DIGI INTERNATIONAL INC
Form 10-Q
August 09, 2010

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

**FORM 10-Q**

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

**For the quarterly period ended: June 30, 2010**

**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) |

**11001 Bren Road East**
**Minnetonka, Minnesota 55343**
(Address of principal executive offices) (Zip Code)
**(952) 912-3444**
(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 þ No o

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

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

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

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

On July 31, 2010, there were 24,990,627 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, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except per common share data) | | | |
| Net sales | $ 47,238 | $ 44,470 | $ 135,282 | $ 125,916 |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) | 22,496 | 21,986 | 63,913 | 60,963 |
| Amortization of purchased and core technology | 1,024 | 1,047 | 3,190 | 3,099 |
| Gross profit | 23,718 | 21,437 | 68,179 | 61,854 |
| Operating expenses: | | | | |
| Sales and marketing | 9,089 | 8,624 | 27,932 | 27,225 |
| Research and development | 7,159 | 6,823 | 20,723 | 19,993 |
| General and administrative | 4,926 | 3,435 | 13,308 | 10,716 |
| Restructuring | | 1,953 | (352) | 1,953 |
| Total operating expenses | 21,174 | 20,835 | 61,611 | 59,887 |
| Operating income | 2,544 | 602 | 6,568 | 1,967 |
| Other income, net: | | | | |
| Interest income | 94 | 275 | 277 | 1,259 |
| Interest expense | (26) | (67) | (110) | (202) |
| Other (expense) income | (16) | 559 | 247 | 364 |
| Total other income, net | 52 | 767 | 414 | 1,421 |
| Income before income taxes | 2,596 | 1,369 | 6,982 | 3,388 |
| Income tax (benefit) provision | (1,216) | (24) | 285 | 264 |
| Net income | $ 3,812 | $ 1,393 | $ 6,697 | $ 3,124 |
| Net income per common share: | | | | |
| Basic | $ 0.15 | $ 0.06 | $ 0.27 | $ 0.13 |
| Diluted | $ 0.15 | $ 0.06 | $ 0.27 | $ 0.12 |

| | | | | |
|---|---|---|---|---|
| Weighted average common shares: | | | | |
| Basic | 24,930 | 24,607 | 24,815 | 24,982 |
| Diluted | 25,272 | 24,875 | 25,123 | 25,250 |

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

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

| | June 30, 2010 | September 30, 2009 |
|---|---|---|
| | (in thousands, except share data) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 35,212 | $ 48,434 |
| Marketable securities | 42,963 | 22,311 |
| Accounts receivable, net | 24,299 | 19,032 |
| Inventories | 27,817 | 26,619 |
| Other | 5,613 | 6,259 |
| Total current assets | 135,904 | 122,655 |
| Marketable securities, long-term | 4,307 | 5,063 |
| Property, equipment and improvements, net | 16,376 | 16,678 |
| Identifiable intangible assets, net | 21,239 | 26,877 |
| Goodwill | 85,190 | 86,558 |
| Other | 879 | 1,117 |
| Total assets | $ 263,895 | $ 258,948 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 10,171 | $ 5,567 |
| Accrued compensation | 4,632 | 3,275 |
| Accrued professional fees | 1,489 | 696 |
| Accrued warranty | 909 | 970 |
| Deferred payment on acquisition | | 2,966 |
| Restructuring | 202 | 721 |
| Other | 2,514 | 2,339 |
| Total current liabilities | 19,917 | 16,534 |
| Income taxes payable | 2,639 | 4,893 |
| Deferred tax liabilities | 2,558 | 4,331 |
| Deferred payment on acquisition | 2,888 | 2,812 |
| Other noncurrent liabilities | 517 | 792 |
| Total liabilities | 28,519 | 29,362 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued and outstanding | | |
| | 286 | 284 |

| | | |
|---|---|---|
| Common stock, $.01 par value; 60,000,000 shares authorized; 28,581,979 and 28,409,198 shares issued | | |
| Additional paid-in capital | 184,284 | 181,282 |
| Retained earnings | 89,405 | 82,708 |
| Accumulated other comprehensive loss | (11,157) | (6,527) |
| Treasury stock, at cost, 3,613,602 and 3,708,302 shares | (27,442) | (28,161) |
| Total stockholders equity | 235,376 | 229,586 |
| Total liabilities and stockholders equity | $ 263,895 | $ 258,948 |

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

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

| | Nine months ended June 30, 2010 | Nine months ended June 30, 2009 |
|---|---|---|
| | (in thousands) | |
| Operating activities: | | |
| Net income | $ 6,697 | $ 3,124 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation of property, equipment and improvements | 2,002 | 1,899 |
| Amortization of identifiable intangible assets and other assets | 5,743 | 5,531 |
| Stock-based compensation | 2,603 | 2,690 |
| Excess tax benefits from stock-based compensation | (39) | (44) |
| Deferred income tax benefit | (2,201) | (2,346) |
| Restructuring | (352) | 1,519 |
| Other | 1,159 | (67) |
| Changes in operating assets and liabilities | (3,287) | (8,033) |
| Net cash provided by operating activities | 12,325 | 4,273 |
| Investing activities: | | |
| Purchase of marketable securities | (38,538) | (21,615) |
| Proceeds from maturities of marketable securities | 18,615 | 45,275 |
| Deferred cash payout for acquisition of Spectrum Design Solutions, Inc. | (3,000) | |
| Acquisition of assets of MobiApps Holdings Private Limited | | (2,969) |
| Proceeds from sale of property and equipment | 11 | |
| Purchase of property, equipment, improvements and certain other intangible assets | (2,337) | (2,327) |
| Net cash (used in) provided by investing activities | (25,249) | 18,364 |
| Financing activities: | | |
| Payments on capital lease obligations | (8) | (311) |
| Excess tax benefits from stock-based compensation | 39 | 44 |
| Proceeds from stock option plan transactions and other | 1,097 | 125 |
| Proceeds from employee stock purchase plan transactions | 691 | 787 |
| Purchase of treasury stock | | (6,576) |
| Net cash provided by (used in) financing activities | 1,819 | (5,931) |
| Effect of exchange rate changes on cash and cash equivalents | (2,117) | (1,211) |
| Net (decrease) increase in cash and cash equivalents | (13,222) | 15,495 |

| | | |
|---|---|---|
| Cash and cash equivalents, beginning of period | 48,434 | 14,176 |
| Cash and cash equivalents, end of period | $ 35,212 | $ 29,671 |

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

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

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

*Basis of Presentation*

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the Company, Digi, we, our, or us ) pursuant to the rules and regulations of the Securities Exchange Commission ( SEC ). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including the summary of significant accounting policies, presented in our Annual Report on Form 10-K for the year ended September 30, 2009 as filed with the SEC ( 2009 Financial Statements ).

The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated financial position and the condensed consolidated results of operations and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year. The year-end condensed balance sheet data were derived from our 2009 Financial Statements, but do not include all disclosures required by accounting principles generally accepted in the United States of America.

*Recently Issued Accounting Pronouncements*

In March 2010, the FASB (Financial Accounting Standards Board) issued an amendment to the accounting standards that provides guidance on criteria used to define a milestone and determines when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent upon achievement of a milestone can be recognized in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. In addition, certain disclosures related to the milestone method of revenue recognition will be required. This amendment is effective on a prospective basis for milestones achieved beginning October 1, 2010. Early adoption is permitted. We are currently evaluating the impact this amendment will have on our consolidated financial statements.

In October 2009, the FASB issued an amendment to the accounting standards that provides guidance for identifying separate deliverables in a revenue-generating transaction where multiple deliverables exist, and for allocating and recognizing revenue based on those separate deliverables. This guidance is expected to result in more multiple-deliverable arrangements being separable than under current guidance. This amendment is effective for revenue arrangements entered into or materially modified in our fiscal year beginning October 1, 2010. Early adoption is permitted. We do not expect this amendment to have a material impact on our consolidated financial statements.

