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

FORM 10-Q

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

For the quarterly period ended: June 30, 2019

OR

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

For the transition period from __________ to __________.

Commission file number: 1-34033

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

Delaware	**41-1532464**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9350 Excelsior Blvd., Suite 700 **Hopkins, Minnesota**	**55343**
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, par value $.01 per share	DGII	The Nasdaq Stock Market LLC

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files.) Yes ☑ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer	o	Accelerated filer	☑
Non-accelerated filer	o	Smaller reporting company	o
Emerging growth company	o		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

On August 6, 2019, there were 28,136,548 shares of the registrant’s $.01 par value Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
	(in thousands, except per share data)			
Revenue:				
Product	$ 47,136	$ 51,691	$ 150,045	$ 137,733
Services and solutions	14,030	10,581	39,198	24,042
Total revenue	61,166	62,272	189,243	161,775
Cost of sales:				
Cost of product	25,982	26,639	80,291	68,929
Cost of services and solutions	6,137	5,244	18,328	12,287
Amortization of intangibles	719	741	2,184	2,118
Total cost of sales	32,838	32,624	100,803	83,334
Gross profit	28,328	29,648	88,440	78,441
Operating expenses:				
Sales and marketing	11,392	11,595	34,583	32,530
Research and development	8,584	8,205	27,671	24,573
General and administrative	6,751	7,234	18,309	19,905
Restructuring (reversal) charge	(20)	190	(87)	190
Total operating expenses	26,707	27,224	80,476	77,198
Operating income	1,621	2,424	7,964	1,243
Other income, net:				
Interest income	205	97	557	343
Interest expense	—	(5)	(94)	(12)
Other (expense) income, net	(174)	535	131	(37)
Total other income, net	31	627	594	294
Income before income taxes	1,652	3,051	8,558	1,537
Income tax expense	4	147	886	3,246
Net income (loss)	$ 1,648	$ 2,904	$ 7,672	$ (1,709)
Net income (loss) per common share:				
Basic	$ 0.06	$ 0.11	$ 0.28	$ (0.06)
Diluted	$ 0.06	$ 0.10	$ 0.27	$ (0.06)
Weighted average common shares:				
Basic	28,072	27,177	27,816	27,002
Diluted	28,589	27,764	28,414	27,002

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
	(in thousands)			
Net income (loss)	$ 1,648	$ 2,904	$ 7,672	$ (1,709)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	532	(3,116)	(1,120)	(1,058)
Change in net unrealized gain (loss) on investments	4	(1)	18	(41)
Less income tax (expense) benefit	(1)	1	(5)	9
Reclassification of realized loss on investments included in net income (1)	—	—	—	31
Less income tax benefit (2)	—	—	—	(8)
Other comprehensive income (loss), net of tax	535	(3,116)	(1,107)	(1,067)
Comprehensive income (loss)	$ 2,183	$ (212)	$ 6,565	$ (2,776)

(1) Recorded in Other (expense) income, net in our Condensed Consolidated Statements of Operations.
(2) Recorded in Income tax expense in our Condensed Consolidated Statements of Operations.

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2019	September 30, 2018 (as adjusted)*
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 84,094	$ 58,014
Marketable securities	2,254	4,736
Accounts receivable, net	44,721	49,819
Inventories	41,796	41,644
Other current assets	5,057	2,613
Assets held for sale	—	5,220
Total current assets	177,922	162,046
Property, equipment and improvements, net	14,417	8,354
Intangible assets, net	32,791	39,320
Goodwill	153,952	154,535
Deferred tax assets	5,343	6,600
Other non-current assets	821	1,291
Total assets	$ 385,246	$ 372,146
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 15,460	$ 12,911
Accrued compensation	5,105	8,190
Unearned revenue	5,031	3,177
Contingent consideration on acquired businesses	5,405	5,890
Other current liabilities	4,020	5,405
Total current liabilities	35,021	35,573
Income taxes payable	684	851
Deferred tax liabilities	273	334
Contingent consideration on acquired businesses	—	4,175
Other non-current liabilities	4,192	720
Total liabilities	40,170	41,653
Contingencies (see Note 13)		
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; 34,510,607 and 33,812,838 shares issued	345	338
Additional paid-in capital	264,225	255,936
Retained earnings	159,633	151,961
Accumulated other comprehensive loss	(24,633)	(23,526)
Treasury stock, at cost, 6,386,324 and 6,385,336 shares	(54,494)	(54,216)
Total stockholders’ equity	345,076	330,493
Total liabilities and stockholders’ equity	$ 385,246	$ 372,146

*Prior period information has been restated for the adoption of ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*,” which we adopted on October 1, 2018.

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

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

	Nine months ended June 30,	
	2019	2018 (as adjusted)*
	(in thousands)	
Operating activities:		
Net income (loss)	$ 7,672	$ (1,709)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation of property, equipment and improvements	3,343	2,440
Amortization of intangible assets	6,669	6,866
Stock-based compensation	4,180	3,598
Deferred income tax provision	1,189	2,781
Gain on sale of property and equipment	(4,458)	(8)
Change in fair value of contingent consideration	1,188	333
Provision for bad debt and product returns	594	404
Provision for inventory obsolescence	1,350	1,550
Restructuring (reversal) charge	(87)	190
Other	131	(58)
Changes in operating assets and liabilities (net of acquisitions)	757	(25,231)
Net cash provided by (used in) operating activities	22,528	(8,844)
Investing activities:		
Proceeds from maturities and sales of marketable securities	2,500	29,752
Proceeds from sale of business	—	2,000
Acquisition of businesses, net of cash acquired	—	(56,588)
Proceeds from sale of property and equipment	10,047	—
Purchase of property, equipment, improvements and certain other intangible assets	(8,600)	(963)
Net cash provided by (used in) investing activities	3,947	(25,799)
Financing activities:		
Acquisition earn-out payments	(3,748)	—
Proceeds from stock option plan transactions	4,054	3,871
Proceeds from employee stock purchase plan transactions	835	892
Purchases of common stock	(1,051)	(730)
Net cash provided by financing activities	90	4,033
Effect of exchange rate changes on cash and cash equivalents	(485)	82
Net increase (decrease) in cash and cash equivalents	26,080	(30,528)
Cash and cash equivalents, beginning of period	58,014	78,222
Cash and cash equivalents, end of period	$ 84,094	$ 47,694
Supplemental schedule of non-cash investing and financing activities:		
Transfer of inventory to property, equipment and improvements	$ (921)	$ (1,750)
Liability related to acquisition of business	$ —	$ (2,300)
Accrual for purchase of property, equipment, improvements and certain other intangible assets	$ (7)	$ —

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

(in thousands)	Common Stock Shares	Common Stock Par Value	Treasury Stock Shares	Treasury Stock Value	Additional Paid-In Capital	Retained Earnings*	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balances, September 30, 2017	33,008	$ 330	6,437	$ (54,533)	$ 245,528	$ 150,363	$ (22,659)	$ 319,029
Cumulative-effect adjustment from adoption of ASU 2016-09					52	(33)		19
Net loss						(1,709)		(1,709)
Other comprehensive loss							(1,067)	(1,067)
Employee stock purchase plan issuances			(106)	897	(5)			892
Repurchase of common stock			73	(730)				(730)
Issuance of stock under stock award plans	638	7			3,864			3,871
Stock-based compensation expense					3,598			3,598
Balances, June 30, 2018	33,646	$ 337	6,404	$ (54,366)	$ 253,037	$ 148,621	$ (23,726)	$ 323,903
Balances, September 30, 2018	33,813	$ 338	6,385	$ (54,216)	$ 255,936	$ 151,961	$ (23,526)	$ 330,493
Net income						7,672		7,672
Other comprehensive loss							(1,107)	(1,107)
Employee stock purchase plan issuances			(91)	773	62			835
Repurchase of common stock			92	(1,051)				(1,051)
Issuance of stock under stock award plans	698	7			4,047			4,054
Stock-based compensation expense					4,180			4,180
Balances, June 30, 2019	34,511	$ 345	6,386	$ (54,494)	$ 264,225	$ 159,633	$ (24,633)	$ 345,076

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

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 unaudited condensed consolidated financial statements of Digi International Inc. ("we", "us", "our", "Digi" or "the Company") have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission applicable to interim financial statements. While these financial statements reflect all normal recurring adjustments that are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. These financial statements should be read in conjunction with the financial statement disclosures in our Annual Report on Form 10-K for the year ended September 30, 2018 (the "2018 Financial Statements"). We use the same accounting policies in preparing quarterly and annual financial statements. The quarterly results of operations are not necessarily indicative of the results to be expected for the full year.

Significant Accounting Policies Update

Effective October 1, 2018, we adopted Accounting Standard Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* as discussed below. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards, as indicated by the "as adjusted" footnote.

Except for the accounting policy for revenue recognition that was updated as a result of adopting ASU 2014-09, there have been no other changes to our significant accounting policies described in our 2018 Financial Statements.

Revenue Recognition

We recognize hardware product revenue upon transfer of control of goods or services to customers in an amount that reflects the consideration we expect to receive in exchange for those goods or services. We determine the amount of revenue to be recognized through application of the following steps:

- Identification of the contract, or contracts with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when or as we satisfy the performance obligations.

Hardware Product Revenue and SmartSense by Digi™ Equipment Revenue and Associated Installation Fees

Our hardware product revenue is derived primarily from the sale of wired and wireless hardware products to our distributors and Direct/Original Equipment Manufacturer ("OEM") customers. Product revenue generally is recognized upon shipment of product to customers. Sales to authorized domestic distributors and Direct/OEM customers are made with certain rights of return and price adjustment provisions. Estimated reserves for future returns and pricing adjustments are established by us based on an analysis of historical patterns of returns and price adjustments as well as an analysis of authorized returns compared to received returns and distribution sales for the current period. Estimated reserves for future returns and price adjustments are charged against revenue in the same period as the corresponding sales are recorded. Material differences between the historical trends used to determine estimated reserves and actual returns and pricing adjustments could result in a material change to our consolidated results of operations or financial position. We have applied consistent methodologies for estimating reserves for future returns and pricing adjustments for all periods presented.

Our SmartSense by Digi™ equipment revenue is recorded as an up-front sale at its stand-alone selling price because the customer could utilize our equipment with other monitoring services or could use our monitoring services with hardware purchased from other vendors. Our installation charges are recorded when the product is installed.

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

Subscription and Support Services Revenue

Our SmartSense by Digi™ subscription revenue is recorded on a monthly basis. These subscriptions are generally in a range from one to five years, and may contain an evergreen renewal provision. Generally, our subscription renewal charges per month are the same as the original contract term.

We also derive service revenue from our Digi Remote Manager®, a platform-as-a-service ("PaaS") offering, whereby customers pay for services consumed based on the number of devices being managed or monitored. This revenue is recognized over the life of the service term.

Digi Support Services revenues are recognized over the life of the support contract. Some of Digi Support Services revenue is for training and this revenue is recognized as the services are performed.

