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

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**FORM 10-Q**

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

For the quarterly period ended: **March 31, 2008**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: **1-34033**

**DIGI INTERNATIONAL INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**41-1532464**

(I.R.S. Employer  
Identification Number)

**11001 Bren Road East  
Minnetonka, Minnesota 55343**

(Address of principal executive offices) (Zip Code)

**(952) 912-3444**

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

On April 30, 2008, there were 25,773,958 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 March 31,		Six months ended March 31,	
	2008	2007	2008	2007
	(in thousands, except per common share data)			
Net sales	\$ 43,070	\$ 42,855	\$ 87,644	\$ 84,666
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	18,986	19,215	38,529	37,865
Amortization of purchased and core technology	907	1,129	2,043	2,277
Gross profit	23,177	22,511	47,072	44,524
Operating expenses:				
Sales and marketing	9,034	8,427	17,720	16,585
Research and development	6,529	6,068	13,118	12,040
General and administrative	3,960	3,302	7,982	6,880
Total operating expenses	19,523	17,797	38,820	35,505
Operating income	3,654	4,714	8,252	9,019
Interest income, net				
Interest income	1,020	777	2,074	1,573
Interest expense	(12)	(18)	(26)	(43)
Total interest income, net	1,008	759	2,048	1,530
Income before income taxes	4,662	5,473	10,300	10,549
Income tax provision	1,565	1,876	3,533	3,150
Net income	\$ 3,097	\$ 3,597	\$ 6,767	\$ 7,399
Net income per common share:				
Basic	\$ 0.12	\$ 0.14	\$ 0.26	\$ 0.29
Diluted	\$ 0.12	\$ 0.14	\$ 0.26	\$ 0.28
Weighted average common shares, basic	25,714	25,186	25,666	25,131
Weighted average common shares, diluted	26,312	25,959	26,479	25,976

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

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

	March 31, 2008	September 30, 2007
	(in thousands, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 27,135	\$ 18,375
Marketable securities	58,020	67,111
Accounts receivable, net	25,344	21,022
Inventories	26,804	26,130
Other	4,769	4,961
Total current assets	142,072	137,599
Marketable securities, long-term	15,682	2,081
Property, equipment and improvements, net	15,472	19,987
Identifiable intangible assets, net	21,032	24,214
Goodwill	67,320	66,817
Other	1,462	1,128
Total assets	<u>\$ 263,040</u>	<u>\$ 251,826</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Capital lease obligations, current portion	\$ 380	\$ 379
Accounts payable	8,929	6,554
Income taxes payable	468	3,156
Accrued expenses:		
Compensation	5,545	7,080
Other	4,101	4,727
Total current liabilities	19,423	21,896
Capital lease obligations, net of current portion	179	358
Income taxes payable — long-term	3,990	—
Deferred gain on building sale — leaseback	1,194	—
Net deferred tax liabilities	4,648	6,667
Total liabilities	<u>29,434</u>	<u>28,921</u>
Stockholders' equity:		
Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value; 60,000,000 shares authorized; 28,323,513 and 28,153,763 shares issued	283	281
Additional paid-in capital	175,684	172,156
Retained earnings	73,041	66,782
Accumulated other comprehensive income	2,834	2,121
Treasury stock, at cost, 2,578,238 and 2,606,419 shares	(18,236)	(18,435)
Total stockholders' equity	233,606	222,905
Total liabilities and stockholders' equity	<u>\$ 263,040</u>	<u>\$ 251,826</u>

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

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

	Six months ended March 31,	
	2008	2007
	(in thousands)	
<b>Operating activities:</b>		
Net income	\$ 6,767	\$ 7,399
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation of property, equipment and improvements	1,293	1,263
Amortization of identifiable intangible assets and other assets	3,499	3,867
(Gain) loss on sale of property, equipment and improvements	(120)	1
Excess tax benefits from stock-based compensation	(165)	(155)
Stock-based compensation	1,776	1,504
Deferred income tax benefit	(1,920)	(722)
Other	152	163
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	(3,109)	(162)
Inventories	(752)	(1,737)
Other assets	237	572
Accounts payable and accrued expenses	978	(3,022)
Income taxes payable	697	2,298
<b>Net cash provided by operating activities</b>	<b>9,333</b>	<b>11,269</b>
<b>Investing activities:</b>		
Purchase of held-to-maturity marketable securities	(51,691)	(40,387)
Proceeds from maturities of held-to-maturity marketable securities	47,181	30,892
Contingent purchase price payments related to business acquisitions	(1,315)	(781)
Increase in noncurrent restricted cash	(392)	—
Proceeds from sale-leaseback and sale of other property, equipment, improvements	6,494	4
Purchase of property, equipment, improvements and certain other intangible assets	(1,908)	(1,486)
<b>Net cash used in investing activities</b>	<b>(1,631)</b>	<b>(11,758)</b>
<b>Financing activities:</b>		
Payments on capital lease obligations	(188)	(198)
Excess tax benefits from stock-based compensation	165	155
Proceeds from stock option plan transactions	1,636	1,201
Proceeds from employee stock purchase plan transactions	348	493
<b>Net cash provided by financing activities</b>	<b>1,961</b>	<b>1,651</b>
Effect of exchange rate changes on cash and cash equivalents	(903)	350
<b>Net increase in cash and cash equivalents</b>	<b>8,760</b>	<b>1,512</b>
Cash and cash equivalents, beginning of period	18,375	15,674
<b>Cash and cash equivalents, end of period</b>	<b>\$ 27,135</b>	<b>\$ 17,186</b>

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

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

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

*Basis of Presentation*

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

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

*Recently Issued Accounting Pronouncements*

In March 2008, the Financial Accounting Standards Board (“FASB”) issued FASB Statement No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133” (“SFAS 161”). This Statement amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently evaluating the impact of SFAS 161 on our consolidated financial statements.

In December 2007, the FASB issued FASB Statement No. 160, “Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51” (“SFAS 160”) to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 establishes accounting and reporting standards that require (i) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheet within equity, but separate from the parent’s equity, (ii) the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income, and (iii) changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. SFAS 160 will be effective for our fiscal years beginning October 1, 2009. Earlier adoption is prohibited. We do not expect SFAS 160 to have a material impact on our consolidated financial statements.

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

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

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

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

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



**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****2. COMPREHENSIVE INCOME**

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

	Three months ended March 31,		Six months ended March 31,	
	2008	2007	2008	2007
Net income	\$ 3,097	\$ 3,597	\$ 6,767	\$ 7,399
Foreign currency translation gain	18	261	713	640
Comprehensive income	<u>\$ 3,115</u>	<u>\$ 3,858</u>	<u>\$ 7,480</u>	<u>\$ 8,039</u>

**3. NET INCOME PER COMMON SHARE**

Basic net income per common share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares of our stock result from dilutive common stock options and shares purchased through the employee stock purchase plan.

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

	Three months ended March 31,		Six months ended March 31,	
	2008	2007	2008	2007
<b>Numerator:</b>				
Net income	<u>\$ 3,097</u>	<u>\$ 3,597</u>	<u>\$ 6,767</u>	<u>\$ 7,399</u>
<b>Denominator:</b>				
Denominator for basic net income per common share — weighted average shares outstanding	25,714	25,186	25,666	25,131
<b>Effect of dilutive securities:</b>				
Employee stock options and employee stock purchase plan	<u>598</u>	<u>773</u>	<u>813</u>	<u>845</u>
Denominator for diluted net income per common share — adjusted weighted average shares	<u>26,312</u>	<u>25,959</u>	<u>26,479</u>	<u>25,976</u>
Net income per common share, basic	<u>\$ 0.12</u>	<u>\$ 0.14</u>	<u>\$ 0.26</u>	<u>\$ 0.29</u>
Net income per common share, diluted	<u>\$ 0.12</u>	<u>\$ 0.14</u>	<u>\$ 0.26</u>	<u>\$ 0.28</u>

Potentially dilutive shares related to stock options to purchase 2,378,069 and 1,021,239 common shares for the three and six month periods ended March 31, 2008, respectively, and potentially dilutive shares related to stock options to purchase 1,545,505 and 1,105,834 common shares for the three and six month periods ended March 31, 2007, respectively, were not included in the computation of diluted earnings per common share because the options' exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive.

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

**4. SELECTED BALANCE SHEET DATA**

(in thousands)

	March 31, 2008	September 30, 2007
<b>Accounts receivable, net:</b>		
Accounts receivable	\$ 25,856	\$ 21,501
Less allowance for doubtful accounts	512	479
	<u>\$ 25,344</u>	<u>\$ 21,022</u>
<b>Inventories:</b>		
Raw materials	\$ 21,231	\$ 20,097
Work in process	653	816
Finished goods	4,920	5,217
	<u>\$ 26,804</u>	<u>\$ 26,130</u>
<b>Other accrued expenses:</b>		
Product warranty accrual	\$ 1,133	\$ 1,155
Accrued professional fees	844	522
Unearned revenue	193	190
Deferred gain on building sale - short-term	299	—
Other accrued expenses	1,632	1,910
Contingent purchase price accrual	—	950
	<u>\$ 4,101</u>	<u>\$ 4,727</u>

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

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

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

	March 31, 2008			September 30, 2007		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	\$ 38,795	\$ (28,819)	\$ 9,976	\$ 38,702	\$ (26,689)	\$ 12,013
License agreements	2,440	(2,440)	—	2,440	(2,290)	150
Patents and trademarks	8,142	(4,224)	3,918	7,925	(3,818)	4,107
Customer maintenance contracts	700	(429)	271	700	(394)	306
Customer relationships	11,778	(4,911)	6,867	11,613	(3,975)	7,638
Total	<u>\$ 61,855</u>	<u>\$ (40,823)</u>	<u>\$ 21,032</u>	<u>\$ 61,380</u>	<u>\$ (37,166)</u>	<u>\$ 24,214</u>

Amortization expense was \$1.6 million and \$1.9 million for the three months ended March 31, 2008 and 2007, respectively, and \$3.5 million and \$3.8 million for the six months ended March 31, 2008 and 2007, respectively.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****5. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS (CONTINUED)**

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

2008 (six months)	\$	2,223
2009		4,202
2010		3,637
2011		3,076
2012		2,512
2013		1,765

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

	Six months ended March 31,	
	2008	2007
Beginning balance, October 1	\$ 66,817	\$ 65,841
Purchase price adjustment — MaxStream	—	(374)
Foreign currency translation adjustment	503	143
Ending balance, March 31	<u>\$ 67,320</u>	<u>\$ 65,610</u>

**6. INCOME TAXES**

For the six month period ended March 31, 2008, income taxes have been provided at an effective rate of 34.3% compared to 29.9% for the six month period ended March 31, 2007. On December 9, 2006, Congress passed H.R. 6111, the “Tax Relief and Health Care Act of 2006”, which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, we recorded a discrete tax benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006, which reduced the effective tax rate by approximately 9 percentage points. The effective tax rate for the six months ended March 31, 2008 is approximately equal to the U.S. statutory rate of 35%. The effective tax rate for the six months ended March 31, 2007 is lower than the U.S. statutory rate of 35.0% primarily due to the aforementioned discrete item.

