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**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: **December 31, 2013**

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**

(Address of principal executive offices)

**55343**

(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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) 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 January 31, 2014, there were 25,876,970 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 December 31,	
	2013	2012
(in thousands, except per common share data)		
<b>Revenue:</b>		
Hardware product	\$ 41,989	\$ 43,043
Service	5,333	3,948
Total revenue	47,322	46,991
<b>Cost of sales:</b>		
Cost of hardware product	20,263	20,126
Cost of service	4,151	2,386
Total cost of sales	24,414	22,512
Gross profit	22,908	24,479
<b>Operating expenses:</b>		
Sales and marketing	10,219	10,274
Research and development	7,257	7,417
General and administrative	4,723	5,116
Restructuring charges, net	81	—
Total operating expenses	22,280	22,807
Operating income	628	1,672
<b>Other income, net:</b>		
Interest income	43	52
Other income, net	93	124
Total other income, net	136	176
Income before income taxes	764	1,848
Income tax provision	76	618
Net income	\$ 688	\$ 1,230
<b>Net income per common share:</b>		
Basic	\$ 0.03	\$ 0.05
Diluted	\$ 0.03	\$ 0.05
<b>Weighted average common shares:</b>		
Basic	25,716	26,188
Diluted	26,229	26,434

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

**DIGI INTERNATIONAL INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(UNAUDITED)**

	Three months ended December 31,	
	2013	2012
	(in thousands)	
Net income	\$ 688	\$ 1,230
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	343	(289)
Change in net unrealized gain on investments	38	2
Less income tax provision	(15)	(1)
Other comprehensive income (loss), net of tax	366	(288)
Comprehensive income	\$ 1,054	\$ 942

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

**DIGI INTERNATIONAL INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	December 31, 2013	September 30, 2013
	(in thousands, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 50,470	\$ 41,320
Marketable securities	47,341	47,006
Accounts receivable, net	23,788	26,829
Inventories	30,479	26,140
Deferred tax assets	3,499	3,174
Other	5,150	4,835
Total current assets	160,727	149,304
Marketable securities, long-term	9,983	17,389
Property, equipment and improvements, net	13,866	13,910
Identifiable intangible assets, net	9,050	9,728
Goodwill	103,918	103,569
Deferred tax assets	5,954	5,832
Other	244	221
Total assets	\$ 303,742	\$ 299,953
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,040	\$ 8,906
Accrued compensation	6,493	7,410
Accrued warranty	1,013	1,063
Other	3,153	3,911
Total current liabilities	20,699	21,290
Income taxes payable	3,625	3,903
Deferred tax liabilities	376	415
Other noncurrent liabilities	114	79
Total liabilities	24,814	25,687
Contingencies (see Note 10)		
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; 30,565,685 and 30,264,224 shares issued	306	303
Additional paid-in capital	215,296	211,982
Retained earnings	116,776	116,088
Accumulated other comprehensive loss	(15,224)	(15,590)
Treasury stock, at cost, 4,673,917 and 4,708,965 shares	(38,226)	(38,517)
Total stockholders' equity	278,928	274,266
Total liabilities and stockholders' equity	\$ 303,742	\$ 299,953

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

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

	Three months ended December 31,	
	2013	2012
	(in thousands)	
<b>Operating activities:</b>		
Net income	\$ 688	\$ 1,230
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation of property, equipment and improvements	897	848
Amortization of identifiable intangible assets	952	1,071
Stock-based compensation	1,023	955
Excess tax benefits from stock-based compensation	(20)	(28)
Deferred income tax benefit	(506)	(542)
Bad debt/product return provision	22	221
Inventory obsolescence	229	250
Restructuring charges, net	81	—
Other	102	38
Changes in operating assets and liabilities (net of acquisition)	(3,805)	(1,755)
Net cash (used in) provided by operating activities	(337)	2,288
<b>Investing activities:</b>		
Purchase of marketable securities	—	(9,873)
Proceeds from maturities of marketable securities	7,109	17,473
Acquisition of business, net of cash acquired	—	(12,919)
Purchase of property, equipment, improvements and certain other intangible assets	(975)	(1,427)
Net cash provided by (used in) investing activities	6,134	(6,746)
<b>Financing activities:</b>		
Excess tax benefits from stock-based compensation	20	28
Proceeds from stock option plan transactions	2,813	169
Proceeds from employee stock purchase plan transactions	296	248
Purchases of common stock	—	(4,226)
Net cash provided by (used in) financing activities	3,129	(3,781)
Effect of exchange rate changes on cash and cash equivalents	224	3
Net increase (decrease) in cash and cash equivalents	9,150	(8,236)
Cash and cash equivalents, beginning of period	41,320	60,246
Cash and cash equivalents, end of period	\$ 50,470	\$ 52,010
<b>Supplemental schedule of non-cash investing activities:</b>		
Issuance of common stock for business acquisition	\$ —	\$ 6,804

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 United States Securities and Exchange Commission (the “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 (“U.S. GAAP”), 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 (but not limited to) the summary of significant accounting policies, presented in our Annual Report on Form 10-K for the year ended September 30, 2013 as filed with the SEC (“2013 Financial Statements”).

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 balance sheets and condensed consolidated statements of operations, comprehensive income 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 consolidated balance sheet data were derived from our 2013 Consolidated Financial Statements, but do not include all disclosures required by U.S. GAAP.

*Changes in Presentation*

Beginning with our 2013 Financial Statements, we began presenting product and service revenue, as well as cost of product and service revenue, on the face of our income statement. The prior year data for these line items has been recast accordingly. These reclassifications had no effect on reported consolidated net earnings for any period presented.

*Recently Issued Accounting Pronouncements*

*Not Adopted*

In July 2013, the Financial Accounting Standards Board, “FASB” issued ASU 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.” This guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU No. 2013-11 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2014. We will adopt this guidance beginning with our fiscal quarter ending December 31, 2015. While we are evaluating the impact of the adoption of ASU 2013-11, we do not currently expect it to have a material impact on our consolidated financial statements.

In March 2013, FASB issued ASU 2013-05, “Foreign Currency Matters (Topic 830); Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity.” This guidance applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We will adopt this guidance beginning with our fiscal quarter ending December 31, 2014. We currently are reviewing the provisions of ASU No. 2013-05 but do not expect it to have an effect on our consolidated financial statements as we currently do not intend to sell any foreign entities for which we hold a controlling financial interest.

## 2. EARNINGS PER 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 restricted stock units.

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):

	Three months ended December 31,	
	2013	2012
<b>Numerator:</b>		
Net income	\$ 688	\$ 1,230
<b>Denominator:</b>		
Denominator for basic net income per common share — weighted average shares outstanding	25,716	26,188
<b>Effect of dilutive securities:</b>		
Stock options and restricted stock units	513	246
Denominator for diluted net income per common share — adjusted weighted average shares	26,229	26,434
Net income per common share, basic	\$ 0.03	\$ 0.05
Net income per common share, diluted	\$ 0.03	\$ 0.05

Because their effect would be anti-dilutive at period end, certain potentially dilutive shares related to stock options to purchase common shares were not included in the above computation of diluted earnings per common share. This is because the options' exercise prices were greater than the average market price of our common shares. There were 2,699,776 and 4,278,823 potentially dilutive shares related to such stock options for the three month periods ended December 31, 2013 and 2012, respectively.

## 3. ACQUISITION

### **Etherios, Inc.**

On October 31, 2012, we acquired Etherios, Inc. ("Etherios"). The total purchase price of \$20.4 million included \$13.7 million in cash (excluding cash acquired of \$0.8 million) and \$6.7 million represented by 715,571 shares of our common stock. The common stock issued was valued at \$9.42 per common share.

Cash in the amount of \$2.35 million was deposited to an escrow fund with a third party agent. Of the \$2.35 million escrow, \$0.3 million related to a holdback amount pending final determination of the unpaid debt and working capital as shown on the closing balance sheet. This holdback amount was released to the sellers in February 2013 as there were no changes to the closing balance sheet. An additional \$2.05 million is held in escrow for a period not to exceed eighteen months from the date of closing to satisfy possible claims that may arise pursuant to specific representation and warranty sections of the stock purchase agreement. The escrowed amounts have been included in the determination of the purchase consideration on the date of acquisition as management expects that the representation and warranty matters is determinable beyond a reasonable doubt.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. During the fourth quarter of fiscal 2013, we recorded final purchase accounting entries that reduced the value of the common stock issued by \$0.1 million to reflect the closing price on the date of the acquisition and we reduced the fair value of the net tangible assets acquired by \$0.3 million. These adjustments resulted in an increase of \$0.2 million in goodwill. The final purchase price allocation resulted in the recognition of \$17.3 million of goodwill. We believe that the acquisition resulted in the recognition of goodwill primarily because Etherios is a salesforce.com Platinum Partner and experienced in end user implementation of the Salesforce Service Cloud. Although we believe the relationship with salesforce.com is important to us, it is not an exclusive relationship and requires Etherios to compete with others for business opportunities. Accordingly, we have determined that this relationship cannot be valued as a separate intangible asset of Etherios and as a result is a component of goodwill. As salesforce.com has signaled its intent for the Service Cloud to be used as a means to monitor machines, we also believe that the



### 3. ACQUISITION (CONTINUED)

acquisition of Etherios likely will further enhance our solutions offerings and provide another channel for revenue of our networking products.

Costs related to the acquisition, which include legal, accounting and valuation fees, in the amount of \$0.2 million were charged directly to operations and are included in general and administrative expense in our consolidated statement of operations for fiscal 2013.

Etherios' operating results were included in our consolidated results of operations from the day following the acquisition on October 31, 2012. The consolidated balance sheet as of September 30, 2013 reflected the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

Because the Etherios acquisition was not material to our consolidated results of operations or financial position, pro forma financial information has not been presented.

### 4. SELECTED BALANCE SHEET DATA

(in thousands)

	December 31, 2013	September 30, 2013
Accounts receivable, net:		
Accounts receivable	\$ 24,220	\$ 27,142
Less allowance for doubtful accounts	432	313
	<u>\$ 23,788</u>	<u>\$ 26,829</u>
Inventories:		
Raw materials	\$ 25,545	\$ 21,171
Work in process	264	224
Finished goods	4,670	4,745
	<u>\$ 30,479</u>	<u>\$ 26,140</u>

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

## 5. MARKETABLE SECURITIES

Our marketable securities consist of certificates of deposit, corporate bonds and government municipal bonds. We analyze our available-for-sale marketable securities for impairment on an ongoing basis. When we perform this analysis, we consider factors such as the length of time and extent to which the securities have been in an unrealized loss position and the trend of any unrealized losses. We also consider whether an unrealized loss is a temporary loss or an other-than-temporary loss based on factors such as: (a) whether we have the intent to sell the security, (b) whether it is more likely than not that we will be required to sell the security before its anticipated recovery, or (c) permanent impairment due to bankruptcy or insolvency.

In order to estimate the fair value for each security in our investment portfolio, we obtain quoted market prices and trading activity for each security where available. We obtain relevant information from our investment advisor and, if warranted, also may review the financial solvency of certain security issuers. At December 31, 2013, 68 of our 77 securities that we held were trading below our amortized cost basis. We determined each decline in value to be temporary based upon the above described factors. We expect to realize the fair value of these securities, plus accrued interest, either at the time of maturity or when the security is sold. All of our current holdings are classified as available-for-sale marketable securities and are recorded at fair value on our consolidated balance sheet with the unrealized gains and losses recorded in accumulated other comprehensive loss. All of our current marketable securities will mature in less than one year and our non-current marketable securities will mature in less than 3 years. During the three months ended December 31, 2013 and 2012, we received proceeds from our available-for-sale marketable securities of \$7.1 million and \$17.5 million, respectively.

At December 31, 2013 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
<b>Current marketable securities:</b>				
Corporate bonds	\$ 37,060	\$ 12	\$ (25)	\$ 37,047
Certificates of deposit	2,754	—	(2)	2,752
Government municipal bonds	7,543	—	(1)	7,542
Current marketable securities	47,357	12	(28)	47,341
<b>Non-current marketable securities:</b>				
Certificates of deposit	10,004	—	(21)	9,983
Total marketable securities	\$ 57,361	\$ 12	\$ (49)	\$ 57,324

(1) Included in amortized cost and fair value is purchased and accrued interest of \$446.

