DIGI INTERNATIONAL INC
Form 10-Q
May 03, 2016

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: March 31, 2016
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 þ 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 April 27, 2016, there were 25,872,329 shares of the registrant's $.01 par value Common Stock outstanding.

INDEX

	Page
PART I. FINANCIAL INFORMATION	
ITEM 1. Unaudited Financial Statements	
Condensed Consolidated Statements of Operations for the three and six months ended March 31, 2016 and 2015	1
Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended March 31, 2016 and 2015	2
Condensed Consolidated Balance Sheets as of March 31, 2016 and September 30, 2015	3
Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2016 and 2015	4
Notes to Condensed Consolidated Financial Statements	5
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	23
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	32
ITEM 4. Controls and Procedures	33
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	33
ITEM 1A. Risk Factors	33
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
ITEM 3. Defaults Upon Senior Securities	33
ITEM 4. Mine Safety Disclosures	34
ITEM 5. Other Information	34
ITEM 6. Exhibits	35

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
Revenue:				
Hardware product	$48,732	$48,108	$96,979	$93,041
Service	1,430	2,293	3,442	4,578
Total revenue	50,162	50,401	100,421	97,619
Cost of sales:				
Cost of hardware product	24,283	25,498	48,993	48,610
Cost of service	1,137	1,668	2,329	3,217
Total cost of sales	25,420	27,166	51,322	51,827
Gross profit	24,742	23,235	49,099	45,792
Operating expenses:				
Sales and marketing	8,165	9,875	16,683	20,110
Research and development	7,757	7,280	15,595	14,363
General and administrative	5,065	4,349	9,126	9,124
Restructuring charge	102	412	753	412
Total operating expenses	21,089	21,916	42,157	44,009
Operating income	3,653	1,319	6,942	1,783
Other (expense) income, net:				
Interest income, net	12	54	112	92
Other (expense) income, net	(284)	1,324	(161)	1,712
Total other (expense) income, net	(272)	1,378	(49)	1,804
Income from continuing operations, before income taxes	3,381	2,697	6,893	3,587
Income tax provision	1,155	1,035	1,536	907
Income from continuing operations	2,226	1,662	5,357	2,680
(Loss) income from discontinued operations, after income taxes	(89)	(216)	3,230	(1,573)
Net income	$2,137	$1,446	$8,587	$1,107
Basic net income (loss) per common share:				
Continuing operations	0.09	0.07	$0.21	$0.11
Discontinued operations	—	(0.01)	$0.13	$(0.06)
Total (1)	$0.08	$0.06	$0.34	$0.05
Diluted net income (loss) per common share:				
Continuing operations	0.09	0.07	$0.21	$0.11
Discontinued operations	—	(0.01)	$0.12	$(0.06)
Total (1)	$0.08	$0.06	$0.33	$0.04
Weighted average common shares:				
Basic	25,820	24,492	25,574	24,319
Diluted	25,998	25,273	26,116	24,816

(1) Earnings per share presented are calculated by line item and may not add due to the use of rounded amounts.

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

Table of Contents

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

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
	(in thousands)			
Net income	$2,137	$1,446	$8,587	$1,107
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	1,421	(3,356)	(446)	(5,729)
Change in net unrealized gain (loss) on investments	106	23	43	(6)
Less income tax (provision) benefit	(39)	(9)	(16)	2
Reclassification of realized loss (gain) on investments included in net income (1)	—	1	(7)	1
Less income tax benefit (2)	—	—	3	—
Other comprehensive income (loss), net of tax	1,488	(3,341)	(423)	(5,732)
Comprehensive income (loss)	$3,625	$(1,895)	$8,164	$(4,625)

(1) Recorded in Other income, net on our Condensed Consolidated Statements of Operations.
(2) Recorded in Income tax provision in our Condensed Consolidated Statements of Operations.
The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2016	September 30, 2015
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$67,270	$ 45,018
Marketable securities	48,114	47,191
Accounts receivable, net	28,569	27,788
Inventories	25,684	31,877
Deferred tax assets	—	3,252
Receivable from sale of business	2,967	—
Other	4,326	3,435
Current assets of discontinued operations	—	1,624
Total current assets	176,930	160,185
Marketable securities, long-term	7,292	13,626
Property, equipment and improvements, net	13,986	14,339
Identifiable intangible assets, net	4,795	2,648
Goodwill	110,707	100,183
Deferred tax assets	7,685	6,255
Receivable from sale of business	1,939	—
Other	215	250
Non-current assets of discontinued operations	—	2,874
Total assets	$323,549	$ 300,360
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,280	$ 6,673
Income taxes payable	236	828
Accrued compensation	6,993	10,156
Accrued warranty	944	1,014
Contingent consideration on acquired business	850	—
Other	4,376	3,037
Current liabilities of discontinued operations	—	1,481
Total current liabilities	20,679	23,189
Income taxes payable	1,366	1,546
Deferred tax liabilities	690	135
Contingent consideration on acquired business	9,672	—
Other non-current liabilities	736	457
Non-current liabilities of discontinued operations	—	95
Total liabilities	33,143	25,422
Contingencies (see Note 11)		
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; 32,346,667 and 31,534,198 shares issued	323	315

Additional paid-in capital	234,699	227,367
Retained earnings	132,991	124,404
Accumulated other comprehensive loss	(23,036)	(22,613)
Treasury stock, at cost, 6,474,338 and 6,487,248 shares	(54,571)	(54,535)
Total stockholders' equity	290,406	274,938
Total liabilities and stockholders' equity	$323,549	$ 300,360

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

Table of Contents

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

	Six months ended March 31,	
	2016	2015
	(in thousands)	
Operating activities:		
Net income	$8,587	$1,107
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, equipment and improvements	1,405	1,445
Amortization of identifiable intangible assets	1,001	1,537
Stock-based compensation	1,719	2,222
Excess tax benefits from stock-based compensation	(202)	—
Deferred income tax provision	1,397	2,212
Gain in insurance settlement related to property and equipment	—	(989)
Gain on sale of business	(2,870)	—
Bad debt/product return provision	168	518
Inventory obsolescence	834	476
Restructuring charge	753	518
Other	182	(27)
Changes in operating assets and liabilities	(1,486)	(7,459)
Net cash provided by operating activities	11,488	1,560
Investing activities:		
Purchase of marketable securities	(22,056)	(22,099)
Proceeds from maturities of marketable securities	27,509	19,763
Proceeds from sale of business	2,849	—
Acquisition of business, net of cash acquired	(2,860)	—
Proceeds from insurance settlement related to property and equipment	—	1,014
Proceeds from sale of property and equipment	—	45
Purchase of property, equipment, improvements and certain other intangible assets	(1,209)	(3,035)
Net cash provided by (used in) investing activities	4,233	(4,312)
Financing activities:		
Excess tax benefits from stock-based compensation	202	—
Proceeds from stock option plan transactions	6,267	6,006
Proceeds from employee stock purchase plan transactions	494	505
Purchases of common stock	(503)	(2,339)
Net cash provided by financing activities	6,460	4,172
Effect of exchange rate changes on cash and cash equivalents	71	(3,253)
Net increase (decrease) in cash and cash equivalents	22,252	(1,833)
Cash and cash equivalents, beginning of period	45,018	47,490
Cash and cash equivalents, end of period	$67,270	$45,657
Supplemental schedule of non-cash investing and financing activities:		
Receivable related to sale of business	$4,906	$—
Liability related to acquisition of business	$(10,550)	$—

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

4

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

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

Basis of Presentation

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the "Company," "Digi," "we," "our," or "us") pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including (but not limited to) the summary of significant accounting policies, presented in our Annual Report on Form 10-K for the year ended September 30, 2015 as filed with the SEC ("2015 Financial Statements").

On October 23, 2015, we sold all of the outstanding stock of our wholly owned subsidiary, Etherios Inc. (Etherios) to West Monroe Partners, LLC. Because the sale of Etherios represented a strategic shift that will have a major effect on our operations and financial results, we have classified our Etherios business as discontinued operations and have therefore segregated its operating results from continuing operations in our Condensed Consolidated Statements of Operations for all periods presented. We have also segregated the assets and liabilities of Etherios on our Condensed Consolidated Balance Sheet for September 30, 2015.

During the first fiscal quarter ending December 31, 2015, we adopted Accounting Standards Update ("ASU") 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes" on a prospective basis. As required by ASU 2015-17, all deferred tax assets and liabilities are classified on a jurisdictional basis as non-current in our condensed consolidated balance sheets, which is a change from our historical presentation whereby certain of our deferred tax assets and liabilities were classified as current and the remainder were classified as non-current. Our prior periods were not retrospectively adjusted.

The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated balance sheets and condensed consolidated statements of operations, comprehensive income (loss) and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year. The year-end condensed consolidated balance sheet data were derived from our 2015 Financial Statements, but do not include all disclosures required by U.S. GAAP.

Contingent Consideration

We measure our contingent consideration liabilities recognized in connection with business combinations at fair value on a recurring basis using significant unobservable inputs classified within Level 3 of the fair value hierarchy as defined in ASC 320 "Investments - Debt and Equity Securities". We used a probability-weighted discounted cash flow approach as a valuation technique to determine the fair value of the contingent consideration on the acquisition date. At each subsequent reporting period, the fair value is remeasured with the change in fair value recognized in general and administrative expense and interest expense in our Condensed Consolidated Statements of Operations. Amounts, if any, paid to the seller in excess of the amount recorded on the acquisition date will be classified as cash flows used in operating activities. Payments to the seller not exceeding the acquisition-date fair value of the contingent consideration will be classified as cash flows used in financing activities.