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

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

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

In general, we warrant our products to be free from defects in material and workmanship under normal use and service for a period of up to five years from the date of receipt. We have the option to repair or replace products we deem defective with regard to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidence and are evaluated on an ongoing basis to ensure the adequacy of the warranty reserve. The following table summarizes the activity associated with the product warranty accrual (in thousands):

	Three months ended March 31,			
	Balance at January 1	Warranties issued	Settlements made	Balance at March 31
2008	\$ 1,134	\$ 193	\$ (194)	\$ 1,133
2007	\$ 964	\$ 224	\$ (182)	\$ 1,006

  

	Six months ended March 31,			
	Balance at October 1	Warranties issued (1)	Settlements made	Balance at March 31
2008	\$ 1,155	\$ 358	\$ (380)	\$ 1,133
2007	\$ 1,104	\$ 309	\$ (407)	\$ 1,006

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

We are not responsible and do not warrant that custom software versions created by original equipment manufacturer (OEM) customers based upon our software source code will function in a particular way, will conform to any specifications or are fit for any particular purpose and do not indemnify these customers from any third-party liability as it relates to or arises from any customization or modifications made by the OEM customer.

**8. CONTINGENCIES***Contingent obligations*

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

*Legal Proceedings*

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

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

**8. CONTINGENCIES (CONTINUED)**

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

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

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

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

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

**8. CONTINGENCIES (CONTINUED)**

We intend to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of this pending lawsuit. We maintain liability insurance for such matters and expect that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of \$250,000 per claim. As of March 31, 2008, we have accrued a liability for the deductible amount of \$250,000 which we believe reflects the amount of loss that is probable. In the event we have losses that exceed the limits of the liability insurance, such losses could have a material effect on our business and our consolidated results of operations or financial condition.

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

**9. SALE AND LEASEBACK OF BUILDING**

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

The building was sold for 4.5 million Euros (equivalent to \$6.9 million), resulting in a gain on the sale of 1.0 million Euros (\$1.6 million). As a result of the leaseback, \$1.5 million of the gain on the sale was deferred and will be recognized ratably over the lease term as an offset to rent expense. The remaining \$0.1 million was recognized in the second quarter of fiscal 2008 as a component of general and administrative expense. Of the total sale price, 4.2 million Euros (\$6.5 million) was received during March 2008 and the remaining 0.3 million Euros (\$0.4 million) were withheld by the buyer until certain obligations and documentation were completed. This withholding is included in accounts receivable, net on our consolidated balance sheet as of March 31, 2008 and was received in April 2008. These obligations required us, as part of the Agreement, to deposit 0.3 million Euros (\$0.4 million) into an interest-bearing bank account, which will be refunded to us at the end of the lease term. This deposit was made during March, 2008 and is included in other noncurrent assets as restricted cash on our consolidated balance sheet.

**10. SUBSEQUENT EVENT**

We announced the acquisition of Sarian Systems, Ltd. ("Sarian") on April 28, 2008. Prior to the acquisition, Sarian was a privately held corporation. Sarian is located in the United Kingdom and is a leader in the European wireless router market. The acquisition was a cash transaction for approximately \$30.5 million for all of the outstanding ordinary shares of Sarian. The purchase price of \$30.5 million includes Sarian's cash on hand as of the acquisition date, estimated to be \$2.5 million. On April 22, 2008, we entered into a short-term loan agreement with Wells Fargo in the amount of \$25.0 million to finance the acquisition. Interest is based on the one month LIBOR rate plus 0.30% (3.2% at April 22, 2008). Per the terms of the agreement, payment of the outstanding balance is due November 30, 2008; however, we have the option to prepay without penalty. We intend to repay the loan before the end of the third quarter of fiscal 2008. Sarian became a wholly owned subsidiary of Digi International Ltd., located in the United Kingdom.

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

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

This Form 10-Q contains certain statements that are "forward-looking statements" as that term is defined under the Private Securities Litigation Reform Act of 1995, and within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

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

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

### **CRITICAL ACCOUNTING POLICIES**

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

### **OVERVIEW**

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

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

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

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

- Net sales of \$43.1 million for the three months ended March 31, 2008 represented an increase of \$0.2 million, or 0.5%, compared to net sales of \$42.9 million for the three months ended March 31, 2007. Revenue in the Americas was \$26.5 million in the second fiscal quarter of 2008 compared to \$28.8 million in the same period a year ago, a decrease of \$2.3 million, or 8.2%, primarily due to the slowing of the U.S. economy and a decrease in revenue from certain key customers. International revenue was \$16.6 million in the second fiscal quarter of 2008 compared to \$14.1 million in the second fiscal quarter of 2007, an increase of \$2.5 million, or 18.4%.
- Gross profit margin increased to 53.8% compared to 52.5% for the three months ended March 31, 2008 and 2007, respectively. Gross profit margin increased to 53.7% compared to 52.6% for the six months ended March 31, 2008 and 2007, respectively.
- Total operating expenses for the three months ended March 31, 2008 were \$19.5 million, or 45.3% of net sales, compared to \$17.8 million, or 41.5% of net sales, for the three months ended March 31, 2007, an increase of \$1.7 million. Total operating expenses for the six months ended March 31, 2008 were \$38.8 million, or 44.3% of net sales, compared to \$35.5 million, or 41.9% of net sales, for the six months ended March 31, 2007, an increase of \$3.3 million. Operating expenses increased by 9.7% and 9.3% for the three months and six months ended March 31, 2008, respectively, compared to the same periods in 2007 due mostly to an increase in compensation-related expenses from increased headcount, continued investments in our Drop-In Networking and international expansion, as well as the unfavorable impact of translating expenses denominated in the Euro to U.S. dollars.
- Net income decreased \$0.5 million to \$3.1 million, or \$0.12 per diluted share, for the three months ended March 31, 2008, compared to \$3.6 million, or \$0.14 per diluted share, for the three months ended March 31, 2007. Net income decreased \$0.6 million to \$6.8 million, or \$0.26 per diluted share, for the six months ended March 31, 2008, compared to \$7.4 million, or \$0.28 per diluted share, for the six months ended March 31, 2007. As a result of the extension of the research and development credit for two additional years beyond calendar 2005, a benefit for research and development credits earned during the last three quarters of fiscal 2006 was recorded during the first quarter of fiscal 2007, resulting in an additional tax benefit of \$0.5 million or \$0.02 per diluted share.
- Our net working capital position (total current assets less total current liabilities) increased \$6.9 million to \$122.6 million during the six months ended March 31, 2008 and our current ratio was 7.3 to 1 as of that date. Cash and cash equivalents and marketable securities, including long-term marketable securities increased \$13.2 million to \$100.8 million during the period which includes 4.2 million Euros (\$6.5 million) received from the building sale in Dortmund, Germany. An additional 0.3 million Euros (\$0.4 million) were withheld by the buyer until certain obligations and documentation were completed, and was received in April 2008. At March 31, 2008, we had no debt other than capital lease obligations.



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

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

	Three months ended March 31,				% increase (decrease)	Six months ended March 31,				% increase (decrease)
	2008		2007			2008		2007		
Net sales	\$43,070	100.0%	\$42,855	100.0%	0.5%	\$87,644	100.0%	\$84,666	100.0%	3.5%
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	18,986	44.1	19,215	44.8	(1.2)	38,529	44.0	37,865	44.7	1.8
Amortization of purchased and core technology	907	2.1	1,129	2.6	(19.7)	2,043	2.3	2,277	2.7	(10.3)
Gross profit	23,177	53.8	22,511	52.5	3.0	47,072	53.7	44,524	52.6	5.7
Operating expenses:										
Sales and marketing	9,034	21.0	8,427	19.7	7.2	17,720	20.2	16,585	19.6	6.8
Research and development	6,529	15.1	6,068	14.1	7.6	13,118	15.0	12,040	14.2	9.0
General and administrative	3,960	9.2	3,302	7.7	19.9	7,982	9.1	6,880	8.1	16.0
Total operating expenses	19,523	45.3	17,797	41.5	9.7	38,820	44.3	35,505	41.9	9.3
Operating income	3,654	8.5	4,714	11.0	(22.5)	8,252	9.4	9,019	10.7	(8.5)
Interest income and other, net	1,008	2.3	759	1.8	32.8	2,048	2.3	1,530	1.8	33.9
Income before income taxes	4,662	10.8	5,473	12.8	(14.8)	10,300	11.7	10,549	12.5	(2.4)
Income tax provision	1,565	3.6	1,876	4.4	(16.6)	3,533	4.0	3,150	3.8	12.2
Net income	\$ 3,097	7.2%	\$ 3,597	8.4%	(13.9)%	\$ 6,767	7.7%	\$ 7,399	8.7%	(8.5)%

**NET SALES**

The following summarizes our net sales for the periods indicated:

(\$ in thousands)	Three months ended March 31,				% increase (decrease)	Six months ended March 31,				% increase (decrease)
	2008		2007			2008		2007		
Non-embedded	\$21,358	49.6%	\$24,445	57.0%	(12.6)%	\$45,215	51.6%	\$49,611	58.6%	(8.9)%
Embedded	21,712	50.4	18,410	43.0	17.9	42,429	48.4	35,055	41.4	21.0
Total net sales	\$43,070	100.0%	\$42,855	100.0%	0.5%	\$87,644	100.0%	\$84,666	100.0%	3.5%

The decrease in net sales in the non-embedded products for the three and six months ended March 31, 2008 as compared to the same periods in the prior year resulted primarily from decreased net sales of serial cards, serial server, USB and cellular products. The decreases are primarily a result of the contracting of the U.S. economy and slower sales activity in the two tier North American distribution channel, as well as a decrease in net sales from certain key customers.

Net sales of most of the embedded products increased in the three and six months ended March 31, 2008 compared to the comparable prior periods. Most of the increase in our embedded net sales took place in Europe and Asia Pacific. While embedded net sales increased slightly in the Americas, the slowing of the U.S. economy, particularly in the second quarter of fiscal 2008, negatively impacted the growth.

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

NET SALES (CONTINUED)

Fluctuation in foreign currency rates, primarily the Euro, for the three and six month periods ended March 31, 2008 compared to the same periods in the prior year had a favorable impact on net sales of \$0.7 million and \$1.4 million, respectively.