Professional Services Revenue

Professional services revenue is derived from our Digi Wireless Design Services contracts on either on a time-and-materials or a fixed-fee basis. These revenues are recognized as the services are performed for time-and-materials contracts, or when milestones are achieved and accepted by the customer for fixed-fee contracts.

Contracts with Multiple Performance Obligations

SmartSense by Digi™ revenues typically are derived from contracts with multiple performance obligations. These obligations may include: delivery of monitoring equipment that the customer either purchases out-right or uses while we retain ownership, monitoring services, providing condition alerts of assets being monitored, and recertification of sensor equipment. When we retain ownership of the equipment, we charge an implementation fee to the customer so they can begin using the equipment. In these instances, all revenue derived from the above obligations is recognized over the subscription term of the contract. If the customer purchases the equipment out-right, that portion of the revenue is recognized at the stand-alone selling price at the time the equipment is shipped and all other revenue is recognized over the subscription term of the contract. We have made an accounting policy election to exclude from the measurement of our revenues any sales or similar taxes we collect from customers.

Recently Issued Accounting Pronouncements

Adopted

In January 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. ASU 2017-04 eliminates the second step in the goodwill impairment test which requires an entity to determine the implied fair value of the reporting unit's goodwill. Instead, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The standard, which should be applied prospectively, is effective for our fiscal year ending September 30, 2021. Early adoption is permitted. This ASU was early adopted by us on October 1, 2018 and did not have an impact on our consolidated financial statements.

In May 2017, FASB issued ASU 2017-09, *Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting*. ASU 2017-09 provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The amendments in this update are to be applied prospectively to an award modified on or after the adoption date. This ASU was effective for us this first fiscal quarter ending December 31, 2018. This ASU was adopted by us on October 1, 2018 and did not have an impact on our consolidated financial statements.

In August 2016, FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. The amendments in this update provide guidance on eight specific cash flow issues, thereby reducing the diversity in practice in how certain transaction are classified in the statement of cash flows. This ASU was effective for us this first fiscal quarter ending December 31, 2018. This ASU was adopted by us on October 1, 2018 and did not have an impact on our consolidated financial statements.

In January 2016, FASB issued ASU 2016-01, *Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 requires equity investments in unconsolidated entities (other than those

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

accounted for using the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. The amendments in this update also simplify the impairment assessment of equity investments without readily determinable fair values. This ASU also has changed the presentation and disclosure requirements for financial instruments. In addition, this ASU has clarified the guidance related to valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The amendments in this ASU were effective for our first fiscal quarter ending December 31, 2018. This ASU was adopted by us on October 1, 2018 and did not have an impact on our consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers ("Topic 606")*. This standard requires that revenue is recognized for the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. It also establishes timing associated with recognizing revenues and amortizing costs, associated with contracts. FASB has issued several amendments to ASU 2014-09, including clarifications on disclosure of prior-period performance obligations and remaining performance obligations. The guidance permits two methods of adoption, one of which is to retrospectively adjust results for each prior reporting period presented. We elected to adopt the standard using this method effective October 1, 2018.

We have described how we recognize revenue in the aforementioned revenue recognition policy. Relative to the amortization of costs there are two impacts to our financial statements. First, in instances where we retain ownership of equipment a customer uses, we charge an implementation fee to the customer so they can begin using the equipment. We amortize this cost of the equipment over its useful life (typically three years). Second, we capitalize and amortize commissions paid to sales personnel or agents on service contracts. If the commissions earned during an accounting period exceed our capitalization threshold, they will be amortized over the calculated average expected life of the pool of contracts closed during that period.

To ease our transition in the adoption of Topic 606, we have elected several practical expedients outlined in the new accounting guidance:

- We have not disclosed the remaining transaction price for reporting periods prior to the first quarter of fiscal 2019.
- For completed contracts that have variable consideration, we will use the as-invoiced amount for all of our time and materials contracts and contracts relating to Digi Remote Manager® in instances where the contracts do not include free service.
- We will expense incremental costs of obtaining a contract when incurred if the amortization period of the asset is one year or less.

The adoption of the standard related to the new revenue recognition impacted our reported results as follows:

	Three months ended June 30, 2018		
(in thousands, except per common share data)	As Reported	Impact of Adoption	As Adjusted
Revenue:			
Product	$ 51,691	$ —	$ 51,691
Services and solutions	11,025	(444)	10,581
Total revenue	62,716	(444)	62,272
Cost of sales:			
Cost of product	26,639	—	26,639
Cost of services and solutions	6,007	(763)	5,244
Amortization of intangibles	741	—	741
Total cost of sales	33,387	(763)	32,624
Gross profit	29,329	319	29,648
Operating expenses	27,292	(68)	27,224
Operating income	$ 2,037	$ 387	$ 2,424
Net income	$ 2,621	$ 283	$ 2,904
Diluted income per share	$ 0.09	$ 0.01	$ 0.10

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

	Nine months ended June 30, 2018		
(in thousands, except per common share data)	As Reported	Impact of Adoption	As Adjusted
Revenue:			
Product	$ 137,733	$ —	$ 137,733
Services and solutions	24,971	(929)	24,042
Total revenue	162,704	(929)	161,775
Cost of sales:			
Cost of product	68,929	—	68,929
Cost of services and solutions	13,737	(1,450)	12,287
Amortization of intangibles	2,118	—	2,118
Total cost of sales	84,784	(1,450)	83,334
Gross profit	77,920	521	78,441
Operating expenses	77,503	(305)	77,198
Operating income	$ 417	$ 826	$ 1,243
Net loss	$ (2,305)	$ 596	$ (1,709)
Diluted loss per share	$ (0.09)	$ 0.02	$ (0.06)

	September 30, 2018		
(in thousands)	As Reported	Impact of Adoption	As Adjusted
Accounts receivable, net	$ 50,817	$ (998)	$ 49,819
Property, equipment and improvements, net	$ 6,270	$ 2,084	$ 8,354
Deferred tax assets	$ 6,665	$ (65)	$ 6,600
Unearned revenue current	$ 2,579	$ 598	$ 3,177
Other non-current liabilities	$ 510	$ 210	$ 720
Retained earnings	$ 151,748	$ 213	$ 151,961

Adoption of the standards related to revenue recognition had no impact to total cash provided by or used in operating, financing or investing on our historical Condensed Consolidated Statements of Cash Flows.

Not Yet Adopted

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, which clarifies the accounting for implementation costs in cloud computing arrangements. ASU 2018-15 is effective for us in the first quarter ending December 31, 2020. Early adoption is permitted. We are evaluating when to adopt, and the impact of adopting, ASU 2018-15 on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement - Disclosure Framework (Topic 820).* The updated guidance improves the disclosure requirements on fair value measurements. The updated guidance is effective for us in the first quarter ending December 31, 2020. Early adoption is permitted for any removed or modified disclosures. We are evaluating when to adopt, and the impact of adopting, ASU 2018-13 on our consolidated financial statements.

In March 2017, FASB issued ASU 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The amendments in this update shorten the amortization period for certain callable debt securities that are held at a premium. The amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount, which would be amortized to maturity. This ASU is effective for us in the first quarter ending December 31, 2019. Early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

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

In June 2016, FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. The amendments in this update replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses. This ASU is effective for us in the first quarter ending December 31, 2020. Entities may early adopt beginning after December 15, 2018. We are evaluating the impact of adopting ASU 2016-13 on our consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, *Leases (Topic 842)*, which amends the existing guidance and requires lessees to recognize lease assets and lease liabilities on the balance sheet for leases with a term longer than 12 months that are classified as operating leases under previous authoritative guidance. The lease liability will be equal to the present value of lease payments and the right-of-use asset will be based on the lease liability, subject to adjustment for certain items. In July 2018, FASB issued two additional amendments that affect this guidance described in the following updates ASU 2018-10, *Codification Improvements to Topic 842, Leases* and ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. The amendments in ASU 2018-10 affect narrow aspects of the guidance issued in ASU 2016-02. The amendments in ASU 2018-11 provide an alternative (and optional) transition method that allows entities to apply the transition provisions in ASU 2016-02 at the adoption date instead of at the earliest comparative period presented in the financial statements. ASU 2016-02 is effective for us, using the modified retrospective approach, the first fiscal quarter ending December 31, 2019. Early adoption is permitted. As noted above, ASU 2018-11 provides for an additional and optional transition method. We plan to apply the optional transition method at the adoption date and are evaluating the impact of adopting ASU 2016-02 on our consolidated financial statements.

2. ACQUISITIONS

Acquisition of Accelerated Concepts, Inc.

On January 22, 2018, we purchased all the outstanding stock of Accelerated Concepts, Inc. ("Accelerated"), a Tampa-based provider of secure, enterprise-grade, cellular (LTE) networking equipment for primary and backup connectivity applications, for cash of $16.4 million (excluding cash acquired of $0.2 million) and future earn-out payments. Accelerated's results have been included in our consolidated financial statements within the IoT Products and Services segment since the date of acquisition. Purchase accounting related to the acquisition of Accelerated was finalized during the fourth quarter of fiscal 2018.

The earn-out payments are scheduled to be paid in two installments and the payment amount, if any, will be calculated based on the revenue performance of Accelerated products. The first installment was based on revenues from January 22, 2018 through January 21, 2019 (the "2018 period") and the second installment will be based on revenues from January 22, 2019 through January 21, 2020 (the "2019 period"). If certain revenue thresholds are met, the cumulative amount of these earn-outs will be $6.5 million. In April 2019, we paid $3.5 million for the first installment. The fair value of the remaining contingent consideration was $2.5 million at June 30, 2019. (see Note 6 to the consolidated financial statements).

Acquisition of TempAlert LLC

On October 20, 2017, we purchased all the outstanding interests of TempAlert LLC ("TempAlert"), a Boston-based provider of automated, real-time temperature monitoring and task management solutions for cash of $40.7 million (excluding cash acquired of $0.6 million) and future earn-out payments. TempAlert's results have been included in our consolidated financial statements within the IoT Solutions segment since the date of acquisition. Purchase accounting related to the acquisition was finalized during the first quarter of fiscal 2019.

The first earn-out payment was scheduled to be paid after December 31, 2018 and the second earn-out payment is scheduled to be paid after December 31, 2019, which is the end of the earn-out periods. No payment was earned for the period ended December 31, 2018. The cumulative amount of the remaining earn-outs for the period ended December 31, 2019, will not exceed $45.0 million. The fair value of the remaining contingent consideration was zero at June 30, 2019 (see Note 6 to the consolidated financial statements).

3. EARNINGS PER SHARE

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
Numerator:				
Net income (loss)	$ 1,648	$ 2,904	$ 7,672	$ (1,709)
Denominator:				
Denominator for basic net income (loss) per common share — weighted average shares outstanding	28,072	27,177	27,816	27,002
Effect of dilutive securities:				
Stock options and restricted stock units	517	587	598	—
Denominator for diluted net income (loss) per common share — adjusted weighted average shares	28,589	27,764	28,414	27,002
Net income (loss) per common share, basic	$ 0.06	$ 0.11	$ 0.28	$ (0.06)
Net income (loss) per common share, diluted	$ 0.06	$ 0.10	$ 0.27	$ (0.06)

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606),*" which we adopted on October 1, 2018.