At September 30, 2013 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
<b>Current marketable securities:</b>				
Corporate bonds	\$ 35,161	\$ 10	\$ (30)	\$ 35,141
Certificates of deposit	1,753	—	(2)	1,751
Government municipal bonds	10,115	—	(1)	10,114
Current marketable securities	47,029	10	(33)	47,006
<b>Non-current marketable securities:</b>				
Corporate bonds	6,439	—	(6)	6,433
Certificates of deposit	11,003	—	(47)	10,956
Non-current marketable securities	17,442	—	(53)	17,389
Total marketable securities	\$ 64,471	\$ 10	\$ (86)	\$ 64,395

(1) Included in amortized cost and fair value is purchased and accrued interest of \$629.

## 5. MARKETABLE SECURITIES (CONTINUED)

The following tables show the fair values and gross unrealized losses of our available-for-sale marketable securities that have been in a continuous unrealized loss position deemed to be temporary, aggregated by investment category (in thousands):

	December 31, 2013			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	\$ 27,230	\$ (23)	\$ 1,815	\$ (1)
Certificates of deposit	12,226	(24)	—	—
Government municipal bonds	5,407	(1)	—	—
Total	\$ 44,863	\$ (48)	\$ 1,815	\$ (1)

	September 30, 2013			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	\$ 29,911	\$ (35)	\$ 2,001	\$ (1)
Certificates of deposit	12,451	(49)	—	—
Government municipal bonds	6,182	(1)	—	—
Total	\$ 48,544	\$ (85)	\$ 2,001	\$ (1)

## 6. FAIR VALUE MEASUREMENTS

Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. This standard also establishes a hierarchy for inputs used in measuring fair value. This standard maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability based upon the best information available in the circumstances. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The hierarchy is broken down into the following three levels:

- Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly.
- Level 3 — Inputs are unobservable for the asset or liability and their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 may also include certain investment securities for which there is limited market activity or a decrease in the observability of market pricing for the investments, such that the determination of fair value requires significant judgment or estimation.

Fair value is applied to financial assets such as our marketable securities, which are classified and accounted for as available-for-sale. These items are stated at fair value at each reporting period using the above guidance.

## 6. FAIR VALUE MEASUREMENTS (CONTINUED)

The following tables provide information by level for financial assets that are measured at fair value on a recurring basis (in thousands):

	Total carrying value at December 31, 2013	Fair Value Measurements at December 31, 2013 using:		
		Quoted price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Cash equivalents:</b>				
Money market	\$ 10,614	\$ 10,614	\$ —	\$ —
<b>Available-for-sale marketable securities:</b>				
Corporate bonds	37,047	—	37,047	—
Certificates of deposit	12,735	—	12,735	—
Government municipal bonds	7,542	—	7,542	—
<b>Total cash equivalents and marketable securities measured at fair value</b>	<b>\$ 67,938</b>	<b>\$ 10,614</b>	<b>\$ 57,324</b>	<b>\$ —</b>

	Total carrying value at September 30, 2013	Fair Value Measurements at September 30, 2013 using:		
		Quoted price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Cash equivalents:</b>				
Money market	\$ 3,957	\$ 3,957	\$ —	\$ —
<b>Available-for-sale marketable securities:</b>				
Corporate bonds	41,574	—	41,574	—
Certificates of deposit	12,707	—	12,707	—
Government municipal bonds	10,114	—	10,114	—
<b>Total cash equivalents and marketable securities measured at fair value</b>	<b>\$ 68,352</b>	<b>\$ 3,957</b>	<b>\$ 64,395</b>	<b>\$ —</b>

Cash equivalents are measured at fair value using quoted market prices in active markets for identical assets and are therefore classified as Level 1 assets. We value our Level 2 assets using inputs that are based on market indices of similar assets within an active market. There were no transfers into or out of our Level 2 financial assets during the three months ended December 31, 2013.

We had no financial assets valued with Level 3 inputs as of December 31, 2013 nor did we purchase or sell any Level 3 financial assets during the three months ended December 31, 2013.

The use of different assumptions, applying different judgment to matters that inherently are subjective and changes in future market conditions could result in different estimates of fair value of our securities, currently and in the future. If market conditions deteriorate, we may incur impairment charges for securities in our investment portfolio.

## 7. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS, NET

Amortizable identifiable intangible assets were (in thousands):

	December 31, 2013			September 30, 2013		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	\$ 46,111	\$ (44,662)	\$ 1,449	\$ 45,960	\$ (44,306)	\$ 1,654
License agreements	2,440	(2,440)	—	2,440	(2,440)	—
Patents and trademarks	11,568	(9,268)	2,300	11,322	(9,000)	2,322
Customer relationships	19,062	(14,604)	4,458	18,954	(14,130)	4,824
Non-compete agreements	1,100	(257)	843	1,100	(202)	898
Order backlog	360	(360)	—	360	(330)	30
<b>Total</b>	<b>\$ 80,641</b>	<b>\$ (71,591)</b>	<b>\$ 9,050</b>	<b>\$ 80,136</b>	<b>\$ (70,408)</b>	<b>\$ 9,728</b>

Amortization was \$1.0 million and \$1.1 million for the three month periods ended December 31, 2013 and 2012, respectively. Amortization expense is recorded on our consolidated statements of operations within cost of sales and in general and administrative expense. Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2014 and the five succeeding fiscal years is (in thousands):

2014 nine months	\$ 2,658
2015	2,987
2016	1,531
2017	733
2018	482
2019	438

The changes in the carrying amount of goodwill are (in thousands):

	Three months ended December 31,	
	2013	2012
Beginning balance, October 1	\$ 103,569	\$ 86,209
Acquisition of Etherios, Inc.	—	17,120
Foreign currency translation adjustment	349	62
Ending balance, December 31	<u>\$ 103,918</u>	<u>\$ 103,391</u>

The goodwill related to the acquisition of Etherios is not tax deductible. Etherios is included in our single reporting unit for purposes of goodwill impairment testing.

Goodwill is tested for impairment on an annual basis as of June 30, or more frequently if events or circumstances occur which could indicate impairment. The calculation of goodwill impairment requires us to make assumptions about the fair value of our one reporting unit, which historically has been approximated by using our market capitalization plus a control premium. Control premium assumptions require judgment and actual results may differ from assumed or estimated amounts.

Our test for potential goodwill impairment is a two-step approach. We estimate the fair value for our one reporting unit by comparing its fair value (market capitalization plus control premium) to our carrying value. If the carrying value of the reporting unit exceeds its estimated fair value, the second step of the goodwill impairment analysis requires us to measure the amount of the impairment loss. An impairment loss is calculated by comparing the implied fair value of the goodwill to its carrying amount. To calculate the implied fair value of goodwill, the fair value of the reporting unit's assets and liabilities, excluding goodwill, is estimated. The excess of the fair value of the reporting unit over the amount assigned to its assets and liabilities, excluding goodwill, is the implied fair value of the reporting unit's goodwill.

## 7. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS, NET (CONTINUED)

At June 30, 2013, our market capitalization was \$241.4 million compared to our carrying value of \$272.3 million. Our market capitalization plus our estimated control premium of 40% (discussed in the paragraphs below) resulted in a fair value in excess of our carrying value by a margin of 24%. As a result, no impairment was indicated and we were not required to complete the second step of the goodwill impairment analysis. No goodwill impairment charges were recorded.

In June 2012 we performed a control premium study to determine the appropriate control premium to include in the calculation of fair value, using a third party valuation firm to assist us in performing the control premium analysis. In order to estimate the range of control premiums appropriate for us, three methodologies were used, including: (1) analysis of individual transactions within our industry; (2) analysis of industry-wide data, and (3) analysis of global transaction data. Individual transactions in the Communication Equipment or Computer & Peripherals industries were used to find transactions of target companies that operated in similar markets and shared similar operating characteristics with Digi. Transaction screening criteria included selection of transactions with the following characteristics:

- At least 50 percent of a target company's equity sought by an acquirer,
- Target company considered operating (not in bankruptcy),
- Target company had publicly traded stock outstanding at the transaction date, and
- Transactions announced between June 30, 2007 and the valuation date.

In analyzing industry-wide data, transactions in three industries were identified that encompassed the products offered by us: Office Equipment and Computer Hardware, Communications, and Computer, Supplies and Services. Finally, control premiums were considered for both domestic and international transactions. The control premium analysis resulted in a range of control premium of 30 percent to 45 percent. We reviewed the data provided and estimated that a 40 percent control premium best represented the amount an investor would likely pay, over and above market capitalization, in order to obtain a controlling interest given the economic conditions at that time. We chose 40 percent as it approximated the midpoint of the range and reflected the overall increase in control premiums over the past several years. Based on our industry knowledge and discussions with our third party valuation firm, we concluded that the control premium study that was performed in conjunction with our annual goodwill impairment assessment at June 30, 2012 remained valid for our June 2013 impairment assessment and that the 40 percent control premium used in our prior year's assessment continued to best represent the amount an investor likely would pay, over and above market capitalization, in order to obtain a controlling interest given the economic conditions in June 2013.

If our stock price or control premium declines, the first step of our goodwill impairment analysis may fail. We have defined the criteria that could result in additional interim goodwill impairment testing. We would perform the second step of the impairment testing if our stock price fell below defined thresholds for a significant period of time, or if our control premium significantly decreased. Events or circumstances may occur that could negatively impact our stock price, including changes in our anticipated revenues and profits and our ability to execute on our strategies. In addition, our control premium could decline due to changes in economic conditions in the technology industry, in the financial markets or more generally. An impairment could have a material effect on our consolidated balance sheet and results of operations. We have identified no goodwill impairment losses since the adoption of Accounting Standards Codification (ASC) 350, Intangibles-Goodwill and Others, in fiscal 2003.

## 8. INCOME TAXES

Income taxes have been provided at an overall effective rate of 9.9% and 33.4% for the three month periods ended December 31, 2013 and 2012, respectively. The overall effective tax rate includes the discrete items mentioned in the following paragraphs. Our effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and discrete events, such as settlements of audits.

In the first three months of fiscal 2014 and fiscal 2013, we recorded a discrete tax benefit of \$0.2 million and \$0.1 million, respectively for the release of income tax reserves due to the expiration of statutes of limitation from various U.S. and foreign tax jurisdictions. For the three month periods ended December 31, 2013 and December 31, 2012, these discrete tax benefits reduced our effective tax rate by 28.1 and 7.8 percentage points, respectively.

**8. INCOME TAXES (CONTINUED)**

During the first three months of both fiscal 2014 and fiscal 2013, the income tax provision before discrete tax benefits was higher than the federal statutory rate primarily due to reserves for unrecognized tax benefits and state income taxes, in excess of domestic tax benefits.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is (in thousands):

Unrecognized tax benefits as of September 30, 2013	\$	3,332
Decreases related to:		
Expiration of statute of limitations		(160)
Unrecognized tax benefits as of December 31, 2013	\$	<u>3,172</u>

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is \$3.2 million. We expect an insignificant change in the total amounts of unrecognized tax benefits over the next 12 months.

We recognize interest and penalties related to income tax matters in income tax expense. During both the three month periods ended December 31, 2013 and 2012, there were insignificant amounts of interest and penalties related to income tax matters in income tax expense. Accrued interest and penalties related to unrecognized tax benefits were \$0.5 million at December 31, 2013 and \$0.6 million at September 30, 2013. Our long-term income taxes payable on our condensed consolidated balance sheets includes these accrued interest and penalties in addition to the unrecognized tax benefits in the table above.