In October 2009, the FASB issued an amendment to the accounting standards related to certain revenue arrangements that include software elements. This standard clarifies the existing accounting guidance such that tangible products that contain both software and non-software components that function together to deliver the product s essential functionality shall be excluded from the scope of the software revenue recognition accounting standards. Accordingly, sales of these products may fall within the scope of other revenue recognition accounting standards or may now be within the scope of this standard and may require an allocation of the arrangement consideration for each element of the arrangement. This amendment is effective for revenue arrangements entered into or materially modified in our fiscal year beginning October 1, 2010. We do not expect this amendment to have a material impact on our consolidated financial statements.

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

2. NET INCOME PER COMMON SHARE

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

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

| | Three months ended June 30, | | Nine months ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Numerator: | | | | |
| Net income | $ 3,812 | $ 1,393 | $ 6,697 | $ 3,124 |
| Denominator: | | | | |
| Denominator for basic net income per common share weighted average shares outstanding | 24,930 | 24,607 | 24,815 | 24,982 |
| Effect of dilutive securities: | | | | |
| Employee stock options and employee stock purchase plan | 342 | 268 | 308 | 268 |
| Denominator for diluted net income per common share adjusted weighted average shares | 25,272 | 24,875 | 25,123 | 25,250 |
| Net income per common share, basic | $ 0.15 | $ 0.06 | $ 0.27 | $ 0.13 |
| Net income per common share, diluted | $ 0.15 | $ 0.06 | $ 0.27 | $ 0.12 |

Potentially dilutive shares related to stock options to purchase 2,482,104 and 2,726,104 common shares for the three and nine month periods ended June 30, 2010, respectively, and 4,339,260 and 4,349,812 common shares for the three and nine month periods ended June 30, 2009, respectively, were not included in the computation of diluted earnings per common share because the options exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive.

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

3. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is comprised of net income (loss), foreign currency translation adjustments and unrealized gain (loss) on available-for-sale marketable securities, net of tax. Comprehensive income (loss) was as follows (in thousands):

| | Three months ended June 30, | | Nine months ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | $ 3,812 | $ 1,393 | $ 6,697 | $ 3,124 |
| Other comprehensive income (loss): | | | | |
| Change in foreign currency translation adjustment | (1,745) | 2,919 | (4,591) | (6,695) |
| Change in unrealized gain (loss) on investments | (34) | (47) | (27) | (50) |
| Less income tax benefit | 13 | 19 | 10 | 20 |
| Reclassification of gain included in net income | | | (36) | |
| Less income tax benefit | | | 14 | |
| Comprehensive income (loss) | $ 2,046 | $ 4,284 | $ 2,067 | $ (3,601) |

4. SELECTED BALANCE SHEET DATA
(in thousands)

| | June 30, 2010 | September 30, 2009 |
|---|---|---|
| Accounts receivable, net: | | |
| Accounts receivable | $ 24,871 | $ 19,656 |
| Less allowance for doubtful accounts | 572 | 624 |
| | $ 24,299 | $ 19,032 |
| Inventories: | | |
| Raw materials | $ 23,024 | $ 21,359 |
| Work in process | 325 | 452 |
| Finished goods | 4,468 | 4,808 |
| | $ 27,817 | $ 26,619 |

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

5. ACQUISITION

**MobiApps Holdings Private Limited**

On June 8, 2009, we acquired substantially all the assets of MobiApps Holdings Private Limited ( MobiApps ), a developer of machine-to-machine ( M2M ) communications technology focusing on satellite, cellular, and hybrid satellite/cellular solutions. MobiApps has locations in India, Singapore and in the U.S. Pursuant to the terms of the asset purchase agreements, Digi acquired the U.S. assets located in Herndon, Virginia. In addition, we established Digi Wireless Singapore Pte. Ltd. and Digi m2m Solutions India Private Limited, which acquired the assets of MobiApps affiliate companies, located in Singapore and India, respectively. The acquisition was a cash transaction for $3.0 million. An additional $0.5 million may be payable at the end of fiscal 2010, contingent on the achievement of certain performance milestones. As of June 30, 2010, we believe that it is unlikely that this contingency will be met. We have determined that the MobiApps acquisition is not material to our consolidated results of operations or financial condition. Therefore, pro forma financial information is not presented.

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

6. MARKETABLE SECURITIES

Our marketable securities consist of commercial paper, certificates of deposit, corporate bonds and government municipal bonds. We obtain quoted market prices and trading activity for each security we hold, where available, and review the financial solvency of each security issuer and obtain other relevant information from our investment advisors to estimate the fair value for each security in our investment portfolio. Thirty-eight of the forty-four securities we hold were trading slightly below our amortized cost basis at June 30, 2010. We determined each decline in value to be temporary as we expect to receive full par value of our investments upon maturity and have no indication from the security issuers of default or any other factor leading us to believe the decline would be other-than-temporary. We expect to realize the fair value of these securities, plus accrued interest, either at the time of maturity or when the security is sold. We monitor our investment values on an ongoing basis and record them at fair value as discussed in Note 7.

During the fourth quarter of fiscal 2008, we recorded an other-than-temporary impairment of $1,014,900 on the bond issued by Lehman Brothers, ( the Lehman Brothers Bond ) with a par amount of $1,194,000. The resulting value of $179,100 for the security became its new cost basis as of September 30, 2008. We sold a portion of the bond in fiscal 2009, leaving the remaining value of the Lehman Brothers Bond as of September 30, 2009 at $134,100. We sold the remainder of the bond in January 2010 for $169,860 and recognized a gain of $35,760 on this sale during the second quarter of fiscal 2010, reflecting the difference between the remaining value and the selling price.

All of our current holdings are classified as available-for-sale marketable securities and are recorded at fair value on our balance sheet with the unrealized gains and losses recorded in accumulated other comprehensive income (loss). Our marketable securities were comprised of the following:

At June 30, 2010 (in thousands)

| | Amortized Cost (1) | Unrealized Gains | Unrealized Losses (2) | Fair Value (1) |
|---|---|---|---|---|
| Current marketable securities: | | | | |
| Corporate bonds | $ 28,992 | $ 5 | $ (68) | $ 28,929 |
| Commercial paper | 1,999 | | | 1,999 |
| Certificates of deposit | 5,500 | | (6) | 5,494 |
| Government municipal bonds | 6,545 | | (4) | 6,541 |
| Current marketable securities | 43,036 | 5 | (78) | 42,963 |
| Non-current marketable securities: | | | | |
| Corporate bonds | 2,175 | | (8) | 2,167 |
| Government municipal bonds | 2,136 | 4 | | 2,140 |
| Non-current marketable securities | 4,311 | 4 | (8) | 4,307 |
| Total marketable securities | $ 47,347 | $ 9 | $ (86) | $ 47,270 |

(1) Included in amortized cost and fair value is purchased and accrued interest of $578.

(2) The aggregate related fair value of securities with unrealized losses as of June 30, 2010 was $36,008.

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

6. MARKETABLE SECURITIES (CONTINUED)

At September 30, 2009 (in thousands)

| | Amortized Cost (1) | Unrealized Gains | Unrealized Losses (3) | Fair Value (1) |
|---|---|---|---|---|
| Current marketable securities: | | | | |
| Corporate bonds (2) | $ 4,236 | $ 18 | $ | $ 4,254 |
| Certificates of deposit | 10,022 | 4 | (1) | 10,025 |
| Government municipal bonds | 8,023 | 11 | (2) | 8,032 |
| Current marketable securities | 22,281 | 33 | (3) | 22,311 |
| Non-current marketable securities: | | | | |
| Corporate bonds | 5,107 | | (44) | 5,063 |
| Total marketable securities | $ 27,388 | $ 33 | $ (47) | $ 27,374 |

(1) Included in amortized cost and fair value is purchased and accrued interest of $264.

