006.

The Company operates in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, the Company must determine the appropriate allocation of income to each of these jurisdictions. This determination requires the Company to make several estimates and assumptions. Tax audits associated with the allocation of this income, and other complex issues, may require an extended period of time to resolve and could result in adjustments to the Company's income tax balances that are material to the consolidated financial position and results of operations. During fiscal 2006 and 2005, the Company adjusted its income tax reserves by $1.6 million and $5.7 million, respectively, primarily resulting from settlements with the French government and the Internal Revenue Service related to audits of prior fiscal years. (See Note 8 to the Company's Consolidated Financial Statements). Certain open tax years are expected to close during fiscal year 2007 and future years that may result in adjustments to the Company's income tax balances in those years that are material to its consolidated financial position and results of operations.

STOCK-BASED COMPENSATION

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Share-Based Payment" (FAS 123R) which revises FAS 123 and supersedes APB 25. This standard requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Under this statement, the Company must measure the cost of employee services received in exchange for an award of equity instruments based upon the fair value of the award on the date of grant. This cost must be recognized over the period during which an employee is required to provide the service (usually the vesting period). In April 2005 the SEC delayed the effective date of FAS 123R and as a result, the Company has adopted the provisions of this standard beginning October 1, 2005. The adoption of this standard resulted in an increase in compensation expense of $2.3 million and a reduction to net income of $1.5 million and net income per diluted common share of $0.06 for fiscal 2006. The consolidated financial statements for the prior periods have not been restated to reflect, and do not include, the impact of FAS123R. (See Note 9 to the Company's Consolidated Financial Statements). Compensation expense for stock-based compensation is estimated on the grant date using the Black-Scholes model. The Company's specific assumptions for the risk free interest rate, expected term, expected volatility and expected dividend yield are documented in Note 9 to the Consolidated Financial Statements. Additionally, under FAS 123R, the Company is required to estimate pre-vesting forfeitures for purposes of determining compensation expense to be recognized.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

The Company's exposure to interest rate risk relates primarily to the Company's investment portfolio. Investments are made in accordance with the Company's investment policy and consist of high grade commercial paper and corporate bonds. The Company does not use derivative financial instruments to hedge against interest rate risk as all investments are held to maturity and the majority of the Company's investments mature in less than a year.

FOREIGN CURRENCY RISK

The Company is exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros or Japanese Yen and foreign currency translation risk as the financial position and operating results of the Company's foreign subsidiaries are translated into U.S. Dollars for consolidation. The Company has not implemented a hedging strategy to reduce foreign currency risk.

During 2006, the average monthly exchange rate for the Euro to the U.S. Dollar decreased by approximately 3.2% from 1.2724 to 1.2312 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar increased by approximately 7.7% from .0093 to .0086. A 10.0% change from the 2006 average exchange rate for the Euro and Yen to the U.S. Dollar would have resulted in a 1.6% increase or decrease in annual net sales and a 1.3% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments the Company may need to consider in response to changes in the exchange rate.

CREDIT RISK

The Company has some exposure to credit risk related to its accounts receivable portfolio. Exposure to credit risk is controlled through regular monitoring of customer financial status, credit limits and collaboration with sales management on customer contacts to facilitate payment.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

## TO THE STOCKHOLDERS AND BOARD OF DIRECTORS OF DIGI INTERNATIONAL INC.

We have completed integrated audits of Digi International Inc.'s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of September 30, 2006 and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows, and of stockholders' equity and comprehensive income present fairly, in all material respects, the financial position of Digi International Inc. and its subsidiaries at September 30, 2006 and 2005 and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 9, the Company adopted the provisions of Financial Accounting Standards Board No. 123 (revised 2004), "Share-Based Payment," (FAS 123R) beginning October 1, 2005.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of September 30, 2006 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2006, based on criteria established in *Internal Control — Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM (CONTINUED)

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management’s Report on Internal Control over Financial Reporting, management has excluded MaxStream, Inc. (MaxStream) from its assessment of internal control over financial reporting as of September 30, 2006 because it was acquired by the Company in a purchase business combination during 2006. We have also excluded MaxStream from our audit of internal control over financial reporting. MaxStream’s total assets represented 2.8% of total consolidated assets as of September 30, 2006 and MaxStream’s total net sales represented 2.2% of the total consolidated net sales for the year ended September 30, 2006.

/s/ PricewaterhouseCoopers LLP
Minneapolis, Minnesota
December 4, 2006

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)**

**DIGI INTERNATIONAL INC.**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
(in thousands, except per common share data)

| For the fiscal years ended September 30, | 2006 | 2005 | 2004 |
|---|---|---|---|
| Net sales | $ 144,663 | $ 125,198 | $ 111,226 |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) | 62,322 | 49,516 | 43,443 |
| Amortization of purchased and core technology | 4,836 | 4,191 | 4,314 |
| Gross profit | 77,505 | 71,491 | 63,469 |
| Operating expenses: | | | |
| Sales and marketing | 28,591 | 26,339 | 25,556 |
| Research and development | 20,861 | 16,531 | 17,159 |
| General and administrative | 12,830 | 11,364 | 8,973 |
| Acquired in-process research & development | 2,000 | 300 | — |
| Total operating expenses | 64,282 | 54,534 | 51,688 |
| Operating income | 13,223 | 16,957 | 11,781 |
| Other income (expense): | | | |
| Interest income | 2,426 | 1,581 | 856 |
| Interest expense | (213) | (104) | (19) |
| Other expense | (169) | (451) | (468) |
| Total other income, net | 2,044 | 1,026 | 369 |
| Income before income taxes | 15,267 | 17,983 | 12,150 |
| Income tax provision | 4,154 | 318 | 3,487 |
| Net income | $ 11,113 | $ 17,665 | $ 8,663 |
| Net income per common share: | | | |
| Basic | $ 0.48 | $ 0.79 | $ 0.41 |
| Diluted | $ 0.46 | $ 0.76 | $ 0.39 |
| Weighted average common shares, basic | 23,338 | 22,450 | 21,196 |
| Weighted average common shares, diluted | 24,080 | 23,371 | 22,031 |

The accompanying notes are an integral part of the consolidated financial statements.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)**

**DIGI INTERNATIONAL INC.**
**CONSOLIDATED BALANCE SHEETS**
(in thousands, except share data)

| As of September 30, | 2006 | 2005 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 15,674 | $ 12,990 |
| Marketable securities | 43,207 | 37,184 |
| Accounts receivable, net | 20,305 | 16,897 |
| Inventories | 21,911 | 18,527 |
| Net deferred tax assets | 2,667 | 2,892 |
| Other | 2,861 | 2,223 |
| Total current assets | 106,625 | 90,713 |
| Property, equipment and improvements, net | 19,488 | 20,808 |
| Identifiable intangible assets, net | 31,341 | 26,342 |
| Goodwill | 65,841 | 38,675 |
| Net deferred tax assets | 1,366 | — |
| Other | 660 | 1,093 |
| Total assets | $ 225,321 | $ 177,631 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Capital lease obligations, current portion, and short-term borrowings | $ 381 | $ 414 |
| Accounts payable | 6,748 | 6,272 |
| Income taxes payable | 4,712 | 3,306 |
| Accrued expenses: | | |
| Compensation | 5,851 | 5,308 |
| Other | 5,318 | 5,048 |
| Deferred revenue | 274 | 370 |
| Total current liabilities | 23,284 | 20,718 |
| Capital lease obligations, net of current portion | 725 | 1,181 |
| Net deferred tax liabilities | 7,482 | 2,195 |
| Total liabilities | 31,491 | 24,094 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued and outstanding | — | — |
| Common stock, $.01 par value; 60,000,000 shares authorized; 27,748,640 and 25,456,755 shares issued and outstanding | 277 | 255 |
| Additional paid-in capital | 164,782 | 136,513 |
| Retained earnings | 47,009 | 35,896 |
| Accumulated other comprehensive income | 940 | 639 |
| Treasury stock, at cost, 2,711,496 and 2,794,562 shares | (19,178) | (19,766) |
| Total stockholders' equity | 193,830 | 153,537 |
| Total liabilities and stockholders' equity | $ 225,321 | $ 177,631 |

The accompanying notes are an integral part of the consolidated financial statements.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)**

**DIGI INTERNATIONAL INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
(in thousands)

| For the fiscal years ended September 30, | 2006 | 2005 | 2004 |
|---|---|---|---|
| Operating activities: | | | |
| Net income | $ 11,113 | $ 17,665 | $ 8,663 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation of property, equipment and improvements | 2,711 | 2,295 | 2,432 |
| Amortization of identifiable intangible assets and other assets | 7,855 | 6,575 | 6,165 |
| Bad debt and product return recoveries | (368) | (820) | (453) |
| Gain on sale of intellectual property | (247) | — | — |
| Provision for inventory obsolescence | 542 | 76 | — |
| Excess tax benefits from stock-based compensation | (726) | — | — |
| Tax benefit related to the exercise of stock options | — | 2,113 | 2,274 |
| Stock-based compensation | 2,289 | 53 | 125 |
| Deferred income taxes | 1,700 | 1,052 | 1,448 |
| Acquired in-process research & development | 2,000 | 300 | — |
| Other | 82 | 1 | 9 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (818) | (2,730) | 926 |
| Inventories | (2,883) | (602) | (790) |
| Other assets | (195) | (736) | (286) |
| Income taxes payable | (631) | (7,039) | (510) |
| Accounts payable | (1,174) | 863 | (1,326) |
| Accrued expenses | (814) | (1,010) | 644 |
| Total adjustments | 9,323 | 391 | 10,658 |
| Net cash provided by operating activities | 20,436 | 18,056 | 19,321 |
| Investing activities: | | | |
| Purchase of held-to-maturity marketable securities | (48,881) | (48,943) | (129,983) |
| Proceeds from maturities of held-to-maturity marketable securities | 42,858 | 73,898 | 108,249 |
| Proceeds from sale of intellectual property | 247 | — | — |
| Purchase of property, equipment, improvements and certain other intangible assets | (1,331) | (1,329) | (1,293) |
| Contingent purchase price payments related to business acquisitions | — | — | (1,961) |
| Acquisition of MaxStream, Inc., net of cash acquired | (16,096) | — | — |
| Acquisition of Rabbit Semiconductor, Inc., net of cash acquired | — | (48,934) | — |
| Acquisition of FS Forth-Systeme GmbH and Sistemas Embebidos S.A., net of cash acquired | — | (4,759) | — |
| Net cash used in investing activities | (23,203) | (30,067) | (24,988) |
| Financing activities: | | | |
| Payments on short-term borrowing and line of credit | — | (1,274) | (2,149) |
| Payments on capital lease obligations and long-term debt | (490) | (152) | — |
| Borrowing on note payable | 5,000 | 21,000 | — |
| Payment on note payable | (5,000) | (21,000) | — |
| Proceeds from stock option plan transactions | 4,558 | 5,600 | 8,587 |
| Proceeds from employee stock purchase plan transactions | 764 | 721 | 668 |
| Excess tax benefits from stock-based compensation | 726 | — | — |
| Net cash provided by financing activities | 5,558 | 4,895 | 7,106 |
| Effect of exchange rates changes on cash and cash equivalents | (107) | 578 | 861 |
| Net increase (decrease) in cash and cash equivalents | 2,684 | (6,538) | 2,300 |
| Cash and cash equivalents, beginning of period | 12,990 | 19,528 | 17,228 |
| Cash and cash equivalents, end of period | $ 15,674 | $ 12,990 | $ 19,528 |
| Supplemental Cash Flows Information: | | | |
| Interest paid | $ 213 | $ 104 | $ 19 |
| Income taxes paid | $ 3,384 | $ 4,314 | $ 347 |
| Income taxes refunded | $ (513) | $ (2) | $ (163) |
| Other non-cash financing items: | | | |
| Assumption of line of credit related to acquisition | $ — | $ 1,275 | $ — |
| Assumption of capital leases related to acquisition | $ — | $ 1,747 | $ — |
| Accrual for FS Forth-Systeme GmbH contingent purchase price payment | $ 800 | $ — | $ — |
| Issuance of common stock for MaxStream acquisition | $ 20,704 | $ — | $ — |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)**

**DIGI INTERNATIONAL INC.**
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**
(in thousands)

For the years ended September 30, 2006, 2005 and 2004

| | Common Stock | | Treasury Stock | | Additional Paid-In Capital | Retained Earnings | Unearned Stock Compen-sation | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Par Value | Shares | Value | | | | | |
| Balances, September 30, 2003 | 23,212 | $ 232 | 2,970 | $ (21,005) | $ 117,720 | $ 9,568 | $ (86) | $ (566) | $ 105,863 |
| Net income | | | | | | 8,663 | | | 8,663 |
| Foreign currency translation adjustment | | | | | | | | 899 | 899 |
| Total comprehensive income | | | | | | | | | 9,562 |
| Employee stock purchase issuances | | | (104) | 735 | (67) | | | | 668 |
| Stock compensation expensed | | | | | | | 80 | | 80 |
| Issuance of stock upon exercise of stock options | 1,466 | 15 | | | 8,572 | | | | 8,587 |
| Tax benefit realized upon exercise of stock options | | | | | 2,274 | | | | 2,274 |
| Forfeiture of stock options | | | | | (6) | | 6 | | — |
| Stock options issued to non-employees | | | | | 45 | | | | 45 |
| Balances, September 30, 2004 | 24,678 | 247 | 2,866 | (20,270) | 128,538 | 18,231 | — | 333 | 127,079 |
| Net income | | | | | | 17,665 | | | 17,665 |
| Foreign currency translation adjustment | | | | | | | | 306 | 306 |
| Total comprehensive income | | | | | | | | | 17,971 |
| Employee stock purchase issuances | | | (71) | 504 | 217 | | | | 721 |
| Issuance of stock upon exercise of stock options | 779 | 8 | | | 5,592 | | | | 5,600 |
| Tax benefit realized upon exercise of stock options | | | | | 2,113 | | | | 2,113 |
| Stock options issued to non-employees | | | | | 53 | | | | 53 |
| Balances, September 30, 2005 | 25,457 | 255 | 2,795 | (19,766) | 136,513 | 35,896 | — | 639 | $ 153,537 |
| Net income | | | | | | 11,113 | | | 11,113 |
| Foreign currency translation adjustment | | | | | | | | 301 | 301 |
| Total comprehensive income | | | | | | | | | 11,414 |
| Employee stock purchase issuances | | | (83) | 588 | 176 | | | | 764 |
| Issuance of stock upon exercise of stock options | 615 | 6 | | | 4,552 | | | | 4,558 |
| Tax benefit realized upon exercise of stock options | | | | | 564 | | | | 564 |
| Stock-based compensation expense | | | | | 2,289 | | | | 2,289 |
| Issuance of stock — MaxStream acquisition | 1,677 | 16 | | | 20,688 | | | | 20,704 |
| Balances, September 30, 2006 | 27,749 | $ 277 | 2,712 | $ (19,178) | $ 164,782 | $ 47,009 | $ — | $ 940 | $ 193,830 |

The accompanying notes are an integral part of the consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BUSINESS DESCRIPTION

Digi is a worldwide leader in device networking for business, developing reliable products and technologies to connect and securely manage local or remote electronic devices over the network or via the Internet. Businesses use Digi products to create, customize and control retail operations, industrial automation and other applications.

Digi’s products are sold globally through distributors, systems integrators, solution providers and direct marketers as well as direct to strategic OEMs, government and commercial partners.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

### CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities in excess of three months are classified as marketable securities. Marketable securities consist of high-grade commercial paper and corporate bonds. All marketable securities are classified as held-to-maturity and are carried at amortized cost. Gross unrealized holding losses were $55,145 and $144,312 as of September 30, 2006 and 2005, respectively. Because the Company intends to hold all marketable securities until maturity, realization of the unrealized holding loss at September 30, 2006 is not likely, and therefore not recorded.

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

Financial instruments that may subject the Company to significant concentrations of credit risk consist primarily of trade receivables. Creditworthiness and account payment status are routinely monitored and collateral is not required. The Company maintains an allowance for doubtful accounts, which reflects the estimate of losses that may result from the inability of some of the Company’s customers to make required payments. The estimate for the allowance for doubtful accounts is based on known circumstances regarding collectibility of customer accounts and historical collections experience.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company’s financial instruments consist primarily of cash equivalents, marketable securities, trade accounts receivable and accounts payable for which current carrying amounts approximate fair market value.

### INVENTORIES

Inventories are stated at the lower of cost or fair market value, with cost determined using the first-in, first-out method. Appropriate consideration is given to deterioration, obsolescence and other factors in evaluating fair market value.

### PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements are carried at cost, net of accumulated depreciation. Depreciation is provided by charges to operations using the straight-line method over their estimated useful lives. Furniture and

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**PROPERTY, EQUIPMENT AND IMPROVEMENTS (CONTINUED)**

fixtures and other equipment are depreciated over a period of three to five years. Building improvements and buildings are depreciated over ten and thirty-nine years, respectively. Equipment under capital lease is depreciated over the lease term. The Company owns and occupies three buildings located in Minnetonka and Eden Prairie, Minnesota and Dortmund, Germany. The Company is attempting to sell the building in Dortmund, Germany.

Expenditures for maintenance and repairs are charged to operations as incurred, while major renewals and betterments are capitalized. The assets and related accumulated depreciation accounts are adjusted for asset retirements and disposals with the resulting gain or loss included in operations.

**IDENTIFIABLE INTANGIBLE ASSETS**

Purchased proven technology, license agreements, covenants not to compete and other identifiable intangible assets are recorded at fair value when acquired in a business acquisition, or at cost when not purchased in a business acquisition. Purchased in-process research and development costs (IPR&D) are expensed upon consummation of the related business acquisition. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets and range from three to thirteen years. Methods of amortization reflect the pattern in which the asset is consumed. To date, all of the Company's identifiable intangible assets are being amortized on a straight-line basis. Amortization of purchased and core technology is presented as a separate component of cost of sales in the Consolidated Statement of Operations. Amortization of all other acquired identifiable intangible assets is charged to operating expense as a component of general and administrative expense.

In accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), identifiable intangible assets are reviewed at least annually for impairment, or whenever events or circumstances indicate that undiscounted expected future cash flows are not sufficient to recover the carrying value amount. The Company measures impairment loss by utilizing an undiscounted cash flow valuation technique using fair values indicated by the income approach. Impairment losses, if any, are recorded currently. No impairments were identified during fiscal 2006, 2005 or 2004.

**GOODWILL**

Goodwill represents the excess of cost over the fair value of identifiable assets acquired. Goodwill is subject to an impairment assessment, using a discounted cash flow technique by reporting unit, at least annually which may result in a charge to operations if the fair value of the reporting unit in which the goodwill is reported declines. The Company performed its annual goodwill impairment assessment as of June 30, 2006 utilizing a discounted cash flow technique. Since the calculated fair value of each reporting unit exceeded book value, there was no impairment identified.

**STOCK REPURCHASES**

From time to time, the Board of Directors authorizes the Company to repurchase common stock when market conditions are favorable or when a strategic opportunity exists. The Company has outstanding a Board of Directors authorization to repurchase up to 1,000,000 shares of its common stock. As of September 30, 2006, no common stock has been repurchased under this authorization.

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**REVENUE RECOGNITION**

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104 “Revenue Recognition in Financial Statements” (SAB 104), Statement of Financial Accounting Standards No. 48 “Revenue Recognition when the Right of Return Exists” (FAS 48), Statement of Position No. 97-2 “Software Revenue Recognition” (SOP 97-2), as amended by SOP 98-4 “Deferral of the Effective Date of Certain Provisions of SOP No. 97-2”, SOP 81-1 “Accounting for Performance of Construction-Type and Certain Production-Type Contracts”, and Emerging Issues Task Force (EITF) 00-21 “Revenue Arrangements with Multiple Deliverables”.

Revenue recognized for hardware product sales was 98.7% of net sales in fiscal 2006 and fiscal 2005 and 97.4% of net sales in fiscal 2004. The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collectibility is reasonably assured and there are no post-delivery obligations, other than warranty. Under these criteria, product revenue is generally recognized upon shipment of product to customers, including Direct (end-user) / OEMs and distributors. Sales to authorized domestic distributors and Direct / OEMs are made with certain rights of return and price adjustment provisions. Estimated reserves for future returns and pricing adjustments are established by the Company based on an analysis of historical patterns of returns and price adjustments as well as an analysis of authorized returns compared to received returns, current on-hand inventory at distributors, and distribution sales for the current period. Estimated reserves for future returns and price adjustments are charged against revenues in the same period as the corresponding sales are recorded.

The Company also generates revenue from the sale of software licenses, post-contract customer support, fees associated with technical support, training, professional and engineering services, and royalties. Revenue recognized resulting from such non-product sales represented 1.3% of net sales in fiscal 2006, 1.3% of net sales in fiscal 2005, and 2.6% of net sales in fiscal 2004. The Company’s software development tools and development boards often include multiple elements, including hardware, software licenses, post-contract customer support, limited training and basic hardware design review. The Company’s customers purchase these products and services during their product development process in which they use the tools to build network connectivity into the devices they are manufacturing. Revenue for software licenses, professional and engineering services and training is recognized upon performance, which includes delivery of a final product version and acceptance by the customer. For post-contract customer support and fees associated with technical support, revenue is deferred and recognized over the life of the contract as service is performed. Royalty revenue is recognized when cash is received from the customer. Unearned post-contract customer support and unearned nonrecurring engineering services revenue is included in deferred revenue on the balance sheet.

**RESEARCH AND DEVELOPMENT**

Research and development costs are expensed when incurred. Research and development costs include compensation, allocation of corporate costs, depreciation, professional services and prototypes. Software development costs are expensed as incurred until the point that technological feasibility and proven marketability of the product are established. To date, the time period between the establishment of technological feasibility and completion of software development has been short, and no significant development costs have been incurred during that period. Accordingly, the Company has not capitalized any software development costs to date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**INCOME TAXES**

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

**NET INCOME PER COMMON SHARE**

Basic net income per common share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common and common equivalent shares outstanding during the period. The Company's only potentially dilutive common shares are those that result from dilutive common stock options and shares purchased through the employee stock purchase plan.

The following table is a reconciliation of the numerators and denominators in the net income per common share calculations (in thousands, except per common share data):

| Years ended September 30, | 2006 | 2005 | 2004 |
|---|---|---|---|
| Numerator: | | | |
| Net income | $ 11,113 | $ 17,665 | $ 8,663 |
| Denominator: | | | |
| Denominator for basic net income per common share — weighted average shares outstanding | 23,338 | 22,450 | 21,196 |
| Effect of dilutive securities: | | | |
| Employee stock options and employee stock purchase plan | 742 | 921 | 835 |
| Denominator for diluted net income per common share — adjusted weighted average shares | 24,080 | 23,371 | 22,031 |
| Basic net income per common share | $ 0.48 | $ 0.79 | $ 0.41 |
| Diluted net income per common share | $ 0.46 | $ 0.76 | $ 0.39 |

Stock options to purchase 1,327,000, 720,875 and 2,053,609 common shares at September 30, 2006, 2005 and 2004, respectively, were not included in the computation of diluted earnings per common share because the options' exercise prices were greater than the average market price of common shares and, therefore, their effect would be antidilutive whether or not the Company generated net income.

**STOCK-BASED COMPENSATION**

Effective October 1, 2005, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), "Share-Based Payment" (FAS No. 123R), as amended by FASB Staff Position No. FAS 123(R)-4 (FSP FAS 123(R)-4), using the modified prospective method of application. This standard requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Under this statement, the Company must measure the cost of employee services received in exchange for an award of equity instruments based upon the fair value of the award on the date of grant. This cost must be recognized over the period during which

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**STOCK-BASED COMPENSATION (CONTINUED)**

an employee is required to provide the service (usually the vesting period). Under the modified prospective method, compensation expense is recognized both for (i) awards granted, modified or settled subsequent to September 30, 2005 and (ii) the non-vested portion of awards granted prior to October 1, 2005. The consolidated financial statements for the prior periods have not been restated to reflect, and do not include, the impact of FAS123R. See Note 9 — Stock-Based Compensation for pro forma disclosure of stock-based compensation for fiscal 2005 and fiscal 2004.