At December 31, 2013, we had approximately \$25.3 million of accumulated undistributed foreign earnings, for which we have not accrued additional U.S. tax. Our policy is to reinvest earnings of our foreign subsidiaries indefinitely to fund current operations and provide for future international expansion opportunities, and only repatriate earnings to the extent that U.S. taxes have already been recorded. Although we have no current need to do so, if we change our assertion that we do not intend to repatriate additional undistributed foreign earnings for cash requirements in the United States, we would have to accrue applicable taxes. The amount of any taxes and the application of any tax credits would be determined based on the income tax laws at the time of such repatriation. Under current tax laws, we estimate the unrecognized deferred tax liability to be in the range of \$1.5 million to \$2.5 million, which could have a material impact on our current consolidated balance sheet, results of operations and cash flows.

We operate in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, we must determine the appropriate allocation of income to each of these jurisdictions. This determination requires us to make several estimates and assumptions. Tax audits associated with the allocation of this income, and other complex issues, may require an extended period of time to resolve and may result in adjustments to our income tax balances in those years that are material to our consolidated balance sheet and results of operations. We are no longer subject to income tax examination for tax years prior to fiscal 2009, except for certain refund claims applicable to fiscal 2009, in the case of U.S. federal tax authorities and prior to fiscal 2008 for non-U.S. income tax authorities. For state taxing authorities, most notably in Minnesota, California and Texas, we are no longer subject to income tax examination for tax years generally before fiscal 2009.

**9. PRODUCT WARRANTY OBLIGATION**

In general, we warrant our products to be free from defects in material and workmanship under normal use and service. The warranty periods generally range from one to five years. We typically have the option to either 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 incidents and are evaluated on an ongoing basis to ensure the adequacy of the warranty accrual.

The following table summarizes the activity associated with the product warranty accrual (in thousands) and is included on our Condensed Consolidated Balance Sheets as its own line item within current liabilities:

Period	Balance at October 1	Warranties issued	Settlements made	Balance at December 31
Three months ended December 31, 2013	\$ 1,063	\$ 146	\$ (196)	\$ 1,013
Three months ended December 31, 2012	\$ 1,021	\$ 50	\$ (136)	\$ 935

## 9. PRODUCT WARRANTY OBLIGATION (CONTINUED)

We are not responsible for, 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. Further, we 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.

## 10. CONTINGENCIES

### *Patent Infringement Lawsuits*

On May 29, 2012, U.S. Ethernet Innovations, LLC (“USEI”) filed a patent infringement lawsuit against us in federal court in the Eastern District of Texas. The lawsuit included allegations against us and one other company pertaining to the infringement of four patents related to Ethernet technology. On April 22, 2013, we announced the settlement of this patent infringement lawsuit for \$1.5 million, which was recorded in general and administrative expense on our Condensed Consolidated Statement of Operations during the second quarter of fiscal 2013. The settlement was paid during the third quarter of fiscal 2013. The settlement fully resolves the claims by USEI with no future payment obligations. Net of taxes, the settlement was \$1.0 million and therefore reduced earnings per diluted share for the second quarter of fiscal 2013 by approximately \$0.04.

In addition to the matters discussed above, in the normal course of business, we are subject to various claims and litigation. There can be no assurance that any claims by third parties, if proven to have merit, will not materially adversely affect our business, liquidity or financial condition.

## 11. RESTRUCTURING

### *Fiscal 2014 Restructuring*

On October 31, 2013, we announced our intention to restructure certain of our operations in India. The restructuring was primarily associated with cost reduction initiatives resulting in the elimination of approximately 40 engineering and sales positions in our work force. We recorded a restructuring charge of \$0.2 million related to severance during the first quarter of fiscal 2014, of which the majority of the severance was paid during the first quarter of fiscal 2014. No additional charges are expected with this restructuring.

### *Fiscal 2013 Restructuring*

On September 27, 2013, we announced our intention to restructure certain of our operations in the U.S. The restructuring was primarily associated with cost reduction initiatives and resulted in the elimination of 15 positions in our work force. We recorded a restructuring charge of \$0.4 million for severance during the fourth quarter of fiscal 2013. The payments associated with these charges and all the actions associated with the restructuring were completed during the first quarter of fiscal 2014.

### *Fiscal 2012 Restructuring*

On April 26, 2012, we announced our intention to restructure certain of our operations. We recorded a \$1.0 million restructuring charge. The restructuring related primarily to changes being implemented to focus on a shift in our business to more aggressively sell end-to-end M2M solutions. As a result of this restructuring, we eliminated employment positions in our work force of 30 employees at a cost of \$0.6 million for severance. We also incurred expenses from vacating facilities in Davis, California and Huntington Beach, California at a cost of approximately \$0.4 million. The payments associated with these charges and all the actions associated with the restructuring were completed during the second quarter of fiscal 2013.



## 11. RESTRUCTURING (CONTINUED)

Below is a summary of the restructuring charges and other activity within the restructuring accrual during the first quarter of fiscal 2014 related to both the fiscal 2013 restructuring and the fiscal 2014 restructuring (in thousands):

	Employee Termination Costs	Other	Total
Balance at September 30, 2013	\$ 350	\$ —	\$ 350
Restructuring charge	152	—	152
Payments	(412)	—	(412)
Reversals	(71)	—	(71)
Balance at December 31, 2013	<u>\$ 19</u>	<u>\$ —</u>	<u>\$ 19</u>

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

Our management's discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended September 30, 2013, as well as our subsequent reports on Forms 10-Q and 8-K.

### 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.

#### *Forward-Looking Statements*

The words "assume," "believe," "anticipate," "intend," "estimate," "target," "may," "will," "expect," "plan," "project," "should," or "continue" or the negative thereof or other variations thereon or similar terminology, which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. Among other items, these statements relate to expectations of the business environment in which we operate, projections of future performance, perceived marketplace opportunities and statements regarding our mission and vision. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, including risks related to the highly competitive market in which our company operates, rapid changes in technologies that may displace products sold by us, declining prices of networking products, our reliance on distributors and other third parties to sell our products, delays in product development efforts, uncertainty in user acceptance of our products, the ongoing shift of our sales efforts to focus more on the delivery of broader based solutions which can be a more complex sales process, has not been a historical sales focus of our company and can involve longer sales cycles than the sale of our legacy hardware products, the ability to integrate our products and services with those of other parties in a commercially accepted manner, potential liabilities that can arise if any of our products have design or manufacturing defects, our ability to defend or settle satisfactorily any litigation, uncertainty in global economic conditions and economic conditions within particular regions of the world which could negatively affect product demand and the financial solvency of customers and suppliers, the impact of natural disasters and other events beyond our control that could negatively impact our supply chain and customers, the ability to achieve the anticipated benefits and synergies associated with acquisitions, and changes in our level of revenue or profitability which can fluctuate for many reasons beyond our control. These and other risks, uncertainties and assumptions identified from time to time in our filings with the United States Securities and Exchange Commission, including without limitation, our annual report on Form 10-K for the year ended September 30, 2013, this report on Form 10-Q and subsequent quarterly reports on Form 10-Q and other filings, could cause the company's future results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. Many of such factors are beyond our ability to control or predict. These forward-looking statements speak only as of the date for which they are made. We disclaim any intent or obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

A description of our critical accounting policies and estimates 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, 2013. There have been no material changes to our critical accounting policies as disclosed in that report.

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

We are a leading provider of machine to machine (M2M) networking products and solutions that enable the connection, monitoring and control of local or remote physical assets by electronic means. These networking products and solutions can connect communication hardware to a physical asset and convey information about the asset's status and performance, which can be sent to a computer system and used to improve or automate one or more processes. Increasingly these products and solutions are being deployed via wireless networks as wireless communications become more and more prevalent. Our products are deployed by a wide range of businesses and institutions. We compete for customers on the basis of existing and planned product features, service and software application capabilities, company reputation, brand recognition, technical support, relationships with partners, quality and reliability, product development capabilities, price and availability.

Total revenue was \$47.3 million for the first quarter of fiscal 2014 compared to \$47.0 million for the first quarter of fiscal 2013, an increase of \$0.3 million, or 0.7%. Revenue for the first fiscal quarter of 2013 included only two months of revenue from Etherios as we completed our acquisition of this company on October 31, 2012.

Hardware product revenue for the first fiscal quarter of 2014 were \$42.0 million, compared to hardware product revenue of \$43.0 million for the first fiscal quarter of 2013, a decrease of \$1.0 million, or 2.4%. Revenue from growth hardware products in the first fiscal quarter of 2014 was \$22.1 million, compared to \$21.9 million in the first fiscal quarter of 2013, an increase of \$0.2 million, or 0.7%. Revenue from mature hardware products was \$19.9 million in the first fiscal quarter of 2014, compared to \$21.1 million in the first fiscal quarter of 2013, a decrease of \$1.2 million, or 5.7%.

Revenue from our service offerings, which are part of our growth portfolio, was \$5.3 million in the first quarter of fiscal 2014, compared to \$4.0 million in the year ago comparable quarter, an increase of \$1.3 million, or 35.1%.

Net income was \$0.7 million in the first quarter of fiscal 2014, or \$0.03 per diluted share, compared to \$1.2 million, or \$0.05 per diluted share, in the first quarter of fiscal 2013. Net income in the first fiscal quarter of 2014 included a tax benefit of \$0.2 million, or \$0.01 per diluted share, resulting from the reversal of tax reserves for the expiration of the statutes of limitation for various U.S. jurisdictions. Net income in the first fiscal quarter of 2013 included a tax benefit of \$0.1 million, or \$0.01 per diluted share, resulting from the reversal of tax reserves for the expiration of the statutes of limitation for various U.S. and foreign jurisdictions.

**CONSOLIDATED RESULTS OF OPERATIONS**

The following table sets forth selected information derived from our interim condensed consolidated statements of operations (dollars in thousands):

	Three months ended December 31,				% incr. (decr.)
	2013		2012		
<b>Revenue:</b>					
Hardware product	\$ 41,989	88.7%	\$ 43,043	91.6%	(2.4)%
Service	5,333	11.3	3,948	8.4	35.1
Total revenue	47,322	100.0	46,991	100.0	0.7
<b>Cost of sales:</b>					
Cost of hardware product	20,263	42.8	20,126	42.8	0.7
Cost of service	4,151	8.8	2,386	5.1	74.0
Total cost of sales	24,414	51.6	22,512	47.9	8.4
Gross profit	22,908	48.4	24,479	52.1	(6.4)
Operating expenses	22,280	47.1	22,807	48.6	(2.3)
Operating income	628	1.3	1,672	3.5	(62.4)
Other income, net	136	0.3	176	0.4	(22.7)
Income before income taxes	764	1.6	1,848	3.9	(58.7)
Income tax provision	76	0.1	618	1.3	(87.7)
Net income	\$ 688	1.5%	\$ 1,230	2.6%	(44.1)%

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

## REVENUE

*Overview*

Total revenue was \$47.3 million for the first quarter of fiscal 2014 compared to \$47.0 million for the first quarter of fiscal 2013, an increase of \$0.3 million, or 0.7%. No significant changes were made to our pricing strategy that would impact revenue during the three month periods ended December 31, 2013 or 2012.

*Hardware Products*

(\$ in thousands)	Three months ended December 31,				% incr.
	2013		2012		(decr.)
Growth hardware products	\$ 22,053	52.5%	\$ 21,900	50.9%	0.7 %
Mature hardware products	19,936	47.5	21,143	49.1	(5.7)
Total product revenue	\$ 41,989	100.0%	\$ 43,043	100.0%	(2.4)%

Our growth hardware product offerings include all wireless products, as well as the ARM-based embedded module product line, which leverages Device Cloud by Etherios™ with both wired and wireless connectivity. Revenue from growth hardware products increased by \$0.2 million, or 0.7% for the three month period ended December 31, 2013 as compared to the same period a year ago. Certain customers who generally make significant purchases each quarter delayed certain purchases during the first quarter of fiscal 2014, which contributed to the decline in revenue versus the first fiscal quarter of 2013. While we expect to continue making sales to these customers in the future, the timing and magnitude of any recovery of these delayed purchases is uncertain. We expect our growth hardware product revenue to increase, the rate of growth may vary from quarter to quarter based on the timing of purchasing decisions by our customers.