(2) The Lehman Brothers Bond is included in amortized cost at a fair value of $134.

(3) The aggregate related fair value of securities with unrealized losses as of September 30, 2009 was $9,009.

7. FAIR VALUE MEASUREMENTS

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

circumstances. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The hierarchy is broken down into three levels defined as follows:

Level 1 Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly.

Level 3 Inputs are unobservable for the asset or liability. See the section below titled *Level 3 Valuation Techniques* for further discussion of how we determine fair value for investments classified as Level 3.

*Assets and Liabilities that are Measured at Fair Value on a Recurring Basis*

Fair value is applied to financial assets, such as commercial paper, certificates of deposit, corporate bonds and government municipal bonds, which are classified and accounted for as available-for-sale. These items are stated at fair value at each reporting period; however, the definition of fair value is applied using the above guidance.

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

7. FAIR VALUE MEASUREMENTS (CONTINUED)

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

| | | Fair Value Measurements at June 30, 2010 Using: | | |
|---|---|---|---|---|
| | Total carrying value at June 30, 2010 | Quoted price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Cash equivalents: | | | | |
| Money market | $ 16,622 | $ 16,622 | $ | $ |
| Available-for-sale marketable securities: | | | | |
| Corporate bonds | 31,096 | | 31,096 | |
| Commercial paper | 1,999 | | 1,999 | |
| Certificates of deposit | 5,494 | | 5,494 | |
| Government municipal bonds | 8,681 | | 8,681 | |
| Total cash equivalents and marketable securities measured at fair value | $ 63,892 | $ 16,622 | $ 47,270 | $ |

Cash equivalents are measured at fair value using quoted market prices in active markets for identical assets. All other marketable securities are measured at fair value using similar assets and are classified within Level 2 of the valuation hierarchy.

Prior to January 1, 2010, we classified certain investments as Level 1 and upon further review, have subsequently determined to classify them as Level 2. As a result, we transferred $34.9 million of assets previously classified within Level 1 to Level 2 on January 1, 2010. It was determined that the fair value of such investments is based off of indices and matrices for similar assets, as defined within Level 2 valuation techniques, and not identical assets, as defined within Level 1 valuation techniques. Our policy for determining when to recognize transfers between levels is based on the actual date of the event or change in circumstances that caused the transfer. This transfer had no impact on the fair value of our investments as stated in any of the periods presented.

*Level 2 Valuation Techniques*

Financial assets are categorized within Level 2 of the hierarchy when their fair values are determined using quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable either directly or indirectly. We value our Level 2 assets using inputs that are based on market indices of similar assets within an active market.

*Level 3 Valuation Techniques*

Financial assets are categorized within Level 3 of the hierarchy when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 also may include certain investment securities for which there is limited market activity or a decrease in the observability of market pricing for the investments, such that the determination of fair value requires significant judgment or estimation. We have no financial assets valued with Level 3 inputs as of June 30, 2010 nor have we purchased or sold any Level 3 financial assets during the three months ended June 30, 2010.

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

7. FAIR VALUE MEASUREMENTS (CONTINUED)

The use of different assumptions, applying different judgment to inherently subjective matters and changes in future market conditions could result in significantly different estimates of fair value of our securities, currently and in the future. The fair value of our securities could change significantly based on changes in market conditions and continued uncertainties in the credit markets. If these uncertainties continue or if these securities experience credit rating downgrades, we may incur impairment charges for securities in our investment portfolio.

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS

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

| | June 30, 2010 | | | September 30, 2009 | | |
|---|---|---|---|---|---|---|
| | Gross carrying amount | Accum. amort. | Net | Gross carrying amount | Accum. amort. | Net |
| Purchased and core technology | $ 46,116 | $ (37,786) | $ 8,330 | $ 46,583 | $ (34,893) | $ 11,690 |
| License agreements | 2,840 | (2,519) | 321 | 2,840 | (2,464) | 376 |
| Patents and trademarks | 9,718 | (6,326) | 3,392 | 9,292 | (5,536) | 3,756 |
| Customer maintenance contracts | 700 | (586) | 114 | 700 | (534) | 166 |
| Customer relationships | 17,163 | (8,433) | 8,730 | 17,607 | (7,334) | 10,273 |
| Non-compete agreements | 1,028 | (676) | 352 | 1,041 | (425) | 616 |
| Total | $ 77,565 | $ (56,326) | $ 21,239 | $ 78,063 | $ (51,186) | $ 26,877 |

Amortization expense was $1.9 million for both the three months ended June 30, 2010 and 2009 and $5.7 million and $5.5 million for the nine months ended June 30, 2010 and 2009, respectively.

Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2010 and the five succeeding fiscal years is as follows (in thousands):

| | |
|---|---|
| 2010 (three months) | $ 1,807 |
| 2011 | 6,638 |
| 2012 | 4,685 |
| 2013 | 3,000 |
| 2014 | 2,362 |
| 2015 | 1,268 |

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

| | Nine months ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Beginning balance, October 1 | $ 86,558 | $ 86,578 |
| Acquisition of MobiApps | | 1,683 |
| Foreign currency translation adjustment | (1,368) | (1,424) |
| Ending balance, June 30 | $ 85,190 | $ 86,837 |

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. As of the close of business on June 30, 2010, our stock price was $8.27. Based on the common shares outstanding at June 30, 2010 of 24,968,377 our market capitalization was $206.5 million compared to our net asset carrying value of $235.4 million.

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

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS (CONTINUED)

Including a control premium of 35 percent, the fair value of our reporting unit exceeded the carrying value of net assets by 18%. As the fair value exceeded the carrying value of net assets by a significant percentage, we determined that we were not at a level of risk of failing the step one test for recognition and measurement of an impairment loss as described in paragraph 350-24-35-4 of the FASB Accounting Standards Codification related to Goodwill - Recognition and Measurement of an Impairment Loss.

In June 2009, we engaged a reputable and independent national third party valuation firm to complete a control premium study which included a review of premiums paid for similar companies over the last five years. In order to compute the control premium, three methodologies were used, including (1) analyzing individual transactions within our industry, (2) analyzing industry-wide data, and (3) analyzing global transaction data. Individual transactions in the Communication Equipment and Computer & Peripherals industries were used to find transactions of target companies that operated in similar markets and shared similar operating characteristics with us. In analyzing industry-wide data, transactions in three industries were identified that encompassed the products offered by us: Office Equipment and Computer Hardware, Communications and Computer, Supplies and Services. Control premiums were considered for both domestic and international transactions. Based on our industry knowledge and recent discussions with our third party valuation firm, we concluded that the control premium study that was performed in conjunction with our annual goodwill impairment assessment on June 30, 2009 remains valid and that the 35 percent control premium used in our prior year s assessment continues to best represent the amount an investor would pay, over and above market capitalization, in order to obtain a controlling interest given the current economic conditions.

We have defined the criteria that will result in additional interim goodwill impairment testing. If these criteria are met, we will undertake the analysis to determine whether a goodwill impairment has occurred, which could have a material effect on our consolidated financial position and results of operations. The evaluation of asset impairment requires us to make assumptions about future cash flows and revenues. These assumptions require significant judgment and actual results may differ from assumed or estimated amounts. If these estimates and assumptions change, we may be required to recognize impairment losses in the future.

9. INCOME TAXES

Income taxes have been provided at an effective rate of (46.8%) and 4.1% for the three and nine month periods ended June 30, 2010, respectively, and (1.8%) and 7.8% for the three and nine month periods ended June 30, 2009, respectively.