**FOREIGN CURRENCY TRANSLATION**

Financial position and results of operations of the Company's international subsidiaries are measured using local currencies as the functional currency. Assets and liabilities of these operations are translated at the exchange rates in effect at each fiscal year-end. Statements of operations accounts are translated at the weighted average rates of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income (loss) in stockholders' equity. The Company has not implemented a hedging strategy to reduce the risk of foreign currency translation exposures.

**USE OF ESTIMATES AND RISKS AND UNCERTAINTIES**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**COMPREHENSIVE INCOME**

For the Company, comprehensive income is comprised of net income and foreign currency translation adjustments. Foreign currency translation adjustments are charged or credited to the accumulated other comprehensive income account in stockholders' equity.

**RECENT ACCOUNTING DEVELOPMENTS**

In May 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections: A Replacement of APB Opinion No. 20 and SFAS No. 3." This statement changes the requirements for the accounting for and reporting of a voluntary change in accounting principle, and also applies to instances when an accounting pronouncement does not include specific transition provisions. The statement replaces the previous requirement that voluntary changes be recognized by including the cumulative effect of the change in net income of the period of the change. The statement requires retrospective application of a new accounting principle to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The statement is effective for changes and corrections made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of the statement at October 1, 2006 to have a material effect on its consolidated financial statements.

In June 2006, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement."

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**RECENT ACCOUNTING DEVELOPMENTS (CONTINUED)**

This standard allows companies to present in their statements of income any taxes assessed by a governmental authority that are directly imposed on revenue-producing transactions between a seller and a customer, such as sales, use, value-added and some excise taxes, on either a gross (included in revenue and costs) or a net (excluded from revenue) basis. This standard will be effective for the Company in interim periods and fiscal years beginning after December 15, 2006. The Company presents these transactions on a net basis, and therefore the adoption of this standard will have no impact on its consolidated financial statements.

In July, 2006 the FASB issued Interpretation No. 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109." FIN 48 prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning October 1, 2007. The Company is in the process of determining the effect, if any, that the adoption of FIN 48 will have on its consolidated financial statements. However, the Company does expect to reclassify a portion of its unrecognized tax benefits from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 requires registrants to apply the new guidance for the first time that it identifies material errors in existence at the beginning of the first fiscal year ending after November 15, 2006 by correcting those errors through a one-time cumulative effect adjustment to beginning-of-year retained earnings. The Company does not expect SAB 108 to have a material impact on its consolidated results of operations or financial position.

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of FAS 157 are effective for the fiscal year beginning October 1, 2008. The Company is currently evaluating the impact of the provisions of FAS 157 on its consolidated financial statements and does not believe the impact of the adoption will be material.

In September 2006, the FASB issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)," ("FAS 158"). FAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit pension and other postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. FAS 158 is effective for fiscal years ending after December 15, 2006. Since the Company does not have a defined benefit or other postretirement plans, FAS 158 will not impact its consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**2. ACQUISITIONS**

**MaxStream, Inc.**

On July 27, 2006, the Company acquired MaxStream, Inc. (MaxStream), a privately held corporation and a leader in the wireless device networking market. The total purchase price of $40.5 million included $19.8 million in cash (excluding cash acquired of $3.7 million) and $20.7 million in common stock, in exchange for all outstanding shares of MaxStream's preferred and common stock and outstanding stock options. The Company did not replace MaxStream's outstanding options with Digi options. The value of the Company's common stock was based on a per share value of $12.35, calculated as the average market price of the common stock during the two business days immediately preceding July 27, 2006 when the parties reached agreement on terms and announced the acquisition.

The above purchase consideration includes an adjustment of $0.6 million pertaining to the closing working capital of MaxStream as of July 27, 2006.

Cash in the amount of $1.925 million and 165,090 shares of common stock have been deposited to an escrow fund established at Wells Fargo Bank, Minnesota. These amounts will be held in escrow for a period not to exceed one year from the date of closing to satisfy possible claims that may arise pursuant to specific representation and warranty sections of the merger agreement. The escrowed amounts of cash and stock have been included in the determination of the purchase consideration on the date of acquisition because management believes the outcome of the representation and warranty matters is determinable beyond a reasonable doubt.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in goodwill of $26.4 million and a charge of $2.0 million for acquired in-process research and development. The Company believes that the acquisition resulted in the recognition of goodwill primarily because MaxStream's wireless technologies and products significantly expand Digi's wireless offering, covering both short and medium range distances using embedded modules and boxed/packaged solutions and provides the capability to provide our customers end-to-end wireless solutions.

MaxStream's operating results are included in the Company's consolidated results of operations from the date of acquisition. The consolidated balance sheet as of September 30, 2006 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

The table below sets forth the final purchase price allocation (in thousands):

| | |
|---|---|
| Cash, including cash in escrow and direct acquisition costs | $ 19,826 |
| Common stock, including stock in escrow | 20,704 |
| | $ 40,530 |
| | |
| Fair value of net tangible assets acquired | $ 4,716 |
| Identifiable intangible assets: | |
| Existing purchased and core technology | 6,900 |
| Existing customer relationships | 3,600 |
| Trade names and trademarks | 300 |
| Patent pending / unpatented technology | 1,300 |
| In-process research and development | 2,000 |
| Goodwill | 26,433 |
| Deferred tax liabilities related to identifiable intangibles | (4,719) |
| | $ 40,530 |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**2. ACQUISITIONS (CONTINUED)**

The purchased and core technologies identified above have useful lives ranging between four to nine years, customer relationships have useful lives of ten years, and patents and trademarks have useful lives between five to ten years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets. The identifiable intangible assets are amortized using the straight-line method which reflects the pattern in which the asset is consumed.

At the time of acquisition, MaxStream had development projects in process associated with the XStream Gen. 2, X. Eleven, Mesh Firmware, Xbee Zigbee Firmware and Xplore products. Management estimated that $2.0 million of the purchase price represented the fair value of acquired in-process research and development related to the products listed below (in thousands) that were under development, had a measurable percentage completed and a documented expected life, had not yet reached technological feasibility, and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

| | |
|---|---|
| XStream Gen. 2 | $ 900 |
| X. Eleven | 500 |
| Mesh Firmware | 400 |
| Xbee Zigbee Firmware | 100 |
| Xplore | 100 |
| Total in-process research and development | $ 2,000 |

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company’s estimate of revenue growth for each of the products over the next five fiscal years, using the assumption that all revenue recorded after that date will be generated from future technologies.
- The estimated gross margin was based upon historical gross margin for MaxStream’s products, with an increase over time attributable to production synergies.
- The estimated operating expenses were based on consideration of historical selling, general and administrative expenses as a percentage of sales and MaxStream’s projected operating expenses.
- Maintenance research and development, defined as the research and development necessary to sustain the existing technology and its revenue stream, was also included as an operating expense. The estimated remaining cost to complete each in-process research and development technology was also included in operating expenses.
- When applying the income valuation approach, the cash flows expected to be generated by an asset are discounted to their present value equivalent using a rate of return that reflects the relative risk of the investment, as well as the time value of money. This return, known as the weighted average cost of capital (“WACC”), is an overall rate based upon the individual rates of return for invested capital (equity and interest-bearing debt). The discount rate used in the income valuation approach was 25%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The Company used a 40% rate of return for the in-process research and development projects.

The Company anticipates that all of the projects will be released in calendar year 2007, with the exception of Xplore which will be released during calendar year 2006. These estimates described above are subject to

Table of Contents



**2. ACQUISITIONS (CONTINUED)**

change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur.

**Rabbit Semiconductor Inc.**

On May 26, 2005, the Company acquired Rabbit Semiconductor Inc. (Rabbit), formerly Z-World, Inc., a privately held corporation for a purchase price of $49.3 million in cash (excluding cash acquired of $0.4 million and assumption of $1.3 million of debt) in exchange for all outstanding shares of Rabbit's common stock and outstanding stock options. The Company did not replace Rabbit's outstanding options with Digi options.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in goodwill of $30.6 million. The Company believes that the acquisition resulted in the recognition of goodwill primarily because the complementary nature of Rabbit microprocessor and microprocessor-based modules, and Z-World single board computer product lines are anticipated to extend Digi's position in the commercial device networking module business.

Rabbit's operating results are included in the Company's consolidated results of operations from the date of acquisition. The consolidated balance sheets as of September 30, 2006 and 2005 reflect the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

The table below sets forth the final purchase price allocation (in thousands):

| | |
|---|---|
| Cash, including direct acquisition costs | $ 49,287 |
| | |
| Fair value of net tangible assets acquired | $ 8,766 |
| Identifiable intangible assets: | |
| Purchased and core technology | 8,700 |
| Customer relationships | 4,400 |
| Patents and trademarks | 2,600 |
| In-process research and development | 300 |
| Goodwill | 30,644 |
| Deferred tax liabilities related to identifiable intangibles | (6,123) |
| | $ 49,287 |

The purchased and core technology identified above have useful lives ranging between five to seven years, customer relationships have useful lives of nine years, and patents and trademarks have useful lives between ten to thirteen years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets. The identifiable intangible assets are amortized using the straight-line method which reflects the pattern in which the asset is consumed.

At the time of acquisition, Rabbit had a development project in process for the Rabbit 4000 microprocessor. The project involved the design and development of a next-generation microprocessor that would have increased code execution speed, reduced code size, added security features, and integrated Ethernet capabilities. Management estimated that $0.3 million of the purchase price represented the fair value of acquired in-process research and development related to the Rabbit 4000 microprocessor that had not yet reached technological

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 2. ACQUISITIONS (CONTINUED)

feasibility and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company's estimate of revenue growth over the next six fiscal years, or the estimated life cycle of the Rabbit 4000 microprocessor, using the assumption that all revenue recorded after that date will be generated from future technologies.
- The estimated gross margin was based upon historical gross margin for Rabbit's products, with an increase over time attributable to production synergies.
- The estimated selling, general and administrative expenses were based on consideration of historical operating expenses as a percentage of sales and Rabbit's projected operating expenses.
- When applying the income valuation approach, the cash flows expected to be generated by an asset are discounted to their present value equivalent using a rate of return that reflects the relative risk of the investment, as well as the time value of money. This return, known as the WACC, is an overall rate based upon the individual rates of return for invested capital (equity and interest-bearing debt). The discount rate used in the income valuation approach was 23%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The Company used a 40% rate of return for the in-process research and development projects.

The Company released the Rabbit 4000 microprocessor in March 2006. The Company anticipates that the projected revenue from the Rabbit 4000 microprocessor will be in line with original projections. These estimates are subject to change and no assurance can be given that deviations from these estimates will not occur.

**FS Forth-Systeme GmbH/Sistemas Embebidos S.A.**

Effective April 1, 2005, the Company acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (collectively referred to as FS Forth) from Embedded Solutions AG of Germany. FS Forth is a provider of embedded modules, software and development services. The purchase price included a payment of $5.6 million in cash, with contingent consideration of up to $1.2 million payable on October 1, 2007 if FS Forth achieves certain future milestones. A payment of $0.8 million was made in October 2006 as contingent consideration based on the achievement of the milestones identified in the merger agreement. This contingent consideration is recorded as an accrued liability and an addition to goodwill as of September 30, 2006.

The purchase price allocation resulted in goodwill of $3.2 million. The Company believes that the FS Forth acquisition resulted in the recognition of goodwill primarily because of the anticipated extension of its commercial device networking module business. FS Forth had modules that would immediately add value to the Company's broader module product line.

FS Forth's operating results are included in the Company's consolidated results of operations from the date of acquisition. The consolidated balance sheets as of September 30, 2006 and 2005 reflect the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**2. ACQUISITIONS (CONTINUED)**

The table below sets forth the purchase price allocation (in thousands):

| | |
|---|---|
| Cash, including direct acquisition costs | $ 5,554 |
| | |
| Fair value of net tangible assets acquired | $ 1,154 |
| Identifiable intangible assets: | |
| Purchased and core technology | 720 |
| Customer relationships | 1,290 |
| Goodwill | 3,174 |
| Deferred tax liabilities related to identifiable intangibles | (784) |
| | $ 5,554 |

The purchased and core technology and customer relationships identified above have useful lives of three years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets. The identifiable intangible assets are amortized using the straight-line method which reflects the pattern in which the asset is consumed.

The Company has determined that the FS Forth acquisition was not material to the consolidated results of operations or financial condition of the Company; therefore, pro forma financial information is not presented.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of MaxStream and Rabbit had occurred as of the beginning of each period presented. Pro forma adjustments include amortization of identifiable intangible assets. The pro forma net income for the year ended September 30, 2006 includes the $2.0 million charge related to acquired in-process research and development associated with the MaxStream acquisition. The pro forma net income for the year ended September 30, 2005 includes the $0.3 million charge related to acquired in-process research and development associated with the Rabbit acquisition.

(in thousands, except per common share amounts)

| | Year ended September 30, | |
|---|---|---|
| | 2006 | 2005 |
| Net sales | $155,749 | $156,574 |
| Net income | $ 10,738 | $ 15,252 |
| Net income per common share, basic | $ 0.46 | $ 0.63 |
| Net income per common share, diluted | $ 0.45 | $ 0.60 |

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the MaxStream and Rabbit acquisitions occurred as of the beginning of each period presented above, nor are they necessarily indicative of the results that will be obtained in the future.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**3. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS**

**Identifiable Intangible Assets**

Amortized identifiable intangible assets as of September 30, 2006 and 2005 are comprised of the following (in thousands):

| | As of September 30, 2006 Total | | | As of September 30, 2005 Total | | |
|---|---|---|---|---|---|---|
| | Gross carrying amount | Accumulated amortization | Net | Gross carrying amount | Accumulated amortization | Net |
| Purchased and core technology | $48,022 | $(31,492) | $16,530 | $41,086 | $(26,517) | $14,569 |
| License agreements | 2,440 | (1,890) | 550 | 2,440 | (1,490) | 950 |
| Patents and trademarks | 7,608 | (2,837) | 4,771 | 5,691 | (1,956) | 3,735 |
| Customer maintenance contracts | 700 | (324) | 376 | 700 | (254) | 446 |
| Customer relationships | 11,470 | (2,356) | 9,114 | 7,803 | (1,161) | 6,642 |
| Total | $70,240 | $(38,899) | $31,341 | $57,720 | $(31,378) | $26,342 |

Amortization expense for fiscal years 2006, 2005 and 2004 is as follows (in thousands):

| Fiscal year | Total |
|---|---|
| 2006 | $7,484 |
| 2005 | $6,037 |
| 2004 | $5,617 |

Estimated amortization expense for the next five years is as follows (in thousands):

| | |
|---|---|
| 2007 | $7,487 |
| 2008 | $5,639 |
| 2009 | $4,358 |
| 2010 | $3,960 |
| 2011 | $3,345 |

**Goodwill**

The changes in the carrying amount of goodwill for fiscal 2006 and 2005 are as follows (in thousands):

| | 2006 | 2005 |
|---|---|---|
| Beginning balance, October 1 | $ 38,675 | $ 5,816 |
| Acquisition of MaxStream | 26,433 | |
| Acquisition of Rabbit | — | 30,644 |
| Acquisition of FS Forth | 800 | 2,374 |
| Other, primarily currency translation adjustment | (67) | (159) |
| Ending balance, September 30 | $ 65,841 | $ 38,675 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 4. SEGMENT INFORMATION AND MAJOR CUSTOMERS

During fiscal 2005 and 2004, the Company operated in two reportable segments. Effective October 1, 2005, the Company changed its organizational structure to functional reporting to eliminate redundancies in management and infrastructure. In addition, certain intellectual property that was previously utilized primarily in products that comprised the Device Networking Solutions segment has now been integrated throughout the Company's products in order to provide more functionality and allow for ease of migration to next generation technologies for the Company's customers. As a result of these changes in organizational structure and use of the Company's product technology, the Chief Executive Officer, as the chief operating decision maker, now reviews and assesses financial information, operating results, and performance of the Company's business in the aggregate. Accordingly, effective October 1, 2005, the Company has a single operating and reporting segment and all periods presented have been reclassified to conform to the single reportable segment.

The Company's revenues consist of products that are in non-embedded and embedded product groupings. Non-embedded products provide external connectivity solutions, while embedded products solutions generally incorporate networking modules or microprocessors that are smaller in size than non-embedded products and are internal to the devices being networked. The products included in the non-embedded product grouping include multi-port serial adapters, network connected products including terminal servers and non-embedded device servers, universal serial bus connected products, and cellular products. The products included in the embedded product grouping include microprocessors and development tools, embedded modules, core modules and single-board computers, and network interface cards. The following table provides revenue by product grouping (in thousands):

| | Year Ended September 30 | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Non-embedded | $ 86,638 | $ 87,453 | $ 82,896 |
| Embedded | 58,025 | 37,745 | 28,330 |
| Total net sales | $ 144,663 | $ 125,198 | $ 111,226 |

The information in the following table provides revenue by the geographic location of the customer for the years ended September 30, 2006, 2005 and 2004 (in thousands):

| | Year Ended September 30, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| United States | $ 88,770 | $ 72,004 | $ 61,881 |
| Europe | 35,104 | 29,380 | 23,090 |
| Asia Pacific | 16,557 | 22,167 | 25,717 |
| Other international | 4,232 | 1,647 | 538 |
| Total net sales | $ 144,663 | $ 125,198 | $ 111,226 |

Net long-lived assets by geographic location:

| | As of September 30, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| United States | $ 13,870 | $ 15,424 | $ 13,016 |
| International, primarily Europe | 5,618 | 5,384 | 5,618 |
| Total net long-lived assets | $ 19,488 | $ 20,808 | $ 18,634 |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**4. SEGMENT INFORMATION AND MAJOR CUSTOMERS (CONTINUED)**

The Company's U.S. export sales comprised 35.4%, 40.4% and 44.2% of net sales for the years ended September 30, 2006, 2005 and 2004, respectively.

The following table identifies customers whose net sales comprised more than 10% of net sales during the years ended September 30, 2006, 2005 and 2004 as well as customers who comprised more than 10% of trade accounts receivable as of September 30, 2006, 2005 and 2004:

| | Year Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2004 | |
| | Net Sales % | Accounts Receivable % | Net Sales % | Accounts Receivable % | Net Sales % | Accounts Receivable % |
| Customer A | * | 11.2% | * | 10.3% | * | 24.7% |
| Customer B | * | * | 12.9% | * | 15.6% | * |
| Customer C | * | * | * | * | * | 11.6% |
| Customer D | * | * | * | * | * | 10.3% |

* Represents less than 10% of net sales or trade accounts receivable, as applicable

**5. SELECTED BALANCE SHEET DATA**

| As of September 30, (in thousands) | 2006 | 2005 |
|---|---|---|
| Accounts receivable, net: | | |
| Accounts receivable | $ 20,800 | $ 17,769 |
| Less allowance for doubtful accounts | 495 | 872 |
| | $ 20,305 | $ 16,897 |
| Inventories: | | |
| Raw materials | $ 16,491 | $ 15,074 |
| Work in process | 606 | 569 |
| Finished goods | 4,814 | 2,884 |
| | $ 21,911 | $ 18,527 |
| Property, equipment and improvements, net: | | |
| Land | $ 2,381 | $ 2,351 |
| Buildings | 20,653 | 20,124 |
| Improvements | 2,612 | 2,638 |
| Equipment | 12,483 | 17,484 |
| Purchased software | 8,929 | 9,794 |
| Furniture and fixtures | 1,756 | 1,615 |
| | 48,814 | 54,006 |
| Less accumulated depreciation and amortization | 29,326 | 33,198 |
| | $ 19,488 | $ 20,808 |
| Other accrued expenses: | | |
| Product warranty accrual | $ 1,104 | $ 1,187 |
| Accrued professional fees | 879 | 1,417 |
| Other accrued expenses | 3,335 | 2,444 |
| | $ 5,318 | $ 5,048 |

Included in equipment at September 30, 2006 is $2.4 million of equipment under capital leases with accumulated depreciation of $1.2 million. Depreciation expense was $2.7 million, $2.3 million and $2.4 million for each of the fiscal years ended 2006, 2005 and 2004, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 6. FINANCIAL GUARANTEES

The Company, in general, warrants its products to be free from defects in material and workmanship under normal use and service. The warranty periods range from 90 days to five years from the date of receipt. The Company has the option to repair or replace products it deems defective due to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidents and are evaluated on an ongoing basis to ensure the adequacy of the warranty accrual. The following table summarizes the activity associated with the product warranty accrual for the years ended September 30, 2006, 2005 and 2004 (in thousands):

| Fiscal year | Balance at October 1, | Accruals for Warranties issued | Settlements made | Balance at September 30, |
|---|---|---|---|---|
| 2006 | $1,187 | $454(1) | $(537) | $1,104 |
| 2005 | $ 855 | $900(1) | $(568) | $1,187 |
| 2004 | $ 879 | $493 | $(517) | $ 855 |

(1) Includes $17 for fiscal 2006 and $97 for fiscal 2005 of warranty liabilities assumed as a result of acquisitions described in Note 2.

The Company is not responsible and does not warrant that customer software versions created by OEM customers based upon the Company's software source code will function in a particular way, conform to any specifications, are fit for any particular purpose and does not indemnify these customers from any third party liability as it relates to or arises from any customization or modifications made by the OEM customer.

## 7. CAPITAL LEASE OBLIGATIONS AND SHORT-TERM BORROWINGS

On July 26, 2006, the Company entered into a short-term loan agreement in the amount of $5.0 million to finance the July 27, 2006 acquisition of MaxStream, Inc. Interest was based on the daily LIBOR rate plus 0.35% which ranged between 5.64% and 5.70% from the date of the loan through August 17, 2006. Per the terms of the agreement, payment of the outstanding balance was due October 31, 2006; however, the Company had the option to prepay without penalty. The Company paid the note in full on August 17, 2006.

On May 20, 2005, the Company entered into a short-term loan agreement in the amount of $21.0 million. This short-term note was used to finance the Rabbit acquisition. Per the terms of the agreement, payment of the outstanding balance was due October 1, 2005; however, the Company had the option to prepay without penalty. The Company paid the note in full on July 15, 2005. Interest was based on the daily LIBOR rate plus 0.35% which ranged between 3.39% and 3.68% from the date of the loan through July 15, 2005.