Our mature hardware product offerings include generally all wired products. Our serial servers, Rabbit-branded modules, chips and USB hardware offerings are mature hardware products. Revenue of our mature hardware products decreased by \$1.2 million, or 5.7% for the three month period ended December 31, 2013, as compared to the same period a year ago. The decrease is primarily due to a decrease in revenue from serial servers and chips, partially offset by an increase in revenue from Rabbit-branded modules. Revenue from mature products can fluctuate due to large orders from customers as product lines mature. Although revenue from our mature products declined slower than expected in the first quarter of fiscal 2014, we expect that revenue from these products will continue to decrease in the future as they are in the mature portion of their product life cycles.

*Services*

The services offerings include our wireless product design and development services, customer relationship management (CRM) consulting services, application development services, licenses to use The Social Machine® application for use on the Force.com platform, our platform-as-a-service (PAAS) recurring revenue generated from Device Cloud, and post-contract customer support and fees associated with technical support and training. Revenue from our service offerings, which are all part of our growth portfolio, was \$5.3 million in the first quarter of fiscal 2014, compared to \$4.0 million in the first quarter of fiscal 2013, an increase of \$1.3 million, or 35.1%. The increase is primarily due to additional revenue from CRM consulting services; however, this increase was less than projected due to work interruptions on two significant customer projects. We anticipate a continued positive growth trend, the rate of growth may vary significantly from quarter to quarter. Revenue for the first fiscal quarter of 2013 included only two months of revenue from Etherios as we completed our acquisition of this company on October 31, 2012.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)***Revenue by Geographic Location*

The following summarizes our revenue by geographic location of our customers:

(\$ in thousands)	Three months ended December 31,		\$ incr.	% incr.
	2013	2012	(decr.)	(decr.)
North America, primarily United States	\$ 29,437	\$ 27,002	\$ 2,435	9.0 %
Europe, Middle East & Africa	11,597	11,983	(386)	(3.2)
Asia	5,073	6,492	(1,419)	(21.9)
Latin America	1,215	1,514	(299)	(19.7)
Total revenue	\$ 47,322	\$ 46,991	\$ 331	0.7 %

Revenue in North America increased by \$2.4 million for the three months ended December 31, 2013 compared to the same period a year ago, primarily due to an increase in revenue of \$1.2 million from CRM consulting services and increased cellular product revenue, partially offset by a decline in embedded modules due to delays in purchases by certain OEM customers during the first quarter of fiscal 2014. All revenue from Etherios is included in North America. Revenue for the first fiscal quarter of 2013 included only two months of revenue from Etherios as we completed our acquisition of this company on October 31, 2012.

Revenue in Europe, Middle East & Africa ("EMEA") decreased by \$0.4 million for the three months ended December 31, 2013, compared to the same period a year ago primarily due to decreases in revenue from cellular products and serial servers, partially offset by an increase in revenue from modules.

Revenue in Asia decreased by \$1.4 million for the three months ended December 31, 2013, compared to the same period a year ago, primarily due to the discontinuation of certain products in fiscal 2013 that are no longer available for sale.

Revenue in Latin America decreased by \$0.3 million for the three months ended December 31, 2013, compared to the same period a year ago primarily due to a decrease in revenue from cellular products.

The fluctuation of foreign currency rates for the three month period ended December 31, 2013 had a favorable impact on total revenue of \$0.2 million due primarily to the strengthening of the Euro compared to the U.S. dollar. For the three month period ended December 31, 2012 the fluctuation of foreign currency rates had an unfavorable impact on total revenue of \$0.1 million due primarily to the weakening of the Euro compared to the U.S. dollar.

**GROSS MARGIN**

Gross margins were 48.4% and 52.1% for the three month periods ended December 31, 2013 and 2012, respectively. The gross margin decreased for the three months ended December 31, 2013 as compared to the same period in the prior year by 3.7 percentage points, of which 2.1 percentage points relates to a decline in service gross margin.

Hardware product gross margin was 51.7% for the three months ended December 31, 2013, compared to 53.2% for the same period a year ago, a decrease of 1.5 percentage points. The decrease was primarily due to product mix, as revenue from mature hardware products, which generally have higher gross margins, decreased faster than the increase in revenue from growth hardware products. This was partially offset by favorable production costs for our hardware products in the first fiscal quarter of 2014 compared to the year ago comparable quarter.

Service gross margin was 22.2% for the three months ended December 31, 2013, compared to 39.6% for the same period a year ago, a decrease of 17.4 percentage points. The decrease was primarily related to lower than anticipated CRM revenue and a resulting underutilization of consulting labor that had been retained for the expected demand for these services. We expect our service gross margin to vary from quarter to quarter for the foreseeable future as our CRM consulting services and our wireless product design and development services margins are dependent on the utilization rates of our personnel.

**OPERATING EXPENSES**

Operating expenses decreased by \$0.5 million for the three month period ended December 31, 2013 as compared to the same period a year ago.

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

The following summarizes our total operating expenses in dollars and as a percentage of total revenue:

(\$ in thousands)	Three months ended December 31,				\$ incr. (decr.)
	2013		2012		
Sales and marketing	\$ 10,219	21.6%	\$ 10,274	21.9%	\$ (55)
Research and development	7,257	15.3	7,417	15.8	(160)
General and administrative	4,723	10.0	5,116	10.9	(393)
Restructuring	81	0.2	—	—	81
Total operating expenses	\$ 22,280	47.1%	\$ 22,807	48.6%	\$ (527)

Sales and marketing expenses for the three months ended December 31, 2013 as compared to the same period a year ago decreased \$0.1 million primarily due to a reduction in advertising and promotion expenses.

Research and development expenses decreased \$0.2 million for the three months ended December 31, 2013 as compared to the same periods a year ago primarily due to reduced compensation-related expenses, partially offset by increases in outside services and occupancy expenses.

General and administrative expenses decreased \$0.4 million for the three months ended December 31, 2013 as compared to the same periods a year ago, primarily due to a decrease in legal expenses.

Restructuring expense of \$0.1 million for the three months ended December 31, 2013 pertains to a restructuring charge in India of \$0.2 million relating to actions that were announced October 31, 2013, partially offset by a reversal of \$0.1 million related to the 2013 restructuring announced September 27, 2013.

**OTHER INCOME, NET**

Other income, net decreased slightly for the three months ended December, 2013 and 2012, respectively, due primarily to less foreign currency gains in the first quarter of fiscal 2014 compared to the same quarter a year ago.

**INCOME TAXES**

Income taxes have been provided at an overall effective rate of 9.9% and 33.4% for the three month periods ended December 31, 2013 and 2012, respectively. The overall effective tax rate includes the discrete items mentioned in the following paragraphs. Our effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and discrete events, such as settlements of audits.

In the first three months of fiscal 2014 and fiscal 2013, we recorded a discrete tax benefit of \$0.2 million and \$0.1 million, respectively for the release of income tax reserves due to the expiration of statutes of limitation from various U.S. and foreign tax jurisdictions. For the three month periods ended December 31, 2013 and December 31, 2012, these discrete tax benefits reduced our effective tax rate by 28.1 and 7.8 percentage points, respectively.

During the first three months of both fiscal 2014 and fiscal 2013, the income tax provision before discrete tax benefits was higher than the federal statutory rate primarily due to reserves for unrecognized tax benefits and state income taxes, in excess of domestic tax benefits.

**LIQUIDITY AND CAPITAL RESOURCES**

We have financed our operations and capital expenditures principally with funds generated from operations. At December 31, 2013, we had cash, cash equivalents and short-term marketable securities of \$97.8 million, compared to \$88.3 million at September 30, 2013. Our working capital (total current assets less total current liabilities) was \$140.0 million at December 31, 2013 and \$128.0 million at September 30, 2013. The increases in both the liquid assets and the working capital resulted primarily from a decrease of \$7.4 million in long-term marketable securities from September 30, 2013 as these securities were reclassified to short-term marketable securities. We presently anticipate total fiscal 2014 capital expenditures will be approximately \$3.9 million.

Net cash used by operating activities was \$0.3 million for the three months ended December 31, 2013 as compared to net cash provided by operating activities of \$2.3 million for the three months ended December 31, 2012, a net decrease of \$2.6 million.

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

This was primarily due to a decrease in net income of \$0.5 million and a decrease in cash resulting from changes in working capital of \$2.1 million. The decrease of \$2.1 million in cash from changes in working capital was due primarily to an increase in inventory and a reduction in accrued compensation partially offset by a decrease in accounts receivable.

Net cash provided by investing activities was \$6.1 million during the three months ended December 31, 2013, compared to net cash used in investing activities of \$6.8 million during the three months ended December 31, 2012, a net increase of \$12.9 million. During the first quarter of fiscal 2013, we received proceeds of \$7.1 million from maturities of marketable securities, offset by \$1.0 million of capital expenditures. During the first quarter of fiscal 2012, we spent \$12.9 million, net of cash acquired, for the purchase of Etherios, Inc. and \$1.5 million for capital expenditures, partially offset by net proceeds from maturities of marketable securities of \$7.6 million.

Cash provided by financing activities was \$3.1 million for the three months ended December 31, 2013, compared to cash used in financing activities of \$3.8 million for the three months ended December 31, 2012. There were no repurchases of common stock during the first quarter of fiscal 2014 compared to repurchases of \$4.2 million during the first three months of fiscal 2013. We also received \$2.7 million of additional proceeds from stock option plan and employee stock purchase plan transactions, the majority of which we received in the first quarter of fiscal 2014.

We generally expect positive cash flows from operations and believe that our current cash, cash equivalents and short-term marketable securities balances, cash generated from operations and our ability to secure debt and/or equity financing will be sufficient to fund our business operations and capital expenditures for the next twelve months and beyond.

On October 29, 2013, our Board of Directors authorized a new program to repurchase up to \$20 million of our common stock, primarily to support our employee stock purchase program and to return capital to shareholders. Shares repurchased under the new program may be made through open market and privately negotiated transactions from time to time and in amounts that management deems appropriate. The timing of share repurchases will depend upon market conditions and other corporate considerations. During the three months ended December 31, 2013, we did not repurchase any shares under this new authorization plan.

At December 31, 2013, our cash, cash equivalents and marketable securities, including long-term marketable securities, were \$107.8 million. This balance includes approximately \$36.8 million of cash and cash equivalents held by our controlled foreign subsidiaries of which \$25.3 million represents accumulated undistributed foreign earnings. Although we have no current need to do so, if we change our assertion that we do not intend to repatriate additional undistributed foreign earnings for cash requirements in the United States, we would have to accrue applicable taxes. The amount of any taxes and the application of any tax credits would be determined based on the income tax laws at the time of such repatriation. Under current tax laws, we estimate the unrecognized deferred tax liability to be in the range of \$1.5 million to \$2.5 million which could have a material impact on our current consolidated balance sheet, results of operations and cash flows.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### *Not Adopted*

In July 2013, the Financial Accounting Standards Board, "FASB" issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." This guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU No. 2013-11 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2014. We will adopt this guidance beginning with our fiscal quarter ending December 31, 2015. While we are evaluating the impact of the adoption of ASU 2013-11, we do not currently expect it to have a material impact on our consolidated financial statements.

In March 2013, FASB issued ASU 2013-05, "Foreign Currency Matters (Topic 830); Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity." This guidance applies to the release of the cumulative translation adjustment into net income

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

when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We will adopt this guidance beginning with our fiscal quarter ending December 31, 2014. We currently are reviewing the provisions of ASU No. 2013-05 but do not expect it to have an effect on our consolidated financial statements as we currently do not intend to sell any foreign entities for which we hold a controlling financial interest.



**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 available-for-sale and are carried at fair value. Our investments consist of certificates of deposit, money market funds, government municipal bonds and corporate bonds. Our investment 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. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than one year.

**FOREIGN CURRENCY RISK**

We have transactions that are executed in the U.S. Dollar, British Pound, Euro, Japanese Yen and Indian Rupee. As a result, we are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros, British Pounds, Japanese Yen or Indian Rupees, 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 formal hedging strategy to reduce foreign currency risk as we continue to mitigate this risk with natural hedging strategies.

For the three months ended December 31, 2013 and 2012, we had approximately \$17.9 million and \$20.0 million, respectively, of revenue from foreign customers including export sales. Of these sales, \$6.0 million and \$6.1 million, respectively, were denominated in foreign currency, predominantly Euros and British Pounds. In future periods, we expect a significant portion of sales will continue to be made in both Euros and British Pounds.