For the three months ended June 30, 2019 and 2018, there were 617,841 and 770,178 potentially dilutive shares, respectively, and for the nine months ended June 30, 2019 and 2018, there were 667,841 and 977,828 potentially dilutive shares, respectively, related to stock options to purchase common shares that were not included in the above computation of diluted earnings per common share since the options' exercise prices were greater than the average market price of our common shares. In addition, due to the net loss for the nine months ended June 30, 2018, there were 440,002 common stock options and restricted stock units that were not included in the above computation of diluted earnings per share.

4. SELECTED BALANCE SHEET DATA

The following table shows selected balance sheet data (in thousands):

	June 30, 2019	September 30, 2018 (as adjusted)*
Accounts receivable, net:		
Accounts receivable	$ 48,747	$ 53,164
Less allowance for doubtful accounts	1,349	785
Less reserve for future returns and pricing adjustments	2,677	2,560
Accounts receivable, net	$ 44,721	$ 49,819
Inventories:		
Raw materials	$ 15,494	$ 22,047
Work in process	649	525
Finished goods	25,653	19,072
Inventories	$ 41,796	$ 41,644

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606),*" which we adopted on October 1, 2018.

5. MARKETABLE SECURITIES

Our marketable securities historically consist of certificates of deposit, commercial paper, corporate bonds and government municipal bonds. As of June 30, 2019, all of our securities that we held were trading below our amortized cost basis. We determined each decline in value to be temporary in nature.

5. MARKETABLE SECURITIES (CONTINUED)

At June 30, 2019 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Certificates of deposit	$ 2,255	$ —	$ (1)	$ 2,254
Total marketable securities	$ 2,255	$ —	$ (1)	$ 2,254

(1) Included in amortized cost and fair value is purchased and accrued interest of $6.

At September 30, 2018 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Certificates of deposit	$ 4,756	$ —	$ (20)	$ 4,736
Total marketable securities	$ 4,756	$ —	$ (20)	$ 4,736

(1) Included in amortized cost and fair value is purchased and accrued interest of $6.

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

	June 30, 2019			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Certificates of deposit	$ —	$ —	$ 2,254	$ (1)
Total	$ —	$ —	$ 2,254	$ (1)

	September 30, 2018			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Certificates of deposit	$ —	$ —	$ 4,736	$ (20)
Total	$ —	$ —	$ 4,736	$ (20)

6. FAIR VALUE MEASUREMENTS

Financial assets and liabilities are classified in the fair value hierarchy based on the lowest level input that is significant to the fair value measurement: Level 1 (unadjusted quoted prices in active markets for identical assets or liabilities); Level 2 (observable market inputs, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data). The following tables provide information by level for financial assets and liabilities that are measured at fair value on a recurring basis (in thousands):

	Total Fair Value at	Fair Value Measurements Using Inputs Considered as		
	June 30, 2019	Level 1	Level 2	Level 3
Assets:				
Money market	$ 20,302	$ 20,302	$ —	$ —
Certificates of deposit	2,254	—	2,254	—
Total assets measured at fair value	$ 22,556	$ 20,302	$ 2,254	$ —
Liabilities:				
Contingent consideration on acquired businesses	$ 5,405	$ —	$ —	$ 5,405
Total liabilities measured at fair value	$ 5,405	$ —	$ —	$ 5,405

6. FAIR VALUE MEASUREMENTS (CONTINUED)

	Total Fair Value at September 30, 2018	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets:				
Money market	$ 24,318	$ 24,318	$ —	$ —
Certificates of deposit	4,736	—	4,736	—
Total assets measured at fair value	$ 29,054	$ 24,318	$ 4,736	$ —
Liabilities:				
Contingent consideration on acquired businesses	$ 10,065	$ —	$ —	$ 10,065
Total liabilities measured at fair value	$ 10,065	$ —	$ —	$ 10,065

In connection with the October 2015 acquisition of Bluenica Corporation (“Bluenica”), we may be required to make contingent payments over a period of up to four years, subject to achieving specified revenue thresholds for sales of Bluenica products. The fair value of the liability for contingent consideration recognized was $10.4 million upon acquisition and was $2.9 million at June 30, 2019. We paid $0.5 million in fiscal 2017, no payments in fiscal 2018 and $2.2 million in the second quarter of fiscal 2019.

In connection with the November 2016 acquisition of FreshTemp, LLC (“FreshTemp”), we were required to make a contingent payment after June 30, 2018, for revenue related to specific customer contracts signed by June 30, 2017. The fair value of the liability for consideration recognized upon acquisition was $1.3 million. We made a final payment of $0.2 million during the first quarter of fiscal 2019.

In connection our acquisition of TempAlert, we agreed to make contingent payments for the twelve month periods ending December 31, 2018 and December 31, 2019 based on the total Digi IoT Solutions segment revenue (see Note 2 to the consolidated financial statements). The fair value of the liability for contingent consideration was zero, both upon acquisition and at June 30, 2019.

In connection with our acquisition of Accelerated, we agreed to make contingent payments, based upon certain thresholds (see Note 2 to the consolidated financial statements). The fair values of the liability for contingent consideration recognized upon acquisition of Accelerated on January 22, 2018 and at June 30, 2019 were $2.3 million and $2.5 million, respectively. The increase was a result of Accelerated outperforming initial revenue expectations. We made the first installment of $3.5 million in the third quarter of fiscal 2019.

The following table presents a reconciliation of the contingent consideration liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Fair value at beginning of period	$ 8,527	$ 8,263	$ 10,065	$ 6,388
Purchase price contingent consideration	—	—	—	2,300
Contingent consideration payments	(3,500)	—	(5,848)	—
Change in fair value of contingent consideration	378	758	1,188	333
Fair value at end of period	$ 5,405	$ 9,021	$ 5,405	$ 9,021

The change in fair value of contingent consideration reflects our estimate of the probability of achieving the relevant targets and is discounted based on our estimated discount rate. We have estimated the fair value of the contingent consideration at June 30, 2019 based on the probability of achieving the specified revenue thresholds at a range of 95.2% to 100.0% for Bluenica, 0% for TempAlert, and a range of 70.0% to 100.0% for Accelerated. A significant change in our estimates of achieving the relevant targets could materially change the fair value of the contingent consideration liability.

7. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Amortizable intangible assets were (in thousands):

	June 30, 2019			September 30, 2018		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$ 57,888	$ (50,455)	$ 7,433	$ 58,102	$ (48,693)	$ 9,409
License agreements	102	(67)	35	102	(46)	56
Patents and trademarks	14,552	(11,725)	2,827	15,701	(12,242)	3,459
Customer relationships	46,457	(24,261)	22,196	46,605	(21,049)	25,556
Non-compete agreements	600	(300)	300	600	(210)	390
Order backlog	1,800	(1,800)	—	1,800	(1,350)	450
Total	$ 121,399	$ (88,608)	$ 32,791	$ 122,910	$ (83,590)	$ 39,320

Amortization expense was $2.1 million and $2.6 million for the three month periods ended June 30, 2019 and 2018, respectively, and $6.7 million and $6.9 million for the nine month periods ended June 30, 2019 and 2018, respectively. Amortization expense is recorded on our consolidated statements of operations within cost of sales and in general and administrative expense.

Estimated amortization expense related to intangible assets for the remainder of fiscal 2019 and the five succeeding fiscal years is (in thousands):

2019 (three months)	$ 2,094
2020	8,277
2021	7,442
2022	6,590
2023	4,392
2024	3,704

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

	Nine months ended June 30,		
	IoT Products and Services	IoT Solutions	Total
Beginning balance, October 1	$ 104,358	$ 50,177	$ 154,535
Foreign currency translation adjustment	(404)	(179)	(583)
Ending balance, June 30	$ 103,954	$ 49,998	$ 153,952

Goodwill is tested for impairment on an annual basis as of June 30, or more frequently if events or circumstances occur which could indicate impairment. We have two reportable operating segments, our IoT Solutions segment and our IoT Products & Services segment (see Note 9 to the Condensed Consolidated Financial Statements). These two operating segments constitute separate reporting units for purposes of the ASC 350-20-35 “Goodwill Measurement of Impairment” assessment and both units were tested individually for impairment.

Our test for potential goodwill impairment is a two-step approach. We first assess qualitative factors to determine whether the existence of events or circumstances to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying value. If we determine based on this assessment that it is more likely than not that the fair value of a reporting units is less than its carrying amount, we perform the goodwill impairment test. This test requires us to determine the fair value of the reporting unit and compare it to the carrying amount, including goodwill, of such reporting unit. If the fair value exceeds the carrying amount, no impairment loss is recognized. However, if the carrying amount of the reporting unit exceeds its fair value, the goodwill of the reporting units is impaired and an impairment loss would be recognized.

We had a total of $104.0 million of goodwill on our Condensed Consolidated Balance Sheet for the IoT Products & Services reporting unit and $50.0 million of goodwill on our Condensed Consolidated Balance Sheet for the IoT Solutions reporting unit

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

as of June 30, 2019. At June 30, 2019, fair value exceeded the carrying value by more than 10% for both reporting units. Implied fair values for both reporting units were each calculated on a standalone basis using a weighted combination of the income approach and market approach.

The income approach indicates the fair value of a business based on the value of the cash flows the business or asset can be expected to generate in the future. A commonly used variation of the income approach used to value a business is the discounted cash flow (“DCF”) method. The DCF method is a valuation technique in which the value of a business is estimated on the earnings capacity, or available cash flow, of that business. Earnings capacity represents the earnings available for distribution to stockholders after consideration of the reinvestment required for future growth. Significant judgment is required to estimate the amount and timing of future cash flows for each reporting unit and the relative risk of achieving those cash flows.

The market approach indicates the fair value of a business or asset based on a comparison of the business or asset to comparable publicly traded companies or assets and transactions in its industry as well as prior company or asset transactions. This approach can be estimated through the guideline company method. This method indicates fair value of a business by comparing it to publicly traded companies in similar lines of business. After identifying and selecting the guideline companies, we make judgments about the comparability of the companies based on size, growth rates, profitability, risk, and return on investment in order to estimate market multiples. These multiples are then applied to the reporting units to estimate a fair value.

The implied fair values of each reporting unit were added together to get an indicated value of total equity to which a range of indicated value of total equity was derived. This range was compared to the total market capitalization of $356.6 million as of June 30, 2019, which implied a range of control premiums of 13.3% to 20.3%. This range of control premiums fell below the control premiums observed in the last five years in the communications equipment industry. As a result, the market capitalization reconciliation analysis proved support for the reasonableness of the fair values estimated for each individual reporting unit.