At the time the Company acquired Rabbit (see Note 2), Rabbit maintained a $5.0 million revolving line of credit with an outstanding balance of $1.3 million. The Company repaid all but $1,000 of this line of credit which is classified as a current short-term borrowing as of September 30, 2005. The remaining $1,000 was paid in December 2005. The revolving line of credit agreement was terminated as of March 2006.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 7. CAPITAL LEASE OBLIGATIONS AND SHORT-TERM BORROWINGS (CONTINUED)

At the time the Company acquired Rabbit and FS Forth (see Note 2), Rabbit and FS Forth had outstanding capital lease agreements for equipment. The following table summarizes future amounts due under capital leases (in thousands):

| Fiscal Year | |
|---|---|
| 2007 | $ 472 |
| 2008 | 445 |
| 2009 | 330 |
| 2010 | 64 |
| Total minimum payments required | 1,311 |
| Less interest on capital lease obligations | (205) |
| Net minimum principal payments | 1,106 |
| Less capital lease obligations, current portion | (381) |
| Capital leases obligations, net of current portion | $ 725 |

## 8. INCOME TAXES

The components of the income tax provision are as follows (in thousands):

| | For the years ended September 30, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Currently payable: | | | |
| Federal | $ 2,248 | $ (2,325) | $ 923 |
| State | 991 | 968 | 700 |
| Foreign | (785) | 623 | 416 |
| Deferred: | | | |
| U.S. | 951 | 589 | 1,266 |
| Foreign | 749 | 463 | 182 |
| | $ 4,154 | $ 318 | $ 3,487 |

The net deferred tax asset at September 30 consists of the following (in thousands):

| | 2006 | 2005 |
|---|---|---|
| Current deferred tax asset | $ 2,667 | $ 2,892 |
| Non-current deferred tax asset | 1,366 | — |
| Non-current deferred tax liability | (7,482) | (2,195) |
| Net deferred tax (liability) asset | $ (3,449) | $ 697 |

| | 2006 | 2005 |
|---|---|---|
| Uncollectible accounts and other reserves | $ 978 | $ 1,393 |
| Depreciation and amortization | 1,073 | 372 |
| Inventories | 845 | 984 |
| Compensation costs | 844 | 515 |
| Net operating loss carryforwards | 1,682 | 3,137 |
| Tax credit carryforwards | 3,140 | 4,246 |
| Identifiable intangible assets | (12,011) | (9,950) |
| Net deferred tax (liability) asset | $ (3,449) | $ 697 |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**8. INCOME TAXES (CONTINUED)**

As of September 30, 2006, the Company had domestic federal net operating loss carryforwards and tax credit carryforwards of $2.6 million and $2.9 million, respectively, which expire at various dates through 2026. The Company also had foreign net operating loss carryforwards and tax credit carryforwards at September 30, 2006, of $2.0 million and $0.2 million, respectively, the majority of which carry forward indefinitely.

The Company has concluded that it is more likely than not that net deferred tax assets will be realized based on future projected taxable income and the anticipated future reversal of deferred tax liabilities, and therefore no valuation allowance has been established at September 30, 2006. The amount of the net deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If the Company's future taxable income projections are not realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in future taxable income is determined.

The reconciliation of the statutory federal income tax rate to the Company's effective income tax rate for the years ended September 30 is as follows:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Statutory income tax rate | 35.0% | 35.0% | 35.0% |
| Increase (decrease) resulting from: | | | |
| State taxes, net of federal benefits | 4.2 | 3.5 | 3.8 |
| Utilization of tax credits | (2.7) | (3.4) | (4.8) |
| Extraterritorial income tax benefit and manufacturing deduction | (3.3) | (3.0) | (3.6) |
| Acquired in-process research and development | 4.6 | 0.6 | — |
| Reversal of tax reserves primarily due to settlement of tax audits | (10.4) | (31.6) | — |
| Non-deductible stock-based compensation | 0.8 | — | — |
| Other | (1.0) | 0.7 | (1.7) |
| | 27.2% | 1.8% | 28.7% |

During fiscal 2006, the Company recorded discrete tax benefits of $1.6 million, primarily related to the settlement of an audit with the French government of certain of the Company's prior fiscal years income tax returns. The Company had established tax reserves that were no longer required as a result of the settlement.

In the first quarter of fiscal 2005, the Internal Revenue Service (IRS) completed an audit of certain of the Company's prior fiscal years income tax returns, subject to final approval by the Congressional Joint Committee on Taxation. As a result of a settlement agreement associated with this audit, the Company paid $3.2 million to the IRS in the first quarter of fiscal 2005 resulting in a reduction to the income taxes payable liability. In February 2005, the Congressional Joint Committee on Taxation approved the settlement with the IRS. The Company had tax reserves recorded in excess of the ultimate amount settled, resulting in an income tax benefit of $5.7 million in fiscal 2005 representing the excess income tax reserves over the amount paid.

The Company operates in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, the Company must determine the appropriate allocation of income to each of these jurisdictions. This determination requires the Company to make several estimates and assumptions. Tax audits associated with the allocation of this income, and other complex issues, may require an extended period of time to resolve. Certain open tax years are expected to close during fiscal year 2007 and future years that may result in adjustments to the Company's income tax balances in those years that are material to its consolidated financial position and results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**9. STOCK-BASED COMPENSATION**

The Company's Stock Option Plan (the Stock Option Plan) provides for the issuance of non-statutory stock options (NSOs) and incentive stock options (ISOs) to key employees and non-employee board members holding not more than 5% of the outstanding shares of the Company's common stock. The Company's Non-Officer Stock Option Plan (the Non-Officer Plan) provides for the issuance of NSOs to key employees who are not officers or directors of the Company. The Company's 2000 Omnibus Stock Plan (the Omnibus Plan and, together with the Stock Option Plan and the Non-Officer Plan, the Plans), provides for the issuance of stock-based incentives, including ISOs and NSOs, to employees and others who provide services to the Company, including consultants, advisers and directors. Options granted under the Plans will expire if unexercised after ten years from the date of grant. Options granted under the Plans generally vest over a four-year service period.

The exercise price for ISOs and non-employee director options granted under the Stock Option Plan or the Omnibus Plan is set at the fair market value of the Company's common stock based on the closing price on the date of grant. The exercise price for nonstatutory options granted under the Plans is set by the Compensation Committee of the Board of Directors. While the Plans expressly permit grants at less than fair market value, the Company's practice is to only award grants at fair market value. The authority to grant options under the Plans and set other terms and conditions rests with the Compensation Committee. The Stock Option Plan and Non-Officer Plan terminate in 2006 and the Omnibus Plan terminates in 2010. The Company recorded cash received from the exercise of stock options of $4.6 million and related tax benefits of $0.7 million during fiscal 2006. Upon exercise, the Company issues new shares of stock.

The Plans have provisions allowing employees to elect to pay their withholding obligation through share reduction. No employees elected to pay income tax withholding obligations through share reduction during fiscal 2006, 2005 or 2004.

In connection with the acquisition of NetSilicon in fiscal 2002, the Company assumed options to purchase shares of common stock of NetSilicon under the NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan, the NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan and the NetSilicon, Inc. 2001 Stock Option and Incentive Plan (the Assumed Plans), which options became exercisable for shares of the Company's common stock. The Company cannot grant additional awards under these plans.

The Company also sponsors an Employee Stock Purchase Plan (the Purchase Plan) covering all domestic employees. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Employee contributions to the Purchase Plan were $0.8 million, $0.5 million and $0.7 million in the fiscal years ended 2006, 2005 and 2004, respectively. Pursuant to the Purchase Plan, 83,066, 71,345 and 103,875 common shares were issued to employees during the fiscal years ended 2006, 2005 and 2004 respectively. Shares are issued under the Purchase Plan from treasury stock. As of September 30, 2006, 169,084 common shares are available for future issuances under the Purchase Plan.

Prior to October 1, 2005, the Company accounted for its stock-based awards using the intrinsic-value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and related interpretations, in accordance with Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" (FAS No. 123). Accordingly, compensation costs for stock options granted were measured as the excess, if any, of the fair value of the Company's common stock at the date of grant over the exercise price to acquire the common stock. Such compensation expense, if any, was amortized on a straight-line basis over the option vesting period.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**9. STOCK-BASED COMPENSATION (CONTINUED)**

Effective October 1, 2005, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), "Share-Based Payment" (FAS No. 123R), as amended by FASB Staff Position No. FAS 123(R)-4 (FSP FAS 123(R)-4), using the modified prospective method of application. Under this method, compensation expense is recognized both for (i) awards granted, modified or settled subsequent to September 30, 2005 and (ii) the non-vested portion of awards granted prior to October 1, 2005. Compensation expense recorded during fiscal 2006 includes approximately $0.7 million related to awards issued subsequent to September 30, 2005. In addition, compensation expense recorded during fiscal 2006 includes approximately $1.6 million related to the current vesting portion of awards issued prior to September 30, 2005.

The impact of adopting FAS No. 123R for the Company's fiscal year ended September 30, 2006 was an increase in compensation expense of $2.3 million and a reduction of $0.07 for basic earnings per share and $0.06 for diluted earnings per share. The total income tax benefit recognized in the income statement for stock based compensation during fiscal 2006 was $0.8 million. Compensation cost capitalized as part of inventory was immaterial as of September 30, 2006.

Stock-based compensation expense (pre-tax) is included in the consolidated results of operations for the year ended September 30, 2006 as follows (in thousands):

| | Year Ended September 30, 2006 |
|---|---|
| Cost of sales | $ 89 |
| Sales and marketing | 694 |
| Research and development | 530 |
| General and administrative | 976 |
| Total stock-based compensation | $ 2,289 |

FAS No. 123R also requires that the excess windfall tax benefit resulting from the tax deductibility of the increase in the value of share-based arrangements be presented as a component of cash flows from financing activities in the Consolidated Statements of Cash Flows. In periods prior to October 1, 2005, such amounts were presented as a component of cash flows from operating activities.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**9. STOCK-BASED COMPENSATION (CONTINUED)**

A summary of options and common shares reserved for grant under the Plans and Assumed Plans are as follows (in thousands, except per common share amounts):

| | Options Available for Grant | Options Outstanding | Weighted Average Exercise Price | Weighted Average Contractual Term (in years) | Aggregate Intrinsic Value(1) |
|---|---|---|---|---|---|
| Balances, September 30, 2003 | 2,002 | 5,856 | $ 8.44 | | |
| Granted | (640) | 640 | 10.02 | | |
| Exercised | — | (1,466) | 5.86 | | |
| Cancelled | 126 | (245) | 14.28 | | |
| Balances, September 30, 2004 | 1,488 | 4,785 | $ 9.15 | | |
| Granted | (635) | 635 | 13.41 | | |
| Exercised | — | (778) | 7.20 | | |
| Cancelled | 97 | (131) | 12.91 | | |
| Balances, September 30, 2005 | 950 | 4,511 | $ 9.98 | | |
| Granted | (478) | 478 | 12.34 | | |
| Exercised | — | (615) | 7.41 | | |
| Cancelled | 125 | (134) | 12.49 | | |
| Balances, September 30, 2006 | 597 | 4,240 | $ 10.54 | 5.40 | $ 15,154 |
| Exercisable at September 30, 2004 | | 3,869 | $ 9.33 | | |
| Exercisable at September 30, 2005 | | 3,544 | $ 9.54 | | |
| Exercisable at September 30, 2006 | | 3,300 | $ 10.08 | 4.48 | $ 13,622 |

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, based on Digi's closing stock price of $13.50 as of September 29, 2006, which would have been received by the option holders had all option holders exercised their options as of that date.

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. The total intrinsic value of all options exercised during the twelve months ended September 30, 2006 was $2.9 million. The weighted average fair value of options granted during the twelve months ended September 30, 2006 was $5.79. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

| | |
|---|---|
| Risk free interest rate | 4.28% — 5.02% |
| Expected option holding period | 3 — 5 years |
| Expected volatility | 50% — 60% |
| Weighted average volatility | 55% |
| Expected dividend yield | 0 |

The fair value of each option award granted during the periods presented was estimated using the Black-Scholes option valuation model that uses the assumptions noted in the table above. Expected volatilities are based on the historical volatility of our stock. We use historical data to estimate option exercise and employee termination information within the valuation model; separate groups of grantees that have similar historical exercise behaviors are considered separately for valuation purposes. The expected term of options granted is derived from the vesting period and historical information and represents the period of time that options granted

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**9. STOCK-BASED COMPENSATION (CONTINUED)**

are expected to be outstanding. The risk-free rate used is the zero-coupon U.S. Treasury bond rate in effect at the time of the grant whose maturity equals the expected term of the option.

A summary of the Company's non-vested options as of September 30, 2006 and changes during the twelve months then ended is presented below (in thousands, except per common share amounts):

| | Number of Options | Weighted Average Grant Date Fair Value per Common Share |
|---|---|---|
| Nonvested at September 30, 2005 | 967 | $4.81 |
| Granted | 478 | 5.79 |
| Vested | (412) | 4.59 |
| Forfeited | (93) | 5.56 |
| Nonvested at September 30, 2006 | 940 | $5.33 |

The Company used historical data to estimate pre-vesting forfeiture rates. The pre-vesting forfeiture rate used in fiscal 2006 was 2.5%. As of September 30, 2006 the total unrecognized compensation cost related to non-vested stock-based compensation arrangements net of expected forfeitures was $4.8 million and the related weighted average period over which it is expected to be recognized is approximately 2.6 years.

At September 30, 2006, the weighted average exercise price and remaining life of the stock options are as follows (in thousands, except remaining life and exercise price):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Options Outstanding | Weighted Average Remaining Contractual Life (In Years) | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price |
| $2.19 — $5.00 | 205 | 6.1 | $ 2.84 | 195 | $ 2.82 |
| $5.01 — $6.00 | 410 | 5.0 | $ 5.40 | 396 | $ 5.41 |
| $6.01 — $7.00 | 332 | 4.4 | $ 6.78 | 319 | $ 6.78 |
| $7.01 — $8.00 | 265 | 3.9 | $ 7.61 | 256 | $ 7.62 |
| $8.01 — $10.00 | 414 | 6.0 | $ 9.58 | 395 | $ 9.57 |
| $10.01 — $11.00 | 1,246 | 4.8 | $10.73 | 995 | $10.75 |
| $11.01 — $12.00 | 281 | 3.7 | $11.90 | 240 | $11.96 |
| $12.01 — $13.00 | 381 | 9.0 | $12.72 | 12 | $12.63 |
| $13.01 — $20.00 | 539 | 6.9 | $14.51 | 325 | $14.44 |
| $20.01 — $27.69 | 167 | 2.7 | $25.61 | 167 | $25.61 |
| $2.19 — $27.69 | 4,240 | 5.4 | $10.54 | 3,300 | $10.08 |

***Information under FAS 123 for Periods Prior to Fiscal 2006:***

Had the Company applied the fair-value-based method of accounting for its stock options granted to employees and for the stock purchases under the employee stock purchase plan and charged operations over the option vesting periods based on the fair value of options on the date of grant, net income and net income per common

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**9. STOCK-BASED COMPENSATION (CONTINUED)**

share would have changed to the pro forma amounts indicated below (in thousands, except per common share data):

| | Years ended September 30, | |
|---|---|---|
| | 2005 | 2004 |
| Net income as reported | $ 17,665 | $ 8,663 |
| Add: Total stock-based compensation expense included in reported net income, net of related tax effects | 35 | 89 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (1,363) | (2,338) |
| Pro forma net income | $ 16,337 | $ 6,414 |
| Net income per common share: | | |
| Basic — as reported | $ 0.79 | $ 0.41 |
| Basic — pro forma | $ 0.73 | $ 0.30 |
| Diluted — as reported | $ 0.76 | $ 0.39 |
| Diluted — pro forma | $ 0.70 | $ 0.29 |

The weighted average fair value of options granted and assumed in fiscal years 2005 and 2004 was $6.35 and $5.07, respectively. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

| Assumptions: | 2005 | 2004 |
|---|---|---|
| Risk free interest rate | 3.52% | 2.86% |
| Expected option holding period | 3.9 years | 3.6 years |
| Expected volatility | 60% | 70% |
| Expected dividend yield | 0 | 0 |

**10. SHARE RIGHTS PLAN**

The Company has adopted a share rights plan. Each right entitles its holder to buy one one-hundredth of a share of a new series of junior participating preferred stock at an exercise price of $115, subject to adjustment. The rights are exercisable only if certain ownership considerations are met. The Company will be entitled to redeem the rights prior to the rights becoming exercisable.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 11. COMMITMENTS

The Company has entered into various operating lease agreements for office facilities and equipment, the last of which expires in fiscal 2015. The office facility leases generally require the Company to pay a pro-rata share of the lessor's operating expenses. Certain operating leases contain escalation clauses and are being amortized on a straight-line basis over the term of the lease. The following schedule reflects future minimum rental commitments under noncancelable operating leases. These minimum payments have not been reduced by minimum sublease rentals of $0.2 million due in the future under noncancelable subleases.

| Fiscal Year | Amount (in thousands) |
|---|---|
| 2007 | $ 2,400 |
| 2008 | 1,328 |
| 2009 | 747 |
| 2010 | 552 |
| 2011 | 553 |
| Thereafter | 958 |
| Total minimum payments required | $ 6,538 |

The following schedule shows the composition of total rental expense for all operating leases for the years ended September 30 (in thousands):

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Rentals | $ 2,352 | $ 1,921 | $ 1,652 |
| Less: sublease rentals | (127) | (183) | (129) |
| | $ 2,225 | $ 1,738 | $ 1,523 |

### 12. EMPLOYEE BENEFIT PLANS

The Company currently has a savings and profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code (the Code), whereby eligible employees may contribute pre-tax earnings, not to exceed amounts allowed under the Code.

Employees may contribute up to 25% of their pre-tax earnings (not to exceed amounts allowed under the Code). The Company provides a match of 100% on the first 3% of each employee's bi-weekly contribution and a 50% match on the next 2% of each employee's bi-weekly contribution. In addition, the Company may make contributions to the plan at the discretion of the Board of Directors. The Company provided matching contributions of $0.9 million, $0.8 million and $0.8 million in the fiscal years ended September 30, 2006, 2005 and 2004, respectively.

### 13. CONTINGENCIES

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of NetSilicon and approximately 300 other public companies. The complaint names as defendants the Company, NetSilicon, certain of its officers and certain underwriters involved in NetSilicon's IPO, among numerous others, and asserts, among other things, that NetSilicon's IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon's IPO underwriters in allocating shares in NetSilicon's IPO to the underwriters' customers. The Company believes that the claims against the NetSilicon defendants

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**13. CONTINGENCIES (CONTINUED)**

are without merit and has defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

In June 2003, the Company elected to participate in a proposed settlement agreement with the plaintiffs in this litigation. If ultimately approved by the Court, this proposed settlement would result in a dismissal, with prejudice, of all claims in the litigation against the Company and against any of the other issuer defendants who elect to participate in the proposed settlement, together with the current or former officers and directors of participating issuers who were named as individual defendants.

Consummation of the proposed settlement remains conditioned upon obtaining approval by the Court. On September 1, 2005, the Court preliminarily approved the proposed settlement and directed that notice of the terms of the proposed settlement be provided to class members. Thereafter, the Court held a fairness hearing on April 24, 2006, at which objections to the proposed settlement were heard. After the fairness hearing, the Court took under advisement whether to grant final approval to the proposed settlement.

If the proposed settlement is not consummated, the Company intends to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, there can be no guarantee as to the ultimate outcome of this pending lawsuit. The Company maintains liability insurance for such matters and expects that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of September 30, 2006, the Company has accrued a liability for the deductible amount of $250,000 which the Company believes reflects the amount of loss that is probable. In the event the Company has losses that exceed the limits of the liability insurance, such losses could have a material effect on the business, or consolidated results of operations or financial condition of the Company.

On April 13, 2004, the Company filed a lawsuit against Lantronix Inc. (Lantronix) alleging that certain of Lantronix's products infringe the Company's U.S. Patent No. 6,446,192. The Company filed the lawsuit in the U.S. District Court in Minnesota. The lawsuit sought both monetary and non-monetary relief. On May 3, 2004, Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,571,305, in the U.S. District Court for the Central District of California. The lawsuit sought both monetary and non-monetary relief. On February 7, 2005 Lantronix and Acticon Technologies LLC filed a lawsuit against the Company alleging that certain of the Company's products infringe U.S. Patent No. 4,972,470. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit sought both monetary and non-monetary relief. On May 12, 2005 Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,881,096. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit sought both monetary and non-monetary relief. On May 2, 2006, Lantronix and the Company settled all pending infringement litigations between the companies. Under and subject to the terms of the agreement, the companies have cross-licensed each others' patents, and each company will have the benefit and protection afforded by all of each others' current and future patents for a period of six years.

In the normal course of business, the Company is subject to various claims and litigation, including patent infringement and intellectual property claims. Management of the Company expects that these various claims and litigation will not have a material adverse effect on the consolidated results of operations or financial condition of the Company.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

**14. QUARTERLY FINANCIAL DATA (UNAUDITED)**

(in thousands, except per common share data)

| | Quarter ended Dec. 31 | Mar. 31 | June 30 | Sept. 30 |
|---|---|---|---|---|
| 2006 | | | | |
| Net sales | $33,376 | $34,380 | $35,860 | $41,047 |
| Gross profit (1) | 18,198 | 18,318 | 19,467 | 21,522 |
| Net income (1)(2)(3) | 2,183 | 2,567 | 3,348 | 3,015 |
| Net income per common share — basic | 0.10 | 0.11 | 0.14 | 0.12 |
| Net income per common share — diluted | 0.09 | 0.11 | 0.14 | 0.12 |
| 2005 | | | | |
| Net sales | $29,470 | $29,312 | $30,208 | $36,208 |
| Gross profit (1) | 17,213 | 17,002 | 17,258 | 20,018 |
| Net income (1)(2)(3) | 2,961 | 8,799 | 2,484 | 3,421 |
| Net income per common share — basic | 0.13 | 0.39 | 0.11 | 0.15 |
| Net income per common share — diluted | 0.13 | 0.37 | 0.11 | 0.15 |

(1) Effective October 1, 2005, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), using the modified prospective method of application. Total compensation cost for stock-based payment arrangements totaled $2.3 million ($1.5 million after tax) during fiscal year 2006. Prior to the adoption of this Statement, no compensation cost for stock-based payment arrangements was recognized in earnings. Refer to Note 9 to the Consolidated Financial Statements for further discussion.

(2) During 2006 and 2005, the Company reversed income tax reserves of $1.6 million and $5.7 million, respectively, which were no longer required primarily as a result of the settlement of tax audits with the French government in 2006 and the Internal Revenue Service in 2005. In 2003, the Company reversed a valuation allowance, resulting in an income tax benefit of $1.4 million, based on anticipated future taxable income generated by the Company's German operations.

(3) The Company adopted the provisions of FAS 142 as of October 1, 2002 at which time it was determined that there was a total goodwill impairment of $43.9 million. The charge was attributable primarily to an impairment of the carrying value of goodwill related to the acquisition of NetSilicon of $38.4 million and goodwill related to the CDC and INXTECH acquisitions of $3.5 million and $2.0 million, respectively.

The summation of quarterly net income per common share may not equate to the year-end calculation as quarterly calculations are performed on a discrete basis.

**SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS**
(in thousands)

| Description | Balance at beginning of period | Charged to costs and expenses | Deductions | Balance at end of period |
|---|---|---|---|---|
| Valuation account — doubtful accounts | | | | |
| September 30, 2006 | $ 872 | $(204) | $173(1) | $ 495 |
| September 30, 2005 | $1,022 | $(123) | $ 27(1) | $ 872 |
| September 30, 2004 | 1,017 | 18 | 13(1) | 1,022 |

(1) Uncollectible accounts charged against allowance, net of recoveries

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective.

### Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2006 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework*. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of September 30, 2006. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of September 30, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

On July 27, 2006, the Company acquired MaxStream, Inc. (MaxStream). MaxStream, whose total assets represented 19.8% of total consolidated assets as of September 30, 2006 and whose total net sales represented 2.2% of total consolidated net sales for the year ended September 30, 2006, was acquired in a purchase business combination and was excluded from the Company's September 30, 2006 assessment of the effectiveness of the Company's internal control over financial reporting.

### Changes in Internal Control Over Financial Reporting

Other than the changes resulting from the MaxStream acquisition, there have been no significant changes in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None

## PART III

### ITEM 10. EXECUTIVE OFFICERS OF THE REGISTRANT

As of the date of filing this Form 10-K, the following individuals were executive officers of the Registrant:

| Name | Age | Position |
|---|---|---|
| Joseph T. Dunsmore | 48 | Chairman, President and Chief Executive Officer |
| Subramanian Krishnan | 52 | Senior Vice President, Chief Financial Officer and Treasurer |
| Lawrence A. Kraft | 40 | Senior Vice President of Sales and Marketing |
| Joel K. Young | 42 | Senior Vice President of Research and Development and Chief Technical Officer |

Mr. Dunsmore joined the Company in October 1999 as President and Chief Executive Officer and a member of the Board of Directors and was elected Chairman of the Board in May 2000. Prior to joining the Company, Mr. Dunsmore was Vice President of Access for Lucent Microelectronics, a telecommunications company now known as Agere Systems Inc., since June 1999. From October 1998 to June 1999, he acted as an independent consultant to various high technology companies. From February 1998 to October 1998, Mr. Dunsmore was Chief Executive Officer of NetFax, Inc., a telecommunications company. From October 1995 to February 1998, he held executive management positions at US Robotics and then at 3COM after 3COM acquired US Robotics in June 1997. Prior to that, Mr. Dunsmore held various marketing management positions at AT&T Paradyne Corporation from May 1983 to October 1995.

