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Server-based remote access

is a vital dimension of remote

DIGI INTERNATIONAL INC.

access...For total server-based

ports, Digi is the market leader

1 9 9 7 a n n u a l r e p o r t

with a 46.3 percent share.

”

**CORPORATE PROFILE** Digi International is a leading ISO 9001-compliant provider of data communications hardware and software that delivers seamless connectivity solutions for multiuser environments, remote access and LAN markets. The Company markets its products through an international network of distributors and resellers, system integrators and original equipment manufacturers (OEMs). The two major product areas include: 1) communications interface cards for multiuser and remote access environments, and 2) “physical layer” and print server products that enhance the data communications capabilities of a LAN.



#### SERVER BASED

Key differentiators of the Company's communications interface cards include: 1) its embedded high-performance operating system software (firmware), and 2) the device driver software component which is optimized to work with a variety of industry-standard operating systems and allows the operating system (OS) to communicate efficiently and reliably with peripheral devices.

The Company's communications interface cards provide asynchronous (transmitting single characters at a time) and synchronous (transmitting characters in a group) data transmissions for analog modems, ISDN (Integrated Services Digital Network), X.25, Frame Relay or T1/E1 connections.

#### PHYSICAL LAYER

MiLAN Technology Division provides cost-effective and power-efficient Ethernet, Fast Ethernet and Token Ring networking connectivity products that are installed on a LAN to increase its productivity. MiLAN products are recognized for their price/performance, reliability, robust features and superior technical support.

The physical layer line includes products that allow users to easily build and expand networks using single and multiport transceivers, converters, modular microhubs and modular repeaters, as well as the first comprehensive family of physical layer connectivity solutions for Fast Ethernet. Print server products, based on the FastPort line, make print sharing convenient and affordable. The FastPort line includes the industry's first multiprotocol network print server providing access to any printer on an Ethernet or Token Ring network without the inconvenience and expense of spooling through a workstation or server.

Digi is a key ingredient in the combination of open operating systems and high-performance PCs which provide server-based remote access. Industry leaders, such as Microsoft, Novell, Compaq, Hewlett-Packard, IBM and Sun Microsystems, are helping to drive this trend.

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## FINANCIAL HIGHLIGHTS

	1997	1996	1995	1994	1993
NET SALES	\$ 165,598	\$ 193,151	\$ 164,978	\$ 130,945	\$ 93,385
RESTRUCTURING	10,472				
AETHERWORKS CORPORATION NET LOSS	(5,764)	(3,624)			
AETHERWORKS CORPORATION WRITE OFF	(5,759)				
(LOSS) INCOME BEFORE TAXES	(15,699)	16,805	29,366	25,351	22,510
NET (LOSS) INCOME	(15,791)	9,300	19,331	16,701	14,905
(LOSS) INCOME PER SHARE	(1.18)	.69	1.38	1.15	1.03
WEIGHTED AVERAGE SHARES OUTSTANDING	13,393	13,523	14,048	14,511	14,564
WORKING CAPITAL	\$ 61,979	\$ 69,696	\$ 74,061	\$ 72,671	\$ 69,648
TOTAL ASSETS	118,311	129,939	126,043	102,758	88,859
STOCKHOLDERS' EQUITY	95,471	109,943	105,827	91,113	80,467
BOOK VALUE PER SHARE	7.13	8.13	7.82	6.64	5.68
RETURN ON SALES	(9.5)%	4.8%	11.7%	12.8%	16.0%
NUMBER OF EMPLOYEES	481	698	605	430	333

(In thousands except per share amounts, percentages and number of employees)

## SELECTED FINANCIAL INFORMATION

	1997	1996	1995	1994	1993
NET SALES	\$ 165,598	\$ 193,151	\$ 164,978	\$ 130,945	\$ 93,385
% CHANGE	(14.3)%	17.0%	26.0%	40.0%	32.0%
NET (LOSS) INCOME	(15,791)	9,300	19,331	16,701	14,905
% CHANGE	(269)%	(52)%	16%	12%	19%
(LOSS) INCOME PER SHARE	(1.18)	.69	1.38	1.15	1.03
% CHANGE	(271)%	(50)%	20%	12%	18%
TOTAL ASSETS	118,311	129,939	126,043	102,758	88,859
% CHANGE	(8)%	3%	23%	16%	27%
STOCKHOLDERS' EQUITY	95,471	109,943	105,827	91,113	80,467
% CHANGE	(13)%	4%	16%	13%	26%

TO THE STOCKHOLDERS OF DIGI INTERNATIONAL INC.

We began 1997 with a clear objective in mind: to return to consistent profitability. This required that we reexamine our mission, refocus our products, restructure our organization and then execute to a plan.

In earlier communications, we have referred to Digi's multiple actions as "work in progress." I'm happy to report that these actions are beginning to positively affect the profitability of the Company and, in turn, stockholder value.

**REFOCUS**

Digi International is a communications company. There are many subsets and opportunities within that wide field of possibilities. Digi's strengths lie in our understanding of various communications protocols, operating systems, PC architectures and applications for high bandwidth data traffic. Digi is both a



**JERRY A. DUSA**

PRESIDENT AND CHIEF EXECUTIVE OFFICER

hardware and a software company with our ultimate competitiveness derived from our knowledge and implementation of software which produces high performance data streams at very little taxation of CPU capabilities. These skills and knowledge provide a very attractive foundation for the creation of a long-term strategy in a market that has great profit potential.

The subset of the networking industry where Digi is refocusing and currently commands important market share is

open systems, server-based communications for remote access — a market that is being fueled by the growth of intranets and the Internet.

Digi is the beneficiary of significant momentum occurring in the remote access market. Adopting an open systems, server-based communications strategy for remote access does not require that Digi wait for

new industry standards to be set, for new technology to be developed, for new wiring structures to be installed or for new partnerships to occur.

While gaining momentum, it is a market in which Digi has already developed products and partnered for several years with open operating system companies like Microsoft and Novell and server-platform companies such as Acer, Compaq, Hewlett-Packard, IBM, Micron and Sun Microsystems. According to International Data Corporation (IDC), a market research firm, Digi is a key component in the trend under way in which the operating system and PC provide server-based remote access. We are already capitalizing on opportunities in this evolving market.

While our focus on server-based communications positions us for the future in the remote access market, we are encouraged by the strength of the multiuser, UNIX-based systems business, which has been our core market, and the solid growth experienced by our MiLAN Technology Division, which provides physical layer and print server products for LANs. These historical markets continue to provide Digi's customers —VARs, systems integrators and OEMs — with a wide range of LAN and WAN products to support their data communications requirements.

## RESTRUCTURE

We took restructuring actions and a \$10.5 million charge in Digi's second fiscal quarter as we refined this strategy to reinvigorate the Company. We consolidated our North American locations in Minneapolis, Minn., and Sunnyvale, Calif., and combined overall research and development and manufacturing at these sites. At the same time, we added sales offices in London and Paris to expand our focus in Europe. In addition, we decentralized marketing activities and technical support into our three geographic regions: North America, Europe and Latin America/Pacific Rim. This allows us to be more focused on individual region requirements and more timely in responding to customers.

The Company divested non-strategic product lines and reduced our workforce by approximately 33 percent to 481 employees by fiscal year end, through a combination of workforce reductions and normal attrition. Layoffs are always difficult, but we recognized that our cost structure was too

high. Our current employee base is ably performing the Company's critical functions as we go forward.

Digi management intentionally made efforts to reduce inventory levels in our distribution channel throughout the fiscal year. The Company has continued this effort during the first quarter of fiscal 1998, which ends December 31, 1997. This will reduce our dependence on rebates and other incentives in the distribution channel and ultimately result in a positive impact on gross margins. Channel reduction efforts so far have been successful and have occurred as planned.

Digi is also making a major investment to upgrade its management information system. This will provide comprehensive reporting systems, greater internal visibility and increased ability to forecast. An ongoing effort during this past year, we expect the system to be on line in early calendar year 1998. We are also upgrading our customer support systems to continue to be highly responsive to our customers.

## EXECUTE

We believe that sequential monthly and quarterly trends, more than anything, reflect our commitment to execute to the plan. We are pleased to report that these trends have significantly improved.

For the three months ended September 30, operating income increased 46 percent to \$4.6 million from \$3.2 million in the year-ago period. For the same period, operating expenses declined 30 percent to \$16.4 million from \$23.3 million in the year-ago period. Digi's cash position, at September 30, 1997, improved over 250 percent to \$31.3 million from \$8.9 million one year ago. Accounts receivable at September 30, 1997, were \$25.6 million, down 40 percent from \$42.9 million in the year-ago period, and inventory levels were \$23.7 million, a 29 percent decrease from \$33.4 million last year.

Digi still has no debt.

## AETHERWORKS

One final action allows us to refocus more closely on our new strategy. Digi continued to monitor its investment in AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology. During the fiscal fourth quarter, the

Company concluded that the most appropriate action was to write off its remaining investment in AetherWorks and to accrue all the remaining future obligations to AetherWorks. This decision was the result of the significant uncertainty regarding the future of AetherWorks as demonstrated by their inability to generate positive cash flow or obtain other sources of equity financing. The write off of the AetherWorks investment is reflected in Digi's fiscal fourth quarter and year-end results.

#### PRODUCT DIRECTION

Clearly, our goal in fiscal 1998 will be to grow the top line as we continue to manage the bottom line. We are poised to do that with a product road map that is both historically consistent and aggressively positioned to take advantage of our market leadership in server-based communications for remote access. Our goals for this product direction are straightforward:

- To be consistently seen as a state-of-the-art provider of data communications products,
- Continue to differentiate via software,
- Optimize large scale integration as a cost-reduction technique,
- Offer enhancements, improvements and additional added-value features, and
- Focus on popular technologies, operating systems and PC architectures.

