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

FORM 10-Q

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

For the quarterly period ended: **June 30, 2008**

OR

- 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: **1-34033**

DIGI INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

41-1532464

(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)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

On July 31, 2008, there were 25,642,711 shares of the registrant's \$.01 par value Common Stock outstanding.

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)**

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
	(in thousands, except per common share data)			
Net sales	\$ 46,995	\$ 43,527	\$ 134,639	\$ 128,193
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	21,200	19,392	59,729	57,257
Amortization of purchased and core technology	938	1,132	2,981	3,409
Gross profit	24,857	23,003	71,929	67,527
Operating expenses:				
Sales and marketing	9,493	8,517	27,213	25,102
Research and development	6,995	6,039	20,113	18,079
General and administrative	3,484	3,349	11,466	10,229
Acquired in-process research & development	1,900	—	1,900	—
Total operating expenses	21,872	17,905	60,692	53,410
Operating income	2,985	5,098	11,237	14,117
Interest income, net				
Interest income	776	872	2,850	2,444
Interest expense	(64)	(17)	(90)	(59)
Total interest income, net	712	855	2,760	2,385
Income before income taxes	3,697	5,953	13,997	16,502
Income tax provision	1,712	(845)	5,245	2,305
Net income	\$ 1,985	\$ 6,798	\$ 8,752	\$ 14,197
Net income per common share:				
Basic	\$ 0.08	\$ 0.27	\$ 0.34	\$ 0.56
Diluted	\$ 0.08	\$ 0.26	\$ 0.33	\$ 0.55
Weighted average common shares, basic	25,742	25,294	25,683	25,186
Weighted average common shares, diluted	26,079	26,152	26,353	26,032

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2008	September 30, 2007
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,751	\$ 18,375
Marketable securities	52,877	67,111
Accounts receivable, net	26,032	21,022
Inventories	28,529	26,130
Other	4,885	4,961
Total current assets	129,074	137,599
Marketable securities, long-term	7,921	2,081
Property, equipment and improvements, net	15,382	19,987
Identifiable intangible assets, net	32,951	24,214
Goodwill	82,831	66,817
Other	1,456	1,128
Total assets	<u>\$ 269,615</u>	<u>\$ 251,826</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Capital lease obligations, current portion	\$ 278	\$ 379
Accounts payable	10,667	6,554
Income taxes payable	1,183	3,156
Accrued expenses:		
Compensation	5,015	7,080
Other	3,982	4,727
Total current liabilities	21,125	21,896
Capital lease obligations, net of current portion	135	358
Income taxes payable — long-term	3,983	—
Deferred gain on building sale — leaseback	1,120	—
Net deferred tax liabilities	7,596	6,667
Total liabilities	<u>33,959</u>	<u>28,921</u>
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; 28,332,658 and 28,153,763 shares issued	283	281
Additional paid-in capital	176,687	172,156
Retained earnings	75,026	66,782
Accumulated other comprehensive income	1,492	2,121
Treasury stock, at cost, 2,521,147 and 2,606,419 shares	(17,832)	(18,435)
Total stockholders' equity	235,656	222,905
Total liabilities and stockholders' equity	<u>\$ 269,615</u>	<u>\$ 251,826</u>

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine months ended June 30,	
	2008	2007
	(in thousands)	
Operating activities:		
Net income	\$ 8,752	\$ 14,197
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, equipment and improvements	1,894	1,878
Amortization of identifiable intangible assets and other assets	5,033	5,769
Gain on sale of property, equipment and improvements	(94)	—
Excess tax benefits from stock-based compensation	(177)	(315)
Stock-based compensation	2,702	2,258
Deferred income tax benefit	(2,696)	(1,612)
Acquired in-process research and development	1,900	—
Other	222	18
Changes in operating assets and liabilities, excluding impact of acquisition:		
Accounts receivable	(2,903)	(1,109)
Inventories	(924)	(3,543)
Other assets	253	709
Accounts payable and accrued expenses	(156)	(903)
Income taxes payable	1,221	1,328
Net cash provided by operating activities	<u>15,027</u>	<u>18,675</u>
Investing activities:		
Purchase of held-to-maturity marketable securities	(57,273)	(56,593)
Proceeds from maturities of held-to-maturity marketable securities	65,667	55,902
Acquisition of Sarian, Inc., net of cash acquired	(27,811)	—
Contingent purchase price payments related to prior business acquisitions	(1,315)	(781)
Increase in non-current restricted cash	(392)	—
Proceeds from sale-leaseback and sale of other property, equipment, improvements	6,915	17
Purchase of property, equipment, improvements and certain other intangible assets	<u>(2,567)</u>	<u>(2,329)</u>
Net cash used in investing activities	<u>(16,776)</u>	<u>(3,784)</u>
Financing activities:		
Payments on capital lease obligations	(293)	(287)
Borrowing on note payable	25,000	—
Payment on note payable	(25,000)	—
Excess tax benefits from stock-based compensation	177	315
Proceeds from stock option plan transactions	1,679	2,433
Proceeds from employee stock purchase plan transactions	<u>802</u>	<u>954</u>
Net cash provided by financing activities	<u>2,365</u>	<u>3,415</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(2,240)</u>	<u>88</u>
Net (decrease) increase in cash and cash equivalents	<u>(1,624)</u>	<u>18,394</u>
Cash and cash equivalents, beginning of period	18,375	15,674
Cash and cash equivalents, end of period	<u>\$ 16,751</u>	<u>\$ 34,068</u>

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

DIGI INTERNATIONAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the “Company,” “Digi,” “we,” “our,” or “us”) pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including the summary of significant accounting policies, presented in our 2007 Annual Report on Form 10-K as filed with the SEC.

The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated financial position and the condensed consolidated results of operations and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Recently Issued Accounting Pronouncements

In June 2008, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position Emerging Issues Task Force 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (“FSP EITF 03-6-1”). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in FASB Statement No. 128, “Earnings Per Share.” This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and will be applied retrospectively. We do not expect the adoption of FSP EITF 03-6-1 to have a material impact on our consolidated financial statements.

In May 2008, the FASB issued FASB Statement No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 is effective 60 days following approval by the SEC of the Public Company Accounting Oversight Board’s amendments to AU Section 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.” We do not expect the adoption of SFAS 162 to have a material impact on our consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP SFAS 142-3"). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142). FSP SFAS 142-3 intends to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flow used to measure the fair value of the asset under SFAS No. 141 (Revised 2007), "Business Combinations" and other accounting principles generally accepted in the United States. This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the impact of FSP SFAS 142-3 on our consolidated financial statements.

In December 2007, the FASB issued FASB Statement No. 141(R), "Business Combinations" ("SFAS 141(R)"). This Statement retained the fundamental requirements in the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defined the acquirer as the entity that obtains control of one or more businesses in the business combination and established the acquisition date as the date that the acquirer achieves control. The new standard requires the acquiring entity in a business combination to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This Statement also makes certain other modifications to the former Statement. SFAS 141(R) is effective for business combinations that are consummated in our fiscal years beginning October 1, 2009. Early adoption is not permitted. SFAS 141(R) is expected to have a material impact on how we will identify, negotiate, and value future acquisitions and how such acquisitions will affect our consolidated financial statements.

In February 2007, the FASB issued FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS 159"). This Statement provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company that adopts SFAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement is effective for fiscal years beginning after November 15, 2007, which for us is our fiscal years beginning October 1, 2008. We do not expect SFAS 159 to have a material impact on our consolidated financial statements, if we decide to adopt.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 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. In February 2008, the FASB issued FASB Staff Position No. 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13" ("FSP 157-1") and FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-1 amends SFAS 157 to exclude various accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13, with the exception of assets or liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141 or SFAS 141(R). FSP 157-1 is effective upon the adoption of FAS 157. FSP 157-2 defers the effective date of FAS 157 for our fiscal years beginning October 1, 2009 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The provisions of FAS 157 are effective for our fiscal years beginning October 1, 2008 for financial assets and financial liabilities. We are currently evaluating the impact of the provisions of FAS 157, FSP 157-1 and FSP 157-2 on our consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**2. 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 potentially dilutive common shares outstanding during the period. Potentially dilutive common shares of our stock 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):

	<u>Three months ended June 30,</u>		<u>Nine months ended June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Numerator:				
Net income	<u>\$ 1,985</u>	<u>\$ 6,798</u>	<u>\$ 8,752</u>	<u>\$ 14,197</u>
Denominator:				
Denominator for basic net income per common share — weighted average shares outstanding	25,742	25,294	25,683	25,186
Effect of dilutive securities:				
Employee stock options and employee stock purchase plan	<u>337</u>	<u>858</u>	<u>670</u>	<u>846</u>
Denominator for diluted net income per common share — adjusted weighted average shares	<u>26,079</u>	<u>26,152</u>	<u>26,353</u>	<u>26,032</u>
Net income per common share, basic	<u>\$ 0.08</u>	<u>\$ 0.27</u>	<u>\$ 0.34</u>	<u>\$ 0.56</u>
Net income per common share, diluted	<u>\$ 0.08</u>	<u>\$ 0.26</u>	<u>\$ 0.33</u>	<u>\$ 0.55</u>

Potentially dilutive shares related to stock options to purchase 3,751,317 and 2,019,831 common shares for the three and nine month periods ended June 30, 2008, respectively, and potentially dilutive shares related to stock options to purchase 595,784 and 1,100,901 common shares for the three and nine month periods ended June 30, 2007, 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 anti-dilutive.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**3. COMPREHENSIVE INCOME**

Comprehensive income is comprised of net income and foreign currency translation adjustments. Foreign currency translation adjustments are charged or credited to accumulated other comprehensive income within stockholders' equity. Comprehensive income was as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Net income	\$ 1,985	\$ 6,798	\$ 8,752	\$ 14,197
Foreign currency translation gain (loss)	(1,342)	(154)	(629)	486
Comprehensive income	<u>\$ 643</u>	<u>\$ 6,644</u>	<u>\$ 8,123</u>	<u>\$ 14,683</u>

4. ACQUISITIONS**Sarian Systems, Ltd.**

On April 28, 2008, we acquired Sarian Systems, Ltd. ("Sarian"), which is now a wholly owned subsidiary of Digi International Ltd. Prior to the acquisition, Sarian was a privately held corporation. Sarian is located in the United Kingdom and is a leader in the European wireless router market. The total purchase price of \$30.9 million, including \$3.1 million of cash acquired and \$0.4 million of direct acquisition costs, was for all of the outstanding ordinary shares of Sarian.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in non-deductible goodwill of \$15.4 million and a charge of \$1.9 million for acquired in-process research and development. We believe that the acquisition resulted in the recognition of goodwill primarily because Sarian's wireless IP Routing capability is highly complementary to our market approach and significantly expands our wireless offering.