Mr. Krishnan was named Senior Vice President, Chief Financial Officer and Treasurer on February 1, 1999, prior to which he served as the Company's Vice President of Finance since January 11, 1999. Prior to joining the Company, he served as a principal with LAWCO Financial, an investment banking firm in Minneapolis, Minnesota from January 1997 to January 1999. Prior to LAWCO, he served for 13 years with the Valspar Corporation as the Director of Corporate Financial Planning and Reporting and Taxes and was primarily responsible for mergers, acquisitions and joint ventures.

Mr. Kraft joined the Company as Vice President of Americas Sales and Marketing in February 2003 and was named Senior Vice President of Sales and Marketing in November 2005. Prior to joining the Company, Mr. Kraft was Vice President of Marketing for Advanced Switching Communications (ASC), a provider of broadband access platforms, from June 1999 to February 2002 where he built a marketing and product management organization. From July 1998 to October 1998, Mr. Kraft was Vice President of Marketing for NetFax, Inc., a telecommunications company. Mr. Kraft also previously held the positions of Manager of Product Marketing at 3COM/U.S. Robotics, Vice President of Marketing for ISDN Systems Corporation, and Group Products Manager for the Internet access program at Sprint Corporation.

Mr. Young joined the Company in July 2000 as Vice President of Engineering and was named Vice President of Research and Development and Chief Technical Officer in November 2005. In October 2006, Mr. Young was named Senior Vice President of Research and Development and Chief Technical Officer. Prior to joining the Company, Mr. Young served as a Vice President for Transcrypt International, a provider of encryption products, in various engineering, sales and marketing positions from February 1996 to June 2000. Before that, he held various engineering and management positions at AT&T and AT&T Bell Laboratories from 1986 to 1996. When he left AT&T, he was a District Manager responsible for creating new business services.

**CODE OF ETHICS**

The Company adopted a "code of ethics" within the meaning of Rule 406 of Regulation S-K, which is applicable to the Company's senior financial management, including specifically the Company's Chief Executive Officer, Chief Financial Officer and Controller. A copy of this code of ethics is listed as an exhibit to this report. The Company intends to satisfy its disclosure obligations regarding any amendment to, or a waiver from, a provision of this code of ethics by posting such information on the Company's website at www.digi.com. The Company also has a "code of conduct" that applies to all directors, officers and employees, a copy of which is available through the Company's website (www.digi.com) under the "About us — Investor Relations — Corporate Governance" caption.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

None.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Consolidated Financial Statements and Schedules of the Company

1. Consolidated Statements of Operations for the fiscal years ended September 30, 2006, 2005 and 2004

   Consolidated Balance Sheets as of September 30, 2006 and 2005

   Consolidated Statements of Cash Flows for the fiscal years ended September 30, 2006, 2005 and 2004

   Consolidated Statements of Stockholders' Equity and Comprehensive Income for the fiscal years ended September 30, 2006, 2005 and 2004

   Notes to Consolidated Financial Statements

2. Schedule of Valuation and Qualifying Accounts

3. Report of Independent Registered Public Accounting Firm

(b) Exhibits

| Exhibit Number | Description |
|---|---|
| 2(a) | Agreement and Plan of Merger among the Company, Dove Sub Inc. and NetSilicon, Inc. dated as of October 30, 2001 (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (1) |
| 2(b) | Purchase and assignment contract dated March 20, 2005 between Embedded Solutions AG, Klaus Flesch, Angelika Flesch and Digi International GmbH (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (2) |
| 2(c) | Agreement and Plan of Merger among Digi International Inc., Karat Sub Inc. and Z-World, Inc. dated as of May 26, 2005 (excluding schedules and exhibits, which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (3) |
| 2(d) | Agreement and Plan of Merger among Digi International Inc., Ocean Acquisition Sub Inc. and MaxStream, Inc. dated as of July 27, 2006 (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (4) |
| 3(a) | Restated Certificate of Incorporation of the Company, as amended (5) |
| 3(b) | Amended and Restated By-Laws of the Company, as amended (6) |
| 4(a) | Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (7) |
| 4(b) | Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (8) |

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (CONTINUED)**

Exhibits (continued)

| Exhibit Number | Description |
|---|---|
| 10(a) | Digi International Inc. Stock Option Plan as Amended and Restated as of November 27, 2006* |
| 10(b) | Form of indemnification agreement with directors and officers of the Company (9) |
| 10(c) | Agreement between the Company and Subramanian Krishnan dated March 26, 1999* (10) |
| 10(c)(i) | Amendment to Agreement between the Company and Subramanian Krishnan dated February 5, 2001* (11) |
| 10(d) | Employment Agreement between the Company and Joseph T. Dunsmore dated September 27, 2006* |
| 10(e) | Digi International Inc. Employee Stock Purchase Plan, as Amended and Restated, of the Company as of November 27, 2006 |
| 10(f) | Digi International Inc. 2000 Omnibus Stock Plan as Amended and Restated as of November 27, 2006* |
| 10(g) | Digi International Inc. Non-Officer Stock Option Plan, as Amended and Restated as of November 27, 2006 |
| 10(h) | NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan (12) |
| 10(i) | NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (13) |
| 10(j) | NetSilicon, Inc. 2001 Stock Option and Incentive Plan (14) |
| 10(k) | Form of Notice of Grant of Stock Options and Option Agreement and Terms and Conditions of Nonstatutory Stock Option Agreement* (15) |
| 10(l) | Fiscal 2007 Executive Officer Compensation* (16) |
| 10(m) | Agreement between the Company and Lawrence A. Kraft, dated February 4, 2003* |
| 14 | Code of Ethics (17) |
| 21 | Subsidiaries of the Company |
| 23 | Consent of Independent Registered Public Accounting Firm |
| 24 | Powers of Attorney |
| 31(a) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31(b) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32 | Section 1350 Certification |

* Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

Table of Contents

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (CONTINUED)**

(1) Incorporated by reference to Annex A to the Company's Registration Statement on Form S-4 (File no. 333-74118).

(2) Incorporated by reference to Exhibit 2(a) to the Company's Form 10-Q for the quarter ended March 31, 2005 (File no. 0-17972).

(3) Incorporated by reference to Exhibit 2 to the Company's Form 8-K dated May 26, 2005 (File no. 0-17972).

(4) Incorporated by reference to Exhibit 2 to the Company's Form 8-K dated July 27, 2006 (File no. 0-17972)

(5) Incorporated by reference to Exhibit 3(a) to the Company's Form 10-K for the year ended September 30, 1993 (File no. 0-17972).

(6) Incorporated by reference to Exhibit 3(b) to the Company's Form 10-K for the year ended September 30, 2001 (File no. 0-17972).

(7) Incorporated by reference of Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File no. 0-17972).

(8) Incorporated by reference to Exhibit 1 to Amendment No. 1 to the Company's Registration Statement on Form 8-A dated February 5, 1999 (File no. 0-17972).

(9) Incorporated by reference to Exhibit 10(b) to the Company's Registration Statement on Form S-1 (File no. 33-30725).

(10) Incorporated by reference to Exhibit 10(k) to the Company's Form 10-Q for the quarter ended March 31, 1999 (File no. 0-17972).

(11) Incorporated by reference to Exhibit 10(e) to the Company's Form 10-Q for the quarter ended December 31, 2000 (File no. 0-17972).

(12) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82672).

(13) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82670).

(14) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82668).

(15) Incorporated by reference to Exhibit 10(a) to the Company's Form 8-K dated September 13, 2004 (File no. 0-17972).

(16) Incorporated by reference to Item 1.01 of the Company's Form 8-K dated September 26, 2006 (File no. 0-17972)

(17) Incorporated by reference to Exhibit 14 to the Company's Form 10-K for the year ended September 30, 2003 (File no. 0-17972).

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DIGI INTERNATIONAL INC.

December 6, 2006

By: /s/ Joseph T. Dunsmore
Joseph T. Dunsmore
President, Chief Executive Officer, Chairman, and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

December 6, 2006

/s/ Joseph T. Dunsmore
Joseph T. Dunsmore
President, Chief Executive Officer, Chairman, and Director (Principal Executive Officer)

December 6, 2006

/s/ Subramanian Krishnan
Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

**GUY C. JACKSON**
**KENNETH E. MILLARD**
**AHMED NAWAZ**
**WILLIAM N. PRIESMEYER**
**BRADLEY J. WILLIAMS**

A majority of the Board of Directors*

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* Joseph T. Dunsmore, by signing his name hereto, does hereby sign this document on behalf of each of the above named directors of the Registrant pursuant to Powers of Attorney duly executed by such persons.

December 6, 2006

/s/ Joseph T. Dunsmore
Joseph T. Dunsmore
Attorney-in-fact

**EXHIBIT INDEX**

| Exhibit | Description | Page |
|---|---|---|
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| 4(a) | Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent | Incorporated by Reference |
| 4(b) | Amendment dated January 26, 1999, to Shares Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent | Incorporated by Reference |
| 10(a) | Digi International Inc. Stock Option Plan as Amended and Restated as of November 27, 2006 | Filed Electronically |
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| 10(f) | Digi International Inc. 2000 Omnibus Stock Plan as Amended and Restated as of November 27, 2006 | Filed Electronically |
| 10(g) | Digi International Inc. Non-Officer Stock Option Plan, as Amended and Restated as of November 27, 2006 | Filed Electronically |
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| 10(j) | NetSilicon, Inc. 2001 Stock Option and Incentive Plan | Incorporated by Reference |
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Table of Contents

**EXHIBIT INDEX (CONTINUED)**

| Exhibit | Description | Page |
|---|---|---|
| 10(l) | Fiscal 2007 Executive Officer Compensation | Incorporated by Reference |
| 10(m) | Agreement between the Company and Lawrence A. Kraft, dated February 4, 2003 | Filed Electronically |
| 14 | Code of Ethics | Incorporated by Reference |
| 21 | Subsidiaries of the Company | Filed Electronically |
| 23 | Consent of Independent Registered Public Accounting Firm | Filed Electronically |
| 24 | Powers of Attorney | Filed Electronically |
| 31(a) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed Electronically |
| 31(b) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer | Filed Electronically |
| 32 | Section 1350 Certification | Filed Electronically |

Exhibit 10(a)

**DIGI INTERNATIONAL INC.**
**STOCK OPTION PLAN**
**AS AMENDED AND RESTATED**
**AS OF NOVEMBER 27, 2006**

1. *Purpose of Plan*. The purpose of this Digi International Inc. Stock Option Plan (the "Plan"), is to promote the interests of Digi International Inc., a Delaware corporation (the "Company"), and its stockholders by providing key personnel of the Company and its subsidiaries with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its subsidiaries. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel of outstanding ability.

2. *Administration of Plan*. This Plan shall be administered by a committee of two or more directors (the "Committee") appointed by the Company's board of directors (the "Board"). No person shall serve as a member of the Committee unless such person shall be a "Non-Employee Director" as that term is defined in Rule 16b-3(a)(3)(i), promulgated under the Securities Exchange Act of 1934, as amended (the "Act"), or any successor statute or regulation comprehending the same subject matter. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and the acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Subject to the provisions of this Plan, the Committee may from time to time adopt such rules for the administration of this Plan as it deems appropriate. The decision of the Committee on any matter affecting this Plan or the rights and obligations arising under this Plan or any option granted hereunder, shall be final, conclusive and binding upon all persons, including without limitation the Company, stockholders, employees and optionees. To the full extent permitted by law, (i) no member of the Committee or the CEO Stock Option Committee (as defined in this paragraph 2) shall be liable for any action or determination taken or made in good faith with respect to this Plan or any option granted hereunder and (ii) the members of the Committee and the CEO Stock Option Committee shall be entitled to indemnification by the Company against and from any loss incurred by such member or person by reason of any such actions and determinations. The Committee may delegate all or any part of its authority under this Plan to a one person committee consisting of the Chief Executive Officer of the Company as its sole member (the "CEO Stock Option Committee") for purposes of granting and administering awards granted to persons other than persons who are then subject to the reporting requirements of Section 16 of the Exchange Act ("Section 16 Individuals").

3. *Shares Subject to Plan*. The shares that may be made subject to options granted under this Plan shall be authorized and unissued shares of common stock (the "Common Shares") of the Company, $.01 par value, or Common Shares held in treasury, and they shall not

exceed 4,129,400 in the aggregate, except that, if any option lapses or terminates for any reason before such option has been completely exercised, the Common Shares covered by the unexercised portion of such option may again be made subject to options granted under this Plan.

4. *Eligible Participants*. Options may be granted under this Plan to any key employee of the Company or any subsidiary thereof, including any such employee who is also an officer or director of the Company or any subsidiary thereof. Nonstatutory stock options, as defined in paragraph 5(a) hereof, also shall be granted to directors of the Company who are not employees of the Company or any subsidiary thereof (the "Outside Directors") in accordance with paragraph 6 hereof and may also be granted to other individuals or entities who are not "employees" but who provide services to the Company or a parent or subsidiary thereof in the capacity of an Outside Director, advisor or consultant. References herein to "employed," "employment" and similar terms (except "employee") shall include the providing of services in any such capacity or as a director. The employees and other individuals and entities to whom options may be granted pursuant to this paragraph 4 are referred to herein as "Eligible Participants."

5. *Terms and Conditions of Employee Options*.

(a) Subject to the terms and conditions of this Plan, the Committee may, from time to time prior to December 1, 2006, grant to such Eligible Participants as the Committee may determine options to purchase such number of Common Shares of the Company on such terms and conditions as the Committee may determine; provided, however, that no Eligible Participant may be granted options with respect to more than 250,000 Common Shares during any calendar year. In determining the Eligible Participants to whom options shall be granted and the number of Common Shares to be covered by each option, the Committee may take into account the nature of the services rendered by the respective Eligible Participants, their present and potential contributions to the success of the Company, and such other factors as the Committee in its sole discretion shall deem relevant. The date and time of approval by the Committee of the granting of an option shall be considered the date and the time of the grant of such option. The Committee in its sole discretion may designate whether an option granted to an employee is to be considered an "incentive stock option" (as that term is defined in Section 422 of the Internal Revenue Code of 1986, as amended, or any amendment thereto (the "Code")) or a nonstatutory stock option (an option granted under this Plan that is not intended to be an "incentive stock option"). The Committee may grant both incentive stock options and nonstatutory stock options to the same employee. However, if an incentive stock option and a nonstatutory stock option are awarded simultaneously, such options shall be deemed to have been awarded in separate grants, shall be clearly identified, and in no event shall the exercise of one such option affect the right to exercise the other. To the extent that the aggregate Fair Market Value (as defined in paragraph 5(c)) of Common Shares with respect to which incentive stock options (determined without regard to this sentence) are exercisable for the first time by any individual during any calendar year (under all plans of the Company and its parent and subsidiary corporations) exceeds $100,000, such options shall be treated as nonstatutory stock options.

(b) The purchase price of each Common Share subject to an option granted pursuant to this paragraph 5 shall be fixed by the Committee. For nonstatutory stock options, such purchase price may be set at not less than 50% of the Fair Market Value (as defined below) of a Common Share on the date of grant. For incentive stock options, such purchase price shall be no less than 100% of the Fair Market Value of a Common Share on the date of grant, provided that if such incentive stock option is granted to an employee who owns, or is deemed under Section 424(d) of the Code to own, at the time such option is granted, stock of the Company (or of any parent or subsidiary of the Company) possessing more than 10% of the total combined voting power of all classes of stock therein (a "10% Stockholder"), such purchase price shall be no less than 110% of the Fair Market Value of a Common Share on the date of grant.

(c) "Fair Market Value" as of any date means, unless otherwise expressly provided in the Plan:

(i) the closing sale price of a Common Share on such date, or, if no sale of Common Shares shall have occurred on that date, on the next preceding day on which a sale of Common Shares occurred

(A) on the composite tape for NASDAQ-listed shares, or

(B) if the Common Shares are not quoted on the composite tape for NASDAQ-listed shares, on the principal United States Securities Exchange registered under the Securities Exchange Act of 1934, as amended, on which the Common Shares are listed, or

(ii) if clause (i) is inapplicable, the mean between the closing "bid" and the closing "asked" quotation of a Common Share on that date, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a closing bid and asked quotation is made, on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or

(iii) if clauses (i) and (ii) are inapplicable, what the Committee determines in good faith to be 100% of the fair market value of a Common Share on that date, using such criteria as it shall determine, in its sole discretion, to be appropriate for valuation.

In the case of an incentive stock option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 13.

(d) Each option agreement provided for in paragraph 14 hereof shall specify when each option granted under this Plan shall become exercisable.

(e) Each option granted pursuant to this paragraph 5 and all rights to purchase shares thereunder shall cease on the earliest of:

(i) ten years after the date such option is granted (or in the case of an incentive stock option granted to a 10% Stockholder, five years after the date such option is granted) or on such date prior thereto as may be fixed by the Committee on or before the date such option is granted;

(ii) the expiration of the period after the termination of the optionee's employment within which the option is exercisable as specified in paragraph 8(b) or 8(c), whichever is applicable; or

(iii) the date, if any, fixed for cancellation pursuant to paragraph 9 of this Plan.

In no event shall any option be exercisable at any time after its original expiration date. When an option is no longer exercisable, it shall be deemed to have lapsed or terminated and will no longer be outstanding.

6. *Terms and Conditions of Outside Director Options*.

(a) Subject to the terms and conditions of this Plan, the Committee shall grant options to each Outside Director who is not on the date such option would be granted the beneficial owner (as defined in Rule 13d-3 under the Act) of more than 5% of the outstanding Common Shares, on the terms and conditions set forth in this paragraph 6. During the term of this Plan and provided that sufficient Common Shares are available pursuant to paragraph 3:

(i) each person who is elected to be an Outside Director and who was not at any time previously a director of the Company shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(i). The number of Common Shares covered by each such option shall be 7,500;

(ii) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders shall be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(ii). The number of Common Shares covered by each such option shall be 9,500;

(iii) each person who is elected to be an Outside Director between Annual Meetings of Stockholders shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(iii). The number of Common Shares covered by each such option shall be 9,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12;

(iv) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders may elect in writing to be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders in lieu of all cash compensation to which such Outside Director would be entitled for the Board year of the Company commencing with such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(iv). The number of Common Shares covered by each such option shall be 3,500. Any such election by an Outside Director shall be subject to prior approval by the Committee; and

(v) each person who is elected to be an Outside Director between Annual Meetings of Stockholders may elect in writing to be granted a nonstatutory stock option in lieu of all cash compensation to which such Outside Director would otherwise be entitled for the period commencing with the date such person is elected to be an Outside Director of the Company by the Board and ending on the date of the next Annual Meeting of Stockholders. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(v). The number of Common Shares covered by each such option shall be 3,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12. Such election by an Outside Director shall be subject to prior approval by the Committee.

(b) The purchase price of each Common Share subject to an option granted to an Outside Director pursuant to this paragraph 6 shall be the Fair Market Value of a Common Share on the date of grant.

(c) (i) Subject to the provisions of paragraphs 6(d) and 6(e) hereof, (x) options granted to Outside Directors pursuant to subparagraph 6(a)(ii) and (iv) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(i) if the date of grant of such options is the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

| Annual Meeting of Stockholders | Cumulative Percentage Becoming Exercisable |
|---|---|
| One Year After Grant | 50% |
| Two Years After Grant | 100% |

(ii) Subject to the provisions of paragraph 6(d) and 6(e) hereof, (x) the options granted to Outside Directors pursuant to subparagraphs 6(a)(iii) and (v) and (y) options granted to Outside Directors pursuant to subparagraph 6(a)(i) if the date of grant of such options is a date other than the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

| Anniversary of the Date of Grant | Cumulative Percentage Becoming Exercisable |
|---|---|
| One Year After Grant | 50% |
| Two Years After Grant | 100% |

(d) Notwithstanding the vesting schedules set forth in paragraph 6(c) hereof, an option held by an Outside Director shall vest and become immediately exercisable upon the latest of (i) the date on which such Outside Director attains 62 years of age, (ii) the date on which such Outside Director has completed five years of Service (as hereinafter defined) and (iii) the first anniversary of the date of grant of such option or, if applicable, the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such option was granted. Any option granted to an Outside Director on or after the first accelerated vesting date for such Outside Director shall automatically vest on the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such option was granted. As used herein, “Service” shall mean service to the Company or any subsidiary thereof in the capacity of any advisor, consultant, employee, officer or director, and Service as a director from an Annual Meeting of Stockholders to the next succeeding Annual Meeting shall constitute a year of Service, notwithstanding that such period may actually be more or less than one year.

(e) Each option granted to an Outside Director pursuant to this paragraph 6 and all rights to purchase shares thereunder shall terminate on the earliest of:

(i) ten years after the date such option is granted;

(ii) the expiration of the period specified in paragraph 8(b) or 8(c), whichever is applicable, after an Outside Director ceases to be a director of the Company; or

(iii) the date, if any, fixed for cancellation pursuant to paragraph 9 of this Plan.

In no event shall such option be exercisable at any time after its original expiration date. When an option is no longer exercisable, it shall be deemed to have lapsed or terminated and will no longer be outstanding.

(f) The provisions of this Section 6 are not intended to be exclusive; the Committee, in its discretion, may grant additional Options to an Outside Director.

7. *Manner of Exercising Options*. A person entitled to exercise an option granted under this Plan may, subject to its terms and conditions and the terms and conditions of this Plan, exercise it in whole at any time, or in part from time to time, by delivery to the Company at its principal executive office, to the attention of its President, of written notice of exercise, specifying the number of shares with respect to which the option is being exercised, accompanied by payment in full of the purchase price of the shares to be purchased at the time. The purchase price of each share on the exercise of any option shall be paid in full in cash (including check, bank draft or money order) at the time of exercise or, at the discretion of the holder of the option, by delivery to the Company of unencumbered Common Shares having an aggregate Fair Market Value on the date of exercise equal to the purchase price, or by a combination of cash and such unencumbered Common Shares. Provided, however, that a person exercising a stock option shall not be permitted to pay any portion of the purchase price with stock if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company. No shares shall be issued until full payment therefor has been made, and the granting of an option to an individual shall give such individual no rights as a stockholder except as to shares issued to such individual.

8. *Transferability and Termination of Options*.

(a) During the lifetime of an optionee, only such optionee or his or her guardian or legal representative may exercise options granted under this Plan, and no option granted under this Plan shall be assignable or transferable by the optionee otherwise than by will or the laws of descent and distribution or pursuant to a domestic relations order as defined in the Code or Title I of the Employee Retirement Income Security Act ("ERISA"), or the rules thereunder; provided, however, that any optionee may transfer a nonstatutory stock option granted under this Plan to a member or members of his or her immediate family (i.e., his or her children, grandchildren and spouse) or to one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners, if (i) the option agreement with respect to such options, which must be approved by the Committee, expressly so provides either at the time of initial grant or by amendment to an outstanding option agreement and (ii) the optionee does not receive any consideration for the transfer. Any options held by any such transferee shall continue to be subject to the same terms and conditions that were applicable to such options immediately prior to their transfer and may be exercised by such transferee as and to the extent that such option has become exercisable and has not terminated in accordance with the provisions of the Plan and the applicable option agreement. For purposes of any provision of this Plan relating to notice to an optionee or to vesting or termination of an option upon the death, disability or termination of employment of an optionee, the references to "optionee" shall mean the original grantee of an option and not any transferee.

