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

FORM 10-Q

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

For the quarterly period ended: March 31, 1998.

OR

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

For the transition period from ____ to ____.

Commission file number: 0-17972

DIGI INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

41-1532464
(I.R.S. Employer
Identification Number)

11001 Bren Road East
Minnetonka, Minnesota 55343
(Address of principal executive offices) (Zip Code)

(612) 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 X No ___

On April 22, 1998, there were 13,517,354 shares of the registrant's \$.01 par value Common Stock outstanding.

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ITEM 1. FINANCIAL STATEMENTS

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE THREE MONTHS AND SIX MONTHS ENDED MARCH 31, 1998 AND 1997
(UNAUDITED)

	<u>Three months</u> <u>ended March</u>		<u>Six months</u> <u>ended March</u>	
	<u>31</u>		<u>31</u>	
	<u>1998</u>	<u>1997</u>	<u>1998</u>	<u>1997</u>
Net sales	\$ 45,058,973	\$ 40,393,222	\$ 87,649,032	\$ 82,629,437
Cost of sales	<u>21,993,344</u>	<u>21,099,206</u>	<u>43,214,657</u>	<u>43,694,943</u>
Gross margin	<u>23,065,629</u>	<u>19,294,016</u>	<u>44,434,375</u>	<u>38,934,494</u>
Operating expenses:				
Sales and marketing	9,007,379	9,185,606	17,266,872	20,197,857
Research and development	3,948,109	4,724,933	7,759,010	10,345,613
General and administrative	3,445,691	4,693,207	7,055,815	9,440,432
Restructuring	-	<u>10,471,482</u>	-	<u>10,471,482</u>
Total operating expenses	<u>16,401,179</u>	<u>29,075,228</u>	<u>32,081,697</u>	<u>50,455,384</u>
Operating income (loss)	6,664,450	(9,781,212)	12,352,678	(11,520,890)
Other income, net	548,470	127,203	817,355	226,234
AetherWorks Corporation net loss	-	<u>(1,589,681)</u>	-	<u>(3,109,470)</u>
Income (loss) before income taxes	7,212,920	(11,243,690)	13,170,033	(14,404,126)
Provision (benefit) for income taxes	<u>2,547,584</u>	<u>(1,843,473)</u>	<u>4,662,359</u>	<u>(2,425,905)</u>
Net income (loss)	<u>\$ 4,665,336</u>	<u>\$ (9,400,217)</u>	<u>\$ 8,507,674</u>	<u>\$ (11,978,221)</u>
Net income (loss) per common share, basic	<u>\$ 0.35</u>	<u>\$ (0.70)</u>	<u>\$ 0.63</u>	<u>\$ (0.90)</u>
Net income (loss) per common share, assuming dilution	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

	<u>0.33</u>	<u>(0.70)</u>	<u>0.60</u>	<u>(0.90)</u>
Weighted average common shares, basic	<u>13,508,084</u>	<u>13,381,615</u>	<u>13,494,509</u>	<u>13,367,885</u>
Weighted average common shares, assuming dilution	<u>14,265,107</u>	<u>13,381,615</u>	<u>14,149,319</u>	<u>13,367,885</u>

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

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET

	March 31 <u>1998</u>	September 30 <u>1997</u>
ASSETS		
Current assets:	(unaudited)	
Cash and cash equivalents	\$ 43,111,877	\$ 31,329,666
Accounts receivable, net	26,502,752	25,658,522
Inventories, net	19,609,395	23,683,312
Other	<u>4,102,343</u>	<u>4,147,942</u>
Total current assets	93,326,367	84,819,442
Property, equipment and improvements, net	23,123,070	23,617,696
Intangible assets, net	7,424,999	6,876,597
Other	<u>2,679,592</u>	<u>2,997,601</u>
Total assets	<u>\$ 126,554,028</u>	<u>\$ 118,311,336</u>
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,424,803	\$ 10,118,921
Income taxes payable	4,780,885	1,771,986
Accrued expenses:		
Advertising	2,468,653	2,847,672
Compensation	3,366,626	2,388,468
Accrued AetherWorks Corporation obligations	1,350,000	3,350,000
Other	<u>2,088,810</u>	<u>2,363,258</u>
Total current liabilities	21,479,777	22,840,305
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; 14,755,796 and 14,727,256 shares issued	147,558	147,273
Additional paid-in capital	44,375,563	44,403,102
Retained earnings	<u>83,621,576</u>	<u>75,113,902</u>
	128,144,697	119,664,277
Unearned stock compensation	(1,081,740)	(1,787,658)
Treasury stock, at cost, 1,245,965 and 1,338,894 common shares	<u>(21,988,706)</u>	<u>(22,405,588)</u>
Total stockholders' equity	<u>105,074,251</u>	<u>95,471,031</u>
Total liabilities and stockholders' equity	<u>\$ 126,554,028</u>	<u>\$ 118,311,336</u>