Recently Issued Accounting Pronouncements

Not Yet Adopted

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting". This update includes provisions intended to simplify various aspects related to how

share-based payments are accounted for and presented in the financial statements. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2016, which for us is the first fiscal quarter ending December 31, 2017. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-09 on our consolidated financial statements.

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

In March 2016, FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606)”. This update clarifies implementation guidance on principal-versus-agent considerations, including how an entity determines whether it is a principal or an agent for each specified good or service promised to the customer and how an entity determines the nature of each specified good or service. In addition, ASU 2016-08 updates the indicators in ASC 606-10-55-39 and revises the existing examples in ASC 606 to better illustrate the application of the principal-versus-agent guidance. This ASU is effective at the same time as those in ASU 2014-09 (as amended by ASU 2015-14), which for us is for our fiscal 2019, including interim periods within that reporting period. We are currently assessing the potential impact of adopting this ASU on our consolidated financial statements and related disclosures.

In February, 2016, FASB issued ASU 2016-02, “Leases (Topic 842)”, which amends the existing guidance to require lessees to recognize lease assets and lease liabilities from operating leases on the balance sheet. This ASU is effective using the modified retrospective approach for annual periods and interim periods within those annual periods beginning after December 15, 2018, which for us is the first fiscal quarter ending December 31, 2019. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 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 will require equity investments in unconsolidated entities (other than those 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 will also simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, eliminate the requirement for public business entities to disclose the method and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet and require these entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. This ASU would also change the presentation and disclosure requirements for financial instruments. In addition, this ASU clarifies 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 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, which for us is the first fiscal quarter ending December 31, 2018. Early adoption is permitted for financial statements of fiscal years and interim periods that have not been issued. We are currently evaluating the impact of the adoption of ASU 2016-01.

In July 2015, FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." This provision would require inventory that was previously recorded using first-in, first-out (FIFO) to be recorded at lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within those years, which for us will be the first fiscal quarter ending December 31, 2017. The amendments in this guidance should be applied prospectively with earlier application permitted as of the beginning of an interim or annual period. We are currently evaluating the impact of the adoption of ASU 2015-11 and whether it would have a material impact on our consolidated financial statements.

In April 2015, FASB issued ASU 2015-05, “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40) - Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.” The new standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If the arrangement does include a software license, the software license element of the arrangement should be accounted for in the same manner as the acquisition of other software licenses. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, with early adoption permitted. We expect to adopt this guidance beginning with our fiscal quarter ending December 31, 2016. We do not expect this guidance to have a material impact on our consolidated financial statements.

In August 2014, FASB issued ASU 2014-15, “Presentation of Financial Statements - Going Concern.” This guidance requires management to evaluate whether there is substantial doubt about a company’s ability to continue as a going

concern and to provide related footnote disclosures. These amendments are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, which for us, will be our annual period ended September 30, 2017. Early adoption is permitted. While we are evaluating the impact of the adoption of ASU 2014-15, we do not expect it to have an impact on our consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, “Revenue from Contracts with Customers.” This guidance provides a five-step analysis in determining when and how revenue is recognized so that an entity will recognize revenue when it transfers promised

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

goods or services to customers in an amount that reflects what it expects in exchange for the goods and services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14 "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" which approved a one-year deferral of the effective date of ASU 2014-09. As a result of this deferral, ASU 2014-09 is effective for our fiscal 2019, including interim periods within that reporting period. The FASB also agreed to allow us to choose to adopt the standard effective for our fiscal 2018. We will adopt the guidance beginning October 1, 2018 and are currently assessing the potential impact of adopting this ASU on our consolidated financial statements and related disclosures.

2. ACQUISITION

Acquisition of Bluenica Corporation

On October 5, 2015 we purchased all of the outstanding stock of Bluenica Corporation (“Bluenica”), a company focused on temperature monitoring of perishable goods in the food industry by using wireless sensors which are installed in grocery and convenience stores, restaurants, and in products during shipment and storage to ensure that quality, freshness and public health requirements are met. This acquisition forms the basis for our Digi Cold Chain Solutions. The terms of the acquisition included an upfront cash payment together with earn-out payments. Cash of $2.9 million was paid at time of closing. The earn-out payments are scheduled to be paid in installments over a four-year period based on revenue achievement of the acquired business. Each of the earn-out payments will be calculated based on the revenue performance of Digi Cold Chain solutions for each respective earn-out period. The cumulative amount of these earn-out payments will not exceed $11.6 million. An additional payment, not to exceed $3.5 million, may also be due depending on revenue performance. The fair value of this contingent consideration was $10.4 million at the date of acquisition (see Note 7 to the Condensed Consolidated Financial Statements). We have determined that the earn-out will be considered as part of the purchase price consideration as there are no continuing employment requirements associated with the earn-out. Costs directly related to the acquisition, including legal, accounting and valuation fees, of approximately of $0.1 million have been charged directly to operations and are included in general and administrative expense in our Condensed Consolidated Statements of Operations in fiscal 2016.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in the recognition of $11.0 million of goodwill. We believe that the acquisition resulted in the recognition of goodwill because this is a complementary acquisition for us and will provide a source of recurring revenue in a new vertically focused solutions business.

Bluenica’s operating results are included in our Condensed Consolidated Statements of Operations from October 6, 2015. The Condensed Consolidated Balance Sheet as of March 31, 2016 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

The Bluenica acquisition has been accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed pursuant to the stock purchase agreement be recognized at fair value as of the acquisition date. Certain estimated values are not yet finalized (see below) and are subject to change, which could be significant. We will finalize the amounts recognized as information necessary to complete the analysis is obtained. We expect to finalize these amounts not later than the end of our third quarter of fiscal 2016. The amounts for deferred tax assets and liabilities, pending the finalization of final tax returns remain subject to change.

2. ACQUISITION (CONTINUED)

The following table summarizes the values of Bluenica assets acquired and liabilities assumed as of the acquisition date. To the extent previously discussed, such amounts are considered preliminary (in thousands):

Cash	$2,888
Purchase price payable upon completion of diligence matters	115
Fair value of contingent consideration on acquired business	10,400
Total purchase price consideration	$13,403
Fair value of net tangible assets acquired	$129
Fair value of identifiable intangible assets acquired:	
Purchased and core technology	2,000
Customer relationships	900
Goodwill	11,020
Deferred tax liabilities, net	(646)
Total	$13,403

The weighted average useful life for all the identifiable intangibles listed above is 5.6 years. For purposes of determining fair value, the purchased and core technology identified above is assumed to have a useful life of five years and the customer relationships are assumed to have useful live of seven years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which we expect to derive benefits from the identifiable intangible assets.

We have determined that because the Bluenica acquisition is not material to our consolidated results of operations or financial position, pro forma financial information is not required to be presented.

3. DISCONTINUED OPERATIONS

On October 23, 2015, we sold all the outstanding stock of our wholly owned subsidiary, Etherios, Inc. (“Etherios”) to West Monroe Partners, LLC. We sold Etherios as part of a strategy to focus on providing highly reliable machine connectivity solutions for business-critical and mission-critical application environments. Etherios was included in our single operating segment.

Below is a summary of the gain on sale (in thousands):

Cash received	$4,096
Less:	
Employee related liabilities	(1,134)
Working capital adjustment	(113)
Net cash proceeds	2,849
Present value of receivable due on October 23, 2016	2,941
Present value of receivable due on October 23, 2017	1,922
Total fair value of consideration received	7,712
Less:	
Net assets of Etherios	(3,383)
Facility abandonment costs	(725)
Transaction costs, primarily professional fees	(734)
Gain on sale of discontinued operations, before income taxes	$2,870

The terms of the sale agreement provide that West Monroe Partners LLC will pay us $3.0 million on October 23, 2016 and $2.0 million on October 23, 2017. The present value of these amounts is included within the total fair value of consideration received. These receivable amounts are unsecured and non-interest bearing. The carrying value of these receivables presented

3. DISCONTINUED OPERATIONS (CONTINUED)

on our Condensed Consolidated Balance Sheet at March 31, 2016 equals their fair values, which were determined using level 3 cash flow fair value measurement techniques.

Goodwill has been included in in the net assets of Etherios based on the relative fair value of Etherios compared to the fair value of the Company.

As a condition to the sale agreement, we retained the operating leases in the Dallas and Chicago locations. Digi is no longer using these facilities and has sublet the Dallas location to West Monroe Partners, LLC through April 30, 2016. In the second quarter of fiscal 2016, the sublease was extended through December 31, 2017. This sublease extension decreased the facility abandonment costs by $0.1 million in the above calculation of the gain on sale of discontinued operations. Also in connection with the sale, we assigned our San Francisco lease to West Monroe Partners, LLC. A remaining potential obligation exists in the event of a default under the assigned lease, however, we believe the likelihood of a liability related to this lease is remote. As of March 31, 2016, the future minimum lease payments for the San Francisco lease are approximately $0.1 million.