(b) During the lifetime of an optionee, an option may be exercised only while the optionee is employed by the Company or a parent or subsidiary thereof, and only if such optionee has been continuously so employed since the date the option was granted, except that:

(i) unless otherwise provided in a stock option agreement, an option granted to an optionee who is not an Outside Director shall continue to be exercisable for three months after termination of such optionee’s employment but, unless otherwise provided in a stock option agreement, only to the extent that the option was exercisable immediately prior to such optionee’s termination of employment, and unless otherwise provided in a stock option agreement, an option granted to an optionee who is an Outside Director shall continue to be exercisable after such Outside Director ceases to be a director of the Company but, unless otherwise provided in a stock option agreement, only to the extent that the option was exercisable immediately prior to such Outside Director’s ceasing to be a director;

(ii) in the case of an optionee who is disabled (within the meaning of Section 22(e)(3) of the Code) while employed, the option granted to such optionee may be exercised within one year after termination of such optionee’s employment; and

(iii) as to any optionee whose termination occurs following a declaration pursuant to paragraph 9 of this Plan, the option granted to such optionee may be exercised at any time permitted by such declaration.

(c) An option may be exercised after the death of the optionee, but only within one year after the death of such optionee.

(d) In the event of the disability (within the meaning of Section 22(e)(3) of the Code) or death of an optionee, any option granted to such optionee that was not previously exercisable shall become immediately exercisable in full if the disabled or deceased optionee shall have been continuously employed by the Company or a parent or subsidiary thereof between the date such option was granted and the date of such disability, or, in the event of death, a date not more than three months prior to such death.

9. *Dissolution, Liquidation, Merger*. In the event of (a) a proposed merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, unless appropriate provision shall have been made for the protection of the outstanding options granted under this Plan by the substitution, in lieu of such options, of options to purchase appropriate voting common stock (the “Survivor’s Stock”) of the corporation surviving any such merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation, or, alternatively, by the delivery of a number of shares of the Survivor’s Stock which has a Fair Market Value as of the effective date of such merger or consolidation equal to the product of (i) the excess of (x) the Event Proceeds per Common Share (as hereinafter defined) covered by the option as of such effective date, over (y) the option price per Common Share, times (ii) the number of Common Shares covered by such option, or (b) the proposed dissolution or liquidation of the Company (such merger, consolidation, dissolution or liquidation being herein called an “Event”), the Committee shall declare, at least ten days prior to the actual effective date of an Event, and provide written notice to each optionee of the declaration, that each outstanding

option, whether or not then exercisable, shall be cancelled at the time of, or immediately prior to the occurrence of, the Event (unless it shall have been exercised prior to the occurrence of the Event) in exchange for payment to the holder of each cancelled option, within ten days after the Event, of cash equal to the amount (if any), for each Common Share covered by the cancelled option, by which the Event Proceeds per Common Share (as hereinafter defined) exceeds the exercise price per Common Share covered by such option. At the time of the declaration provided for in the immediately preceding sentence, each option shall immediately become exercisable in full and each holder of an option shall have the right, during the period preceding the time of cancellation of the option, to exercise his or her option as to all or any part of the Common Shares covered thereby. Each outstanding option granted pursuant to this Plan that shall not have been exercised prior to the Event shall be cancelled at the time of, or immediately prior to, the Event, as provided in the declaration, and this Plan shall terminate at the time of such cancellation, subject to the payment obligations of the Company provided in this paragraph 9. For purposes of this paragraph, "Event Proceeds per Common Share" shall mean the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Common Share by the stockholders of the Company upon the occurrence of the Event.

10. *Substitution Options*. Options may be granted under this Plan from time to time in substitution for stock options held by employees of other corporations who are about to become employees of the Company or a subsidiary of the Company, or whose employer is about to become a subsidiary of the Company, as the result of a merger or consolidation of the Company or a subsidiary of the Company with another corporation, the acquisition by the Company or a subsidiary of the Company of all or substantially all the assets of another corporation or the acquisition by the Company or a subsidiary of the Company of at least 50% of the issued and outstanding stock of another corporation. The terms and conditions of the substitute options so granted may vary from the terms and conditions set forth in this Plan to such extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the stock options in substitution for which they are granted, but with respect to stock options which are incentive stock options, no such variation shall be permitted which affects the status of any such substitute option as an incentive stock option under Section 422A of the Code.

11. *Tax Withholding*. Delivery of Common Shares upon exercise of any nonstatutory stock option granted under this Plan shall be subject to any required withholding taxes. A person exercising such an option may, as a condition precedent to receiving the Common Shares, be required to pay the Company a cash amount equal to the amount of any required withholdings. In lieu of all or any part of such a cash payment, the Committee may, but shall not be required to, permit the optionee to elect to cover all or any part of the required withholdings, and to cover any additional withholdings up to the amount needed to cover such optionee's full FICA and federal, state and local income tax liability with respect to income arising from the exercise of the option, through a reduction of the number of Common Shares delivered to the person exercising the option or through a subsequent return to the Company of shares delivered to the person exercising the option.

12. *Termination of Employment*. Neither the transfer of employment of an optionee between any combination of the Company, a parent corporation or a subsidiary thereof, nor a leave of absence granted to such optionee and approved by the Committee, shall be deemed a termination of employment for purposes of this Plan. The terms "parent" or "parent corporation" and "subsidiary" as used in this Plan shall have the meaning ascribed to "parent corporation" and "subsidiary corporation", respectively, in Sections 424(e) and (f) of the Code.

13. *Adjustment for Changes in Capitalization*. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Common Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Common Shares that may be issued under the Plan, (ii) the limitations on the number of Common Shares that may be issued to an individual Participant as an option in any calendar year; and (iii) the number and kind of Shares and the exercise price (if applicable) of any then outstanding awards of options, provided, in each case, that with respect to incentive stock options, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision, and provided further, with respect to all awards of such options, that no such adjustment shall be authorized to the extent that such adjustment would cause the awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), or any partial or complete liquidation of the Company, including an Event (subject to Plan Section 9), such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Common Shares subject to an option shall always be a whole number. In no event shall an outstanding option be amended for the sole purpose of reducing the exercise price thereof.

14. *Other Terms and Conditions*. The Committee shall have the power, subject to the other limitations contained herein, to fix any other terms and conditions for the grant or exercise of any option under this Plan. Nothing contained in this Plan, or in any option granted pursuant to this Plan, shall confer upon any optionee any right to continued employment by the Company or any parent or subsidiary of the Company or limit in any way the right of the Company or any such parent or subsidiary to terminate an optionee's employment at any time.

15. *Option Agreements*. All options granted under this Plan shall be evidenced by a written agreement in such form or forms as the Committee may from time to time determine, which agreement shall, among other things, designate whether the options being granted thereunder are nonstatutory stock options or incentive stock options under Section 422 of the Code.

16. *Amendment and Discontinuance of Plan*. The Board may at any time amend, suspend or discontinue this Plan; provided, however, that no amendment by the Board shall, without further approval of the Stockholders of the Company, if required in order for the Plan to continue to meet the requirements of the Code:

(a) change the persons eligible to receive options;

(b) except as provided in paragraph 3 hereof, increase the total number of Common Shares of the Company which may be made subject to options granted under this Plan;

(c) except as provided in paragraph 3 hereof, change the minimum purchase price for the exercise of an option; or

(d) extend the term of this Plan beyond December 1, 2006.

No amendment to this Plan shall, without the consent of the holder of the option, alter or impair any options previously granted under this Plan.

17. *Effective Date*. This Plan shall be effective July 26, 1989.

Exhibit 10(d)

**EMPLOYMENT AGREEMENT**
(Joseph T. Dunsmore)

This Agreement is made as of September 27, 2006 by and between DIGI INTERNATIONAL INC., a Delaware corporation (the "Company"), and Joseph T. Dunsmore (the "Executive").

WHEREAS the Company desires to continue to employ Executive in accordance with the terms and conditions stated in this Agreement;

WHEREAS Executive desires to continue his employment pursuant to the terms and conditions of this Agreement; and

WHEREAS the parties wish to supersede and terminate that certain employment agreement dated as of October 1, 1999 between the Executive and the Company;

NOW THEREFORE, in consideration of the covenants and agreements contained herein, the parties hereto agree as follows:

## I. EMPLOYMENT

1.1 Employment As Senior Executive. The Company hereby agrees to employ Executive, continuing until the date his employment terminates pursuant to Article III hereof, in a senior executive capacity, presently as President and Chief Executive Officer of the Company and Chairman of the Board.

Executive accepts such employment pursuant to the terms of this Agreement. Executive shall perform such duties and responsibilities as may be determined from time to time by the Board of Directors of the Company, which shall be consistent with his position as a senior officer of the Company.

1.2 Exclusive Services. Executive agrees to devote his full time, attention and energy to performing his duties and responsibilities to the Company under this Agreement.

## II. COMPENSATION, BENEFITS AND PERQUISITES

2.1 Base Salary. The Company shall pay Executive a base salary at the annual rate of $375,000, payable bi-weekly. The Board of Directors of the Company (the "Board", which term shall include a duly authorized committee of the Board of Directors) will review the base salary annually, and may in its sole discretion increase it to reflect performance and other factors. However, the Board is not obligated to provide for any increases.

2.2 Bonuses. Executive shall be eligible to receive a cash performance bonus targeted at 100% of base salary paid for each fiscal year during which this Agreement is in effect, as follows:

(a) The Board of Directors will define a bonus plan annually, determining the objectives for the fiscal year that must be met to earn the target bonus. Such objectives may include, in the sole discretion of the Board, the achievement of financial objectives set forth in the Board-approved business plan (the “Business Plan”) for a particular fiscal year, or such other objectives as the Board, in its sole discretion, shall determine.

(b) The annual bonus plan definition may, at the discretion of the Compensation Committee, include a provision for payment of a portion, if any, of the target bonus amount in the event some or all of the annual objectives are not met and a provision for payment above target if the Executive exceeds annual objectives.

(c) Executive must be employed by the Company on September 30th of each fiscal year to be eligible to receive the annual bonus under this Section 2.2 for that fiscal year. The actual bonus for each fiscal year shall be paid to Executive as soon as the Company determines whether the objectives for such bonus have been met for that year. Such payment shall be made by the March 15th following the end of the fiscal year to which the bonus relates (or such earlier or later deadline as may be required for the bonus payment to be exempt from the requirements of Section 409A of the Internal Revenue Code as a “short-term deferral” under the applicable regulations).

(d) In any fiscal year in which the objectives for the cash bonus are based upon financial objectives in the Board-approved Business Plan for such fiscal year, the Board will consult with Executive before determining the Business Plan for each fiscal year. However, the Board will have authority to establish the Business Plan for each year in its sole discretion.

(e) In any fiscal year in which the objectives for the cash bonus are based upon financial objectives in the Board-approved Business Plan for such fiscal year, the objectives set by the Company’s Board-approved Business Plan for such fiscal year shall not be adjusted for the acquisition, by any means, of any businesses or business units (and expenses related thereto) that may occur during a particular fiscal year unless such a provision has been pre-defined in the Executive’s annual bonus plan design. The objectives set by the Company’s Board-approved Business Plan for any such fiscal year shall be equitably adjusted by the Board for the divestiture, by any means, of any businesses or business units (and expenses related thereto) that may occur during a particular fiscal year and to eliminate any reorganization, restructuring or other extraordinary charge that may be incurred during a particular fiscal year. The final determination of any such adjustments is at the discretion of the Compensation Committee.

2.3 Stock Options. The Compensation Committee will annually consider whether to make a stock option award to Executive. On or about September 30 of each year the Compensation Committee of the Board of the Company considers stock options to key employees of the Company and its subsidiaries. These awards are made in the discretion of the Compensation Committee. Actual stock option awards are made on or about November 20 of each year.

2.4 Vacations. Executive shall be entitled to vacation in accordance with policies of the Company.

2.5 Employee Benefits. Executive shall be entitled to the benefits and perquisites which the Company generally provides to its other senior executives under the applicable Company plans and policies, and to future benefits and perquisites made generally available to senior executives of the Company. Executive’s participation in such benefit plans shall be on the same basis as applies to other senior executives of the Company. Executive shall pay any contributions which are generally required of senior executives to receive any such benefits.

2.6 Employment Taxes and Withholding. Executive recognizes that the compensation, benefits and other amounts provided by the Company under this Agreement may be subject to federal, state or local income taxes. It is expressly understood and agreed that all such taxes shall be the responsibility of the Executive. To the extent that federal, state or local law requires withholding of taxes on compensation, benefits or other amounts provided under this Agreement, the Company shall withhold the necessary amounts from the amounts payable to Executive under this Agreement.

2.7 Company Responsibility for Insured Benefits. In this Article II, the Company is agreeing to provide certain benefits which are provided in the form of payment of premiums of insurance coverage. The Company is not itself promising to pay the benefit an insurance company is obligated to pay under the policy the insurance company has issued. If an insurance company becomes insolvent and cannot pay benefits it owes to Executive or his beneficiaries under the insurance policy, neither Executive nor his personal representative or beneficiary shall have any claim for benefits against the Company. The insurance companies presently providing such benefits are as set forth in the Company’s benefits enrollment booklet previously delivered to Executive. In addition, the Company presently provides $500,000 of term life insurance to senior executives and director and officer liability coverage, with a $10 million policy limit.

2.8 Expenses. During the term of his employment hereunder, Executive shall be entitled to receive prompt reimbursement from the Company (in accordance with the policies and procedures in effect for the Company’s employees) for all reasonable travel and other expenses incurred by him in connection with his services hereunder.

## III. TERMINATION OF EXECUTIVE'S EMPLOYMENT

3.1 Termination of Employment. Executive's employment under this Agreement may be terminated by the Company or by Executive at any time for any reason. The termination shall be effective as of the date specified by the party initiating the termination in a written notice delivered to the other party. In the case of a notice given by Executive to the Company, the termination date shall not be earlier than 60 days following the date such notice is delivered to the Company. Executive's rights to pay and benefits shall cease on the date his employment under this Agreement terminates; provided, however, that if Executive's employment is terminated by the Company for a reason other than for Cause, in exchange for a full release of claims against the Company, Executive shall be entitled to receive the following payments:

(a) Executive shall receive his base salary in effect as of the date of termination for a period of 24 months from his date of termination. The benefit under this subsection (a) shall be paid as follows: (i) Executive shall receive a lump sum payment equal to 12 months of base salary, which shall be paid as soon as administratively feasible after the later of the date of termination or the date the release of claims has become irrevocable; and (ii) commencing on the first regular payroll date which occurs at least 12 months following the date of termination, Executive shall receive his regular base salary per pay period until the remaining 12 months of base salary has been paid.

(b) In addition, Executive shall receive a pro-rata bonus based on (i) the number of months worked in the fiscal year in which Executive's employment is terminated by the Company for reason other than Cause; and (ii) the Company's actual performance against annual objectives. This pro-rata bonus shall be paid on the later of (I) the date that is six months after the date Executive's employment terminates, or (II) as soon as the Company determines whether the objectives for such bonus have been met for that fiscal year and determines the amount of the pro-rata bonus.

This Agreement shall terminate in its entirety immediately upon the death of the Executive. Termination of Executive's employment pursuant to this Article III shall have no effect on Executive's obligations under Article IV.

3.2 Cause. For purposes of this Article III, "Cause" shall mean only the following: (i) indictment or conviction of, or a plea of nolo contendere to, (A) any felony (other than any felony arising out of negligence), or any misdemeanor involving moral turpitude with respect to the Company, or (B) any crime or offense involving dishonesty with respect to the Company; (ii) theft or embezzlement of Company property or commission of similar acts involving dishonesty or moral turpitude; (iii) repeated material negligence in the performance of Executive's duties after notice; (iv) Executive's failure to devote substantially all of his working time and efforts during normal business hours to the Company's business; (v) knowing engagement in conduct which is materially injurious to the Company; (vi) knowing failure, for Executive's own benefit, to comply with the covenants contained in Sections 4.1 or 4.2 of this Agreement; (vii) knowingly providing materially misleading information concerning the Company to the Company's Board of Directors, any governmental body or regulatory agency or to any lender or other financing source or proposed financing source of the Company.

3.3 Disability. If Executive has become disabled from substantially performing his duties under this Agreement and the disability has continued for a period of more than ninety (90) days, the Board may, in its discretion, determine that Executive will not return to work and terminate his employment under this Agreement. Upon any such termination for disability, Executive shall be entitled to such disability, medical, life insurance, and other benefits as may be provided generally for disabled employees of the Company during the period he remains disabled.

3.4 Resignation. Executive agrees that, upon termination of Executive's employment hereunder for any reason, he shall be deemed to have resigned as a director of the Company and as a director, officer and/or employee of any parent company of the Company or any of their subsidiaries, unless prior to termination of Executive's employment hereunder the provisions of this Section 3.4 shall have been waived by vote of the Board (excluding Executive).

3.5 Compliance with Code Section 409A. This Agreement is intended to be exempt to the extent possible from the requirements of Code Section 409A, including current and future guidance and regulations interpreting such provisions. To the extent that any provision of this Agreement fails to satisfy a requirement for such an exemption, the provision shall automatically be modified in a manner that, in the good-faith opinion of the Company, brings the provisions into compliance with such requirement while preserving as closely as possible the original intent of the provision and this Agreement. If it is determined by the Company that any payment under this Agreement is subject to the requirements of Code Section 409A notwithstanding the preceding sentences, then the provisions of the Agreement shall be automatically modified in such manner as brings the Agreement into compliance with such requirements. In particular, and without limiting the preceding sentence, while any stock of the Company is or is treated as publicly traded and Executive is a "specified employee" under Code Section 409A(a)(2)(B)(i), then any payment under this Agreement that is treated as deferred compensation under Code Section 409A shall be delayed until the date which is six months after the date of separation from service (without interest or earnings).

## IV. NON-COMPETITION, CONFIDENTIALITY AND TRADE SECRETS

4.1 Agreement Not to Compete. In consideration of the covenants and agreements contained in this Agreement, Executive agrees that, on or before the date which is one year after the date Executive's employment by the Company, any parent company of the Company or any of their subsidiaries terminates, he will not, unless he receives the prior approval of the Board of Directors of the Company, directly or indirectly engage in any of the following actions:

(a) Own an interest in (except as provided below), manage, operate, join, control, lend money or render financial or other assistance to, or participate in or be connected with, as an officer, employee, partner, stockholder, consultant or otherwise, any entity whose products or services compete with those of the Company, any parent company of the Company, or any of their subsidiaries. However, nothing in this subsection (a) shall preclude Executive from holding less than one percent of the outstanding capital stock of any corporation required to file periodic reports with the Securities and Exchange Commission under Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the securities of which are listed on any securities exchange, quoted on the Nasdaq National Market or Nasdaq SmallCap Market or traded in the over-the-counter market.

(b) Intentionally solicit, endeavor to entice away from the Company, any parent company of the Company or any of their subsidiaries, or otherwise interfere with the relationship of the Company, any parent company of the Company or any of their subsidiaries with, any person who is employed by or otherwise engaged to perform services for the Company, any parent company of the Company or any of their subsidiaries (including, but not limited to, any independent sales representatives or organizations), or any persons or entity who is, or was within the then most recent 12-month period, a customer or client of the Company, any parent company of the Company or any of their subsidiaries, whether for Executive’s own account or for the account of any other individual, partnership, firm, corporation or other business organization.

If the scope of the restrictions in this section are determined by a court of competent jurisdiction to be too broad to permit enforcement of such restrictions to their full extent, then such restrictions shall be construed or rewritten (blue-lined) so as to be enforceable to the maximum extent permitted by law, and Executive hereby consents, to the extent he may lawfully do so, to the judicial modification of the scope of such restrictions in any proceeding brought to enforce them.

4.2 Non-Disclosure of Information. During the period of his employment hereunder, and at all times thereafter, Executive shall not, without the written consent of the Board of Directors, disclose to any person, other than an employee of the Company, any parent company of the Company or any of their subsidiaries or a person to whom disclosure is reasonably necessary or appropriate in connection with the performance by Executive of his duties as an executive of the Company, except where such disclosure may be required by law, any material confidential information obtained by him while in the employ of the Company, any parent company of the Company or any of their subsidiaries with respect to any products, technology, know-how or the like, services, customers, methods or future plans of the Company, any parent company of the Company or any of their subsidiaries, all of which Executive acknowledges are valuable, special and unique assets, the disclosure of which Executive acknowledges may be materially damaging.

4.3 Remedies. Executive acknowledges that the Company's remedy at law for any breach or threatened breach by Executive of Section 4.1 or Section 4.2 will be inadequate. Therefore, the Company shall be entitled to injunctive and other equitable relief restraining Executive from violating those requirements, in addition to any other remedies that may be available to the Company under this Agreement or applicable law.

4.4 Proprietary Information and Employment Limitations. Executive agrees that no trade secret or proprietary information belonging to his previous employers will be disclosed or used by him at the Company, and that no such information, whether in the form of documents, memoranda, software, drawings, etc. will be retained by him or brought with him to the Company. Executive represents and warrants to the Company that he has brought to the Company's attention and provided it with a copy of any agreement which may impact his future employment by the Company, including non-disclosure, non-competition, invention assignment agreements or agreements containing future work restrictions, and that he is subject to no restrictions under any agreement of this type that would impact his employment by the Company.

**V. MISCELLANEOUS**

5.1 Amendment. This Agreement may be amended only in writing, signed by both parties and approved by the Board.

5.2 Entire Agreement. This Agreement is intended to define the full extent of the legally enforceable undertakings of the parties hereto, and no related promise or representation, written or oral, which is not set forth explicitly in this Agreement is intended by either party to be legally binding. Both parties acknowledge that in deciding to enter into this transaction they have relied on no representations, written or oral, other than those explicitly set forth in this Agreement. Executive has relied entirely on his own judgment and that of his advisers in entering into this Agreement. This Agreement supersedes and terminates that certain employment agreement dated as of October 1, 1999 between the parties hereto.

5.3 Assignment. The Company may in its sole discretion assign this Agreement to any entity which succeeds to some or all of the business of the Company through merger, consolidation, a sale of some or all of the assets of the Company, or any similar transaction. Executive acknowledges that the services to be rendered by him are unique and personal. Accordingly, Executive may not assign any of his rights or obligations under this Agreement.

5.4 Successors. Subject to Section 5.3, the provisions of this Agreement shall be binding upon the parties hereto, upon any successor to or assign of the Company, and upon Executive's heirs and the personal representative of Executive or Executive's estate.

5.5 Notices. Any notice required to be given under this Agreement shall be in writing and shall be delivered either in person or by certified or registered mail, return receipt requested. Any notice by mail shall be addressed as follows:

If to the Company, to:

Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

Attention: Lead Director of the Board

With a copy to:

Faegre & Benson LLP
2200 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402-3601
Attention: James E. Nicholson

If to Executive, to:

Joseph T. Dunsmore
Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

or to such other addresses as either party may designate in writing to the other party from time to time.

5.6 Waiver of Breach. Any waiver by either party of compliance with any provision of this Agreement by the other party shall not operate or be construed as a waiver of any other provision of this Agreement, or of any subsequent breach by such party of a provision of this Agreement. No waiver by the Company shall be valid unless in writing and signed by the Chairman of the Board of Directors (if a person other than Executive) or Chairman of the Compensation Committee.

5.7 Severability. If any one or more of the provisions (or portions thereof) of this Agreement shall for any reason be held by a final determination of a court of competent jurisdiction to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provisions (or portions of the provisions) of this Agreement, and the invalid, illegal or unenforceable provisions shall be deemed replaced by a provision that is valid, legal and enforceable and that comes closest to expressing the intention of the parties hereto.