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

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED MARCH 31, 1998 AND 1997
(UNAUDITED)

1998	1997		
Operating activities:			
Net income (loss)		\$8,507,674	(11,978,221)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Restructuring		\$ -	10,270,361
Depreciation and amortization		3,380,308	3,770,910
AetherWorks Corporation net loss		-	3,109,470
Provision for losses on accounts receivable		707,992	522,236
Provision for inventory obsolescence		3,084,569	1,481,285
Loss on sale of fixed assets		135,134	67,033
Stock compensation		531,827	50,225
Changes in operating assets and liabilities		340,760	(438,769)
Total adjustments		8,180,590	18,832,751
Net cash provided by operating activities		16,688,264	6,854,530
Investing activities:			
Purchase of property, equipment and improvements, and intangibles		(3,469,771)	(3,010,780)
Investment in AetherWorks Corporation		(2,000,000)	(3,500,000)
Net cash used in investing activities		(5,469,771)	(6,510,780)
Financing activities:			
Stock benefit plan transactions, net		563,718	389,792
Net cash provided by financing activities		563,718	389,792
Net increase in cash and cash equivalents		11,782,211	733,542
Cash and cash equivalents, beginning of period		31,329,666	8,943,390
Cash and cash equivalents, end of period		\$ 43,111,877	\$ 9,676,932

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

1. BASIS OF PRESENTATION

The interim condensed consolidated financial statements included in this Form 10-Q have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, 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 included in the Company's 1997 Annual Report and Form 10-K.

The condensed consolidated financial statements presented herein as of March 31, 1998 and for the three month and six month periods ended March 31, 1998 and 1997, reflect, in the opinion of management, all adjustments (which, other than the restructuring charge recorded in the three and six month periods ended March 31, 1997, consist only of normal, recurring adjustments) necessary for a fair presentation of the consolidated financial position and the consolidated results of operations and cash flows for the periods presented. The consolidated results of operations for any interim period are not necessarily indicative of results for the full year.

2. INVESTMENT IN AETHERWORKS CORPORATION

Through March 31, 1998, under a financing arrangement, the Company purchased \$13,796,525 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 no obligation to purchase additional notes. The convertible notes held by the Company at March 31, 1998 are convertible into 62.7% of AetherWorks' common stock, based on AetherWorks' present capitalization. In connection with the financing arrangement, the Company has also guaranteed \$3,060,000 of lease obligations of AetherWorks. In addition, in the fourth quarter of fiscal 1997, the Company leased to AetherWorks \$1,325,000 of computer equipment under a three-year direct financing lease.

As of September 30, 1997, because of significant uncertainty as to the future of AetherWorks Corporation, the Company wrote off its remaining investment in AetherWorks and accrued and expensed its then remaining future obligation to purchase additional convertible notes. In addition, the Company has also accrued \$1,350,000 for its estimated probable obligation resulting from its guarantees of certain AetherWorks lease obligations.

For the three month and six month periods ended March 31, 1997, the Company reported its investment in AetherWorks on the equity method and reported net losses of \$1,589,681 and \$3,109,470, respectively. Such losses represented 100% of AetherWorks net losses for the periods. The percentage of AetherWorks' net losses included in the Company's financial

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. INVESTMENT IN AETHERWORKS CORPORATION (CONTINUED)

statements was based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks during the periods. No such losses were recorded in the three month or six month periods ended March 31, 1998, due to the aforementioned write off of the Company's AetherWorks investment and the accrual of its remaining funding obligations to AetherWorks in the fourth quarter of fiscal 1997.

3. INVENTORIES

Inventories, net are stated at the lower of cost or market, with cost determined on the first-in, first-out method. Inventories at March 31, 1998 and September 30, 1997 consisted of the following:

	<u>March 31, 1998</u>	<u>September 30, 1997</u>
Raw materials	\$6,966,551	\$7,967,598
Work in process	6,910,102	8,704,357
Finished goods	5,732,742	7,011,357

4. NET INCOME (LOSS) PER SHARE

Net income (loss) per share for all periods presented has been calculated pursuant to the provisions of Statement of Financial Accounting Standards No. 128, which the Company adopted in the first quarter of fiscal 1998. Basic net income (loss) per share is calculated based on only the weighted average of common shares outstanding during the period. Net income (loss) per share, assuming dilution, is computed by dividing net income (loss) by the weighted average number of common and common equivalent shares outstanding during each period. The Company's only common stock equivalents are those that result from dilutive common stock options. Such common stock equivalents were excluded in determining the weighted average common and common stock equivalents outstanding for the three month and six month periods ended March 31, 1997, because their effect was antidilutive.

5. RECLASSIFICATION OF CERTAIN EXPENSES

Certain costs relating to systems support and communication costs, which previously were included in general and administrative expenses, have been reclassified into sales and marketing and research and development expenses for the three month and six month periods ended March 31, 1998 and 1997. Such amounts were \$853,158 and \$1,706,316 for the three month and six month periods ended March 31, 1998 and \$649,981 and \$1,316,622 for the three month and six month periods ended March 31, 1997, respectively. These reclassifications had no impact on previously reported operating income (loss) or net income (loss).

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. LEGAL PROCEEDINGS

Discussion of legal matters is incorporated by reference from Part II, Item I of this Form 10-Q “Legal Proceedings” and should be considered an integral part of these consolidated condensed financial statements and accompanying notes. The ultimate outcomes of the lawsuits 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.

REVIEW REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of
Digi International Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Digi International Inc. and subsidiaries as of March 31, 1998, and the related condensed consolidated statements of operations for the three month and six month periods ended March 31, 1998 and 1997, and cash flows for the six month periods ended March 31, 1998 and 1997. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet as of September 30, 1997, and the related consolidated statements of operations and cash flows for the year then ended (not presented herein); and in our report dated December 15, 1997, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of September 30, 1997, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ COOPERS & LYBRAND L.L.P.

Minneapolis, Minnesota
April 23, 1998

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

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from the Company's interim condensed consolidated statement of operations expressed as percentages of sales:

	Three months		%	Six Months		%
	ended		Increase	ended		Increase
	March 31		(decrease)	March 31		(Increase)
	<u>1998</u>	<u>1997</u>		<u>1998</u>	<u>1997</u>	
Net sales	100.0%	100.0%	11.6%	100.0%	100.0%	6.1%
Cost of sales	<u>48.8</u>	<u>52.2</u>	<u>4.2</u>	<u>49.3</u>	<u>52.9</u>	<u>(1.1)</u>
Gross margin	<u>51.2</u>	<u>47.8</u>	<u>19.5</u>	<u>50.7</u>	<u>47.1</u>	<u>14.1</u>
Operating expenses:						
Sales and marketing	20.0	22.7	(1.9)	19.7	24.4	(14.5)
Research and development	8.8	11.7	(16.4)	8.9	12.5	(25.0)
General and administrative	7.6	11.6	(26.6)	8.1	11.4	(25.3)
Restructuring	<u>0.0</u>	<u>25.9</u>	<u>(100.0)</u>	<u>0.0</u>	<u>12.7</u>	<u>100.0</u>
Total operating expenses	<u>36.4</u>	<u>72.0</u>	<u>(43.6)</u>	<u>36.6</u>	<u>61.1</u>	<u>(36.4)</u>
Operating income (loss)	14.8	(24.2)	168.1	14.1	(13.9)	207.2
Other income, net	1.2	0.3	331.2	0.9	0.3	261.3
AetherWorks Corporation net loss	<u>0.0</u>	<u>(3.9)</u>	<u>100.0</u>	<u>0.0</u>	<u>(3.8)</u>	<u>100.0</u>
Income (loss) before income taxes	16.0	(27.8)	164.2	15.0	(17.4)	191.4
Provision (benefit) for income taxes	<u>5.7</u>	<u>(4.6)</u>	<u>238.2</u>	<u>5.3</u>	<u>(2.9)</u>	<u>292.2</u>
Net income (loss)	<u>10.4%</u>	<u>(23.3%)</u>	<u>149.6%</u>	<u>9.7%</u>	<u>(14.5%)</u>	<u>171.0</u>

NET SALES

Net sales for the three month and six month periods ended March 31, 1998 were higher than net sales for the corresponding periods ended March 31, 1997 by approximately \$4.7 million and \$5.0 million or 11.6% and 6.1% respectively. The majority of the increase was due to the Company completing its effort to reduce inventory levels in the distribution channel through the first fiscal quarter of 1998, resulting in a net increase in sales into the distribution channel during the second quarter of fiscal 1998.

Net sales to the distribution markets, as a percentage of total net sales, increased to 72.4% and 68.0% for the three month and six month periods ended March 31, 1998, as compared to 60.5% and 64.8% for the comparable periods of 1997. Sequentially, net sales to the distribution markets for the three month period ended March 31, 1998 increased 20.8%, as compared to the

three month period ended December 31, 1997. The increase was directly related to the Company completing its program of reducing inventory levels, as previously discussed.

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

CONSOLIDATED RESULTS OF OPERATIONS (CONTINUED)

NET SALES (CONTINUED)

Net sales to original equipment manufacturers (OEM's), as a percentage of total net sales, were 19.8% and 23.5% for the respective three and six month periods ended March 31, 1998, as compared to 25.0% and 22.4% for the comparable periods in 1997.

The decline in the second quarter of fiscal 1998 was due to a decline in demand in print servers and a shift by certain OEM customers to a just in time shipment method, thereby reducing the amount of orders for the quarter. Sequentially, net sales to OEM's for the three month period ended March 31, 1998 declined 23.8% compared to the three month period ended December 31, 1997. The Company expects the OEM portion of the Company's business in the third quarter of fiscal 1998 to approximate the overall six month 1998 percentage of total net sales.

GROSS MARGIN

Gross margin for the three and six month periods ended March 31, 1998 was 51.2% and 50.7%, respectively, as compared to 47.8% and 47.1% for the comparable periods in 1997. Such increases versus 1997 were due primarily to a decrease of historically lower margin OEM and physical layer product net sales as a percentage of total net sales for the three months ended March 31, 1998 and to a \$1 million reduction in rebates during the first fiscal quarter of 1998.

OPERATING EXPENSES

Operating expenses for the three month period ended March 31, 1998 decreased 11.8% versus operating expenses (excluding \$10.5 million of restructuring charges) for the corresponding period ended March 31, 1997 and decreased as a percentage of net sales to 36.4% for the three month period ended March 31, 1998 from 46.1% (excluding restructuring charges) for the three month period ended March 31, 1997. Operating expenses for the six month period ended March 31, 1998 decreased by 19.8% versus operating expenses (excluding restructuring charges) for the six month period ended March 31, 1997. As a percentage of net sales, operating expenses declined to 36.6% for the six month period ended March 31, 1998, from 48.4% (excluding restructuring charges) for the corresponding period in 1997.

Such declines were due to reductions in the workforce, decreased marketing costs and cost savings achieved through consolidation of research and development functions.

The Company expects that operating expenses for subsequent quarters of fiscal 1998 will be similar to or slightly higher than the \$16.4 million incurred in the three months ended March 31, 1998.

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

CONSOLIDATED RESULTS OF OPERATIONS (CONTINUED)

OTHER INCOME

The increase in other income for the three month and six month periods ended March 31, 1998 was a result of additional interest income earned on increased cash and cash equivalent balances.