The following summarizes our net sales by geographic region:

(\$ in thousands)	Three months ended March 31, \$ increase % increase				Six months ended March 31, \$ increase % increase			
	2008	2007	(decrease)	(decrease)	2008	2007	(decrease)	(decrease)
Americas	\$ 26,420	\$ 28,794	\$ (2,374)	(8.2)%	\$ 55,312	\$ 58,365	\$ (3,053)	(5.2)%
Europe	12,630	10,787	1,843	17.1	23,775	19,630	4,145	21.1
Asia Pacific	4,020	3,274	746	22.8	8,557	6,671	1,886	28.3
Total net sales	\$ 43,070	\$ 42,855	\$ 215	0.5%	\$ 87,644	\$ 84,666	\$ 2,978	3.5%

GROSS PROFIT

Gross profit for the three and six months ended March 31, 2008 was \$23.2 million, or 53.8% and \$47.1 million, or 53.7%, respectively, compared to \$22.5 million, or 52.5%, and \$44.5 million, or 52.6%, for the three and six months ended March 31, 2007, respectively. Gross profit increased by \$0.7 million, or 3.0%, in the second quarter of 2008 compared to the second quarter of 2007, primarily due to product mix changes within both the embedded and non-embedded product groups and a decrease in amortization of purchased and core technology. Amortization of purchased and core technology decreased by \$0.2 million in the second quarter of 2008 compared to the same quarter a year ago, and accounted for a 0.5 percentage point increase in gross profit margin.

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

OPERATING EXPENSES

(\$ in thousands)	Three months ended March 31, \$ increase				Six months ended March 31, \$ increase				
	2008	2007	(decrease)	(decrease)	2008	2007	(decrease)	(decrease)	
Operating expenses:									
Sales and marketing	\$ 9,034	21.0%	\$ 8,427	19.7%	\$ 17,720	20.2%	\$ 16,585	19.6%	\$ 1,135
Research and development	6,529	15.1	6,068	14.1	13,118	15.0	12,040	14.2	1,078
General and administrative	3,960	9.2	3,302	7.7	7,982	9.1	6,880	8.1	1,102
Total operating expenses	\$19,523	45.3%	\$17,797	41.5%	\$38,820	44.3%	\$35,505	41.9%	\$ 3,315

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

### OPERATING EXPENSES (CONTINUED)

The net increase of \$0.6 million in sales and marketing expenses for the three months ended March 31, 2008, as compared to March 31, 2007, was primarily due to an increase of \$0.3 million for compensation-related expenses pertaining to a headcount increase of 14 people and \$0.2 million for additional ad placement costs. For the six months ended March 31, 2008 compared to March 31, 2007, the net increase in expenses was \$1.1 million due to an increase of \$0.7 million of compensation-related expenses due to increased headcount related to the Drop-In Networking initiative and international expansion and \$0.3 million of additional ad placement and marketing literature expenses.

The net increase of \$0.5 million in research and development expenses for the three months ended March 31, 2008 compared to March 31, 2007 was due primarily to an increase of \$0.3 million for compensation-related expenses pertaining to a headcount increase of 16 people and \$0.1 million of outside service expense primarily for certification of wireless products. Research and development expenses for the six months ended March 31, 2008 increased \$1.1 million compared to the same period a year ago due primarily to an increase of \$0.7 million in compensation-related expenses related to increased headcount related to the Drop-In Networking initiative and \$0.4 million in outside service expense primarily for certification of wireless products, offset by a net decrease of \$0.2 million pertaining to the timing of various chip development projects.

The net increase in general and administrative expenses of \$0.7 million for the three months ended March 31, 2008 compared to the three months ended March 31, 2007 is primarily due to compensation-related expenses of \$0.3 million and increased professional fees and outside consulting fees of \$0.4 million, offset by a \$0.1 million recognized gain on the sale of the Dortmund building. For the six months ended March 31, 2008 compared to March 31, 2007, the net increase in general and administrative expenses of \$1.1 million was due primarily to an increase in compensation-related expenses of \$0.6 million and increased professional fees and outside consulting fees of \$0.4 million, offset by a \$0.1 million recognized gain on the sale of the Dortmund building (see Note 9 to the Consolidated Financial Statements).

### INTEREST INCOME AND OTHER, NET

Interest income and other, net was \$1.0 million and \$2.0 million for the three and six months ended March 31, 2007 compared to \$0.7 million and \$1.5 million for the three and six months ended March 31, 2007, respectively. We realized interest income on marketable securities and cash and cash equivalents of \$1.0 million and \$2.1 million for the three and six month periods ended March 31, 2008 and \$0.8 and \$1.6 million for the three and six month periods ended March 31, 2007, respectively, due to an increase in the average invested balance. We earned an average interest rate of 4.7% and 4.9% for the three and six months ended March 31, 2008, respectively, compared to 5.1% for both the three and six months ended March 31, 2007. The average invested balance for the three and six months ended March 31, 2008 was \$86.1 million and \$84.6 million, respectively, and for the three and six months ended March 31, 2007 was \$62.1 million and \$58.7 million, respectively.

### INCOME TAXES

For the six month period ended March 31, 2008, income taxes have been provided at an effective rate of 34.3% compared to 29.9% for the six month period ended March 31, 2007. On December 9, 2006, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, we recorded a discrete tax benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006, which reduced the effective tax rate by approximately 9 percentage points. The effective tax rate for the six months ended March 31, 2008 is approximately equal to the U.S. statutory rate of 35%. The effective tax rate for the six months ended March 31, 2007 is lower than the U.S. statutory rate of 35% primarily due to the aforementioned discrete item. We expect our annualized 2008 income tax rate to be approximately 37% — 39%, which includes the impact, for tax purposes, of the non-deductible in-process research and development expenses of approximately \$2.1 million related to the acquisition of Sarian.

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

Effective October 1, 2007, we adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109" ("FIN 48"). We further discuss the adoption of FIN 48 in Note 6 to our consolidated financial statements.

**LIQUIDITY AND CAPITAL RESOURCES**

We have financed our operations principally with funds generated from operations. At March 31, 2008, we had cash, cash equivalents and marketable securities, including long-term marketable securities of \$100.8 million, compared to \$87.6 million at September 30, 2007, an increase of \$13.2 million which includes 4.2 million Euros (\$6.5 million) received from the building sale in Dortmund, Germany. Our working capital (total current assets less total current liabilities) increased \$6.9 million to \$122.6 million at March 31, 2008 compared to \$115.7 million at September 30, 2007.

**Consolidated Statement of Cash Flow Highlights (in thousands)**

	Six months ended March 31,		
	2008	2007	Change
Operating activities	\$ 9,333	\$ 11,269	\$ (1,936)
Investing activities	(1,631)	(11,758)	10,127
Financing activities	1,961	1,651	310
Effect of exchange rate changes on cash and cash equivalents	(903)	350	(1,253)
Net increase in cash and cash equivalents	<u>\$ 8,760</u>	<u>\$ 1,512</u>	<u>\$ 7,248</u>

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

	Six months ended March 31,		
	2008	2007	Change
Net income	\$ 6,767	\$ 7,399	\$ (632)
Deferred income taxes	(1,920)	(722)	(1,198)
Depreciation and amortization	4,792	5,130	(338)
Stock-based compensation	1,776	1,504	272
Excess tax benefits from stock-based compensation	(165)	(155)	(10)
(Gain) loss on sale of property, equipment and improvements	(120)	1	(121)
Other reconciling items	152	163	(11)
Net income adjusted for non-cash expenses	11,282	13,320	(2,038)
Changes in working capital	(1,949)	(2,051)	102
Cash flows provided by operating activities	<u>\$ 9,333</u>	<u>\$ 11,269</u>	<u>\$ (1,936)</u>

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

**LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)**

Net cash provided by operating activities was \$9.3 million and \$11.3 million for the six months ended March 31, 2008 and 2007, respectively, resulting in a net decrease of \$2.0 million. This net decrease is primarily due to decreases of \$0.6 million of net income, \$1.2 million for deferred income taxes and \$0.3 million for depreciation and amortization, offset by a \$0.1 million increase for working capital changes. The \$0.1 million increase in net cash from working capital for the comparable six month periods ended March 31, 2008 and 2007 is primarily due to a net increase in accounts payable of \$4.0 million compared to the prior comparable period due to timing of material receipts and the related supplier payments, offset by a net increase in accounts receivable balances of \$2.9 million as of March 31, 2008 compared to the prior comparable period due to a slowdown in customer payments. Net inventory balances decreased by \$1.0 million for the comparable aforementioned periods. Additional tax payments in fiscal 2008 offset partially by an adjustment related to the adoption of FIN 48 in the first quarter of fiscal 2008, reduced cash inflows related to income taxes payable by \$1.6 million in addition to other assets, which increased by \$0.3 million.

Net cash used in investing activities was \$1.6 million and \$11.8 million during the six months ended March 31, 2008 and 2007 resulting in a \$10.2 million increase in cash flow. The increase in cash flow is due to a \$5.0 million increase in sales of marketable securities, net of purchases and \$6.5 million proceeds from the sale-leaseback of our building in Dortmund, Germany. This was offset by additional cash usage of \$0.4 million related to the deposit for the Dortmund building leaseback, a net reduction of \$0.5 million of contingent purchase price payments related to the FS Forth acquisition and additional purchases of \$0.4 million of property, equipment, improvements and certain other intangible assets. We anticipate total fiscal 2008 capital expenditures to approximate \$4.0 million.

We generated \$1.9 million from financing activities during the six months ended March 31, 2008 compared to \$1.7 million during the same period a year ago, primarily as a result of proceeds from stock option and employee stock purchase plan transactions in both periods, and the reflection of cash provided by the excess tax benefits related to the exercise of stock options.

Management believes that current financial resources, cash generated from operations and our potential capacity for additional debt and/or equity financing will be sufficient to fund operations for at least the next twelve months. On April 22, 2008, we entered into a short-term loan agreement with Wells Fargo in the amount of \$25.0 million to finance the acquisition of Sarian. We intend to repay the loan before the end of the third quarter of fiscal 2008 (see Note 10 to the Condensed Consolidated Financial Statements).

In conjunction with our adoption of FIN 48, we reclassified the portion of our unrecognized tax benefits that we do not expect to pay in cash over the next 12 months from a short-term liability to a long-term liability. All of our liabilities for unrecognized tax benefits are recorded as a long-term liability as we do not expect significant payments to occur over the next 12 months. Further information concerning the adoption of FIN 48 is included in Note 6 to our Condensed Consolidated Financial Statements.

During March 2008, our Dortmund, Germany building was sold for 4.5 million Euros (equivalent to \$6.9 million), resulting in a gain on the sale of 1.0 million Euros (\$1.6 million). We received 4.2 million Euros (\$6.5 million) for the sale of the Dortmund, Germany building in March, 2008. We received the amount withheld by the buyer at the sale date of 0.3 million Euros (\$0.4 million) in April, 2008. We also deposited 0.3 million Euros (\$0.4 million) into an interest-bearing bank account which will be refunded to us at the end of the lease term. Of the total gain of \$1.6 million, \$0.1 million was recognized immediately and \$1.5 million was deferred and will be recognized over the lease term of five years. The current portion of the deferred gain of \$0.3 million is included in other current liabilities and the long-term portion of the deferred gain of \$1.2 million is classified as a noncurrent liability on our condensed consolidated balance sheet.

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In March 2008, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 161"). This Statement amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently evaluating the impact of SFAS 161 on our consolidated financial statements.