The table below compares the average monthly exchange rates of the Euro, British Pound, Japanese Yen and Indian Rupee to the U.S. Dollar:

	Three months ended December 31,		% increase (decrease)
	2013	2012	
Euro	1.3610	1.2972	4.9 %
British Pound	1.6188	1.6064	0.8 %
Japanese Yen	0.0100	0.0123	(18.7)%
Indian Rupee	0.0162	0.0185	(12.4)%

A 10% change from the first three months of fiscal year 2014 average exchange rate for the Euro, British Pound, Japanese Yen and Indian Rupee to the U.S. Dollar would have resulted in a 1.3% increase or decrease in revenue and a 1.9% increase or decrease in stockholders' equity due to foreign currency translation. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

**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 and customer contacts to facilitate payment.

Investments are made in accordance with our investment policy and consist of certificates of deposit, money market funds, government municipal bonds and corporate bonds. The fair value of our investments contains an element of credit exposure, which could change based on changes in market conditions. If market conditions deteriorate or if the issuers of these securities experience credit rating downgrades, we may incur impairment charges for securities in our investment portfolio. All of our securities are held domestically.

## 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 SEC rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

### CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during our most recently completed fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

None

#### ITEM 1A. RISK FACTORS

Except as noted below, there have been no material changes in our risk factors from those previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended September 30, 2013.

***We do not have any large scale customers that represent more than 10% of our revenue. Our revenue may be subject to fluctuations based on the level of significant one time purchases.***

No single customer has represented more than 10% of our revenue in any of the last three fiscal years. Many of our customers, however, make significant one time hardware purchases for large projects which are not repeated. As a result our revenue may be subject to significant fluctuations based on whether we are able to close significant sales opportunities. Our failure to complete one or a series of significant sales opportunities in a particular fiscal period could have a material adverse effect on our revenue for that period. For instance, in the first fiscal quarter of 2014, our revenue was negatively impacted by the delay of certain purchases that we expected to occur in the quarter.

***The ongoing shift of our sales efforts to focus more on the delivery of broader based solutions involves a more complex sales process and may involve longer sales cycles than the sale of our legacy hardware products.***

We are migrating more of our sales resources towards the delivery of broader based solutions that can include the sale of hardware, custom applications and application hosting rather than the sale of only hardware point products. The sale of broader based solutions is often more complex than the sale of hardware products on a standalone basis and often involves the delivery of a value proposition that is based on business factors other than product features and functionality that drive many hardware sales. These sales also are more likely to be subject to increased levels of internal review by our customers compared to hardware point product sales and can have longer sales cycles as well. Sales of these types of solutions have not been a focal point of our company historically and our failure to develop our solutions based sales capabilities could have a material adverse impact on our long term business prospects. For instance, in the first quarter of 2014, our revenue and gross margin from our CRM implementation services offerings was negatively impacted by expenses related to labor that was underutilized as we experienced lower demand for services than we expected. In addition, the migration of more sales and marketing resources towards the delivery of broader based solutions could affect our sales and results of operations from quarter to quarter adversely as we devote less resources towards hardware point product sales that have traditionally represented the significant majority of our revenue and more towards the development of new sales channels for broader based solutions.

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

On October 29, 2013, our Board of Directors authorized a new program to repurchase up to \$20 million of our common stock primarily to support our employee stock purchase program and to return capital to shareholders. This new repurchase authorization expires on October 31, 2014 and replaced a similar program for fiscal 2013. Shares repurchased under the new program may be made through open market and privately negotiated transactions from time to time and in amounts that management deems appropriate. The timing of share repurchases will depend upon market conditions and other corporate considerations. Since we did not repurchase any shares under this new authorization plan during the three months ended December 31, 2013, \$20 million of our common stock repurchase authorization remains fully available for future repurchases.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

Exhibit No.	Description
3 (a)	Restated Certificate of Incorporation of the Company, as amended (1)
3 (b)	Amended and Restated By-Laws of the Company (2)
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)
10 (a)	Digi International Inc. Employee Stock Purchase Plan as Amended and Restated as of October 29, 2013
10 (b)	Digi International Inc. 2014 Omnibus Incentive Plan
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
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

(1) 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)

(2) Incorporated by reference to Exhibit 3 to the Company's Current Report on Form 8-K filed January 21, 2011 (File No. 1-34033)

(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)

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: February 3, 2014

By: /s/ Steven E. Snyder

Steven E. Snyder

Senior Vice President, Chief Financial Officer and  
Treasurer (Principal Financial Officer and Authorized Officer)

## EXHIBIT INDEX

Exhibit Number	Document Description	Form of Filing
3 (a)	Restated Certificate of Incorporation of the Company, as Amended	Incorporated by Reference
3 (b)	Amended and Restated By-Laws of the Company	Incorporated by Reference
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
10 (a)	Digi International Inc. Employee Stock Purchase Plan as Amended and Restated as of October 29, 2013	Filed Electronically
10 (b)	Digi International Inc. 2014 Omnibus Incentive Plan	Filed Electronically
31 (a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31 (b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32	Section 1350 Certification	Filed Electronically
101.INS	XBRL Instance Document	Filed Electronically
101.SCH	XBRL Taxonomy Extension Schema Document	Filed Electronically
101.CAL	XBRL Taxonomy Calculation Linkbase Document	Filed Electronically
101.DEF	XBRL Taxonomy Definition Linkbase Document	Filed Electronically
101.LAB	XBRL Taxonomy Label Linkbase Document	Filed Electronically
101.PRE	XBRL Taxonomy Presentation Linkbase Document	Filed Electronically

**DIGI INTERNATIONAL INC.  
EMPLOYEE STOCK PURCHASE PLAN  
AS AMENDED AND RESTATED AS OF OCTOBER 29, 2013**

**(effective October 29, 2013, subject to stockholder approval)**

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

2. **DEFINITIONS.**

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

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

(b) “Board of Directors” means the Board of Directors of the Company.

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

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

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

(f) “Company” means Digi International Inc.

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

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

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

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

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

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

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

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

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

(p) "Share" means a share of Common Stock.

3. SCOPE OF THE PLAN. Shares of Common Stock may be sold by the Company to Eligible Employees commencing April 1, 1996, as hereinafter provided, but not more than 2,800,000 (subject to adjustment as provided in Section 14) shall be sold to Eligible Employees pursuant to this Plan. All sales of Common Stock pursuant to this Plan shall be subject to the same terms, conditions, rights and privileges. The shares of Common Stock delivered by the Company pursuant to this Plan may be acquired shares having the status of any combination of authorized but unissued shares, newly issued shares, or treasury shares.

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

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

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

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

#### 6. METHOD OF PARTICIPATION.

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

6.2. Each Eligible Employee who desires to participate in the Plan for a Purchase Period shall signify his or her election to do so by signing an election form developed by the Committee. An Eligible Employee may elect to have any whole percent of Compensation withheld, but not exceeding ten percent (10%) per pay period. An election to participate in the Plan and to authorize payroll deductions as described herein must be made before the first day of the Purchase Period to which it relates and shall remain in effect unless and until such Participant withdraws from this Plan, modifies his or her authorization, or terminates his or her employment with the Company, as hereinafter provided.



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

#### 7. RECORDKEEPING ACCOUNT.

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

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

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

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

#### 8. RIGHT TO ADJUST PARTICIPATION OR TO WITHDRAW.

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

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

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

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

9. TERMINATION OF EMPLOYMENT. If the employment of a Participant is terminated for any reason, including death, disability, or retirement, the entire balance in the Participant's Recordkeeping Account will be applied to the purchase of shares as provided in Section 10.1 as of the last day of the Purchase Period in which the Participant's employment terminated; except that if such Participant so requests prior to the last day of such Purchase Period, the Company shall refund in cash within 15 days all amounts credited to his or her Recordkeeping Account.

#### 10. PURCHASE OF SHARES.

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

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

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

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

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

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

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

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

14. ADJUSTMENT FOR CHANGES IN CAPITALIZATION. In the event of any equity restructuring (within the meaning of authoritative guidance issued by the Financial Accounting Standards Board relating to stock-based compensation) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to the number, class and purchase price of Shares that may be purchased under the Plan. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan.

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

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

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

18. GOVERNMENTAL REGULATIONS AND LISTING. All rights granted or to be granted to Eligible Employees under this Plan are expressly subject to all applicable laws and regulations and to the approval of all governmental authorities required in connection with the authorization, issuance, sale or transfer of the shares of Common Stock reserved for this Plan, including, without limitation, there being a current registration statement of the Company under the Securities Act of 1933, as amended, covering the shares of Common Stock purchasable on the last day of the Purchase Period applicable to such shares, and if such a registration statement shall not then be effective, the term of such Purchase Period shall be extended until the first business day after the effective date of such a registration statement, or post-effective amendment thereto. If applicable, all such rights hereunder are also similarly subject to effectiveness of an appropriate listing application to a national securities exchange or a national market system, covering the shares of Common Stock under the Plan upon official notice of issuance.

19. MISCELLANEOUS.

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

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

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

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

**Digi International Inc.**  
**2014 Omnibus Incentive Plan**

1. *Purpose.* The purpose of the Digi International Inc. 2014 Omnibus Incentive Plan (the “Plan”) is to promote the interests of the Company and its stockholders by providing key personnel of the Company and its Affiliates and Non-Employee Directors with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its Affiliates. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel and Non-Employee Directors of outstanding ability.

2. *Definitions.*

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

(a) “Affiliate” means any corporation that is a “parent corporation” or “subsidiary corporation” of the Company, as those terms are defined in Code Sections 424(e) and (f), or any successor provisions, and, for purposes other than the grant of Incentive Stock Options, any entity in which the Company or any such “subsidiary corporation” owns at least 20% of the combined voting power of the entity’s voting securities and which is designated by the Committee as covered by the Plan.

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

(c) “Award” or “Awards” means a grant made under the Plan in the form of Restricted Stock, Options, Stock Appreciation Rights, Stock Units, an Other Stock-Based Award or a Cash Incentive Award.

(d) “Board” means the Board of Directors of the Company.

(e) “Cash Incentive Award” means an Award described in Section 8.2 of the Plan.

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

(g) “Committee” means two or more Non-Employee Directors designated by the Board to administer the Plan under Plan Section 3.1, each of whom shall be (i) an independent director within the meaning and rules of the Nasdaq Stock Market, (ii) a “non-employee director” within the meaning of Exchange Act Rule 16b-3 and (iii) an “outside director” for purposes of Code Section 162(m). Unless otherwise specified by the Board, the Committee shall be the Compensation Committee of the Board.

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

(i) “Effective Date” means the date specified in Plan Section 13.1.

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

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

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

(m) “Fair Market Value” as of any date means, unless otherwise expressly provided in the Plan, the fair market value of a Share determined as follows:

(i) If the Shares are then readily tradable on an established securities market (as determined under Code Section 409A), then Fair Market Value will be the closing sale price for a Share on the principal securities market on which it trades on such date, or if no sale of Shares occurred on that date, on the next preceding date on which a

sale of Shares occurred, as reported in *The Wall Street Journal* or such other source as the Committee deems reliable; or

(ii) If clause (i) is inapplicable, then Fair Market Value will be determined by the Committee as the result of a reasonable application of a reasonable valuation method that satisfies the requirements of Code Section 409A.

In the case of an Incentive Stock Option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 17.

(m) "Full Value Award" means any Award other than an Option Award, Stock Appreciation Rights Award or Cash Incentive Award.

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

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

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

(q) "Non-Employee Director" means a member of the Board who is not an Employee.

(r) "Non-Statutory Stock Option" means an Option other than an Incentive Stock Option.

(s) "Option" means a right to purchase Stock, including both Non-Statutory Stock Options and Incentive Stock Options.

(t) "Other Stock-Based Award" means an Award described in Section 8.1 of the Plan.

(u) "Participant" means a person to whom an Award is or has been made in accordance with the Plan.

(v) "Performance-Based Compensation" means a Full Value or Cash Incentive Award to a person who is, or is determined by the Committee to likely become, a "covered employee" (as defined in Code Section 162(m)(3)) and that is intended to constitute "performance-based compensation" within the meaning of Code Section 162(m)(4)(C).

(w) "Performance Cycle" means the period of time as specified in an Agreement over which a performance-based Award is to be earned.

(x) "Plan" means this Digi International Inc. 2014 Omnibus Incentive Plan, as may be amended and in effect from time to time.

(y) "Prior Plans" means the Digi International Inc. 2000 Omnibus Stock Plan, as amended and restated as of December 4, 2009 (the "2000 Plan"), and the Digi International Inc. 2013 Omnibus Incentive Plan (the "2013 Plan").

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

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

(bb) "Share" means a share of Stock.

(cc) "Stock" means the common stock, par value \$.01 per share, of the Company.

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

(ee) "Stock Unit" means an Award described in Section 11 of the Plan.

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

(gg) “Substitute Award” means an Award granted under the circumstances described in Section 21 of the Plan.

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

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

(jj) “Transferee” means any “family member” of a Participant as the term is defined in General Instruction A(5) to Form S-8 under the Securities Act of 1933, as amended.

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

### 3. *Administration and Indemnification.*

#### 3.1 *Administration.*

(a) The Committee shall administer the Plan. The Committee shall have exclusive power to (i) make Awards, (ii) determine when and to whom Awards will be granted, the form of each Award, the amount of each Award, and any other terms or conditions of each Award consistent with the Plan, and (iii) determine whether, to what extent and under what circumstances, Awards may be settled, paid or exercised in cash, Shares or other Awards, or other property or canceled, forfeited or suspended. Each Award shall be subject to an Agreement authorized by the Committee. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Any such action of the Committee shall be valid and effective even if any member of the Committee at the time of the action is later determined not to have satisfied all of the criteria for membership in clauses (i), (ii) and (iii) of Section 2(f). Notwithstanding the foregoing, the Board shall have the sole and exclusive power to administer the Plan with respect to Awards granted to Non-Employee Directors.

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

(c) To the extent within its discretion and subject to Plan Sections 16, 17, and 19, the Committee may amend the terms and conditions of any outstanding Award.

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

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

(f) The Committee may grant Awards to Employees and other eligible service providers who are foreign nationals, who are located outside of the United States or who are not compensated from a payroll maintained in the United States, or who are otherwise subject to (or could cause the Company to be subject to) legal or regulatory requirements of countries outside of the United States, on such terms and conditions different from those specified in the Plan as may, in the judgment of the Committee, be necessary or desirable to comply with applicable foreign laws and regulatory requirements and to promote achievement of the purposes of the Plan. In connection therewith, the Committee may establish such sub-plans and modify exercise procedures and other Plan rules and procedures to the extent such actions are deemed necessary or desirable, and may take any other action that it deems advisable to obtain local regulatory approvals or to comply with any necessary local governmental regulatory exemptions.

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

#### 4. *Shares Available Under the Plan and Maximum Awards.*

4.1 *Number of Shares Available for Grants*. Subject to adjustment as provided in Sections 4.1(a) and 17 herein, the number of Shares that may be the subject of Awards and issued to Participants under the Plan shall be 2,250,000. After the Effective Date, no additional awards may be granted under the Prior Plans. Any Shares that are subject to Awards of Options shall be counted against the maximum Share limitation as one Share for every one Share granted, and Awards of Stock Appreciation Rights shall be counted against this maximum Share limitation as equal to the number of Shares to which such Stock Appreciation Rights relate. Any Shares that are subject to Full Value Awards shall be counted against this maximum Share limitation as 2.0 Shares for every one Share granted. Substitute Awards shall not be counted against this maximum Share limitation, nor shall they reduce the number of Shares authorized for grant to a Participant in any calendar year. The Shares to be delivered under the Plan will be made available from authorized but unissued Shares or issued Shares that are held in the Company's treasury.

(a) Any Shares subject to an Award under this Plan, or to an award granted under one of the Prior Plans that is outstanding on the Effective Date (a "Prior Plan Award"), that expires, is forfeited, cancelled, returned to the Company for failure to satisfy vesting requirements, is settled for cash or otherwise terminates without payment being made thereunder shall, to the extent of such expiration, forfeiture, cancellation, return, cash settlement or termination, again be available for grant under the Plan. Each Share that again becomes available for grant pursuant to the preceding sentence shall increase the total number of Shares remaining available for Awards by (i) one Share if such Share was subject to an Option or Stock Appreciation Right granted under the Plan or to a stock option or stock appreciation right granted under one of the Prior Plans, (ii) 2.0 Shares if such Share was subject to a Full Value Award granted under the Plan or under the 2013 Plan, or (iii) 1.3 Shares if such Share was subject to a Full Value Award granted under the 2000 Plan. The following Shares will, however, continue to be charged against the foregoing maximum Share limitation and will not again become available for grant: (i) Shares tendered by the Participant or withheld by the Company in payment of the purchase price of an Option, (ii) Shares tendered by the Participant or withheld by the Company to satisfy any tax withholding obligation with respect to an Award, (iii) Shares subject to a Stock Appreciation Right that are not issued in connection with the settlement of the Stock Appreciation Right upon its exercise, and (iv) Shares repurchased by the Company with proceeds received from the exercise of a stock option issued under this Plan or the Prior Plan.

(b) Where two or more types of Awards (all of which are payable in Shares) are granted to a Participant in tandem with each other, such that the exercise of one type of Award with respect to a number of Shares cancels at least an equal number of Shares of the other, the number of Shares to be counted against the maximum Share limitation shall be the maximum number of Shares available under the larger of the two Awards.

(c) If a company acquired by the Company or any Subsidiary or with which the Company or any Subsidiary combines has shares available under a pre-existing plan approved by stockholders and not adopted in contemplation of such acquisition or combination, the number of shares remaining available for grant pursuant to the terms of such pre-existing plan (as adjusted, to the extent appropriate, using the exchange ratio or other adjustment or valuation ratio or formula used in such acquisition or combination to determine the consideration payable to the holders of common stock of the entities party to such acquisition or combination) may be used for Awards under the Plan and shall not reduce the number of Shares authorized for grant under the Plan. Awards using such available shares shall not be made after the date awards or grants could have been made under the terms of the pre-existing plan, absent the acquisition or combination, and shall only be made to individuals who were not Employees or Non-Employee Directors prior to such acquisition or combination.

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

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

4.2 Individual Award Limitations. Subject to adjustment pursuant to Plan Section 17, the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Options is 350,000, and the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Stock Appreciation Rights is 175,000.

5. Eligibility. Participation in the Plan shall be limited to Employees, Non-Employee Directors and any consultant or advisor who is a natural person and who provides services to the Company or any Affiliate (other than in connection with (i) the offer or sale of securities in a capital-raising transaction or (ii) directly or indirectly promoting or maintaining a market in Company securities). The granting of Awards is solely at the discretion of the Committee, except that Incentive Stock Options may only be granted to Employees. References herein to “employed,” “employment” or similar terms (except “Employee”) shall include the providing of services to the Company or an Affiliate as a Non-Employee Director, consultant or advisor. Neither the transfer of employment of a Participant between any of the Company or its Affiliates, nor a leave of absence granted to such Participant and approved by the Committee, shall be deemed a termination of employment for purposes of the Plan.

#### 6. General Terms of Awards.

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

6.2 Term. Each Agreement, other than those relating solely to Awards of Shares without restrictions, shall set forth the Term of the Option, Stock Appreciation Right, Restricted Stock, Stock Unit or other Award or the Performance Cycle for any performance-based Award, as the case may be. Acceleration of the expiration of the applicable Term is permitted, upon such terms and conditions as shall be set forth in the Agreement, which may, but need not, include, without limitation, acceleration in the event of the Participant’s death or retirement. Acceleration of the Performance Cycle of any performance-based Awards shall be subject to Plan Section 6.6. Each award granted to a Participant shall have such Term as the Committee shall determine at the time of grant; provided, however, that any such Term shall not exceed eight (8) years.

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

6.4 Termination of Employment. Except as otherwise determined by the Committee or provided by the Committee in an Agreement, in case of a Participant’s termination of employment (which includes other service relationships as provided in Section 5), the following provisions shall apply:

##### (a) Options and Stock Appreciation Rights.

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

(ii) If a Participant’s employment with the Company and its Affiliates terminates because the Participant is disabled (within the meaning of Section 22(e)(3) of the Code), then any Option or Stock Appreciation Right that



has not expired or been terminated shall become exercisable in full if the Participant's employment has been continuous between the date the Option or Stock Appreciation Right was granted and the date of such disability, and the Participant or the Participant's Successor may exercise such Option or Stock Appreciation Right at any time, or from time to time, within one year after the date of the Participant's disability.

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

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

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

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

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

6.6 Performance-Based Awards. Any Award may be granted as a performance-based Award if the Committee establishes one or more measures of Company, Subsidiary, business unit or individual performance which must be attained, and the Performance Cycle over which the specified performance is to be attained, as a condition to the vesting, exercisability, lapse of restrictions and/or settlement in cash or Shares of such Award. In connection with any such Award, the Committee shall determine the extent to which performance goals have been attained and other applicable terms and conditions have been satisfied, and the degree to which vesting, exercisability, lapse of restrictions and/or settlement in cash or Shares of such Award has been earned. Any performance-based Award that is intended by the Committee to qualify as Performance-Based Compensation shall additionally be subject to the requirements of Section 12 of this Plan. Except as provided in Section 12 with respect to Performance-Based Compensation, the Committee shall also have the authority to provide, in an Agreement or otherwise, for the acceleration of a Performance Cycle and an adjustment or waiver of the achievement of performance goals upon the occurrence of certain events, which may, but need not include, without limitation, a Fundamental Change, a recapitalization, a change in the accounting practices of the Company, a change in a Participant's title or employment responsibilities, a Participant's death or retirement or, with respect to settlements in Shares with respect to an Award, a reclassification, stock dividend, stock split or stock combination as provided in Plan Section 17. An Agreement also may provide for a limitation on the value of an Award that a Participant may receive.

6.7 Dividends and Dividend Equivalents. Any dividends or distributions paid with respect to Shares that are subject to the unvested portion of a Restricted Stock Award will be subject to the same restrictions as the Shares to which such

dividends or distributions relate, except for regular cash dividends on Shares subject to the unvested portion of a Restricted Stock Award that is subject only to service-based vesting conditions. In its discretion, the Committee may provide in an Agreement for a Stock Unit Award or an Other Stock-Based Award that the Participant will be entitled to receive dividend equivalents on the units or other Share equivalents subject to the Award based on dividends actually declared on outstanding Shares. The terms of any dividend equivalents will be as set forth in the applicable Award Agreement, including the time and form of payment and whether such dividend equivalents will be credited with interest or deemed to be reinvested in additional units or Share equivalents. Any dividend equivalents payable with respect to the unvested portion of a Stock Unit Award or an Other Stock-Based Award that is performance-based within the meaning of Section 6.6 will be subject to the same restrictions as the units or other Share equivalents to which such dividend equivalents relate. The Committee may, in its discretion, provide in Award Agreements for restrictions on dividends and dividend equivalents in addition to those specified in this Section 6.7.

6.8 Minimum Vesting Period. The Committee may provide in an Agreement for such vesting conditions as it may determine, subject to the following limitations on Full Value Awards:

(1) A Full Value Award that vests solely as the result of the passage of time and continued employment by the Participant shall be subject to a vesting period of not less than three years from the grant date of the Award (but permitting pro rata vesting over such vesting period); and

(2) A Full Value Award whose vesting is subject to the satisfaction of performance goals over a Performance Cycle shall be subject to a Performance Cycle of not less than one year.

The minimum vesting periods specified in clauses (1) and (2) above will not, however, apply in the following situations: (i) an Award made to attract a key executive to join the Company; (ii) upon a Fundamental Change; (iii) upon termination of Service due to death, disability or retirement; (iv) Awards made in payment of or exchange for other earned compensation (including performance-based Awards); (v) any Substitute Award that does not reduce the vesting period of the award being replaced; (vi) Awards made to Non-Employee Directors; and (vii) Awards involving an aggregate number of Shares not in excess of 10% of the number of Shares specified in the first sentence of Section 4.1.