In the third quarter of fiscal 2010, we recorded a discrete tax benefit of $2.2 million resulting from the reversal of tax reserves associated with the statutory closing of a prior tax year and the conclusion of an audit of prior tax years. Further, in the first quarter of fiscal 2010, we recorded a discrete tax benefit of $0.1 million related to an expiration of statute of limitations.

During the third quarter of fiscal 2009, we recorded a discrete tax benefit of $0.5 million resulting largely from an expiration of the statute of limitations for a prior tax year. Further, in the first quarter of fiscal 2009, we recorded a discrete tax benefit of $0.4 million resulting from the enactment on October 3, 2008 of the retroactive extension of the research and development tax credit for activity from January 1, 2008 to September 30, 2008.

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

9. INCOME TAXES (CONTINUED)

| | Nine months ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Effective tax rate before impact of discrete tax benefits from the reversal of tax reserves and retroactive extension of the research and development credit | 36.6% | 33.9% |
| Impact of discrete tax benefits | -32.5% | -26.1% |
| Effective tax rate | 4.1% | 7.8% |

A reconciliation of the beginning and ending amount of uncertain tax positions is as follows (in thousands):

| | |
|---|---|
| Uncertain tax positions as of March 31, 2010 | $ 4,076 |
| Increases related to: | |
| Prior year income tax positions | 36 |
| Decreases related to: | |
| Prior year income tax positions | (1,708) |
| Expiration of the statute of limitations | (298) |
| Uncertain tax positions as of June 30, 2010 | $ 2,106 |

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is $1.5 million. We recognize interest and penalties related to income tax matters in income tax expense. During the three months ended June 30, 2010, we reversed $0.3 million in interest. As of June 30, 2010, we had $0.5 million in accrued interest and penalties on our consolidated balance sheet.

It is reasonably possible that there are tax positions taken in prior years that may be realized within the next 12 months that will decrease the total amount of unrecognized tax benefits, primarily due to the expiration of the statute of limitations for foreign tax returns. We estimate that the reduction in unrecognized tax benefits will be approximately $0.4 million.

We operate in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, we must determine the appropriate allocation of income to each of these jurisdictions. This determination requires us to make several estimates and assumptions. Certain open tax years are expected to close in future periods that may result in adjustments to our income tax balances in those periods that are material to our consolidated financial position and results of operations.

10. FINANCIAL GUARANTEES

In general, we warrant our products to be free from defects in material and workmanship under normal use and service. The warranty periods range from one to five years from the date of receipt. We have the option to repair or replace products we deem defective with regard to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidents and are evaluated on an ongoing basis to ensure the adequacy of the warranty accrual.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. FINANCIAL GUARANTEES (CONTINUED)

The following table summarizes the activity associated with the product warranty accrual (in thousands):

| | Three months ended June 30, | | | |
|---|---|---|---|---|
| Fiscal year | Balance at April 1 | Warranties issued | Settlements made | Balance at June 30 |
| 2010 | $ 965 | $ 161 | $ (217) | $ 909 |
| 2009 | $ 1,143 | $ 9 | $ (132) | $ 1,020 |

| | Nine months ended June 30, | | | |
|---|---|---|---|---|
| Fiscal year | Balance at October 1 | Warranties issued | Settlements made | Balance at June 30 |
| 2010 | $ 970 | $ 586 | $ (647) | $ 909 |
| 2009 | $ 1,214 | $ 353 | $ (547) | $ 1,020 |

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

11. CONTINGENCIES

*Initial Public Offering Securities Litigation*

There have been no additional developments in In re Initial Public Offering Securities Litigation since our Annual Report on Form 10-K for the year ended September 30, 2009. Under the settlement, our insurers are to pay the full amount of settlement share allocated to us, and we would bear no financial liability beyond our deductible of $250,000. While there can be no guarantee as to the ultimate outcome of this pending lawsuit, we expect that our liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of June 30, 2010, we have an accrued liability for the anticipated settlement of $300,000 which we believe is adequate and reflects the amount of loss that is probable and a receivable related to the insurance proceeds of $50,000, which represents the anticipated settlement of $300,000 less our $250,000 deductible. In the event we should have losses that exceed the limits of the liability insurance, such losses could have a material adverse effect on our business and our consolidated results of operations or financial condition.

*Investigation*

As previously reported in the third fiscal quarter 2010 earnings release of July 22, 2010, after receiving allegations regarding possible violations of our gifts, travel and entertainment policy for activities in the Asia Pacific (APAC) region by a few employees, we initiated an investigation of these policy and corresponding internal control issues, and any possible related violations of applicable law, including the Foreign Corrupt Practices Act (FCPA). We voluntarily disclosed the allegations to the United States Department of Justice (DOJ) and the United States Securities and Exchange Commission (SEC). The investigation has been under the direction of the Audit Committee, comprised solely of independent directors, utilizing outside counsel, and focused on the APAC region. For completeness purposes, the investigation reviewed certain other foreign regions where no allegations have been made. At that time, we believed the investigation was substantially complete, pending input from the DOJ and the SEC. We have been providing the DOJ and SEC with updates and our proposed remediation plan.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. CONTINGENCIES (CONTINUED)

Digi has now received confirmation through discussions with representatives of the DOJ and the SEC that they will not be initiating any enforcement proceedings against Digi, including not seeking any monetary or other sanctions.

The investigation identified violations of company policy that primarily involved three individuals in Hong Kong and our Chief Financial Officer. The investigation also found an unsubstantiated accrued liability recorded in Hong Kong. All four individuals were terminated or had resigned from the company as of May 12, 2010. In the three and nine months ended June 30, 2010, we incurred additional general and administrative expense of $1.0 million related to the cost of the investigation.

As a result of the allegations and the ultimate findings of the investigation, we performed an evaluation of our internal controls over financial reporting during the third fiscal quarter of 2010 to consider the implications of these findings. A discussion of our controls evaluation and changes in internal control over financial reporting, including remediation efforts appears in Part I, Item 4 of this Quarterly Report on Form 10-Q. While we determined that no adjustment was required to our previously reported consolidated financial statements, we recorded an immaterial out-of-period adjustment this period in order to correct the unsubstantiated accrued liability in Hong Kong.

*Shareholder Derivative Litigation*

On June 18, 2010 and June 24, 2010, respectively, two shareholders filed derivative actions against our directors, our former Chief Financial Officer, and another executive officer, in the Hennepin County District Court, State of Minnesota, in Minneapolis. We also were named as a nominal defendant in the actions. The complaints allege that the individual defendants caused us to operate in countries with dubious business practices without having internal controls or an accounting system that were adequate to ensure that we did not violate the Foreign Corrupt Practices Act. The complaints allege causes of action against the individual defendants for (1) breach of fiduciary duty, (2) waste of corporate assets, and (3) unjust enrichment. The complaints seek to recover, purportedly on our behalf, unspecified damages, equitable relief, attorneys fees, and costs of litigation. On August 2, 2010, we filed a motion to dismiss these lawsuits. We are not able to predict the ultimate outcome of these actions, but they may be costly and disruptive. The total costs may not be reasonably estimated at this time. Derivative litigation can result in substantial costs and divert our management s attention and resources, which may have a material adverse effect on our business and results of operations, including our cash flows.

*Patent Infringement Lawsuit*

On May 11, 2010, SIPCO, LLC filed a patent infringement lawsuit against us in federal court in the Eastern District of Texas. The lawsuit included allegations against Digi and five other companies pertaining to the infringement of SIPCO s patents by wireless mesh networking products. The lawsuit seeks monetary and non-monetary relief. We cannot predict the outcome of this matter at this time or whether it will have a materially adverse impact on our business prospects and our consolidated financial condition, results of operations or cash flow.