In December 2007, the FASB issued FASB Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51" ("SFAS 160") to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 establishes accounting and reporting standards that require (i) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheet within equity, but separate from the parent's equity, (ii) the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income, and (iii) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. SFAS 160 will be effective for our fiscal years beginning October 1, 2009. Earlier adoption is prohibited. We do not expect SFAS 160 to have a material impact on our consolidated financial statements.

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

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

### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

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

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

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **RISK FACTORS**

Multiple risk factors exist which could have a material effect on our operations, results of operations, profitability, financial position, liquidity and capital resources. In addition to the risk factors provided in Part I, Item 1A of our 2007 Annual Report on Form 10-K as filed with the SEC on December 6, 2007, our risk factors now include a risk that if global economic and market conditions, or economic conditions in the U.S. or other key markets deteriorate, we may experience material impacts on our business, operating results, and financial condition.

### **INTEREST RATE RISK**

Our exposure to interest rate risk relates primarily to our investment portfolio. Investments are made in accordance with our investment policy and consist of high grade commercial paper and corporate bonds. We do not use derivative financial instruments to hedge against interest rate risk as all investments are held to maturity and the majority of our investments mature in less than a year. A change in interest rates would not have a material effect on our consolidated financial statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **INTEREST RATE RISK (CONTINUED)**

Our marketable securities are classified as held-to-maturity and are carried at amortized cost. Marketable securities consist of high-grade commercial paper and corporate bonds. Our credit policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. Our portfolio contains no auction rate securities. We intend to hold all marketable securities currently in our portfolio to maturity and we believe that realization of any unrealized holding losses is not likely at this time and is therefore not recorded.

#### **FOREIGN CURRENCY RISK**

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

For the six months ended March 31, 2008 and 2007, we had approximately \$35.0 million and \$29.6 million, respectively, of net sales to foreign customers including export sales, of which \$12.4 million and \$11.7 million, respectively, were denominated in foreign currency, predominantly Euros. In future periods, a significant portion of sales will continue to be made in Euros.

The average monthly exchange rate for the Euro to the U.S. Dollar increased approximately 13.3% from 1.3000 to 1.4723 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar increased approximately 8.6% from 0.0084 to 0.0092 for the first six months of fiscal year 2008 as compared to the same period one year ago. A 10% change from the first six months of fiscal 2008 average exchange rate for the Euro and Yen to the U.S. Dollar would have resulted in a 1.3% increase or decrease in net sales and a 1.1% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments we need to consider in response to changes in the exchange rate.

#### **CREDIT RISK**

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

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.



**ITEM 4. CONTROLS AND PROCEDURES**

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES (CONTINUED)

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

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The disclosures set forth in Note 8 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

In addition to the risk factors provided in Part I, Item 1A of our 2007 Annual Report on Form 10-K as filed with the SEC on December 6, 2007, our risk factors now include a risk that if global economic and market conditions, or economic conditions in the U.S. or other key markets deteriorate, we may experience material impacts on our business, operating results, and financial condition.

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

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

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

Our Annual Meeting of Stockholders was held on January 24, 2008. Of the 25,652,529 shares of Digi common stock entitled to vote at the meeting, 22,805,373 shares were present at the meeting in person or by proxy. The stockholders voted on the following:

- a) The following individuals designated by our Board of Directors as nominees for director were elected for a three-year term, with voting as follows:

Nominee	Total Votes For	Withhold Authority
Joseph T. Dunsmore	22,273,572	531,801
Bradley J. Williams	22,539,052	266,321

- b) Proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending September 30, 2008. The proposal passed on a vote of 22,561,718 in favor, 227,058 against, 16,597 abstentions and no broker non-votes.

**ITEM 5. OTHER INFORMATION**

None

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS**

<u>Exhibit No.</u>	<u>Description</u>
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request)
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)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, N.A. (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (3)
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, N.A. (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (4)
4(c)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (5)
4(d)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (6)
10(a)	English Language Summary of Sale and Leaseback Agreement dated February 18, 2008 between Digi International GmbH and Deutsche Structured Finance GmbH & Co. Alphard KG.
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

- 
- (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(b) to the Company's Form 10-Q for the quarter ended March 31, 2007 (File no. 0-17972)
  - (3) Incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File No. 0-17972)
  - (4) Incorporated by reference to Exhibit 1 to Amendment 1 to the Company's Registration Statement on Form 8-A dated February 5, 1999 (File No. 0-17972)
  - (5) 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)
  - (6) Incorporated by reference to Exhibit 4(b) to the Company's Registration Statement on Form 8-A filed on April 25, 2008 (File No. 1-34033)

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

DIGI INTERNATIONAL INC.

Date: May 8, 2008

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

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Document Description</u>	<u>Form of Filing</u>
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request)	Filed Electronically
3(a)	Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1993 (File No. 0-17972))	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Company	Incorporated by Reference
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank, N.A. (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent	Incorporated by Reference
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated June 10, 1998 between Digi International Inc. and Wells Fargo Bank, N.A. (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent	Incorporated by Reference
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32	Section 1350 Certification	Filed Electronically

**DATED 28 APRIL 2008**

**(1) THOSE PERSONS NAMED IN SCHEDULE 1**

**- AND -**

**(2) DIGI INTERNATIONAL LIMITED**

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**SHARE PURCHASE AGREEMENT\***

**relating to**

**Sarian Systems Limited**

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7 PILGRIM STREET | LONDON | EC4V 6LB

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REF: fb.uk.30576085.03

\* The Company has omitted certain schedules at pages 21-79 in accordance with Regulation S-K 601(b)(2). The Company will furnish the omitted schedules to the Commission upon request.

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**THIS AGREEMENT** is made on 28<sup>th</sup> April 2008

**BETWEEN**

- (1) **THE SEVERAL PERSONS** whose names and addresses are set out in Part 1 of Schedule 1 (together the “**Sellers**” and each a “**Seller**”); and
- (2) **DIGI INTERNATIONAL LIMITED** incorporated and registered in England & Wales with company number 3138036 whose registered office is at Devonshire House, 66 Church Street, Leatherhead, Surrey KT22 8DP (the “**Buyer**”).

**RECITALS**

- (A) The Company has an issued share capital of £12,724 divided into 7,216 A Ordinary Shares of £1 each and 5,508 B Ordinary Shares of £1 each.
- (B) Further particulars of the Company and of the Subsidiary at the date hereof are set out in Schedule 2.
- (C) The Sellers are the legal and beneficial owners of the number of Sale Shares set out opposite their respective names in Schedule 1 comprising in aggregate the whole of the issued share capital of the Company.
- (D) The Sellers have agreed to sell and the Buyer has agreed to buy the Sale Shares on and subject to the terms and conditions of this agreement.

**IT IS AGREED** as follows:

**1. Interpretation**

1.1. The definitions and rules of interpretation in this clause apply in this agreement.

<b>“Accounts”</b>	the statutory accounts of the Company and the Subsidiary as at and to the Accounts Date, including in the case of the Company the abbreviated balance sheet together with the notes thereon and the auditor’s and Directors’ reports and in the case of the Subsidiary the balance sheet and the profit and loss account together with notes thereon and the auditor’s and Directors’ reports (copies of which are attached to the Disclosure Letter);
<b>“Accounts Date”</b>	30 June 2007;
<b>“Business”</b>	the business of the Company and the Subsidiary, namely the manufacture and distribution of IP routers;
<b>“Business Day”</b>	a day (other than a Saturday, Sunday or public holiday) when banks in the City of London are open for business;
<b>“Buyer’s Solicitors”</b>	Faegre & Benson LLP of 7 Pilgrim Street, London EC4V 6LB;
<b>“CAA 2001”</b>	the Capital Allowances Act 2001;

<b>“Claim”</b>	a claim for any breach of any of the Warranties or Title Warranties;
<b>“Company”</b>	Sarian Systems Limited, a company incorporated and registered in England and Wales with company number 3746721, further details of which are set out in Part 1 of Schedule 2;
<b>“Companies Acts”</b>	the Companies Act 1985 and the Companies Act 2006;
<b>“Completion”</b>	completion of the sale and purchase of the Sale Shares in accordance with this agreement;
<b>“Completion Accounts”</b>	the balance sheet of the Company and the Subsidiary as at the Completion Date stating the amount of the Net Asset Value prepared in accordance with, and subject to the provisions of, Part 3 of Schedule 3;
<b>“Completion Date”</b>	the date of this agreement;
<b>“Connected”</b>	in relation to a person, has the meaning contained in section 839 of the ICTA 1988;
<b>“Consultancy Agreements”</b>	the consultancy agreements in agreed form to be entered into between the Company and each of Nicholas Monaghan and Christopher Nisbett;
<b>“Control”</b>	<p>in relation to a body corporate, the power of a person to secure that the affairs of the body corporate are conducted in accordance with the wishes of that person:</p> <p>(a) by means of the holding of shares, or the possession of voting power, in or in relation to that or any other body corporate; or</p> <p>(b) by virtue of any powers conferred by the constitutional or corporate documents, or any other document, regulating that or any other body corporate,</p> <p>and a <b>“Change of Control”</b> occurs if a person who controls any body corporate ceases to do so or if another person acquires control of it;</p>
<b>“Director”</b>	each person who is a director or shadow director of the Company or the Subsidiary, the names of whom are set out in Schedule 2;
<b>“Disclosed”</b>	fairly disclosed in or under the Disclosure Letter;
<b>“Disclosure Letter”</b>	the letter from the Warrantors to the Buyer of even or near date herewith and described as the disclosure letter, including the bundle of documents attached to it ( <b>“Disclosure Bundle”</b> );



<b>“Encumbrance”</b>	any interest or equity of any person (including any right to acquire, option or right of pre-emption) or any mortgage, charge, pledge, lien, assignment, hypothecation, security, interest, title, retention or any other security agreement or arrangement;
<b>“Escrow Account”</b>	means the separately designated interest bearing deposit account in the joint names of the Buyer’s Solicitors and the Warrantors’ Solicitors and dealt with in accordance with Schedule 9;
<b>“Escrow Account Instruction Letter”</b>	means the letter in the agreed form from the Buyer and the Warrantors to the Buyer’s Solicitors and the Warrantors’ Solicitors;
<b>“Escrow Amount”</b>	the sum of US\$1,000,000 plus any interest accruing on it from time to time (as apportioned between the Warrantors in the proportions set out in Schedule 1) to be held in the Escrow Account;
<b>“Event”</b>	has the meaning given in Schedule 5;
<b>“FSMA”</b>	the Financial Services and Markets Act 2000;
<b>“Funds”</b>	The Yorkshire Fund, British Smaller Technology Companies VCT 2 plc and The Second HSBC UK Enterprise Fund for Yorkshire and Humberside;
<b>“Group”</b>	in relation to a company (wherever incorporated) that company, its subsidiaries, any company of which it is a subsidiary (its holding company) and any other subsidiaries of any such holding company; and each company in a group is a member of the group;  Unless the context otherwise requires, the application of the definition of Group to any company at any time will apply to the company as it is at that time;
<b>“ICTA 1988”</b>	the Income and Corporation Taxes Act 1988;
<b>“IHTA 1984”</b>	the Inheritance Tax Act 1984;
<b>“Independent Accountants”</b>	chartered accountants appointed by the Sellers and the Buyer jointly by agreement or, in default of such agreement within 7 days of one party notifying the other of its wish to appoint an independent firm, appointed by President of the Institute of Chartered Accountants on the application of either party;
<b>“Intellectual Property Rights”</b>	has the meaning given in paragraph 19.1 of Part 1 of Schedule 4;
<b>“Management Accounts”</b>	the unaudited consolidated balance sheet and the unaudited consolidated profit and loss account of the Company and the Subsidiary for the period of nine months ended 31 March 2008 (a copy of which is attached to the Disclosure Letter);