## 7. Restricted Stock Awards.

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

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

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

7.4 Rights as a Stockholder. Except as otherwise provided in the Plan, a Participant or a Transferee with a Restricted Stock Award shall have all the rights of a stockholder, including the right to vote the Shares of Restricted Stock.

## 8. Other Awards.

8.1 Other Stock-Based Awards. The Committee may from time to time grant Stock and other Awards that are valued by reference to and/or payable in whole or in part in Shares under the Plan. The Committee, in its sole discretion, shall determine the terms and conditions of such Awards, provided that such Awards shall not be inconsistent with the terms and purposes of the Plan. The Committee may, at its sole discretion, direct the Company to issue Shares subject to restrictive legends and/or stop transfer instructions that are consistent with the terms and conditions of the Award to which the Shares relate.

8.2 Cash Incentive Awards. A Cash Incentive Award shall be considered a performance-based Award for purposes of, and subject to, Section 6.6, the payment of which shall be contingent upon the degree to which one or more specified performance goals have been achieved over a specified Performance Cycle. Cash Incentive Awards may be granted to any Participant in such amounts and upon such terms and at such times as shall be determined by the Committee, and may be denominated in units that have a dollar value established by the Committee as of the applicable grant date. Following the

completion of the applicable Performance Cycle and the vesting of a Cash Incentive Award, payment of the settlement amount of the Award to the Participant shall be made at such time or times in the form of cash or other forms of Awards under the Plan (valued for these purposes at their grant date fair value) or a combination of cash and other forms of Awards as determined by the Committee and specified in the applicable Agreement. If a Cash Incentive Award is not by its terms exempt from the requirements of Code Section 409A, then the applicable Agreement shall contain terms and conditions intended to avoid adverse tax consequences specified in Code Section 409A.

## 9. Stock Options.

### 9.1 Terms of All Options.

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

(b) The purchase price of the Shares with respect to which an Option is exercised shall be payable in full at the time of exercise, provided that to the extent permitted by law, the Agreement may permit some or all Participants to simultaneously exercise Options and sell the Shares thereby acquired pursuant to a brokerage or similar relationship and use the proceeds from the sale as payment of the purchase price of the Shares. The purchase price may be payable in cash or in such other manner as the Committee may permit, including by delivery to the Company of Shares (by actual delivery or attestation) already owned by the Participant or by the Company withholding Shares otherwise issuable to the Participant upon the exercise of the Option (in either case, such Shares delivered or withheld having a Fair Market Value as of the date the Option is exercised equal to the purchase price of the Shares being purchased pursuant to the Option), or a combination thereof, as determined by the Committee, but no fractional Shares will be issued or accepted.

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

(d) Each Option granted to a Participant shall expire at such time as the Committee shall determine at the time of grant; provided, however, that no Option shall be exercisable later than the eight (8<sup>th</sup>) anniversary date of its grant.

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

(a) The maximum number of Shares that may be issued upon the exercise of Incentive Stock Options shall equal the maximum number of Shares that may be the subject of Awards and issued under the Plan as provided in the first sentence of Section 4.1.

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

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

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

10. Stock Appreciation Rights. An Award of a Stock Appreciation Right shall entitle the Participant (or a Successor or Transferee), subject to terms and conditions determined by the Committee, to receive upon exercise of the Stock Appreciation Right all or a portion of the excess of (i) the Fair Market Value of a specified number of Shares as of the date of exercise of the Stock Appreciation Right over (ii) a specified price that shall not be less than 100% of the Fair Market Value of such Shares as of the date of grant of the Stock Appreciation Right. A Stock Appreciation Right may be granted in connection with part or all of, in addition to, or completely independent of an Option or any other Award under the Plan. If issued in connection with a previously or contemporaneously granted Option, the Committee may impose a condition that exercise of a Stock Appreciation

Right cancels a pro rata portion of the Option with which it is connected and vice versa. Each Stock Appreciation Right may be exercisable in whole or in part on the terms provided in the Agreement. No Stock Appreciation Right shall be exercisable at any time after the expiration of its Term. When a Stock Appreciation Right is no longer exercisable, it shall be deemed to have lapsed or terminated. Upon exercise of a Stock Appreciation Right, payment to the Participant or a Successor or Transferee shall be made at such time or times as shall be provided in the Agreement in the form of cash, Shares or a combination of cash and Shares as determined by the Committee. The Agreement may provide for a limitation upon the amount or percentage of the total appreciation on which payment (whether in cash and/or Shares) may be made in the event of the exercise of a Stock Appreciation Right. The Term of a Stock Appreciation Right granted under the Plan shall be determined by the Committee, in its sole discretion; provided, however, that such Term shall not exceed eight (8) years.

#### 11. Stock Units.

11.1 Vesting and Consideration. A Stock Unit shall consist of the right to receive, in cash and/or in Shares as determined by the Committee, the Fair Market Value of one or more Shares, with any Stock Unit Award subject to such vesting conditions, and the corresponding lapse of forfeiture conditions and other restrictions, based on such factors and occurring over such period of time as the Committee may determine in its discretion. The Committee may provide whether any consideration other than Services must be received by the Company or any Affiliate as a condition precedent to the settlement of a Stock Unit Award.

11.2 Payment of Award. Following the vesting of a Stock Unit Award, settlement of the Award and payment to the Participant shall be made at such time or times in the form of cash, Shares (which may themselves be considered Restricted Stock under the Plan subject to restrictions on transfer and forfeiture conditions) or a combination of cash and Shares as determined by the Committee. If the Stock Unit Award is not by its terms exempt from the requirements of Code Section 409A, then the applicable Agreement shall contain terms and conditions intended to avoid adverse tax consequences specified in Code Section 409A.

#### 12. Performance-Based Compensation.

12.1 Designation of Awards. If the Committee determines at the time a Full Value Award or a Cash Incentive Award is granted to a Participant that such Participant is, or is likely to be, a “covered employee” for purposes of Code Section 162(m) as of the end of the tax year in which the Company would ordinarily claim a tax deduction in connection with such Award, then the Committee may provide that this Section 12 will be applicable to such Award, which shall be considered Performance-Based Compensation.

12.2 Compliance with Code Section 162(m). If an Award is subject to this Section 12, then the lapsing of restrictions thereon and the distribution of cash, Shares or other property pursuant thereto, as applicable, shall be subject to the achievement over the applicable Performance Cycle of one or more performance goals based on one or more of the performance measures specified in Section 12.4. The Committee will select the applicable performance measure(s) and specify the performance goal(s) based on those performance measures for any Performance Cycle, specify in terms of an objective formula or standard the method for calculating the amount payable to a Participant if the performance goal(s) are satisfied, and certify the degree to which applicable performance goals have been satisfied and any amount payable in connection with an Award subject to this Section 12, all within the time periods prescribed by and consistent with the other requirements of Code Section 162(m). In specifying the performance goals applicable to any performance period, the Committee may provide that one or more objectively determinable adjustments shall be made to the performance measures on which the performance goals are based, which may include adjustments that would cause such measures to be considered “non-GAAP financial measures” within the meaning of Rule 101 under Regulation G promulgated by the Securities and Exchange Commission. The Committee may also adjust performance goals for a Performance Cycle to the extent permitted by Code Section 162(m) in connection with an event described in Section 17 to prevent the dilution or enlargement of a Participant’s rights with respect to Performance-Based Compensation. The Committee may adjust downward, but not upward, any amount determined to be otherwise payable in connection with such an Award. The Committee may also provide, in an Agreement or otherwise, that the achievement of specified performance goals in connection with an Award subject to this Section 12 may be waived upon the death or Disability of the Participant or under any other circumstance with respect to which the existence of such possible waiver will not cause the Award to fail to qualify as “performance-based compensation” under Code Section 162(m).

12.3 Limitations. With respect to Awards of Performance-Based Compensation, the maximum number of Shares that may be the subject of any Full Value Awards that are denominated in Shares or Share equivalents and that are granted to any one Participant during any calendar year shall not exceed 175,000 Shares (subject to adjustment as provided in Section 17). The maximum amount payable with respect to any Cash Incentive Awards and Full Value Awards that are denominated other than in Shares or Share equivalents and that are granted to any one Participant during any calendar year shall not exceed \$1,000,000.

12.4 *Performance Measures*. For purposes of any Full Value Award or Cash Incentive Award considered Performance-Based Compensation subject to this Section 12, the performance measures to be utilized shall be limited to one or a combination of two or more of the following: revenue or net sales; gross profit; operating profit; net income; earnings before one or more of interest, taxes, depreciation, amortization and other adjustments; profitability as measured by return ratios (including, but not limited to, return on assets, return on equity, return on investment and return on revenues or gross profit) or by the degree to which any of the foregoing earnings measures exceed a percentage of revenues or gross profit; cash flow; market share; margins (including one or more of gross, operating and net earnings margins); stock price; total stockholder return; asset quality; non-performing assets; operating assets; operating expenses; balance of cash, cash equivalents and marketable securities; improvement in or attainment of expense levels or cost savings; operating asset turnover; accounts receivable levels (including measured in terms of days sales outstanding); economic value added; improvement in or attainment of working capital levels; employee retention; customer satisfaction; implementation or completion of critical projects; and growth in customer base. Any performance goal based on one or more of the foregoing performance measures may, in the Committee's discretion, be expressed in absolute amounts, on a per share basis (basic or diluted), relative to one or more other performance measures, as a growth rate or change from preceding periods, or as a comparison to the performance of specified companies or a published or special index (including stock market indices) or other external measures, may relate to one or any combination of Company, Affiliate or business unit performance, and may be expressed in terms of differing levels of achievement, such as threshold, target and maximum levels of achievement.

13. *Effective Date and Duration of the Plan*.

13.1 *Effective Date*. The Plan shall become effective on the date it is approved by the Company's stockholders, which shall be considered the date of its adoption for purposes of Treasury Regulation §1.422-2(b)(2)(i). No Awards shall be made under the Plan prior to its Effective Date. If the Company's stockholders fail to approve the Plan within 12 months of its approval by the Board, the Plan shall be of no further force or effect.

13.2 *Duration of the Plan*. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 16, or the tenth anniversary of the effective date of the Plan, whichever occurs first (the "Termination Date"). Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date unless limited in the Agreement or otherwise. No Award of an Incentive Stock Option shall be made more than 10 years after the Effective Date of the Plan (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. The date and time at which an Award is made or granted shall be the date and time the Committee approves the grant of the Award, or such later date and time as may be specified by the Committee at the time it approves the Award.

14. *Plan Does Not Affect Employment Status*.

14.1 *No Entitlement to Award*. Status as an eligible Employee or other service provider shall not be construed as a commitment that any Award will be made under the Plan to that eligible Employee or service provider or to eligible individuals generally.

14.2 *No Right to Continued Employment*. Nothing in the Plan or in any Agreement or related documents shall confer upon any Participant any right to continue in the employment of the Company or any Affiliate or constitute any contract of employment or affect any right that the Company or any Affiliate may have to change such person's compensation, other benefits, job responsibilities, or title, or to terminate the employment of such person with or without cause.

15. *Tax Withholding*. The Company shall have the right to withhold from any cash payment under the Plan to a Participant or other person (including a Successor or a Transferee) an amount sufficient to cover any required withholding taxes. The Company shall have the right to require a Participant or other person receiving Shares under the Plan to pay the Company a cash amount sufficient to cover any required withholding taxes before actual receipt of those Shares. In lieu of all or any part of a cash payment from a person receiving Shares under the Plan, the Committee may permit the individual to cover all or any part of the required withholdings (up to the Participant's minimum required tax withholding rate) through a reduction of the number of Shares delivered or delivery or tender to the Company of Shares held by the Participant or other person, in each case valued in the same manner as used in computing the withholding taxes under the applicable laws.

16. *Amendment, Modification and Termination*.