Should the facts and circumstances surrounding our assumptions change, the first step of our goodwill impairment analysis may fail. Assumptions and estimates to determine fair values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. For example, if our future operating results do not meet current forecasts or if we experience a sustained decline in our market capitalization that is determined to be indicative of a reduction in fair value of one or more of our reporting units, we may be required to record future impairment charges for goodwill. An impairment could have a material effect on our consolidated balance sheet and results of operations. We have had no goodwill impairment losses since the adoption of ASC 350, Intangibles-Goodwill and Others, in fiscal 2003.

8. SALE OF BUILDING

On October 2, 2018, we sold our 130,000 square feet corporate headquarters building in Minnetonka, Minnesota to Minnetonka Leased Housing Associates II, LLLP. The sale price was $10.0 million in cash adjusted for certain selling costs and an escrow for the leaseback of the building for four months. At September 30, 2018 the net book value of the land, building and improvements was $5.2 million and listed as assets held for sale on our Condensed Consolidated Balance Sheet. As a result, we recorded a $1.1 million tax benefit in the fourth quarter of fiscal 2018 because we were able to use credit loss carryforwards which previously had a valuation allowance. We recorded a gain of $4.4 million ($3.4 million net of tax) in the first quarter of fiscal 2019, which is recorded in general and administrative expense. During the nine months ended June 30, 2019, we paid $6.8 million for leasehold improvements to build out our new headquarters space. These improvements will be depreciated over 10 years, which is the estimated useful life of the improvements.

9. SEGMENT INFORMATION

We have two reportable operating segments: (1) IoT Products & Services, and (2) IoT Solutions. Summary operating results for each of our segments were as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
Revenue				
IoT Products & Services	$ 50,510	$ 54,406	$ 159,843	$ 145,111
IoT Solutions	10,656	7,866	29,400	16,664
Total revenue	$ 61,166	$ 62,272	$ 189,243	$ 161,775
Operating income (loss)				
IoT Products & Services	$ 3,117	$ 4,544	$ 13,969	$ 10,497
IoT Solutions	(1,496)	(2,120)	(6,005)	(9,254)
Total operating income	$ 1,621	$ 2,424	$ 7,964	$ 1,243
Depreciation and amortization				
IoT Products & Services	$ 1,391	$ 1,754	$ 4,711	$ 4,332
IoT Solutions	1,795	1,719	5,301	4,974
Total depreciation and amortization	$ 3,186	$ 3,473	$ 10,012	$ 9,306

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

Total expended for property, plant and equipment was as follows (in thousands):

	Nine months ended June 30,	
	2019	2018
Expended for property, equipment and improvements		
IoT Products & Services	$ 8,212	$ 963
IoT Solutions*	388	—
Total expended for property, plant and equipment	$ 8,600	$ 963

* Excluded from this amount is $921 and $1,750 of transfers of inventory to property plant and equipment for the nine months ended June 30, 2019 and 2018, respectively.

Total assets for each of our segments were as follows (in thousands):

	June 30, 2019	September 30, 2018 (as adjusted)*
Assets		
IoT Products & Services	$ 204,069	$ 209,574
IoT Solutions	94,828	99,822
Unallocated**	86,349	62,750
Total assets	$ 385,246	$ 372,146

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.
**Unallocated consists of cash and cash equivalents and current marketable securities.

10. REVENUE

Revenue Disaggregation

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

	Three months ended June 30,		Nine months ended June 30,	
($ in thousands)	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
North America, primarily the United States	$ 43,604	$ 44,740	$ 138,808	$ 113,246
Europe, Middle East & Africa	9,582	10,216	30,450	29,876
Rest of world	7,980	7,316	19,985	18,653
Total revenue	$ 61,166	$ 62,272	$ 189,243	$ 161,775

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606),*" which we adopted on October 1, 2018.

Net sales of services and solutions disaggregated by product group:

	Three months ended June 30,		Nine months ended June 30,	
($ in thousands)	2019	2018 (as adjusted)*	2019	2018 (as adjusted)*
IoT Products & Services Segment				
Product	$ 47,136	$ 51,691	$ 150,045	$ 137,733
Services	3,374	2,715	9,798	7,378
Total IoT Products & Services Segment	50,510	54,406	159,843	145,111
IoT Solutions Segment				
Solutions	10,656	7,866	29,400	16,664
Total Revenue	$ 61,166	$ 62,272	$ 189,243	$ 161,775

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606),*" which we adopted on October 1, 2018.

Contract Balances

Contract Assets

Contract assets consist of subscriber assets. These subscriber assets relate to an implementation fee in certain contracts that we charge our customers so they can begin using the equipment. In this case, we retain the ownership of this equipment that the customer uses. The total net book value of subscriber assets of $2.3 million and $2.1 million as of June 30, 2019 and September 30, 2018, respectively, are included in property, equipment and improvements, net. Amortization expense for these subscriber assets was $0.3 million and $0.2 million for the three month periods ended June 30, 2019 and June 30, 2018, respectively and $0.7 million and $0.3 million for the nine month periods ended June 30, 2019 and June 30, 2018, respectively. We amortize the cost of this equipment over its useful life (typically three years).

Contract Liabilities

The timing of revenue recognition may differ from the timing of invoicing to customers. Customers are invoiced for subscription services in advance on a monthly, quarterly or annual basis. Contract liabilities consist of unearned revenue related to annual or multi-year contracts for subscription services and related implementation fees for our IoT Solutions segment and our Digi Remote Manager® services in our IoT Products & Services segment.

10. REVENUE (CONTINUED)

Changes in unearned revenue were as follows:

		Nine months ended June 30,
($ in thousands)		2019
Unearned revenue, beginning of period*	$	3,933
Billings		18,908
Revenue recognized		(17,370)
Unearned revenue, end of period	$	5,471

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

Remaining Transaction Price

Transaction price allocated to the remaining performance obligations represents contracted revenue that has not been recognized, which includes unearned revenue and unbilled amounts that will be recognized as revenue in future periods. As of June 30, 2019 approximately $7.2 million of revenue is expected to be recognized from remaining performance obligations for subscriptions contracts. We expect to recognize revenue on approximately $4.9 million of remaining performance obligations over the next twelve months. Revenue from the remaining performance obligations we expect to recognize revenue over a range of two to five years.

11. INCOME TAXES

Our income tax expense was $0.9 million for the nine months ended June 30, 2019. Included in this expense was a net tax benefit discretely related to the nine months ended June 30, 2019 of $0.6 million, primarily a result of expiring statute of limitations of uncertain tax benefits as well as adjustments from the filing of the federal and foreign income tax returns. For the nine months ended June 30, 2019, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate due primarily to certain income tax credits generated in the U.S.

Income tax expense was $3.2 million for the nine months ended June 30, 2018. Included in this expense was a net tax expense discretely related to the nine months ended June 30, 2018 of $3.0 million, primarily as a result of new U.S. tax legislation that was enacted during the first quarter of fiscal 2018. For the nine months ended June 30, 2018, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate primarily due to the mix of income between taxing jurisdictions, certain of which had lower statutory tax rates than the U.S., and also due to certain tax credits generated in the U.S.

Our effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and tax items discretely related to the period, such as settlements of audits. We expect that we may record other benefits or expenses in the future that are specific to a particular quarter such as expiration of statutes of limitation, the completion of tax audits, or legislation that is enacted for both U.S. and foreign jurisdictions.

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

Unrecognized tax benefits as of September 30, 2018	$	1,561
Decreases related to:		
Prior year income tax positions		(34)
Expiration of statute of limitations		(128)
Unrecognized tax benefits as of June 30, 2019	$	1,399

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is $1.3 million, after considering the impact of interest and deferred benefit items. We expect that the total amount of unrecognized tax benefits will decrease by a minimal amount over the next 12 months.

12. PRODUCT WARRANTY OBLIGATION

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

Period		Balance at April 1		Warranties issued		Settlements made		Balance at June 30
Three months ended June 30, 2019	$	1,109	$	47	$	(101)	$	1,055
Three months ended June 30, 2018	$	1,348	$	82	$	(135)	$	1,295

Period		Balance at October 1		Warranties issued		Settlements made		Balance at June 30
Nine months ended June 30, 2019	$	1,172	$	263	$	(380)	$	1,055
Nine months ended June 30, 2018	$	987	$	798	$	(490)	$	1,295

13. COMMITMENTS AND CONTINGENCIES

Lease Commitments

In October 2018, we signed a thirteen-year lease agreement for our new headquarters located in Hopkins, Minnesota, with minimum lease obligations of $14.8 million with Colfin Midwest NNN Investor, LLC for 59,497 square feet of office space. In April 2019, we received $3.3 million for a tenant improvement allowance associated with our new headquarters.

We have entered into various operating lease agreements for office facilities and equipment, the last of which expires in fiscal 2032. The office facility leases generally require us to pay a pro-rata share of the lessor’s operating expenses. Certain operating leases contain escalation clauses and are being amortized on a straight-line basis over the term of the lease.

The following schedule reflects future minimum rental commitments at June 30, 2019 under noncancelable operating leases (in thousands):

Fiscal year		Amount
2019 (three months)	$	426
2020		2,522
2021		2,490
2022		2,228
2023		2,049
2024		2,095
Thereafter		11,361
Total minimum payments required	$	23,171

Contingencies

In November 2018, DimOnOff Inc., a company headquartered in Quebec City, Quebec, Canada (“DimOnOff”), which sells control systems in the building automation and street lighting markets sued us and a former distributor from whom DimOnOff purchased certain of our products. The suit was brought in the Superior Court of the Province of Quebec in the District of Quebec (Canada) and alleges certain Digi products it purchased and incorporated into street lighting systems in a Canadian city were defective causing some of the street lights to malfunction. It alleges damages of just over CAD 1.0 million. We intend to defend ourselves against DimOnOff’s claims. At this time we cannot assess the likelihood or amount of any potential loss.

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

14. STOCK-BASED COMPENSATION

Stock-based awards were granted under the 2019 Omnibus Incentive Plan (the “2019 Plan”) beginning February 4, 2019 and, prior to that, were granted under the 2018 Omnibus Incentive Plan (the “2018 Plan”). Upon stockholder approval of the 2019 Plan, we ceased granting awards under any prior plan. Shares subject to awards under prior plans that are forfeited, canceled, returned to the Company for failure to satisfy vesting requirements, settled in cash or otherwise terminated without payment also will be available for grant under the 2019 Plan. The authority to grant options under the 2019 Plan and to set other terms and conditions rests with the Compensation Committee of the Board of Directors.