Sarian's operating results are included in our consolidated results of operations from the date of acquisition. The consolidated balance sheet as of June 30, 2008 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. This allocation is preliminary, pending the completion of detailed analyses and outside appraisals of the fair values of the assets acquired. Once these analyses and appraisals have been completed, the allocation of the purchase price will be finalized. The table below sets forth the preliminary purchase price allocation (in thousands):

Cash, including direct acquisition costs	<u>\$ 30,920</u>
Fair value of net tangible assets acquired, including cash of \$3.1 million	\$ 4,055
Identifiable intangible assets:	
Existing purchased and core technology	7,800
Existing customer relationships	4,800
Trade names	340
Non-compete agreements	300
In-process research and development	1,900
Goodwill	15,432
Deferred tax liabilities related to identifiable intangibles	(3,707)
	<u>\$ 30,920</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**4. ACQUISITIONS (CONTINUED)**

The weighted average useful life for the total of all the identifiable intangibles listed above is 7.1 years. The weighted average useful life for each intangible asset class is as follows: purchased and core technology is 4.7 years, customer relationships is 11.0 years, trade names is 8.5 years and non-compete agreements is 3.0 years.

Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which we expect to derive benefits from the identifiable intangible assets. The identifiable intangible assets, other than customer relationships, are amortized using the straight-line method which reflects the pattern at which the asset is consumed. Customer relationships are amortized based upon an accelerated method following estimated cash flows generated from the intangible asset, whereby more of the amortization is taken in the early years rather than later years. We do not expect the above intangible assets to have any significant residual value once they become fully amortized.

At the time of acquisition, Sarian had development projects in process associated with the IPV6, Gate Array and VPN technologies. We estimated that \$1.9 million of the purchase price represented the fair value of acquired in-process research and development related to the products listed below (in thousands):

IPV6	\$ 1,300
Gate Array	400
VPN technologies	200
Total in-process research and development	<u>\$ 1,900</u>

These products 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.

We utilized the excess earnings method, a variation of the income approach, to determine the estimated fair value of the acquired in-process research and development. The estimated values are based upon the future cash flows to be generated by these in-process research and development projects over the projected period. These estimates were based on the following assumptions:

- The estimated revenues were based upon our estimate of revenue growth for each of the products over the next ten fiscal years, using the assumption that all revenue recorded after the ten year period will be generated from future technologies.
- The estimated operating expenses were based on consideration of historical selling, general and administrative expenses as a percentage of sales and Sarian'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 excess earnings method, 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 excess earnings method was 35%. 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. We used a 35% rate of return for the in-process research and development projects.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. ACQUISITIONS (CONTINUED)

We anticipate that all the projects will be completed by the end of calendar year 2008 and are expected to start generating revenues beginning in calendar year 2009. The 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.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of Sarian had occurred as of the beginning of fiscal 2007. Pro forma adjustments include amortization of identifiable intangible assets associated with the Sarian acquisition. The table below shows the pro forma amounts for net sales, net income and net income per share (in thousands, except per common share amounts):

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Net sales	\$ 47,787	\$ 46,784	\$ 142,317	\$ 135,923
Net income	\$ 1,389	\$ 6,531	\$ 7,938	\$ 13,061
Net income per common share, basic	\$ 0.05	\$ 0.26	\$ 0.31	\$ 0.52
Net income per common share, diluted	\$ 0.05	\$ 0.25	\$ 0.30	\$ 0.50

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of the beginning of fiscal 2007, nor are they necessarily indicative of the results that will be obtained in the future.

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

Effective April 1, 2005, we acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (collectively referred to as FS Forth) from Embedded Solutions AG of Germany. The purchase price of \$6.5 million in cash included contingent consideration of \$0.8 million paid in October 2006 and the final payment of \$0.9 million, which was paid in October 2007, based on the achievement of milestones identified in the merger agreement.

5. SELECTED BALANCE SHEET DATA
(in thousands)

	June 30, 2008	September 30, 2007
Accounts receivable, net:		
Accounts receivable	\$ 26,612	\$ 21,501
Less allowance for doubtful accounts	580	479
	<u>\$ 26,032</u>	<u>\$ 21,022</u>
Inventories:		
Raw materials	\$ 22,446	\$ 20,097
Work in process	1,748	816
Finished goods	4,335	5,217
	<u>\$ 28,529</u>	<u>\$ 26,130</u>
Other accrued expenses:		
Product warranty accrual	\$ 1,124	\$ 1,155
Accrued professional fees	626	522
Other accrued expenses	2,232	2,100
Contingent purchase price accrual — FS Forth	—	950
	<u>\$ 3,982</u>	<u>\$ 4,727</u>

Inventories are stated at the lower of cost or market value, with cost determined using the first-in, first-out method.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS

Amortizable identifiable intangible assets were comprised of the following (in thousands):

	June 30, 2008			September 30, 2007		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	\$ 46,634	\$ (29,759)	\$ 16,875	\$ 38,702	\$ (26,689)	\$ 12,013
License agreements	2,440	(2,440)	—	2,440	(2,290)	150
Patents and trademarks	8,633	(4,447)	4,186	7,925	(3,818)	4,107
Customer maintenance contracts	700	(446)	254	700	(394)	306
Customer relationships	16,602	(5,251)	11,351	11,613	(3,975)	7,638
Non-compete agreements	302	(17)	285	—	—	—
Total	\$ 75,311	\$ (42,360)	\$ 32,951	\$ 61,380	\$ (37,166)	\$ 24,214

Amortization expense was \$1.5 million and \$1.9 million for the three months ended June 30, 2008 and 2007, respectively, and \$5.0 million and \$5.7 million for the nine months ended June 30, 2008 and 2007, respectively.

Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2008 and the five succeeding fiscal years is as follows (in thousands):

2008 (three months)	\$ 1,555
2009	6,045
2010	5,480
2011	4,877
2012	4,255
2013	3,508

The changes in the carrying amount of goodwill were as follows (in thousands):

Beginning balance, October 1, 2007	\$ 66,817
Acquisition of Sarian	15,432
Foreign currency translation adjustment	582
Ending balance, June 30, 2008	<u>\$ 82,831</u>

7. INCOME TAXES

Income taxes have been provided for at an effective rate of 46.3% and 37.5% for the three and nine month periods ended June 30, 2008, respectively, compared to an effective rate of (14.2%) and 14.0% for the three and nine month periods ended June 30, 2007, respectively.

Income tax expense for the third quarter of fiscal 2008 includes a net discrete tax benefit of \$0.2 million resulting from a reversal of previously established tax reserves associated with the closing of a tax year. In the third quarter of fiscal 2007, we recorded discrete tax benefits of \$2.9 million, of which \$2.3 million resulted from the reversal of previously established income tax reserves that were no longer required as a result of the closing of a domestic tax return. In addition, we completed a foreign tax audit in the third quarter of 2007 and reversed \$0.6 million in income tax reserves that had been previously established and were no longer required.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**7. INCOME TAXES (CONTINUED)**

During the first quarter of 2007, Congress passed H.R. 6111, the “Tax Relief and Health Care Act of 2006”, which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, we recorded a discrete income tax benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006.

The \$1.9 million charge that was recorded in the third quarter of fiscal 2008 for in-process research and development was non-deductible. This non-deductible charge, along with the above discrete tax events, affected our effective tax rates as shown in the table below:

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Effective tax rate before impact of discrete tax events & non-deductible in-process research and development	37.3%	35.0%	35.1%	36.1%
Impact of non-deductible in-process research and development charge	14.4%	0.0%	3.8%	0.0%
Impact of discrete tax events	-5.4%	-49.2%	-1.4%	-22.1%
Effective tax rate	<u>46.3%</u>	<u>-14.2%</u>	<u>37.5%</u>	<u>14.0%</u>

The effective tax rate before the impact of discrete tax events and non-deductible in-process research and development charge for the nine months ended June 30, 2008 and 2007 was approximately equal to the U.S. statutory rate of 35%.

Effective October 1, 2007, we adopted FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109” (“FIN 48”). As a result of our adoption of FIN 48, we recognized an increase in our existing liabilities for unrecognized tax benefits of \$1.1 million and additional deferred tax assets of \$0.6 million, with an offsetting cumulative effect adjustment resulting in a decrease to the opening balance of retained earnings of \$0.5 million. At the adoption date, we had \$3.5 million of gross unrecognized tax benefits and accrued interest and penalties of \$0.5 million. If all of our unrecognized tax benefits were recognized, approximately \$3.5 million would impact our effective tax rate. In conjunction with our adoption of FIN 48, we reclassified \$4.0 million of unrecognized tax benefits as a long-term liability as we do not expect significant payments to occur over the next 12 months. We have elected to recognize interest and penalties related to income tax matters in income tax expense.

During the three months ended June 30, 2008, we reduced our unrecognized tax benefits for a \$0.2 million discrete item mentioned above, offset by an increase in the unrecognized tax benefit for interest accrued on prior periods benefits of \$0.2 million.

We file a consolidated U.S. federal income tax return, as well as income tax returns in various state and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by taxing authorities for years prior to fiscal 2004. Although the timing and resolution of potential tax audits is uncertain, we do not believe it is reasonably possible that the total amounts of unrecognized tax benefits will materially change in the next 12 months.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**8. FINANCIAL GUARANTEES**

In general, we warrant our products to be free from defects in material and workmanship under normal use and service for a period of up to five years from the date of receipt. We have the option to repair or replace products we deem defective with regard 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 incidence and are evaluated on an ongoing basis to ensure the adequacy of the warranty reserve. The following table summarizes the activity associated with the product warranty accrual (in thousands):

	Three months ended June 30,			Balance at June 30
	Balance at April 1	Warranties issued	Settlements made	
2008	\$ 1,133	\$ 218	\$ (227)	\$ 1,124
2007	\$ 1,006	\$ 176	\$ (223)	\$ 959

	Nine months ended June 30,			Balance at June 30
	Balance at October 1	Warranties issued (1)	Settlements made	
2008	\$ 1,155	\$ 576	\$ (607)	\$ 1,124
2007	\$ 1,104	\$ 485	\$ (630)	\$ 959

(1) Warranties issued include a decrease in estimate adjustment of \$132,000 in the first quarter of fiscal 2007.

We are not responsible and do not warrant that custom software versions created by original equipment manufacturer (OEM) customers based upon our software source code will function in a particular way, will conform to any specifications or are fit for any particular purpose and do 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.

9. CONTINGENCIES*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 our subsidiary NetSilicon, Inc. and approximately 300 other public companies. The complaint names us as defendants along with 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. We believe that the claims against the NetSilicon defendants are without merit and have 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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. CONTINGENCIES (CONTINUED)

In June 2003, we elected to participate in a proposed settlement agreement with the plaintiffs in this litigation. Had it been approved by the Court, this proposed settlement would have resulted in a dismissal, with prejudice, of all claims in the litigation against us and against any of the other issuer defendants who elected to participate in the proposed settlement, together with the current or former officers and directors of participating issuers who were named as individual defendants. This proposed settlement was conditioned on, among other things, a ruling by the District Court that the claims against NetSilicon and against the other issuers who had agreed to the settlement would be certified for class action treatment for purposes of the proposed settlement, such that all investors included in the proposed classes in these cases would be bound by the terms of the settlement unless an investor opted to be excluded from the settlement in a timely and appropriate fashion.