5.8 Governing Law. THIS AGREEMENT SHALL BE INTERPRETED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF MINNESOTA, APPLICABLE TO CONTRACTS EXECUTED AND FULLY PERFORMED WITHIN THE STATE OF MINNESOTA WITHOUT GIVING EFFECT

TO CONFLICT OF LAW PRINCIPLES. EXECUTIVE HEREBY IRREVOCABLY SUBMITS TO THE JURISDICTION OF ANY MINNESOTA STATE OR FEDERAL COURT IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT, AND THE COMPANY AND EXECUTIVE HEREBY IRREVOCABLY AGREE THAT ALL CLAIMS IN RESPECT OF SUCH ACTION OR PROCEEDING MAY BE HEARD AND DETERMINED ONLY IN SUCH MINNESOTA STATE COURT OR SUCH FEDERAL COURT AND IN NO OTHER COURT. EXECUTIVE HEREBY IRREVOCABLY WAIVES, TO THE FULLEST
EXTENT HE MAY EFFECTIVELY DO SO, THE DEFENSE OF AN INCONVENIENT FORUM TO THE MAINTENANCE OF SUCH ACTION OR PROCEEDING. EACH OF THE COMPANY AND EXECUTIVE HEREBY IRREVOCABLY CONSENTS TO THE SERVICE OF COPIES OF THE SUMMONS AND COMPLAINT AND ANY OTHER PROCESS WHICH MAY BE SERVED IN ANY SUCH ACTION OR PROCEEDING BY CERTIFIED MAIL, RETURN RECEIPT REQUESTED, OR BY DELIVERING OF A COPY OF SUCH PROCESS TO OF THE COMPANY OR EXECUTIVE, AS THE CASE MAY BE, AT THE RESPECTIVE ADDRESS SPECIFIED IN SECTION 5.5 OR BY ANY OTHER METHOD PROVIDED BY LAW. EACH OF THE COMPANY AND EXECUTIVE AGREES THAT A FINAL JUDGMENT IN ANY SUCH ACTION OR PROCEEDING SHALL BE CONCLUSIVE AND MAY BE ENFORCED IN OTHER JURISDICTIONS BY SUIT ON THE JUDGMENT OR BY ANY OTHER MANNER PROVIDED BY LAW.

5.9 Headings. The headings of articles and sections herein are included solely for convenience and reference and shall not control the meaning or interpretation of any of the provisions of this Agreement.

5.10 Counterparts. This Agreement may be executed by either of the parties hereto in counterparts, each of which shall be deemed to be an original, but all such counterparts shall constitute a single instrument.

IN WITNESS WHEREOF, the parties have executed this Agreement in Minnetonka, Minnesota, effective as of the date set forth above.

DIGI INTERNATIONAL INC.

/s/ Ken Millard

By /s/ Ken Millard
Its Lead Director of the Board

EXECUTIVE

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore

Exhibit 10(e)

**DIGI INTERNATIONAL INC.**
**EMPLOYEE STOCK PURCHASE PLAN**
**AS AMENDED AND RESTATED AS OF NOVEMBER 27, 2006**
**(effective November 27, 2006, subject to stockholder approval)**

1. PURPOSE AND SCOPE OF PLAN. The purpose of this Digi International Inc. Employee Stock Purchase Plan (the "Plan") is to provide the employees of Digi International Inc. (the "Company") with an opportunity to acquire a proprietary interest in the Company through the purchase of its Common Stock and, thus, to develop a stronger incentive to work for the continued success of the Company. The Plan is intended to be an "employee stock purchase plan" within the meaning of Section 423(b) of the Internal Revenue Code of 1986, as amended, and shall be interpreted and administered in a manner consistent with such intent.

2. DEFINITIONS.

2.1. The terms defined in this section are used (and capitalized) elsewhere in this Plan:

(a) "Affiliate" means any corporation that is a "parent corporation" or "subsidiary corporation" of the Company, as defined in Sections 424(e) and 424(f) of the Code or any successor provision, and whose participation in the Plan has been approved by the Board of Directors.

(b) "Board of Directors" means the Board of Directors of the Company.

(c) "Code" means the Internal Revenue Code of 1986, as amended from time to time.

(d) "Committee" means three or more Disinterested Persons designated by the Board of Directors to administer the Plan under Section 13.

(e) "Common Stock" means the common stock, par value $.01 per share (as such par value may be adjusted from time to time), of the Company.

(f) "Company" means Digi International Inc.

(g) "Compensation" means the gross cash compensation (including wage, salary, commission, bonus, and overtime earnings) paid by the Company or any Affiliate to a Participant in accordance with the terms of employment.

(h) "Disinterested Persons" means a member of the Board of Directors who is considered a disinterested person within the meaning of Exchange Act Rule 16b-3 or any successor definition.

(i) “Eligible Employee” means any employee of the Company or an Affiliate who has been employed for at least 90 days and whose customary employment is at least 20 hours per week; provided, however, that “Eligible Employee” shall not include any person who would be deemed for purposes of Section 423(b)(3) of the Code, to own stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company.

(j) “Exchange Act” means the Securities Exchange Act of 1934, as amended from time to time.

(k) “Fair Market Value” of a share of Common Stock as of any date means, if the Company’s Common Stock is listed on a national securities exchange or traded in the national market system, the mean between the high and low sale prices for such Common Stock on such exchange or market on said date, or, if no sale has been made on such exchange or market on said date, on the last preceding day on which any sale shall have been made. If such determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury applicable to plans intended to qualify as an “employee stock purchase plan” within the meaning of Section 423(b) of the Code, however, Fair Market Value shall be determined in accordance with such regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Section 14.

(l) “Participant” means an Eligible Employee who has elected to participate in the Plan in the manner set forth in Section 4.

(m) “Plan” means this Digi International Inc. Employee Stock Purchase Plan, as amended from time to time.

(n) “Purchase Period” means each quarter of the Company’s fiscal year. The first Purchase Period will be the quarter that starts April 1, 1996 and ends June 30, 1996.

(o) “Recordkeeping Account” means the account maintained in the books and records of the Company recording the amount withheld from each Participant through payroll deductions made under the Plan.

(p) “Share” means a share of Common Stock.

3. SCOPE OF THE PLAN. Shares of Common Stock may be sold by the Company to Eligible Employees commencing April 1, 1996, as hereinafter provided, but not more than 1,750,000 *shares of Common Stock (subject to adjustment as provided in Section 14) shall be sold to Eligible Employees pursuant to this Plan. All sales of Common Stock pursuant to this Plan shall be subject to the same terms, conditions, rights and privileges. The shares of Common Stock delivered by the Company pursuant to this Plan may be acquired shares having the status of any combination of authorized but unissued shares, newly issued shares, or treasury shares.

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* Includes 500,000 shares subject to stockholder approval.

4. ELIGIBILITY AND PARTICIPATION. To be eligible to participate in the Plan for a given Purchase Period, an employee must be an Eligible Employee on the first day of such Purchase Period. An Eligible Employee may elect to participate in the Plan by filing an enrollment form with the Company before the first day of such Purchase Period that authorizes regular payroll deductions from Compensation beginning with the first payday in such Purchase Period and continuing until the Eligible Employee withdraws from the Plan, modifies his or her authorization, or ceases to be an Eligible Employee, as hereinafter provided.

5. AMOUNT OF COMMON STOCK EACH ELIGIBLE EMPLOYEE MAY PURCHASE.

5.1. Subject to the provisions of the Plan, each Eligible Employee shall be offered the right to purchase on the last day of the Purchase Period the number of shares of Common Stock (including fractional shares) that can be purchased at the price specified in Section 5.2 with the entire credit balance in the Participant’s Recordkeeping Account; provided, however, that the Fair Market Value (determined on the first day of any Purchase Period) of shares of Common Stock that may be purchased by a Participant during such Purchase Period shall not exceed the excess, if any, of (i) $25,000 over (ii) the Fair Market Value (determined on the first day of the relevant Purchase Period) of shares of Common Stock previously acquired by the Participant in any prior Purchase Period during such calendar year. Notwithstanding the foregoing, no Eligible Employee shall be granted an option to acquire shares of Common Stock under this Plan which permits the Eligible Employee’s rights to purchase shares of Common Stock under this Plan and all employee stock purchase plans of the Company and the Affiliates to accrue at a rate which exceeds $25,000 of Fair Market Value (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. If the purchases by all Participants would otherwise cause the aggregate number of shares of Common Stock to be sold under the Plan to exceed the number specified in Section 3, however, each Participant shall be allocated at a ratable portion of the maximum number of shares of Common Stock which may be sold.

5.2. The purchase price of each share of Common Stock sold pursuant to this Plan will be the lesser of (a) or (b) below: (a) 85% of the Fair Market Value of such share on the first day of the Purchase Period. (b) 85% of the Fair Market Value of such share on the last day of the Purchase Period.

6. METHOD OF PARTICIPATION.

6.1. The Company shall give notice to each Eligible Employee of the opportunity to purchase shares of Common Stock pursuant to this Plan and the terms and conditions for such offering. Such notice is subject to revision by the Company at any time prior to the date of purchase of such shares. The Company contemplates that for tax purposes the first day of a Purchase Period will be the date of the offering of such shares.

6.2. Each Eligible Employee who desires to participate in the Plan for a Purchase Period shall signify his or her election to do so by signing an election form developed by the Committee. An Eligible Employee may elect to have any whole percent of Compensation withheld, but not exceeding ten percent (10%) per pay period. An election to participate in the

Plan and to authorize payroll deductions as described herein must be made before the first day of the Purchase Period to which it relates and shall remain in effect unless and until such Participant withdraws from this Plan, modifies his or her authorization, or terminates his or her employment with the Company, as hereinafter provided.

6.3. Any Eligible Employee who does not make a timely election as provided in Section 6.2, shall be deemed to have elected not to participate in the Plan. Such election shall be irrevocable for such Purchase Period.

7. RECORDKEEPING ACCOUNT.

7.1. The Company shall maintain a Recordkeeping Account for each Participant. Payroll deductions pursuant to Section 6 will be credited to such Recordkeeping Accounts on each payday.

7.2. No interest will be credited to a Participant's Recordkeeping Account.

7.3. The Recordkeeping Account is established solely for accounting purposes, and all amounts credited to the Recordkeeping Account will remain part of the general assets of the Company.

7.4. A Participant may not make any separate cash payment into the Recordkeeping Account.

8. RIGHT TO ADJUST PARTICIPATION OR TO WITHDRAW.

8.1. A Participant may, at any time during a Purchase Period, direct the Company to make no further deductions from his or her Compensation or to adjust the amount of such deductions. Upon either of such actions, future payroll deductions with respect to such Participant shall cease or be adjusted in accordance with the Participant's direction.

8.2. Any Participant who stops payroll deductions may not thereafter resume payroll deductions during such Purchase Period.

8.3. At any time before the end of a Purchase Period, any Participant may also withdraw from the Plan. In such event, all future payroll deductions shall cease and the entire credit balance in the Participant's Recordkeeping Account will be paid to the Participant, without interest, in cash within 15 days. A Participant who withdraws from the Plan will not be eligible to reenter the Plan until the next succeeding Purchase Period.

8.4. Notification of a Participant's election to adjust or terminate deductions, or to withdraw from the Plan, shall be made by the filing of an appropriate notice to such effect with the Company.

9. TERMINATION OF EMPLOYMENT. If the employment of a Participant is terminated for any reason, including death, disability, or retirement, the entire balance in the Participant's

Recordkeeping Account will be applied to the purchase of shares as provided in Section 10.1 as of the last day of the Purchase Period in which the Participant's employment terminated; except that if such Participant so requests prior to the last day of such Purchase Period, the Company shall refund in cash within 15 days all amounts credited to his or her Recordkeeping Account.

10. PURCHASE OF SHARES.

10.1. As of the last day of the Purchase Period, the entire credit balance in each Participant's Recordkeeping Account will be used to purchase shares (including fractional shares) of Common Stock (subject to the limitations of Section 5) unless the Participant has filed an appropriate form with the Company in advance of that date (which either elects to purchase a specified number of shares which is less than the number described above or elects to receive the entire credit balance in cash). Any amount in a Participant's Recordkeeping Account that is not used to purchase shares pursuant to this Section 10.1 will be refunded to the Participant.

10.2. Shares of Common Stock acquired by each Participant shall be held in a general account maintained for the benefit of all Participants.

10.3. Certificates for the number of whole shares of Common Stock, determined as aforesaid, purchased by each Participant shall be issued and delivered to him or her only upon request of the Participant or his or her representative directed to the Company. No Certificates for fractional shares will be issued. Instead, Participants will receive a cash distribution representing any fractional shares.

10.4. Dividends with respect to a Participant's shares held in the general account will, at the election of the Participant, either be paid to the Participant in cash or reinvested in additional shares of Common Stock. If a Participant fails to make such an election, all dividends with respect to the Participant's shares held in the general account will automatically be reinvested to purchase additional shares of Common Stock.

10.5. Each Participant will be entitled to vote all shares held for the benefit of such Participant in the general account.

11. RIGHTS AS A STOCKHOLDER. A Participant shall not be entitled to any of the rights or privileges of a stockholder of the Company with respect to such shares, including the right to receive any dividends which may be declared by the Company, until (i) he or she actually has paid the purchase price for such shares and (ii) either the shares have been credited to his or her account or certificates have been issued to him or her, both as provided in Section 10.

12. RIGHTS NOT TRANSFERABLE. A Participant's rights under this Plan are exercisable only by the Participant during his or her lifetime, and may not be sold, pledged, assigned or transferred in any manner other than by will or the laws of descent and distribution. Any attempt to sell, pledge, assign or transfer the same shall be null and void and without effect. The amounts credited to a Recordkeeping Account may not be assigned, transferred, pledged or hypothecated in any way, and any attempted assignment, transfer, pledge, hypothecation or other disposition of such amounts will be null and void and without effect.

13. ADMINISTRATION OF THE PLAN. This Plan shall be administered by the Committee, which is authorized to make such uniform rules as may be necessary to carry out its provisions. The Committee shall determine any questions arising in the administration, interpretation and application of this Plan, and all such determinations shall be conclusive and binding on all parties.

14. ADJUSTMENT FOR CHANGES IN CAPITALIZATION. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to the number, class and purchase price of Shares that may be purchased under the Plan. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan.

15. REGISTRATION OF CERTIFICATES. Stock certificates will be registered in the name of the Participant, or jointly in the name of the Participant and another person, as the Participant may direct on an appropriate form.

16. AMENDMENT OF PLAN. The Board of Directors may at any time amend this Plan in any respect which shall not adversely affect the rights of Participants pursuant to shares previously acquired under the Plan, except that, without stockholder approval, no amendment shall be made (i) to increase the number of shares to be reserved under this Plan, (ii) to decrease the minimum purchase price, (iii) to withdraw the administration of this Plan from the Committee, or (iv) to change the definition of employees eligible to participate in the Plan.

17. EFFECTIVE DATE OF PLAN. This Plan shall consist of an offering commencing April 1, 1996, and ending June 30, 1996, and continuing on a quarterly basis thereafter. All rights of Participants in any offering hereunder shall terminate at the earlier of (i) the day that Participants become entitled to purchase a number of shares of Common Stock equal to or greater than the number of shares remaining available for purchase or (ii) at any time, at the discretion of the Board of Directors, after 30 days' notice has been given to all Participants. Upon termination of this Plan, shares of Common Stock shall be issued to Participants in accordance with Section 10, and cash, if any, remaining in the Participant's Recordkeeping Accounts shall be refunded to them, as if the Plan were terminated at the end of a Purchase Period.

18. GOVERNMENTAL REGULATIONS AND LISTING. All rights granted or to be granted to Eligible Employees under this Plan are expressly subject to all applicable laws and regulations and to the approval of all governmental authorities required in connection with the authorization, issuance, sale or transfer of the shares of Common Stock reserved for this Plan,

including, without limitation, there being a current registration statement of the Company under the Securities Act of 1933, as amended, covering the shares of Common Stock purchasable on the last day of the Purchase Period applicable to such shares, and if such a registration statement shall not then be effective, the term of such Purchase Period shall be extended until the first business day after the effective date of such a registration statement, or post-effective amendment thereto. If applicable, all such rights hereunder are also similarly subject to effectiveness of an appropriate listing application to a national securities exchange or a national market system, covering the shares of Common Stock under the Plan upon official notice of issuance.

19. MISCELLANEOUS.

19.1. This Plan shall not be deemed to constitute a contract of employment between the Company and any Participant, nor shall it interfere with the right of the Company to terminate any Participant and treat him or her without regard to the effect which such treatment might have upon him or her under this Plan.

19.2. Wherever appropriate as used herein, the masculine gender may be read as the feminine gender, the feminine gender may be read as the masculine gender, the singular may be read as the plural and the plural may be read as the singular.

19.3. The Plan, and all agreements hereunder, shall be construed in accordance with and governed by the laws of the State of Minnesota.

19.4. Delivery of shares of Common Stock or of cash pursuant to this Plan shall be subject to any required withholding taxes. A person entitled to receive shares of Common Stock may, as a condition precedent to receiving such shares, be required to pay the Company a cash amount equal to the amount of any required withholdings.

Exhibit 10(f)

**Digi International Inc.**
**2000 Omnibus Stock Plan**
**as Amended and Restated as of**
**September 27, 2006**

**(effective as of November 27, 2006, subject to stockholder approval)**

1. Purpose. The purpose of the Digi International Inc. 2000 Omnibus Stock Plan (the "Plan") is to promote the interests of the Company and its stockholders by providing key personnel of the Company and its Affiliates and Outside Directors with an opportunity to acquire a proprietary interest in the Company and reward them for achieving a high level of corporate performance and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its Affiliates. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel and Outside Directors of outstanding ability.

2. Definitions.

2.1 The capitalized terms used elsewhere in the Plan have the meanings set forth below.

(a) "Affiliate" means any corporation that is a "parent corporation" or "subsidiary corporation" of the Company, as those terms are defined in Code Sections 424(e) and (f), or any successor provisions, and, for purposes other than the grant of Incentive Stock Options, any joint venture in which the Company or any such "parent corporation" or "subsidiary corporation" owns an equity interest.

(b) "Agreement" means a written contract (i) consistent with the terms of the Plan entered into between the Company or an Affiliate and a Participant and (ii) containing the terms and conditions of an Award in such form and not inconsistent with the Plan as the Committee shall approve from time to time, together with all amendments thereto, which amendments may be unilaterally made by the Company (with the approval of the Committee) unless such amendments are deemed by the Committee to be materially adverse to the Participant and not required as a matter of law.

(c) "Award" or "Awards" means a grant made under the Plan in the form of Restricted Stock, Options, Stock Appreciation Rights, Performance Units, Stock or any other stock-based award.

(d) "Board" means the Board of Directors of the Company.

(e) "Code" means the Internal Revenue Code of 1986, as amended and in effect from time to time or any successor statute.

(f) “Committee” means two or more Non-Employee Directors designated by the Board to administer the Plan under Plan Section 3.1 and constituted so as to permit grants thereby to comply with Exchange Act Rule 16b-3 and Code Section 162(m).

(g) “Company” means Digi International Inc., a Delaware corporation, or any successor to all or substantially all of its businesses by merger, consolidation, purchase of assets or otherwise.

(h) “Effective Date” means the date specified in Plan Section 12.1.

(i) “Employee” means an employee (including an officer or director who is also an employee) of the Company or an Affiliate.

(j) “Exchange Act” means the Securities Exchange Act of 1934, as amended and in effect from time to time or any successor statute.

(k) “Exchange Act Rule 16b-3” means Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as now in force and in effect from time to time or any successor regulation.

(l) “Fair Market Value” as of any date means, unless otherwise expressly provided in the Plan:

(i) the closing sale price of a Share on such date, or, if no sale of Shares shall have occurred on that date, on the next preceding day on which a sale of Shares occurred

(A) on the composite tape for NASDAQ-listed shares, or

(B) if the Shares are not quoted on the composite tape for NASDAQ-listed shares, on the principal United States Securities Exchange registered under the Exchange Act on which the Shares are listed, or

(ii) if clause (i) is inapplicable, the mean between the closing “bid” and the closing “asked” quotation of a Share on that date, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a closing bid and asked quotation is made, on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or

(iii) if clauses (i) and (ii) are inapplicable, what the Committee determines in good faith to be 100% of the fair market value of a Share on that date, using such criteria as it shall determine, in its sole discretion, to be appropriate for valuation.

In the case of an Incentive Stock Option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 16.

(m) “Fundamental Change” means a dissolution or liquidation of the Company, a sale of substantially all of the assets of the Company, a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or a statutory share exchange involving capital stock of the Company.

(n) “Incentive Stock Option” means any Option designated as such and granted in accordance with the requirements of Code Section 422 or any successor provision.

(o) “Insider” as of a particular date means any person who, as of that date is an officer of the Company as defined under Exchange Act Rule 16a-1(f) or its successor provision.

(p) “Non-Employee Director” means a member of the Board who is considered a non-employee director within the meaning of Exchange Act Rule 16b-3(b)(3) or its successor provision and an outside director for purposes of Code Section 162(m).

(q) “Non-Statutory Stock Option” means an Option other than an Incentive Stock Option.

(r) “Option” means a right to purchase Stock, including both Non-Statutory Stock Options and Incentive Stock Options.

(s) “Outside Director” means a director who is not an Employee.

(t) “Participant” means a person or entity to whom an Award is or has been made in accordance with the Plan.

(u) “Performance Cycle” means the period of time as specified in an Agreement over which Performance Units are to be earned.

(v) “Performance Units” means an Award made pursuant to Plan Section 11.

(w) “Plan” means this Digi International Inc. 2000 Omnibus Stock Plan, as may be amended and in effect from time to time.

(x) “Restricted Stock” means Stock granted under Plan Section 7 so long as such Stock remains subject to one or more restrictions.

(y) “Section 16” or “Section 16(b)” means Section 16 or Section 16(b), respectively, of the Exchange Act or any successor statute and the rules and regulations promulgated thereunder as in effect and as amended from time to time.

(z) “Share” means a share of Stock.

(aa) “Stock” means the common stock, par value $.01 per share, of the Company.

(bb) “Stock Appreciation Right” means a right, the value of which is determined in relation to the appreciation in value of Shares pursuant to an Award granted under Plan Section 10.

(cc) “Subsidiary” means a “subsidiary corporation,” as that term is defined in Code Section 424(f) or any successor provision.

(dd) “Successor” with respect to a Participant means the legal representative of an incompetent Participant, and if the Participant is deceased the estate of the Participant or the person or persons who may, by bequest or inheritance, or pursuant to the terms of an Award, acquire the right to exercise an Option or Stock Appreciation Right or to receive cash and/or Shares issuable in satisfaction of an Award in the event of the Participant’s death.

(ee) “Term” means the period during which an Option or Stock Appreciation Right may be exercised or the period during which the restrictions or terms and conditions placed on Restricted Stock or any other Award are in effect.

(ff) “Transferee” means any member of the Participant’s immediate family (i.e., his or her children, step-children, grandchildren and spouse) or one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners.

2.2 Gender and Number. Except when otherwise indicated by the context, reference to the masculine gender shall include, when used, the feminine gender and any term used in the singular shall also include the plural.

3. Administration and Indemnification.

3.1 Administration.

(a) The Committee shall administer the Plan. The Committee shall have exclusive power to (i) make Awards, (ii) determine when and to whom Awards will be granted, the form of each Award, the amount of each Award, and any other terms or conditions of each Award consistent with the Plan, and (iii) determine whether, to what extent and under what circumstances, Awards may be settled, paid or exercised in cash, Shares or other Awards, or other property or canceled, forfeited or suspended. Each Award shall be subject to an Agreement authorized by the Committee. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Notwithstanding the foregoing, the Board shall have the sole and exclusive power to administer the Plan with respect to Awards granted to Outside Directors.

(b) Solely for purposes of determining and administering Awards to Participants who are not Insiders, the Committee may delegate all or any portion of its authority under the Plan to one or more persons who are not Non-Employee Directors.