<b>“Net Asset Value”</b>	the aggregate amount of assets less liabilities of the Company and the Subsidiary as calculated from the Completion Accounts prepared in accordance with Part 3 of Schedule 3;
<b>“Net Asset Value Adjustment”</b>	means the adjustment (if any) to the Purchase Price carried out in accordance with Clause 3.3;
<b>“Pension Scheme”</b>	the personal pension plan established with Scottish Equitable which is registered under Chapter 2 of Part 4 of the Finance Act 2004;
<b>“Previously-owned Land and Buildings”</b>	has the meaning given in paragraph 24.1 of Part 1 of Schedule 4;
<b>“Properties”</b>	has the meaning given in paragraph 24.1 of Part 1 of Schedule 4;
<b>“Purchase Price”</b>	US\$30,500,000 being the purchase price for the Sale Shares to be paid by the Buyer to the Sellers in accordance with and subject to the provisos of clause 3;
<b>“Recognised Investment Exchange”</b>	any recognised investment exchange (as defined in section 285 (as amended) of the Financial Services and Markets Act 2000 and the AIM market of London Stock Exchange plc;
<b>“Sale Shares”</b>	the 7,216 A Ordinary Shares of £1 each and the 5,508 B Ordinary Shares of £1 each in the capital of the Company, all of which have been issued and are fully paid;
<b>“Service Agreements”</b>	the service agreements in agreed form to be entered into between the Company and each of Andy Hood, Robin Hudson, Duncan Ellison, Alistair Craven and Francis Sreeves;
<b>“subsidiary”</b>	in relation to a company wherever incorporated (a holding company) means a “subsidiary” as defined in section 736 of the Companies Act 1985 and any other company which is a subsidiary (as so defined) of a company which is itself a subsidiary of such holding company.  Unless the context otherwise requires, the application of the definition of subsidiary to any company at any time will apply to the company as it is at that time;
<b>“Subsidiary”</b>	Sarian Systems Distribution Limited, a company incorporated and registered in England and Wales with company number 5851110, further details of which are set out in Part 2 of Schedule 2.
<b>“Tax or Taxation”</b>	has the meaning given in Schedule 5;
<b>“Tax Covenant”</b>	the tax covenant as set out in Schedule 5;

“ <b>Tax Claim</b> ”	has the meaning given in Schedule 5;
“ <b>Tax Warranties</b> ”	the Warranties in Part 2 of Schedule 4;
“ <b>Taxation Authority</b> ”	has the meaning given in Schedule 5;
“ <b>Taxation Statute</b> ”	has the meaning given in Schedule 5;
“ <b>TCGA 1992</b> ”	the Taxation of Chargeable Gains Act 1992;
“ <b>Title Warranties</b> ”	those warranties set out at paragraphs 1.1, 1.2, 1.4, 2.2, 2.5, 2.7 13.1.3 and 13.3 of Part 1 of Schedule 4 of this agreement;
“ <b>TMA 1970</b> ”	the Taxes Management Act 1970;
“ <b>Transaction</b> ”	the transaction contemplated by this agreement or any part of that transaction;
“ <b>VATA 1994</b> ”	the Value Added Tax Act 1994;
“ <b>Warranties</b> ”	the warranties in clause 5 and Schedule 4;
“ <b>Warrantors</b> ”	those persons whose names are set out in Part 2 of Schedule 1;
“ <b>Warrantors’ Solicitors</b> ”	Walker Morris of Kings Court, 12 King Street, Leeds LS1 2HL.

- 1.2. Clause and schedule headings do not affect the interpretation of this agreement.
- 1.3. A **person** includes a corporate or unincorporated body.
- 1.4. Words in the singular include the plural and in the plural include the singular.
- 1.5. A reference to one gender includes a reference to the other gender.
- 1.6. A reference to a particular statute, statutory provision or subordinate legislation is a reference to it as it is in force from time to time taking account of any amendment or re-enactment and includes any statute, statutory provision or subordinate legislation which it amends or re-enacts and subordinate legislation for the time being in force made under it. Provided that, as between the parties, no such amendment or re-enactment made after the date of this agreement shall apply for the purposes of this agreement to the extent that it would impose any new or extended obligation, liability or restriction on, or otherwise adversely affect the rights of, any party.
- 1.7. **Writing** or **written** includes faxes but not e-mail.
- 1.8. Documents in **agreed form** are documents in the form agreed by the parties or on their behalf and initialled by them or on their behalf for identification.
- 1.9. References to clauses and Schedules are to the clauses and Schedules of this agreement; references to paragraphs are to paragraphs of the relevant Schedule.

1.10. Unless otherwise expressly provided, the obligations and liabilities of the Sellers under this agreement are several and the obligations of the Warrantors shall be joint and several.

1.11. References to this agreement include this agreement as amended or varied in accordance with its terms.

## **2. Sale and purchase and waiver of pre-emption rights**

2.1. On the terms of this agreement, the Sellers shall sell and the Buyer shall buy, with effect from Completion, the Sale Shares with full title guarantee, free from all Encumbrances and together with all rights that attach (or may in the future attach) to them including, in particular, the right to receive all dividends and distributions declared, made or paid on or after the date of this agreement.

2.2. Each of the Sellers severally waives any right of pre-emption or any restriction on transfer or any other entitlement in respect of the Sale Shares or any of them conferred on him under the articles of association of the Company or otherwise and shall procure the irrevocable waiver of any such right, restriction or entitlement conferred on any other person who is not a party to this agreement in respect of the Sale Shares owned by him.

2.3. The Buyer is not obliged to complete the purchase of any of the Sale Shares unless the purchase of all the Sale Shares is completed simultaneously, but completion of the purchase of some of the Sale Shares will not effect the rights of the Buyer with respect to the purchase of the other Sale Shares.

## **3. Purchase price**

3.1. Subject to clause 3.2 and clause 3.3, the aggregate Purchase Price shall be apportioned between the Sellers as set out opposite the Sellers' respective names in Schedule 1. The Purchase Price (less the Escrow Amount) and the Escrow Amount shall be paid in accordance with clause 4.3. For the avoidance of doubt, the Funds will not be required to make any contribution to the Escrow Account.

3.2. The Purchase Price shall be deemed to be reduced (or, as the case may be in respect of clause 3.2.4, increased) pro tanto by the amount of any payment made to the Buyer:

3.2.1. for a breach of any Warranty; or

3.2.2. under clause 9; or

3.2.3. under the Tax Covenant; or

3.2.4. by way of adjustment in accordance with clauses 3.3 and 3.4 below.

For the avoidance of doubt, any payment to the Buyer made by the Warrantors for breach of the Warranties, pursuant to clause 9 or in respect of a claim under the Tax Covenant shall not reduce the amount of the Purchase Price received by the Funds as set out in Part 1 of Schedule 1.

3.3. Net Asset Value Adjustment

3.3.1. The amount of the Net Asset Value Adjustment shall be determined and paid or satisfied as the case may be as provided for in this clause 3.

3.3.2. The Sellers shall as promptly as practicable, and in any event within 30 Business Days following Completion prepare and deliver to the Buyer draft Completion Accounts prepared in accordance with Part 3 of Schedule 3 to determine the Net Asset Value.

- 3.3.3. The Sellers and the Buyer shall attempt to agree the Completion Accounts as soon as possible and in any event within 20 Business Days after receipt of the same under clause 3.3.2.
- 3.3.4. Unless within the 20 Business Days referred to in clause 3.3.3 the Buyer notifies the Sellers in writing (setting out the adjustments, if any, which it proposes should be made to the draft Completion Accounts) that it disagrees with the draft Completion Accounts, the draft Completion Accounts, shall be deemed to be agreed and shall thereupon, save in the case of manifest error, become final and binding on the Sellers and the Buyer for all purposes of this agreement.
- 3.3.5. If by the end of the 20 Business Day period referred to in clause 3.3.3 the Completion Accounts have not been, or been deemed to be, agreed, the Sellers and the Buyer shall try to resolve in good faith any differences within the following 10 Business Days or such additional period as the parties may agree in writing.
- 3.3.6. At the end of the 20 Business Day period referred to in clause 3.3.5, any remaining matters in dispute shall be referred to Independent Accountants. The Independent Accountants shall act as experts and not arbitrators. The Sellers and the Buyer shall act in good faith towards each other regarding such application and in particular shall endeavour with reasonable expedition to settle the terms of reference of the Independent Accountants. The Independent Accountants shall agree, amend or prepare the Completion Accounts always in accordance with this agreement. The Independent Accountants shall be entitled to call for and inspect such documents as they shall reasonably consider necessary. The determination prepared by the Independent Accountants together with the supporting reasoning, shall be delivered to the Sellers and the Buyer within 25 Business Days of their formal appointment and shall (save in the case of manifest error) be final and binding on the Sellers and the Buyer for all purposes of this agreement.
- 3.3.7. The Sellers and the Buyer shall each pay their own expenses and the charges of any accountants instructed by them in respect of work carried out pursuant to this clause. The charges of the Independent Accountants shall be apportioned between the Sellers and the Buyer in such proportions as the Independent Accountants may determine in the light of the merits of the objections taken by the Sellers and the Buyer to the Completion Accounts. As between the Sellers any charges which the Independent Accountants may apportion to them pursuant to this clause 3.3.7 shall be payable by the Sellers in the proportions set out in the third column of the table in Part 1 of Schedule 1.
- 3.3.8. The Sellers and the Buyer shall procure that the Independent Accountants are given access to all of the working papers the Independent Accountants reasonably deem necessary.
- 3.4. The Net Asset Value Adjustment shall be:
- 3.4.1. if the Net Asset Value at Completion as determined by the final and binding Completion Accounts is less than £2,368,223, the total amount of the shortfall shall be payable by the Sellers to the Buyer on a £ for £ basis (in the case of the Warrantors, by direct transfer from the Escrow Account) to a bank account specified by the Buyer for such purpose within 5 Business Days after the Completion Accounts become final and binding PROVIDED ALWAYS that if the shortfall is less than £50,000 then no payment shall be made;

- 3.4.2. if the Net Asset Value at Completion as determined by the final and binding Completion Accounts is in excess of £2,368,223 the total amount of the surplus shall be payable to the Sellers by the Buyer in cash on a £ for £ basis in the manner set out at clause 4.3.1 within 5 Business Days after the Completion Accounts become final and binding PROVIDED ALWAYS that if the surplus is less than £50,000 then no payment shall be made.
- 3.5. Any payment to be made by the Sellers to the Buyer pursuant to clause 3.4.1 or by the Buyer to the Sellers pursuant to clause 3.4.2 shall be payable by or to the Sellers (as relevant) in the proportions set out in the third column of the table in Part 1 of Schedule 1.