#### MANAGEMENT

Dino G. Kasdagly recently joined Digi as senior vice president of development after 17 years at IBM. In his new role, he is responsible for guiding the Company's engineering and product development efforts. Dino joins Jon Killmer, senior vice president, chief financial officer and treasurer, Doug Glader, senior vice president, manufacturing operations, and others on the executive management team. They, along with all of our valued employees, are making significant strides in reshaping the new Digi. We are gratified by our progress to date.

#### FINAL THOUGHTS

It is incumbent upon the whole team to continue to execute to the plan we have established. Stockholders can be confident that dependable performance and enhanced stockholder value are overriding goals in fiscal 1998.

In the remaining sections of this annual report, we review our operating and financial performance, and we also describe the server-based remote access market, the momentum that we see emerging, the view of industry analysts and our position in this market. I encourage you to review the sections carefully so you have a better picture of the new Digi that is emerging.



JERRY A. DUSA

PRESIDENT AND CHIEF EXECUTIVE OFFICER

DECEMBER 12, 1997



Q

WHAT TRENDS ARE OCCURRING IN THE  
COMPUTER INDUSTRY THAT ARE AFFECTING DIGI?

A

Communications is now at the core of business computing. That is a major shift. As part of this shift, the most important trend to affect Digi is the emergence of server-based remote access as a viable and significant market.

The trend is being driven primarily by Microsoft and Novell, and by PC platform vendors, such as Compaq, IBM, HP and Sun, who all see the opportunity for using the PC as a communications device, not just a computing device. That opens up new markets for them and for Digi.

Server-based remote access, which is a subset of the general remote access market, connects telecommuters, mobile workers and branch offices to corporate LANs, or branch offices to other branches or makes the connections to the Internet.

Electronic mail, file transfer, database access, network management and administration, workgroup applications and order entry are among the most important applications for remote access as well as corporate Internet and Web server access.

Server-based remote access products compete with stand-alone remote access solutions on the basis of price, server-platform compatibility and the potential to offer greater operating system integration.

Communications is now at the core of business computing.

Q

HOW BIG IS THIS SERVER-BASED REMOTE ACCESS MARKET  
AND HOW FAST IS IT GROWING?

A

There are several ways to look at the market, based on either the number of communications ports sold (Digi's part of the server-based remote access solutions) or from an overall size, including all components. The Aberdeen Group suggests that server-based RAS ports will reach just over 27.5 million units by 2003. This represents a CAGR of 52 percent over the forecast period (1997-2003).\*

Q

WHAT ARE THE COMPONENTS OF SERVER-BASED REMOTE ACCESS SOLUTIONS?

A

The components of server-based remote access include an open (not proprietary) operating system such as Microsoft Windows NT or Novell NetWare, and its RAS (remote access server) software, such as Windows NT RAS or NetWare Connect; plus a PC-based server platform and communication interface cards.

These network servers, operating systems and adapter cards are combined to create:

- remote access servers
- routers
- World Wide Web servers
- SNA gateways

The transmission medium for remote access are POTS (Plain Old Telephone Service), digital phone service (ISDN — Integrated Services Digital Networks), Frame Relay and X.25.

Digi's component in this solution is the communications interface card (sometimes called the communications adapter). This component provides multiple communications ports and transmits the data traffic that is moving onto or off the network via dial-in/dial-out activities.

\*Reprinted by permission of the Aberdeen Group, Inc., Boston, MA.

**GREAT SUPPORT, DEPENDABLE PRODUCTS** Eagan, Minnesota-based Sovran has been a reseller of Digi products since the late 1980s. Today, the systems integrator implements a wide variety of Digi products in banking, financial, health care and other applications. “Our relationship with Digi is the big thing for us,” said Henry Rogers, Sovran president. “It goes back to our old days with UNIX. With the emergence of the World Wide Web and other technologies, the network world has gotten much more complicated. However, the Digi product line has expanded, and we can always count on great support and dependable products.”

Rogers says delivering a remote access solution requires thought, product and installation. It often involves working on home systems and laptops, in addition to integrating office systems and wide area networks. That means there is a higher level of consulting dollars in providing the service to customers.

Sovran’s ability to minimize complexity, however, is fundamental to the value they bring to customers as a systems integrator. “We use a lot of Digi products for that reason. Products that are easy to install, use, and maintain are cost savers to the customer.”

Digi’s server-based strategy fits perfectly with Sovran’s expertise in Microsoft Windows NT and Novell NetWare and its customer’s needs, according to Rogers. “The simple reality is that it’s less expensive and easier to manage. In the past, you would typically have to connect 20 or more remote PCs with separate phone lines and modems. That’s a tough environment to control and the phone line costs add up quickly. With Digi, we can use a server-based approach and cost-effectively share high-speed digital phone lines to give remote users access to the corporate network over the Internet. Plus, with Digi, I never have to worry that the product won’t be supported down the line.”

**BRAND RECOGNITION,  
COST-COMPETITIVE SOLUTIONS** As the number one Novell NetWare reseller in France, Allium is instrumental in the networking plans of many of the country's largest corporations. The company is also rapidly becoming a known Windows NT expert and, because Digi supports both NetWare and NT, in addition to UNIX, the level of business that Allium does with Digi is growing.

Allium owns a significant portion of the network server integration market in France and has more than 600 people dedicated to improving the information systems of their customers. "From this perspective," says Philippe Camps, Allium's communications product manager, "we are compelled to offer the best of breed remote access solutions and Digi provides one of the best."

"We originally worked with many different suppliers of remote access boxes," said Camps. "However, the scalability and reliability of Digi's products have led us to move toward their server-based solutions. It supports our position of strength within the server market and enables us to move into the remote access market."

Why does Allium choose to work with Digi? "In our market, Digi means quality," said Camps. "They have good brand recognition and a cost-competitive solution, and their products are complementary with the Windows NT environment where many of our customers are moving."

A server-based remote access solution can be as little as one-half the cost per communications port of a stand-alone remote access system.

Q

WHAT ARE THE ADVANTAGES OF SERVER-BASED SOLUTIONS?

A

Server-based remote access solutions leverage:

- existing PC-server platforms
- existing open system, network operating systems
- users who already know and are trained on the system
- support staff who already maintain the existing system

Q

DO SERVER-BASED SOLUTIONS GIVE USERS FREEDOM?

A

Absolutely. Users choose the components for their current needs. PC server-based platforms host the widest range of solutions. It is easy to upgrade processors, communications ports and protocols — because they are all based on open, not closed (proprietary), industry standards. Open APIs (application programming interfaces) mean freedom from dependence on a single vendor.

With server-based solutions, users can start small and scale up easily as needs change. They are flexible. Users can start with modems today and add ISDN tomorrow. Shared communications ports mean more cost-effective communications. A server-based solution allows users to consolidate functions onto fewer platforms, and tight integration with the network operating system means full value from the NOS.

And server-based solutions are extremely cost-effective. A server-based remote access solution can be as little as one-half the cost per communications port of a stand-alone remote access system.

With server-based solutions, you can start small and scale up easily as needs change. They are flexible.

Q

WHY WILL COMPUTER USERS DEMAND  
SERVER-BASED REMOTE ACCESS?

A

Look at the history of the computing industry. All computing devices start out as proprietary (closed) systems. But soon users begin to demand more. They want open systems, industry standard alternatives that are viable and cost-effective. They want more flexibility in the product. They want to mix and match and upgrade easily. They do not want to rely on a single vendor. They want the freedom that open systems bring. Server-based solutions give them these options. It happened with mainframes and operating systems and applications. And it is happening with remote access.

**FLEXIBLE, EXPANDABLE,**

**EASILY CONFIGURED** SingNet, the number one commercial Internet Service Provider (ISP) in Singapore, uses Digi Acceleport C/X boards to provide access to its share of the more than 300,000 Internet customers in the Singapore region. Singapore Telecom, a leader in the telecommunications industry, established SingNet as the first commercial ISP in Singapore in July 1994. Company directors sought to become a world-class ISP by providing customers with fast and reliable Internet access as well as a comprehensive range of value-added services. SingNet has responded to customer needs by offering increased bandwidth options, remote dial-up to Internet accounts from anywhere in the region as well as round-the-clock customer service for all of their customers.

Using Digi solutions allows SingNet's service base to grow rapidly while improving the quality and range of services they offer. Increasing Internet traffic and the demands placed upon an ISP's infrastructure by remote access often require extensive reconfiguration of modem connectivity solutions as well as the addition of modems as the number of customers and their Internet use expands. Digi's Acceleport C/X modem solutions are flexible and expandable, scaling up as traffic on the ISP grows. SingNet has expanded twice in three short years, and network managers simply installed additional boards to handle the increased demand.

Chang Wai Leong, deputy director of SingNet, said, "In the three years since SingNet began operations as Singapore's first Internet Service Provider, our customers have come to expect a high level of service combined with the rapidly expanding opportunities that the Internet affords. In order to guarantee our customers unrivaled performance and access to the Internet, SingNet uses Digi expandable solutions for remote dial-up access. Digi's C/128 is the most expandable and easily configured device we've used, and Digi's solutions scale readily as the demand for our services grows."

Q

WHAT IS DIGI'S POSITION AND ITS GREATEST STRENGTHS IN THE SERVER-BASED MARKET?

A

IDC suggests that Digi holds almost 50 percent market share — the largest installed base of server-based remote access communications interface cards. As of September 30, Digi passed the threshold of selling two million remote access ports.

Digi has long-term and ongoing strategic relationships with platform and network operating system vendors and has the widest range of communication interface cards available for server-based remote access, including:

- asynchronous products for analog modems (POTS)
- BRI (Basic Rate Interface) ISDN
- PRI (Primary Rate Interface) ISDN
- synchronous products for Frame Relay and X.25

IDC suggests that Digi holds almost 50 percent market share...as of September 30, Digi passed the threshold of selling two million remote access ports.

**COMPANY PRODUCT OVERVIEW**

**MARKET**

**APPLICATIONS**

**PRODUCT SOLUTIONS**

**SERVER-BASED REMOTE ACCESS**

Dial-in/dial-out access to corporate LANs from home or on the road, Internet access, point-of-sale (POS), inventory control, data collection and dissemination, factory automation, office automation, BBS (bulletin board systems).