The 2019 Plan authorizes the issuance of up to 1,500,000 common shares in connection with awards of stock options, stock appreciation rights, restricted stock, restricted stock units, performance-based full value awards or other stock-based awards. Eligible participants include our employees, our affiliates, non-employee directors of our Company and any consultant or advisor who is a natural person and provides services to us or our affiliates. Options that have been granted under the 2019 Plan typically vest over a four-year period and will expire if unexercised after seven years from the date of grant. Restricted stock unit awards (“RSUs”) that have been granted to directors typically vest in one year. RSUs that have been granted to executives and employees typically vest in January over a four-year period. The 2019 Plan is scheduled to expire on February 3, 2029. Options under the 2019 Plan can be granted as either incentive stock options or non-statutory stock options. The exercise price of options and the grant date price of restricted stock units is determined by our Compensation Committee but will not be less than the fair market value of our common stock based on the closing price as of the date of grant. Upon exercise of options or settlement of vested restricted stock units, we issue new shares of stock. As of June 30, 2019, there were approximately 1,556,370 shares available for future grants under the 2019 Plan.

Our equity plans and corresponding forms of award agreements generally have provisions allowing employees to elect to satisfy tax withholding obligations through the delivery of shares, having us retain a portion of shares issuable under the award or paying cash to us for the withholding. During the nine months ended June 30, 2019 and 2018, our employees forfeited 91,580 shares and 72,918 shares, respectively in order to satisfy $1.1 million and $0.7 million, respectively of withholding tax obligations related to stock-based compensation, pursuant to terms of awards under our board and shareholder-approved compensation plans for each respective period.

Employee contributions to the Employee Stock Purchase Plan (the “Purchase Plan”) were $0.8 million and $0.9 million during the nine month periods ended June 30, 2019 and 2018, respectively. Pursuant to the Purchase Plan, 90,592 and 105,732 common shares were issued to employees during the nine months ended June 30, 2019 and 2018, respectively. Shares are issued under the Purchase Plan from treasury stock. As of June 30, 2019, 224,984 common shares were available for future issuances under the Purchase Plan.

Stock-based compensation expense is included in the consolidated results of operations as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Cost of sales	$ 55	$ 49	$ 135	$ 145
Sales and marketing	453	406	1,272	1,131
Research and development	268	168	737	343
General and administrative	697	597	2,036	1,979
Stock-based compensation before income taxes	1,473	1,220	4,180	3,598
Income tax benefit	(306)	(249)	(863)	(747)
Stock-based compensation after income taxes	$ 1,167	$ 971	$ 3,317	$ 2,851

14. STOCK-BASED COMPENSATION (CONTINUED)

Stock Options

The following table summarizes our stock option activity (in thousands, except per common share amounts):

	Options Outstanding	Weighted Average Exercised Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at September 30, 2018	3,526	$10.49		
Granted	606	11.64		
Exercised	(448)	9.04		
Forfeited / Canceled	(346)	12.52		
Balance at June 30, 2019	3,338	$10.68	4.1	$ 6,983
Exercisable at June 30, 2019	2,226	$10.34	3.3	$ 5,418

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, based on our closing stock price of $12.68 as of June 30, 2019, which would have been received by the option holders had all option holders exercised their options as of that date. The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price.

The total intrinsic value of all options exercised during the nine months ended June 30, 2019 was $1.7 million and during the nine months ended June 30, 2018 was $0.7 million.

The table below shows the weighted average fair value, which was determined based upon the fair value of each option on the grant date utilizing the Black-Scholes option-pricing model and the related assumptions:

	Nine months ended June 30,	
	2019	2018
Weighted average per option grant date fair value	$4.37	$3.76
Assumptions used for option grants:		
Risk free interest rate	2.3% - 2.93%	2.12% - 2.88%
Expected term	6.00 years	6.00 years
Expected volatility	33% - 34%	33% - 34%
Weighted average volatility	33%	31%
Expected dividend yield	0	0

The fair value of each option award granted during the periods presented was estimated using the Black-Scholes option valuation model that uses the assumptions noted in the table above. Expected volatilities are based on the historical volatility of our stock. We use historical data to estimate option exercise and employee termination information within the valuation model. The expected term of options granted is derived from the vesting period and historical information and represents the period of time that options granted are expected to be outstanding. The risk-free rate used is the zero-coupon U.S. Treasury bond rate in effect at the time of the grant whose maturity equals the expected term of the option.

As of June 30, 2019, the total unrecognized compensation cost related to non-vested stock options was $4.2 million and the related weighted average period over which it is expected to be recognized is approximately 2.6 years.

14. STOCK-BASED COMPENSATION (CONTINUED)

Non-vested Restricted Stock Units

A summary of our non-vested restricted stock units as of June 30, 2019 and changes during the nine months then ended is presented below (in thousands, except per common share amounts):

	Number of Awards	Weighted Average Grant Date Fair Value
Nonvested at September 30, 2018	674	$ 11.05
Granted	547	$ 11.62
Vested	(250)	$ 10.42
Canceled	(131)	$ 12.20
Nonvested at June 30, 2019	840	$ 11.43

As of June 30, 2019, the total unrecognized compensation cost related to non-vested restricted stock units was $7.6 million, and the related weighted average period over which it is expected to be recognized is approximately 1.5 years.

15. RESTRUCTURING

Below is a summary of the restructuring charges and other activity (in thousands) all within our IoT Products and Services segment:

	Manufacturing Transition	2017 Restructuring		
	Employee Termination Costs	Employee Termination Costs	Other	Total
Balance at September 30, 2018	$ 147	$ 293	$ 13	$ 453
Payments	(108)	(233)	(18)	(359)
Reversals	(39)	(53)	5	(87)
Foreign currency fluctuation	—	(7)	—	(7)
Balance at June 30, 2019	$ —	$ —	$ —	$ —

Manufacturing Transition

As announced on April 3, 2018, we transferred the manufacturing functions of our Eden Prairie, Minnesota operations facility to existing contract manufacture suppliers. As a result, approximately 53 employment positions were eliminated, resulting in restructuring charges of approximately $0.5 million related to employee costs during the third and fourth quarters of fiscal 2018. The payments associated with these charges were completed in the first half of fiscal 2019.

2017 Restructuring

In May 2017, we approved a restructuring plan primarily impacting our France location, which is now closed. We also eliminated certain employee costs in the U.S. The restructuring was the result of a decision to consolidate our France operations to our Europe, Middle East and Africa (“EMEA”) headquarters in Munich. The total restructuring charges amounted to $2.5 million that included $2.3 million of employee costs and $0.2 million of contract termination costs during the third quarter of fiscal 2017. These actions resulted in an elimination of 10 positions in the U.S. and 8 positions in France. The payments associated with these charges were completed in the first half of fiscal 2019.

16. COMMON STOCK REPURCHASE

On April 24, 2018 our Board of Directors authorized a program to repurchase up to $20.0 million of our common stock primarily to return capital to shareholders. This repurchase authorization expired on May 1, 2019. There were no shares repurchased under this program.

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

Our management's discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended September 30, 2018, as well as our subsequent reports on Form 8-K and any amendments thereto.

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

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

Forward-Looking Statements

The words "anticipate," "assume," "believe," "continue," "estimate," "expect," "intend," "may," "plan," "should," or "will" or the negative thereof or other variations thereon or similar terminology, which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. Among other items, these statements relate to expectations of the business environment in which we operate, estimated future values and projections of future performance, perceived marketplace opportunities and statements regarding our mission and vision. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, including risks related to the highly competitive market in which our company operates, rapid changes in technologies that may displace products sold by us, declining prices of networking products, our reliance on distributors and other third parties to sell our products, the potential for significant purchase orders to be canceled or changed, delays in product development efforts, uncertainty in user acceptance of our products, the ability to integrate our products and services with those of other parties in a commercially accepted manner, potential liabilities that can arise if any of our products have design or manufacturing defects, our ability to defend or settle satisfactorily any litigation, uncertainty in global economic conditions and economic conditions within particular regions of the world which could negatively affect product demand and the financial solvency of customers and suppliers, the impact of natural disasters and other events beyond our control that could negatively impact our supply chain and customers, potential unintended consequences associated with restructuring or other similar business initiatives that may impact our operations and our ability to retain important employees, the ability to achieve the anticipated benefits and synergies associated with acquisitions or divestitures, and changes in our level of revenue or profitability, which can fluctuate for many reasons beyond our control. These and other risks, uncertainties and assumptions identified from time to time in our filings with the United States Securities and Exchange Commission, including without limitation, our Annual Report on Form 10-K for the year ended September 30, 2018, and subsequent quarterly reports on Form 10-Q and other filings, could cause the company's future results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. Many of such factors are beyond our ability to control or predict. These forward-looking statements speak only as of the date for which they are made. We disclaim any intent or obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Presentation of Non-GAAP Financial Measures

This report includes adjusted earnings before interest, taxes and amortization ("Adjusted EBITDA"), which is a non-GAAP measure. We understand that there are material limitations on the use of non-GAAP measures. Non-GAAP measures are not substitutes for GAAP measures, such as net (loss) income, for the purpose of analyzing financial performance. The disclosure of these measures does not reflect all charges and gains that were actually recognized by the company. Non-GAAP measures are not prepared in accordance with, or as an alternative for measures prepared in accordance with, generally accepted accounting principles and may be different from non-GAAP measures used by other companies or presented by us in prior reports. In addition, non-GAAP measures are not based on any comprehensive set of accounting rules or principles. We believe that non-GAAP measures have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP and that these measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. Additionally, Adjusted EBITDA does not reflect our cash expenditures, the cash requirements for the replacement of depreciated and amortized assets, or changes in or cash requirements for our working capital needs.

Management believes that Adjusted EBITDA, defined as EBITDA adjusted for stock-based compensation expense, acquisition-related expenses, restructuring charges and recoveries, and gains from the disposition of our former corporate headquarters is useful to investors to evaluate the Company's core operating results and financial performance because it excludes items that are significant non-cash or non-recurring expenses reflected in the Condensed Consolidated Statements of Operations. We believe that the presentation of Adjusted EBITDA as a percentage of revenue is useful because it provides a reliable and consistent approach to measuring our performance from year to year and in assessing our performance against that of other companies. We believe this information helps compare operating results and corporate performance exclusive of the impact of our capital structure and the method by which assets were acquired.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Refer to an update to our critical accounting policies included within Item 1, Notes to the Consolidated Financial Statements ("Note 1") of this Form 10-Q. No other material changes have occurred to the critical accounting policies set forth in our Annual Report on Form 10-K for the fiscal year ended September 30, 2018.

OVERVIEW

We are a leading global provider of business and mission-critical Internet-of-Things ("IoT") connectivity products, services and solutions. We have two reportable operating segments:

- IoT Products & Services segment; and
- IoT Solutions segment.

Our IoT Products & Services segment consists primarily of distinct communications products and also includes communication product development services. Among other things, these products and services help our customers create next-generation connected products and deploy and manage critical communications infrastructures in demanding environments with high levels of security and reliability. This segment creates secure, easy-to-implement embedded solutions and services to help customers build IoT connectivity. It also deploys ready-to-use, complete box solutions to connect remote equipment. The IoT Products & Services segment also offers dedicated professional services for the design of specialized wireless communications products for customers. Finally, this segment offers managed cloud services that enable customers to capture and manage data from devices they connect to networks. Our IoT products and services are used by a wide range of businesses and institutions.