AETHERWORKS CORPORATION NET LOSS

In connection with the Company's purchase of \$13.8 million of convertible notes from AetherWorks Corporation, a development stage company engaged in the development of wireless and dial-up remote access technology, the Company's ownership interest upon conversion would be a majority of AetherWorks' common stock. In fiscal 1997, the Company reported its investment in AetherWorks on the equity method and recorded net losses of \$1,589,681 and \$3,109,470 for the three and six month periods ended March 31, 1997, respectively. These net losses represent 100% of AetherWorks' net losses for such periods. The percentage of AetherWorks' net losses included in the Company's financial statements was based upon the percentage of financial support provided by the Company (versus other investors) during such periods. The Company wrote off its investment in Aetherworks and accrued its then remaining obligations to purchase additional convertible notes and also accrued an additional \$1.4 million for its estimated probable obligation resulting from its guarantees of certain Aetherworks lease obligations as of September 30, 1997. As such, no losses were recorded in the three month or six month periods ended March 31, 1998. The Company completed its remaining obligations to purchase additional convertible notes during the second fiscal quarter of 1998.

INCOME TAXES

Income taxes have been accrued at an overall effective rate of 35.3% and 35.4% for the respective three and six month periods ended March 31, 1998. Due to the net losses incurred in both the three and six month periods ended March 31, 1997, the Company had recorded an income tax benefit of \$1,843,473 and \$2,425,905, respectively. Such benefits were lower than those which would have been determined using the overall statutory income tax rate due to the non-deductibility of certain intangible assets written off as part of the restructuring charge and the AetherWorks net losses.

FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations. Investing activities for the three month and six month periods ended March 31, 1998 consisted of purchases of equipment and capital improvements, including a new enterprise wide computer

system and intangibles and the final purchases of AetherWorks Corporation convertible notes. Equipment, system and other purchases totaled \$3,469,771 during the six month period ended

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

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

March 31, 1998. The final convertible note purchases from AetherWorks amounted to \$2 million for the six month period ended March 31, 1998. The Company has no further financial obligations under its agreements with AetherWorks Corporation other than approximately \$1.4 million for its estimated probable obligation resulting from its guarantees of certain AetherWorks lease obligations.

At March 31, 1998, the Company had working capital of approximately \$72 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 future business operations.

FOREIGN CURRENCY TRANSLATION

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

INFLATION

Management believes inflation has not had a material effect on the Company's operations or on its financial position.

NEW ACCOUNTING STANDARDS

As described in Note 4 to the Condensed Consolidated Financial Statements, the Company, in the first fiscal quarter of 1998, adopted Statement of Financial Accounting Standards No. 128, "Earnings Per Share."

In addition, during the first fiscal quarter of 1998, the Emerging Issues Task Force of the Financial Accounting Standards Board released Issue No. 97-13, "Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation" (EITF 97-13). The Task Force reached a consensus that the cost of business process reengineering activities, whether done internally or by third parties, is to be expensed as incurred. This consensus did not have a significant impact on the Company in its fiscal first and second quarters of 1998. The Company, however, will incur future costs in connection with the completion of its enterprise-wide information systems implementation project that will be required to be expensed pursuant to EITF 97-13. Such amounts are not expected to be material.

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

FORWARD LOOKING STATEMENTS

Certain statements made above, which are summarized below, are forward-looking statements that involve risks and uncertainties, and actual results may be materially different. Factors that could cause actual results to differ include those identified as follows:

The expectation that the Original Equipment Manufacturer (OEM) portion of the Company's business will return to the overall six month percentage of total net sales of March 31, 1998 in the third fiscal quarter - This expectation may be impacted by unanticipated revenue opportunities or changes in ordering levels that may reduce expected levels of net sales to OEMs.

The expectation that operating expenses in the remaining quarters of fiscal 1998 will be at levels similar to or slightly higher than those incurred in the second fiscal quarter of 1998 -This expectation may be impacted by presently unanticipated revenue opportunities or by unanticipated expenses.

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 3, 1997, the Company and certain of its previous officers were named as defendants in a putative securities class action lawsuit 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. Between January 17, 1997 and March 7, 1997, four similar putative securities class actions also were commenced. By Memorandum and Order dated April 2, 1997, the District Court consolidated all five of the putative securities class actions for all purposes including trial, appointed 21 persons to serve as lead plaintiffs in the consolidated class actions, and allowed the lead plaintiffs to file and serve a consolidated class action complaint.

On May 12, 1997, a consolidated amended class action complaint (the “Consolidated Amended Complaint”) was filed in the combined actions, which are captioned In re Digi International Inc. Securities Litigation, Master File No. 97-5 (JRT/RLE) (U.S. District Court for the District of Minnesota). The Consolidated Amended Complaint alleges that the Company and its previous officers Ervin F. Kamm, Jr., Gerald A. Wall and Gary L. Deaner violated the federal securities laws by, among other things, misrepresenting and/or omitting material information concerning the Company’s operations and financial results. The Consolidated Amended Complaint seeks compensatory damages in an unspecified amount plus interest against all defendants, jointly and severally, and an award of attorneys’ fees, experts’ fees and costs.

On July 3, 1997, defendants served a motion to dismiss the Consolidated Amended Complaint on the ground, among others, that it fails to plead claims in accordance with applicable law. The motion to dismiss was argued before the District Court on October 31, 1997. A ruling has not yet been received.

On February 25, 1997, the Company and certain of its previous officers also were named as defendants in a securities lawsuit filed in the United States District Court for the District of Minnesota by the Louisiana State Employees Retirement System and entitled Louisiana State Employees Retirement System in behalf of itself and in behalf of all other parties similarly situated and circumstanced who desire to personally join in this action and to contribute to the costs and expenses thereof, Plaintiffs, vs. Digi International Inc., Gary L. Deaner, Ervin F. Kamm, Jr., Gerald A. Wall, and “John Doe and “Richard Roe”, the names “John Doe” and “Richard Roe” being fictitious, the parties intended being those parties, presently unknown to the plaintiff, who participated in the wrongful acts set forth herein, Defendants, Civil File No. 97-440, Master File No. 97-5 (JRT/RLE) (U.S. District Court for the District of Minnesota). On June 3, 1997, the Louisiana State Employees Retirement System filed an Amended Complaint (the “Louisiana Amended Complaint”). The Louisiana Amended Complaint alleges that the Company and its previous officers Ervin F. Kamm, Jr., Gerald A. Wall and Gary L. Deaner violated federal securities laws and state common law by, among other things, misrepresenting and/or omitting material information concerning the Company’s operations and financial results.

PART II. OTHER INFORMATION (CONTINUED)

ITEM 1. LEGAL PROCEEDINGS (CONTINUED)

The Louisiana Amended Complaint seeks compensatory damages in the amount of \$718,404.70 plus interest against all defendants, jointly and severally, and an award of attorneys' fees, disbursements and costs. This action has been consolidated with the consolidated class actions for pretrial purposes.

On July 17, 1997, defendants served a motion to dismiss the Louisiana Amended Complaint on the ground, among others, that it fails to plead claims in accordance with applicable law. The motion to dismiss was argued before the District Court on October 31, 1997. A ruling has not yet been received.

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

At the Annual Meeting of Stockholders held on January 28, 1998, the stockholders approved the following:

- (a) Proposal to elect three directors, Richard E. Eichhorn, Mykola Moroz and Jerry A. Dusa for three-year terms. Mr. Eichhorn was elected on a vote of 11,754,699 in favor, with 305,769 shares withholding authority to vote. Mr. Moroz was elected on a vote of 11,831,626 in favor, with 228,842 shares withholding authority to vote. Mr. Dusa was elected on a vote of 11,824,694 in favor, with 235,774 shares withholding authority to vote.
- (b) Proposal to ratify the appointment of Coopers & Lybrand L.L.P. as independent public accountants for the Company for fiscal 1998. The proposal passed on a vote of 11,862,794 in favor, 171,542 against, 26,132 abstentions and no broker non-votes.

ITEM 5. OTHER INFORMATION

None

PART II. OTHER INFORMATION (CONTINUED)

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit No.	Description
3(a)	Restated Certificate of Incorporation of the Registrant, As Amended*
3(b)	Amended and Restated By-Laws of the Registrant**
15	Letter Re: Unaudited Interim Financial Information
27	Financial Data Schedule

(b) Reports on Form 8-K:

None.

*Incorporated by reference to the corresponding exhibit number of the Company's Form 10-K for the year ended September 30, 1992 (File No. 0-17972)

**Incorporated by reference to the corresponding exhibit number of the Company's Registration Statement on Form S-1 (File No. 33-42384)

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: April 30, 1998

By: /s/ Jonathon E. Killmer

Jonathon E. Killmer
Chief Financial Officer
(duly authorized officer and
Principal Financial Officer)