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

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

12. RESTRUCTURING

On April 23, 2009, we announced a business restructuring to increase our focus on wireless products and solutions that include hardware, software and services. The restructuring included the closing of an engineering facility in Long Beach, California, and the relocation and consolidation of the manufacturing facility in Davis, California to our Minneapolis, Minnesota headquarters. We paid a lease cancellation fee for one of the leased facilities in Davis and had vacated the facility as of the end of fiscal 2009. We continue to maintain non-manufacturing activities at the remaining leased facility in Davis, California. As a result of these initiatives, during the third quarter of fiscal 2009 we recorded a $2.0 million charge, which consisted of $1.8 million for employee termination costs for 86 positions and $0.2 million for contract termination fees and other relocation costs.

All of the 86 positions were vacated in fiscal 2009. The employee termination costs include severance and the associated costs of continued medical benefits and outplacement services. The other restructuring expenses include contract termination fees for non-renewal of lease terms relating to one of the facilities in Davis, California and relocation expenses for employees. A summary of the restructuring charges and other activity within the restructuring accrual is listed below (in thousands):

| | Employee Termination Costs | Other | Total |
|---|---|---|---|
| Balance at September 30, 2009 | $ 620 | $ 101 | $ 721 |
| Restructuring charge | 75 | | 75 |
| Payments | (231) | (11) | (242) |
| Reversal | (352) | | (352) |
| Balance at June 30, 2010 | $ 112 | $ 90 | $ 202 |

The remaining liability is mostly related to continued medical benefits as part of the American Recovery and Reinvestment Act of 2009 (ARRA), which provides for premium reductions for health benefits under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The ARRA was amended by the Department of Defense Appropriations Act of 2010 on December 19, 2009, which provides an additional six months (from nine to fifteen months) for receiving the subsidy. We recorded an additional accrual of $0.1 million for the additional six months of continued medical benefits during the three months ended December 31, 2009. During the second quarter of fiscal 2010, we eliminated $0.4 million of the restructuring accrual as a result of lower than expected costs associated with continued medical benefits and lower than expected relocation costs. We expect the remaining liability to be settled by the end of the second quarter of fiscal 2011.

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

The terms we, our or us mean Digi International Inc. and all of the subsidiaries included in the consolidated financial statements unless the context indicates otherwise. 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, 2009, as well as our reports on Forms 10-Q and 8-K and other publicly available information.

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

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

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

Our operating results and performance trends may be affected by a number of factors, including, without limitation, those described under Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended September 30, 2009. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in our filings with the Securities and Exchange Commission, including without limitation, our quarterly reports on Form 10-Q and our registration statements, could cause our actual future results to differ materially from those projected in the forward-looking statements as a result of the factors set forth in our various filings with the Securities and Exchange Commission and of changes in general economic conditions, changes in interest rates and/or exchange rates and changes in the assumptions used in making such forward-looking statements.

CRITICAL ACCOUNTING POLICIES

A description of our critical accounting policies was provided in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended September 30, 2009.

**OVERVIEW**

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

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

**OVERVIEW (CONTINUED)**

Net sales increased from $44.5 million in the third quarter of fiscal 2009 to $47.2 million in the third quarter of fiscal 2010, an increase of $2.7 million, or 6.2%. Net sales in the third quarter of fiscal 2010 also increased by $2.2 million, or 4.8%, compared to the second quarter of fiscal 2010. Revenue in North America increased by $5.9 million, or 25.8%, in the third fiscal quarter of 2010 compared to the year ago comparable quarter. Revenue in the Asian region increased by $1.9 million or 48.0% and in the Latin American region increased $0.5 million or 61.3% in the third fiscal quarter of 2010 compared to the year ago comparable quarter. Revenue in the EMEA (Euro, Middle East and Africa) region decreased by $5.5 million, or 31.9%, in the third quarter of fiscal 2010 compared to the third quarter of fiscal 2009 primarily as a result of a large sale to a legacy Sarian Systems customer in the third fiscal quarter of 2009 and a large sale of a discontinued chip set during fiscal 2009 that was phased out as the technology was mature. The strengthening of the U.S. dollar to the British Pound and the Euro also contributed $0.5 million to the decrease in EMEA net sales in the third quarter of fiscal 2010 compared to the same period a year ago.

Our wireless product net sales grew from $15.7 million, or 35.2% of net sales, in the third quarter of fiscal 2009 to $18.9 million, or 40.0% of net sales, in the third quarter of fiscal 2010, an increase of 20.6%. Wireless product net sales increased from $43.1 million, or 34.2% of net sales, in the first nine months of fiscal 2009 to $49.8 million, or 36.8% of net sales, in the first nine months of fiscal 2010.

Our gross margins have improved from 48.2% and 49.1% for the three and nine months ended June 30, 2009, respectively, to 50.2% and 50.4% for the three and nine months ended June 30, 2010, respectively. We believe that the initiation of the restructuring plan announced in the third quarter of fiscal 2009 has contributed to the improvement in our gross margin, in addition to other cost reduction initiatives.

We suspended our non-sales incentive compensation program for fiscal 2009, for both executive management as well as a large part of the employee base. This program was reinstated at a reduced level for fiscal 2010. We also reduced our sales commission program in the last half of fiscal 2009 and we have fully restored the program in fiscal 2010. Also, during the third quarter of fiscal 2010, we incurred $1.0 million of expense related to the investigation that is discussed in Note 11 to our consolidated financial statements.

Net income and net income per diluted share increased from $1.4 million, or $0.06 per diluted share, in the third quarter of fiscal 2009 to $3.8 million, or $0.15 per diluted share, in the third quarter of fiscal 2010, an increase of $2.4 million, or $0.09 per diluted share. Net income during the third quarter of fiscal 2010 benefited by $2.2 million, or $0.09 per diluted share, resulting from the reversal of tax reserves associated with the statutory closing of a prior tax year and the conclusion of an audit of prior tax years. This was partially offset by a decrease in net income during the third quarter of fiscal 2010 by $0.7 million, net of taxes, or $0.03 per diluted share as a result of investigation expenses.

We anticipate that growth in the future will result from products and services that are developed internally as well as from products and services that are acquired. We are continuing to invest in wireless products and services while closely monitoring and controlling discretionary spending. We also are actively managing our supply chain to ensure that our key sources of supply are intact.

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**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 (dollars in thousands):

| | Three months ended June 30, | | | | % increase | Nine months ended June 30, | | | | % increase |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | | 2009 | | (decrease) | 2010 | | 2009 | | (decrease) |
| Net sales | $ 47,238 | 100.0% | $ 44,470 | 100.0% | 6.2% | $ 135,282 | 100.0% | $ 125,916 | 100.0% | 7.4% |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) | 22,496 | 47.6 | 21,986 | 49.4 | 2.3 | 63,913 | 47.2 | 60,963 | 48.4 | 4.8 |
| Amortization of purchased and core technology | 1,024 | 2.2 | 1,047 | 2.4 | (2.2) | 3,190 | 2.4 | 3,099 | 2.5 | 2.9 |
| Gross profit | 23,718 | 50.2 | 21,437 | 48.2 | 10.6 | 68,179 | 50.4 | 61,854 | 49.1 | 10.2 |
| Operating expenses | 21,174 | 44.8 | 20,835 | 46.8 | 1.6 | 61,611 | 45.5 | 59,887 | 47.5 | 2.9 |
| Operating income | 2,544 | 5.4 | 602 | 1.4 | 322.6 | 6,568 | 4.9 | 1,967 | 1.6 | 233.9 |
| Interest income and other, net | 52 | 0.1 | 767 | 1.7 | (93.2) | 414 | 0.3 | 1,421 | 1.1 | (70.9) |
| Income before income taxes | 2,596 | 5.5 | 1,369 | 3.1 | 89.6 | 6,982 | 5.2 | 3,388 | 2.7 | 106.1 |
| Income tax (benefit) provision | (1,216) | (2.6) | (24) | 0.0 | N/M | 285 | 0.2 | 264 | 0.2 | 8.0 |
| Net income | $ 3,812 | 8.1% | $ 1,393 | 3.1% | 173.7% | $ 6,697 | 5.0% | $ 3,124 | 2.5% | 114.4% |