#### **4. Completion**

- 4.1. Completion shall take place on the Completion Date:
- 4.1.1. at the offices of the Buyer's Solicitors; or
- 4.1.2. at any other place or time as may be agreed in writing by the Sellers and the Buyer.
- 4.2. At Completion the Sellers shall:
- 4.2.1. deliver or cause to be delivered the documents and evidence set out in Part 1 of Schedule 3;
- 4.2.2. procure that a board meeting of each of the Company and the Subsidiary is held at which the matters identified in Part 2 of Schedule 3 are carried out; and
- 4.2.3. deliver any other documents referred to in this agreement as being required to be delivered by them.
- 4.3. At Completion, subject to the Sellers having complied in full with their obligations under clause 4.2, the Buyer shall:
- 4.3.1. pay the Purchase Price (less the Escrow Amount) by bank transfer in cleared funds to the US\$ account of the Warrantors' Solicitors (who are irrevocably authorised to receive the same on behalf of all the Sellers) at Royal Bank of Scotland, "Walker Morris Client USD Account", account number WALMOR-USDA, IBAN GB37 RBOS 1663 0000 411896. Payment made in accordance with this clause shall constitute a valid discharge of the Buyer's obligations under clause 3.1; and
- 4.3.2. pay the Escrow Amount by bank transfer in cleared funds to the Escrow Account to be set up by the Buyer's Solicitors and the Warrantors' Solicitors pursuant to the Escrow Account Instruction Letter.
- 4.4. As soon as possible after Completion the Sellers shall send to the Buyer (at the Buyer's registered office for the time being) all records, correspondence, documents, files, memoranda and other papers relating to the Company and the Subsidiary not required to be delivered at Completion which are in the possession of the Sellers and which are not kept at any of the Properties, other than any information in the possession of the Funds and relating to the Funds investment in the Company.
- 4.5. Within five Business Days of Completion, the Buyer shall, or shall procure that the Company shall, pay a bonus to each of the following persons in the gross amount (less any deductions in respect of PAYE and employee national insurance contributions) set against his name:

<b>Payee</b>	<b>(£)</b>
Alistair Craven	45,000
Sally Cross	5,000
Colin Lucy	50,000
Francis Sreeves	20,000
Duncan Ellison	50,000
Julian Megson	10,000
Chris Nisbet	20,000
<b>Total</b>	<b>200,000</b>

## 5. Warranties

- 5.1. The Buyer is entering into this agreement on the basis of the Warranties.
- 5.2. The Warrantors jointly and severally warrant to the Buyer that each Warranty is true, accurate and not misleading on the date of this agreement, except as Disclosed.
- 5.3. Each of the Funds severally warrants to the Buyer in terms of the Title Warranties in respect of itself and its own Sale Shares (as set out in Part 1 of Schedule 1) only. For the avoidance of doubt, the Funds are giving no Warranties other than the Title Warranties to the extent provided in this clause 5.3.
- 5.4. Warranties qualified by the expression **so far as the Warrantors are aware** or any similar expression are deemed to be given after the Warrantors have made careful enquiries of the following persons only:
- (a) each other;
  - (b) the following members of senior management: Colin Lucy, Alistair Craven and Sally Cross;
  - (c) in relation to the Intellectual Property warranties in paragraph 19 of Part 1 of Schedule 4 the following engineers: Francis Sreeves and Nick Monaghan;
  - (d) in relation to the Accounts warranties in paragraph 24 of Part 1 of Schedule 4 and the Tax Warranties in Part 2 of Schedule 4: John Holroyd of Mazars LLP (being the auditors of the Company and the Subsidiary as at the date of this agreement); and
  - (e) in relation to the insurance warranties in paragraph 6 of Part 1 of Schedule 4: Alan Bridge of Towergate Underwriting Group Limited (being the Company's insurance brokers as at the date of this agreement).
- and the Warrantors shall be deemed to have knowledge of any information which such enquiry reveals or would, if made, have revealed.
- 5.5. Each of the Warranties is separate and, unless otherwise specifically provided, is not limited by reference to any other Warranty or any other provision in this agreement.
- 5.6. With the exception of the matters Disclosed, no information of which the Buyer and/or its agents and/or advisers has knowledge (actual, constructive or imputed) or which could have been discovered (whether by investigation made by the Buyer or made on its behalf) shall prejudice or prevent any Claim or reduce any amount recoverable thereunder.

- 5.7. The Warrantors agree that any information supplied by the Company or the Subsidiary or by or on behalf of any of the employees, directors, agents or officers of the Company or of the Subsidiary (“**Officers**”) or the Funds to the Warrantors or their advisers in connection with the Warranties, the information Disclosed or otherwise shall not constitute a warranty, representation or guarantee as to the accuracy of such information in favour of the Warrantors, and the Warrantors hereby undertake to the Buyer, Company, the Subsidiary and each Officer and the Funds that they waive any and all claims which they might otherwise have against any of them in respect of such matters except for fraud.
- 5.8. The Buyer acknowledges and agrees that the Warrantors do not give any Warranty:
- 5.8.1. in respect of matters relating to insurance, save for the Warranties in paragraph 6 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of matters relating to insurance;
  - 5.8.2. in respect of defective products and services, save for the Warranties in paragraph 9 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of defective products and services;
  - 5.8.3. in respect of environmental matters, save for the Warranties in paragraph 18 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of environmental matters;
  - 5.8.4. in respect of Intellectual Property Rights, save for the Warranties in paragraph 19 of Part 1 of Schedule 4 and, to the extent that agreements relating to Intellectual Property Rights constitute Material Contracts, the Warranties in paragraph 13 of Part 1 of schedule 4, and each of the other Warranties shall be deemed not to be given in respect of Intellectual Property Rights;
  - 5.8.5. in respect of the IT Systems, save for the Warranties in paragraph 20 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of the IT Systems;
  - 5.8.6. in respect of employment matters, save for the Warranties contained in paragraph 22 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of employment matters;
  - 5.8.7. in respect of the Properties, save for the Warranties in paragraph 23 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of the Properties;
  - 5.8.8. in respect of the Accounts, save for the Warranties in paragraph 24 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of the Accounts;
  - 5.8.9. in respect of pension schemes and retirement benefits or any related claims, liabilities or other matters, save for the Warranties contained in paragraph 28 of Part 1 of Schedule 4, and each of the other Warranties shall be deemed not to be given in respect of any such matters; and
  - 5.8.10. in respect of Tax (as defined in schedule 5), save for the Tax Warranties, and each of the other Warranties shall be deemed not to be given in respect of any matter involving or relating to Tax

provided that no such limitations shall apply in relation to any Claim made under the warranties contained in paragraph 8 of Part 1 Schedule 4 (Disputes and Investigations).



## 6. Limitations on claims

- 6.1. For the purposes of this clause, a Claim is **connected** with another Claim if they all arise out of the occurrence of the same event or relate to the same subject matter.
- 6.2. This clause limits the liability of the Sellers in relation to any Claim and, where expressly so stated, any claim under the Tax Covenant or otherwise under this agreement.
- 6.3. Subject to Clause 6.7, the Sellers shall not be liable for a Claim or a claim under the Tax Covenant unless:
- 6.3.1. the amount of a Claim, or of a series of connected Claims of which that Claim is one, or the amount due in respect of a claim under the Tax Covenant, exceeds US\$10,000; and
  - 6.3.2. the amount of all Claims and all claims under the Tax Covenant that are not excluded under clause 6.3.1 when taken together, exceeds US\$100,000, in which case the whole amount (and not just the amount by which the limit in this clause 6.3.2 is exceeded) is recoverable by the Buyer.
- 6.4. The Sellers are not liable for a Claim to the extent that the Claim:
- 6.4.1. relates to matters Disclosed; or
  - 6.4.2. relates to any matter specifically provided for in the Accounts or the Completion Accounts.
- 6.5. Subject to Clause 6.7, the total liability of each of the Sellers under this agreement and the Tax Covenant shall not exceed in aggregate the amount set out against his name in the fifth column of Part 1 of Schedule 1.
- 6.6. The Sellers are not liable for a Claim or a claim under the Tax Covenant unless the Buyer has given the Sellers notice in writing of the Claim or the claim under the Tax Covenant, summarising the nature of the Claim or the claim under the Tax Covenant as far as is known to the Buyer and the amount claimed:
- 6.6.1. in the case of a claim made under the Tax Warranties or the Tax Covenant, within the period of seven years beginning with the Completion Date; and
  - 6.6.2. in any other case, within the period of 18 months beginning with the Completion Date
- provided that the Sellers' liability shall absolutely determine (if such Claim or claim under the Tax Covenant has not been previously satisfied, settled or withdrawn) if legal proceedings in respect of such Claim (or claim under the Tax Covenant) shall not have been commenced within six months of such notice, and for this purpose proceedings shall not be deemed to have been commenced unless they shall have been properly issued and validly served upon the Sellers.
- 6.7. Other than clauses 6.14 and 6.9 nothing in clause 6 applies to a Claim or a claim under the Tax Covenant that:
- 6.7.1. arises or is delayed as a result of dishonesty, fraud or wilful concealment by the Sellers, their agents or advisers;
  - 6.7.2. arises as result of any breach of the warranties contained under the Title Warranties of this agreement.