On December 5, 2006, the U.S. Court of Appeals for the Second Circuit issued a decision in In re Initial Public Offering Securities Litigation that six purported class action lawsuits containing allegations substantially similar to those asserted against us could not be certified as class actions due, in part, to the Court of Appeals' determination that individual issues of reliance and knowledge would predominate over issues common to the proposed classes. On January 8, 2007, the plaintiffs filed a petition seeking rehearing en banc of this ruling. On April 6, 2007 the Court of Appeals denied the plaintiffs' petition for rehearing of the Court's December 5, 2006 ruling. The Court of Appeals, however, noted that the plaintiffs remained free to ask the District Court to certify classes different from the ones originally proposed which might meet the standards for class certification that the Court of Appeals articulated in its December 5, 2006 decision. The plaintiffs have since moved for certification of different classes in the District Court, and that motion remains pending.

In light of the Court of Appeals' December 5, 2006 decision regarding certification of the plaintiffs' claims, the District Court entered an order on June 25, 2007 terminating the proposed settlement between the plaintiffs and the issuers, including NetSilicon. Because any possible future settlement with the plaintiffs, if a settlement were ever to be negotiated and ultimately agreed to, would involve the certification of a class action for settlement purposes, the impact of the Court of Appeals' rulings on the possible future settlement of the claims against NetSilicon is uncertain.

On August 14, 2007, the plaintiffs filed amended complaints in the six focus cases. The issuer defendants and the underwriter defendants separately moved to dismiss the claims against them in the amended complaints in the six focus cases. On March 26, 2008, the District Court issued an order in which it denied in substantial part the motions to dismiss the amended complaints in the six focus cases. In addition, on October 1, 2007, the plaintiffs submitted their briefing in support of their motions to certify different classes in the six focus cases. The issuer defendants and the underwriter defendants filed separate oppositions to those motions on December 21, 2007. The motions to certify classes in the six focus cases remain pending.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. CONTINGENCIES (CONTINUED)

We intend to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of this pending lawsuit. We maintain liability insurance for such matters and expect 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 June 30, 2008, we have accrued a liability for the deductible amount of \$250,000 which we believe reflects the amount of loss that is probable. In the event we have losses that exceed the limits of the liability insurance, such losses could have a material effect on our business and our consolidated results of operations or financial condition.

In addition to the matter discussed above, in the normal course of business, we are subject to various claims and litigation, including patent infringement and intellectual property claims. Our management expects that these various claims and litigation will not have a material adverse effect on our consolidated results of operations or financial condition.

10. SALE AND LEASEBACK OF BUILDING

On February 18, 2008, we entered into a contract for the sale of our building in Dortmund, Germany, and subsequent partial leaseback for a five year term (the "Agreement"). Upon the closing of the transaction in March 2008, we initiated the leaseback of approximately 40% of the property for a period of five years, with a renewal option for an additional five years.

The building was sold for 4.5 million Euros (equivalent to \$6.9 million), resulting in a gain on the sale of 1.0 million Euros (\$1.6 million). As a result of the leaseback, \$1.5 million of the gain on the sale was deferred and is being recognized ratably over the lease term as an offset to rent expense. The remaining \$0.1 million was recognized in the second quarter of fiscal 2008 as a component of general and administrative expense. Of the total sale price, 4.2 million Euros (\$6.5 million) was received during March 2008 and the remaining 0.3 million Euros (\$0.4 million) was received in April 2008. We were required, as part of the Agreement, to deposit 0.3 million Euros (\$0.4 million) into an interest-bearing bank account, which will be refunded to us at the end of the lease term. This deposit was made during March 2008 and is included in other noncurrent assets as restricted cash on our consolidated balance sheet as of June 30, 2008.

11. SHORT-TERM LOAN

On April 22, 2008, we entered into a short-term loan agreement with Wells Fargo Bank, N.A. in the amount of \$25.0 million. This short-term loan was used to finance the Sarian acquisition (see Note 4). Interest was based on a one-month fixed LIBOR rate at the first day of the loan plus 0.30% until May 23, 2008, at which time the rate was changed to a daily LIBOR rate plus 0.30% and ranged between 2.41% and 3.20% from the date of the loan through May 29, 2008. Per the terms of the agreement, payment of the outstanding balance was due November 30, 2008; however, we had the option to prepay without penalty. In May 2008, we repaid the entire \$25.0 million utilizing the proceeds from the sales of our marketable securities upon maturity.

12. SUBSEQUENT EVENTS

On July 23, 2008, we acquired Spectrum Design Solutions, Inc. ("Spectrum") as a wholly owned subsidiary of Digi International Inc. Prior to the acquisition, Spectrum was a privately held Minneapolis-based corporation and a leading wireless design services organization. The acquisition was a cash merger for approximately \$10.0 million of which \$4.0 million was paid on the acquisition date, \$3.0 million will be paid in January 2010, and the remaining \$3.0 million will be paid in July 2011.

As part of the previously announced stock repurchase program authorized by our Board of Directors, we announced, on July 23, 2008, the authorization of an additional 500,000 shares of common stock for repurchase. The total number of shares authorized for repurchase is now 1,500,000 shares.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Form 10-Q 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 our management as of the time of such statements and relate to, among other things, expectations of the business environment in which we operate, projections of our future performance, perceived opportunities in the market and statements regarding our mission and vision. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Our operating results and performance trends may be affected by a number of factors, including, without limitation, those described under Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended September 30, 2007. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in our filings with the Securities and Exchange Commission, including without limitation, our quarterly reports on Form 10-Q and our registration statements, could cause our actual future results to differ from those projected in the forward-looking statements as a result of the factors set forth in our 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.

CRITICAL ACCOUNTING POLICIES

A description of our critical accounting policies was provided in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended September 30, 2007. An update to our critical accounting policy related to goodwill is included below.

We performed our annual goodwill impairment assessment in the third quarter of fiscal 2008. Based on our analysis, we conclude that the fair value of our reporting unit exceeds the carrying amount and therefore goodwill is not considered impaired. When the assessment was performed, our market capitalization, which is an indicator of fair value, was below the carrying value of our reporting unit due to significant declines in our stock price during the year. However, an estimated control premium was also used in our determination of fair value. The control premium represents the amount an investor would pay, over and above market capitalization, in order to obtain a controlling interest in a company. Therefore, the fair value of our reporting unit was measured using our market capitalization as of June 30, 2008, plus a control premium. The estimated control premium was determined by a review of premiums paid for similar companies over the past five years. The control premium used in our determination of fair value is subject to management judgment, including the interpretation of current economic indicators and market valuations as well as our strategic plans with regard to our operations. To the extent additional information arises or our strategies change, it is possible that our conclusion regarding goodwill impairment could change, which could have a material effect on our financial position and results of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

OVERVIEW

We operate 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. 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.

We help customers connect, monitor, and control local or remote electronic devices over a network or via the Internet. We continue to leverage a common core technology base to develop and provide innovative connectivity solutions to our customers. Our Drop-In Networking solutions initiative, which is based on our wireless solutions, provides end-to-end wireless connectivity to electronic devices in locations where wires do not work or cannot be used. This initiative provides opportunities for connecting devices and machines. Incorporating products from both our embedded and non-embedded categories, including modules, wireless communications adapters, cellular routers, gateways, sensors, and network management software, as well as other design services, Drop-in Networking holds the potential to economically extend network connectivity to millions of new devices.

We anticipate that growth in the future will result from both products and services that are developed internally as well as from products and services that are acquired.

- Net sales of \$47.0 million for the three months ended June 30, 2008 represented an increase of \$3.5 million, or 8.0%, compared to net sales of \$43.5 million for the three months ended June 30, 2007. Sarian Systems, Ltd. ("Sarian"), which was acquired on April 28, 2008, provided \$2.4 million of revenue from Sarian-branded products for the three months ended June 30, 2008. Revenue in North America was \$26.1 million in the third fiscal quarter of 2008 compared to \$27.9 million in the same period a year ago, a decrease of \$1.8 million, or 6.6%, primarily due to the slowing of the U.S. economy and a decrease in revenue from certain key customers. International revenue was \$20.9 million in the third fiscal quarter of 2008 compared to \$15.6 million in the third fiscal quarter of 2007, an increase of \$5.3 million, or 34.1%, of which \$2.4 million was from revenue from Sarian-branded products.
- Gross profit margin increased to 52.9% for the three months ended June 30, 2008 as compared to 52.8% for the three months ended June 30, 2007. Gross profit margin increased to 53.4% for the nine months ended June 30, 2008 as compared to 52.7% for the nine months ended June 30, 2007. The increase in gross profit margin for both the three and nine months ended June 30, 2008 was primarily due to reduced amortization of purchased and core technology due to certain technologies becoming fully amortized and favorable product mix changes within both the embedded and non-embedded product groups, offset by a decrease due to Sarian-branded products which provide lower gross profit margins than our other product lines.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

OVERVIEW (CONTINUED)

- Total operating expenses for the three months ended June 30, 2008 were \$21.9 million, or 46.5% of net sales, compared to \$17.9 million, or 41.1% of net sales, for the three months ended June 31, 2007, an increase of \$4.0 million. Total operating expenses for the nine months ended June 30, 2008 were \$60.7 million, or 45.1% of net sales, compared to \$53.4 million, or 41.7% of net sales, for the nine months ended June 30, 2007, an increase of \$7.3 million. Operating expenses increased by 22.2% and 13.6% for the three months and nine months ended June 30, 2008, respectively, compared to the same periods in 2007 due mostly to a charge of \$2.1 million for in-process research and development and other acquisition-related expenses, as well as incremental ongoing operating expenses for Sarian from the date of acquisition of \$0.6 million both of which were incurred during the three month period ended June 30, 2008. In addition, operating expenses increased as a result of our Drop-In Networking initiative.
- Net income decreased \$4.8 million to \$2.0 million, or \$0.08 per diluted share, for the three months ended June 30, 2008, compared to \$6.8 million, or \$0.26 per diluted share, for the three months ended June 30, 2007. Net income decreased \$5.4 million to \$8.8 million, or \$0.33 per diluted share, for the nine months ended June 30, 2008, compared to \$14.2 million, or \$0.55 per diluted share, for the nine months ended June 30, 2007.
- Our net working capital position (total current assets less total current liabilities) decreased \$7.8 million to \$107.9 million during the nine months ended June 30, 2008 and our current ratio was 6.1 to 1 as of that date. Cash and cash equivalents and short-term marketable securities decreased \$15.9 million to \$69.6 million during the nine month period which includes payments of \$27.8 million, net of cash acquired of \$3.1 million, for the acquisition of Sarian, offset by 4.5 million Euros (\$6.9 million) received from the building sale in Dortmund, Germany. At June 30, 2008, we had no debt other than capital lease obligations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from our interim condensed consolidated statements of operations expressed in dollars, as a percentage of net sales and as a percentage of change from period-to-period for the periods indicated (dollars in thousands):