(c) To the extent within its discretion and subject to Plan Sections 15 and 16, other than price, the Committee may amend the terms and conditions of any outstanding Award.

(d) It is the intent that the Plan and all Awards granted pursuant to it shall be administered by the Committee so as to permit the Plan and Awards to comply with Exchange Act Rule 16b-3, except in such instances as the Committee, in its discretion, may so provide. If any provision of the Plan or of any Award would otherwise frustrate or conflict with the intent expressed in this Section 3.1(d), that provision to the extent possible shall be interpreted and deemed amended in the manner determined by the Committee so as to avoid the conflict. To the extent of any remaining irreconcilable conflict with this intent, the provision shall be deemed void as applicable to Insiders to the extent permitted by law and in the manner deemed advisable by the Committee.

(e) The Committee's interpretation of the Plan and of any Award or Agreement made under the Plan and all related decisions or resolutions of the Board or Committee shall be final and binding on all parties with an interest therein. Consistent with its terms, the Committee shall have the power to establish, amend or waive regulations to administer the Plan. In carrying out any of its responsibilities, the Committee shall have discretionary authority to construe the terms of the Plan and any Award or Agreement made under the Plan.

3.2 Indemnification. Each person who is or shall have been a member of the Committee, or of the Board, and any other person to whom the Committee delegates authority under the Plan, shall be indemnified and held harmless by the Company, to the extent permitted by law, against and from any loss, cost, liability or expense that may be imposed upon or reasonably incurred by such person in connection with or resulting from any claim, action, suit or proceeding to which such person may be a party or in which such person may be involved by reason of any action taken or failure to act, made in good faith, under the Plan and against and from any and all amounts paid by such person in settlement thereof, with the Company's approval, or paid by such person in satisfaction of any judgment in any such action, suit or proceeding against such person, provided such person shall give the Company an opportunity, at the Company's expense, to handle and defend the same before such person undertakes to handle and defend it on such person's own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person or persons may be entitled under the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

4. <u>Shares Available Under the Plan</u>.

(a) The number of Shares available for distribution under the Plan shall not exceed 3,250,000* (subject to adjustment pursuant to Plan Section 16).

(b) Any Shares subject to the terms and conditions of an Award under the Plan that are not used because the terms and conditions of the Award are not met may again be used for an Award under the Plan; provided however, that Shares with respect to which a Stock Appreciation Right has been exercised whether paid in cash and/or in Shares may not again be awarded under the Plan.

(c) Any unexercised or undistributed portion of any terminated, expired, exchanged, or forfeited Award, or any Award settled in cash in lieu of Shares (except as provided in Plan Section 4(b)) shall be available for further Awards.

(d) For the purposes of computing the total number of Shares granted under the Plan, the following rules shall apply to Awards payable in Shares where appropriate:

(i) each Option shall be deemed to be the equivalent of the maximum number of Shares that may be issued upon exercise of the particular Option;

(ii) an Award (other than an Option) payable in some other security shall be deemed to be equal to the number of Shares to which it relates;

(iii) where the number of Shares available under the Award is variable on the date it is granted, the number of Shares shall be deemed to be the maximum number of Shares that could be received under that particular Award; and

(iv) where two or more types of Awards (all of which are payable in Shares) are granted to a Participant in tandem with each other, such that the exercise of one type of Award with respect to a number of Shares cancels at least an equal number of Shares of the other, each such joint Award shall be deemed to be the equivalent of the maximum number of Shares available under the largest single Award.

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* Includes 2,500,000 shares added to the Plan subject to stockholder approval.

Additional rules for determining the number of Shares granted under the Plan may be made by the Committee as it deems necessary or desirable.

(e) No fractional Shares may be issued under the Plan; however, cash shall be paid in lieu of any fractional Share in settlement of an Award.

(f) The maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Options is 250,000, the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Restricted Stock is 100,000, and the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Stock Appreciation Rights is 100,000.

5. Eligibility. Participation in the Plan shall be limited to Employees and to individuals or entities who are not Employees but who provide services to the Company or an Affiliate, including services provided in the capacity of a consultant, advisor or director. The granting of Awards is solely at the discretion of the Committee, except that Incentive Stock Options may only be granted to Employees. References herein to "employed," "employment" or similar terms (except "Employee") shall include the providing of services in any capacity or as a director. Neither the transfer of employment of a Participant between any of the Company or its Affiliates, nor a leave of absence granted to such Participant and approved by the Committee, shall be deemed a termination of employment for purposes of the Plan.

6. General Terms of Awards.

6.1 Amount of Award. Each Agreement shall set forth the number of Shares of Restricted Stock, Stock or Performance Units subject to the Agreement, or the number of Shares to which the Option subject to the Agreement applies or with respect to which payment upon the exercise of the Stock Appreciation Right subject to the Agreement is to be determined, as the case may be, together with such other terms and conditions applicable to the Award as determined by the Committee acting in its sole discretion.

6.2 Term. Each Agreement, other than those relating solely to Awards of Shares without restrictions, shall set forth the Term of the Option, Stock Appreciation Right, Restricted Stock or other Award or the Performance Cycle for the Performance Units, as the case may be. Acceleration of the expiration of the applicable Term is permitted, upon such terms and conditions as shall be set forth in the Agreement, which may, but need not, include, without limitation, acceleration in the event of the Participant's death or retirement. Acceleration of the Performance Cycle of Performance Units shall be subject to Plan Section 11.2.

6.3 Transferability. Except as provided in this Section, during the lifetime of a Participant to whom an Award is granted, only that Participant (or that Participant's legal representative) may exercise an Option or Stock Appreciation Right, or receive payment with respect to Performance Units or any other Award. No Award of Restricted Stock (before the expiration of the restrictions), Options, Stock Appreciation Rights or Performance Units or other Award may be sold, assigned, transferred, exchanged or otherwise encumbered other than to a Successor in the event of a Participant's death or pursuant to a qualified domestic relations order as defined in the Code or Title 1 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or the rules thereunder; any attempted transfer in violation of this Section 6.3 shall be of no effect. Notwithstanding the immediately preceding sentence, the Committee, in an Agreement or otherwise at its discretion, may provide that the Award (other than Incentive Stock Options) may be transferable to a Transferee if the Participant does not receive any consideration for the transfer. Any Award held by a Transferee shall continue to be subject to the same terms and conditions that were applicable to that Award immediately before the transfer thereof to the Transferee. For purposes of any provision of the Plan relating to notice to a Participant or to acceleration or termination of an Award upon the death, disability or termination of employment of a Participant the references to "Participant" shall mean the original grantee of an Award and not any Transferee.

6.4 Termination of Employment. Except as otherwise determined by the Committee or provided by the Committee in an Agreement, in case of a Participant's termination of employment, the following provisions shall apply:

(a) Options and Stock Appreciation Rights.

(i) If a Participant's employment or other relationship with the Company and its Affiliates terminates because of the Participant's death, then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and a date not more than three months prior to such death, and may be exercised by the Participant's Successor at any time, or from time to time, within one year after the date of the Participant's death.

(ii) If a Participant's employment or other relationship with the Company and its Affiliates terminates because the Participant is disabled (within the meaning of Section 22(e)(3) of the Code), then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and the date of such disability, and the Participant or the Participant's Successor may exercise such Option or Stock Appreciation Right at any time, or from time to time, within one year after the date of the Participant's disability.

(iii) If a Participant's employment terminates for any reason other than death or disability, then any Option or Stock Appreciation Right that has not expired or been terminated shall remain exercisable for three months after termination of the Participant's employment, but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Participant's termination of employment; provided, however, that if the Participant is an Outside Director, the Option or Stock Appreciation Right shall remain exercisable until the expiration of the Term after such Outside Director ceases to be a director of the Company but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Outside Director ceasing to be a director.

(iv) Notwithstanding the foregoing Plan Sections 6.4(a)(i), (ii) and (iii), in no event shall an Option or a Stock Appreciation Right be exercisable after the expiration of the Term of such Award. Any Option or Stock Appreciation Right that is not exercised within the periods set forth in Plan Sections 6.4 (i), (ii) and (iii), except as otherwise provided by the Committee in the Agreement, shall terminate as of the end of the periods described in such Sections.

(b) Performance Units. If a Participant's employment or other relationship with the Company and its Affiliates terminates during a Performance Cycle because of death or disability, or under other circumstances provided by the Committee in its discretion in the Agreement or otherwise, the Participant, unless the Committee shall otherwise provide in the Agreement, shall be entitled to a payment with respect to Performance Units at the end of the Performance Cycle based upon the extent to which achievement of performance targets was satisfied at the end of such period (as determined at the end of the Performance Cycle) and prorated for the portion of the Performance Cycle during which the Participant was employed by the Company or its Affiliates. Except as provided in this Section 6.4(b) or in the Agreement, if a Participant's employment or other relationship with the Company and its Affiliates terminates during a Performance Cycle, then such Participant shall not be entitled to any payment with respect to that Performance Cycle.

(c) Restricted Stock Awards. Unless otherwise provided in the Agreement, in case of a Participant's death or disability, the Participant shall be entitled to receive a number of Shares of Restricted Stock under outstanding Awards that has been prorated for the portion of the Term of the Awards during which the Participant was employed by the Company and its Affiliates, and, with respect to such Shares, all restrictions shall lapse. Any Shares of Restricted Stock as to which restrictions do not lapse under the preceding sentence shall terminate at the date of the Participant's termination of employment and such Shares of Restricted Stock shall be forfeited to the Company.

6.5 Rights as Stockholder. Each Agreement shall provide that a Participant shall have no rights as a stockholder with respect to any securities covered by an Award unless and until the date the Participant becomes the holder of record of the Stock, if any, to which the Award relates.

7. Restricted Stock Awards.

(a) An Award of Restricted Stock under the Plan shall consist of Shares subject to restrictions on transfer and conditions of forfeiture, which restrictions and conditions shall be included in the applicable Agreement. The Committee may provide for the lapse or waiver of any such restriction or condition based on such factors or criteria as the Committee, in its sole discretion, may determine.

(b) Except as otherwise provided in the applicable Agreement, each Stock certificate issued with respect to an Award of Restricted Stock shall either be deposited with the Company or its designee, together with an assignment separate from the certificate, in blank, signed by the Participant, or bear such legends with respect to the restricted nature of the Restricted Stock evidenced thereby as shall be provided for in the applicable Agreement.

(c) The Agreement shall describe the terms and conditions by which the restrictions and conditions of forfeiture upon awarded Restricted Stock shall lapse. Upon the lapse of the restrictions and conditions, Shares free of restrictive legends, if any, relating to such restrictions shall be issued to the Participant or a Successor or Transferee.

(d) A Participant or a Transferee with a Restricted Stock Award shall have all the other rights of a stockholder including, but not limited to, the right to receive dividends and the right to vote the Shares of Restricted Stock.

(e) No more than 1,000,000** of the total number of Shares available for Awards under the Plan shall be issued during the term of the Plan as Restricted Stock. This limitation shall be calculated pursuant to the applicable provisions of Plan Sections 4 and 16.

8. Other Awards. The Committee may from time to time grant Stock and other Awards under the Plan including, without limitation, those Awards pursuant to which Shares are or may in the future be acquired, Awards denominated in Stock units, securities convertible into Stock and phantom securities. The Committee, in its sole discretion, shall determine the terms and conditions of such Awards provided that such Awards shall not be inconsistent with the terms and purposes of the Plan. The Committee may, at its sole discretion, direct the Company to issue Shares subject to restrictive legends and/or stop transfer instructions that are consistent with the terms and conditions of the Award to which the Shares relate. No more than 50,000 of the total number of Shares available for Awards under the Plan shall be issued during the term of the Plan in the form of Stock without restrictions.

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** Changed from 100,000, subject to stockholder approval.

9. Stock Options.

9.1 Terms of All Options.

(a) An Option shall be granted pursuant to an Agreement as either an Incentive Stock Option or a Non-Statutory Stock Option. The purchase price of each Share subject to an Option shall be determined by the Committee and set forth in the Agreement, but shall not be less than the Fair Market Value of a Share as of the date the Option is granted (except as provided in Plan Sections 9.2 and 19).

(b) The purchase price of the Shares with respect to which an Option is exercised shall be payable in full at the time of exercise, provided that to the extent permitted by law, the Agreement may permit some or all Participants to simultaneously exercise Options and sell the Shares thereby acquired pursuant to a brokerage or similar relationship and use the proceeds from the sale as payment of the purchase price of the Shares. The purchase price may be payable in cash, by delivery or tender of Shares having a Fair Market Value as of the date the Option is exercised equal to the purchase price of the Shares being purchased pursuant to the Option, or a combination thereof, as determined by the Committee, but no fractional Shares will be issued or accepted. Provided, however, that a Participant exercising a stock option shall not be permitted to pay any portion of the purchase price with Shares if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company.

(c) Each Option shall be exercisable in whole or in part on the terms provided in the Agreement. In no event shall any Option be exercisable at any time after the expiration of its Term. When an Option is no longer exercisable, it shall be deemed to have lapsed or terminated.

9.2 Incentive Stock Options. In addition to the other terms and conditions applicable to all Options:

(i) the purchase price of each Share subject to an Incentive Stock Option shall not be less than 100% of the Fair Market Value of a Share as of the date the Incentive Stock Option is granted if this limitation is necessary to qualify the Option as an Incentive Stock Option (except as provided in Plan Section 20);

(ii) the aggregate Fair Market Value (determined as of the date the Option is granted) of the Shares with respect to which Incentive Stock Options held by an individual first become exercisable in any calendar year (under the Plan and all other incentive stock option plans of the Company and its Affiliates) shall not exceed $100,000 (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option and to the extent an Option or Options granted to a Participant exceed this limit the Option or Options shall be treated as a Non-Statutory Stock Option;

(iii) an Incentive Stock Option shall not be exercisable more than 10 years after the date of grant (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option;

(iv) the Agreement covering an Incentive Stock Option shall contain such other terms and provisions that the Committee determines necessary to qualify this Option as an Incentive Stock Option; and

(v) notwithstanding any other provision of the Plan to the contrary, no Participant may receive an Incentive Stock Option under the Plan if, at the time the Award is granted, the Participant owns (after application of the rules contained in Code Section 424(d), or its successor provision), Shares possessing more than 10% of the total combined voting power of all classes of stock of the Company or its Subsidiaries, unless (i) the exercise price for that Incentive Stock Option is at least 110% of the Fair Market Value of the Shares subject to that Incentive Stock Option on the date of grant and (ii) that Option is not exercisable after the date five years from the date that Incentive Stock Option is granted.

10. Stock Appreciation Rights. An Award of a Stock Appreciation Right shall entitle the Participant (or a Successor or Transferee), subject to terms and conditions determined by the Committee, to receive upon exercise of the Stock Appreciation Right all or a portion of the excess of (i) the Fair Market Value of a specified number of Shares as of the date of exercise of the Stock Appreciation Right over (ii) a specified price that shall not be less than 100% of the Fair Market Value of such Shares as of the date of grant of the Stock Appreciation Right. A Stock Appreciation Right may be granted in connection with part or all of, in addition to, or completely independent of an Option or any other Award under the Plan. If issued in connection with a previously or contemporaneously granted Option, the Committee may impose a condition that exercise of a Stock Appreciation Right cancels a pro rata portion of the Option with which it is connected and vice versa. Each Stock Appreciation Right may be exercisable in whole or in part on the terms provided in the Agreement. No Stock Appreciation Right shall be exercisable at any time after the expiration of its Term. When a Stock Appreciation Right is no longer exercisable, it shall be deemed to have lapsed or terminated. Upon exercise of a Stock Appreciation Right, payment to the Participant or a Successor or Transferee shall be made at such time or times as shall be provided in the Agreement in the form of cash, Shares or a combination of cash and Shares as determined by the Committee. The Agreement may provide for a limitation upon the amount or percentage of the total appreciation on which payment (whether in cash and/or Shares) may be made in the event of the exercise of a Stock Appreciation Right.

11. Performance Units.

11.1 Initial Award.

(a) An Award of Performance Units under the Plan shall entitle the Participant or a Successor or Transferee to future payments of cash, Shares or a combination of cash and Shares, as determined by the Committee, based upon the achievement of pre-established performance targets. These performance targets may, but need not, include, without limitation, targets relating to one or more of the Company's or a group's, unit's, Affiliate's or an individual's performance. The Agreement may establish that a portion of a Participant's Award will be paid for performance that exceeds the minimum target but falls below the maximum target applicable to the Award. The Agreement shall also provide for the timing of the payment.

(b) Following the conclusion or acceleration of each Performance Cycle, the Committee shall determine the extent to which (i) performance targets have been attained, (ii) any other terms and conditions with respect to an Award relating to the Performance Cycle have been satisfied and (iii) payment is due with respect to an Award of Performance Units.

11.2 Acceleration and Adjustment. The Agreement may permit an acceleration of the Performance Cycle and an adjustment of performance targets and payments with respect to some or all of the Performance Units awarded to a Participant, upon the occurrence of certain events, which may, but need not include, without limitation, a Fundamental Change, a recapitalization, a change in the accounting practices of the Company, a change in the Participant's title or employment responsibilities, the Participant's death or retirement or, with respect to payments in Shares with respect to Performance Units, a reclassification, stock dividend, stock split or stock combination as provided in Plan Section 16. The Agreement also may provide for a limitation on the value of an Award of Performance Units that a Participant may receive.

12. Effective Date and Duration of the Plan.

12.1 Effective Date. The Plan shall become effective as of November 6, 2000, provided that the Plan is approved by the requisite vote of stockholders at the January 2001 Annual Meeting of Stockholders or any adjournment thereof.

12.2 Duration of the Plan. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 15, or November 27, 2016*** (the "Termination Date"); provided, however, that Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date unless limited in the Agreement or otherwise. No Award of an Incentive Stock Option shall be made more than 10 years after the Effective Date (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. The date and time of approval by the Committee of the granting of an Award shall be considered the date and time at which the Award is made or granted.

13. Plan Does Not Affect Employment Status.

(a) Status as an eligible Employee shall not be construed as a commitment that any Award will be made under the Plan to that eligible Employee or to eligible Employees generally.

*** Changed from November 6, 2010, subject to stockholder approval.

(b) Nothing in the Plan or in any Agreement or related documents shall confer upon any Employee or Participant any right to continue in the employment of the Company or any Affiliate or constitute any contract of employment or affect any right that the Company or any Affiliate may have to change such person's compensation, other benefits, job responsibilities, or title, or to terminate the employment of such person with or without cause.

14. Tax Withholding. The Company shall have the right to withhold from any cash payment under the Plan to a Participant or other person (including a Successor or a Transferee) an amount sufficient to cover any required withholding taxes. The Company shall have the right to require a Participant or other person receiving Shares under the Plan to pay the Company a cash amount sufficient to cover any required withholding taxes before actual receipt of those Shares. In lieu of all or any part of a cash payment from a person receiving Shares under the Plan, the Committee may permit the individual to cover all or any part of the required withholdings through a reduction of the number of Shares delivered or delivery or tender return to the Company of Shares held by the Participant or other person, in each case valued in the same manner as used in computing the withholding taxes under the applicable laws.

15. Amendment, Modification and Termination of the Plan.

(a) The Board may at any time and from time to time terminate, suspend or modify the Plan. Except as limited in (b) below, the Committee may at any time alter or amend any or all Agreements under the Plan to the extent permitted by law.

(b) No termination, suspension, or modification of the Plan will materially and adversely affect any right acquired by any Participant or Successor or Transferee under an Award granted before the date of termination, suspension, or modification, unless otherwise agreed to by the Participant in the Agreement or otherwise, or required as a matter of law; but it will be conclusively presumed that any adjustment for changes in capitalization provided for in Plan Sections 11.2 or 16 does not adversely affect these rights.

16. Adjustment for Changes in Capitalization. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Shares that may be issued under the Plan, (ii) the limitations on the number of Shares that may be issued to an individual Participant as an Option or a Stock Appreciation Right in any calendar year or that may be issued in the form of Restricted Stock or Shares without restrictions and (iii) the number and kind of Shares or, subject to Plan Section 11.2, Performance Units, subject to and the exercise price (if applicable) of any then outstanding Awards of Options, Stock Appreciation Rights, Restricted Stock, Performance Units or any other Awards related to shares of Stock (to the extent such other Awards would not otherwise automatically adjust in the equity restructuring); provided, in each case, that with respect to Incentive Stock Options, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor

provision; provided further, with respect to all Awards, no such adjustment shall be authorized to the extent that such adjustment would cause the Awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), including a Fundamental Change (subject to Plan Section 17), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Shares subject to an Award shall always be a whole number. In no event shall an outstanding Option or Stock Appreciation Right be amended for the sole purpose of reducing the exercise price or grant price thereof.

17. Fundamental Change. In the event of a proposed Fundamental Change, the Committee may, but shall not be obligated to:

(a) if the Fundamental Change is a merger or consolidation or statutory share exchange, make appropriate provision for the protection of the outstanding Options and Stock Appreciation Rights by the substitution of options, stock appreciation rights and appropriate voting common stock of the corporation surviving any merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation; or

(b) at least ten days before the occurrence of the Fundamental Change, declare, and provide written notice to each holder of an Option or Stock Appreciation Right of the declaration, that each outstanding Option and Stock Appreciation Right, whether or not then exercisable, shall be canceled at the time of, or immediately before the occurrence of the Fundamental Change in exchange for payment to each holder of an Option or Stock Appreciation Right, within ten days after the Fundamental Change, of cash equal to (i) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section) per Share exceeds the exercise price per Share covered by such Option or (ii) for each Stock Appreciation Right, the price determined pursuant to Section 10, except that Fair Market Value of the Shares as of the date of exercise of the Stock Appreciation Right, as used in clause (i) of Plan Section 10, shall be deemed to mean Fair Market Value for each Share with respect to which the Stock Appreciation Right is calculated determined in the manner hereinafter referred to in this Section. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option shall immediately become exercisable in full and each person holding an Option or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option or Stock Appreciation Right, to exercise the Option as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to Plan Section 17(b), each outstanding Option and Stock Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Fundamental Change shall be canceled at the time of, or immediately before, the Fundamental Change, as provided in the declaration.

Notwithstanding the foregoing, no person holding an Option or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 17(b) if such Option or Stock Appreciation Right shall have terminated, expired or been cancelled. For purposes of this Section only, “Fair Market Value” per Share means the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the stockholders of the Company upon the occurrence of the Fundamental Change.

18. Prohibition on Repricing. Without the approval of the Company’s stockholders, the Committee will not reprice, adjust or amend the exercise price of any Option or the grant price of any Stock Appreciation Right previously awarded, whether through amendment, cancellation and replacement grant or any other means, except pursuant to Section 16 of the Plan in connection with an equity restructuring, or pursuant to Section 17 of the Plan in connection with a Fundamental Change, in order to prevent dilution or enlargement of the benefits, or potential benefits intended to be provided under the Plan.

19. Forfeitures. An Agreement may provide that if a Participant has received or been entitled to payment of cash, delivery of Shares, or a combination thereof pursuant to an Award within six months before the Participant’s termination of employment with the Company and its Affiliates, the Committee, in its sole discretion, may require the Participant to return or forfeit the cash and/or Shares received with respect to the Award (or its economic value as of (i) the date of the exercise of Options or Stock Appreciation Rights, (ii) the date of, and immediately following, the lapse of restrictions on Restricted Stock or the receipt of Shares without restrictions, or (iii) the date on which the right of the Participant to payment with respect to Performance Units vests, as the case may be) in the event of certain occurrences specified in the Agreement. The Committee’s right to require forfeiture must be exercised within 90 days after discovery of such an occurrence but in no event later than 15 months after the Participant’s termination of employment with the Company and its Affiliates. The occurrences may, but need not, include competition with the Company or any Affiliate, unauthorized disclosure of material proprietary information of the Company or any Affiliate, a violation of applicable business ethics policies of the Company or Affiliate or any other occurrence specified in the Agreement within the period or periods of time specified in the Agreement.