16.1 *Amendment, Modification and Termination of Plan*. The Board may at any time and from time to time terminate, suspend or modify the Plan. No termination, suspension, or modification of the Plan may materially and adversely affect any right acquired by any Participant or Successor or Transferee under an Award granted before the date of termination, suspension, or modification, unless (i) otherwise agreed to by the Participant in the Agreement or otherwise, or (ii) such action is necessary to comply with applicable law or stock exchange rules. It will be conclusively presumed that any adjustment for changes in capitalization provided for in Plan Sections 6.6 or 17 does not adversely affect these rights.

16.2 Amendment of Agreement. Subject to Section 19, the Committee may unilaterally amend the terms of any Agreement previously granted, except that no such amendment may materially and adversely affect the rights of any Participant under the applicable Award without the Participant's consent, unless such amendment is necessary to comply with applicable law or stock exchange rules or any compensation recovery policy as provided in Section 20.3.

17. Adjustment for Changes in Capitalization. In the event of any equity restructuring (within the meaning of authoritative guidance issued by the Financial Accounting Standards Board relating to stock-based compensation) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Shares that may be issued under the Plan, (ii) the limitations on the number of Shares that may be issued to an individual Participant as an Option or a Stock Appreciation Right or in the form of Restricted Stock in any calendar year or that may be issued in the form of Restricted Stock or Shares without restrictions and (iii) the number and kind of Shares or, subject to Plan Section 6.6, Stock Units, subject to and the exercise price (if applicable) of any then outstanding Awards of Options, Stock Appreciation Rights, Restricted Stock, Stock Units or any other Awards related to shares of Stock (to the extent such other Awards would not otherwise automatically adjust in the equity restructuring); provided, in each case, that with respect to Incentive Stock Options, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; provided further, with respect to all Awards, no such adjustment shall be authorized to the extent that such adjustment would cause the Awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), including a Fundamental Change (subject to Plan Section 18), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Shares subject to an Award shall always be a whole number. In no event shall an outstanding Option or Stock Appreciation Right be amended for the sole purpose of reducing the exercise price or grant price thereof.

18. Fundamental Change. In the event of a proposed Fundamental Change, the Committee may, but shall not be obligated to:

(a) if the Fundamental Change is a merger or consolidation or statutory share exchange, make appropriate provision for the protection of the outstanding Options and Stock Appreciation Rights by the substitution of options, stock appreciation rights and appropriate voting common stock of the corporation surviving any merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation; or

(b) at least ten days before the occurrence of the Fundamental Change, declare, and provide written notice to each holder of an Option or Stock Appreciation Right of the declaration, that each outstanding Option and Stock Appreciation Right, whether or not then exercisable, shall be canceled at the time of, or immediately before the occurrence of the Fundamental Change in exchange for payment to each holder of an Option or Stock Appreciation Right, within ten days after the Fundamental Change, of cash equal to (i) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section) per Share exceeds the exercise price per Share covered by such Option or (ii) for each Stock Appreciation Right, the price determined pursuant to Section 10, except that Fair Market Value of the Shares as of the date of exercise of the Stock Appreciation Right, as used in clause (i) of Plan Section 10, shall be deemed to mean Fair Market Value for each Share with respect to which the Stock Appreciation Right is calculated determined in the manner hereinafter referred to in this Section. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option shall immediately become exercisable in full and each person holding an Option or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option or Stock Appreciation Right, to exercise the Option as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to Plan Section 18(b), each outstanding Option and Stock Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Fundamental Change shall be canceled at the time of, or immediately before, the Fundamental Change, as provided in the declaration.

Notwithstanding the foregoing, no person holding an Option or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 18(b) if such Option or Stock Appreciation Right shall have terminated, expired or been cancelled. For purposes of this Section 18 only, "Fair Market Value" per Share means the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the stockholders of the Company upon the occurrence of the Fundamental Change.

19. Prohibition on Repricing. Except pursuant to Section 17 of the Plan in connection with an equity restructuring, or pursuant to Section 18 of the Plan in connection with a Fundamental Change, in either case in order to prevent dilution or enlargement of the benefits or potential benefits intended to be provided under the Plan, no Option or Stock Appreciation Right granted under the Plan may be amended to decrease the exercise price or grant price thereof, be cancelled in exchange for the grant of any

new Option or Stock Appreciation Right with a lower exercise or grant price or any new Full Value Award, be repurchased by the Company or any Affiliate, or otherwise be subject to any action that would be treated under accounting rules or otherwise as a “repricing” of such Option or Stock Appreciation Right, unless such action is first approved by the Company’s stockholders.

## 20. Forfeitures and Compensation Recovery.

20.1 Forfeiture for Cause. Notwithstanding any other provision of the Plan or an Agreement, if a Participant’s employment is terminated for cause as defined in this Section 20.1, then as of the date of such termination, any of the Participant’s outstanding Awards that have not vested or been exercised by the Participant will be forfeited to the Company. For purposes of this Section 20.1, “cause” means the Participant: (i) committed a felony or a crime involving moral turpitude or committed any other act or omission involving fraud, embezzlement or any other act of dishonesty in the course of his employment by the Company or an Affiliate which conduct damaged the Company or an Affiliate; (ii) substantially and repeatedly failed to perform duties of the office held by the Participant as reasonably directed by the Company or an Affiliate; (iii) committed gross negligence or willful misconduct with respect to the Company or an Affiliate; (iv) committed a material breach of any employment agreement between the Participant and the Company or an Affiliate that is not cured within ten (10) days after receipt of written notice thereof from the Company or the Affiliate, as applicable; (v) failed, within ten (10) days after receipt by the Participant of written notice thereof from the Company or an Affiliate, to correct, cease or otherwise alter any failure to comply with instructions or other action or omission which the Board reasonably believes does or may materially or adversely affect the Company’s or an Affiliate’s business or operations; (vi) committed misconduct which is of such a serious or substantial nature that a reasonable likelihood exists that such misconduct will materially injure the reputation of the Company or an Affiliate; (vii) harassed or discriminated against the Company’s or an Affiliate’s employees, customers or vendors in violation of the Company’s policies with respect to such matters; (viii) misappropriated funds or assets of the Company or an Affiliate for personal use or willfully violated the Company policies or standards of business conduct as determined in good faith by the Board; (ix) failed, due to some action or inaction on the part of the Participant, to have immigration status that permits the Participant to maintain full-time employment with the Company or an Affiliate in the United States in compliance with all applicable immigration law; or (x) disclosed trade secrets of the Company or an Affiliate. The findings and decision of the Committee or the Board, if applicable, with respect to any such matter, including those regarding the acts of the Participant and the damage done to the Company, will be final for all purposes. No decision of the Committee, however, will affect the finality of the discharge of the individual by the Company or an Affiliate.

20.2 Forfeiture Events. The Committee may specify in an Agreement that the Participant’s rights, payments and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions of an Award. Such events may include, but shall not be limited to, termination of employment for cause, termination of employment for any other reason, violation of material policies of the Company and its Affiliates, breach of noncompetition, confidentiality, or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company and its Affiliates.

20.3 Compensation Recovery Policy. Awards and any compensation associated therewith may be made subject to forfeiture, recovery by the Company or other action pursuant to any compensation recovery policy adopted by the Board or the Committee at any time, including in response to the requirements of Section 10D of the Exchange Act and any implementing rules and regulations thereunder, or as otherwise required by law. Any Agreement may be unilaterally amended by the Committee to comply with any such compensation recovery policy.

21. Corporate Mergers, Acquisitions, Etc. The Committee may also grant Substitute Awards under the Plan in substitution for, or in connection with the assumption of, existing options, stock appreciation rights, restricted stock or other awards granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to which the Company or a Subsidiary is a party. The terms and conditions of the Substitute Awards may vary from the terms and conditions set forth in the Plan to the extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

22. Unfunded Plan. The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, its Affiliates, the Committee, nor the Board of Directors shall be deemed to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and/or its Affiliates, and a Participant or Successor or Transferee. To the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

## 23. Limits of Liability.

23.1 Contractual Liability Only. Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.

23.2 Liability Limit. Except as may be required by law, neither the Company nor any member of the Board of Directors or of the Committee, nor any other person participating in any determination of any question under the Plan, or in the interpretation, administration or application of the Plan, shall have any liability to any party for any action taken, or not taken, in good faith under the Plan.

24. Compliance with Applicable Legal Requirements. No certificate for Shares distributable pursuant to the Plan shall be issued and delivered unless the issuance of the certificate complies with all applicable legal requirements including, without limitation, compliance with the provisions of applicable state securities laws, the Securities Act of 1933, as amended and in effect from time to time or any successor statute, the Exchange Act and the requirements of the exchanges on which the Company's Shares may, at the time, be listed.

25. Deferrals and Settlements. The Committee may require or permit Participants to elect to defer the issuance of Shares or the settlement of Awards in cash under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts.

26. Other Benefit and Compensation Programs. Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay laws of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or an Affiliate unless expressly so provided by such other plan, contract or arrangement, or unless the Committee expressly determines that an Award or portion of an Award should be included to accurately reflect competitive compensation practices or to recognize that an Award has been made in lieu of a portion of competitive cash compensation.

27. Beneficiary Upon Participant's Death. To the extent that the transfer of a Participant's Award at his or her death is permitted under an Agreement, a Participant's Award shall be transferable at death to the estate or to the person who acquires the right to succeed to the Award by bequest or inheritance.

28. Requirements of Law.

28.1 Governing Law. To the extent that federal laws do not otherwise control, the Plan and all determinations made and actions taken pursuant to the Plan shall be governed by the laws of the State of Minnesota without regard to its conflicts-of-law principles and shall be construed accordingly.

28.2 Severability. If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

29. Code Section 409A. It is intended that (i) all Awards of Options, Stock Appreciation Rights and Restricted Stock under the Plan will not provide for the deferral of compensation within the meaning of Code Section 409A and thereby be exempt from Code Section 409A, and (ii) all other Awards under the Plan will either not provide for the deferral of compensation within the meaning of Code Section 409A, or will comply with the requirements of Code Section 409A, and the Committee shall endeavor to structure Awards and administer and interpret the Plan in accordance with this intent. The Plan and any Agreement may be unilaterally amended by the Company in any manner deemed necessary or advisable by the Committee or Board in order to maintain such exemption from or compliance with Code Section 409A, and any such amendment shall conclusively be presumed to be necessary to comply with applicable law. Notwithstanding anything to the contrary in the Plan or any Agreement, with respect to any Award that constitutes a deferral of compensation subject to Code Section 409A:

(1) If any amount is payable under such Award upon a termination of employment, a termination of employment will be deemed to have occurred only at such time as the Participant has experienced a "separation from service" as such term is defined for purposes of Code Section 409A; and

(2) If any amount shall be payable with respect to any such Award as a result of a Participant's "separation from service" at such time as the Participant is a "specified employee" within the meaning of Code Section 409A, then no payment shall be made, except as permitted under Code Section 409A, prior to the first business day after the earlier of (i) the date that is six months after the Participant's separation from Service or (ii) the Participant's death. Unless the Committee has adopted a specified employee identification policy as contemplated by Code Section 409A, specified employees will be identified in accordance with the default provisions specified under Code Section 409A.



None of the Company, the Committee nor any other person involved with the administration of this Plan shall in any way be responsible for ensuring the exemption of any Award from, or compliance by any Award with, the requirements of Code Section 409A. By accepting an Award under this Plan, each Participant acknowledges that the Company has no duty or obligation to design or administer the Plan or Awards granted thereunder in a manner that minimizes a Participant's tax liabilities, including the avoidance of any additional tax liabilities under Code Section 409A.

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

I, Joseph T. Dunsmore, 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 (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

February 3, 2014

/s/ Joseph T. Dunsmore

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Joseph T. Dunsmore

President, Chief Executive Officer and Chairman

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

I, Steven E. Snyder, 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 (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

February 3, 2014

/s/ Steven E. Snyder

Steven E. Snyder

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 December 31, 2013 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.

February 3, 2014

/s/ Joseph T. Dunsmore

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Joseph T. Dunsmore

President, Chief Executive Officer, and Chairman

/s/ Steven E. Snyder

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Steven E. Snyder

Senior Vice President, Chief Financial Officer and Treasurer