All of the revenue we report in our consolidated financial statements as product revenue is derived from products included in this segment. These products include our cellular products, radio frequency ("RF") products, embedded and network products. Our cellular product category includes our cellular routers and all gateways. Our RF product category includes our XBee® modules as well as other RF Solutions. Our Embedded product category includes Digi Connect® and Rabbit® embedded systems on module and single board computers. Our network product category, which has the highest concentration of mature products, includes console and serial servers and USB connected products. Revenues we report as services and solutions revenue in our consolidated financial statements from this segment include Digi Wireless Design Services, Digi Remote Manager® and Digi Support Services we provide for our products.

On June 12, 2019, our IoT Products & Services segment received purchase orders for the delivery of over $20.0 million of cellular routers to an existing enterprise customer for a project it expects to implement on behalf of a large governmental agency. The project will utilize Digi's Remote Manager® platform, expert technical support services and application development services to deliver a comprehensive solution to the customer. There is uncertainty with respect to the timing of delivery of products and services as well as the period over which the products and services will be delivered. Each product shipment expected to occur under the purchase order remains subject to customary acceptance provisions under an existing resale agreement with the customer. Revenue from the purchase order was not significant for the three and nine months ended June 30, 2019. As of August 9, 2019, we have no material purchase commitments related to these customer purchase orders.

Our IoT Solutions segment offers wireless temperature and other condition-based monitoring services as well as employee task management services. These solutions are focused on three primary vertical markets: healthcare (including retail pharmacies, hospitals and other medical facilities), food service and transportation/logistics. These solutions are marketed as SmartSense by

Digi™, formerly Digi Smart Solutions. We have formed, expanded and enhanced the IoT Solutions segment through acquisition. All revenues from this segment are reported in our consolidated financial statements as services and solutions revenue as customers subscribe for ongoing monitoring services that are enabled by the deployment of hardware and related software.

For further detail on segment performance, see Segment Results of Operations section of the management discussion and analysis.

We compete for customers on the basis of existing and planned product features, service and software application capabilities, company reputation, brand recognition, technical support, alliance relationships, quality and reliability, product development capabilities, price and availability.

We utilize many financial, operational, and other metrics to evaluate our financial condition and financial performance. Below we highlight the metrics for the third quarter of fiscal 2019 that we feel are most important in these evaluations:

Total Revenue was $61.2 Million. Our revenue was $61.2 million for the third quarter of fiscal 2019 compared to $62.3 million in the third quarter of fiscal 2018, a decrease of $1.1 million, or 1.8%.

Product revenue decreased by $4.6 million, or 8.8%, in the third quarter of fiscal 2019 compared to the same period a year ago.

Services and solutions revenue increased by $3.5 million, or 32.6%, in the third quarter of fiscal 2019 compared to the same period a year ago.

Gross Margin was 46.3%. Our gross margin decreased as a percentage of revenue to 46.3% in the third quarter of fiscal 2019 as compared to 47.6% in the third quarter of fiscal 2018.

Net income for the third fiscal quarter of 2019 was $1.6 million, or $0.06 per diluted share. Net income for the third fiscal quarter of 2018 was $2.9 million, or $0.10 per diluted share.

Adjusted EBITDA for the third fiscal quarter of 2019 was $6.1 million, or 10.0% of total revenue. In the third fiscal quarter of fiscal 2018, Adjusted EBITDA was $7.9 million, or 12.6% of total revenue.

Below is a reconciliation of net income to Adjusted EBITDA:

	Three months ended June 30,				Nine months ended June 30,			
	2019		2018 (as adjusted)*		2019		2018 (as adjusted)*	
($ in thousands)		% of total revenue		% of total revenue		% of total revenue		% of total revenue
Total revenue	$ 61,166	100.0%	$ 62,272	100.0%	$ 189,243	100.0%	$ 161,775	100.0%
Net income (loss)	$ 1,648		$ 2,904		$ 7,672		$ (1,709)	
Interest income, net	(205)		(92)		(463)		(331)	
Income tax expense	4		147		886		3,246	
Depreciation and amortization	3,186		3,473		10,012		9,306	
Stock-based compensation	1,473		1,220		4,180		3,598	
Gain on sale of building	—		—		(4,396)		—	
Restructuring (reversal) charge	(20)		190		(87)		190	
Acquisition-related expense	54		13		1,045		1,763	
Adjusted EBITDA	$ 6,140	10.0%	$ 7,855	12.6%	$ 18,849	10.0%	$ 16,063	9.9%

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

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:

	Three months ended June 30,				% incr.	Nine months ended June 30,				% incr.
($ in thousands)	2019		2018 (as adjusted)*		(decr.)	2019		2018 (as adjusted)*		(decr.)
Revenue:										
Product	$ 47,136	77.1 %	$ 51,691	83.0%	(8.8)	$ 150,045	79.3%	$ 137,733	85.1 %	8.9
Services and solutions	14,030	22.9	10,581	17.0	32.6	39,198	20.7	24,042	14.9	63.0
Total revenue	61,166	100.0	62,272	100.0	(1.8)	189,243	100.0	161,775	100.0	17.0
Cost of sales:										
Cost of product	25,982	42.5	26,639	42.8	(2.5)	80,291	42.4	68,929	42.6	16.5
Cost of services and solutions	6,137	10.0	5,244	8.4	17.0	18,328	9.7	12,287	7.6	49.2
Amortization of intangibles	719	1.2	741	1.2	(3.0)	2,184	1.2	2,118	1.3	3.1
Total cost of sales	32,838	53.7	32,624	52.4	0.7	100,803	53.3	83,334	51.5	21.0
Gross profit	28,328	46.3	29,648	47.6	(4.5)	88,440	46.7	78,441	48.5	12.7
Operating expenses	26,707	43.6	27,224	43.7	(1.9)	80,476	42.5	77,198	47.7	4.2
Operating income	1,621	2.7	2,424	3.9	(33.1)	7,964	4.2	1,243	0.8	(540.7)
Other income, net	31	—	627	1.0	(95.1)	594	0.3	294	0.1	102.0
Income before income taxes	1,652	2.7	3,051	4.9	(45.9)	8,558	4.5	1,537	0.9	(456.8)
Income tax expense	4	—	147	0.2	(97.3)	886	0.4	3,246	2.0	(72.7)
Net income (loss)	$ 1,648	2.7 %	$ 2,904	4.7%	(43.3)	$ 7,672	4.1%	$ (1,709)	(1.1)%	548.9

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*", which we adopted on October 1, 2018.

REVENUE

Product

Product revenue decreased by $4.6 million, or 8.8%, in the third fiscal quarter of 2019 compared to the third fiscal quarter of 2018. This decrease was primarily a result of lower sales of terminal servers in our network product category to a significant customer. Partially offsetting this decrease were increases in sales of RF products to a significant customer as well as increased sales of embedded products.

Product revenue increased by $12.3 million, or 8.9%, in the nine months ended June 30, 2019 compared to the same period in the prior fiscal year. This increase included $5.4 million of incremental revenue related from Accelerated Concepts, Inc. ("Accelerated"), a provider of cellular (LTE) networking equipment, since the acquisition in January 2018. This increase also included increased sales within our industrial cellular, RF and embedded product categories due to increased customer demand, significant new customers and new product introductions. This was offset partially by lower sales of terminal servers in our network category to a significant customer.

Our product revenue is subject to large customer projects and deployments that can fluctuate from period to period. We entered in to several large purchase orders with a customer in the third fiscal quarter with uncertainty in timing and delivery of the specified products. Revenue from these purchase orders was not significant during the third fiscal quarter of 2019.

Services and Solutions

Services and solutions revenue increased by $3.5 million and $15.1 million, or 32.6% and 63.0% for the three and nine month periods ended June 30, 2019, respectively, as compared to the same periods in the prior fiscal year. This primarily was driven by the growth of our SmartSense by Digi™ business of $2.8 million and $12.7 million for the three and nine month periods ended June 30, 2019, respectively. These increases were driven by new customer deployments, additional purchases and an increase in our recurring revenue base. In addition, for the nine month period ended June 30, 2019 compared to the same period in the prior fiscal year, we experienced Solutions revenue equipment upgrades from existing customers. The equipment updates that have taken place have occurred almost entirely during the second quarter of fiscal 2019. Also, our services revenue increased by $0.7 million and $2.4 million for the three and nine month periods ended June 30, 2019, respectively, as compared to the same periods in the prior fiscal year. The services revenue increases for both comparable periods were primarily due to Digi Remote Manager® and support services revenue. As previously mentioned, we entered in to several large purchase orders with a customer in the third fiscal quarter with uncertainty in timing and deployment of the specified services.

We expect our Solutions revenue to increase over time. The growth rate in revenue may be subject to fluctuations from period to period as large-scale deployments to specific customers may take place in certain time frames and may not occur in every quarter. Further, one-time orders, equipment upgrades or replacement equipment from existing customers could cause there to be one-time increases in revenue that are not repeated in subsequent quarters.

Foreign Currency Impacts

Included in revenue performance for the year was a minimal decrease in foreign currency translation for the three and nine month periods ended June 30, 2019, when compared to the same periods in the prior fiscal year.

Revenue by Geographic Location

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

	Three months ended June 30,		$ incr.	% incr.	Nine months ended June 30,		$ incr.	% incr.
($ in thousands)	2019	2018 (as adjusted)*	(decr.)	(decr.)	2019	2018 (as adjusted)*	(decr.)	(decr.)
North America, primarily United States	$ 43,604	$ 44,740	(1,136)	(2.5)	$ 138,808	$ 113,246	25,562	22.6
Europe, Middle East & Africa	9,582	10,216	(634)	(6.2)	30,450	29,876	574	1.9
Rest of world	7,980	7,316	664	9.1	19,985	18,653	1,332	7.1
Total revenue	$ 61,166	$ 62,272	(1,106)	(1.8)	$ 189,243	$ 161,775	27,468	17.0

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

Revenue in North America decreased by $1.1 million, or 2.5%, for the three months ended June 30, 2019 compared to the same period a year ago. This decrease was primarily related to lower sales of terminal servers in our network product category to a significant customer. This was partially offset by increases in sales of our SmartSense by Digi™ business, Digi Remote Manager and support services.

Revenue in North America increased by $25.6 million, or 22.6%, for the nine months ended June 30, 2019 compared to the same period a year ago. This increase was primarily related to increased sales of our SmartSense by Digi™ business of $12.7 million and incremental revenue of $5.4 million from our acquisition of Accelerated. We also had increased sales of our industrial cellular products, embedded products as well as our Digi Remote Manager and support services. This was partially offset by a decline in sales of terminal servers as we had sales to a significant customer in the nine months ended June 30, 2018. We expect North America revenue to increase as a percentage of total revenue as our SmartSense by Digi™ and Accelerated products and services are sold primarily in North America.