**DIGI PRODUCTS**

- 232/422 Asynchronous Serial Port Boards
- Terminal Server Connectivity
- RAS Concentrator
- Integrated Solutions
- Synchronous Boards
- ISDN Network Interface Cards

**SERVER-BASED REMOTE ACCESS COMPONENTS**



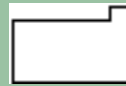
**SERVER-CLASS PC**

+



**NETWORK OPERATING SYSTEM  
+  
REMOTE ACCESS FEATURES**

+



**DIGI COMMUNICATIONS  
INTERFACE CARD**

=

**SERVER-BASED  
REMOTE ACCESS**

**LAN CONNECTIVITY**

**PHYSICAL LAYER**

For busy, growing or congested LANs. Products reside directly on a LAN to allow networks to grow and change without rewiring. These interconnections can convert, speed up or switch traffic activity on the LAN to enhance performance.

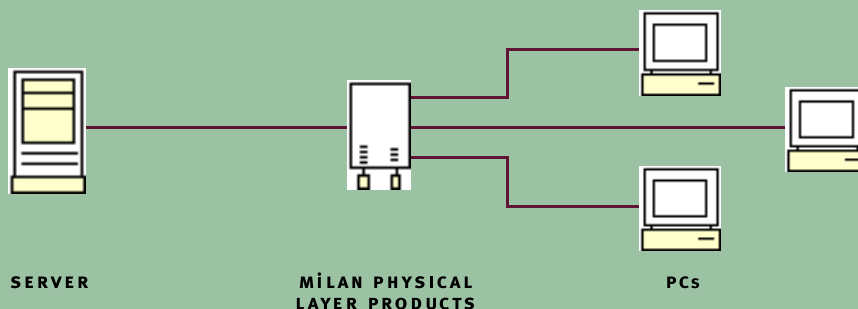
**PRINT SHARING**

Print sharing provides multiprotocol access to any Ethernet or Token Ring network; especially suitable for heavy graphics activity.

**MILAN PRODUCTS**

- Transceivers
- Media Converters
- Modular MicroHubs
- Modular Repeaters
- Micro Modules
- Fast Ethernet Products
- Print Servers

**LAN PHYSICAL LAYER CONFIGURATION**



## FINANCIAL INFORMATION

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

### RESULTS OF OPERATIONS

The following table sets forth selected information derived from the Company's Consolidated Statements of Operations, expressed as a percentage of net sales.

	Year ended September 30			Percentage increase/(decrease)	
	1997	1996	1995	1997 over 1996	1996 over 1995
NET SALES	100.0%	100.0%	100.0%	(14.3)%	17.1%
COST OF SALES	51.6	48.2	47.8	(8.2)	18.0
GROSS MARGIN	48.4	51.8	52.2	(19.9)	16.3
OPERATING EXPENSES:					
SALES AND MARKETING	22.1	22.5	19.1	(15.6)	37.3
RESEARCH AND DEVELOPMENT	10.9	11.0	8.9	(15.5)	43.6
GENERAL AND ADMINISTRATIVE	11.7	7.9	7.6	27.0	24.9
RESTRUCTURING	6.3			100.0	
	51.0	41.4	35.6	5.6	36.3
OPERATING (LOSS) INCOME	(2.6)	10.4	16.6	(121.5)	(26.6)
OTHER INCOME, PRINCIPALLY INTEREST	0.1	0.2	1.2	(53.6)	(83.1)
AETHERWORKS CORPORATION NET LOSS	(3.5)	(1.9)		59.1	100.0
AETHERWORKS CORPORATION WRITE OFF	(3.5)			100.0	
(LOSS) INCOME BEFORE INCOME TAXES	(9.5)	8.7	17.8	(193.4)	(42.8)
PROVISION FOR INCOME TAXES		3.9	6.1	(98.8)	(25.2)
NET (LOSS) INCOME	(9.5)%	4.8%	11.7%	(269.0)%	(51.9)%

## NET SALES

The decrease in net sales from 1996 to 1997 of \$27.6 million and the increase in net sales from 1995 to 1996 of \$28.2 million were dispersed between the Company's two principal product groups as follows:

Product Market	Percent of Annual Net Sales			Annual Sales Increase (Decrease)	
	1997	1996	1995	1997	1996
SERVER BASED	75.7%	80.2%	81.6%	(19.1%)	15.1%
PHYSICAL LAYER	23.9%	18.9%	18.4%	8.2%	20.3%
OTHER	.4%	.9%		(56.5%)	N/A

Net sales for 1997 were lower than those for 1996 due to a conscious effort by the Company to reduce inventory levels in the distribution channel. In addition, sales for 1997 were net of customer rebates of \$3.5 million, as compared to rebates of \$2.7 million for 1996. Net sales for 1996 were higher than those for 1995, primarily due to increased volume.

Net sales to original equipment manufacturers (OEMs), as a percentage of total net sales, rose to 23.5% for 1997, as compared to 20.3% in 1996. Net sales to OEMs for 1995 were 22.9%. The Company expects the OEM portion of the Company's business for fiscal 1998 to remain relatively stable with the 1997 level.

Net sales to the distribution market, as a percentage of total net sales, declined to 64.1% for 1997, as compared to 65.5% in 1996. This decline was a result of a conscious effort by the Company to reduce inventory levels in the distribution channel. Net sales to the distribution market for 1995 represented 61.2% of total net sales.

The effort by the Company to reduce inventory levels in the distribution channel has continued through the first quarter of fiscal 1998, ending December 31, 1997.

During fiscal years 1997, 1996 and 1995, the Company's net sales to customers outside the United States, primarily in Europe, amounted to approximately \$39.6 million, \$39.9 million and \$33 million, respectively, comprising approximately 23.9%, 20% and 20%.

## GROSS MARGIN

Gross margin for 1997 declined to 48.4%, as compared to 51.8% and 52.2% for 1996 and 1995, respectively. Such decline in 1997 was principally due to the increase of OEM and physical layer product net sales as a percentage of total net sales. OEM and physical layer products generally contribute lower gross margins, as compared to sales to the distribution channel and sales of multiuser and remote access products. In

addition, the Company has increased its reserves for excess and obsolete inventories by approximately \$1.5 million in 1997 versus 1996. Such reserves increased by approximately \$.7 million in 1996, in comparison to 1995.

## OPERATING EXPENSES

Operating expenses for 1997 declined 7.5% from operating expenses for 1996, without consideration of the approximately \$10.5 million restructuring charge recorded in 1997. Such decline was due to decreased marketing costs and cost savings achieved through consolidation of research and development efforts, as well as a reduction of funding levels for new product development. The 1996 operating expenses increased 36.3% over 1995 levels due to expansion of the Company's infrastructure and increased product development costs.

The restructuring charge of approximately \$10.5 million, recorded in the second quarter of fiscal 1997, related to a Board-approved plan that simplified operations, increased consolidation and reduced costs and expenses. The plan included the closing of the Cleveland, Ohio manufacturing facility, the reduction of selected product lines and the consolidation and closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included: (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of carrying values of goodwill and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories and (iii) severance costs associated with the elimination of 105 positions.

Subsequent to the actions covered by the restructuring charge, the Company has made additional headcount reductions and has consolidated other research and development activities into its Minneapolis facilities. Actual headcount for the Company as of September 30, 1997 was 481, down from 714 at January 31, 1997.

The Company expects that operating expenses for fiscal 1998 will remain at levels similar to or slightly higher than the \$16.4 million incurred in the fourth quarter of fiscal 1997.

## OTHER INCOME

Other income for 1997 declined by 53.6% from 1996 levels due primarily to increased losses on disposal of capital assets, principally at its research and development location in Cleveland. Other income for 1996 declined by 83.0% from 1995 levels due primarily to lower interest income resulting from a decrease in invested funds as well as losses on disposal of capital assets.

#### AETHERWORKS CORPORATION OPERATING LOSSES

In connection with the purchase of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology, the Company has the ability, under certain conditions, to convert its investment into a majority of AetherWorks' common stock. The Company has reported its investment in AetherWorks on the equity method and has recorded net losses of \$5.8 million and \$3.6 million, respectively, for 1997 and 1996. These net losses represent 100% of AetherWorks' losses for such years. The percentage of AetherWorks' net losses included in the Company's financial statements is based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during such years.

In connection with the financing arrangement, the Company has also guaranteed \$3,060,000 of lease obligations of AetherWorks. In addition, the Company has also leased to AetherWorks \$1,325,000 of computer equipment under a three-year direct financing lease.

On October 14, 1997, the Company entered into a revised note agreement with AetherWorks, that clarifies and limits the Company's financial commitment for the purchase of convertible notes of up to a maximum of \$13.8 million, which would result in the Company's ownership interest upon conversion of 62.7% based on AetherWorks' present capitalization. The revised agreement, however, also provides for payments, at the discretion of AetherWorks, on the outstanding convertible notes of up to \$7.2 million in exchange for a reduction in the Company's potential ownership interest, upon conversion, to 19%. The revised note agreement, among other things, rescinded previous technology transfer and manufacturing agreements.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of generating positive cash flow, obtaining other sources of equity financing and its continued uncertainty in developing commercially marketable products, the Company decided, as of September 30, 1997, to write off its remaining investment of \$2.4 million in AetherWorks, and to accrue and expense its remaining future obligation to purchase additional notes of \$2.0 million. In addition, the Company has also accrued \$1.4 million for its probable obligations resulting from its guarantees of certain AetherWorks' lease obligations.

#### INCOME TAXES

The Company recorded a \$.1 million tax provision for 1997, even though it has reported a pre-tax loss for the year. Such provision was necessary due to the non-deductibility of certain intangible assets written off as part of the restructuring charge, the AetherWorks operating losses, and the related investment write off. In addition, the Company has also provided additional provision in connection with an IRS examination of certain tax returns filed in prior years. The Company's effective income tax rate increased from 34.2% in 1995 to 44.7% in 1996 due primarily to the non-deductibility of the AetherWorks losses.