- 6.8. The Sellers shall not plead the Limitation Act 1980 in respect of any claims made under the Tax Warranties or Tax Covenant up to seven years after the Completion Date.
- 6.9. No right of rescission shall be available to the Buyer by reason of any breach of this agreement or any agreement or document entered into pursuant to this agreement nor shall the Buyer have the right to claim that any such breach constitutes repudiation of this agreement.
- 6.10. The Sellers shall not be liable in respect of any Claim (other than a Claim under the Tax Warranties):
- 6.10.1. to the extent that the claim arises as a result of, or would not have arisen but for, or a liability is increased as a result of:
- 6.10.1.1. any statutory or other binding or advisory legislative or regulatory provision not in force at the date of this agreement; or
- 6.10.1.2. any change in any statutory or other binding or advisory legislative or regulatory provision after the date of this agreement; or
- 6.10.2. to the extent that the claim arises as a result of, or would not have arisen but for, or a liability is increased as a result of, any publication or withdrawal of any decision of the courts or any other relevant regulatory authority after the date of this agreement altering the accepted interpretation of any such provision; or
- 6.10.3. to the extent that the claim is based upon liability which is contingent only, unless and until such contingent liability becomes an actual liability.
- 6.11. The Sellers shall not be liable in respect of any Claim (other than a Claim under the Tax Warranties):
- 6.11.1. to the extent that the claim arises, or would not have arisen but for, or a liability is increased as a result of any breach by the Buyer of any of its obligations under this agreement or any other agreement or document entered into pursuant to this agreement; or
- 6.11.2. to the extent that the claim arises or a liability is increased as a result of any transaction, arrangement, act or omission (or any combination of them) carried out or effected at any time after Completion by the Company, the Buyer or any member of the Buyer's Group:
- (a) outside the ordinary course of its business; or
- (b) in any other case, if the Buyer or the relevant member of the Buyer's Group, as the case may be, (i) knew or ought reasonably to have known that it would give rise to such a claim and (ii) the Company and/or the Subsidiary was not contractually obliged, prior to Completion, to carry out or effect such transaction, arrangement, act or omission.
- 6.12. Subject to this not materially prejudicing the business interests of the Buyer's Group, where the Buyer, the Company and/or the Subsidiary is at any time entitled to recover from some other person (including its insurers) any sum in respect of any matter giving rise to a Claim (other than a Claim under the Tax Warranties which shall be governed by paragraph 7 of Schedule 5), the Buyer shall and shall procure that the Company or the Subsidiary, as the case may be shall, subject to being indemnified by the Warrantors to the reasonable satisfaction of the Buyer in respect of all liabilities, costs and expenses arising in relation thereto, undertake all necessary steps to enforce such recovery prior to taking any action (other than notifying the Sellers of the potential claim) against the Sellers and in the event that the Buyer or the Company, or the Subsidiary shall recover any amount from such other person, the amount of the claim against the Sellers shall be reduced by the amount recovered, less all reasonable costs, charges and expenses properly incurred by the Buyer or the Company or the Subsidiary in recovering that sum from such other person.

- 6.13. If the Sellers at any time pay to the Buyer an amount pursuant to a Claim (other than a Claim under the Tax Warranties which shall be governed by paragraph 7 of Schedule 5) and the Buyer or the Company or the Subsidiary subsequently becomes entitled to make recovery in whole or in part from any third party in respect of any matter giving rise to such claim the Buyer shall, subject to being indemnified by the Warrantors to the reasonable satisfaction of the Buyer in respect of all liabilities, costs and expenses arising in relation thereto, procure that the Company or the Subsidiary, as the case may be shall, take all necessary steps to enforce such recovery and if the Buyer or the Company or the Subsidiary recovers from some other person a sum that is referable to that payment the Buyer shall repay to the Sellers an amount equal to the amount recovered upon receipt, less all reasonable costs, charges and expenses properly incurred by the Buyer or the Company or the Subsidiary in recovering that sum from such other person or, if lower, the amount paid by the Sellers in relation to such Claim.
- 6.14. The Sellers shall have no liability under this agreement or the Tax Covenant more than once in respect of the same loss arising out of or in respect of the same act, matter or thing and for this purpose any payment by the Warrantors under the Tax Covenant shall be deemed to satisfy any claim under this agreement for the same amount in respect of the same matter and vice versa.
- 6.15. If any claim is made against the Buyer, the Company or any member of the Buyer's Group by any third party which may in turn lead to a Claim (other than a Claim under the Tax Warranties which shall be governed by paragraph 9 of Schedule 5) (the **Third Party Claim**) the Buyer shall:
- 6.15.1. give notice of such claim to the Sellers as soon as reasonably practicable after becoming aware of it;
  - 6.15.2. take such action and give such information and access to personnel, premises, chattels, documents and records to the Sellers and their professional advisers (in connection with the Third Party Claim) as the Sellers may reasonably request and, subject to the Buyer and the relevant member of the Buyer's group being indemnified to their reasonable satisfaction by the Warrantors against all liabilities, costs, expenses, damages and losses (including, without limitation, the reasonable and proper costs of its legal advisers) suffered or incurred in connection with such claim, the Sellers shall be entitled to require the Buyer to take (or procure the taking of) such reasonable action and give (or procure the giving of) such reasonable information and assistance in order to avoid, dispute, resist, mitigate, compromise, defend or appeal against any Third Party Claim and any adjudication with respect of any such claim unless such action may, in the reasonable opinion of the Buyer, materially prejudice the business interests of the Buyer's Group;
  - 6.15.3. make no admission of liability, agreement, settlement or compromise with or to any third party in relation to any such Third Party Claim or adjudication without the prior written consent of the Sellers.
- 6.16. Nothing in this agreement shall relieve the Buyer of any common law duty to mitigate any loss, liability or damage suffered or incurred by it.

**7. Tax covenant**

The provisions of Schedule 5 apply in this agreement.

**8. INTENTIONALLY BLANK**

**9. Restrictions on Warrantors**

9.1. Each of the Warrantors severally covenants with the Buyer that he shall not:

9.1.1. at any time during the period of three years beginning with the Completion Date, in any geographic areas in which any business of the Company or the Subsidiary was carried on at the Completion Date, carry on or be employed, engaged or interested in any business which would be in direct competition with any part of the Business as the Business was carried on at the Completion Date; or

9.1.2. at any time during the period of three years beginning with the Completion Date, deal with any person who is at the Completion Date, or who has been at any time during the period of 12 months immediately preceding that date, a client or customer of the Company or the Subsidiary for the purpose of offering to that person goods or services which are of the same type as goods or services supplied by the Company at the date hereof; or

9.1.3. at any time during the period of three years beginning with the Completion Date, canvass, solicit or otherwise seek to supply goods or services of the same type as those supplied by the Company at the date hereof to any person who is at the Completion Date, or who has been at any time during the period of 12 months immediately preceding that date, a client or customer of the Company or the Subsidiary; or

9.1.4. at any time during the period of three years beginning with the Completion Date:

9.1.4.1. offer employment to, enter into a contract for the services of, or attempt to entice away from the Company or the Subsidiary, any individual who is at the time of the offer or attempt, and was at the Completion Date, employed or directly or indirectly engaged in an executive or managerial position with the Company or the Subsidiary; or

9.1.4.2. procure or facilitate the making of any such offer or attempt by any other person; or

PROVIDED ALWAYS that nothing in this Clause 9.1 shall prevent the employment of any person who responds to a general advertisement.

9.1.5. at any time after Completion, use in the course of any business:

9.1.5.1. the words "SARIAN" or "SARIAN SYSTEMS"; or

9.1.5.2. any trade or service mark, business or domain name, design or logo which, at Completion, was or had been used by the Company or the Subsidiary; or

9.1.5.3. anything which is capable of confusion with such words, mark, name, design or logo; or

- 9.1.6. at any time during a period of three years beginning with the Completion Date, solicit or entice away from the Company or the Subsidiary any supplier to the Company or the Subsidiary who had supplied goods and/or services to the Company or the Subsidiary at any time during the 12 months immediately preceding the Completion Date, if that solicitation or enticement causes or would cause such supplier to cease supplying, or materially reduce its supply of, those goods and/or services to the Company or the Subsidiary.
- 9.2. The covenants in clause 9 are intended for the benefit of the Buyer, the Company and the Subsidiary and apply to actions carried out by the Warrantors in any capacity and whether directly or indirectly, on the Warrantors' own behalf, on behalf of any other person or jointly with any other person.
- 9.3. Nothing in clause 9 shall prevent the Warrantors or any of them from holding for investment purposes only:
- 9.3.1. any units of any authorised unit trust; or
- 9.3.2. not more than 5 per cent. of any class of shares or securities of any company traded on any Recognised Investment Exchange.
- 9.4. Each of the covenants in clause 9 is a separate undertaking by each Warrantor in relation to himself and his interests and shall be enforceable by the Buyer separately and independently of its right to enforce any one or more of the other covenants contained in clause 10. Each of the covenants in clause 9 is considered fair and reasonable by the parties, but if any restriction is found to be unenforceable, but would be valid if any part of it were deleted or the period or area of application reduced, the restriction shall apply with such modifications as may be necessary to make it valid and enforceable.
- 9.5. The consideration for the undertakings contained in clause 9 is included in the Purchase Price.

## **10. Confidentiality and announcements**

- 10.1. Each of the Sellers severally undertakes to the Buyer to keep confidential the terms of this agreement and all information which it has acquired about the Company and the Subsidiary and the Buyer's Group (as such Group is constituted immediately before Completion) and to use the information only for the purposes contemplated by this agreement.
- 10.2. The Buyer undertakes to each of the Sellers to keep confidential the terms of this agreement and all information that it has acquired about that Seller and to use the information only for the purposes contemplated by this agreement.
- 10.3. Each of the Sellers severally undertakes to each of the other Sellers to keep confidential the terms of this agreement and all information that they have acquired about that Seller and to use the information only for the purposes contemplated by this agreement.
- 10.4. A party does not have to keep confidential or to restrict its use of:
- 10.4.1. information that is or becomes public knowledge other than as a direct or indirect result of a breach of this agreement; or
- 10.4.2. information that it receives from a source not connected with the party to whom the duty of confidence is owed that it acquires free from any obligation of confidence to any other person.
- 10.5. Any party may disclose any information that it is otherwise required to keep confidential under this clause 10:

- 10.5.1. to such professional advisers, consultants and employees or officers of its Group as are reasonably necessary to advise on this agreement, or to facilitate the Transaction, if the disclosing party procures that the people to whom the information is disclosed keep it confidential as if they were that party; or
- 10.5.2. with the written consent of all the other parties; or
- 10.5.3. with the written consent of one party, if such information relates only to that party; or
- 10.5.4. to confirm that the sale has taken place, and the date of the sale (but without otherwise revealing any other details of the sale or making any other announcement).
- 10.5.5. to the extent that the disclosure is required:
  - 10.5.5.1. by law; or
  - 10.5.5.2. by a regulatory body, Taxation Authority or securities exchange; or
  - 10.5.5.3. to make any filing with, or obtain any authorisation from, a regulatory body, Taxation Authority or securities exchange; or
  - 10.5.5.4. to protect the disclosing party's interest in any legal proceedings,  
but shall use reasonable endeavours to consult the other parties and to take into account any reasonable requests they may have in relation to the disclosure before making it.
- 10.6. Each party shall supply any other party with any information about itself, its Group or this agreement as such other party may reasonably require for the purposes of satisfying the requirements of a law, regulatory body or securities exchange to which such other party is subject.

#### **11. Further assurance**

The Sellers shall (at their expense) promptly execute and deliver all such documents, and do all such things, as the Buyer may from time to time reasonably require for the purpose of transferring the legal and beneficial ownership of the Sale Shares.

#### **12. Assignment**

- 12.1. Except as provided otherwise in this agreement, no party may assign, or grant any Encumbrance or security interest over, any of its rights under this agreement or any document referred to in it.
- 12.2. Each party that has rights under this agreement is acting on its own behalf.
- 12.3. The Buyer may assign any or all of its rights under this agreement (or any document referred to in this agreement) but not its obligations to a member of its Group.
- 12.4. If there is an assignment:
  - 12.4.1. the Sellers may discharge their obligations under this agreement to the assignor until they receive notice of the assignment; and
  - 12.4.2. the assignee may enforce this agreement as if it were a party to it, but the Buyer shall remain liable for any obligations under this agreement.