	Three months ended June 30,				% increase (decrease)	Nine months ended June 30,				% increase (decrease)
	2008		2007			2008		2007		
Net sales	\$46,995	100.0%	\$43,527	100.0%	8.0%	\$134,639	100.0%	\$128,193	100.0%	5.0%
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	21,200	45.1	19,392	44.6	9.3	59,729	44.4	57,257	44.7	4.3
Amortization of purchased and core technology	938	2.0	1,132	2.6	(17.1)	2,981	2.2	3,409	2.6	(12.6)
Gross profit	24,857	52.9	23,003	52.8	8.1	71,929	53.4	67,527	52.7	6.5
Operating expenses:										
Sales and marketing	9,493	20.2	8,517	19.6	11.5	27,213	20.2	25,102	19.6	8.4
Research and development	6,995	14.9	6,039	13.8	15.8	20,113	15.0	18,079	14.1	11.3
General and administrative	3,484	7.4	3,349	7.7	4.0	11,466	8.5	10,229	8.0	12.1
Acquired in-process research and development	1,900	4.0	—	0.0	N/A	1,900	1.4	—	0.0	N/A
Total operating expenses	21,872	46.5	17,905	41.1	22.2	60,692	45.1	53,410	41.7	13.6
Operating income	2,985	6.4	5,098	11.7	(41.4)	11,237	8.3	14,117	11.0	(20.4)
Interest income and other, net	712	1.5	855	2.0	(16.7)	2,760	2.1	2,385	1.9	15.7
Income before income taxes	3,697	7.9	5,953	13.7	(37.9)	13,997	10.4	16,502	12.9	(15.2)
Income tax provision (benefit)	1,712	3.6	(845)	(1.9)	(302.6)	5,245	3.9	2,305	1.8	127.5
Net income	\$ 1,985	4.2%	\$ 6,798	15.6%	(70.8)%	\$ 8,752	6.5%	\$ 14,197	11.1%	(38.4)%

NET SALES

The following summarizes our net sales for the periods indicated:

(\$ in thousands)	Three months ended June 30,				% increase (decrease)	Nine months ended June 30,				% increase (decrease)
	2008		2007			2008		2007		
Non-embedded	\$26,325	56.0%	\$24,750	56.9%	6.4%	\$ 71,540	53.1%	\$ 74,361	58.0%	(3.8)%
Embedded	20,670	44.0	18,777	43.1	10.1	63,099	46.9	53,832	42.0	17.2
Total net sales	\$46,995	100.0%	\$43,527	100.0%	8.0%	\$134,639	100.0%	\$128,193	100.0%	5.0%

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NET SALES (CONTINUED)

Revenue from non-embedded products includes all Sarian-branded revenue of \$2.4 million for the three months ended June 30, 2008 from the date of acquisition. Net sales of non-embedded products for the three months ended June 30, 2008 as compared to the same period in the prior year resulted in an increase of 6.4%, primarily from Sarian products, offset by decreases of net sales of serial cards, serial server, and USB products. The decrease in net sales in the non-embedded products for the nine months ended June 30, 2008 as compared to the same periods in the prior year resulted primarily from decreased net sales of serial cards, serial server, USB and cellular products. The decreases are primarily a result of the slowing of the U.S. economy. The decline in net sales of non-embedded products was a result of declines in the North American region and was partially offset by increases in international net sales.

Net sales of most of the embedded products increased in the three and nine months ended June 30, 2008 compared to the comparable prior periods. Most of the increase in our embedded net sales took place in Europe, Middle East and Africa ("EMEA") and Asia Pacific. While embedded net sales increased slightly in the North American region, we believe the slowing of the U.S. economy, particularly in the second and third quarters of fiscal 2008, negatively impacted the growth.

The following summarizes our net sales by geographic region:

(\$ in thousands)	Three months ended June 30,		\$ increase (decrease)	% increase (decrease)	Nine months ended June 30,		\$ increase (decrease)	% increase (decrease)
	2008	2007			2008	2007		
North America	\$ 26,131	\$ 27,968	\$ (1,837)	(6.6)%	\$ 78,214	\$ 83,541	\$ (5,327)	(6.4)%
EMEA	14,503	10,657	3,846	36.1	38,432	30,555	7,877	25.8
Asia Pacific	5,075	3,817	1,258	33.0	14,225	11,031	3,194	29.0
Latin America	1,286	1,085	201	18.5	3,768	3,066	702	22.9
Total net sales	\$ 46,995	\$ 43,527	\$ 3,468	8.0%	\$ 134,639	\$ 128,193	\$ 6,446	5.0%

Fluctuation in foreign currency rates, primarily the Euro, for the three and nine month periods ended June 30, 2008 compared to the same periods in the prior year had a favorable impact on net sales of \$0.8 million and \$2.2 million, respectively.

GROSS PROFIT

Gross profit for the three and nine months ended June 30, 2008 was \$24.9 million, or 52.9%, and \$71.9 million, or 53.4%, respectively, compared to \$23.0 million, or 52.8%, and \$67.5 million, or 52.7%, for the three and nine months ended June 30, 2007, respectively. Gross profit margin increased by 0.1% and 0.7% for the three and nine months ended June 30, 2008 as compared to the same periods in the prior year. The increase in gross profit margin for both the three and nine months ended June 30, 2008 was primarily due to reduced amortization of purchased and core technology due to certain technologies becoming fully amortized and favorable product mix changes within both the embedded and non-embedded product groups, offset by a decrease due to Sarian-branded products which provide lower gross profit margins than our other product lines.

We anticipate that our gross profit margins for the remainder of the fiscal year will be in a range of 52 to 54 percent which includes estimated amortization of purchased and core technology of approximately two percentage points.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)
OPERATING EXPENSES

(\$ in thousands)	Three months ended June 30,		\$ increase (decrease)	Nine months ended June 30,		\$ increase (decrease)				
	2008	2007		2008	2007					
Operating expenses:										
Sales and marketing	\$ 9,493	20.2%	\$ 8,517	19.6%	\$ 976	\$27,213	20.2%	\$25,102	19.6%	\$ 2,111
Research and development	6,995	14.9	6,039	13.8	956	20,113	15.0	18,079	14.1	2,034
General and administrative	3,484	7.4	3,349	7.7	135	11,466	8.5	10,229	8.0	1,237
Acquired in-process research and development	1,900	4.0	—	0.0	1,900	1,900	1.4	—	0.0	1,900
Total operating expenses	<u>\$21,872</u>	<u>46.5%</u>	<u>\$17,905</u>	<u>41.1%</u>	<u>\$ 3,967</u>	<u>\$60,692</u>	<u>45.1%</u>	<u>\$53,410</u>	<u>41.7%</u>	<u>\$ 7,282</u>

The net increase of \$1.0 million in sales and marketing expenses for the three months ended June 30, 2008, as compared to June 30, 2007, was primarily due to \$0.4 million of incremental ongoing expenses of Sarian, an increase of \$0.3 million for compensation-related expenses and \$0.2 million for additional ad placement costs and commissions. For the nine months ended June 30, 2008 compared to June 30, 2007, the net increase in expenses was \$2.1 million due primarily to \$0.4 million of incremental ongoing expenses of Sarian, an increase of \$1.0 million of compensation-related expenses due to increased headcount primarily related to the Drop-In Networking initiative and \$0.4 million of additional ad placement and marketing literature expenses.

The net increase of \$1.0 million in research and development expenses for the three months ended June 30, 2008 compared to June 30, 2007 was due primarily to \$0.4 million of various development projects, a net increase of \$0.2 million for compensation-related expenses and \$0.3 million of outside service expense primarily for certification of wireless products including Sarian products. Research and development expenses for the nine months ended June 30, 2008 increased \$2.0 million compared to the same period a year ago due primarily to an increase of \$1.0 million in compensation-related expenses primarily for the Drop-In Networking initiative, \$0.5 million in outside service expense primarily for certification of wireless products including Sarian products and \$0.2 million for various development projects.

The net increase in general and administrative expenses of \$0.1 million for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 is primarily due to \$0.3 million of incremental ongoing expenses of Sarian, offset by a \$0.3 million reduction in amortization expenses as certain intangible assets became fully amortized. For the nine months ended June 30, 2008 compared to June 30, 2007, the net increase in general and administrative expenses of \$1.2 million was due primarily to \$0.3 million of incremental ongoing expenses of Sarian, an increase in compensation-related expenses of \$0.7 million and increased professional fees and outside services of \$0.5 million, offset by a reduction in amortization expense of \$0.3 million and \$0.1 million recognized gain on the sale of the Dortmund Building (see Note 10 to the Consolidated Financial Statements).

Fluctuation in foreign currency rates, primarily the Euro, for the three and nine month periods ended June 30, 2008 compared to the same periods in the prior year had an unfavorable impact on operating expenses of \$0.6 million and \$1.3 million, respectively.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**INTEREST INCOME AND OTHER, NET**

Interest income and other, net was \$0.7 million and \$2.8 million for the three and nine months ended June 30, 2008 compared to \$0.9 million and \$2.4 million for the three and nine months ended June 30, 2007, respectively. We realized interest income on marketable securities and cash and cash equivalents of \$0.8 million and \$2.9 million for the three and nine month periods ended June 30, 2008 and \$0.9 million and \$2.4 million for the three and nine month periods ended June 30, 2007, respectively, due to an increase in the average invested balance. We earned an average interest rate of 4.2% and 4.6% for the three and nine months ended June 30, 2008, respectively, compared to 5.1% for both the three and nine months ended June 30, 2007. The average invested balance for the three and nine months ended June 30, 2008 was \$72.6 million and \$80.6 million, respectively, and for the three and nine months ended June 30, 2007 was \$70.4 million and \$62.6 million, respectively.

INCOME TAXES

Income taxes have been provided for at an effective rate of 46.3% and 37.5% for the three and nine month periods ended June 30, 2008, respectively, compared to an effective rate of (14.2%) and 14.0% for the three and nine month periods ended June 30, 2007, respectively.

Income tax expense for the third quarter of fiscal 2008 includes a net discrete tax benefit of \$0.2 million resulting from a reversal of previously established tax reserves associated with the closing of a tax year. In the third quarter of fiscal 2007, we recorded discrete tax benefits of \$2.9 million, of which \$2.3 million resulted from the reversal of previously established income tax reserves that were no longer required as a result of the closing of a domestic tax return. In addition, we completed a foreign tax audit in the third quarter of 2007 and reversed \$0.6 million in income tax reserves that had been previously established and were no longer required.

During the first quarter of 2007, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, we recorded a discrete income tax benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006.

The \$1.9 million charge that was recorded in the third quarter of fiscal 2008 for in-process research and development was non-deductible. This non-deductible charge, along with the above discrete tax events, affected our effective tax rates as shown in the table below:

	<u>Three months ended June 30,</u>		<u>Nine months ended June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Effective tax rate before impact of discrete tax events & non-deductible in-process research and development	37.3%	35.0%	35.1%	36.1%
Impact of non-deductible in-process research and development charge	14.4%	0.0%	3.8%	0.0%
Impact of discrete tax events	-5.4%	-49.2%	-1.4%	-22.1%
Effective tax rate	<u>46.3%</u>	<u>-14.2%</u>	<u>37.5%</u>	<u>14.0%</u>

The effective tax rate before the impact of discrete tax events and non-deductible in-process research and development charge for the nine months ended June 30, 2008 and 2007 was approximately equal to the U.S. statutory rate of 35%.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**INCOME TAXES (CONTINUED)**

We expect our annualized 2008 income tax rate to be approximately 37% — 39%, which includes the impact, for tax purposes, of the non-deductible in-process research and development expenses of approximately \$1.9 million related to the acquisition of Sarian.