20. Corporate Mergers, Acquisitions, Etc. The Committee may also grant Options, Stock Appreciation Rights, Restricted Stock or other Awards under the Plan in substitution for, or in connection with the assumption of, existing options, stock appreciation rights, restricted stock or other award granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to which the Company or a Subsidiary is a party. The terms and conditions of the substitute Awards may vary from the terms and conditions set forth in the Plan to the extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

21. Unfunded Plan. The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, its Affiliates, the Committee, nor the Board of Directors shall be deemed

to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and/or its Affiliates, and a Participant or Successor or Transferee. To the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

22. Limits of Liability.

(a) Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.

(b) Except as may be required by law, neither the Company nor any member of the Board of Directors or of the Committee, nor any other person participating in any determination of any question under the Plan, or in the interpretation, administration or application of the Plan, shall have any liability to any party for any action taken, or not taken, in good faith under the Plan.

23. Compliance with Applicable Legal Requirements. No certificate for Shares distributable pursuant to the Plan shall be issued and delivered unless the issuance of the certificate complies with all applicable legal requirements including, without limitation, compliance with the provisions of applicable state securities laws, the Securities Act of 1933, as amended and in effect from time to time or any successor statute, the Exchange Act and the requirements of the exchanges on which the Company's Shares may, at the time, be listed.

24. Deferrals and Settlements. The Committee may require or permit Participants to elect to defer the issuance of Shares or the settlement of Awards in cash under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts.

25. Other Benefit and Compensation Programs. Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay laws of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or an Affiliate unless expressly so provided by such other plan, contract or arrangement, or unless the Committee expressly determines that an Award or portion of an Award should be included to accurately reflect competitive compensation practices or to recognize that an Award has been made in lieu of a portion of competitive cash compensation.

26. Beneficiary Upon Participant's Death. To the extent that the transfer of a Participant's Award at his or her death is permitted under an Agreement, a Participant's Award shall be transferable at death to the estate or to the person who acquires the right to succeed to the Award by bequest or inheritance.

27. Requirements of Law.

(a) To the extent that federal laws do not otherwise control, the Plan and all determinations made and actions taken pursuant to the Plan shall be governed by the laws of the State of Minnesota without regard to its conflicts-of-law principles and shall be construed accordingly.

(b) If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not effect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

Exhibit 10(g)

**DIGI INTERNATIONAL INC.**
**NON-OFFICER STOCK OPTION PLAN**
**AS AMENDED AND RESTATED AS OF NOVEMBER 27, 2006**

1. *Purpose of Plan.* The purpose of this Digi International Inc. Non-Officer Stock Option Plan (the "Plan"), is to promote the interests of Digi International Inc., a Delaware corporation (the "Company"), and its stockholders by providing key personnel of the Company and its subsidiaries (other than officers and directors of the Company) with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its subsidiaries. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel of outstanding ability.

2. *Administration of Plan.* This Plan shall be administered by a committee of two or more directors (the "Committee") appointed by the Company's board of directors (the "Board"). A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and the acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Subject to the provisions of this Plan, the Committee may from time to time adopt such rules for the administration of this Plan as it deems appropriate. The decision of the Committee on any matter affecting this Plan or the rights and obligations arising under this Plan or any option granted hereunder, shall be final, conclusive and binding upon all persons, including without limitation the Company, stockholders, employees and optionees. To the full extent permitted by law, (i) no member of the Committee, the CEO Stock Option Committee (if any) or the Authorized Officer (as defined in this paragraph 2) shall be liable for any action or determination taken or made in good faith with respect to this Plan or any option granted hereunder and (ii) the members of the Committee, the CEO Stock Option Committee and the Authorized Officer shall be entitled to indemnification by the Company against and from any loss incurred by such member or person by reason of any such actions and determinations. The Committee may delegate (x) all or any part of its authority under this Plan to a one person committee consisting of the Chief Executive Officer of the Company as its sole member (the "CEO Stock Option Committee") for purposes of granting and administering awards or (y) its authority to designate Eligible Participants to receive options under the Plan and to determine the number of options to be granted to such Eligible Participant to an officer of the Company (an "Authorized Officer"); provided that the Authorized Officer cannot designate himself or herself as an Eligible Participant to receive options under the Plan. The stock option grants by the Authorized Officer pursuant to this paragraph 2 shall not exceed the number of shares of Common Stock available for issuance under this Plan taking into account any outstanding and unexercised options, subject to such further limitations on the authority of the Authorized Officer as the Committee shall approve.

3. *Shares Subject to Plan.* The shares that may be made subject to options granted under this Plan shall be authorized and unissued shares of common stock (the "Common Shares") of the Company, $.01 par value, or Common Shares held in treasury, and they shall not exceed 2,750,000 in the aggregate, except that, if any option lapses or terminates for any reason before

such option has been completely exercised, the Common Shares covered by the unexercised portion of such option may again be made subject to options granted under this Plan.

4. *Eligible Participants.* Options may be granted under this Plan to any key employee of the Company or any subsidiary thereof, who is not an officer or director of the Company, and may also be granted to other individuals or entities who are not "employees" but who provide services to the Company or a parent or subsidiary thereof in the capacity of an advisor or consultant. References herein to "employed," "employment" and similar terms (except "employee") shall include the providing of services in any such capacity or as a director. The employees and other individuals and entities to whom options may be granted pursuant to this paragraph 4 are referred to herein as "Eligible Participants."

5. *Terms and Conditions of Employee Options.*

(a) Subject to the terms and conditions of this Plan, the Committee may, from time to time prior to December 1, 2006, grant to such Eligible Participants as the Committee may determine options to purchase such number of Common Shares of the Company on such terms and conditions as the Committee may determine. In determining the Eligible Participants to whom options shall be granted and the number of Common Shares to be covered by each option, the Committee may take into account the nature of the services rendered by the respective Eligible Participants, their present and potential contributions to the success of the Company, and such other factors as the Committee in its sole discretion shall deem relevant. The date and time of approval by the Committee of the granting of an option shall be considered the date and the time of the grant of such option.

(b) The purchase price of each Common Share subject to an option granted pursuant to this paragraph 5 shall be fixed by the Committee. Such purchase price may be set at not less that 50% of the Fair Market Value (as defined below) of a Common Share on the date of grant.

(c) "Fair Market Value" as of any date means, unless otherwise expressly provided in the Plan:

(i) the closing sale price of a Common Share on such date, or, if no sale of Common Shares shall have occurred on that date, on the next preceding day on which a sale of Common Shares occurred

(A) on the composite tape for NASDAQ-listed shares, or

(B) if the Common Shares are not quoted on the composite tape for NASDAQ-listed shares, on the principal United States Securities Exchange registered under the Securities Exchange Act of 1934, as amended, on which the Common Shares are listed, or

(ii) if clause (i) is inapplicable, the mean between the closing "bid" and the closing "asked" quotation of a Common Share on that date, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a closing bid and asked quotation is made, on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or

(iii) if clauses (i) and (ii) are inapplicable, what the Committee determines in good faith to be 100% of the fair market value of a Common Share on that date, using such criteria as it shall determine, in its sole discretion, to be appropriate for valuation.

(d) Each option agreement provided for in paragraph 13 hereof shall specify when each option granted under this Plan shall become exercisable.

(e) Each option granted pursuant to this paragraph 5 and all rights to purchase shares thereunder shall cease on the earliest of:

(i) ten years after the date such option is granted or on such date prior thereto as may be fixed by the Committee on or before the date such option is granted;

(ii) the expiration of the period after the termination of the optionee's employment within which the option is exercisable as specified in paragraph 7(b) or 7(c), whichever is applicable; or

(iii) the date, if any, fixed for cancellation pursuant to paragraph 7 of this Plan.

In no event shall any option be exercisable at any time after its original expiration date. When an option is no longer exercisable, it shall be deemed to have lapsed or terminated and will no longer be outstanding.

6. *Manner of Exercising Options.* A person entitled to exercise an option granted under this Plan may, subject to its terms and conditions and the terms and conditions of this Plan, exercise it in whole at any time, or in part from time to time, by delivery to the Company at its principal executive office, to the attention of its President, of written notice of exercise, specifying the number of shares with respect to which the option is being exercised, accompanied by payment in full of the purchase price of the shares to be purchased at the time. The purchase price of each share on the exercise of any option shall be paid in full in cash (including check, bank draft or money order) at the time of exercise or, at the discretion of the holder of the option, by delivery to the Company of unencumbered Common Shares having an aggregate Fair Market Value on the date of exercise equal to the purchase price, or by a combination of cash and such unencumbered Common Shares. Provided, however, that a person exercising a stock option shall not be permitted to pay any portion of the purchase price with stock if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company. No shares shall be issued until full payment therefor has been made, and the granting of an option to an individual shall give such individual no rights as a stockholder except as to shares issued to such individual.

7. *Transferability and Termination of Options.*

(a) During the lifetime of an optionee, only such optionee or his or her guardian or legal representative may exercise options granted under this Plan, and no option granted under this Plan shall be assignable or transferable by the optionee otherwise than by will or the laws of descent and distribution or pursuant to a domestic relations order as defined in the Internal Revenue Code of 1986, as amended, or any amendment thereto (the "Code") or Title I of the Employee Retirement Income Security Act ("ERISA"), or the rules thereunder; provided, however, that any optionee may transfer a stock option granted under this Plan to a member or members of his or her immediate family (i.e., his or her children, grandchildren and spouse) or to one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners, if (i) the option agreement with respect to such options, which must be approved by the Committee, expressly so provides either at the time of initial grant or by amendment to an outstanding option agreement and (ii) the optionee does not receive any consideration for the transfer. Any options held by any such transferee shall continue to be subject to the same terms and conditions that were applicable to such options immediately prior to their transfer and may be exercised by such transferee as and to the extent that such option has become exercisable and has not terminated in accordance with the provisions of the Plan and the applicable option agreement. For purposes of any provision of this Plan relating to notice to an optionee or to vesting or termination of an option upon the death, disability or termination of employment of an optionee, the references to "optionee" shall mean the original grantee of an option and not any transferee.

(b) During the lifetime of an optionee, an option may be exercised only while the optionee is employed by the Company or a parent or subsidiary thereof, and only if such optionee has been continuously so employed since the date the option was granted, except that:

(i) unless otherwise provided in a stock option agreement, an option granted to an optionee shall continue to be exercisable for three months after termination of such optionee's employment but only to the extent that the option was exercisable immediately prior to such optionee's termination of employment;

(ii) in the case of an optionee who is disabled (within the meaning of Section 22(e)(3) of the Code) while employed, the option granted to such optionee may be exercised within one year after termination of such optionee's employment; and

(iii) as to any optionee whose termination occurs following a declaration pursuant to paragraph 7 of this Plan, the option granted to such optionee may be exercised at any time permitted by such declaration.

(c) An option may be exercised after the death of the optionee, but only within one year after the death of such optionee.

(d) In the event of the disability (within the meaning of Section 22(e)(3) of the Code) or death of an optionee, any option granted to such optionee that was not previously exercisable shall become immediately exercisable in full if the disabled or deceased optionee shall have been continuously employed by the Company or a parent or subsidiary thereof between the date such option was granted and the date of such disability, or, in the event of death, a date not more than three months prior to such death.

8. *Dissolution, Liquidation, Merger.* In the event of (a) a proposed merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, unless appropriate provision shall have been made for the protection of the outstanding options granted under this Plan by the substitution, in lieu of such options, of options to purchase appropriate voting common stock (the "Survivor's Stock") of the corporation surviving any such merger or consolidation or, if appropriate, the parent corporation of the

Company or such surviving corporation, or, alternatively, by the delivery of a number of shares of the Survivor's Stock which has a Fair Market Value as of the effective date of such merger or consolidation equal to the product of (i) the excess of (x) the Event Proceeds per Common Share (as hereinafter defined) covered by the option as of such effective date, over (y) the option price per Common Share, times (ii) the number of Common Shares covered by such option, or (b) the proposed dissolution or liquidation of the Company (such merger, consolidation, dissolution or liquidation being herein called an "Event"), the Committee shall declare, at least ten days prior to the actual effective date of an Event, and provide written notice to each optionee of the declaration, that each outstanding option, whether or not then exercisable, shall be cancelled at the time of, or immediately prior to the occurrence of, the Event (unless it shall have been exercised prior to the occurrence of the Event) in exchange for payment to the holder of each cancelled option, within ten days after the Event, of cash equal to the amount (if any), for each Common Share covered by the cancelled option, by which the Event Proceeds per Common Share (as hereinafter defined) exceeds the exercise price per Common Share covered by such option. At the time of the declaration provided for in the immediately preceding sentence, each option shall immediately become exercisable in full and each holder of an option shall have the right, during the period preceding the time of cancellation of the option, to exercise his or her option as to all or any part of the Common Shares covered thereby. Each outstanding option granted pursuant to this Plan that shall not have been exercised prior to the Event shall be cancelled at the time of, or immediately prior to, the Event, as provided in the declaration, and this Plan shall terminate at the time of such cancellation, subject to the payment obligations of the Company provided in this paragraph 8. For purposes of this paragraph, "Event Proceeds per Common Share" shall mean the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Common Share by the stockholders of the Company upon the occurrence of the Event.

9. *Substitution Options.* Options may be granted under this Plan from time to time in substitution for stock options held by employees of other corporations who are about to become employees of the Company or a subsidiary of the Company, or whose employer is about to become a subsidiary of the Company, as the result of a merger or consolidation of the Company or a subsidiary of the Company with another corporation, the acquisition by the Company or a subsidiary of the Company of all or substantially all the assets of another corporation or the acquisition by the Company or a subsidiary of the Company of at least 50% of the issued and outstanding stock of another corporation. The terms and conditions of the substitute options so granted may vary from the terms and conditions set forth in this Plan to such extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the stock options in substitution for which they are granted.

10. *Tax Withholding.* Delivery of Common Shares upon exercise of any nonstatutory stock option granted under this Plan shall be subject to any required withholding taxes. A person exercising such an option may, as a condition precedent to receiving the Common Shares, be required to pay the Company a cash amount equal to the amount of any required withholdings. In lieu of all or any part of such a cash payment, the Committee may, but shall not be required to, permit the optionee to elect to cover all or any part of the required withholdings, and to cover any additional withholdings up to the amount needed to cover such optionee's full FICA and federal, state and local income tax liability with respect to income arising from the exercise of the option, through a reduction of the number of Common Shares delivered to the person

exercising the option or through a subsequent return to the Company of shares delivered to the person exercising the option.

11. *Termination of Employment.* Neither the transfer of employment of an optionee between any combination of the Company, a parent corporation or a subsidiary thereof, nor a leave of absence granted to such optionee and approved by the Committee, shall be deemed a termination of employment for purposes of this Plan. The terms "parent" or "parent corporation" and "subsidiary" as used in this Plan shall have the meaning ascribed to "parent corporation" and "subsidiary corporation", respectively, in Sections 424(e) and (f) of the Code.

12. *Adjustment for Changes in Capitalization*. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Common Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Common Shares that may be issued under the Plan and (ii) the number and kind of Common Shares and the exercise price (if applicable) of any then outstanding awards of options, provided that, with respect to all awards of options, no such adjustment shall be authorized to the extent that such adjustment would cause the awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), or any partial or complete liquidation of the Company, including an Event (subject to Plan Section 8), such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Common Shares subject to an option shall always be a whole number. In no event shall an outstanding option be amended for the sole purpose of reducing the exercise price thereof.

13. *Other Terms and Conditions.* The Committee shall have the power, subject to the other limitations contained herein, to fix any other terms and conditions for the grant or exercise of any option under this Plan. Nothing contained in this Plan, or in any option granted pursuant to this Plan, shall confer upon any optionee any right to continued employment by the Company or any parent or subsidiary of the Company or limit in any way the right of the Company or any such parent or subsidiary to terminate an optionee's employment at any time.

14. *Option Agreements.* All options granted under this Plan shall be evidenced by a written agreement in such form or forms as the Committee may from time to time determine.

15. *Amendment and Discontinuance of Plan.* The Board may at any time amend, suspend or discontinue this Plan. No amendment to this Plan shall, without the consent of the holder of an option previously granted under this Plan, shall alter or impair any option.

16. *Effective Date.* This Plan shall be effective April 2, 1998.

Exhibit 10(m)

February 4, 2003

Mr. Lawrence Kraft
3108 2nd Street North
Arlington, VA 22201

Dear Larry,

On behalf of Digi International Inc., I am pleased to offer you employment as Vice President, Americas Sales & Marketing reporting to Joe Dunsmore.

**Compensation**

Your annualized total compensation target for this position is $300,000. The annualized base salary is $165,000 with an annualized incentive target of $135,000.

You will participate in Digi International's Executive Incentive Plan. For the current fiscal year, your plan will contain the following components:

**Quarterly Performance:** 37.5% of your incentive target will be based on achievement of quarterly revenue and profitability targets.

**Annual Performance "At Plan":** 12.5% of your incentive target will be based on achievement of the annual revenue and profitability plan.

**Increasing Annual Profitability:** 50% of your incentive target will be based on the company's exceeding the annual profitability and revenue plan. There is a provision for partial payment under this component based on level of achievement.

Please see the attached worksheet for more information on the Executive Incentive Plan. All payments are pro-rated based on length of service in the quarter/fiscal year.

**Stock Options**

We will recommend to the Board of Directors an initial grant of 75,000 stock options. Your options will be at the market price at the time the board approves your grant and will vest over four years at a rate of 25% (18,750 shares) upon completion of one year, then proportionate monthly vesting thereafter. This option request will be brought to the Board of Directors on your start date.

**Benefits**

Digi offers a comprehensive benefit program which includes Medical, Dental, Vision, Life and Disability Insurance, Medical and Dependent Care Reimbursement Plans, 401(k) Savings Plan, Employee Stock Purchase Plan, and a Tuition Reimbursement Program. You will be eligible for participation in Digi's health insurance programs on the first day active employment with the company and will be eligible for participation in the 401(k) Savings Plan on the first day of the month following date of hire. Stock Purchase Plan participation eligibility begins on the first of January, April, July and October following date of hire.

You will be eligible to participate in Digi's $500,000 Executive Life Insurance program. If accepted by the carrier, Digi International will pay the full annual premium. This is in additional to the basic and optional life insurance programs offered to all employees.

Vacation eligibility begins on the date of hire. Upon hire, you will receive four weeks of vacation. You will not accrue above or below this amount regardless of time taken. Should you leave the company at any point in the future, you will be paid for four weeks of accrued vacation.

**Relocation**

Digi will cover the full cost of your relocation to Minnesota. This will include:

- Professional relocation assistance by our corporate provider, Relocation Today. You can utilize a realtor that they recommend or work with one outside of their referral group.
- Commuting expenses for a period of eight (8) months. This includes one roundtrip airfare per week for either you or your wife.
- The company will secure temporary housing for a period of eight (8) months. If you elect an alternative termporary housing arrangement, we will reimburse your expenses for a period of four (4) months.
- Automobile expenses for the first 30 days in Minnesota.
- Shipment and temporary storage of household goods.
- Realtor fees and closing costs on the sale of your existing home.
- Closing costs on the purchase of your new home. This will not include "points" paid on the purchase of a new home, real estate taxes or any other extraordinary closing costs.
- Reimbursement of any other reasonable expenses not listed above as approved by myself.
- A "gross-up" of all taxable relocation expenses.

If you should voluntarily leave Digi International before twelve months of employment, all relocation costs paid on your behalf or to you must be repaid to the company. Your signature on this offer letter indicates your agreement to this provision and authorizes Digi International to deduct any amount due from any final payments owed to you. This provision will not be enforced in the event that Digi International experiences a change of control during the first twelve months of your employment.

**Other**

If Digi International should involuntarily terminate your employment at any time in the future, you will be provided with six months of severance pay (based on your base salary) as consideration for a Release of Claims against the Company. You will be considered an active employee for the purposes of health, dental, life, 401(k) and stock option plan participation during the severance period if you elect bi-weekly severance payments. If you elect a lump sum payment, the Company will pay the first six months of COBRA premiums for health and dental continuation. You will receive a pro-rated bonus for the applicable period worked calculated on the company's achievement levels at the time of the event.

This does not include any situations where you were involuntarily terminated for cause (performance or misconduct). In the event of a change of control, you will be provided with the six months of severance pay for either an involuntary or voluntary termination. Severance pay will be taxed per applicable tax regulations without any "gross up" or other provision for the taxation of your payment.

**Digi International Employment Agreement**

This offer of employment is contingent upon your signature on the enclosed Digi International Employment Agreement. Your signature constitutes acceptance of the terms and conditions contained in the Agreement, so please read it thoroughly prior to signing. This offer is also conditioned upon Digi's determination that you are not subject to any agreement with any former employer or any other party that would prohibit you from working in the position of Vice President, Americas Sales & Marketing. If at any time in the future the Company determines that you are subject to an agreement that, in Digi's sole discretion, would prohibit your employment by Digi, Digi may withdraw this offer of employment or terminate your employment with the Company.

Employment with Digi International Inc. is "at will," which means that it is for no definite period and may be terminated by either you or Digi at any time for any reason without prior notice. I understand, agree, and acknowledge that any reliance on any statements by any representative of the company contrary to this "at will" arrangement is unreasonable and may not form any basis for my reliance thereon.

Your start date will be February 10, 2003. Please inform me of your acceptance of this offer by February 5, 2003 and acknowledge your acceptance by signing one of the enclosed copies and returning it to me along with your signed Employment Agreement prior to your first day of employment.

Larry, we are fortunate and excited to have you join the "Digi Team". I look forward to working with you.

Sincerely,

***Digi International Inc.***

Tracy Roberts
Director, Human Resources

/s/ Tracy Roberts

***Offer accepted:***

| | | |
|---|---|---|
| /s/ Lawrence A. Kraft | 2/5/03 | 2/10/03 |
| Lawrence A. Kraft | Date | Start Date |

**Exhibit 21**

Subsidiaries of the Company

Digi International GmbH

Digi International (HK) Ltd.

Digi International Kabushikikaisha

Digi International Limited

Digi International SARL

FS Forth-Systeme GmbH

ITK International, Inc.

MaxStream, Inc.

NetSilicon, Inc.

Rabbit Semiconductor Inc.

Sistemas Embebidos S.A.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-138029) and Form S-8 (Nos. 333-00099, 333-23857, 333-57869, 333-53366, 333-55488, 333-82674, 333-82678, 333-82668, 333-82670, 333-82672) of Digi International Inc. of our report dated December 4, 2006 relating to the consolidated financial statements, financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Minneapolis, Minnesota
December 6, 2006

Exhibit 24

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 27th day of November, 2006.

/s/ Guy C. Jackson

Guy C. Jackson

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 27th day of November, 2006.

/s/ Kenneth E. Millard

Kenneth E. Millard

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 25th day of November, 2006.

/s/ Ahmed Nawaz

Ahmed Nawaz

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 23rd day of November, 2006.

/s/ William N. Priesmeyer

William N. Priesmeyer

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 27th day of November, 2006.

/s/ Bradley J. Williams
Bradley J. Williams

**EXHIBIT 31(a)**

**CERTIFICATIONS**

I, Joseph T. Dunsmore, certify that:

1. I have reviewed this annual report on Form 10-K of Digi International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 6, 2006

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore
President, Chief Executive Officer, and Chairman

**EXHIBIT 31(b)**

## CERTIFICATIONS

I, Subramanian Krishnan, certify that:

1. I have reviewed this annual report on Form 10-K of Digi International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: December 6, 2006

/s/ Subramanian Krishnan

Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer

Exhibit 32

CEO AND CFO CERTIFICATION OF PERIODIC REPORT

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, each of the undersigned certifies that:

(1) the Annual Report on Form 10-K of the Company for the year ended September 30, 2006 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore
President, Chief Executive Officer, Chairman and Director

/s/ Subramanian Krishnan

Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer