DIGI INTERNATIONAL INC
Form 10-Q
May 07, 2009

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

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended: March 31, 2009
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____.
Commission file number: 1-34033
DIGI INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	**41-1532464**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

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

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

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

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

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

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

On April 30, 2009, there were 24,620,820 shares of the registrant s $.01 par value Common Stock outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	Three months ended March 31,		Six months ended March 31,	
	2009	2008	2009	2008
	(in thousands, except per common share data)			
Net sales	$ 40,085	$ 43,070	$ 81,446	$ 87,644
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	19,908	18,986	38,977	38,529
Amortization of purchased and core technology	1,008	907	2,052	2,043
Gross profit	19,169	23,177	40,417	47,072
Operating expenses:				
Sales and marketing	8,976	9,034	18,601	17,720
Research and development	6,196	6,529	13,170	13,118
General and administrative	3,398	3,941	7,281	7,982
Total operating expenses	18,570	19,504	39,052	38,820
Operating income	599	3,673	1,365	8,252
Other income (expense):				
Interest income	404	1,020	984	2,074
Interest expense	(50)	(12)	(135)	(26)
Other income (expense)	41	(19)	(195)	
Total other income (expense)	395	989	654	2,048
Income before income taxes	994	4,662	2,019	10,300
Income tax provision	279	1,565	288	3,533
Net income	$ 715	$ 3,097	$ 1,731	$ 6,767
Net income per common share:				
Basic	$ 0.03	$ 0.12	$ 0.07	$ 0.26
Diluted	$ 0.03	$ 0.12	$ 0.07	$ 0.26

Weighted average common shares:				
Basic	24,953	25,714	25,169	25,666
Diluted	25,195	26,312	25,439	26,479

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

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DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2009	September 30, 2008
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,541	$ 14,176
Marketable securities	32,589	59,337
Accounts receivable, net	20,762	24,310
Inventories	34,212	30,240
Income taxes receivable	608	
Other	4,750	5,106
Total current assets	121,462	133,169
Marketable securities, long-term	2,507	179
Property, equipment and improvements, net	16,304	16,255
Identifiable intangible assets, net	28,293	34,032
Goodwill	83,122	86,578
Other	1,191	1,203
Total assets	$ 252,879	$ 271,416
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Capital lease obligations, current portion	$ 204	$ 267
Accounts payable	8,033	10,343
Income taxes payable		182
Accrued expenses:		
Compensation	3,840	5,981
Warranty	1,143	1,214
Deferred payment on acquisition	2,913	
Other	2,910	2,946
Total current liabilities	19,043	20,933
Capital lease obligations, net of current portion	2	78
Income taxes payable	4,780	4,358
Deferred tax liabilities	5,387	7,582
Deferred payment on acquisition	2,762	5,575
Other noncurrent liabilities	791	956
Total liabilities	32,765	39,482
Commitments and contingencies		
Stockholders equity:		

Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 60,000,000 shares authorized; 28,367,265 and 28,335,876 shares issued	283	283
Additional paid-in capital	179,394	177,614
Retained earnings	80,356	78,625
Accumulated other comprehensive loss	(11,513)	(1,897)
Treasury stock, at cost, 3,738,034 and 2,960,457 shares	(28,406)	(22,691)
Total stockholders equity	220,114	231,934
Total liabilities and stockholders equity	$ 252,879	$ 271,416