Revenue in EMEA decreased by $0.6 million, or 6.2%, for the three months ended June 30, 2019 compared to the same period a year ago. This was primarily due to a significant decrease in sales to certain customers in our industrial cellular and network product categories. These decreases were offset by an increase in distributor sales of embedded products. Revenue in EMEA increased $0.6 million, or 1.9% for the nine months ended June 30, 2019 compared to the same period a year ago, primarily due to increases in distributor sales of embedded products. In addition, we had a large customer deployment of RF products. These increases were partially offset by a decrease in sales of our industrial cellular products.

Revenue in Rest of world increased by $0.7 million and $1.3 million, or 9.1% and 7.1% for the three and nine months ended June 30, 2019, respectively, compared to the same periods a year ago. This increase was almost entirely due to increased sales to a significant customer of our RF products, along with smaller increases in both cellular and network products.

No significant changes were made to our pricing strategy that impacted revenue during the nine months ended June 30, 2019 as compared to the same period in the prior fiscal year. As foreign currency rates fluctuate, we may from time to time adjust the prices of our products, services and solutions.

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

GROSS PROFIT

Gross profit for the three months ended June 30, 2019 and 2018 was $28.3 million and $29.6 million, respectively, a decrease of $1.3 million, or 4.5%. Gross profit for the nine months ended June 30, 2019 and 2018 was $88.4 million and $78.4 million, respectively, an increase of $10.0 million, or 12.7%.

Product gross profit for the three months ended June 30, 2019 and 2018 was $21.2 million, or 44.9%, and $25.1 million, or 48.5%, respectively, a decrease of $3.9 million, or 15.6%. This decrease was primarily due to product and customer mix driven by lower sales of network products, which typically have higher gross margins. Product gross profit for the nine months ended June 30, 2019 and 2018 was $69.8 million, or 46.5%, and $68.8 million, or 50.0%, respectively, an increase of $1.0 million, or 1.4%. The increase was caused by incremental gross profit of $2.3 million since the January 2018 acquisition of Accelerated. This was offset by lower sales of network products, which typically have higher gross margins.

Services and solutions gross profit, across both segments, was $7.9 million, or 56.3%, and $5.3 million, or 50.4%, for the three months ended June 30, 2019 and 2018, respectively. Services and solutions gross profit, across both segments, was $20.9 million, or 53.2%, and $11.8 million, or 48.9%, for the nine months ended June 30, 2019 and 2018, respectively. The increase in gross profit primarily was driven by our SmartSense by Digi™ business. As recurring revenue increases and becomes a greater percentage of total revenue, we expect gross margins to increase over time.

OPERATING EXPENSES

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

	Three months ended June 30,				$ incr.	Nine months ended June 30,				$ incr.
($ in thousands)	2019		2018 (as adjusted)*		(decr.)	2019		2018 (as adjusted)*		(decr.)
Sales and marketing	$ 11,392	18.6 %	$ 11,595	18.6%	$ (203)	$ 34,583	18.3%	$ 32,530	20.1%	$ 2,053
Research and development	8,584	14.0 %	8,205	13.2%	379	27,671	14.6%	24,573	15.3%	3,098
General and administrative	6,751	11.0 %	7,234	11.6%	(483)	18,309	9.7%	19,905	12.3%	(1,596)
Restructuring reversal	(20)	— %	190	0.3%	(210)	(87)	0.1%	190	0.1%	(277)
Total operating expenses	$ 26,707	43.7 %	$ 27,224	43.7%	$ (517)	$ 80,476	42.5%	$ 77,198	47.7%	$ 3,278

*Prior period information has been restated for the adoption of ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)*," which we adopted on October 1, 2018.

Sales and marketing expenses decreased $0.2 million for the three months ended June 30, 2019 compared to the same period a year ago. The decrease related primarily to a decrease in employee-related expenses. Sales and marketing expenses increased $2.1 million for the nine months ended June 30, 2019 compared to the same period a year ago. This included incremental expenses for Accelerated of $1.1 million since the January 2018 acquisition. The remainder of the increase related primarily to an increase in employee-related and marketing expenses.

Research and development expenses increased $0.4 million for the three months ended June 30, 2019 compared to the same period a year ago. The increase related primarily to an increase in employee-related and information technology ("IT") expenses. Research and development expenses increased $3.1 million for the nine months ended June 30, 2019 compared to the same period a year ago. The increase includes incremental expenses related to the acquisition of Accelerated of $0.8 million since the January 2018 acquisition. The remainder of the increase primarily was related to employee-related expenses and increased facility costs.

General and administrative expenses decreased $0.5 million for the three months ended June 30, 2019 compared to the same period a year ago. This was primarily due to decreases of $0.4 million in adjustments in contingent consideration, $0.3 million in reduced depreciation and amortization expense, partially offset by an increase of $0.3 million in facility costs. General and administrative expenses decreased $1.6 million for the nine months ended June 30, 2019 compared to the same period a year ago. This decrease primarily is related to $4.4 million gain recorded in the first quarter of fiscal 2019, incremental expenses for Accelerated of $0.9 million, as well as decreased acquisition-related expenses of $0.7 million. This was offset partially by increases in employee-related expenses of $1.4 million, adjustments in contingent consideration of $0.9 million, depreciation and amortization expenses of $1.0 million (includes acceleration of depreciation for assets that were disposed of as part of the move of our corporate headquarters), professional fees of $0.4 million and facility costs of $0.3 million.

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

OTHER INCOME, NET

Other income, net decreased $0.6 million for the three months ended June 30, 2019 compared to the same period a year ago. This was primarily related to foreign currency gains in fiscal 2018 as compared to foreign currency losses in fiscal 2019, primarily related to the Euro and the Japanese Yen. Other income, net increased $0.3 million for the nine months ended June 30, 2019 compared to the same period a year ago, primarily due to an increase in interest income.

INCOME TAXES

See Note 11 to the consolidated financial statements for discussion of income taxes.

SEGMENT RESULTS OF OPERATIONS

IoT PRODUCTS & SERVICES

($ in thousands)	Three months ended June 30, 2019		Three months ended June 30, 2018 (as adjusted)*		% incr. (decr.)	Nine months ended June 30, 2019		Nine months ended June 30, 2018 (as adjusted)*		% incr. (decr.)
Revenue:										
Product	$ 47,136	93.3%	$ 51,691	95.0%	(8.8)	$ 150,045	93.9%	$ 137,733	94.9%	8.9
Services	3,374	6.7	2,715	5.0	24.3	9,798	6.1	7,378	5.1	32.8
Total revenue	50,510	100.0	54,406	100.0	(7.2)	159,843	100.0	145,111	100.0	10.2
Cost of sales:										
Cost of product	25,982	51.4	26,639	49.0	(2.5)	80,291	50.2	68,929	47.5	16.5
Cost of services	1,252	2.5	1,655	3.0	(24.4)	4,895	3.1	4,404	3.0	11.1
Amortization of intangibles	218	0.4	219	0.4	(0.5)	670	0.4	549	0.4	22.0
Total cost of sales	27,452	54.3	28,513	52.4	(3.7)	85,856	53.7	73,882	50.9	16.2
Gross profit	23,058	45.7	25,893	47.6	(10.9)	73,987	46.3	71,229	49.1	3.9
Total operating expenses	19,941	39.5	21,349	39.2	(6.6)	60,018	37.6	60,732	41.9	(1.2)
Operating income	$ 3,117	6.2%	$ 4,544	8.4%	(31.4)	$ 13,969	8.7%	$ 10,497	7.2%	33.1

Revenue

Revenue from our IoT Products & Services segment decreased $3.9 million for the three months ended June 30, 2019 compared to the same period in the prior fiscal year. For the nine months ended June 30, 2019 compared to the same period in the prior fiscal year, revenue increased $14.7 million from our IoT Products & Services segment.

Product revenue decreased by $4.6 million, or 8.8%, in the third fiscal quarter of 2019 compared to the third fiscal quarter of 2018. This decrease was primarily a result of lower sales of terminal servers in our network category to a significant customer. Partially offsetting this decrease were increases in sales of RF products to a significant customer as well as increased sales of embedded products. Services revenue from this segment increased $0.7 million for the three months ended June 30, 2019 compared to the same period a year ago, primarily due to sales of Digi Remote Manager® and support services, partially offset by a decline in our wireless design services revenues.

Product revenue increased by $12.3 million, or 8.9%, in the nine months ended June 30, 2019 compared to the nine months ended June 30, 2018. This included incremental revenue of $5.4 million from our acquisition of Accelerated for the nine months ended June 30, 2019 since the acquisition in January 2018. This increase also included increased sales within our industrial cellular, RF and embedded product categories due to increased customer demand, significant new customers and new product introductions. This was offset partially by lower sales of terminal servers in our network category to a significant customer. Services revenue from this segment increased $2.4 million for the nine months ended June 30, 2019 compared to the same period a year ago, primarily due to sales of Digi Remote Manager® and support services.

Our product revenue is subject to large customer projects and deployments that can fluctuate from period to period. We entered in to several large purchase orders with a customer in the third fiscal quarter with uncertainty in timing and delivery of the specified products and services. Revenue from these purchase orders was not significant during the third fiscal quarter of 2019.

Operating Income

Operating income decreased $1.4 million, or 31.4% for the three months ended June 30, 2019 compared to the same period in the prior fiscal year. The decrease was primarily related to decreased gross profit of $2.8 million offset by a reduction of $1.4 million in operating expenses. The reduction in operating expenses included a decline of $0.4 million in adjustments to contingent consideration, a $0.5 million decrease in amortization expense and a reduction of our employee-related expenses.

Operating income increased $3.5 million, or 33.1%, for the nine months ended June 30, 2019 compared to the same period in the prior fiscal year. The increase was primarily related to increased gross profit of $2.8 million and a reduction of $0.7 million in operating expenses. The decrease in operating expense includes a $4.4 million of gain related to the sale of our corporate headquarters in the first quarter of fiscal 2019. In addition, operating expense decreased $1.8 million for acquisition-related expenses for the first nine months of fiscal 2019 as compared to the first nine months of fiscal 2018. This was partially offset by $2.8 million of incremental costs, primarily employee-related, associated with Accelerated. In addition there were increases in employee-related expenses due to improved company performance, $0.9 million of adjustments to contingent consideration along with increased facilities costs.

IoT SOLUTIONS

	Three months ended June 30,				% incr.	Nine months ended June 30,				% incr.
($ in thousands)	2019		2018 (as adjusted)*		(decr.)	2019		2018 (as adjusted)*		(decr.)
Solutions revenue	$ 10,656	100.0 %	$ 7,866	100.0 %	35.5	$ 29,400	100.0 %	$ 16,664	100.0 %	76.4
Cost of sales:										
Cost of services	4,885	45.8	3,589	45.7	36.1	13,433	45.7	7,883	47.3	70.4
Amortization of intangibles	501	4.7	522	6.6	(4.0)	1,514	5.1	1,569	9.4	(3.5)
Total cost of sales	5,386	50.5	4,111	52.3	31.0	14,947	50.8	9,452	56.7	58.1
Gross profit	5,270	49.5	3,755	47.7	(40.3)	14,453	49.2	7,212	43.3	100.4
Total operating expenses	6,766	63.5	5,875	74.7	15.2	20,458	69.6	16,466	98.8	24.2
Operating loss	$ (1,496)	(14.0)%	$ (2,120)	(27.0)%	(29.4)	$ (6,005)	(20.4)%	$ (9,254)	(55.5)%	(35.1)

*Prior period information has been restated for the adoption of ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*”, which we adopted on October 1, 2018.