### **13. Whole agreement**

- 13.1. This agreement, and any documents referred to in it, constitute the whole agreement between the parties and supersede any arrangements, understanding or previous agreement between them relating to the subject matter they cover.
- 13.2. The Buyer acknowledges that, in entering into this agreement it has not relied on any representation, warranty, assurance or undertaking, warranties, representations or statements other than as expressly set out in this agreement or the Tax Covenant.
- 13.3. Nothing in this clause 13 operates to limit or exclude any liability for fraud or fraudulent misrepresentation.

### **14. Variation and waiver**

- 14.1. Any variation of this agreement shall be in writing and signed by or on behalf of the parties.
- 14.2. Any waiver of any right under this agreement is only effective if it is in writing and it applies only to the party to whom the waiver is addressed and to the circumstances for which it is given.
- 14.3. A party that waives a right in relation to one party, or takes or fails to take any action against that party, does not affect its rights in relation to any other party.
- 14.4. No failure to exercise or delay in exercising any right or remedy provided under this agreement or by law constitutes a waiver of such right or remedy or shall prevent any future exercise in whole or in part thereof.
- 14.5. No single or partial exercise of any right or remedy under this agreement shall preclude or restrict the further exercise of any such right or remedy.
- 14.6. Unless specifically provided otherwise, rights arising under this agreement are cumulative and do not exclude rights provided by law.

### **15. Costs**

Unless otherwise provided, all costs in connection with the negotiation, preparation, execution and performance of this agreement, and any documents referred to in it, shall be borne by the party that incurred the costs.

### **16. Notice**

- 16.1. A notice given under this agreement:

- 16.1.1. shall be in writing in the English language (or be accompanied by a properly prepared translation into English);
- 16.1.2. shall be sent for the attention of the person, and to the address or fax number, specified in this clause 16 (or such other address, fax number or person as each party may notify to the others in accordance with the provisions of this clause 16); and
- 16.1.3. shall be:
  - 16.1.3.1. delivered personally; or
  - 16.1.3.2. sent by fax; or

16.1.3.3. sent by pre-paid first-class post or recorded delivery; or

16.1.3.4. (if the notice is to be served by post outside the country from which it is sent) sent by airmail.

16.2. Any notice to be given to or by all of the Sellers under this agreement is deemed to have been properly given if it is given to or by the Warrantors' representative and the Funds' representative named in clause 16.3. Any notice to be given to or by all of the Funds under this agreement is deemed to have been properly given if it is given to or by the Funds representative named in clause 16.3. Likewise any notice to be given to or by all of the Warrantors under this agreement is deemed to have been properly given if it is given to or by the Warrantors' Representative named in clause 16.3. Any notice required to be given to or by some only of the Funds or Warrantors shall be given to or by the Funds or Warrantors concerned (and in the case of a notice to the Funds or Warrantors) at their address or fax number as set out in Schedule 1.

16.3. The addresses for service of notice are:

16.3.1. FUNDS' REPRESENTATIVE

16.3.1.1. name: David Gee

16.3.1.2. address: St. Martin's House, 210-212 Chapeltown Road, Leeds LS7 4HZ

16.3.1.3. fax number: +44 (0)113 294 5002

16.3.2. WARRANTORS' REPRESENTATIVE

16.3.2.1. name: Andrew Hood

16.3.2.2. address: 46 Effingham Road, Harden, Bradford, West Yorkshire BD16 1LQ

16.3.3. Digi International Limited

16.3.3.1. address: Devonshire House, 66 Church Street, Leatherhead, Surrey KT22 8DP

16.3.3.2. for the attention of: Dieter Vesper

16.3.3.3. fax number: +44 (0)1372 22 47 07

with a copy to:

Digi International Inc.

address: 11001 Bren Road East, Minnetonka, MN 55343, USA

For the attention of: Subramanian Krishnan

Fax number: 001 952 912 4998.

16.4. A notice is deemed to have been received:

16.4.1. if delivered personally, at the time of delivery; or

16.4.2. in the case of fax, at the time of transmission; or



- 16.4.3. in the case of pre-paid first class post or recorded delivery 2 Business Days from the date of posting; or
- 16.4.4. in the case of airmail, 7 Business Days from the date of posting; or
- 16.4.5. if deemed receipt under the previous paragraphs of clause 16.4 is not within business hours (meaning 9.00 am to 5.30 pm Monday to Friday on a day that is not a public holiday in the place of receipt), when business next starts in the place of receipt.

16.5. To prove service, it is sufficient to prove that the notice was transmitted by fax to the fax number of the party or, in the case of post, that the envelope containing the notice was properly addressed and posted.

**17. Interest on late payment**

- 17.1. Where a sum is required to be paid under this agreement (other than under the Tax Covenant) but is not paid before or on the date the parties agreed, the party due to pay the sum shall also pay an amount equal to interest on that sum for the period beginning with that date and ending with the date the sum is paid (and the period shall continue after as well as before judgment).
- 17.2. The rate of interest shall be 4 per cent. per annum above the base lending rate for the time being of Barclays Bank plc. Interest shall accrue on a daily basis and be compounded quarterly.
- 17.3. Clause 18 is without prejudice to any claim for interest under the law.

**18. Severance**

- 18.1. If any provision of this agreement (or part of a provision) is found by any court or administrative body of competent jurisdiction to be invalid, unenforceable or illegal, the other provisions shall remain in force.
- 18.2. If any invalid, unenforceable or illegal provision would be valid, enforceable or legal if some part of it were deleted, the provision shall apply with whatever modification is necessary to give effect to the commercial intention of the parties.

**19. Agreement survives completion**

This agreement (other than obligations that have already been fully performed) remains in full force after Completion.

**20. Third party rights**

- 20.1. This agreement and the documents referred to in it are made for the benefit of the parties and their successors and permitted assigns and are not intended to benefit, or be enforceable by, anyone else.
- 20.2. Each of the parties represents to the others that their respective rights to terminate, rescind or agree any amendment, variation, waiver or settlement under this agreement are not subject to the consent of any person that is not a party to this agreement.

**21. Successors**

The rights and obligations of the Sellers and the Buyer under this agreement shall continue for the benefit of, and shall be binding on, their respective successors and assigns.

## **22. Counterparts**

This agreement may be executed in any number of counterparts, each of which is an original and which together have the same effect as if each party had signed the same document.

## **23. Governing law and jurisdiction**

23.1. This agreement and any disputes or claims arising out of or in connection with its subject matter are governed by and construed in accordance with the law of England.

23.2. The parties irrevocably agree that the courts of England have exclusive jurisdiction to settle any dispute or claim that arises out of or in connection with this agreement.

This agreement has been entered into on the date stated at the beginning of it.

## Schedules\*

Schedule 1 — Particulars of Sellers and Warrantors

Schedule 2 — Particulars of the Company and the Subsidiary

Schedule 3 — Completion

Schedule 4 — Warranties

Schedule 5 — Tax Covenant

Schedule 6 — Registered Intellectual Property Rights

Schedule 7 — Particulars of Properties

Schedule 8 — Escrow

Schedule 9 — Part 2 — Escrow Account Instruction Letter

\* The Company has omitted certain schedules at pages 21-79 in accordance with Regulation S-K 601(b)(2). The Company will furnish the omitted schedules to the Commission upon request.

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Signed by **ANDREW HOOD**

/s/ Andrew Hood

Signed by **ROBIN HUDSON**

/s/ Robin Hudson

Signed by **NICHOLAS MONAGHAN**

/s/ Andrew Hood (by Power of Attorney)

Signed by **DUNCAN ELLISON**

/s/ Duncan Ellison

Signed by JEP Gervasio for the  
British Smaller Technology  
Companies VCT2 Plc:

/s/ J E P Gervasio  
Secretary

Signed by White Rose Nominee Investments Limited as  
general partner of The Second HSBC UK Enterprise Fund  
for Yorkshire and Humberside acting by:

/s/ J E P Gervasio  
Secretary

Signed by YFM Private Equity Limited as general partner  
of The Yorkshire Fund acting by:

/s/ David Gee  
Director

Signed by Subramanian Krishnan for and on behalf of  
**DIGI INTERNATIONAL LIMITED**

/s/ Subramanian Krishnan  
Director

**English Language Summary of Sale and Leaseback Agreement\***

On February 18, 2008, Digi International GmbH, a subsidiary of Digi International Inc. ("Digi") entered into a binding contract for the sale of its building (the "Building") to Deutsche Structured Finance GmbH & Co. Alphard KG ("DSF"). On the same date, DIGI signed a leaseback agreement with DSF to lease back a part of the building. The Building is located at Joseph-von-Fraunhofer-Str. 23, D-44227 Dortmund, Germany.

Both parties agreed to the following:

1. **SALE OF THE BUILDING.** DSF will purchase the building for 4,500,000 Euros.
2. **TRANSFER OF OWNERSHIP.** The ownership of the Building is transferred at the date of payment. The due date of the payment is 10 days after certain common legal criteria per the contract have been met. The transfer of ownership is expected to take place in the month of March, 2008.
3. **WITHHOLDING AMOUNTS.** DSF can withhold from the purchase price an amount of 266,260 Euros (see Item 4 below), the temporary guarantee of the rental deposit for the second tenant for the rental agreement between the second tenant and DSF (25,000 Euros) and the handover of building plans and other certain documentation regarding the building (7,500 Euros).
4. **LEASEBACK AGREEMENT.** The effective date of the Leaseback Agreement will be the transfer of ownership date. As per the agreement, DIGI will lease back 1,996 square meters, which represents approximately 40% of the total building space. The initial period of the contract is 5 years with a renewal option of an additional 5 years, if DSF is notified 12 months before the end of the initial lease term. The monthly rent excluding overhead expenses is 20,100 Euros. Rental payments may be adjusted along with the consumer price index. Along with the leaseback agreement, DIGI will deposit 266,260 Euros as a security deposit into an interest bearing bank account at Deutsche Bank, Dortmund.

The Sale and Leaseback Agreement also contains provisions with respect to other obligations of the parties to each other, including various covenants and conditions to close, the governing law and other miscellaneous matters.

In addition, the Sale and Leaseback Agreement also contains several addendums, which have been omitted from this summary. These addendums include the following:

1. Table of existing lease agreements
2. New lease agreement between Digi and DSF and also between second tenant and DSF which also includes floor and occupancy plans, summary of space leased, requirements for the deposit given by Digi (see Item 4 above), regulations on how occupancy costs are compiled, and tenant occupancy rules
3. Documentary requirements including general requirements, maps of the land parcel, building floor plans, and technical documentation.
4. Document stating that the signers representing DSF are authorized to sign the sale agreement.

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\* This document is an English Language summary of an original document in the German Language.

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

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

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

May 8, 2008

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

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

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

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

May 8, 2008

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

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

In connection with the Quarterly Report of Digi International Inc. (the Registrant) on Form 10-Q for the fiscal quarter ending March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Quarterly Report on Form 10-Q complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

May 8, 2008

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

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