#### INFLATION

The Company believes inflation has not had a material effect on its operations or on its financial condition.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations, and in prior years, with proceeds from earlier public offerings. Investing activities for 1997 consisted of purchases of \$8.8 million of equipment and capital improvements, including a new enterprise-wide computer system, which will provide Year 2000 capabilities, and the purchase of \$6.5 million of additional convertible notes from AetherWorks Corporation.

During 1997, the Company has increased its cash balances by approximately \$22.4 million, through cash flow from operations, principally due to reductions in its outstanding accounts receivable and inventory levels.

Investing activities for 1996 consisted primarily of the redemption of maturing investments offset by purchases of property and equipment, and purchases of \$5.3 million of convertible notes from AetherWorks Corporation.

During 1996, the Company made open market purchases of the Company's common stock aggregating \$7.3 million pursuant to a one million share repurchase program authorized by the Company's Board of Directors on March 27, 1995. On January 31, 1996, the Board of Directors authorized a separate 500,000 share repurchase program for the purpose of purchasing common stock to be utilized for the Company's Employee Stock Purchase Plan, which purchase was funded through employee withholding. The Company suspended all existing stock purchase programs at its October 1996 board meeting, and does not presently contemplate any such stock purchase programs in the near future.

At September 30, 1997, the Company had working

capital of \$62 million and no debt. The Company has negotiated a \$5 million unsecured line of credit with its bank, but has not utilized such line. The Company's management believes that current financial resources, cash generated from operations and the Company's potential capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations.

#### FOREIGN CURRENCY TRANSLATION

Substantially all of the Company's foreign transactions are negotiated, invoiced and paid in U.S. dollars.

#### NEW ACCOUNTING STANDARD

In March 1997, the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings Per Share, was issued by the Financial Accounting Standards Board. This standard, which the Company must adopt for its 1998 fiscal interim and year-end reporting, requires dual presentation of basic and diluted EPS on the face of the Statement of Operations. Net income or loss per share currently (except for 1997) includes both common shares outstanding and common stock equivalents. The basic income or loss per share under SFAS No. 128 will be calculated based on only common shares outstanding. Diluted income or loss per share would be calculated based on both common shares outstanding and consideration of the dilutive effect of common stock equivalents.

#### FORWARD-LOOKING STATEMENTS

Certain statements made in this annual report, which are summarized here, are forward-looking statements that involve risk and uncertainties, and actual results may be materially different. Factors that could cause actual results to differ include, but are not limited to those identified:

- *Digi's open system server-based communications strategy should be characterized as forward looking and, as such, may involve risks and uncertainties.*
- *Continued growth in sales of the Company's multiuser, remote access and LAN products* — General market conditions and competitive conditions within these markets, development and acceptance of new products offered by the Company, and the introduction of products by competitors in these markets.
- *The expectation that steps taken by the Company will bring it back to consistent profitability* — This expectation may be impacted by unanticipated expenses or general market conditions and competitive conditions that may be encountered.

- *The expectation that operating expenses in fiscal 1998 will remain at levels similar to or slightly higher than those incurred in the fiscal fourth quarter of 1997* — This expectation may be impacted by presently unanticipated revenue opportunities or by unanticipated expenses.
- *The expectation that AetherWorks Corporation will not generate positive cash flow, obtain other sources of equity financing or develop commercially marketable products* — This expectation may be impacted by presently unanticipated revenue opportunities, securing other investors or developing commercially marketable products.
- *The expectation that OEM sales for fiscal 1998 will remain relatively stable with 1997 levels* — OEM orders are subject to cancellation at the option of the customer, and are subject to greater quarterly fluctuations than sales through the Company's other channels, as well as competitive conditions in markets served by the Company's OEM customers. OEM sales could also be adversely impacted by component shortages.
- *The expectation that the Company does not contemplate any stock purchase programs in the near future* — Changes in operating results, credit availability and equity market conditions may impact the Company's decision to resume such stock purchase programs.
- *The belief that the Company's current financial resources, cash generated from operations and the Company's potential capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations* — Changes in anticipated operating results, credit availability and equity market conditions may further enhance or inhibit the Company's ability to maintain or raise appropriate levels of cash.
- *The expectation that the upgrade to the Company's management information system will provide comprehensive reporting systems, greater internal visibility, increased ability to forecast and be on line in early calendar 1998* — This expectation may be impacted by presently unanticipated delays or ability to use the system.

## CONSOLIDATED STATEMENTS OF OPERATIONS

For the fiscal years ended September 30

	1997	1996	1995
NET SALES	\$ 165,597,937	\$ 193,150,898	\$ 164,978,018
COST OF SALES	85,482,536	93,108,624	78,933,221
GROSS MARGIN	80,115,401	100,042,274	86,044,797
OPERATING EXPENSES:			
SALES AND MARKETING	36,671,271	43,449,864	31,643,800
RESEARCH AND DEVELOPMENT	17,978,135	21,279,551	14,816,413
GENERAL AND ADMINISTRATIVE	19,324,777	15,215,512	12,186,056
RESTRUCTURING	10,471,482		
TOTAL OPERATING EXPENSES	84,445,665	79,944,927	58,646,269
OPERATING (LOSS) INCOME	(4,330,264)	20,097,347	27,398,528
OTHER INCOME, NET	153,809	331,789	1,967,565
AETHERWORKS CORPORATION NET LOSS	(5,764,201)	(3,623,776)	
AETHERWORKS CORPORATION WRITE OFF	(5,758,548)		
(LOSS) INCOME BEFORE INCOME TAXES	(15,699,204)	16,805,360	29,366,093
PROVISION FOR INCOME TAXES	91,640	7,505,140	10,035,000
NET (LOSS) INCOME	\$ (15,790,844)	\$ 9,300,220	\$ 19,331,093
(LOSS) INCOME PER COMMON AND COMMON EQUIVALENT SHARE	\$ (1.18)	\$ .69	\$ 1.38
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	13,393,408	13,522,905	14,057,109

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

## CONSOLIDATED BALANCE SHEETS

	September 30 1997	September 30 1996
<b>ASSETS</b>		
CURRENT ASSETS:		
CASH AND CASH EQUIVALENTS	\$ 31,329,666	\$ 8,943,390
ACCOUNTS RECEIVABLE, NET	25,658,522	42,874,898
INVENTORIES, NET	23,683,312	33,372,164
INCOME TAX REFUND RECEIVABLE		1,675,626
OTHER	4,147,942	2,825,828
TOTAL CURRENT ASSETS	84,819,442	89,691,906
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	23,617,696	24,230,101
INTANGIBLE ASSETS, NET	6,876,597	10,854,845
INVESTMENT IN AETHERWORKS CORPORATION		1,672,749
OTHER	2,997,601	3,489,228
TOTAL ASSETS	\$ 118,311,336	\$ 129,938,829
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
ACCOUNTS PAYABLE	\$ 10,118,921	\$ 12,549,738
INCOME TAXES PAYABLE	1,771,986	
ACCRUED EXPENSES:		
ADVERTISING	2,847,672	3,761,619
COMPENSATION	2,388,468	1,622,549
ACCRUED AETHERWORKS CORPORATION FUNDING OBLIGATIONS	3,350,000	
OTHER	2,363,258	2,061,782
TOTAL CURRENT LIABILITIES	22,840,305	19,995,688
COMMITMENTS AND CONTINGENCY		
STOCKHOLDERS' EQUITY:		
PREFERRED STOCK, \$.01 PAR VALUE: 2,000,000 SHARES AUTHORIZED; NONE OUTSTANDING		
COMMON STOCK, \$.01 PAR VALUE; 60,000,000 SHARES AUTHORIZED; 14,727,256 AND 14,677,150 SHARES ISSUED	147,273	146,772
ADDITIONAL PAID-IN CAPITAL	44,403,102	42,866,758
RETAINED EARNINGS	75,113,902	90,904,746
	119,664,277	133,918,276
UNEARNED STOCK COMPENSATION	(1,787,658)	(295,156)
TREASURY STOCK, AT COST, 1,269,492 AND 1,338,894 SHARES	(22,405,588)	(23,679,979)
TOTAL STOCKHOLDERS' EQUITY	95,471,031	109,943,141
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 118,311,336	\$ 129,938,829

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the fiscal years ended September 30

1997

1996

1995

## OPERATING ACTIVITIES:

NET (LOSS) INCOME	\$ (15,790,844)	\$ 9,300,220	\$ 19,331,093
ADJUSTMENTS TO RECONCILE NET (LOSS) INCOME TO CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:			
PROVISION FOR RESTRUCTURING	9,211,713		
DEPRECIATION OF PROPERTY AND EQUIPMENT	5,587,132	5,017,735	2,289,554
AETHERWORKS CORPORATION NET LOSS	5,764,201	3,623,776	
AETHERWORKS CORPORATION WRITE OFF	5,758,548		
AMORTIZATION OF INTANGIBLES	1,114,023	1,320,457	1,132,006
LOSS ON SALE OF FIXED ASSETS	760,555	238,222	
PROVISION FOR LOSSES ON ACCOUNTS RECEIVABLE	1,933,251	262,164	243,895
PROVISION FOR INVENTORY OBSOLESCENCE	2,910,988	1,455,895	716,300
DEFERRED INCOME TAXES	(1,787,933)	(393,153)	(84,750)
STOCK COMPENSATION	244,569	204,973	166,667
CHANGES IN OPERATING ASSETS AND LIABILITIES:			
ACCOUNTS RECEIVABLE	15,283,125	(11,176,126)	(10,457,106)
INVENTORIES	3,780,241	(7,808,974)	(4,043,377)
INCOME TAXES PAYABLE/RECEIVABLE	3,447,612	(1,545,461)	(1,157,823)
OTHER ASSETS	713,772	(1,953,252)	(1,266,098)
ACCOUNTS PAYABLE	(2,430,817)	443,223	7,420,550
ACCRUED EXPENSES	153,448	(664,452)	1,365,901
TOTAL ADJUSTMENTS	52,444,428	(10,974,973)	(3,674,281)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	36,653,584	(1,674,753)	15,656,812

## INVESTING ACTIVITIES:

PURCHASE OF PROPERTY AND EQUIPMENT	(8,841,473)	(12,902,436)	(9,573,995)
PROCEEDS FROM SALE OF FIXED ASSETS		1,133,197	
PROCEEDS FROM HELD-TO-MATURITY MARKETABLE SECURITIES		20,640,962	25,004,985
PROCEEDS FROM AVAILABLE-FOR-SALE MARKETABLE SECURITIES		13,060,000	
PURCHASE OF HELD-TO-MATURITY MARKETABLE SECURITIES		(482,187)	(21,751,326)
PURCHASE OF AVAILABLE-FOR-SALE MARKETABLE SECURITIES		(5,250,000)	(7,810,000)
BUSINESS ACQUISITIONS, NET OF CASH REQUIRED			(5,487,374)
INVESTMENT IN AETHERWORKS CORPORATION	(6,500,000)	(5,296,525)	
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(15,341,473)	10,903,011	(19,617,710)

## FINANCING ACTIVITIES:

PURCHASE OF TREASURY STOCK		(7,249,325)	(5,930,313)
STOCK OPTION TRANSACTIONS, NET	539,838	1,659,838	1,145,925
EMPLOYEE STOCK PURCHASE PLAN TRANSACTIONS, NET	534,327	200,888	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	1,074,165	(5,388,599)	(4,784,388)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,386,276	3,839,659	(8,745,286)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	\$ 8,943,390	\$ 5,103,731	\$ 13,849,017
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 31,329,666	\$ 8,943,390	\$ 5,103,731
SUPPLEMENTAL CASH FLOW DISCLOSURE: INCOME TAXES PAID	\$ 238,439	\$ 8,944,627	\$ 10,815,846

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

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the fiscal years ended September 30, 1997, 1996 and 1995

	COMMON STOCK		TREASURY STOCK		ADDITIONAL	RETAINED	UNEARNED	TOTAL
	SHARES	PAR VALUE	SHARES	VALUE	PAID-IN-CAPITAL	EARNINGS	STOCK COMPENSATION	STOCKHOLDERS' EQUITY
BALANCES, SEPTEMBER 30, 1994	14,474,663	\$ 144,747	755,229	\$ (10,701,229)	\$ 39,788,556	\$ 62,273,433	\$ (392,332)	\$ 91,113,175
TREASURY STOCK, AT COST			277,500	(5,930,313)				(5,930,313)
ISSUANCE OF STOCK OPTIONS BELOW								
MARKET PRICES					448,750		(448,750)	
STOCK COMPENSATION							166,667	166,667
ISSUANCE OF STOCK UPON EXERCISE OF								
STOCK OPTIONS, NET OF WITHHOLDING	88,295	883			683,315			684,198
TAX BENEFIT REALIZED UPON EXERCISE								
OF STOCK OPTIONS					461,727			461,727
FORFEITURE OF STOCK OPTIONS					(76,028)		76,028	
NET INCOME						19,331,093		19,331,093
BALANCES, SEPTEMBER 30, 1995	14,562,958	145,630	1,032,729	(16,631,542)	41,306,320	81,604,526	(598,387)	105,826,547
TREASURY STOCK, AT COST			315,000	(7,249,325)				(7,249,325)
EMPLOYEE STOCK PURCHASE ISSUANCES			(8,835)	200,888				200,888
ISSUANCE OF STOCK OPTIONS BELOW								
MARKET PRICES					12,500		(12,500)	
STOCK COMPENSATION							204,973	204,973
ISSUANCE OF STOCK UPON EXERCISE								
OF STOCK OPTIONS	114,192	1,142			1,159,569			1,160,711
TAX BENEFIT REALIZED UPON EXERCISE								
OF STOCK OPTIONS					499,127			499,127
FORFEITURE OF STOCK OPTIONS					(110,758)		110,758	
NET INCOME						9,300,220		9,300,220
BALANCES, SEPTEMBER 30, 1996	14,677,150	146,772	1,338,894	(23,679,979)	42,866,758	90,904,746	(295,156)	109,943,141
EMPLOYEE STOCK PURCHASE ISSUANCES			(69,402)	1,274,391	(740,064)			534,327
ISSUANCE OF STOCK OPTIONS BELOW								
MARKET PRICES					1,892,015		(1,892,015)	
STOCK COMPENSATION							244,569	244,569
ISSUANCE OF STOCK UPON EXERCISE OF								
STOCK OPTIONS, NET OF WITHHOLDING	50,106	501			379,720			380,221
TAX BENEFIT REALIZED UPON EXERCISE								
OF STOCK OPTIONS					159,617			159,617
FORFEITURE OF STOCK OPTIONS					(154,944)		154,944	
NET LOSS						(15,790,844)		(15,790,844)
BALANCES, SEPTEMBER 30, 1997	14,727,256	\$ 147,273	1,269,492	\$ (22,405,588)	\$ 44,403,102	\$ 75,113,902	\$ (1,787,658)	\$ 95,471,031

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BUSINESS DESCRIPTION

Digi International Inc. (the “Company”) is a leading ISO 9001-compliant provider of data communications hardware and software that delivers seamless connectivity solutions for multiuser environments, open systems server-based remote access and LAN (Local Area Network) markets. The Company markets its products through an international network of distributors and resellers, system integrators and OEMs (original equipment manufacturers).

The two major product areas include: 1) communications interface cards for multiuser and remote access environments, and 2) “physical layer” and print server products that enhance the data communications capabilities of a LAN.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

### CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

### REVENUE RECOGNITION

Sales are recognized at the date of shipment. Estimated warranty costs and customer returns are recorded at the time of sale.

### INVENTORIES

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

Fair market value for raw materials is based on replacement cost and for other inventory classifications based on net realizable value. Appropriate consideration is given to deterioration, obsolescence and other factors in evaluating net realizable value.

### PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements are carried at cost. Depreciation is provided by charges to operations using the straight-line method based on estimated useful lives, ranging from three to 39 years.

Expenditures for maintenance and repairs are charged to operations as incurred, while major renewals and betterments are capitalized. The assets and related accumulated depreciation accounts are adjusted for asset retirements and disposals with the resulting gain or loss included in operations.

### INTANGIBLE ASSETS

Purchased technology, license agreements, covenants not to compete and other intangible assets are recorded at cost. Goodwill represents the excess of cost over the fair value of assets acquired and is being amortized on a straight-line basis over its estimated useful life of 15 years. All other intangible assets are amortized on a straight-line basis over their estimated useful lives of one to five years.

The Company periodically, at least quarterly, analyzes intangible assets for potential impairment, assessing the appropriateness of lives and recoverability of unamortized balances through measurement of undiscounted operating cash flows on a basis consistent with generally accepted accounting principles.

### RESEARCH AND DEVELOPMENT

Research and development costs are expensed when incurred. Software development costs are expensed as incurred. Such costs are required to be expensed until the point that

technological feasibility and proven marketability of the product are established. Costs otherwise capitalizable after such point also are expensed because they are insignificant.

#### INCOME TAXES

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

Tax credits are accounted for under the flow-through method, which recognizes the benefit in the year in which the credit is utilized.

#### INCOME (LOSS) PER COMMON SHARE

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock and common stock equivalents outstanding during each period. Common stock equivalents result from dilutive stock options. No common stock equivalents were included in determining the net loss per common share for the year ended September 30, 1997, because their effect would be antidilutive.

In March 1997, the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings Per Share, was issued by the Financial Accounting Standards Board. This standard, which the Company must adopt for its 1998 fiscal interim and year-end reporting, requires dual presentation of basic and diluted EPS on the face of the Statement of Operations. Net income (loss) per share currently (except for fiscal 1997) includes both common shares outstanding and common stock equivalents. The basic income or loss per share under SFAS No. 128 will be calculated based on only common shares outstanding. Diluted income or loss per share would be calculated based on both common shares outstanding and consideration of the dilutive effect of common stock equivalents.

#### USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from

those estimates. The most significant areas which require the use of management's estimates relate to the determination of the allowances for obsolete inventories and uncollectable accounts receivable, sales returns and warranty cost accruals.

#### STOCK-BASED COMPENSATION

The Company uses the intrinsic value-based method to measure compensation cost for its stock option plan.

## 2 RESTRUCTURING

On February 13, 1997, the Company's Board of Directors approved a restructuring plan which resulted in a restructuring charge of \$10,471,482 (\$8,283,681, net of tax benefits or \$.62 per share). This corporate restructuring plan simplified operations, increased consolidation and reduced costs and expenses. It included the closing of the Cleveland, Ohio manufacturing facility, the reduction of selected product lines and the consolidation and closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included: (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of the carrying values of goodwill and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories and (iii) severance costs associated with the elimination of 105 positions.

The restructuring charge consisted of \$1,259,769 in net cash expenditures (primarily severance), all of which has been paid as of September 30, 1997, and \$9,211,713 resulting from the write down of asset carrying values.

## 3 RECLASSIFICATION OF CERTAIN EXPENSES

Rebates to customers of \$2,681,742 for the year ended September 30, 1996 now reflected as a reduction of sales, were previously included in sales and marketing expenses. This reclassification had no impact on previously reported operating income or net income. Rebates to customers for the year ended September 30, 1995 were not significant.

In addition, certain costs relating to systems support and communications costs, which previously were included in general and administrative expenses, have been reclassified into sales and marketing and research and development expenses for all periods presented. Such amounts were \$2,647,207, \$2,707,024 and \$286,525 for the years ended September 30, 1997, 1996 and 1995, respectively. These reclassifications had no impact on previously reported operating income or net income.