Effective October 1, 2007, we adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109" ("FIN 48"). We further discuss the adoption of FIN 48 in Note 7 to our consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally with funds generated from operations. At June 30, 2008, we had cash, cash equivalents and short-term marketable securities of \$69.6 million, compared to \$85.5 million at September 30, 2007, a decrease of \$15.9 million. Our working capital (total current assets less total current liabilities) decreased \$7.8 million to \$107.9 million at June 30, 2008 compared to \$115.7 million at September 30, 2007.

Consolidated Statement of Cash Flow Highlights (in thousands)

	Nine months ended June 30,		
	2008	2007	Change
Operating activities	\$ 15,027	\$ 18,675	\$ (3,648)
Investing activities	(16,776)	(3,784)	(12,992)
Financing activities	2,365	3,415	(1,050)
Effect of exchange rate changes on cash and cash equivalents	(2,240)	88	(2,328)
Net (decrease) increase in cash and cash equivalents	\$ (1,624)	\$ 18,394	\$ (20,018)

Reconciliation of Net Income to Cash Inflows (Outflows) from Operating Activities (in thousands)

	Nine months ended June 30,		
	2008	2007	Change
Net income	\$ 8,752	\$ 14,197	\$ (5,445)
Deferred income taxes	(2,696)	(1,612)	(1,084)
Depreciation and amortization	6,927	7,647	(720)
Stock-based compensation	2,702	2,258	444
Excess tax benefits from stock-based compensation	(177)	(315)	138
Gain on sale of property, equipment and improvements	(94)	—	(94)
Acquired in-process research and development	1,900	—	1,900
Other reconciling items	222	18	204
Net income adjusted for non-cash expenses	17,536	22,193	(4,657)
Changes in working capital, excluding impact of acquisition	(2,509)	(3,518)	1,009
Cash flows provided by operating activities	\$ 15,027	\$ 18,675	\$ (3,648)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

Net cash provided by operating activities was \$15.0 million and \$18.7 million for the nine months ended June 30, 2008 and 2007, respectively, resulting in a net cash decrease of \$3.7 million. This net decrease is primarily due to a decrease of \$5.4 million of net income, offset by net increases in non-cash expenses of \$0.7 million as described in the table above. In addition, net cash increased by \$1.0 million due to a change in working capital for the comparable nine month periods ended June 30, 2008 and 2007, primarily due to a net increase due to inventory of \$2.6 million and a net increase of \$0.7 million related to accounts payable due to timing of material receipts and the related supplier payments. This was offset by a net increase in accounts receivable balances of \$1.8 million as of June 30, 2008 compared to the prior comparable period due to a slowdown in customer payments and a net decrease of \$0.5 million related to increased inventory balances at June 30, 2008.

Net cash used in investing activities was \$16.8 million and \$3.8 million during the nine months ended June 30, 2008 and 2007 resulting in a \$13.0 million decrease in cash flow. The decrease is primarily due to the acquisition of Sarian for \$27.8 million (purchase price of \$30.9 million, net of cash acquired of \$3.1 million), \$0.4 million related to the deposit for the Dortmund building leaseback, a net reduction of \$0.5 million of contingent purchase price payments related to the FS Forth acquisition and additional purchases of \$0.2 million of property, equipment, improvements and certain other intangible assets. This was offset by \$6.9 million proceeds from the sale-leaseback of our building in Dortmund, Germany (see Note 10 to the Consolidated Financial Statements) and \$9.0 million increase in sales of marketable securities, net of purchases. We anticipate total fiscal 2008 capital expenditures to approximate \$3.5 million.

Net cash provided by financing activities was \$2.4 million and \$3.4 million during the nine months ended June 30, 2008 and 2007 resulting in a \$1.0 million decrease in cash flow, primarily as a result of proceeds from stock option and employee stock purchase plan transactions in both periods, and the reflection of cash provided by the excess tax benefits related to the exercise of stock options.

Management believes that current financial resources, cash generated from operations and our potential capacity for additional debt and/or equity financing will be sufficient to fund operations for at least the next twelve months. During the third quarter of fiscal 2008, we entered into a \$25.0 million short-term loan of which the full \$25.0 million was repaid during the same quarter (see Note 11 to the Condensed Consolidated Financial Statements). We determined that it was more economical to borrow funds to finance the Sarian acquisition than to liquidate marketable securities prior to their scheduled maturities.

In conjunction with our adoption of FIN 48, we reclassified the portion of our unrecognized tax benefits that we do not expect to pay in cash over the next 12 months from a short-term liability to a long-term liability. All of our liabilities for unrecognized tax benefits are recorded as a long-term liability as we do not expect significant payments to occur over the next 12 months. Further information concerning the adoption of FIN 48 is included in Note 7 to our Condensed Consolidated Financial Statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position Emerging Issues Task Force 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in FASB Statement No. 128, "Earnings Per Share." This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and will be applied retrospectively. We do not expect the adoption of FSP EITF 03-6-1 to have a material impact on our consolidated financial statements.

In May 2008, the FASB issued FASB Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 is effective 60 days following approval by the SEC of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." We do not expect the adoption of SFAS 162 to have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP SFAS 142-3"). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). FSP SFAS 142-3 intends to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flow used to measure the fair value of the asset under SFAS No. 141 (Revised 2007), "Business Combinations" and other accounting principles generally accepted in the United States. This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the impact of FSP SFAS 142-3 on our consolidated financial statements.

In December 2007, the FASB issued FASB Statement No. 141(R), "Business Combinations" ("SFAS 141(R)"). This Statement retained the fundamental requirements in the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defined the acquirer as the entity that obtains control of one or more businesses in the business combination and established the acquisition date as the date that the acquirer achieves control. The new standard requires the acquiring entity in a business combination to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This Statement also makes certain other modifications to the former Statement. SFAS 141(R) is effective for business combinations that are consummated in our fiscal years beginning October 1, 2009. Early adoption is not permitted. SFAS 141(R) is expected to have a material impact on how we will identify, negotiate, and value future acquisitions and how such acquisitions will affect our consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In February 2007, the FASB issued FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS 159"). This Statement provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company that adopts SFAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement is effective for fiscal years beginning after November 15, 2007, which for us is our fiscal years beginning October 1, 2008. We do not expect SFAS 159 to have a material impact on our consolidated financial statements, if we decide to adopt.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 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. In February 2008, the FASB issued FASB Staff Position No. 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13" ("FSP 157-1") and FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-1 amends SFAS 157 to exclude various accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13, with the exception of assets or liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141 or SFAS 141(R). FSP 157-1 is effective upon the adoption of FAS 157. FSP 157-2 defers the effective date of FAS 157 for our fiscal years beginning October 1, 2009 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The provisions of FAS 157 are effective for our fiscal years beginning October 1, 2008 for financial assets and financial liabilities. We are currently evaluating the impact of the provisions of FAS 157, FSP 157-1 and FSP 157-2 on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Our marketable securities are classified as held-to-maturity and are carried at amortized cost. Marketable securities consist of high-grade commercial paper and corporate bonds. Our credit policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. Our portfolio contains no auction rate securities. We intend to hold all marketable securities currently in our portfolio to maturity and we believe that realization of any unrealized holding losses is not likely at this time and is therefore not recorded. We do not use derivative financial instruments to hedge against interest rate risk as all investments are held to maturity and the majority of our investments mature in less than a year. A change in interest rates would not have a material effect on our consolidated financial statements.

FOREIGN CURRENCY RISK

We have transactions that are executed in the U.S. Dollar, British Pound, Euro or Japanese Yen. As a result, we are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros, British Pounds or Japanese Yen, and foreign currency translation risk as the financial position and operating results of our foreign subsidiaries are translated into U.S. Dollars for consolidation. We have not implemented a hedging strategy to reduce foreign currency risk.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

FOREIGN CURRENCY RISK (CONTINUED)

For the nine months ended June 30, 2008 and 2007, we had approximately \$55.4 million and \$44.6 million, respectively, of net sales to foreign customers including export sales, of which \$32.3 million and \$22.3 million, respectively, were denominated in foreign currency, predominantly Euros. In future periods, a significant portion of sales will continue to be made in Euros.

As of June 30, 2008, we had intercompany loans totaling \$27.9 million denominated in U.S. Dollars with Digi International Ltd. for the acquisition of Sarian. As these intercompany loans are not considered to be a long-term investment and are expected to be repaid by Digi International Ltd., we are exposed to foreign currency translation gains and losses.

The average monthly exchange rate for the Euro to the U.S. Dollar increased approximately 14.2% from 1.3160 to 1.5024, the average monthly exchange rate for the British Pound to the U.S. Dollar increased approximately 2.3% from 1.9517 to 1.9984 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar increased approximately 10.9% from 0.0084 to 0.0093 for the first nine months of fiscal year 2008 as compared to the same period one year ago. A 10% change from the first nine months of fiscal 2008 average exchange rate for the Euro, British Pound and Yen to the U.S. Dollar would have resulted in a 1.6% increase or decrease in net sales and a 2.3% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments we need to consider in response to changes in the exchange rate.

CREDIT RISK

We have some exposure to credit risk related to our 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 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our 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 our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. We have completed the implementation of an upgrade to our systems for financial reporting and operations. We do not currently believe that this implementation will adversely affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The disclosures set forth in Note 9 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors provided in Part I, Item 1A of our 2007 Annual Report on Form 10-K as filed with the SEC on December 6, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (1)
3(a)	Restated Certificate of Incorporation of the Company, as amended (2)
3(b)	Amended and Restated By-Laws of the Company
4(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (3)
4(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (4)
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

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- (1) Incorporated by reference to Exhibit 2(a) to the Company's Form 10-Q for the quarter ended March 31, 2008 (File No. 1-34033)
- (2) 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)
- (3) Incorporated by reference to Exhibit 4(a) to the Company's Registration Statement on Form 8-A filed on April 25, 2008 (File No. 1-34033)
- (4) Incorporated by reference to Exhibit 4(b) to the Company's Registration Statement on Form 8-A filed on April 25, 2008 (File No. 1-34033)

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SIGNATURE

Pursuant to the requirements 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.

Date: August 7, 2008

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

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EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Document Description</u>	<u>Form of Filing</u>
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request)	Incorporated by Reference
3(a)	Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1993 (File No. 0-17972))	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Company	Filed Electronically
4(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent	Incorporated by Reference
4(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares	Incorporated by Reference
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

BY-LAWS OF
DIGI INTERNATIONAL INC.
AS AMENDED AND RESTATED AS OF JULY 22, 2008

I. OFFICES

Section 1.01. Registered Office. The Corporation shall maintain a registered office and registered agent within the State of Delaware at such place within such State as may be designated from time to time by the Board of Directors of the Corporation.

Section 1.02. Other Offices. The Corporation also may have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine.