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

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

	Six months ended March 31, 2009	2008
	(in thousands)	
Operating activities:		
Net income	$ 1,731	$ 6,767
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, equipment and improvements	1,203	1,293
Amortization of identifiable intangible assets and other assets	3,662	3,499
Excess tax benefits from stock-based compensation	(42)	(165)
Stock-based compensation	1,842	1,776
Deferred income tax benefit	(1,540)	(1,920)
Other	40	32
Changes in operating assets and liabilities	(7,694)	(1,949)
Net cash (used in) provided by operating activities	(798)	9,333
Investing activities:		
Purchase of held-to-maturity marketable securities	(7,647)	(51,691)
Proceeds from maturities of held-to-maturity marketable securities	32,063	47,181
Contingent purchase price payments related to business acquisitions		(1,315)
Increase in noncurrent restricted cash		(392)
Proceeds from sale-leaseback and sale of other property, equipment, improvements		6,494
Purchase of property, equipment, improvements and certain other intangible assets	(1,666)	(1,908)
Net cash provided by (used in) investing activities	22,750	(1,631)
Financing activities:		
Payments on capital lease obligations	(139)	(188)
Excess tax benefits from stock-based compensation	42	165
Proceeds from stock option plan transactions	120	1,636
Proceeds from employee stock purchase plan transactions	529	348
Purchase of treasury stock	(6,150)	
Net cash (used in) provided by financing activities	(5,598)	1,961
Effect of exchange rate changes on cash and cash equivalents	(1,989)	(903)

Net increase in cash and cash equivalents	14,365	8,760
Cash and cash equivalents, beginning of period	14,176	18,375
Cash and cash equivalents, end of period	$ 28,541	$ 27,135

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

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

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

Basis of Presentation

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the Company, Digi, we, our, or us) pursuant to the rules and regulations of the Securities Exchange Commission (SEC). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including the summary of significant accounting policies, presented in our 2008 Annual Report on Form 10-K as filed with the SEC.

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

Changes in Presentation

We have reclassified certain prior year amounts to conform to the current year s presentation and to the presentation in our 2008 Annual Report on Form 10-K. These reclassifications had no effect on our reported consolidated net earnings.

Recently Issued Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP SFAS 157-4). FSP SFAS 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, Fair Value Measurements , when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP SFAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP SFAS 157-4 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009, and shall be applied prospectively. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

In April 2009, the FASB issued FASB Staff Position No. 115-2 and No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP SFAS 115-2). FSP SFAS 115-2 amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments in the financial statements. FSP SFAS 115-2 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009 and shall be applied to new and existing investments held by us as of April 1, 2009. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP SFAS 107-1). FSP SFAS 107-1 amends SFAS No. 107 Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements and also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. FSP SFAS 107-1 applies to all financial statements within the scope of SFAS No. 107 and requires all entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. FSP SFAS 107-1 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). FSP SFAS 142-3 intends to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flow used to measure the fair value of the asset under SFAS No. 141 (Revised 2007), Business Combinations and other accounting principles generally accepted in the United States. This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the impact of FSP SFAS 142-3 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)). This Statement retained the fundamental requirements in the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defined the acquirer as the entity that obtains control of one or more businesses in the business combination and established the acquisition date as the date that the acquirer achieves control. The new standard requires the acquiring entity in a business combination to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This Statement also makes certain other modifications to the former Statement. SFAS 141(R) is effective for business combinations that are consummated by us beginning October 1, 2009. Early adoption is not permitted. SFAS 141(R) is expected to have a material impact on how we will identify, negotiate, and value future acquisitions and how such acquisitions will affect our consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13 (FSP 157-1) and FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-1 amends SFAS 157 to exclude various accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13, with the exception of assets or liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141 or SFAS 141(R). FSP 157-2 defers the effective date of SFAS 157 to our fiscal years beginning October 1, 2009 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued FASB Staff Position No. 157-3 (FSP 157-3) which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. We adopted the required provisions of SFAS 157 for our financial assets and liabilities at the beginning of our fiscal year 2009 (see Note 7) and the remaining provisions for nonfinancial assets and liabilities will be adopted by us for our fiscal years beginning October 1, 2009. We are currently evaluating the impact of FSP 157-2 on our consolidated financial statements.

2. COMPREHENSIVE INCOME

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

	Three months ended March 31,		Six months ended March 31,	
	2009	2008	2009	2008
Net income	$ 715	$ 3,097	$ 1,731	$ 6,767
Other comprehensive (loss) income:				
Change in foreign currency translation (loss) gain	(1,713)	18	(9,614)	713
Change in unrealized gain (loss) on investments, net of tax	6		(2)	
Comprehensive (loss) income	$ (992)	$ 3,115	$ (7,885)	$ 7,480

3. NET INCOME PER COMMON SHARE

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. NET INCOME PER COMMON SHARE (CONTINUED)

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

	Three months ended March 31,		Six months ended March 31,	
	2009	2008	2009	2008
Numerator:				
Net income	$ 715	$ 3,097	$ 1,731	$ 6,767
Denominator:				
Denominator for basic net income per common share weighted average shares outstanding	24,953	25,714	24,169	25,666
Effect of dilutive securities:				
Employee stock options and employee stock purchase plan	242	598	270	813
Denominator for diluted net income per common share adjusted weighted average shares	25,195	26,312	24,439	26,479
Net income per common share, basic	$ 0.03	$ 0.12	$ 0.07	$ 0.26
Net income per common share, diluted	$ 0.03	$ 0.12	$ 0.07	$ 0.26

Potentially dilutive shares related to stock options to purchase 4,587,240 and 4,365,675 common shares for the three and six month periods ended March 31, 2009, respectively, and 2,378,069 and 1,021,239 common shares for the three and six month periods ended March 31, 2008, respectively, were not included in the computation of diluted earnings per common share because the options exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive.

4. ACQUISITIONS

Sarian Systems, Ltd.

On April 28, 2008, we acquired Sarian Systems, Ltd. (Sarian), which is now a wholly owned subsidiary of Digi International Ltd. Prior to the acquisition, Sarian was a privately held corporation located in the United Kingdom. The total purchase price of $30.9 million, net of $3.1 million of cash acquired, was for all of the outstanding ordinary shares of Sarian.

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in non-deductible goodwill of $15.4 million and a charge of $1.9 million for acquired in-process research and development. We believe that the acquisition resulted in the recognition of goodwill primarily because Sarian s wireless IP-based routing capability is highly complementary to our market approach and significantly expands our wireless offering.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of Sarian had occurred as of October 1, 2007 (in thousands, except per common share amounts).

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. ACQUISITIONS (CONTINUED)

Pro forma adjustments include amortization of identifiable intangible assets and the $1.9 million charge related to acquired in-process research and development associated with the Sarian acquisition.

	Three months ended March 31, 2008		Six months ended March 31, 2008	
	Pro forma	As Reported	Pro forma	As Reported
Net sales	$ 45,943	$ 43,070	$ 94,530	$ 87,644
Net income	$ 918	$ 3,097	$ 4,650	$ 6,767
Net income per common share, basic	$ 0.04	$ 0.12	$ 0.18	$ 0.26
Net income per common share, diluted	$ 0.03	$ 0.12	$ 0.18	$ 0.26

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the Sarian acquisition occurred as of the beginning of fiscal 2008 as presented above, nor are they necessarily indicative of the results that will be obtained in the future.

Spectrum Design Solutions, Inc.

On July 23, 2008, we acquired Spectrum Design Solutions, Inc. (Spectrum), which is a wholly owned subsidiary of Digi International Inc. Prior to the acquisition, Spectrum was a privately held Minneapolis-based corporation and a leading wireless design services organization. The acquisition was a cash merger for $10.0 million of which $4.0 million was paid on the acquisition date, $3.0 million will be paid in January 2010, and the remaining $3.0 million will be paid in July 2011. We have determined that the Spectrum acquisition is not material to our consolidated results of operations or financial condition. Therefore, pro forma financial information is not presented.

5. SELECTED BALANCE SHEET DATA
(in thousands)

	March 31, 2009	September 30, 2008
Accounts receivable, net:		
Accounts receivable	$ 21,286	$ 25,007
Less allowance for doubtful accounts	524	697
	$ 20,762	$ 24,310
Inventories:		
Raw materials	$ 26,882	$ 20,979
Work in process	1,437	981
Finished goods	5,893	8,280
	$ 34,212	$ 30,240
Other accrued expenses:		
Accrued professional fees	621	507
Deferred gain on building sale short-term	250	273
Unearned revenue	61	353
Other accrued expenses	1,978	1,813
	$ 2,910	$ 2,946