(Loss) income from discontinued operations, after tax, as presented in the Condensed Consolidated Statements of Operations for the three and six months ended March 31, 2016 and 2015 is as follows (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Service revenue	$—	$2,750	$891	$4,255
Cost of service	—	1,907	713	4,047
Gross profit	—	843	178	208
Operating expenses:				
Sales and marketing	—	424	148	981
Research and development	—	499	103	978
General and administrative	—	191	43	604
Restructuring	—	106	—	106
Total operating expenses	—	1,220	294	2,669
Loss from discontinued operations, before income taxes	—	(377)	(116)	(2,461)
(Loss) gain on sale of discontinued operations, before income taxes	(42)	—	2,870	—
Total (loss) income from discontinued operations, before income taxes	(42)	(377)	2,754	(2,461)
Income tax expense (benefit) on discontinued operations	47	(161)	(476)	(888)
(Loss) income from discontinued operations, after income taxes	$(89)	$(216)	$3,230	$(1,573)

Income tax benefit on discontinued operations for the six months ended March 31, 2016 was $0.5 million and primarily represents income tax benefits for deductible transaction costs, partially offset by a tax expense for equity awards for which we will not receive a tax deduction. For tax purposes, we expect that this transaction will result in a capital loss, as the tax basis of the Etherios stock was higher than the book basis of the assets that were sold. Since we do not expect to be able to utilize this capital loss in the five year carryforward period, a deferred tax asset offset by a full valuation allowance is expected to be recorded upon completion of the capital loss calculation.

3. DISCONTINUED OPERATIONS (CONTINUED)

At September 30, 2015, the carrying amounts of major classes of assets and liabilities of discontinued operations included in the Consolidated Balance Sheet was as follows (in thousands):

	September 30, 2015
Current assets:	
Accounts receivable, net	$ 1,417
Deferred tax assets	127
Other current assets	80
Total current assets	1,624
Property, equipment and improvements, net	18
Identifiable intangible assets, net	1,531
Goodwill	1,914
Deferred tax assets (1)	(589)
Total assets of discontinued operations	$ 4,498
Current liabilities:	
Accounts payable	$ 50
Accrued compensation	1,346
Other current liabilities	85
Total current liabilities	1,481
Other non-current liabilities	95
Total liabilities of discontinued operations	$ 1,576

(1) As of September 30, 2015, the we had a net deferred income tax asset related to the United States federal jurisdiction. That net deferred income tax asset position included a deferred income tax liability of $589 thousand related to Etherios which was entirely in the United States federal tax jurisdiction.

The following table presents amortization, depreciation and purchases of property, equipment, improvements and certain other intangible assets of the discontinued operations related to Etherios (in thousands):

	Six months ended March 31, 20162015	
Amortization of identifiable intangible assets	$30	$241
Depreciation of property, equipment and improvements	$—	$14
Purchases of property, equipment, improvements and certain other intangible assets	$—	$(11)

4. EARNINGS PER SHARE

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

Table of Contents

4. EARNINGS PER SHARE (CONTINUED)

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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Numerator:				
Income from continuing operations	$2,226	$1,662	$5,357	$2,680
(Loss) income from discontinued operations, after income taxes	(89)	(216)	3,230	(1,573)
Net income	$2,137	$1,446	$8,587	$1,107
Denominator:				
Denominator for basic net income (loss) per common share — weighted average shares outstanding	25,820	24,492	25,574	24,319
Effect of dilutive securities:				
Stock options and restricted stock units	178	781	542	497
Denominator for diluted net income (loss) per common share — adjusted weighted average shares	25,998	25,273	26,116	24,816
Basic net income (loss) per common share:				
Continuing operations	$0.09	$0.07	$0.21	$0.11
Discontinued operations	$—	$(0.01)	$0.13	$(0.06)
Net income (1)	$0.08	$0.06	$0.34	$0.05
Diluted net income (loss) per common share:				
Continuing operations	$0.09	$0.07	$0.21	$0.11
Discontinued operations	$—	$(0.01)	$0.12	$(0.06)
Net income (1)	$0.08	$0.06	$0.33	$0.04

(1) Earnings per share presented are calculated by line item and may not add due to the use of rounded amounts.

For the three months ended March 31, 2016 and 2015, there were 2,735,177 and 2,366,812 potentially dilutive shares, respectively, and for the six months ended March 31, 2016 and 2015, there were 1,495,104 and 3,496,463 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. This is because the options' exercise prices were greater than the average market price of our common shares.

5. SELECTED BALANCE SHEET DATA

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

	March 31, 2016	September 30, 2015
Accounts receivable, net:		
Accounts receivable	$28,932	$ 28,073
Less allowance for doubtful accounts	363	285
Accounts receivable, net	$28,569	$ 27,788
Inventories:		
Raw materials	$21,195	$ 26,037
Work in process	519	598
Finished goods	3,970	5,242
Inventories	$25,684	$ 31,877

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

Table of Contents

6. MARKETABLE SECURITIES

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

In order to estimate the fair value for each security in our investment portfolio, we obtain quoted market prices and trading activity for each security where available. We obtain relevant information from our investment advisor and, if warranted, also may review the financial solvency of certain security issuers. As of March 31, 2016, 21 of our 59 securities that we held were trading below our amortized cost basis. We determined each decline in value to be temporary based upon the above described factors. We expect to realize the fair value of these securities, plus accrued interest, either at the time of maturity or when the security is sold. All of our current holdings are classified as available-for-sale marketable securities and are recorded at fair value on our consolidated balance sheet with the unrealized gains and losses recorded in accumulated other comprehensive income (loss). All of our current marketable securities will mature in less than one year and our non-current marketable securities will mature in less than three years. Our balance sheet classification of available for sale securities is based on our best estimate of when we expect to liquidate such investments and, presently, is consistent with the stated maturity dates of such investments. However, we are not committed to holding these investments until their maturity and may determine to liquidate some or all of these investments earlier based on our liquidity and other needs. During the six months ended March 31, 2016 and 2015, we received proceeds from our available-for-sale marketable securities of $27.5 million and $19.8 million, respectively.

At March 31, 2016 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Corporate bonds	$ 25,033	$ —	$ (31)	$25,002
Commercial paper	17,974	—	(14)	17,960
Certificates of deposit	2,002	2	—	2,004
Government municipal bonds	3,153	—	(5)	3,148
Current marketable securities	48,162	2	(50)	48,114
Non-current marketable securities:				
Certificates of deposit	7,260	32	—	7,292
Total marketable securities	$ 55,422	$ 34	$ (50)	$55,406

(1) Included in amortized cost and fair value is purchased and accrued interest of $209.

Table of Contents

6. MARKETABLE SECURITIES (CONTINUED)

At September 30, 2015 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Corporate bonds	$ 31,753	$ —	$ (39)	$31,714
Commercial paper	7,986	—	(1)	7,985
Certificates of deposit	6,253	8	—	6,261
Government municipal bonds	1,232	—	(1)	1,231
Current marketable securities	47,224	8	(41)	47,191
Non-current marketable securities:				
Corporate bonds	4,138	—	(12)	4,126
Certificates of deposit	7,511	2	(6)	7,507
Government municipal bonds	1,996	—	(3)	1,993
Non-current marketable securities	13,645	2	(21)	13,626
Total marketable securities	$ 60,869	$ 10	$ (62)	$60,817

(1) Included in amortized cost and fair value is purchased and accrued interest of $252.

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):

	March 31, 2016			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$19,843	$ (30)	$3,002	$ (1)
Commercial paper	17,960	(14)	—	—
Government municipal bonds	3,084	(5)	—	—
Total	$40,887	$ (49)	$3,002	$ (1)

	September 30, 2015			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$33,664	$ (52)	$—	$ —
Commercial paper	5,987	(1)	—	—
Certificates of deposit	4,244	(6)	499	(1)
Government municipal bonds	3,159	(3)	—	—
Total	$47,054	$ (62)	$499	$ (1)

7. FAIR VALUE MEASUREMENTS

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

13

Table of Contents

7. FAIR VALUE MEASUREMENTS (CONTINUED)

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

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

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 carrying value at March 31, 2016	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets:				
Money market	$ 29,578	$29,578	$—	$—
Corporate bonds	25,002	—	25,002	—
Commercial paper	17,960	—	17,960	—
Certificates of deposit	9,296	—	9,296	—
Government municipal bonds	3,148	—	3,148	—
Total assets measured at fair value	$ 84,984	$29,578	$55,406	$—
Liabilities:				
Contingent consideration on acquired business	10,522	$—	$—	$10,522
Total liabilities measured at fair value	$ 10,522	$—	$—	$10,522

	Total carrying value at September 30, 2015	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
Assets:				
Money market	$ 14,436	$14,436	$—	$ —
Corporate bonds	35,840	—	35,840	—
Commercial paper	7,985	—	7,985	—
Certificates of deposit	13,768	—	13,768	—
Government municipal bonds	3,224	—	3,224	—
Total assets measured at fair value	$ 75,253	$14,436	$60,817	$ —

Our money market funds, which have been determined to be cash equivalents, are measured at fair value using quoted market prices in active markets for identical assets and are therefore classified as Level 1 assets. We value our Level 2

assets using inputs that are based on market indices of similar assets within an active market. There were no transfers into or out of our Level 2 financial assets during the six months ended March 31, 2016.

The use of different assumptions, applying different judgment to matters that inherently are subjective and changes in future market conditions could result in different estimates of fair value of our securities or contingent consideration, currently and in

Table of Contents

7. FAIR VALUE MEASUREMENTS (CONTINUED)

the future. If market conditions deteriorate, we may incur impairment charges for securities in our investment portfolio. We may also incur changes to our contingent consideration liability as discussed below.

In connection with the Bluenica acquisition discussed in Note 2, we are required to make contingent payments over a period of up to four years, subject to Digi Cold Chain solutions achieving specified revenue thresholds. The fair value of the liability for contingent payments recognized upon acquisition was $10.4 million, and was estimated by discounting to present value the probability-weighted contingent payments expected to be made. Assumptions used in this calculation included the discount rate and various probability factors. This liability is considered to be a Level 3 financial liability that is re-measured each reporting period.

The following table presents a reconciliation of the liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended March 31, 2016 (in thousands):

	Three months ended March 31, 2016	Six months ended March 31, 2016
Fair value at beginning of period	$10,400	$—
Purchase price contingent consideration	—	10,400
Change in fair value of contingent consideration	122	122
Fair value at end of period	$10,522	$10,522

The change in fair value of contingent consideration for the acquisition of Bluenica is included in general and administrative and interest expense on our Condensed Consolidated Statements of Operations and 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 based on the probability of achieving the specified revenue thresholds at 93.6% to 98.1% and a discount rate between 1.2% and 2.5%, reflecting the risk profiles of satisfying these thresholds. A significant increase (decrease) in our estimates of achieving the relevant targets or a significant increase (decrease) in the discount rates used could materially increase (decrease) the fair value of the contingent consideration liability.

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS, NET

Amortizable identifiable intangible assets were (in thousands):

	March 31, 2016			September 30, 2015		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$47,165	$(45,352)	$1,813	$45,449	$(45,424)	$25
License agreements	18	(4)	14	18	(4)	14
Patents and trademarks	11,596	(10,710)	886	11,377	(10,385)	992
Customer relationships	17,817	(15,735)	2,082	17,090	(15,473)	1,617
Total	$76,596	$(71,801)	$4,795	$73,934	$(71,286)	$2,648

Amortization expense was $0.5 million and $0.6 million for the three month periods ended March 31, 2016 and 2015, respectively. Amortization expense was $1.0 million and $1.3 million for the six month periods ended March 31, 2016 and 2015, respectively. Amortization expense is recorded on our consolidated statements of operations within cost of sales and in general and administrative expense.

Table of Contents

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

Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2016 and the five succeeding fiscal years is (in thousands):

2016 (six months)	$988
2017	1,547
2018	1,110
2019	698
2020	328
2021	50

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

	Six months ended March 31,	
	2016	2015
Beginning balance, October 1	$100,183	$101,484
Acquisition of Bluenica	11,020	—
Foreign currency translation adjustment	(496)	(1,656)
Ending balance, March 31	$110,707	$99,828

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

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

At June 30, 2015, our market capitalization was $238.6 million compared to our carrying value of $270.6 million. Our market capitalization plus our estimated control premium of 35% (discussed in the paragraphs below) resulted in a fair value in excess of our carrying value by a margin of 19%. We concluded that no impairment was indicated and we were not required to complete the second step of the goodwill impairment analysis. No goodwill impairment charges were recorded.

In June 2014, we performed a control premium study to determine the appropriate control premium to include in the calculation of fair value. We used a third party valuation firm to assist us in performing this control premium analysis. In order to estimate the range of control premiums appropriate for us, the following three methodologies were used: (1) analysis of individual transactions within our industry; (2) analysis of industry-wide data, and (3) analysis of global transaction data. Individual transactions in the Communication Equipment or Technology Hardware, Storage and Peripherals industries were used to find transactions of target companies that operated in similar markets and shared similar operating characteristics with us. Transaction screening criteria included selection of transactions with the following characteristics:

- At least 50 percent of a target company's equity sought by an acquirer,
- Target company considered operating (not in bankruptcy),
- Target company had publicly traded stock outstanding at the transaction date, and
- Transactions announced between June 30, 2009 and the valuation date.

In analyzing industry-wide data, transactions in the following three industries were identified that encompassed the products offered by us: Office Equipment and Computer Hardware, Communications, and Computer, Supplies and Services. Finally, control premiums were considered for both domestic and international transactions. The control premium analysis resulted in a

Table of Contents

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

range of control premium of 30 percent to 40 percent. We reviewed the data and concluded that a 35 percent control premium best represented the amount an investor would likely pay, over and above market capitalization, in order to obtain a controlling interest given the economic conditions at that time.

Based on our industry knowledge, including recent industry merger and acquisition activity, we concluded that the control premium study that was performed as of June 2014 was still an appropriate study to use for our June 30, 2015 goodwill impairment assessment.

If our stock price or control premium declines, the first step of our goodwill impairment analysis may fail. We have identified factors that could result in additional interim goodwill impairment testing. For example, we would perform the second step of the impairment testing if our stock price fell below certain thresholds for a significant period of time, or if our control premium significantly decreased. Events or circumstances may occur that could negatively impact our stock price, including changes in our anticipated revenues and profits and our ability to execute on our strategies. In addition, our control premium could decline due to changes in economic conditions in the technology industry or more generally in the financial markets. 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 Accounting Standards Codification (ASC) 350, Intangibles-Goodwill and Others, in fiscal 2003.

9. INCOME TAXES

Income tax provision for continuing operations was $1.5 million for the six months ended March 31, 2016. Net tax benefits specific to the six months ended March 31, 2016 were $0.7 million resulting from the reinstatement of the federal research and development tax credit for calendar year 2015 and reversal of tax reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions. For the six months ended March 31, 2016, our continuing operations effective tax rate before items specific to the period was less than the U.S. statutory rate due primarily in the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and certain tax credits in the U.S.

Income tax provision for continuing operations was $0.9 million for the six months ended March 31, 2015. Net tax benefits specific to the period of $0.5 million included a reversal of reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions and the reinstatement of the federal research and development tax credit for calendar year 2014. For the six months ended March 31, 2015, our continuing operations effective tax rate before items specific to the period was more than the statutory rate primarily due to a mix of income between foreign jurisdictions, an adjustment for certain foreign income taxed at the U.S. rate, and lower than expected benefits associated with certain state tax credits.

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 specific 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.

During the first quarter of fiscal 2016, we adopted ASU 2015-17 on a prospective basis. As required by ASU 2015-17, all deferred tax assets and liabilities are classified on a jurisdictional basis as non-current in our condensed consolidated balance sheets, which is a change from our historical presentation whereby certain of our deferred tax assets and liabilities were classified as current and the remainder were classified as non-current. Our prior periods were not retrospectively adjusted.

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

Unrecognized tax benefits as of September 30, 2015	$1,618
Increases related to:	
Prior year income tax positions	60
Decreases related to:	
Expiration of statute of limitations	(121)
Unrecognized tax benefits as of March 31, 2016	$1,557

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is $1.5 million, after considering the impact of interest and deferred benefit items. We expect the change in the total amount of unrecognized tax benefits will be insignificant over the next 12 months.

Table of Contents

10. PRODUCT WARRANTY OBLIGATION

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

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

Period	Balance at January 1	Warranties issued	Settlements made	Balance at March 31
Three months ended March 31, 2016	$ 968	$ 172	$ (196)	$ 944
Three months ended March 31, 2015	$ 950	$ 206	$ (233)	$ 923

Period	Balance at October 1	Warranties issued	Settlements made	Balance at March 31
Six months ended March 31, 2016	$ 1,014	$ 292	$ (362)	$ 944
Six months ended March 31, 2015	$ 862	$ 497	$ (436)	$ 923

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

11. CONTINGENCIES

On December 23, 2015, JSDQ Mesh Technologies LLC filed a complaint naming us as a defendant in federal court in the District of Delaware. The complaint included allegations against us and one other company pertaining to the infringement of four patents relating to mesh networking technology. On April 27. 2016, we settled a patent infringement claim. The settlement fully resolves the claim by JSDQ Mesh Technologies LLC with no future payment obligations.

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.

12. STOCK-BASED COMPENSATION

Stock-based awards were granted under the 2016 Omnibus Incentive Plan (the “2016 Plan”) beginning February 1, 2016 and prior to that were granted under the 2014 Omnibus Incentive Plan (the “2014 Plan”). Stock-based awards were granted under the 2014 Plan during the six months ended March 31, 2015. Upon stockholder approval of the 2016 Plan, we ceased granting awards under any prior plan. The authority to grant options under the 2016 Plan and to set other terms and conditions rests with the Compensation Committee of the Board of Directors.

The 2016 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 2016 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 November over a

four-year period. Awards may be granted under the 2016 Plan until January 31, 2026. Options under the 2016 Plan can be granted as either incentive stock options (ISOs) or non-statutory stock options (NSOs). The exercise price of options and the grant date price of restricted stock shall be determined by our Compensation Committee but shall not be less than the fair market value of our common stock based on the closing price on the date of grant. Upon exercise, we issue new shares of stock.

Table of Contents

12. STOCK-BASED COMPENSATION (CONTINUED)

The 2014 Plan, under which grants ceased upon approval of the 2016 Plan, authorized the issuance of up to 2,250,000 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 included 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 2014 Plan typically vest over a four year service period and would expire if unexercised after eight years from the date of grant. RSUs that have been granted to directors typically vest in one year. RSUs that have been granted to executives and employees typically vested in November over a four-year period. Options under the 2014 Plan could be granted as either ISOs or NSOs. The exercise price of options and the grant date price of restricted stock was determined by our Compensation Committee but shall not be less than the fair market value of our common stock based on the closing price on the date of grant. Upon exercise, we issued new shares of stock.

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 six months ended March 31, 2016, our employees forfeited 42,427 shares in order to satisfy $0.5 million of withholding tax obligations related to stock-based compensation, pursuant to terms of awards under our board and shareholder-approved compensation plans. As of March 31, 2016, there were approximately 1,342,807 shares available for future grants under the 2016 Plan.

Cash received from the exercise of stock options was $6.3 million during the six months ended March 31, 2016 and $6.0 million during the six months ended March 31, 2015. There were $0.2 million in excess tax benefits from stock-based compensation for the six months ended March 31, 2016. There were no excess tax benefits from stock-based compensation during the six months ended March 31, 2015.

We sponsor an Employee Stock Purchase Plan (the Purchase Plan), covering all domestic employees with at least 90 days of continuous service and who are customarily employed at least 20 hours per week. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Employee contributions to the Purchase Plan were $0.5 million during both the six month periods ended March 31, 2016 and 2015. Pursuant to the Purchase Plan, 55,343 and 72,306 common shares were issued to employees during the six months ended March 31, 2016 and 2015, respectively. Shares are issued under the Purchase Plan from treasury stock. As of March 31, 2016, 562,188 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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Cost of sales	$51	$83	$105	$189
Sales and marketing	227	306	426	649
Research and development	147	196	295	388
General and administrative	478	453	888	996
Stock-based compensation before income taxes	903	1,038	1,714	2,222
Income tax benefit	(293)	(361)	(550)	(775)
Stock-based compensation after income taxes	$610	$677	$1,164	$1,447

Stock-based compensation cost capitalized as part of inventory was immaterial as of March 31, 2016 and September 30, 2015.

Table of Contents

12. STOCK-BASED COMPENSATION (CONTINUED)

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, 2015	4,800	$10.21		
Granted	505	11.51		
Exercised	(667)	9.78		
Forfeited / Canceled	(589)	11.09		
Balance at March 31, 2016	4,049	$10.32	4.9	$ 1,700
Exercisable at March 31, 2016	2,809	$10.50	4.1	$ 981

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, based on our closing stock price of $9.43 as of March 31, 2016, 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 six months ended March 31, 2016 was $1.7 million and during the six months ended March 31, 2015 was $0.8 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:

	Six months ended March 31,	
	2016	2015
Weighted average per option grant date fair value	$3.92	$2.91
Assumptions used for option grants:		
Risk free interest rate	1.61% - 1.85%	1.77% - 1.85%
Expected term	6.00 years	6.00 years
Expected volatility	32%	35% - 36%
Weighted average volatility	32%	35%
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; separate groups of grantees that have similar historical exercise behaviors are considered separately for valuation purposes. 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.

We use historical data to estimate pre-vesting forfeiture rates. The pre-vesting forfeiture rate used during the six months ended March 31, 2016 was 10.0%. As of March 31, 2016 the total unrecognized compensation cost related to non-vested stock options, net of expected forfeitures, was $3.5 million and the related weighted average period over which it is expected to be recognized is approximately 3.4 years.

Table of Contents

12. STOCK-BASED COMPENSATION (CONTINUED)

A summary of our non-vested restricted stock units as of March 31, 2016 and changes during the six 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, 2015	543	$ 8.41
Granted	233	$ 10.92
Vested	(165)	$ 8.36
Canceled	(99)	$ 8.09
Nonvested at March 31, 2016	512	$ 9.64

As of March 31, 2016, the total unrecognized compensation cost related to non-vested restricted stock units was $3.6 million and the related weighted average period over which it is expected to be recognized is approximately 1.7 years.

13. RESTRUCTURING

Below is a summary of the restructuring charges and other activity within the restructuring accrual (in thousands):

	Q2 2016 Restructuring Employee Termination Costs	Q1 2016 Restructuring Employee Termination Costs	Other	Total
Balance at September 30, 2015	$ —	$ —	$ —	$—
Restructuring charge	—	480	171	651
Balance at December 31, 2015	—	480	171	651
Restructuring charge	78	—	24	102
Payments	(76)	(113)	(195)	(384)
Foreign currency fluctuation	—	13	—	13
Balance at March 31, 2016	$ 2	$ 380	$ —	$382

Q1 2016 Restructuring

In November 2015, we approved a restructuring plan impacting our corporate staff. The plan most principally will close our Dortmund office and relocate certain employees to our Munich office. We also recorded a contract termination charge as we relocated our employees in our Minneapolis office to our corporate headquarters in Minnetonka in December 2015. We recorded a restructuring charge of $0.7 million that included $0.5 million of severance and $0.2 million of contract termination costs during the first quarter of fiscal 2016. This restructuring resulted in an elimination of approximately 10 positions. The payments associated with these charges are expected to be completed by the third quarter of fiscal 2016.

Q2 2016 Restructuring

In January 2016, we approved a restructuring plan impacting our wireless design services group. This restructuring resulted in an elimination of 5 positions. We recorded a restructuring charge of $0.1 million related to severance during the second quarter of fiscal 2016 and paid the majority of the severance during that same quarter.

Table of Contents

14. SUBSEQUENT EVENT

On April 27, 2016 we settled a patent infringement claim with JSDQ Mesh Technologies LLC. For more detail see Note 11 to our Condensed Consolidated Financial Statements.

On April 26, 2016, our Board of Directors authorized a new program to repurchase up to $15.0 million of our common stock primarily to return capital to shareholders. This new repurchase authorization expires on May 1, 2017. Shares repurchased under the new program may be made through open market and privately negotiated transactions from time to time and in amounts that management deems appropriate. The amount and timing of share repurchases will depend upon market conditions and other corporate considerations.

Table of Contents

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, 2015, as well as our subsequent reports on Forms 10-Q and 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," "project," "should," o negative thereof or other variations thereon or similar terminology, which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. Among other items, these statements relate to expectations of the business environment in which we operate, projections of future performance, perceived marketplace opportunities and statements regarding our mission and vision. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, including risks related to the highly competitive market in which our company operates, rapid changes in technologies that may displace products sold by us, declining prices of networking products, our reliance on distributors and other third parties to sell our products, delays in product development efforts, uncertainty in user acceptance of our products, the 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, 2015, 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 EBITDA from continuing operations, 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 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 an alternative for measures prepared in accordance with, generally accepted accounting principles and may be different from non-GAAP measures used by other companies. 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, we understand that Adjusted EBITDA from continuing operations 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. We believe that the presentation of Adjusted EBITDA from continuing operations 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. EBITDA from continuing operations is used as an internal metric for executive compensation, as well as incentive compensation for the rest of the employee base, and it is monitored quarterly for these purposes.

Table of Contents

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

A description of our critical accounting policies and estimates was provided in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended September 30, 2015. There have been no material changes to our critical accounting policies as disclosed in that report. An update to our critical accounting policy related to contingent consideration is included below:

We measure our contingent consideration liabilities recognized in connection with business combinations at fair value on a recurring basis using significant unobservable inputs classified within Level 3 of the fair value hierarchy as defined in ASC 320. "Investments - Debt and Equity Securities." We use a probability-weighted discounted cash flow approach as a valuation technique to determine the fair value of the contingent consideration on the acquisition date. At each subsequent reporting period, the fair value is remeasured with the change in fair value recognized in general and administrative expense in our Condensed Consolidated Statements of Operations. Amounts paid in excess of the amount recorded on the acquisition date will be classified as cash flows used in operating activities. Payments not exceeding the acquisition-date fair value of the contingent consideration will be classified as cash flows used in financing activities.

OVERVIEW

We provide a wide range of wireless products for the Internet-of-Things ("IoT"), a cloud computing platform tailored to enable monitoring and remote control of devices and development services to help customers get to market fast with wireless devices and applications. Our solution set is capable of allowing any device to communicate with any application, anywhere in the world. We have a single operating and reporting segment. 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.

Our revenue consists of hardware product revenue and service revenue. Our hardware product offerings are comprised of our cellular routers and gateways, radio frequency (RF), embedded and network products. Our service offerings include wireless design services, Digi Device Cloud (which includes Digi Remote Manager™) and enterprise support services. Digi Cold Chain Solutions, which was formed in October 2015 through our acquisition of Bluenica Corporation ("Bluenica"), is also one of our service offerings. On October 23, 2015, we sold all the outstanding stock of our wholly owned subsidiary, Etherios, Inc. ("Etherios") to West Monroe Partners, LLC. We sold our Etherios business as part of a strategy to focus on providing highly reliable machine connectivity solutions for business-critical and mission-critical application environments (see Note 3 to the Condensed Consolidated Financial Statements). This transaction was accounted for as a discontinued operation.

We utilize many financial, operational, and other metrics to evaluate our financial condition and financial performance. Below we highlight the metrics for the second quarter of fiscal 2016 that we feel are most important in these evaluations:

Revenue was $50.2 Million. Our revenue decreased $0.2 million, or 0.5%, compared to $50.4 million for the second quarter of fiscal 2015. This decrease was driven by a decline in service revenue of $0.8 million, or 37.6%. Product revenue performance increased by $0.6 million, or 1.3%, primarily due to an increase in embedded and network product categories that was partially offset by a decrease in revenue from RF and cellular products. Revenue was unfavorably impacted by $0.1 million due to the weakening of the Euro and British Pound compared to the U.S.

Dollar.

Gross Margin was 49.3%. Our gross margin increased as a percentage of revenue to 49.3% in the second quarter of fiscal 2016 as compared to 46.1% in the second quarter of fiscal 2015. The increase in gross margin was due primarily to strong revenue performance in our embedded products, as well as increased revenue from legacy products included in our network category which both are traditionally higher margin products. We also realized manufacturing cost reductions associated with our cellular products.

Table of Contents

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

Net income for the second fiscal quarter of 2016 was $2.1 million, or $0.08 per diluted share. Net income for the second fiscal quarter of 2015 was $1.4 million, or $0.06 per diluted share. Income from continuing operations for the second fiscal quarter of 2016 was $2.2 million, or $0.09 per diluted share, compared to $1.7 million, or $0.07 per diluted share, in the prior year comparable quarter. Loss from discontinued operations was $0.1 million, or $0.00 loss per diluted share, in the second fiscal quarter of 2016, compared to a loss of $0.2 million, or $0.01 loss per diluted share, for the prior year comparable quarter.

Adjusted EBITDA from Continuing Operations for the second fiscal quarter of 2016 was $4.6 Million, or 9.1% of total revenue. In the second fiscal quarter of fiscal 2015, Adjusted EBITDA from Continuing Operations was $3.0 million, or 5.9% of total revenue.

Below is a reconciliation of Income from Continuing Operations to Adjusted EBITDA from Continuing Operations (in thousands):

	Three months ended March 31,			
	2016		2015	
		% of total revenue		% of total revenue
Total revenue	$50,162	100.0%	$50,401	100.0%
Income from continuing operations	$2,226		$1,662	
Recovery of insurance proceeds	—		(989)	
Interest income, net	(12)		(54)	
Income tax provision	1,155		1,035	
Depreciation and amortization	1,214		1,332	
Adjusted EBITDA from continuing operations	$4,583	9.1%	$2,986	5.9%

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 March 31,				% incr.	Six months ended March 31,				% incr.
	2016		2015		(decr.)	2016		2015		(decr.)
Revenue:										
Hardware product	$48,732	97.1%	$48,108	95.5%	1.3	$96,979	96.6%	$93,041	95.3%	4.2
Service	1,430	2.9	2,293	4.5	(37.6)	3,442	3.4	4,578	4.7	(24.8)
Total revenue	50,162	100.0	50,401	100.0	(0.5)	100,421	100.0	97,619	100.0	2.9
Cost of sales:										
Cost of hardware product	24,283	48.4	25,498	50.6	(4.8)	48,993	48.8	48,610	49.8	0.8
Cost of service	1,137	2.3	1,668	3.2	(31.8)	2,329	2.3	3,217	3.3	(27.6)
Total cost of sales	25,420	50.7	27,166	53.9	(6.4)	51,322	51.1	51,827	53.1	(1.0)
Gross profit	24,742	49.3	23,235	46.1	6.5	49,099	48.9	45,792	46.9	7.2
Operating expenses	21,089	42.0	21,916	43.5	(3.8)	42,157	42.0	44,009	45.1	(4.2)
Operating income	3,653	7.3	1,319	2.7	177.0	6,942	6.9	1,783	1.8	289.3

Other (expense) income, net	(272)	(0.6)	1,378	2.7	(119.7)	(49)	—	1,804	1.8	(102.7)
Income from continuing operations, before income taxes	3,381	6.7	2,697	5.5	25.4	6,893	6.9	3,587	3.7	92.2
Income tax provision	1,155	2.3	1,035	2.1	11.6	1,536	1.5	907	0.9	69.3
Income from continuing operations	2,226	4.4 %	1,662	3.3 %	33.9	5,357	5.4	2,680	2.7	99.9
(Loss) income from discontinued operations, after income taxes	(89)	(0.1)	(216)	(0.4)	(58.8)	3,230	3.2	(1,573)	(1.6)	(305.3)
Net income	$2,137	4.3 %	$1,446	2.9 %	47.8	$8,587	8.6 %	$1,107	1.1 %	675.7

Table of Contents

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

REVENUE

Overview

Total revenue was $50.2 million for the second quarter of fiscal 2016 compared to $50.4 million for the second quarter of fiscal 2015, a decrease of $0.2 million or 0.5%. Service revenue decreased $0.8 million, or 37.6%, partially offset by an increase in product revenue of $0.6 million or 1.3%.

Total revenue was $100.4 million for the six months ended March 31, 2016, an increase of $2.8 million or 2.9%, compared to $97.6 million for the same period in the prior fiscal year. Product revenue increased $3.9 million or 4.2%, partially offset by a decline in service revenue of $1.1 million or 24.8%.

No significant changes were made to our pricing strategy that impacted revenue during the six months ended March 31, 2016 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 and services.

Hardware Products

Beginning in the first quarter of fiscal 2016, we transitioned away from reporting revenue in terms of growth and mature hardware products and now report four product categories: Cellular routers and gateways, RF, Embedded and Network. We believe this is a more meaningful presentation and reflects how we are monitoring our revenue.

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.

	Three months ended March 31,					% incr.	Six months ended March 31,					% incr.
($ in thousands)	2016		2015			(decr.)	2016		2015			(decr.)
Cellular routers and gateways	$12,910	26.5 %	$14,859	30.9 %		(13.1)	$25,070	25.8 %	$28,559	30.7 %		(12.2)
RF	7,879	16.2	10,027	20.8		(21.4)	17,065	17.6	17,174	18.5		(0.6)
Embedded	13,795	28.3	11,977	24.9		15.2	26,923	27.8	23,204	24.9		16.0
Network	14,148	29.0	11,245	23.4		25.8	27,921	28.8	24,104	25.9		15.8
Total product revenue	$48,732	100.0%	$48,108	100.0%		1.3	$96,979	100.0%	$93,041	100.0%		4.2

Cellular router and gateway revenue decreased $2.0 million and $3.5 million, or 13.1% and 12.2%, for the three and six months ended March 31, 2016, respectively, compared to same periods a year ago. The decreases were primarily due to large customer projects completed in fiscal 2015, primarily in Europe, Middle East and Africa ("EMEA") and Latin America that were not replaced in fiscal 2016. This was partially offset by an increase in new project business in North America in the second quarter of fiscal 2016. The cellular router and gateway revenue is driven by large customer projects that may not carry into future periods and may result in revenue fluctuations from quarter to quarter.

RF products revenue decreased $2.1 million, or 21.4%, for the three months ended March 31, 2016, compared to the same period in the prior fiscal year. Revenue in the second quarter of fiscal 2015 benefited from orders that were delayed from the first fiscal quarter of 2015 due to the fire at our subcontract manufacturer's location. RF product revenue decreased by $0.1 million, or 0.6%, for the six months ended March 31, 2016 as compared to the same period in the prior fiscal year. This decrease was due to lower sales in the North American region, partially offset by a large customer project in our Latin American region in the first quarter of fiscal 2016.

Embedded product revenue increased $1.8 million and $3.7 million, or 15.2% and 16.0%, for the three and six months ended March 31, 2016, respectively, compared to the same periods a year ago. The increases were primarily due to higher sales of our embedded modules in North America and EMEA as significant customers have begun moving to production of their products that use our modules.

Network products revenue increased by $2.9 million and $3.8 million, or 25.8% and 15.8%, for the three and six months ended March 31, 2016, respectively, compared to the same periods a year ago. The increases were primarily due to large terminal server sales to significant customers, which we expect to decrease later in this fiscal year. Most of our network products are in

Table of Contents

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

the mature phase of their product life cycle. We expect that revenue from these products will generally decrease in the future, however revenue may fluctuate from quarter to quarter due to the timing of specific customer purchases.

Services

Our service offerings include Digi Cold Chain Solutions, wireless design services, revenue generated from the Digi Device Cloud platform and enterprise support services. Revenue from our service offerings was $1.4 million and $2.3 million for the three months ended March 31, 2016 and 2015, respectively, a decrease of $0.8 million, or 37.6%. Service offering revenue was $3.4 million an $4.6 million for the six months ended March 31, 2016 and 2015, respectively, a decrease of $1.2 million, or 24.8%. The decrease in services revenue was driven primarily in wireless design services, partially offset by revenue from Digi Cold Chain Solutions which was acquired during the first quarter of fiscal 2016. Historically revenue from our service offerings have fluctuated from quarter to quarter and we expect that trend to continue.

Revenue by Geographic Location

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

	Three months ended March 31,		$ incr.	% incr.	Six months ended March 31,		$ incr.	% incr.
($ in thousands)	2016	2015	(decr.)	(decr.)	2016	2015	(decr.)	(decr.)
North America, primarily United States	$33,332	$29,638	3,694	12.5	$63,900	$58,846	5,054	8.6
Europe, Middle East & Africa	10,965	12,383	(1,418)	(11.5)	21,982	23,614	(1,632)	(6.9)
Asia	5,025	5,714	(689)	(12.1)	10,149	11,117	(968)	(8.7)
Latin America	840	2,666	(1,826)	(68.5)	4,390	4,042	348	8.6
Total revenue	$50,162	$50,401	(239)	(0.5)	$100,421	$97,619	2,802	2.9

Revenue in North America increased by $3.7 million and $5.1 million, or 12.5% and 8.6%, for the three and six months ended March 31, 2016, respectively, compared to the same periods a year ago. The increases for both comparable periods was a result of higher sales in network, cellular and embedded products, partially offset by a decrease in RF products and service revenue.

Revenue in EMEA decreased by $1.4 million and $1.6 million, or 11.5% and 6.9%, for the three and six months ended March 31, 2016, respectively, compared to the same periods a year ago. The decreases were primarily driven by an unfavorable impact on total revenue of $0.1 million and $0.8 million for the three and six months ended March 31, 2016, respectively, compared to the same period a year ago, due to the weakening of the Euro and British pound compared to the U.S. Dollar (see Foreign Currency Risk in Part I, Item 3, of this Form 10-Q).

Revenue in Asia decreased by $0.7 million and $1.0 million, or 12.1% and 8.7%, for the three and six months ended March 31, 2016, respectively, compared to the same periods a year ago. Revenue decreases for both comparable periods were primarily due to decreased volume of network products.

Revenue in Latin America decreased by $1.8 million, or 68.5%, for the three months ended March 31, 2016, compared to the same period a year ago. The decrease was primarily related to completion of a large cellular project in the prior fiscal year. Latin America revenue increased $0.3 million, or 8.6%, for the six months ended March 31, 2016, compared to the same period a year ago, primarily due to a large RF project in the first quarter of fiscal 2016, partially offset by a decline in cellular products revenue.

GROSS PROFIT

Gross profit for the three months ended March 31, 2016 and 2015 was $24.7 million and $23.2 million, respectively, an increase of $1.5 million, or 6.5%. Gross profit for the six months ended March 31, 2016 and 2015 was $49.1 million and $45.8 million, respectively, an increase of $3.3 million, or 7.2%.

Hardware product gross profit was $24.4 million, or 50.2%, and $22.6 million, or 47.0%, for the three months ended March 31, 2016 and 2015, respectively. Hardware product gross profit was $48.0 million, or 49.5%, and $44.4 million, or 47.8%, for the six months ended March 31, 2016 and 2015, respectively. The increase in both the quarter and year-to-date periods was due primarily to strong revenue performance in our embedded modules, as well as increased revenue from legacy products included in our network category which are traditionally higher margin

products. We also realized manufacturing cost reductions associated with our cellular products.

Table of Contents

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

Service gross profit was $0.3 million, or 20.5%, and $0.6 million, or 27.3% for the three months ended March 31, 2016 and 2015, respectively. Service gross profit was $1.1 million, or 32.3%, and $1.4 million, or 29.7% for the six months ended March 31, 2016 and 2015, respectively. The decreases in the three-month and six-month comparable periods primarily were a result of amortization costs for purchased and core technology associated with our Cold Chain Solutions acquisition in the first quarter of fiscal 2016.

Historically, our service gross profit varies from quarter to quarter, and we expect that trend to continue for the foreseeable future as our wireless product design and development service margins are dependent on the utilization rates of our personnel.

OPERATING EXPENSES

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

	Three months ended March 31,				$ incr.	Six months ended March 31,				$ incr.
($ in thousands)	2016		2015		(decr.)	2016		2015		(decr.)
Sales and marketing	$8,165	16.3%	$9,875	19.6%	$(1,710)	$16,683	16.6%	$20,110	20.6%	$(3,427)
Research and development	7,757	15.5%	7,280	14.5%	477	15,595	15.5%	14,363	14.7%	1,232
General and administrative	5,065	10.0%	4,349	8.6 %	716	9,126	9.1 %	9,124	9.4 %	2
Restructuring	102	0.2 %	412	0.8 %	(310)	753	0.8 %	412	0.4 %	341
Total operating expenses	$21,089	42.0%	$21,916	43.5%	$(827)	$42,157	42.0%	$44,009	45.1%	$(1,852)

Sales and marketing expenses decreased $1.7 million and $3.4 million for the three and six months ended March 31, 2016, respectively, compared to the same period a year ago. The decreases in both comparable periods was mostly related to a decrease in compensation-related expenses as a result of reduced headcount. We also had a decrease in travel and entertainment expenses and marketing expenses.

Research and development expenses increased $0.5 million and $1.2 million for the three and six months ended March 31, 2016, respectively, compared to the same period a year ago, primarily due to compensation-related expenses related to an increase in the number of U.S. based engineers and development and certification expenses.

General and administrative expenses increased $0.7 million for the three months ended March 31, 2016, compared to the same period a year ago. The increase was related to professional fees, partially offset by a decrease in compensation-related expenses. General and administrative expenses remained at $9.1 million for the six months ended March 31, 2016 compared to the same period a year ago. Professional fees increased as compared to the six months ended March 31, 2015, offset by a decrease in compensation-related expenses as we incurred CEO transition expenses in fiscal 2015.

Restructuring expense was $0.1 million and $0.8 million for the three and six months ended March 31, 2016, respectively, pertaining to our corporate staff and related employee termination costs associated with the merging of our Dortmund, Germany office into our Munich, Germany office and contract termination charges associated with the consolidation of our Minneapolis office into our Minnetonka headquarters (see Note 13 to our Condensed Consolidated Financial Statements). Restructuring expense was $0.4 million for both the three and six months ended March 31, 2015, respectively, relating to our India operations.

OTHER (EXPENSE) INCOME, NET

We recorded a decrease in other income of $1.6 million for the three months ended March 31, 2016, compared to the same period a year ago. During the second quarter of fiscal 2015 we recorded $1.0 million in insurance proceeds relating to the replacement of our capital equipment destroyed in the fire at our subcontract manufacturer's location. We also recorded a $0.6 million decrease related to foreign currency losses as the U.S. Dollar weakened against primarily the Euro and Yen. Other (expense) income, net decreased $1.9 million for the six months ended March 31, 2016, compared to the same period a year ago primarily as a result of $1.0 million in the aforementioned insurance proceeds recorded in the prior fiscal year and a $0.9 million decrease related to foreign currency losses as the U.S. Dollar weakened against primarily the Euro and Yen.

Table of Contents

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

INCOME TAXES

Income tax provision for continuing operations was $1.5 million for the six months ended March 31, 2016. Net tax benefits specific to the six months ended March 31, 2016 were $0.7 million resulting from the reinstatement of the federal research and development tax credit for calendar year 2015 and reversal of tax reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions. For the six months ended March 31, 2016, our continuing operations effective tax rate before items specific to the period was less than the U.S. statutory rate due primarily in the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and certain tax credits in the U.S.

Income tax provision for continuing operations was $0.9 million for the six months ended March 31, 2015. Net tax benefits specific to the period of $0.5 million included a reversal of reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions and the reinstatement of the federal research and development tax credit for calendar year 2014. For the six months ended March 31, 2015, our continuing operations effective tax rate before items specific to the period was more than the statutory rate primarily due to a mix of income between foreign jurisdictions, an adjustment for certain foreign income taxed at the U.S. rate, and lower than expected benefits associated with certain state tax credits.

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 specific 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.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations and capital expenditures principally with funds generated from operations. At March 31, 2016, cash, cash equivalents and short-term marketable securities were $115.4 million compared to $92.2 million at September 30, 2015. At March 31, 2016, our cash, cash equivalents and marketable securities, including long-term marketable securities, were $122.7 million.

Our working capital (total current assets less total current liabilities) was $156.3 million at March 31, 2016. At September 30, 2015, our working capital was $137.0 million, which included $3.2 million of working capital related to current deferred taxes. As a result of adopting ASU 2015-17 prospectively in the first quarter of fiscal 2016, all deferred tax assets and liabilities are classified on a jurisdictional basis as non-current in our condensed consolidated balance sheets, which is a change from our historical presentation whereby certain of our deferred tax assets and liabilities were classified as current and the remainder was classified as non-current. We presently anticipate total fiscal 2016 capital expenditures will be approximately $4.8 million, of which we spent $1.2 million.

Net cash provided by operating activities was $11.5 million and $1.6 million for the six months ended March 31, 2016 and 2015, respectively, a net increase of $9.9 million, resulting from changes in working capital of $6.0 million, partially offset by an increase in net income after adjustments for non-cash items of $3.9 million. The increase in cash provided by operating assets and liabilities of $6.0 million was primarily driven by a $8.5 million increase related to inventory reduction and a $3.4 million decrease in accrued liabilities for compensation accruals. Included in operating cash flows for the six months ended March 31, 2015 was $0.8 million of net cash outflows related to Etherios. We expect that the disposition of Etherios will have a positive impact on our operating cash flow in future periods.

Net cash provided by investing activities was $4.2 million during the six months ended March 31, 2016 compared to net cash used by investing activities of $4.3 million during the six months ended March 31, 2015, a net increase in cash flows of $8.5 million. The increase in cash flows is related to additional maturities of $7.8 million for marketable securities, proceeds from the sale of Etherios of $2.8 million, and $1.8 million less capital expenditures during the first six months of fiscal 2016 compared to the prior year comparable period. This was partially offset by cash used for the acquisition of Bluenica of $2.9 million and proceeds from an insurance settlement in fiscal 2015 of $1.0 million.

Net cash provided by financing activities was $6.5 million and $4.2 million during the six months ended March 31, 2016 and 2015, respectively, a net increase of $2.3 million. During the first six months of fiscal 2016, we had $0.5

million more proceeds from stock option plan and employee stock purchase plan transactions compared to the same period a year ago and $1.8 million fewer purchases of common stock.

Table of Contents

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

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

Recently Issued Accounting Pronouncements

Not Yet Adopted

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting". This update includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2016, which for us is the first fiscal quarter ending December 31, 2017. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-09 on our consolidated financial statements.

In March 2016, FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606)". This update clarifies implementation guidance on principal-versus-agent considerations, including how an entity determines whether it is a principal or an agent for each specified good or service promised to the customer and how an entity determines the nature of each specified good or service. In addition, ASU 2016-08 updates the indicators in ASC 606-10-55-39 and revises the existing examples in ASC 606 to better illustrate the application of the principal-versus-agent guidance. This ASU is effective at the same time as those in ASU 2014-09 (as amended by ASU 2015-14), which for us is for our fiscal 2019, including interim periods within that reporting period. We are currently assessing the potential impact of adopting this ASU on our consolidated financial statements and related disclosures.

In February, 2016, FASB issued ASU 2016-02, "Leases (Topic 842)", which amends the existing guidance to require lessees to recognize lease assets and lease liabilities from operating leases on the balance sheet. This ASU is effective using the modified retrospective approach for annual periods and interim periods within those annual periods beginning after December 15, 2018, which for us is the first fiscal quarter ending December 31, 2019. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 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 will require equity investments in unconsolidated entities (other than those 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 will also simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, eliminate the requirement for public business entities to disclose the method and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet and require these entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. This ASU would also change the presentation and disclosure requirements for financial instruments. In addition, this ASU clarifies 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 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, which for us is the first fiscal quarter ending December 31, 2018. Early adoption is permitted for financial statements of fiscal years and interim periods that have not been issued. We are currently evaluating the impact of the adoption of ASU 2016-01.

In July 2015, FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." This provision would require inventory that was previously recorded using first-in, first-out (FIFO) to be recorded at lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within those years, which for us will be the first fiscal quarter ending December 31,

2017. The amendments in this guidance should be applied prospectively with earlier application permitted as of the beginning of an interim or annual period. We are currently evaluating the impact of the adoption of ASU 2015-11 and whether it would have a material impact on our consolidated financial statements.

In April 2015, FASB issued ASU 2015-05, “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40) - Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.” The new standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If the arrangement does include a software license,

Table of Contents

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

the software license element of the arrangement should be accounted for in the same manner as the acquisition of other software licenses. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, with early adoption permitted. We expect to adopt this guidance beginning with our fiscal quarter ending December 31, 2016. We do not expect this guidance to have a material impact on our consolidated financial statements.

In August 2014, FASB issued ASU 2014-15, "Presentation of Financial Statements - Going Concern." This guidance requires management to evaluate whether there is substantial doubt about a company's ability to continue as a going concern and to provide related footnote disclosures. These amendments are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, which for us, will be our annual period ended September 30, 2017. Early adoption is permitted. While we are evaluating the impact of the adoption of ASU 2014-15, we do not expect it to have an impact on our consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This guidance provides a five-step analysis in determining when and how revenue is recognized so that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods and services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14 "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" which approved a one-year deferral of the effective date of ASU 2014-09. As a result of this deferral, ASU 2014-09 is effective for our fiscal 2019, including interim periods within that reporting period. The FASB also agreed to allow us to choose to adopt the standard effective for our fiscal 2018. We will adopt the guidance beginning October 1, 2018 and are currently assessing the potential impact of adopting this ASU on our consolidated financial statements and related disclosures.

Table of Contents

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 have not implemented a formal hedging strategy to reduce foreign currency risk as we continue to mitigate this risk with natural hedging strategies such as mitigating our net asset position in non-functional currencies.

For the six months ended March 31, 2016 and 2015, we had approximately $36.5 million and $38.8 million, respectively, of revenue from foreign customers including export sales. Of these sales, $11.2 million and $11.1 million, respectively, were denominated in foreign currency, predominantly Euros and British Pounds. In future periods, we expect a significant portion of sales will continue to be made in both Euros and British Pounds.

Total revenue was unfavorably impacted by foreign currency translation of $0.1 million and $0.8 million for the three and six months ended March 31, 2016, respectively, as compared to the same period 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:

	Six months ended March 31,		% increase
	2016	2015	(decrease)
Euro	1.0991	1.1910	(7.7)%
British Pound	1.4757	1.5514	(4.9)%
Japanese Yen	0.0085	0.0086	(1.2)%
Canadian Dollar	0.7384	NA	NA

A 10% change from the first six months of fiscal 2016 average exchange rate for the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar would have resulted in a 1.1% increase or decrease in revenue and a 2.3% increase or decrease in stockholders' equity due to foreign currency translation. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

CREDIT RISK

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

Investments are made in accordance with our investment policy and consist of 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.

Table of Contents

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 the Company's internal control over financial reporting during the quarterly period ended March 31, 2016 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 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 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, 2015.

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

On April 26, 2016, our Board of Directors authorized a new program to repurchase up to $15.0 million of our common stock primarily to return capital to shareholders. This new repurchase authorization expires on May 1, 2017. Shares repurchased under the new program may be made through open market and privately negotiated transactions from time to time and in amounts that management deems appropriate. The amount and timing of share repurchases will depend upon market conditions and other corporate considerations.

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 second quarter of fiscal 2016:

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
January 1, 2016 - January 31, 2016	9,524	$10.4754	—	$0.00
February 1, 2016 - February 29, 2016	—	—	—	$0.00

March 1, 2016 - March 31, 2016	—	—	—	$0.00
Total	9,524	$10.4754	–	$0.00

(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

Table of Contents

ITEM 4. MINE SAFETY DISCLOSURES

None

ITEM 5. OTHER INFORMATION

None

Table of Contents

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 effective December 17, 2014 (2)
4	(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (3)
4	(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (4)
10	(a)	Digi International Inc. 2016 Omnibus Incentive Plan (5)*
10	(a)(i)	Form of (Director) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)*
10	(a)(ii)	Form of (Executive) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)*
10	(a)(iii)	Form of (Employee) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)*
10	(a)(iv)	Form of Notice of Grant of Stock Options and Option Agreement (for grants under Digi International Inc. 2016 Omnibus Incentive Plan)*
31	(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31	(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32		Section 1350 Certification
101.INS		XBRL Instance Document
101.SCH		XBRL Taxonomy Extension Schema Document
101.CAL		XBRL Taxonomy Calculation Linkbase Document
101.DEF		XBRL Taxonomy Definition Linkbase Document
101.LAB		XBRL Taxonomy Label Linkbase Document
101.PRE		XBRL Taxonomy Presentation Linkbase Document

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

Table of Contents

(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 3.2 to the Company's Current Report on Form 8-K filed December 5, 2014 (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)

(5) Incorporated by reference to Appendix A to the Company's definitive proxy statement on Schedule 14A filed December 11, 2015 (File No. 1-34033)

Table of Contents

SIGNATURE

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

	DIGI INTERNATIONAL INC.	
Date: May 3, 2016	By:	/s/ Michael C. Goergen Michael C. Goergen Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer and Authorized Officer)

Table of Contents

Exhibit Number		Document Description	Form of Filing
2		Stock Purchase Agreement dated as of October 23, 2015	Incorporated by Reference
3	(a)	Restated Certificate of Incorporation of the Company, as Amended	Incorporated by Reference
3	(b)	Amended and Restated By-Laws effective December 17, 2014	Incorporated by Reference
4	(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent	Incorporated by Reference
4	(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares	Incorporated by Reference
10	(a)	Digi International Inc. 2016 Omnibus Incentive Plan	Incorporated by Reference
10	(a)(i)	Form of (Director) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)	Filed Electronically
10	(a)(ii)	Form of (Executive) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)	Filed Electronically
10	(a)(iii)	Form of (Employee) Restricted Stock Unit Award Agreement (for awards under Digi International Inc. 2016 Omnibus Incentive Plan)	Filed Electronically
10	(a)(iv)	Form of Notice of Grant of Stock Options and Option Agreement (for grants under Digi International Inc. 2016 Omnibus Incentive Plan)	Filed Electronically
31	(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31	(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32		Section 1350 Certification	Filed Electronically
101.INS		XBRL Instance Document	Filed Electronically
101.SCH		XBRL Taxonomy Extension Schema Document	Filed Electronically
101.CAL		XBRL Taxonomy Calculation Linkbase Document	Filed Electronically
101.DEF		XBRL Taxonomy Definition Linkbase Document	Filed Electronically
101.LAB		XBRL Taxonomy Label Linkbase Document	Filed Electronically

101.PRE	XBRL Taxonomy Presentation Linkbase Document	Filed Electronically

38