#### 4 ACQUISITIONS

On September 29, 1995, the Company acquired LAN Access Corporation ("LAN Access"), a provider of remote access products, for cash of approximately \$5.5 million, substantially all of which was allocated to goodwill. This acquisition was accounted for as a purchase. In connection with the restructuring plan adopted in 1997 (see Note 2), the Company sold the assets related to the LAN Access operations and wrote off all related goodwill.

#### 5 INVESTMENT IN AETHERWORKS CORPORATION

During 1997 and 1996, under a note purchase agreement, the Company purchased \$6,500,000 and \$5,296,525, respectively, of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology. The convertible notes presently held by the Company at September 30, 1997 are convertible into 60% of AetherWorks' common stock. In connection with the financing arrangement, the Company has also guaranteed \$3,060,000 of lease obligations of AetherWorks. In addition, the Company has also leased to AetherWorks \$1,325,000 of computer equipment under a three-year direct financing lease.

For the years 1997 and 1996, the Company has reported its investment in AetherWorks on the equity method and has reported losses of \$5,764,201 and \$3,623,776, respectively. Such losses, which exclude \$5,758,548 of additional charges related to the AetherWorks investment, as described below, represent 100% of AetherWorks' net losses for the two years. The percentage of AetherWorks' net losses included in the Company's Statement of Operations was based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during such years.

#### INVESTMENT IN AETHERWORKS CORPORATION

The following represents condensed financial information from the audited financial statements of AetherWorks for each of the years in the two-year period ended September 30, 1997:

<i>Balance sheet data, as of September 30</i>	<i>1997</i>	<i>1996</i>
CURRENT ASSETS	\$ 955,695	\$ 104,307
FIXED ASSETS, NET	4,813,266	3,993,731
TOTAL ASSETS	5,578,887	4,407,779
CURRENT LIABILITIES	3,240,729	3,942,032
NOTES PAYABLE	14,243,854	6,105,467
STOCKHOLDERS' DEFICIT	(11,905,696)	(5,639,720)
<i>Operating data for the fiscal year ended September 30</i>		
OPERATING EXPENSES:		
RESEARCH AND DEVELOPMENT	\$ 3,505,134	\$ 2,567,844
GENERAL AND ADMINISTRATIVE	2,069,304	999,247
OTHER	1,169,345	481,007
ELIMINATIONS	(979,582)	(424,322)
NET LOSS	\$ (5,764,201)	\$ (3,623,776)

On October 14, 1997, the Company entered into a revised note agreement with AetherWorks, that clarifies and limits the Company's financial commitment for the purchase of convertible notes to a maximum of \$13,800,000, which would result in the Company's ownership interest upon conversion of 62.7% based on AetherWorks' present capitalization. The revised note agreement, however, also provides for payments, at the discretion of AetherWorks, on the outstanding convertible notes of up to \$7,200,000 in exchange for a reduction in the Company's potential ownership interest, upon conversion, to 19%. The revised note agreement, among other things, rescinded previous technology transfer and manufacturing agreements with AetherWorks.

Because of the significant uncertainty of the future of AetherWorks Corporation, as demonstrated by its lack of ability to generate positive cash flow, obtaining other sources of equity financing and its continued uncertainty in developing commercially marketable products, the Company decided, as of September 30, 1997, to write off its remaining investment of \$2,408,500 in AetherWorks, and to accrue and expense its remaining future obligation to purchase additional notes of \$2,000,000. In addition, the Company has also accrued \$1,350,000 for its probable obligations resulting from its guarantees of certain AetherWorks' lease obligations.

## 6 SELECTED BALANCE SHEET AND STATEMENT OF CASH FLOWS DATA

	1997	1996
ACCOUNTS RECEIVABLE, NET:		
TRADE ACCOUNTS RECEIVABLE	\$ 26,838,275	\$ 43,610,340
LESS RESERVE FOR RETURNS AND DOUBTFUL ACCOUNTS	1,179,753	735,442
	<u>\$ 25,658,522</u>	<u>\$ 42,874,898</u>
INVENTORIES, NET:		
RAW MATERIALS	\$ 10,160,377	\$ 19,145,019
WORK IN PROCESS	8,704,357	10,469,315
FINISHED GOODS	7,011,357	4,925,930
	<u>25,876,091</u>	<u>34,540,264</u>
LESS RESERVE FOR OBSOLESCENCE	2,192,779	1,168,100
	<u>\$ 23,683,312</u>	<u>\$ 33,372,164</u>
PROPERTY, EQUIPMENT AND IMPROVEMENTS:		
LAND	\$ 1,800,000	\$ 1,800,000
BUILDING	10,522,285	10,519,731
IMPROVEMENTS	629,240	631,362
EQUIPMENT	18,377,899	18,629,353
PURCHASED SOFTWARE	5,186,787	1,968,127
FURNITURE AND FIXTURES	927,859	1,899,928
	<u>37,444,070</u>	<u>35,448,501</u>
LESS ACCUMULATED DEPRECIATION	13,826,374	11,218,400
	<u>\$ 23,617,696</u>	<u>\$ 24,230,101</u>
INTANGIBLE ASSETS:		
PURCHASED TECHNOLOGY	\$ 910,859	\$ 1,672,850
LICENSE AGREEMENTS	1,133,900	1,174,908
COVENANTS NOT TO COMPETE		520,250
GOODWILL	6,364,242	11,185,506
OTHER	1,772,035	20,449
	<u>10,181,036</u>	<u>14,573,963</u>
LESS ACCUMULATED AMORTIZATION	3,304,439	3,719,118
	<u>\$ 6,876,597</u>	<u>\$ 10,854,845</u>

## Supplemental disclosure of non-cash financing and investing information:

During fiscal 1997, the Company entered into a three-year direct financing lease agreement with a related party. In connection with this transaction, the Company has established a gross lease receivable of \$1,430,000 (see Note 5).

7 STOCK OPTIONS AND  
EMPLOYEE STOCK PURCHASE PLAN

The Company has a stock option plan (the "Plan") that provides for the issuance of nonstatutory stock options and incentive stock options (ISOs) to key employees and non-employee board members holding less than 5% of the outstanding shares of the Company's common stock.

The option price for ISOs and non-employee directors options is set at fair market value of the Company's common stock on the date of grant. The option price for nonstatutory options is set by the Compensation Committee of the Board of Directors. The authority to grant options and set other terms and conditions rests with the Compensation Committee. The Plan terminates in 2007.

During the years ended September 30, 1997, 1996, and 1995, 50,106, 114,192, and 88,295 shares of the Company's Common Stock, respectively, were issued upon the exercise of options for 50,617, 123,959, and 95,367 shares, respectively. The difference between shares issued and options exercised results from the Plan's provision allowing employees to elect to pay their withholding obligation through share reduction. Withholding taxes paid by the Company as a result of the share withholding provision amounted to \$5,171 in 1997, \$186,927 in 1996, and \$413,000 in 1995.

During the year ended September 30, 1997, the Board of Directors authorized the cancellation and reissue of non-statutory stock options to certain employees for the purchase of 823,326 shares, at an exercise price below the market value

of the stock. Under this authorization, the original option issues were canceled and new options were issued with a new four-year vesting schedule. During the years ended September 30, 1996 and 1995, the Board of Directors authorized the issuance of nonstatutory stock options for the purchase of 2,500 and 50,000 shares, respectively, at prices below the market value of the stock on the grant dates. The difference between the option price and market value at the date of grant for the above option arrangements has been recorded as additional paid-in capital with an offsetting debit within stockholders' equity to unearned stock compensation. The compensation expense related to these option grants is amortized to operations over the five-year vesting period in which the employees perform services and amounted to \$244,569 in 1997, \$204,793 in 1996, and \$166,667 in 1995.

Stock options and common shares reserved for grant under the plan are as follows:

#### STOCK OPTIONS

	AVAILABLE FOR GRANT	OPTIONS OUTSTANDING	WEIGHTED AVERAGE PRICE PER SHARE
BALANCES, SEPTEMBER 30, 1994	7,162	903,338	\$ 13.30
ADDITIONAL SHARES APPROVED FOR GRANT	2,000,000		
GRANTED	(808,375)	808,375	18.74
EXERCISED		(95,367)	9.06
CANCELLED	119,251	(119,251)	15.33
BALANCES, SEPTEMBER 30, 1995	1,318,038	1,497,095	\$ 16.41
GRANTED	(1,186,525)	1,186,525	20.67
EXERCISED		(123,959)	11.38
CANCELLED	223,001	(223,001)	22.18
BALANCES, SEPTEMBER 30, 1996	354,514	2,336,660	\$ 18.14
ADDITIONAL SHARES APPROVED FOR GRANT	500,000		
GRANTED	(1,509,701)	1,509,701	8.62
EXERCISED		(50,617)	7.71
CANCELLED	1,894,636	(1,894,636)	19.01
BALANCES, SEPTEMBER 30, 1997	1,239,449	1,901,108	\$ 10.01

Commencing in April 1996, the Company has sponsored an Employee Stock Purchase Plan which covers all domestic employees with at least 90 days of service. The 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 plan were \$534,327 and \$200,888 for the fiscal years 1997 and 1996, respectively. Pursuant to the plan, 69,402 and 8,835 shares were issued to employees during fiscal years 1997 and 1996, respectively. As of September 30, 1997, 421,763 shares are available for future issuances.

## 8 STOCK-BASED COMPENSATION

In accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), the Company has chosen to continue to account for stock-based compensation using the intrinsic value method.

Had the Company used the fair-value-based method of accounting for its stock options granted in 1997 and 1996, and charged operations over the option vesting periods based on the fair value of options at the date of grant, net (loss) income and net (loss) income per common share would have been reduced to the following pro forma amounts:

	1997	1996
NET (LOSS) INCOME		
AS REPORTED	\$(15,790,844)	\$ 9,300,220
PRO FORMA	(17,449,611)	8,536,111
NET (LOSS) INCOME PER SHARE		
AS REPORTED	\$ (1.18)	\$ .69
PRO FORMA	(1.30)	.63

The pro forma information presented includes only stock options granted in fiscal years 1997 and 1996. Compensation expense, under the fair-value-based method, will increase over the next few years as additional stock option grants are considered.