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. MARKETABLE SECURITIES

Our marketable securities consist of commercial paper, corporate bonds and government municipal bonds. Prior to October 1, 2008, all marketable securities were classified as held-to-maturity and carried at amortized cost, except for the Lehman Brothers security, which was carried at expected realizable value due to an other-than-temporary impairment recorded during the fourth quarter of fiscal 2008. We changed our policy as of October 1, 2008 to account for our marketable securities as available-for-sale on a prospective basis with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders equity. In addition, we have reclassified the Lehman Brothers security as available-for-sale as we plan on selling a portion of this bond in fiscal 2009, as discussed further below. We continue to account for all other marketable securities purchased prior to October 1, 2008 as held-to-maturity.

We analyze our held-to-maturity investments for impairment on an ongoing basis. Factors considered in determining whether an unrealized loss is a temporary loss or an other-than-temporary loss include the length of time and extent to which the securities have been in an unrealized loss position, the trend of any unrealized losses and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated market recovery. During the fourth quarter of fiscal 2008, we recorded an other-than-temporary impairment of $1,014,900 on a bond issued by Lehman Brothers with a par amount of $1,194,000. This impairment reflected the estimated decline in the value of this security precipitated by the bankruptcy of the security s issuer. The impairment charge was recorded as a temporary tax difference as we have sufficient capital gains in the available carryback years to utilize the capital loss that will be realized when the bond is sold. We expect to sell a portion of the bond in fiscal 2009, and carryback the capital loss to utilize a capital gain which was generated in fiscal 2006 for which the statute of limitations will expire at the end of fiscal 2009. The resulting value of $179,100 for the security became its new cost basis as of September 30, 2008. No additional other-than-temporary impairment charges for the Lehman Brothers bond were recorded for the six month period ended March 31, 2009 as there has not been any change in the fair value assumptions utilized to calculate the impairment.

We obtain quoted market prices and trading activity for each security, where available, review the financial solvency of each security issuer and obtain other relevant information from our investment advisors to estimate the fair value for each security in our investment portfolio. As of March 31, 2009, 13 of our securities were trading below our amortized cost basis. Other than the impaired Lehman Brothers security, we determined each decline in value to be temporary based upon the factors described above. We expect to realize the full par value of these securities, plus accrued interest, at the time of maturity for our held-to-maturity investments. For those assets classified as available-for-sale, we expect to realize the fair value of these securities, plus accrued interest, either at the time of maturity or when the security is sold.

Held-to-maturity marketable securities are recorded at amortized cost on our balance sheet as of March 31, 2009 and were comprised of the following (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Corporate bonds	$ 23,675	$ 17	$ (196)	$ 23,496
Government municipal bonds	3,663	16		3,679
	$ 27,338	$ 33	$ (196)	$ 27,175

(1) Included in amortized cost and fair value is purchased and accrued interest

of $416,507.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. MARKETABLE SECURITIES (CONTINUED)

Available-for-sale marketable securities are recorded at fair value on our balance sheet and the unrealized loss is recorded in accumulated other comprehensive loss as of March 31, 2009 and was comprised of the following (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Corporate bonds (2)	$ 4,285	$ 5	$ (1)	$ 4,289
Government municipal bonds	3,477		(8)	3,469
	$ 7,762	$ 5	$ (9)	$ 7,758

(1) Included in amortized cost and fair value is purchased and accrued interest of $101,969.

(2) The Lehman Brothers security is included in amortized cost at a fair value of $179,100, net of the impairment charge of $1,014,900 recorded in the fourth quarter of fiscal 2008.

Marketable securities were comprised of the following as of September 30, 2008 (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Corporate bonds (2)	$ 55,807	$ 12	$ (2,771)	$ 53,048
Government municipal bonds	3,709		(10)	3,699
Total marketable securities	$ 59,516	$ 12	$ (2,781)	$ 56,747

(1) Included in amortized cost and fair value is purchased and accrued interest

of $967,258.

(2) The Lehman Brothers security is included in amortized cost at a fair value of $179,100, net of the impairment charge of $1,014,900 recorded in the fourth quarter of fiscal 2008.

Securities that mature within one year are classified as current assets on the balance sheet and securities classified as noncurrent have a maturity of greater than one year from the date of purchase. We do not invest in securities with a maturity in excess of 24 months.

7. FAIR VALUE MEASUREMENTS

We adopted SFAS 157 as of October 1, 2008, with the exception of the application of SFAS 157 to nonfinancial assets and liabilities. SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements.

Under SFAS 157, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. SFAS 157 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability based upon the best information available in the circumstances. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. FAIR VALUE MEASUREMENTS (CONTINUED)

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

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

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

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

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

As of our effective date of October 1, 2008, fair value under SFAS 157 is applied to financial assets such as commercial paper, corporate bonds and government municipal bonds which are classified and accounted for as available-for-sale. These items are stated at fair value at each reporting period; however, the definition of fair value is now applied using SFAS 157.

The following table provides information by level for financial assets that are measured at fair value, as defined by SFAS No. 157, on a recurring basis (in thousands):

		Fair Value Measurements at March 31, 2009 Using:		
	Total carrying value at March 31, 2009	Quoted price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash equivalents:				
Money market	$ 14,585	$ 14,585	$	$
Available-for-sale marketable securities:				
Corporate bonds	7,758	7,579		179
Total cash equivalents and marketable securities measured at fair value	$ 22,343	$ 22,164	$	$ 179

Cash equivalents and marketable securities measured at fair value using quoted market prices are classified within Level 1 of the valuation hierarchy.

Level 3 Valuation Techniques

Financial assets are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial assets also include certain investment securities for which there is limited market activity or a decrease in the observability of market pricing for these investments, such that the determination of fair value requires significant judgment or estimation. Our Lehman Brothers security was valued at $179,100 primarily using broker pricing that incorporates transaction details within an inactive market as a baseline, as well as assumptions about liquidity and credit valuation adjustments of marketplace participants at March 31, 2009. No change was made in the Level 3 valuation during the first six months of fiscal 2009.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. FAIR VALUE MEASUREMENTS (CONTINUED)

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

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS

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

	March 31, 2009			September 30, 2008		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$ 45,035	$ (32,518)	$ 12,517	$ 46,660	$ (30,745)	$ 15,915
License agreements	2,440	(2,440)		2,440	(2,440)	
Patents and trademarks	9,132	(5,166)	3,966	8,906	(4,682)	4,224
Customer maintenance contracts	700	(499)	201	700	(464)	236
Customer relationships	17,056	(6,218)	10,838	18,137	(5,472)	12,665
Non-compete agreements	1,014	(243)	771	1,075	(83)	992
Total	$ 75,377	$ (47,084)	$ 28,293	$ 77,918	$ (43,886)	$ 34,032

Amortization expense was $1.8 million and $1.6 million for the three months ended March 31, 2009 and 2008, respectively, and $3.7 million and $3.5 million for the six months ended March 31, 2009 and 2008, respectively. Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2009 and the five succeeding fiscal years is as follows (in thousands):

2009 (six months)	$ 3,850
2010	7,253
2011	5,362
2012	3,952
2013	2,962
2014	2,648

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

	Six months ended March 31, 2009	Six months ended March 31, 2008
Beginning balance, October 1	$ 86,578	$ 66,817
Foreign currency translation adjustment	(3,456)	503
Ending balance, March 31	$ 83,122	$ 67,320

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. INCOME TAXES

Income taxes have been provided at an effective rate of 14.3% and 34.3% for the six month periods ended March 31, 2009 and 2008, respectively.

On October 3, 2008 the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was signed into law. That act retroactively extended the research and development tax credit until December 31, 2009. We recorded a discrete tax benefit of $0.4 million during the first quarter of fiscal 2009 for research and development credits earned during the last three quarters of fiscal 2008.

The discrete tax event affected our effective tax rates as shown in the table below:

	Six months ended March 31,	
	2009	2008
Effective tax rate before impact of discrete tax benefits	34.8%	34.3%
Impact of discrete tax benefits	-20.5%	0.0%
Effective tax rate	14.3%	34.3%

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

Uncertain tax positions as of December 31, 2008	$ 3,851
Increases related to current year income tax positions	150
Uncertain tax positions as of March 31, 2009	$ 4,001

The total amount of uncertain tax positions that, if recognized, would affect our effective tax rate is $3.8 million.

We recognize interest and penalties related to income tax matters in income tax expense. During the six months ended March 31, 2009, we recognized $0.1 million in interest and penalties. As of March 31, 2009, we had $0.8 million in accrued interest and penalties on our consolidated balance sheet.

There are no tax positions for which it is reasonably possible that the total amounts of uncertain tax positions will significantly increase or decrease over the next 12 months.

We operate in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, we must determine the appropriate allocation of income to each of these jurisdictions. This determination requires us to make several estimates and assumptions. Tax audits associated with the allocation of this income, and other complex issues, may require an extended period of time to resolve and may result in adjustments to our income tax balances in those years that are material to our consolidated financial position and results of operations. Certain open tax years are expected to close in future periods that may result in adjustments to our income tax balances in those periods that are material to our consolidated financial position and results of operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. FINANCIAL GUARANTEES

In general, we warrant our products to be free from defects in material and workmanship under normal use and service for a period of up to five years from the date of receipt. We have the option to repair or replace products we deem defective with regard to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidence and are evaluated on an ongoing basis to ensure the adequacy of the warranty reserve. The following table summarizes the activity associated with the product warranty accrual (in thousands):

	Three months ended March 31,			
Fiscal year	Balance at January 1	Warranties issued	Settlements made	Balance at March 31
2009	$ 1,230	$ 123	$ (210)	$ 1,143
2008	$ 1,134	$ 193	$ (194)	$ 1,133

	Six months ended March 31,			
Fiscal year	Balance at October 1	Warranties issued	Settlements made	Balance at March 31
2009	$ 1,214	$ 344	$ (415)	$ 1,143
2008	$ 1,155	$ 358	$ (380)	$ 1,133

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

11. CONTINGENCIES

Contingent obligations

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of our subsidiary NetSilicon, Inc. and approximately 300 other public companies. We acquired Net Silicon, Inc. on February 13, 2002. The complaint names us as a defendant along with NetSilicon, certain of its officers and certain underwriters involved in NetSilicon s IPO, among numerous others, and asserts, among other things, that NetSilicon s IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon s IPO underwriters in allocating shares in NetSilicon s IPO to the underwriters customers. We believe that the claims against the NetSilicon defendants are without merit and have defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

In June 2003, we elected to participate in a proposed settlement agreement with the plaintiffs in this litigation. Had it been approved by the Court, this proposed settlement would have resulted in a dismissal, with prejudice, of all claims in the litigation against us and against any of the other issuer defendants who elected to participate in the proposed settlement, together with the current or former officers and directors of participating issuers who were named as individual defendants. This proposed issuer settlement was conditioned on, among other things, a ruling by the District Court that the claims against NetSilicon and against the other issuers who had agreed to the settlement would be certified for class action treatment for purposes of the proposed settlement, such that all investors included in the proposed classes in these cases would be bound by the terms of the settlement unless an investor opted to be excluded from the settlement in a timely and appropriate fashion.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. CONTINGENCIES (CONTINUED)

On December 5, 2006, the U.S. Court of Appeals for the Second Circuit issued a decision in In re Initial Public Offering Securities Litigation that six purported class action lawsuits containing allegations substantially similar to those asserted against us could not be certified as class actions due, in part, to the Court of Appeals determination that individual issues of reliance and knowledge would predominate over issues common to the proposed classes. On January 8, 2007, the plaintiffs filed a petition seeking rehearing en banc of this ruling. On April 6, 2007 the Court of Appeals denied the plaintiffs petition for rehearing of the Court s December 5, 2006 ruling. The Court of Appeals, however, noted that the plaintiffs remained free to ask the District Court to certify classes different from the ones originally proposed which might meet the standards for class certification that the Court of Appeals articulated in its December 5, 2006 decision. The plaintiffs have since moved for certification of different classes in the District Court, and that motion remains pending. In light of the Court of Appeals December 5, 2006 decision regarding certification of the plaintiffs claims, the District Court entered an order on June 25, 2007 terminating the proposed settlement between the plaintiffs and the issuers, including NetSilicon.

On August 14, 2007, the plaintiffs filed amended complaints in six focus cases. On November 13, 2007, the issuer defendants and the underwriter defendants separately moved to dismiss the claims against them in the amended complaints in the six focus cases. On March 26, 2008, the District Court issued an order in which it denied in substantial part the motions to dismiss the amended complaints in the six focus cases.

On February 25, 2009, the parties advised the District Court that they have reached an agreement-in-principle to settle the litigation in its entirety. A stipulation of settlement was filed with the District Court on April 2, 2009. The proposed global settlement remains subject to preliminary and final approval by the District Court. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of this pending lawsuit. We maintain liability insurance for such matters and expect that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of March 31, 2009, we have an accrued liability for the deductible amount of $250,000 which we believe is adequate and reflects the amount of loss that is probable. In the event we have losses that exceed the limits of the liability insurance, such losses could have a material effect on our business and our consolidated results of operations or financial condition.

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

12. SALE AND LEASEBACK OF BUILDING

On February 18, 2008, we entered into a contract for the sale of our building in Dortmund, Germany, and subsequent partial leaseback for a five year term (the Agreement). Upon the closing of the transaction in March 2008, we initiated the leaseback of approximately 40% of the property for a period of five years, with a renewal option for an additional five years.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

12. SALE AND LEASEBACK OF BUILDING (CONTINUED)

The building was sold for 4.5 million Euros (equivalent to $6.9 million), resulting in a gain on the sale of 1.0 million Euros ($1.6 million). As a result of the leaseback, $1.5 million of the gain on the sale was deferred and will be recognized ratably over the lease term as an offset to rent expense. The remaining $0.1 million was recognized in the second quarter of fiscal 2008 as a component of general and administrative expense. Of the total sale price, 4.2 million Euros ($6.5 million) was received during March 2008 and the remaining 0.3 million Euros ($0.4 million) was received in April 2008. These obligations required us, as part of the Agreement, to deposit 0.3 million Euros ($0.4 million) into an interest-bearing bank account, which will be refunded to us at the end of the lease term. This deposit was made during March 2008 and is included in other noncurrent assets as restricted cash on our consolidated balance sheet.

13. SUBSEQUENT EVENT

On April 23, 2009, we announced a business restructuring to increase our focus on wireless and reduce our emphasis on individual hardware products in favor of solutions that include hardware, software and services. The restructuring will include the closing of an engineering location in Long Beach, California, and the relocation and consolidation of the manufacturing facility in Davis, California to our Minneapolis, Minnesota headquarters. The restructuring will result in a workforce reduction of 87 positions or 13% of our total workforce. We believe that these restructuring actions will improve profitability in future quarters. We expect to record a pre-tax charge of approximately $2.0 million during the third quarter of fiscal 2009 related to this restructuring.

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

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

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

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

Our operating results and performance trends may be affected by a number of factors, including, without limitation, those described under Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended September 30, 2008. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in our filings with the Securities and Exchange Commission, including without limitation, our quarterly reports on Form 10-Q and our registration statements, could cause our actual future results to differ from those projected in the forward-looking statements as a result of the factors set forth in our various filings with the Securities and Exchange Commission and of changes in general economic conditions, changes in interest rates and/or exchange rates and changes in the assumptions used in making such forward-looking statements.

CRITICAL ACCOUNTING POLICIES

A description of our critical accounting policies was provided in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended September 30, 2008. An update to our critical accounting policy related to goodwill and marketable securities is included below.

Goodwill

Goodwill is tested for impairment on an annual basis as of June 30, or more frequently if events or circumstances occur which could indicate impairment. We continue to closely monitor for possible impairment due to our declining stock prices, the continuing impacts of the economic downturn on our expected operating results and the broader effects of U.S. market conditions on the fair value of our assets.