II. STOCKHOLDERS

Section 2.01. Place of Meetings. Meetings of stockholders may be held at the principal executive offices of the Corporation or at such other place, either within or without the State of Delaware, as may be designated by the Board of Directors or the chief executive officer of the Corporation.

Section 2.02. Annual Meetings and Advance-Notice of Business, Other Than Director Nominations and Elections. An annual meeting of stockholders shall be held in each calendar year for the election of directors on such date and at such time as shall be designated from time to time by the Board of Directors.

(a) Timing of Notice. Any proper business other than the nomination and election of directors may be transacted at the annual meeting, provided that such business is specified in the notice of meeting (or a supplement thereto) given by or at the direction of the Board of Directors, or brought before the meeting after written notice of a stockholder delivered to, or mailed to and received at, the principal executive offices of the Corporation not less than sixty (60) days prior to the date fixed for the annual meeting; provided, however, that in the event that less than seventy-five (75) days' prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder to be timely must be received not later than the close of business on the fifteenth (15th) day following the day on which such public disclosure was made.

(b) Content of Notice. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting; (ii) the name and record address of the stockholder proposing such business; (iii) a description of all securities or contracts, with a value derived in whole or in part from the value of any shares of the Corporation, held by or to which the stockholder is a party; (iv) any material interest of the stockholder and beneficial owner, if any, in such business, and any agreements the stockholder has with other entities in connection with such business; and (v) a representation that the stockholder will appear at the meeting to make the proposal.

(c) Consequences of Failure to Give Timely Notice. Notwithstanding anything in these By-Laws to the contrary, no business (other than the nomination and election of directors) shall be conducted at any annual or special meeting except in accordance with the procedures set forth in this paragraph. The presiding Officer of the meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the provisions of this paragraph and, if the presiding Officer should so determine, the presiding Officer shall so declare to the meeting, and any such business not properly brought before the meeting shall not be transacted.

Section 2.03. Special Meetings. Unless otherwise specifically provided by law or the Certificate of Incorporation, a special meeting of stockholders, for any purpose or purposes, may be called only by the Chairman or the President and shall be called by either such officer upon the written request of a majority of the Board of Directors or by a committee of the Board of Directors which has been duly designated by the Board of Directors, and whose powers and authority, as expressly provided in a resolution of the Board of Directors, include the power to call such meetings. Such request shall state the purpose or purposes of the proposed meeting. If the authorized officers fail to cause such meeting to be called within thirty (30) days after receipt of such request and held within ninety (90) days after receipt of such request, the directors making the request may call the meeting by giving notice as provided in these By-Laws at the expense of the Corporation. Business transacted at any special meeting shall be limited to the purposes stated in the notice of the meeting.

Section 2.04. Notice of Meetings. A written notice stating the place, date and hour of the meeting and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be personally delivered or mailed, postage prepaid, not less than ten (10) nor more than sixty (60) days before the date of such meeting to each stockholder of record of the Corporation entitled to vote at such meeting at the stockholder's mailing address shown upon the records of the Corporation. Service of notice is complete upon mailing.

Section 2.05. Waiver of Notice. Notice of any annual or special meeting of stockholders may be waived either before, at or after such meeting in a writing signed by the person or persons entitled to the notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transacting of any business because the meeting is not lawfully called or convened.

Section 2.06. Quorum. At each meeting of stockholders, except where otherwise provided by law or the Certificate of Incorporation or these By-Laws, the holders of a majority of the outstanding capital stock entitled to vote at the meeting, present in person or represented by proxy, shall constitute a quorum. If a quorum is once present at the meeting, the stockholders may continue to transact business until adjournment notwithstanding the withdrawal of enough stockholders to leave less than a quorum.

Section 2.07. Adjourned Meetings. The stockholders present, though less than a quorum, may, by majority vote, adjourn the meeting from time to time to a later day or hour or to another place. If the adjournment is for more than thirty (30) days, or if after adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting. Otherwise, notice of any adjourned meeting need not be given if the time and place thereof are announced at the meeting at which the adjournment is taken. At an adjourned meeting at which a quorum is present or represented by proxy, any business may be transacted which might have been transacted at the meeting as originally convened.

Section 2.08. Voting. Unless otherwise provided in the Certificate of Incorporation, each stockholder entitled to vote at any meeting of stockholders shall have one vote for each share of stock having voting power upon the matter in question which is held by such stockholder and registered in the stockholder's name on the books of the Corporation as of the applicable record date. All elections of directors shall be conducted by written ballot, unless the Certificate of Incorporation otherwise provides. The vote upon any other question before a meeting need not be by written ballot, and need not be conducted by inspectors, unless otherwise determined by the Board of Directors or the officer presiding at the meeting. At all meetings of stockholders for the election of directors a plurality of the votes cast shall be sufficient to elect such directors. All other elections and questions at a meeting shall be decided by a majority vote of the number of shares entitled to vote represented at the meeting at the time of the vote except where otherwise required by statute, the Certificate of Incorporation or these By-Laws.

Section 2.09. Proxies. Each stockholder entitled to vote at a meeting of stockholders may authorize another person or persons to act for him or her by proxy in any manner, including without limitation via telephone, Internet or such other manner as permitted by Section 212 of the Delaware General Corporation Law, as amended from time to time, provided that such authorization sets forth or contains information from which the Corporation can determine that the authorization was granted by the stockholder. If the authorization is granted in a manner other than in a written form, the proxy holder shall provide such reasonable verification as required by the Corporation. If any such authorization designates two or more persons to act as proxies, a majority of such persons present at the meeting, or, if only one shall be present, then that one, shall have and may exercise all of the powers conferred by such authorization upon all of the persons so designated unless such authorization shall otherwise provide.

Section 2.10. Fixing Date for Determination of Stockholders of Record.

(a) In order that the Corporation may determine the stockholders entitled (i) to notice of or to vote at any meeting of stockholders or any adjournment thereof, or (ii) to express consent to corporate action in writing without a meeting, or (iii) to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall be (X) not more than sixty (60) nor less than ten (10) days before the date of any such meeting; (Y) not more than ten (10) days after the date upon which the resolution fixing the record date for any written action is adopted by the Board of Directors; and (Z) not more than sixty (60) days prior to any other action.

(b) If no record date is fixed:

(i) The record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held.

(ii) The record date for determining stockholders entitled to express consent to corporate action in writing without a meeting, (A) when no prior action by the Board of Directors is necessary, shall be the day on which the first signed written consent setting forth the action taken or proposed to be taken is delivered to the Corporation, and (B) when prior action by the Board of Directors is necessary, shall be at the close of business on the day on which the Board of Directors adopts the resolution taking such prior action.

(iii) The record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

(c) A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

Section 2.11. Stockholder List. The officer of the Corporation who has charge of the stock ledger of the Corporation shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list also shall be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present. The stock ledger shall be the only evidence as to who are the stockholders entitled to examine the stock ledger, the list of stockholders or the books of the Corporation, or to vote in person or by proxy at any meeting of stockholders.

III. BOARD OF DIRECTORS

Section 3.01. General Powers; Organization. The business of the Corporation shall be managed by or under the direction of its Board of Directors, which may exercise all such powers of the Corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these By-Laws directed or required to be exercised or done by the stockholders. The Board of Directors may annually elect a Chairman of the Board from among its members who shall preside at its meetings, or in his or her absence the President shall so preside, or in his or her absence a chairman chosen at the meeting shall so preside. The Secretary shall act as secretary of the meeting, but in his or her absence the chairman of the meeting may appoint any person to act as secretary of the meeting. Any meeting of the Board of Directors may be held within or without the State of Delaware.

Section 3.02. Number, Qualification and Term of Office. The number of directors constituting the Board of Directors shall be fixed from time to time by resolution of the Board of Directors. The directors shall be elected at the annual meeting of the stockholders, except as provided in Section 3.03 of these By-Laws, and each director elected shall hold office for the term elected and until his or her successor is duly elected and qualified. Any director may resign at any time upon giving written notice to the Corporation. Directors need not be stockholders.

Section 3.03. Vacancies.

(a) Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, in their sole discretion and whether or not constituting less than a quorum, and the directors so chosen shall hold office until the next election of the class for which such directors shall have been chosen and until their successors to such class are duly elected and qualified, or until their earlier resignation, retirement or removal.

(b) Whenever the holders of any class or classes of stock or series thereof are entitled to elect one or more directors by the provisions of the Certificate of Incorporation of the Corporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.

Section 3.04. Regular Meetings. Regular meetings of the Board of Directors may be held without notice at such time and place as may be designated from time to time by the Board of Directors.

Section 3.05. Special Meetings. Special meetings of the Board of Directors may be called from time to time by the Chairman, if any, or the President, and, upon request by any two directors, shall be called by the Chairman or the President.

Section 3.06. Notice of Special Meetings. Notice of each special meeting of the Board of Directors stating the place, date and hour of the meeting shall be given to each director by mail not less than forty-eight (48) hours, or personally or by telephone, telegram, telex or cable not less than twenty-four (24) hours, before the date and hour of the meeting.

Section 3.07. Waiver of Notice. Notice of any meeting of the Board of Directors may be waived either before, at or after such meeting in a writing signed by each director or directors to whom the notice was not duly given. Attendance of a director at a meeting shall constitute a waiver of notice of such meeting, except when the director attends the meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

Section 3.08. Quorum. Unless otherwise specifically provided by law, the Certificate of Incorporation or these By-Laws, at all meetings of the Board of Directors, a majority of the total number of directors shall constitute a quorum for the transaction of business, and the vote of a majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 3.09. Committees of Directors.

(a) The Board of Directors may, by resolution adopted by a majority of the total number of directors, designate one or more committees, each committee to consist of one or more of the directors of the Corporation and to have such name as may be determined by the Board of Directors. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

(b) Any committee, to the extent allowed by law and provided in the resolution designating the committee, may exercise the powers of the Board of Directors in the management of the business and affairs of the Corporation and may authorize the corporate seal, if any, to be affixed to all papers that may require it.

(c) Each committee shall keep regular minutes of its proceedings and report the same to the Board of Directors when required. Unless the Board of Directors otherwise provides, each committee may make, alter and repeal rules for the conduct of its business. In the absence of such rules each committee shall conduct its business in the same manner as the Board of Directors conducts its business pursuant to these By-Laws.

Section 3.10. Conference Communications. Directors may participate in any meeting of the Board of Directors, or of any duly constituted committee thereof, by means of a conference telephone conversation or other comparable method of communication by which all persons participating in the meeting can hear and communicate with each other. For the purpose of establishing a quorum and taking any action at the meeting, such directors participating pursuant to this Section 3.10 shall be deemed present in person at the meeting; and the place of the meeting shall be the place of origination of the conference telephone conversation or other comparable method of communication.

Section 3.11. Action by Written Consent of Directors. Any action required or permitted to be taken at a meeting of the Board of Directors or any committee thereof may be taken without a meeting if all directors or committee members consent thereto in writing and the writing or writings are filed with the minutes of proceedings of the Board of Directors or the committee.

Section 3.12. Compensation. The Board of Directors shall have the authority to fix the compensation of directors.

Section 3.13. Advance-Notice of Stockholder-Sponsored Director Nominations.