N/M=not meaningful

NET SALES

The following summarizes our net sales by product categories for the periods indicated:

| | Three months ended June 30, | | | | % increase | Nine months ended June 30, | | | | % increase |
|---|---|---|---|---|---|---|---|---|---|---|
| ($ in thousands) | 2010 | | 2009 | | (decrease) | 2010 | | 2009 | | (decrease) |
| Non-embedded | $ 24,948 | 52.8% | $ 24,026 | 54.0% | 3.8% | $ 74,755 | 55.3% | $ 70,081 | 55.7% | 6.7% |
| Embedded | 22,290 | 47.2 | 20,444 | 46.0 | 9.0 | 60,527 | 44.7 | 55,835 | 44.3 | 8.4 |
| Total net sales | $ 47,238 | 100.0% | $ 44,470 | 100.0% | 6.2% | $ 135,282 | 100.0% | $ 125,916 | 100.0% | 7.4% |

*Non-embedded*

Our non-embedded revenue increased by $0.9 million or 3.8% for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 and increased by $4.7 million or 6.7% for the nine months ended June 30, 2010 compared to the nine months ended June 30, 2009. The increases resulted primarily from an increase in cellular products, wireless communication adaptors, serial servers and USB products, which were offset by decreases in net sales of products from the Sarian acquisition and serial cards. Most of the increase in our non-embedded net sales took place in the North American, Asian and Latin American regions primarily resulting from a favorable product mix, offset by a decrease in the European, Middle Eastern and African ( EMEA ) region. In fiscal 2009, net sales of products from the Sarian acquisition, located in the EMEA region, were higher due to a large sale to a legacy customer of Sarian Systems, Inc. in the second and third quarters of fiscal 2009. Revenue also decreased in the EMEA region as a result of the strengthening of the U.S. Dollar to the British Pound and Euro.

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

NET SALES (CONTINUED)

*Embedded*

Our embedded revenue increased by $1.8 million or 9.0% for the three months ended June 30, 2010 compared to the three months ended June 30, 2009, and increased by $4.7 million or 8.4% for the nine months ended June 30, 2010 compared to the nine months ended June 30, 2009. Most of the increase in our embedded net sales took place in the North American, Asian and Latin American regions primarily related to increased net sales of modules and incremental net sales of satellite-related products due to our acquisition of MobiApps on June 8, 2009. This was partially offset by a decrease in net sales in the EMEA region primarily relating to a large sale of a discontinued chip set in fiscal 2009 that was phased out during fiscal 2009.

The following summarizes our net sales by geographic region:

| | Three months ended June 30, | | $ increase | % increase | Nine months ended June 30, | | $ increase | % increase |
|---|---|---|---|---|---|---|---|---|
| ($ in thousands) | 2010 | 2009 | (decrease) | (decrease) | 2010 | 2009 | (decrease) | (decrease) |
| North America (1) | $ 28,477 | $ 22,631 | $ 5,846 | 25.8% | $ 80,517 | $ 66,500 | $ 14,017 | 21.1% |
| EMEA | 11,640 | 17,094 | (5,454) | (31.9) | 35,008 | 45,356 | (10,348) | (22.8) |
| Asia countries (2) | 5,905 | 3,991 | 1,914 | 48.0 | 16,478 | 11,601 | 4,877 | 42.0 |
| Latin America | 1,216 | 754 | 462 | 61.3 | 3,279 | 2,459 | 820 | 33.3 |
| Total net sales | $ 47,238 | $ 44,470 | $ 2,768 | 6.2% | $ 135,282 | $ 125,916 | $ 9,366 | 7.4% |

(1) Includes Satellite net sales of $365 and $668 for the three and nine months ended June 30, 2010, respectively.

(2) Includes Satellite net sales of $197 and $837 for the three and nine months ended June 30, 2010, respectively and $47 for both the three and nine months ended June 30, 2009.

The fluctuation of foreign currency rates for the three month and nine month periods ended June 30, 2010 had an unfavorable impact on net sales of $0.4 million and a favorable impact on net sales of $0.3 million, respectively, compared to the same periods a year ago.

GROSS MARGIN

Gross margins were 50.2% and 50.4% for the three and nine months ended June 30, 2010, respectively, compared to 48.2% and 49.1% for the three and nine month comparable periods ended June 30, 2009. The increase in the gross margin for both the three and nine months ended June 30, 2010 as compared to the same period a year ago was primarily due to lower manufacturing expenses related to the restructuring in the third quarter of fiscal 2009 resulting in the consolidation of manufacturing operations. The increase in gross margin was also due to a favorable product mix as a result of a large sale to a legacy customer of Sarian Systems, Inc. and a large sale in fiscal 2009 of a discontinued chip set which reduced gross margin by 1.3% and 1.0% for the three and nine months ended June 30, 2009. Product cost reductions also contributed to the increase in gross margins for the three and nine months ended June 30, 2010.

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

OPERATING EXPENSES

| ($ in thousands) | Three months ended June 30, 2010 | | 2009 | | $ increase (decrease) | Nine months ended June 30, 2010 | | 2009 | | $ increase (decrease) |
|---|---|---|---|---|---|---|---|---|---|---|
| Sales and marketing | $ 9,089 | 19.2% | $ 8,624 | 19.4% | $ 465 | $ 27,932 | 20.7% | $ 27,225 | 21.6% | $ 707 |
| Research and development | 7,159 | 15.2 | 6,823 | 15.3 | 336 | 20,723 | 15.3 | 19,993 | 15.9 | 730 |
| General and administrative | 4,926 | 10.4 | 3,435 | 7.7 | 1,491 | 13,308 | 9.8 | 10,716 | 8.5 | 2,592 |
| Restructuring | | 0.0 | 1,953 | 4.4 | (1,953) | (352) | (0.3) | 1,953 | 1.5 | (2,305) |
| Total operating expenses | $ 21,174 | 44.8% | $ 20,835 | 46.8% | $ 339 | $ 61,611 | 45.5% | $ 59,887 | 47.5% | $ 1,724 |

The net increase of $0.5 million in sales and marketing expenses for the three months ended June 30, 2010 compared to June 30, 2009 was primarily due to an increase of $0.3 million in marketing expenses, $0.1 million in compensation-related expenses and $0.1 million due to the incremental ongoing expenses resulting from our acquisition of MobiApps. The net increase of $0.7 million in sales and marketing expenses for the nine months ended June 30, 2010 as compared to June 30, 2009 was primarily due to an increase of $0.3 million in compensation-related expenses and $0.3 million due to the incremental ongoing expenses resulting from the MobiApps acquisition.

The net increase of $0.3 million in research and development expenses for the three months ended June 30, 2010 compared to June 30, 2009 was due primarily to an increase of $0.3 million pertaining to professional services and contract labor and $0.2 million related to incremental ongoing research and development expenses resulting from the MobiApps acquisition, offset by a reduction of $0.2 million related to various development projects. Research and development expenses for the nine months ended June 30, 2010 increased $0.7 million compared to the same period a year ago due primarily to an increase of incremental ongoing expenses of $0.7 million resulting from the MobiApps acquisition and $0.5 million in professional services, contract labor and certification testing, offset by a decrease of $0.5 million related to the timing of various development projects.