The weighted average fair value of options granted in fiscal years 1997 and 1996 was \$8.57 and \$20.67, respectively. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

	1997	1996
RISK-FREE INTEREST RATE	6.02%	5.99%
EXPECTED OPTION HOLDING PERIOD	4 YEARS	4 YEARS
EXPECTED VOLATILITY	40%	50%
EXPECTED DIVIDEND YIELD	0	0

At September 30, 1997, the weighted average exercise price and remaining life of the stock options are as follows:

	\$5.0-10.75	\$11.25-17.50	\$19.25-29.25	TOTAL
TOTAL OPTIONS OUTSTANDING	1,472,398	259,335	169,375	1,901,108
WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	6.21	6.42	6.90	6.51
WEIGHTED AVERAGE EXERCISE PRICE	\$7.92	\$13.44	\$22.84	\$10.01
OPTIONS EXERCISABLE	86,438	181,840	141,825	410,103
WEIGHTED AVERAGE PRICE OF EXERCISABLE OPTIONS	\$5.45	\$13.71	\$22.82	\$13.99

## 9 LINE OF CREDIT

During 1996, the Company negotiated a \$5 million uncollateralized line of credit with its bank, to be used to fund general corporate cash needs. The interest rate varies depending on the "base" or "prime" rate established by the bank. During fiscal 1997 and 1996, the Company did not use this line of credit.

## 10 COMMITMENTS

The Company has entered into various operating lease agreements, the last of which expires in fiscal year 2002. Below is a schedule of future minimum commitments under noncancelable operating leases:

FISCAL YEAR	AMOUNT
1998	\$ 835,142
1999	591,358
2000	576,377
2001	491,990
2002	280,510

Total rental expense for all operating leases for the years ended September 30, 1997, 1996 and 1995 was \$1,405,582, \$965,710 and \$946,000, respectively.

## 11 INCOME TAXES

The components of the provision for income taxes for the years ended September 30, 1997, 1996 and 1995 are as follows:

	1997	1996	1995
CURRENT PAYABLE:			
FEDERAL	\$ 1,737,116	\$ 6,977,337	\$ 9,505,650
STATE	142,457	920,956	614,100
DEFERRED	(1,787,933)	(393,153)	(84,750)
	\$ 91,640	\$ 7,505,140	\$ 10,035,000

The net deferred tax asset at September 30, 1997 and 1996 consists of the following:

	1997	1996
VALUATION RESERVES	\$ 1,791,903	\$ 615,631
INVENTORY VALUATION	800,364	432,225
VACATION COSTS	197,107	311,250
DEPRECIATION	193,525	(164,850)
NET DEFERRED TAX ASSET	\$ 2,982,899	\$ 1,194,256

The reconciliation of the federal statutory income tax rate to the effective income tax rate for the years ended September 30, 1997, 1996 and 1995, are as follows:

	1997	1996	1995
STATUTORY INCOME TAX RATE	(34.0)%	35.0%	35.0%
INCREASE (REDUCTION) RESULTING FROM:			
UTILIZATION OF RESEARCH AND DEVELOPMENT TAX CREDITS	(0.9)	(1.7)	(1.7)
STATE TAXES, NET OF FEDERAL BENEFITS	1.0	3.6	2.5
AETHERWORKS CORPORATION NET OPERATING LOSS	12.5	8.0	
AETHERWORKS CORPORATION WRITE OFF	9.6		
RESTRUCTURING CHARGE	9.3		
TAX CONTINGENCY	4.7		
FOREIGN AND OTHER	(2.1)	(0.2)	(1.6)
	.1%	44.7%	34.2%

## 12 FOREIGN SALES AND MAJOR CUSTOMERS

The Company maintains foreign sales offices but does not otherwise have any foreign operations. Foreign export sales, primarily to Europe, comprised approximately 23.9%, 20%, and 20% of net sales for the years ended September 30, 1997, 1996 and 1995, respectively.

During 1997, one customer (customer A) accounted for 15.1% of net sales while another (customer B) accounted for 10.5% of net sales. In addition, customer A accounted for 28% of the trade accounts receivable outstanding at September 30, 1997.

During 1996, one customer (customer B) accounted for 13.9% of net sales and 11.8% of accounts receivable at September 30, 1996, while another (customer A) accounted for 13.4% of net sales and 14.3% of accounts receivable at September 30, 1996. During 1995, one customer (customer A) accounted for 12.5% of net sales and another customer (customer C) accounted for 11.7%.

## 13 EMPLOYEE BENEFIT PLAN

The Company has a savings and profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code ("the Code"), whereby eligible employees may contribute up to 15% of their earnings, not to exceed amounts allowed under the Code. In addition, the Company may make contributions at the discretion of the Board of Directors. No Company contribution was made in 1997 or 1996. During 1995, the Company provided for matching contributions totaling \$125,000.

## 14 CONTINGENCIES

During fiscal 1997, the Company and certain of its previous officers were named as defendants in a series of putative securities class action lawsuits in the United States District Court for the District of Minnesota on behalf of an alleged class of purchasers of its common stock during the period January 25, 1996 through December 23, 1996, inclusive, which were consolidated, and a Consolidated Amended Complaint was filed in May 1997. Also in 1997, a similar, but separate action was filed by the Louisiana State Employees Retirement System. The Consolidated Amended Complaint and the Louisiana Complaint allege the Company and certain of its previous officers violated federal securities laws by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results. The Louisiana Complaint also alleges misrepresentations in violation of state common law.

The defendants served motions to dismiss the Consolidated Amended Complaint and the Louisiana Complaint on the ground, among others, that they fail to plead claims in accordance with applicable law. The motions were argued before the District Court at a hearing on October 31, 1997. No ruling has been received as of December 15, 1997.

Because the lawsuits are in their preliminary stages, the ultimate outcomes cannot be determined at this time, and no potential assessment of the probable or possible effects of such litigation, if any, on the Company's financial position, liquidity or future operations can be made.

## REPORT OF MANAGEMENT


## TO THE STOCKHOLDERS OF DIGI INTERNATIONAL INC.:

The Company's management is responsible for the integrity, objectivity and consistency of the financial information presented in this annual report. The consolidated financial statements contained herein were prepared in accordance with generally accepted accounting principles and were based on informed judgments and management's best estimates as required. Financial information elsewhere in this annual report is consistent with that contained in the consolidated financial statements.

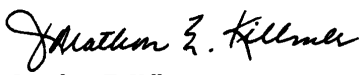
The Company maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded, transactions are properly executed in accordance with management's authorization, and accounting records may be relied upon for the preparation of financial statements and other financial information. The system is monitored by direct management review. Limitations exist in any system of internal control, based upon the recognition that the cost of the system should not exceed the benefits derived.

The Company's consolidated financial statements have been audited by Coopers & Lybrand L.L.P., independent certified public accountants. Their audit was conducted in accordance with generally accepted auditing standards. As part of their audits of the Company's consolidated financial statements, these independent accountants considered the Company's internal controls to the extent they deemed necessary to determine the nature, timing and extent of their audit tests.

The Audit Committee of the Board of Directors is composed entirely of non-employee directors and is responsible for monitoring and overseeing the quality of the Company's accounting and reporting policies, internal controls and other matters deemed appropriate. The independent certified public accountants have free access to the Audit Committee without management present.



Jerry A. Dusa  
President and Chief Executive Officer



Jonathon E. Killmer  
Senior Vice President, Chief Financial Officer and Treasurer

## REPORT OF INDEPENDENT ACCOUNTANTS

## TO THE STOCKHOLDERS AND BOARD OF DIRECTORS OF DIGI INTERNATIONAL INC.:

We have audited the consolidated balance sheets of Digi International Inc. and subsidiaries as of September 30, 1997 and 1996, and the related consolidated statements of operations, cash flows and stockholders' equity for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. As discussed in Note 5, the Company has recorded its investment in AetherWorks Corporation (AetherWorks) on the equity method; the 1997 and 1996 consolidated statements of operations include AetherWorks' net operating losses for the years ended September 30, 1997 and 1996 of \$5,764,201 and \$3,623,776, respectively. We did not audit the financial statements of AetherWorks, which statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for AetherWorks' net operating losses, is based solely on the report of other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors for the years ended September 30, 1997 and 1996, provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors for the years ended September 30, 1997 and 1996, and the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digi International Inc. and subsidiaries as of September 30, 1997 and 1996, and the consolidated results of their operations and their cash flows for each of the three years in the period ended September 30, 1997, in conformity with generally accepted accounting principles.



Coopers & Lybrand L.L.P.  
Minneapolis, Minnesota  
December 15, 1997

**QUARTERLY FINANCIAL DATA (UNAUDITED):**

	Quarter Ended			
	DEC. 31	MAR. 31	JUNE 30	SEPT. 30
<b>1997</b>				
NET SALES	\$ 42,236	\$ 40,393	\$ 40,843	\$ 42,125
GROSS MARGIN	19,640	19,294	20,118	21,063
RESTRUCTURING		(10,471)		
AETHERWORKS CORPORATION NET LOSS	(1,520)	(1,590)	(1,525)	(1,130)
AETHERWORKS CORPORATION WRITE OFF				(5,759)
NET (LOSS) INCOME	(2,578)	(9,400)	67	(3,880)
NET (LOSS) INCOME PER SHARE	(.19)	(.70)	.01	(.29)
<b>1996</b>				
NET SALES	\$ 43,716(A)	\$ 47,973(A)	\$ 49,643(A)	\$ 51,819(A)
GROSS MARGIN	23,729(A)	25,391(A)	24,451(A)	26,471(A)
AETHERWORKS CORPORATION NET LOSS	(279)	(656)	(1,204)	(1,485)
NET (LOSS) INCOME	4,522	4,620	(51)	209
NET INCOME PER SHARE	.33	.34	.0	.02
<b>1995</b>				
NET SALES	\$ 37,879	\$ 40,076	\$ 41,179	\$ 45,844
GROSS MARGIN	19,745	21,169	22,131	23,000
NET INCOME	4,491	4,597	4,847	5,396
NET INCOME PER SHARE	.32	.33	.35	.38

The summation of quarterly net income per share may not equate to the year-end calculation as quarterly calculations are performed on a discrete basis.