(a) **Timing of Notice.** No person (other than a person nominated by or at the direction of the Board of Directors) shall be eligible for election as a director at any annual or special meeting unless timely notice is given in writing of such nomination by a stockholder of record to the President of the Corporation. To be timely, a stockholder's notice must be delivered to or mailed to and received at, the principal executive offices of the Corporation not less than sixty (60) days prior to the date fixed for the meeting; provided, however, that in the event that less than seventy-five (75) days' prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder to be timely must be received not later than the close of business on the fifteenth (15th) day following the day on which such public disclosure was made.

(b) **Content of Notice.** A stockholder's notice shall only be deemed to have been submitted on the date at which all of the following has been received by the Corporation: (i) all information about the nominee(s) which may be required to be provided in any proxy or information statement pursuant to the Securities Exchange Act of 1934 and rules promulgated thereunder, as amended; (ii) a statement signed by the nominee(s) consenting to his or her nomination and agreeing, if elected, to serve as a director of the Corporation; (iii) appropriate evidence that the person submitting the nomination(s) is a stockholder of the Corporation; (iv) a description of all securities or contracts, with a value derived in whole or in part from the value of any shares of the Corporation, held by or to which the person submitting the nomination(s) is a party; (v) a description of any material relationships, including financial transactions and compensation, between the stockholder and the proposed nominee(s); and (vi) a representation that the person submitting the nomination(s) will appear at the meeting to nominate the person or persons specified in the submission.

(c) **Consequences of Failure to Give Timely Notice.** Notwithstanding anything in these By-Laws to the contrary, the stockholder-sponsored nomination and election of directors shall not be conducted at any annual or special meeting except in accordance with the procedures set forth in this paragraph. The presiding Officer of the meeting shall, if the facts warrant, determine and declare to the meeting that the nomination(s) was not properly brought before the meeting in accordance with the provisions of this paragraph and, if the presiding Officer should so determine, the presiding Officer shall so declare to the meeting, and any such nomination(s) not properly brought before the meeting shall not be transacted.

IV. OFFICERS

Section 4.01. **Number.** The Board of Directors shall elect a President, a Secretary and a Treasurer, and it may, if it so determines, elect a Chairman of the Board from among its members. The Board of Directors also may choose one or more Vice-Presidents, one or more Assistant Secretaries, one or more Assistant Treasurers or any other officers or agents as the Board of Directors by a majority vote of the total number of directors may designate. Any person may hold two or more offices.

Section 4.02. **Election, Term of Office and Qualifications.** The Board of Directors shall elect the officers of the Corporation, who shall hold their offices for such terms and shall exercise such powers and perform such duties not inconsistent with these By-Laws as shall be determined from time to time by the Board of Directors. All officers of the Corporation shall hold their offices until their respective successors are elected and qualified, or until their respective offices are eliminated by vote of the majority of all directors, or until their earlier resignation, retirement or removal. Officers may be, but need not be, directors. Any officer may resign at any time upon written notice to the Corporation.

Section 4.03. Compensation. The salaries of the officers of the Corporation shall be fixed from time to time by the Board of Directors or by the chief executive officer if authorized by the Board of Directors.

Section 4.04. Removal and Vacancies. Any officer may be removed from office, with or without cause, by a majority vote of the total number of directors, but such removal shall be without prejudice to the contract rights of such officer, if any, with the Corporation. Any vacancy occurring in any office of the Corporation may be filled by the Board of Directors.

Section 4.05. Chief Executive Officer. The Board of Directors shall designate the Chairman or the President as the chief executive officer of the Corporation. If there be no Chairman, the President shall be the chief executive officer. The chief executive officer shall have the general powers and duties of management and supervision usually vested in and imposed upon the chief executive officer of a corporation. The chief executive officer shall preside at all meetings of the stockholders.

Section 4.06. Chairman of the Board. The Chairman, if one is elected, shall preside at all meetings of the Board of Directors. During the absence or disability of the President, the Chairman shall exercise all the powers and discharge all the duties of the President.

Section 4.07. President. The President, subject to the control of the Board of Directors and the Chairman (if the Chairman is the chief executive officer of the Corporation), shall have general supervision of the business of the Corporation, shall maintain the stock ledger and prepare the stockholder list as required by these By-Laws, and shall see that all orders and resolutions of the Board of Directors are carried into effect. During the absence or disability of the Chairman or if there be no Chairman, the President shall preside at all meetings of the Board of Directors.

Section 4.08. Vice-Presidents. During the absence or disability of the Chairman and the President, the Vice-President (or in the event there be more than one Vice-President, the Vice-Presidents in the order designated by the Board of Directors or, in the absence of any designation, in the order they were first elected as Vice-Presidents) shall perform the duties and have the authority of the President.

Section 4.09. Secretary. The Secretary shall keep the minutes of the meetings of the stockholders, the Board of Directors and any committees in a book to be kept for that purpose and shall perform such other ministerial duties as the Board of Directors of the Corporation may direct. The Secretary shall duly give notice of all meetings of the stockholders, special meetings of the Board of Directors and meetings of its committees, if any. The Secretary shall not be deemed an executive officer of the Corporation.

Section 4.10. Treasurer. The Treasurer shall keep accurate accounts of all moneys of the Corporation received or disbursed. He or she shall deposit all moneys, drafts and checks in the name of and to the credit of the Corporation in such banks and depositories as a majority of the whole Board of Directors shall from time to time designate. The Treasurer shall have power to endorse for deposit all notes, checks and drafts received by the Corporation. He or she shall disburse the funds of the Corporation as ordered by the Board of Directors, making proper vouchers therefor. The Treasurer shall render to the Board of Directors or the chief executive officer of the Corporation, whenever required, an account of all his or her transactions as Treasurer and of the financial condition of the Corporation.

Section 4.11. Authority and Other Duties. All officers of the Corporation shall be subject to the supervision and direction of the Board of Directors and, in addition to the foregoing authority and duties, all officers of the Corporation shall respectively have such authority and perform such other duties in the management of the business of the Corporation as may be designated from time to time by the Board of Directors. Unless prohibited by a resolution approved by the affirmative vote of a majority of the directors present, an officer elected or appointed by the Board may, without the approval of the Board, delegate some or all of the duties and powers of his or her office to other persons.

V. INDEMNIFICATION

Section 5.01. Indemnification. The Corporation shall indemnify such persons, for such expenses and liabilities, in such manner, under such circumstances, and to such extent, as required or permitted by subsections (a) through (e) of Section 145 of the Delaware General Corporation Law, as amended from time to time.

Section 5.02. Insurance. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against any liability asserted against and incurred by such person in or arising from that capacity, whether or not the Corporation would otherwise be required or permitted to indemnify the person against the liability. The Company shall not be obligated under these By-Laws to make any payment in connection with any claim made against any person if and to the extent that such person has actually received payment therefor under any insurance policy or policies.

Section 5.03. Indemnification Upon a Change of Control.

(a) If a Change in Control (as defined in this Section 5.03) has occurred and the person seeking indemnification so requests, a determination of whether such person is eligible for indemnification under Section 5.01 hereof shall be made in a written opinion rendered by independent legal counsel chosen by the person seeking indemnification and not reasonably objected to by the Board of Directors (whose fees and expenses shall be paid by the Corporation) and such determination shall be binding on the Corporation.

(b) For purposes of Section 5.03(a), "independent legal counsel" shall mean legal counsel other than an attorney, or a firm having associated with it an attorney, who has been retained by or has performed services for the Corporation or the person seeking indemnification within the previous three years.

(c) For purposes of Section 5.03(a), a “Change in Control” shall be deemed to have occurred if:

(i) a majority of the directors of the Corporation shall be persons other than persons (A) who were directors of the Corporation at July 1, 1989, (B) for whose election proxies shall have been solicited by the Board of Directors, or (C) who are then serving as directors appointed by the Board of Directors to fill vacancies on the Board of Directors caused by newly-created directorships or the death or resignation (but not removal) of a director;

(ii) any “person” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the “Act”)), other than the Corporation, a subsidiary of the Corporation or the person seeking indemnification, and other than a person who acquires or becomes the beneficial owner (as defined in Rule 13d-3 under the Act, or any successor rule thereto), directly or indirectly, of twenty percent or more of the then outstanding shares of voting stock of the Corporation as a result of the merger of Digiboard, Inc., a Minnesota corporation, with and into the Corporation, together with its “affiliates” and “associates” (as those terms are defined in Rule 12b-2 under the Act), or any group of persons acting in concert, not including the person seeking indemnification, acquires or becomes a beneficial owner (as so defined in Rule 13d-3), directly or indirectly, of twenty percent or more of the then outstanding shares of voting stock of the Corporation; or

(iii) the stockholders of the Corporation approve a definitive agreement or plan to (A) merge or consolidate the Corporation with or into another corporation (other than (1) a merger or consolidation with a subsidiary of the Corporation, or (2) a merger in which the Corporation is the surviving corporation and no outstanding voting stock of the Corporation (other than fractional shares) held by stockholders immediately prior to the merger is converted into cash, securities, or other property), (B) exchange, pursuant to a statutory exchange of shares of voting stock of the Corporation held by stockholders of the Corporation immediately prior to the exchange, shares of one or more classes or series of voting stock of the Corporation for shares of another corporation, (C) sell or otherwise dispose of all or substantially all of the assets of the Corporation (in one transaction or a series of transactions), or (D) liquidate or dissolve the Corporation, unless a majority of the voting stock (or the voting equity interest) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Corporation (in the case of a merger, consolidation or disposition of assets) or the Corporation (in the case of a statutory share exchange) is, immediately following the merger, consolidation, statutory share exchange or disposition of assets, beneficially owned by the person seeking indemnification or a group of persons, including the person seeking indemnification, acting in concert; or

(iv) the Corporation enters into an agreement in principle or a definitive agreement relating to an event described in clause (i), (ii) or (iii) above which ultimately results in an event described therein, or a tender or exchange offer or proxy contest is commenced which ultimately results in an event described therein.

Section 5.04. Good Faith Defined, Etc. For purposes of any determination of whether a person is entitled to indemnification, such person shall be deemed to have acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Corporation, or, with respect to any criminal action or proceeding, to have had no reasonable cause to believe his or her conduct was unlawful, if such person relied on the records or books of account of the Corporation or other enterprise, or on information supplied to him or her by the officers of the Corporation or other enterprise, or on information or records given or reports made to the Corporation or other enterprise by an independent certified public accountant or by an appraiser or other expert selected with reasonable care by the Corporation or other enterprise. The term “other enterprise” as used in this Section 5.04 shall mean any enterprise other than the Corporation, including any corporation, partnership, joint venture, trust, employee benefit plan or other enterprise as to which such person is or was serving at the request of the Corporation as a director, officer, employee, agent or trustee. The provisions of this Section 5.04 shall not be deemed to be exclusive or to limit in any way the circumstances in which a person may be deemed to have met the applicable standard of conduct set forth in Section 145 of the Delaware General Corporation Law, as amended from time to time.

Section 5.05. Right to Indemnification Upon Application; Procedure Upon Application; Etc.