The net increase in general and administrative expenses of $1.5 million for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 was primarily due to an increase of $1.1 million in professional fees, of which $1.0 million is investigation charges, $0.2 million of incremental ongoing expenses due to the acquisition of MobiApps and a $0.2 million increase in other general and administrative expenses. For the nine months ended June 30, 2010 compared to June 30, 2009, the net increase in general and administrative expenses of $2.6 million was due primarily to an increase of $1.1 million in professional services, of which $1.0 million is related to the investigation charges, $0.4 million in compensation-related expenses, $0.6 million in incremental ongoing expenses due to the acquisition of MobiApps and $0.5 million in other general and administrative expenses.

During the third quarter of fiscal 2009 we recorded a $2.0 million charge, which consisted of $1.8 million for employee termination costs for 86 positions and $0.2 million for contract termination fees and other relocation costs. During the second quarter of fiscal 2010, we reversed $0.4 million of the accrual as a result of lower than expected costs associated with continued medical benefits and lower than expected relocation costs.

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

OTHER INCOME, NET

Other income, net was $0.1 million and $0.4 million for the three and nine months ended June 30, 2010, respectively, compared to $0.8 million and $1.4 million for the comparable periods ended June 30, 2009. For the three months ended June 30, 2010 compared to the three months ended June 30, 2009, interest income, net decreased $0.1 million and net foreign currency transaction gains decreased $0.6 million. The decrease of $1.0 million for the nine months ended June 30, 2010 compared to the same period a year ago was due to a $0.9 million reduction in interest income and a $0.1 million reduction in net foreign currency transaction gains. We earned an average annual interest rate of 0.5% and 0.6% for the three and nine months ended June 30, 2010, respectively, compared to 2.0% and 2.8% for the three and nine months ended June 30, 2009. The average invested balance for the three and nine months ended June 30, 2010 was $69.7 million and $68.2 million, respectively, and for the three and nine months ended June 30, 2009 the average invested balance was $55.0 million and $56.4 million, respectively.

INCOME TAXES

For the nine months ended June 30, 2010, income taxes have been provided at an effective rate of 4.1% compared to 7.8% for the nine months ended June 30, 2009. In the third quarter of fiscal 2010, we recorded a discrete tax benefit of $2.2 million resulting from the reversal of tax reserves associated with the statutory closing of a prior tax year and the conclusion of an audit of prior tax years. In the first quarter of fiscal 2010, we recorded a discrete tax benefit of $0.1 million related to an expiration of statute of limitations. During the third quarter of fiscal 2009, we recorded a discrete tax benefit of $0.5 million primarily resulting from a reversal of previously established tax reserves associated with the closing of a prior tax year. We recorded a discrete tax benefit of $0.4 million during the first quarter of fiscal 2009 resulting from the enactment on October 3, 2008 of the retroactive extension of the research and development tax credit for activity from January 1, 2008 to September 30, 2008. Total discrete tax benefits for the nine months ended June 30, 2010 and 2009 reduced the effective tax rate by 32.5 percentage points and 26.1 percentage points, respectively. We expect our annualized 2010 income tax rate, before the impact of discrete items, to be approximately 33% to 36% and after the impact of discrete items to be approximately 13% to 17%.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally with funds generated from operations. At June 30, 2010, we had cash, cash equivalents and short-term marketable securities of $78.2 million compared to $70.7 million at September 30, 2009. Our working capital (current assets less total current liabilities) increased $9.9 million to $116.0 million at June 30, 2010 compared to $106.1 million at September 30, 2009. We anticipate total fiscal 2010 capital expenditures will be approximately $3.5 million.

Net cash provided by operating activities was $12.3 million for the nine months ended June 30, 2010 compared to $4.3 million for the nine months ended June 30, 2009, resulting in a net increase of $8.0 million. This increase was primarily due to increases in net income and net increases in accounts payable and other accrued liabilities, partially offset by increases in accounts receivable and inventory. Cash provided by operating activities also increased in the nine months ended June 30, 2010 compared to the same period a year ago due to non-cash changes in the restructuring accrual and unrealized foreign currency losses and gains.

Net cash used in investing activities was $25.2 during the nine months ended June 30, 2010 compared to net cash provided by investing activities of $18.4 million during the nine months ended June 30, 2009. The increase in net cash used was due to the timing of settlements and maturities of marketable securities. We also paid $3.0 million to the former shareholders of Spectrum Design Solutions, Inc. (Spectrum) for a deferred cash payout related to our acquisition of Spectrum.

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

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

Cash provided by financing activities was $1.8 million during the nine months ended June 30, 2010 compared to a cash usage of $5.9 million during the same period a year ago, or a net increase of $7.8 million. We used $6.6 million for the purchase of treasury stock and spent $0.3 million on payments of capital leases during the nine months ended June 30, 2009. We received $0.9 million more in proceeds from stock option and employee stock purchase plan transactions during the first nine months of fiscal 2010 as compared to the same period a year ago.

We believe the strength of our capital structure provides us with stable access to capital markets. Historically we have only accessed capital markets on a short-term basis in order to finance our acquisitions. We may need to access capital markets for future acquisitions. We believe that current financial resources, cash generated from operations, and our capacity for debt and/or equity financing will be sufficient to meet currently anticipated growth plans, including capital expenditures, working capital investments, contingent obligations and acquisitions.

The contractual and contingent obligations disclosed in our Annual Report on Form 10-K for the year ended September 30, 2009 did not materially change through June 30, 2010. In January 2010, we paid $3.0 million to the former shareholders of Spectrum as provided in the purchase agreement.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In March 2010, the FASB (Financial Accounting Standards Board) issued an amendment to the accounting standards that provides guidance on criteria used to define a milestone and determines when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent upon achievement of a milestone can be recognized in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. In addition, certain disclosures related to the milestone method of revenue recognition will be required. This amendment is effective on a prospective basis for milestones achieved beginning October 1, 2010. Early adoption is permitted. We are currently evaluating the impact this amendment will have on our consolidated financial statements.

In October 2009, the FASB issued an amendment to the accounting standards that provides guidance for identifying separate deliverables in a revenue-generating transaction where multiple deliverables exist, and for allocating and recognizing revenue based on those separate deliverables. This guidance is expected to result in more multiple-deliverable arrangements being separable than under current guidance. This amendment is effective for revenue arrangements entered into or materially modified in our fiscal year beginning October 1, 2010. Early adoption is permitted. We do not expect this amendment to have a material impact on our consolidated financial statements.

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In October 2009, the FASB issued an amendment to the accounting standards related to certain revenue arrangements that include software elements. This standard clarifies the existing accounting guidance such that tangible products that contain both software and non-software components that function together to deliver the product s essential functionality shall be excluded from the scope of the software revenue recognition accounting standards. Accordingly, sales of these products may fall within the scope of other revenue recognition accounting standards or may now be within the scope of this standard and may require an allocation of the arrangement consideration for each element of the arrangement. This amendment is effective for revenue arrangements entered into or materially modified in our fiscal year beginning October 1, 2010. We do not expect this amendment to have a material impact on our consolidated financial statements.

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

INTEREST RATE RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Our marketable securities are classified as available-for-sale and are carried at fair value. Marketable securities consist of commercial paper, certificates of deposit, corporate bonds and government 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. Our portfolio contains no auction rate securities. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than a year.

FOREIGN CURRENCY RISK

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

For the nine months ended June 30, 2010 and 2009, we had approximately $54.8 million and $59.4 million, respectively, of net sales to foreign customers including export sales, of which $16.9 million and $27.9 million, respectively, were denominated in foreign currency, predominantly Euros and British Pounds. In future periods, we expect a significant portion of sales will continue to be made in both Euros and British Pounds.