Revenue

Revenue from our IoT Solutions segment increased $2.8 million and $12.7 million, or 35.5% and 76.4%, for the three and nine months ended June 30, 2019, respectively, compared to the same periods a year ago. This primarily was driven by the growth of our SmartSense by Digi™ business. The increase is driven by new customer deployments, additional purchases and an increase in our recurring revenue base. Revenue for the nine months ended June 30, 2019 includes second fiscal quarter equipment upgrades from existing customers. Recurring revenue for this segment was approximately 34.2% of revenue for the nine months ended June 30, 2019. We are serving just over 61,000 sites as of June 30, 2019 compared to nearly 48,000 sites a year ago. We believe this marketplace offers a path to a significant base of recurring revenue that can provide both stable revenue generation and significant growth for us.

We expect our Solutions revenue to increase over time. The growth rate in revenue may be subject to fluctuations from period to period as large-scale deployments to specific customers may take place in certain time frames and may not occur in every quarter. Further, one-time orders or replacement equipment from existing customers could cause there to be one-time increases in revenue that are not repeated in subsequent quarters.

Operating Loss

Operating loss decreased $0.6 million and $3.2 million for the three and nine months ended June 30, 2019, respectively, as compared to the same periods in the prior fiscal year.

The decrease in operating loss for the three months ended June 30, 2019 compared to the same period in the prior fiscal year was due to an increase in gross profit of $1.5 million, or 40.3%, offset by an increase in operating expenses of $0.9 million, or 15.2%.

The decrease in operating loss for the nine months ended June 30, 2019 compared to the same period in the prior year fiscal year was due to an increase in gross profit of $7.2 million, or 100.4%, offset by an increase in operating expenses of $4.0 million, or 24.2%. Operating expenses increased primarily related to employee-related expenses due to increased headcount and incentive compensation. In addition, included in the operating loss for the nine months ended June 30, 2019 was $1.1 million of acquisition-related expense.

We expect our IoT Solutions gross margin to increase in future periods as recurring revenue from this segment increases.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations and capital expenditures principally with funds generated from operations. In addition, we received $10.0 million of proceeds related to the sale of our corporate headquarters during the first quarter of fiscal 2019 and spent $6.8 million on the build-out of our new corporate headquarters during the first nine months of fiscal 2019 prior to the receipt in April of 2019 of a $3.3 million tenant improvement allowance. At June 30, 2019, cash, cash equivalents and short-term marketable securities were $86.3 million compared to $62.8 million at September 30, 2018. Our working capital (total current assets less total current liabilities) was $142.9 million at June 30, 2019. At September 30, 2018, our working capital was $126.5 million.

We presently anticipate total fiscal 2019 capital expenditures will be approximately $11.1 million, prior to the receipt of $3.3 million in tenant improvement incentive payments resulting in net capital expenditures of $7.8 million. As of June 30, 2019, we have spent $8.6 million and received $3.3 million in tenant improvement incentive payments, resulting in net capital expenditures of $5.3 million.

Net cash provided by operating activities was $22.5 million compared to net cash used in operating activities of $8.8 million for the nine months ended June 30, 2019 and 2018, respectively, a net increase in cash of $31.3 million. This increase was primarily a result of net income of $7.7 million in the first nine months of fiscal 2019 compared to a net loss of $1.7 million in the first nine months of fiscal 2018, resulting in a net increase of $9.4 million. We also had an increase related to changes in working capital of $26.0 million, depreciation and amortization of $0.7 million, earn-out expenses of $0.9 million and additional stock compensation of $0.6 million. This was offset partially by the gain on the sale of the corporate headquarters of $4.4 million and a decrease in deferred income tax provision of $1.6 million related to the Tax Cuts and Jobs Act (see Note 11 to the consolidated financial statements).

The changes in working capital that resulted in an increase in cash of $26.0 million were primarily driven by an increase of $19.4 million in cash related to decreased accounts receivable as we collected on certain large customer sales. In addition, we also had an increase of $8.7 million related to prior year inventory as we had additional inventory expenditures in the nine months ended June 30, 2018 due to the manufacturing transition and strategic purchases of finished goods. There was also an increase of $1.7 million related to increased accounts payable. This was offset partially by decreases of $2.2 million related to prepaids and other assets, $1.0 million related to taxes payable and $0.6 million related to accrued liabilities in the first nine months of fiscal 2019 compared to the first nine months of fiscal 2018.

Net cash provided by investing activities was $4.0 million during the nine months ended June 30, 2019 and net cash used in investing activities was $25.8 million during the nine months ended June 30, 2018. This resulted in a net increase of $29.8 million. This increase is related primarily to $56.6 million that was spent for businesses acquired in fiscal 2018 and $10.0 million of proceeds from the sale of our corporate headquarters in fiscal 2019. This was partially offset by decreases in cash due to $27.2 million in fewer proceeds from the sale of marketable securities, $2.0 million in proceeds from the sale of Etherios received in fiscal 2018 and an additional $7.6 million in purchases of property, equipment, and improvements mostly related to the build-out of our new corporate headquarters.

Net cash provided by financing activities was $0.1 million and $4.0 million during the nine months ended June 30, 2019 and 2018, respectively, a net decrease of $3.9 million. This decrease is a result of a $3.7 million earn-out payment to the former shareholders of Accelerated, FreshTemp and Bluenica in the first nine months of fiscal 2019. In addition, we had more purchases of common stock of $0.3 million. This was partially offset by additional proceeds from employee stock plans of $0.1 million.

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

Recently Issued Accounting Pronouncements

For information on new accounting pronouncements, see Note 1 to our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Our marketable securities are classified as available-for-sale and are carried at fair value. Our investments consist of money market funds, certificates of deposit, commercial paper, corporate bonds and government municipal bonds. Our investment policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than one year.

FOREIGN CURRENCY RISK

We are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros, British Pounds, Japanese Yen or Canadian Dollars and in certain cases, transactions in U.S. Dollars in our foreign entities. We are also exposed to foreign currency translation risk as the financial position and operating results of our foreign subsidiaries are translated into U.S. Dollars for consolidation. We manage our net asset or net liability position for non-functional currency accounts, primarily the U.S. Dollar accounts in our foreign locations to reduce our foreign currency risk. In addition, as foreign currency rates fluctuate, we may from time to time, adjust the prices of our products, services and solutions. We have not implemented a formal hedging strategy.

For the nine months ended June 30, 2019 and 2018, we had approximately $50.4 million and $48.5 million, respectively, of revenue from foreign customers including export sales. Of these sales, $2.7 million and $7.8 million, respectively, were denominated in foreign currency, predominantly Euros and Canadian Dollar. In future periods, we expect a portion of sales will continue to be made in both Euros and Canadian Dollar.

Included in revenue performance for the year was a minimal decrease in foreign currency translation for the three and nine month periods ended June 30, 2019, when compared to the same periods in the prior fiscal year.

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

	Nine months ended June 30,		% increase
	2019	2018	(decrease)
Euro	1.1359	1.1997	(5.3)%
British Pound	1.2915	1.3601	(5.0)%
Japanese Yen	0.0090	0.0094	(4.3)%
Canadian Dollar	0.7499	0.7835	(4.3)%

A 10% change from the first nine months of fiscal 2019 average exchange rate for the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar would have resulted in a 0.2% increase or decrease in revenue and a 1.5% increase or decrease in stockholders' equity due to foreign currency translation. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

CREDIT RISK

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

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

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting that occurred during the quarterly period ended June 30, 2019 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The disclosures set forth under the heading “Contingencies” in Note 13 to the consolidated financial statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended September 30, 2018.

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

On April 24, 2018 our Board of Directors authorized a program to repurchase up to $20.0 million of our common stock primarily to return capital to shareholders. This repurchase authorization expired on May 1, 2019. There were no shares repurchased under this program.

The following table presents the information with respect to purchases made by or on behalf of Digi International Inc. or any “affiliated purchaser” (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the third quarter of fiscal 2019:

Period	Total Number of Shares Purchased (1)		Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
April 1, 2019 - April 30, 2019	270	$	12.81	—	$20,000,000.00
May 1, 2019 - May 31, 2019	270	$	12.75	—	—
June 1, 2019 - June 30, 2019	—	$	—	—	—
Total	540	$	12.78	—	—

(1) All shares reported were forfeited by employees in connection with the satisfaction of tax withholding obligations related to the vesting of restricted stock units.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit No.		Description	Method of Filing
3	(a)	Restated Certificate of Incorporation of the Company, as amended (1)	Incorporated by Reference
3	(b)	Amended and Restated By-Laws of the Company (2)	Incorporated by Reference
10	(a)	Offer Letter with James J. Loch dated May 1, 2019 (3)*	Incorporated by Reference
31	(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31	(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32		Section 1350 Certification	Filed Electronically
101.INS		XBRL Instance Document	Filed Electronically
101.SCH		XBRL Taxonomy Extension Schema Document	Filed Electronically
101.CAL		XBRL Taxonomy Calculation Linkbase Document	Filed Electronically
101.DEF		XBRL Taxonomy Definition Linkbase Document	Filed Electronically
101.LAB		XBRL Taxonomy Label Linkbase Document	Filed Electronically
101.PRE		XBRL Taxonomy Presentation Linkbase Document	Filed Electronically

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

(1) Incorporated by reference to Exhibit 3(a) to the Company’s Annual Report on 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 Current Report on Form 8-K filed on August 28, 2017 (File No. 1-34033)
(3) Incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on May 10, 2019 (File No. 1-34033)

SIGNATURE

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

DIGI INTERNATIONAL INC.

Date:	August 9, 2019	By:	/s/ James J. Loch
			James J. Loch
			Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer and Authorized Officer)

Exhibit No. 31(a)

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

I, Ronald E. Konezny, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and

5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

August 9, 2019

/s/ Ronald E. Konezny

Ronald E. Konezny
President and Chief Executive Officer

Exhibit No. 31(b)

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

I, James J. Loch, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digi International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

August 9, 2019	/s/ James J. Loch
	James J. Loch
	Senior Vice President, Chief Financial Officer and Treasurer

Exhibit No. 32

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

In connection with the Quarterly Report of Digi International Inc. (the Registrant) on Form 10-Q for the fiscal quarter ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

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

August 9, 2019

/s/ Ronald E. Konezny

Ronald E. Konezny
President and Chief Executive Officer

/s/ James J. Loch

James J. Loch
Senior Vice President, Chief Financial Officer and Treasurer