(a) Any indemnification under these By-Laws shall be made no later than forty-five (45) days after receipt by the Corporation of the written request of the director or officer, or former director or officer, unless a determination is made within said 45-day period in accordance with Section 5.03 that such person has not met the applicable standard of conduct.

(b) The right to indemnification or expense advances under these By-Laws shall be enforceable by the director or officer, or former director or officer, in any court of competent jurisdiction. Following a Change in Control (as defined in Section 5.03(c)), the burden of proving that indemnification is not appropriate shall be on the Corporation. Neither the absence of any prior determination that indemnification is proper in the circumstances, nor a prior determination that indemnification is not proper in the circumstances, shall be a defense to the action or create a presumption that the director or officer, or former director or officer, has not met the applicable standard of conduct. The expenses (including attorneys’ fees and expenses) incurred by the director or officer, or former director or officer, in connection with successfully establishing his or her right to indemnification, in whole or in part, in any such action (or in any action or claim brought by him or her to recover under any insurance policy or policies referred to in Section 5.02) also shall be indemnified by the Corporation.

(c) If any person is entitled under any provision of these By-Laws to indemnification by the Corporation for some or a portion of expenses, judgments, fines, penalties or amounts paid in settlement incurred by him or her, but not, however, for the total amount thereof, the Corporation shall nevertheless indemnify such person for the portion of such expenses, judgments, fines, penalties and amounts to which he or she is entitled.

Section 5.06. Certain Persons Not Entitled to Indemnification. Notwithstanding any other provision of these By-Laws, no person shall be entitled to indemnification or expense advances under these By-Laws with respect to any action, suit, proceeding or claim brought or made by him or her against the Corporation, other than an action, suit, proceeding or claim seeking, or defending such person’s right to, indemnification and/or expense advances pursuant to these By-Laws or otherwise.

Section 5.07. Non-Exclusivity and Survival of Indemnification. Except as otherwise provided in Section 5.06, but notwithstanding any other provision of these By-Laws, it is the policy of the Corporation that indemnification and expense advances shall be made to the fullest extent permitted by law, and, accordingly, in the event of any change in law, by legislation or otherwise, permitting greater indemnification and/or expense advances, the provisions of these By-Laws shall be construed so as to require such greater indemnification and/or expense advances. The provisions of these By-Laws shall not be deemed to preclude the indemnification of any person whom the Corporation has the power to indemnify under the provisions of the General Corporation Law of the State of Delaware or otherwise. All rights to indemnification and advancement of expenses under these By-Laws shall be deemed to be provided by a contract between the Corporation and the director or officer who serves in such capacity at any time while these By-Laws are in effect. Any repeal or modification of the indemnification provisions of these By-Laws shall not affect any rights or obligations then existing. The Corporation may provide additional indemnification rights to a director or officer of the Corporation by separate agreement.

Section 5.08. Successors; Meaning of "Corporation". The indemnification provisions of these By-Laws shall be binding upon and enforceable against any direct or indirect successor by purchase, merger, consolidation or otherwise to all or substantially all of the business and/or assets of the Corporation. For purposes of these By-Laws, but subject to the provisions of any agreement relating to any merger or consolidation of the kind referred to in clause (a) below or of any agreement relating to the acquisition of any corporation of the kind referred to in clause (b) below, references to "the Corporation" shall include (a) any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger with the Corporation which, if its separate existence had continued, would have had power and authority to indemnify its directors and officers, so that any person who is or was a director or officer of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or trustee of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, shall stand in the same position under the provisions of these By-Laws with respect to the Corporation as he or she would have with respect to such constituent corporation if its separate existence had continued; and (b) any corporation of which at least a majority of the voting power (as represented by its outstanding stock having voting power generally in the election of directors) is owned directly or indirectly by the Corporation.

Section 5.09. Severability. The indemnification provisions of these By-Laws shall be severable in the event that any provision hereof (including any provision within a single section, subsection, clause, paragraph or sentence) is held invalid, void or otherwise unenforceable on any ground by any court of competent jurisdiction. In the event of any such holding, the remaining indemnification provisions of these By-Laws shall continue in effect and be enforceable to the fullest extent permitted by law.

VI. STOCK

Section 6.01. Certificated and Uncertificated Shares. Shares of stock of the Corporation shall be represented by certificates, provided that the Board of Directors may provide by resolution or resolutions that some or all of any or all classes or series of stock may be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Corporation. Certificates representing shares shall be in such form as shall be prescribed by the Board of Directors, certifying the number of shares owned by the holder. Shares represented by certificates shall be numbered in the order in which they shall be issued and shall be signed in the name of the Corporation by the Chairman, the President or a Vice-President, and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary, and the seal of the Corporation, if any, shall be affixed thereto.

Section 6.02. Issuance of Stock. The Board of Directors is authorized to cause to be issued stock of the Corporation up to the full amount authorized by the Certificate of Incorporation in such amounts and for such consideration as may be determined by the Board of Directors. No shares shall be allotted except in consideration of cash, labor, personal property, or real property, or leases thereof, or of an amount transferred from surplus to stated capital upon a stock dividend. At the time of such allotment of stock, the Board of Directors shall state its determination of the fair value to the Corporation in monetary terms of any consideration other than cash for which shares are allotted. The amount of consideration to be received in cash or otherwise shall not be less than the par value of the shares so allotted. Stock so issued shall be fully paid and nonassessable. Treasury shares may be disposed of by the Corporation for such consideration as may be fixed by the Board of Directors.

Section 6.03. Partly Paid Stock. The Corporation may issue the whole or any part of its stock as partly paid and subject to call for the remainder of the consideration to be paid therefor. Upon the face or back of each certificate issued to represent any such partly paid stock, or upon the stock ledger in the case of uncertificated shares, the total amount of the consideration to be paid therefor and the amount paid thereon shall be stated. The Board of Directors may, from time to time, demand payment in respect of each share of stock not fully paid, of such sum of money as the necessities of the business may, in the judgment of the Board of Directors, require, not exceeding in the whole the balance remaining unpaid on such stock, and such sum so demanded shall be paid to the Corporation at such times and by such installments as the Board of Directors shall direct.

Section 6.04. Registered Stockholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

Section 6.05. Transfers of Stock. Transfers of stock shall be made on the books of the Corporation only by the record holder of such stock, or such holder's legal representative or duly authorized attorney-in-fact, and, in the case of stock represented by a certificate, upon surrender of the certificate or the certificates for such stock. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignation or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books. No new certificate or certificates shall be issued in exchange for any existing certificate until such certificate shall have been so cancelled, except in cases provided for in Section 6.06.

Section 6.06. Lost, Stolen or Destroyed Certificates. Any stockholder claiming a certificate for stock to be lost, stolen or destroyed shall make an affidavit of that fact in such form as the Corporation may require and shall, if the Corporation so requires, give the Corporation a bond of indemnity in form, in an amount, and with one or more sureties satisfactory to the Corporation, to indemnify the Corporation against any claims which may be made against it on account of the alleged loss, theft or destruction of the certificate or issuance of such new certificate. A new certificate may then be issued in the same tenor and for the same number of shares as the one claimed to have been lost, stolen or destroyed.

Section 6.07. Facsimile Signatures. Whenever any certificate is countersigned by a transfer agent or by a registrar other than the Corporation or one of its employees, then the signatures of the officers or agents of the Corporation may be facsimiles. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed on any such certificate shall cease to be such officer, transfer agent or registrar before such certificate is issued, it nevertheless may be issued by the Corporation as though the person who signed such certificate or whose facsimile signature or signatures had been placed thereon were such officer, transfer agent or registrar at the date of issue.

VII. MISCELLANEOUS

Section 7.01. Dividends. The Board of Directors may declare at any regular or special meeting dividends from the Corporation's surplus, or if there be none, out of its net profits for the current fiscal year and/or the preceding fiscal year, in such amounts as in their opinion the condition of the affairs of the Corporation shall render it advisable unless otherwise restricted by law. Dividends may be paid in cash, in property or in shares of capital stock of the Corporation, subject to the provisions of the Certificate of Incorporation.

Section 7.02. Interested Directors and Officers. No contract or transaction between the Corporation and one or more of its directors or officers, or between the Corporation and any other corporation, partnership, association or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for that reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee thereof which authorizes the contract or transaction, or solely because his, her or their votes are counted for such purpose, if: (a) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee, and the Board of Directors or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or (b) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or (c) the contract or transaction is fair as to the Corporation as of the time it is authorized, approved or ratified, by the Board of Directors, a committee thereof, or the stockholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

Section 7.03. Voting Securities Held by the Corporation. Unless otherwise ordered by the Board of Directors, powers of attorney, proxies, waivers of notice of meeting, consents and other instruments relating to securities owned by the Corporation may be executed in the name of and on behalf of the Corporation by the Chairman or the President, and either such officer may, in the name of and on behalf of the Corporation, take all such action as such officer may deem advisable to vote in person or by proxy at any meeting of security holders of other corporations in which the Corporation may hold securities, and at any such meeting such officer shall possess and may exercise any and all rights and powers incident to the ownership of such securities that the Corporation might have possessed and exercised if it had been present. The Board of Directors may from time to time confer like powers upon any other person or persons.

Section 7.04. Execution of Instruments.

(a) All deeds, mortgages, bonds, checks, contracts and other instruments pertaining to the business and affairs of the Corporation shall be signed on behalf of the Corporation by the Chairman, the President or any Vice President, or by such other person or persons as may be designated from time to time by the Board of Directors.

(b) If a document must be executed by persons holding different offices or functions and one person holds such offices or exercises such functions, that person may execute the document in more than one capacity if the document indicates each such capacity.

Section 7.05. Advances. The Corporation may, without a vote of the directors, advance money to its directors, officers or employees to cover expenses that can reasonably be anticipated to be incurred by them in the performance of their duties and for which they would be entitled to reimbursement in the absence of an advance.

Section 7.06. Fiscal Year. The fiscal year end of the Corporation shall be September 30 or such other date as may be fixed from time to time by resolution of the Board of Directors.

Section 7.07. Corporate Seal. The corporate seal, if one is adopted by the Board of Directors, shall be circular in form and shall have inscribed thereon the name of the Corporation, the word "Delaware" and the words "Corporate Seal." The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise placed on any document requiring it.

Section 7.08. Power to Amend. These By-Laws may be altered, amended or repealed or new By-Laws may be adopted as provided in the Certificate of Incorporation of the Corporation.

**CERTIFICATION PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Joseph T. Dunsmore, President, Chief Executive Officer and Chairman of Digi International Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 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:
 - (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.

August 7, 2008

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

**CERTIFICATION PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Subramanian Krishnan, Senior Vice President, Chief Financial Officer and Treasurer of Digi International Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 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:
 - (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.

August 7, 2008

/s/ Subramanian Krishnan
Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer

**CERTIFICATION PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Digi International Inc. (the Registrant) on Form 10-Q for the fiscal quarter ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Quarterly Report on Form 10-Q complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

August 7, 2008

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore

President, Chief Executive Officer, and Chairman

/s/ Subramanian Krishnan

Subramanian Krishnan

Senior Vice President, Chief Financial Officer and Treasurer