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

| | Nine months ended June 30, | | |
|---|---|---|---|
| | 2010 | 2009 | % increase |
| Euro | 1.3803 | 1.3296 | 3.8% |
| British Pound | 1.5632 | 1.5213 | 2.8% |
| Yen | 0.0110 | 0.0105 | 5.2% |

A 10% change from the first nine months of fiscal year 2010 average exchange rate for the Euro, British Pound and Yen to the U.S. Dollar would have resulted in a 1.4% increase or decrease in net sales and a 2.0% increase or decrease in stockholders equity. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (CONTINUED)

CREDIT RISK

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

Investments are made in accordance with our investment policy and consist of commercial paper, certificates of deposit, government bonds and corporate bonds. We may have some credit exposure related to the fair value of our securities, which could change significantly based on changes in market conditions and continued uncertainties in the credit markets. If these uncertainties continue or if these securities experience credit rating downgrades, we may incur impairment charges for securities in our investment portfolio.

## ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2010 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

INVESTIGATION IN HONG KONG

The previously announced investigation, which was the result of allegations that we learned of in April 2010, was completed in July 2010 (refer to Note 11 of the Condensed Consolidated Financial Statements for more detail). Soon after learning of these allegations, the Company began to take immediate remedial actions. The investigation identified violations of company policy that primarily involved three individuals in Hong Kong and our Chief Financial Officer. The investigation also found an unsubstantiated accrued liability recorded in Hong Kong. All four individuals were terminated or had resigned from the company as of May 12, 2010.

As a result of the allegations and the ultimate findings of the investigation, we performed an evaluation of our internal controls over financial reporting during the third fiscal quarter of 2010 to consider the implications of these findings. We identified deficiencies in the design of the internal reporting structure in Hong Kong, as well as deficiencies in the design of certain controls in Hong Kong, including expense reviews, cash controls, review of Hong Kong financial information and account reconciliations in both Hong Kong and the corporate office, and in the competency of those performing financial accounting and reporting activities in Hong Kong. These deficiencies allowed inappropriate activities, such as those that ultimately led to the investigation and terminations and resignation noted above, to not be prevented or detected on a timely basis. We have determined based on a review of the internal reporting structure and controls at Hong Kong in comparison to our other locations that these issues were unique to the Hong Kong entity and that the Company's other entities had controls in place that were operating and effective. While we determined that no adjustment was required to our previously reported consolidated financial statements, we determined that the aggregation of these control

### ITEM 4. CONTROLS AND PROCEDURES (CONTINUED)

deficiencies, combined with the influence and span of control of our former CFO in the Hong Kong region and collusion on the part of the individuals involved, resulted in a material weakness in the Company's control environment. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The control deficiencies at Digi could have resulted in a material misstatement of the consolidated financial statements that would not have been prevented or detected on a timely basis.

As described below, we determined that this material weakness was remediated as of June 30, 2010.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been changes in internal control over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting. In response to the material weakness discussed above, the Company implemented the following remedial actions which were all completed as of June 30, 2010:

- We terminated the three involved individuals in Hong Kong and our Chief Financial Officer resigned.

- We realigned the reporting of our finance function in Hong Kong to ensure appropriate segregation of duties, as well as the appropriate levels of review and oversight by the corporate finance team. Further, the corporate finance team performed, and continues to perform, a monthly detailed review of all account reconciliations and transaction activity for the Hong Kong region.

- Additional controls over cash in Hong Kong were implemented in May 2010. We restricted the use of petty cash in Hong Kong for payment of business expenditures and the signers on the Hong Kong bank accounts were replaced with two individuals in our corporate office. One of these individuals must sign all checks and authorize all wire transfers. Requests for payment in Hong Kong are forwarded to the corporate accounting department, along with supporting back-up, for approval and payment.

- Representatives from the corporate office visited the Hong Kong office in May and June 2010 to meet with employees and the outside accounting and statutory auditing firms. During these visits, the corporate employees reinforced the code of conduct, corporate policies, Digi's intolerance for violation of company policy and regulations, and appropriate expense reporting procedures in Hong Kong. The corporate office will continue to visit Hong Kong at least annually going forward to reinforce these policies.

- The corporate office performed a detailed balance sheet and income statement review of the Hong Kong financial statements in each of May and June 2010. We have incorporated this detailed monthly financial statement review into our ongoing controls for Hong Kong.

- We improved controls over the review around travel and entertainment expenses in Hong Kong which will be sustained going forward. The corporate office is currently reviewing and approving all expense reports for Hong Kong to ensure compliance to the gifts, travel and entertainment policy.

These activities have been incorporated into our internal control structure and were in place as of June 30, 2010 and will be sustained going forward such that the underlying control deficiencies that aggregated to the material weakness have been substantially remediated as of June 30, 2010, and therefore the material weakness no longer exists as of June 30, 2010.

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## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The disclosures set forth in Note 11 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

### ITEM 1A. RISK FACTORS

There are no material changes to the risk factors from those previously disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

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

None

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

### ITEM 5. OTHER INFORMATION

**Entry into a Material Definitive Agreement**

On August 5, 2010, the Company entered into an indemnification agreement with Brenda L. Mueller in connection with her service as an officer of the Company. Under the indemnification agreement, subject to the exceptions and limitations provided in the agreement, the Company has agreed to indemnify Ms. Mueller, to the fullest extent authorized and permitted by law and the Company s By-Laws, against expenses and other liabilities reasonably paid in settlement of a claim arising out of her service as an officer of the Company.

The foregoing description is qualified in its entirety by the full text of the form of indemnification agreement, which is filed as Exhibit 10 to this Quarterly Report on Form 10-Q and is incorporated by reference herein.

## ITEM 6. EXHIBITS

| Exhibit No. | Description |
|---|---|
| 3(a) | Restated Certificate of Incorporation of the Company, as amended (1) |
| 3(b) | Amended and Restated By-Laws of the Company (2) |
| 4(a) | Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (3) |
| 4(b) | Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (4) |
| 10 | Form of Indemnification Agreement with directors and officers of the Company |
| 31(a) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31(b) | Rule 13a-14(a)/15d-14(a) Certification of Corporate Controller and Acting Principal Financial Officer |
| 32 | Section 1350 Certification |

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

(2) Incorporated by reference to Exhibit 3(b) to the Company s Form 10-Q for the quarter ended June 30, 2008 (File No. 1-34033)

(3) Incorporated by reference to Exhibit 4(a) to the Company s Registration

Statement on Form 8-A filed on April 25, 2008 (File No. 1-34033)

(4) Incorporated by reference to Exhibit 4(b) to the Company s Registration Statement on Form 8-A filed on April 25, 2008 (File No. 1-34033)

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SIGNATURE

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

| | DIGI INTERNATIONAL INC. |
|---|---|
| Date: August 9, 2010 | By: /s/ Brenda Mueller<br>Brenda Mueller<br>Corporate Controller and Acting Principal<br>Financial Officer<br>(Principal Financial and Accounting Officer) |

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EXHIBIT INDEX

| Exhibit Number | Document Description | Form of Filing |
|---|---|---|
| 3(a) | Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company s Form 10-K for the year ended September 30, 1993 (File No. 0-17972)) | Incorporated by Reference |
| 3(b) | Amended and Restated By-Laws of the Company | Incorporated by Reference |
| 4(a) | Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent | Incorporated by Reference |
| 4(b) | Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares | Incorporated by Reference |
| 10 | Form of Indemnification Agreement with directors and officers of the Company | Filed Electronically |
| 31(a) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed Electronically |
| 31(b) | Rule 13a-14(a)/15d-14(a) Certification of Corporate Controller and Acting Principal Financial Officer | Filed Electronically |
| 32 | Section 1350 Certification | Filed Electronically |