(A) Restated for the reclassification of rebates.

## DIRECTORS AND OFFICERS

### DIRECTORS

#### JOHN P. SCHINAS (3)

Mr. Schinas is a founder of the Company and has been its Chairman of the Board since July 1991. He has been a member of the Board of Directors since the Company's inception in July 1985 and served as the Company's CEO from July 1985 to January 1992.

#### JERRY A. DUSA

Mr. Dusa has been a member of the Board of Directors and President and Chief Executive Officer of the Company since March 12, 1997 after serving the Company as interim acting Chief Executive Officer from January 3, 1997 to March 12, 1997. Mr. Dusa has over 25 years experience in the computer industry and has held executive management positions in a number of high technology companies.

#### WILLIS K. DRAKE (2)

Mr. Drake has been a member of the Board of Directors since 1987 and a private investor since 1983.

#### RICHARD E. EICHHORN (2)(3)

Mr. Eichhorn has been a member of the Board of Directors since 1987. Since April 1992, Mr. Eichhorn has been a private investor.

#### ROBERT S. MOE (1)(2)

Mr. Moe has been a member of the Board of Directors since October 1996. From 1981 to his retirement in 1993, he was the Chief Financial Officer of Polaris Industries, a manufacturer of snowmobiles, all-terrain vehicles and personal watercraft.

#### MYKOLA MOROZ (1)

Mr. Moroz has been a member of the Board of Directors since July 1991. Mr. Moroz was a founder of the Company and CEO from January 1992 to September 1994. Mr. Moroz was Chief Operating Officer of the Company from July 1991 to January 1992. From October 1985 to July 1991, he occupied various management positions with the Company. He is now a private consultant.

#### DAVID STANLEY (1)(3)

Mr. Stanley has been a member of the Board of Directors since 1990. Mr. Stanley has been Chairman and CEO of Payless Cashways, Inc., a building materials retailer, since 1984.

*(1) Audit Committee*

*(2) Compensation Committee*

*(3) Corporate Governance and Nominating Committee*

### EXECUTIVE OFFICERS

#### JERRY A. DUSA

President and Chief Executive Officer

#### DOUGLAS J. GLADER

Senior Vice President, Manufacturing Operations

#### DINO G. KASDAGLY

Senior Vice President, Development

#### JONATHON E. KILLMER

Senior Vice President, Chief Financial Officer and Treasurer

### CORPORATE SECRETARY

#### JAMES E. NICHOLSON

Partner, Faegre & Benson LLP

### CORPORATE GOVERNANCE

- The majority of the board's membership is comprised of non-employee directors.
- The compensation and audit committees are comprised of all non-employee directors.
- The positions of Chairman of the Board and Chief Executive Officer are separate.

## STOCKHOLDER AND INVESTOR INFORMATION

### STOCK LISTING

The Company's common stock has been publicly traded since its initial public offering on October 5, 1989. The Company's common stock trades on the Nasdaq National Market tier of the Nasdaq Stock Market<sup>SM</sup> under the symbol "DGII." At December 12, 1997, the number of holders of the Company's Common Stock was approximately 9,274 consisting of 362 record holders and approximately 8,912 stockholders whose stock is held by a bank, broker or other nominee.

High and low sale prices for each quarter during the years ended September 30, 1997 and 1996, as reported on the Nasdaq Stock Market, were as follows:

#### STOCK PRICES

1997	First	Second	Third	Fourth
High	\$18.75	\$10.50	\$11.75	\$16.00
Low	8.625	6.750	5.125	9.875

1996	First	Second	Third	Fourth
High	\$28.75	\$30.00	\$30.75	\$27.375
Low	17.125	17.00	23.875	11.875

### DIVIDEND POLICY

The Company has never paid cash dividends on its common stock. The Board of Directors presently intends to retain all earnings for use in the Company's business and does not anticipate paying cash dividends in the foreseeable future.

The Company does not have a Dividend Reinvestment Plan or a Direct Stock Purchase Plan.

### STOCKHOLDER INFORMATION

#### TRANSFER AGENT AND REGISTRAR

Norwest Bank Minnesota, N.A.  
Norwest Shareowners Services  
P.O. Box 64854  
St. Paul, MN 55164-0854  
(612) 450-4064  
(800) 468-9716

#### LEGAL COUNSEL

Faegre & Benson LLP  
2200 Norwest Center  
Minneapolis, MN 55402-3901

#### INDEPENDENT PUBLIC ACCOUNTANTS

Coopers & Lybrand L.L.P.  
650 Third Avenue South  
Minneapolis, MN 55402-4333

#### ANNUAL MEETING

The Company's Annual Meeting of Stockholders will be held on Wednesday, January 28, 1998, at 3:30 p.m., at the Marquette Hotel, 710 Marquette Avenue, Minneapolis, Minnesota.

#### INVESTOR RELATIONS

A copy of the Company's Form 10-K, filed with the Securities and Exchange Commission, is available free upon written request.

Contact: Maureen McGarrigle  
Director, Investor Relations  
Digi International Inc.  
11001 Bren Road East  
Minnetonka, MN 55343  
(612) 912-3444  
email: ir@dgii.com

## GLOSSARY

### **ANSI (AMERICAN NATIONAL STANDARDS INSTITUTE)**

a non-profit membership organization that coordinates the development of voluntary standards. It is the U.S. member body to ISO (International Organization for Standardization) and IEC (International Electrotechnical Commission).

### **ASYNCHRONOUS COMMUNICATIONS**

transmitting single characters at a time; a common method of data transmission between PCs (personal computers) and terminals, printers, plotters, modems or other peripheral devices.

### **FRAME RELAY**

an ANSI and ITU-T defined local and wide area networking standard for switching blocks of data using packet techniques similar to X.25, but at higher speeds and with less processing overhead.

### **INTRANET**

uses the same communications protocols and hypertext links as the Web and thus provides a standard way of disseminating information internally and extending the application worldwide at the same time.

### **INTERNET**

is made up of interconnected networks worldwide, comprised of commercial, academic and government networks. Originally developed for the military, the Internet became widely used for academic and commercial research. Today, the Internet is being commercialized into a worldwide information highway.

### **I/O (INPUT/OUTPUT)**

a transfer of data between the CPU and a peripheral device (such as a terminal, printer, plotter, modem). For every transfer as an output from one device, there is an input to another device.

### **ISDN (INTEGRATED SERVICES DIGITAL NETWORK)**

a public digital telecommunications network designed by the ITU-T. It allows a communications channel to simultaneously carry data, voice and video.

### **ISO 9001**

is an internationally recognized quality standard within which a company chooses to operate. The standard was developed to provide a common ground for companies doing business in Europe and it has now spread worldwide.

### **ITU-T (INTERNATIONAL TELECOMMUNICATIONS UNION FOR TELEPHONY)**

the international body responsible for telephone and computer communications standards describing interface techniques and practices. These standards include those which define how a nation's telephone and data systems connect to the worldwide communications network.

### **LAN (LOCAL AREA NETWORK)**

a network that serves multiple users within a confined geographical space (an area such as a department, building or plant). It typically refers to the interconnection of PCs.

### **MODEM**

a device used to connect a computer to a telephone line. It converts the computer's digital signal to analog, which the telephone system uses.

### **MULTIUSER**

two or more users sharing a single PC.

### **MULTITASKING**

running two or more programs in one computer at the same time.

### **NETWORK OPERATING SYSTEM (NOS)**

a control program that resides in a server within a local area network that handles the requests for data from all the users on the network.

### **PORT**

an interface (connector) between the computer and the outside world. The number of ports on a communications controller or front-end processor determines the number of communications channels that can be connected to it. The number of ports on a computer determines the number of peripheral devices that can be attached to it.

### **REMOTE COMMUNICATIONS**

communications software that lets a PC access or control the operation of another PC in a remote location using a standard dial-up or ISDN telephone line.

### **SERIAL**

implies one after another. Serial devices (terminals, printers, plotters and modems for example) transmit data in this manner between the device and the CPU (central processing unit).

### **SERIAL PORT**

is a receptacle on a PC through which a serial device such as a modem, mouse or printer is connected.

### **SERVER/COMMUNICATIONS SERVER/FILE SERVER**

a computer in a local area network configuration used to store the programs and data files shared by the users connected to the network. A server acts like a remote disk drive to the users on a network.

### **SYNCHRONOUS COMMUNICATIONS**

data transmission in which characters are transmitted in groups (as opposed to asynchronous, which is a single character at a time).

### **UNIX**

a multiuser, multitasking operating system that runs on a wide variety of computer systems from PC to mainframe.

### **WIDE AREA NETWORK (WAN)**

a network that interconnects geographical boundaries such as cities, usually via standard dial-up or ISDN telephone lines.

### **X.25**

the ITU-T recommendation of the interface between packet switches and computers.

*Brand names or product names used herein may be trademarks or registered trademarks of their respective holders.*

## COMPANY LOCATIONS

### CORPORATE OFFICE

Digi International  
11001 Bren Road East  
Minnetonka, MN 55343  
TEL: 612-912-3444  
FAX: 612-912-4991

### NORTH AMERICAN SALES OFFICES

Digi International  
11001 Bren Road East  
Minnetonka, MN 55343  
TEL: 800-344-4273, 612-912-3444  
FAX: 612-912-4952

Digi International  
1299 Orleans Drive  
Sunnyvale, CA 94089  
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