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

CRITICAL ACCOUNTING POLICIES (CONTINUED)

We have defined the criteria that will result in additional interim goodwill impairment testing. If these criteria are met, we will undertake the analysis to determine whether a goodwill impairment has occurred, which could have a material effect on our financial position and results of operations. As of March 31, 2009 the estimated fair value of common stock, including a control premium of 30%, exceeded the carrying value of our net assets. However, our stock price has continued to decline from the previous quarter at both December 31, 2008 and March 31, 2009. If our stock price were to decline from current levels and then remain low, the risk of a near-term impairment increases significantly.

The evaluation of asset impairment requires us to make assumptions about future cash flows and revenues. These assumptions require significant judgment and actual results may differ from assumed or estimated amounts. If these estimates and assumptions change, we may be required to recognize impairment losses in the future.

Marketable Securities

We changed our policy as of October 1, 2008 to account for our marketable securities as available-for-sale on a prospective basis. All marketable securities purchased after October 1, 2008 are carried at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders equity. In addition, we have reclassified the Lehman Brothers bond as available-for-sale as we plan on selling a portion of this bond in fiscal 2009. We obtain quoted market prices and trading activity for each security, where available, review the financial solvency of each security issuer and obtain other relevant information from our investment advisors to estimate the fair value for each security in our investment portfolio.

OVERVIEW

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

We help customers connect, monitor, and control local or remote electronic devices over a network or via the Internet. We continue to leverage a common core technology base to develop and provide innovative connectivity solutions to our customers. Our Drop-In Networking Solutions initiative provides opportunities for us in the next wave of Internet growth. The initial wave was focused on connecting people, first with personal computers and now with cell phones, PDA s and other related consumer devices. This next wave is about connecting devices and machines. We are ideally positioned to take full advantage of the second wave of Internet growth with our Drop-In Networking Solutions that will provide significant market expansion in what is now being referred to in the market as wireless machine to machine (M2M) connectivity.

M2M communication works by connecting communication hardware to a physical asset so that information about its status and performance can be sent to a computer system and used to automate a business process or a human action so that a person does not have to do it manually. Incorporating products from both our embedded and non-embedded categories, our Drop-In Networking Solutions are making it easy for customers to effectively drop-in a wireless M2M solution. During the second quarter of fiscal 2009, we expanded on Drop-in Networking and introduced our iDigi Solutions brand. iDigi Solution bundles software and services to our Drop-in Networking product offerings to make M2M deployments even easier, faster, and more economical. At the heart of an iDigi Solution bundle is the iDigi Platform, a Platform as a Service (PaaS) that quickly and easily connects remote assets to a customer s business applications. The iDigi Platform runs on a grid of Digi-managed servers. As an on-demand model, customers pay only for services consumed, conserving capital and requiring no infrastructure. iDigi Energy was launched as the first iDigi Solution bundle and targets the Smart Grid efforts of energy services providers.

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

OVERVIEW (CONTINUED)

The decrease in revenue and earnings per diluted share for the first six months of fiscal 2009 compared to the first six months of fiscal 2008 is a result of lower than anticipated revenue across all regions and most product lines attributable to rapidly deteriorating demand conditions for our products that began in November 2008. The strengthening of the U.S. dollar compared to the Euro and the British pound also contributed to the decrease in revenue and operating income. Total revenue was lower than anticipated in the second fiscal quarter of 2009 compared to the prior year comparable quarter. Wireless revenue increased as a percent of total revenue from 21.8% in the second quarter of fiscal 2008 to 34.9% in the second quarter of fiscal 2009. We anticipate that growth in the future will result from products and services that are developed internally as well as from products and services that are acquired. We are continuing to invest in our wireless products and services while closely monitoring and controlling discretionary spending. We also are actively managing our supply chain to ensure that our key sources of supply are intact.

During the second quarter of fiscal 2009, as part of our expense reduction measures, we eliminated our non-sales incentive compensation program for fiscal 2009. This program applies to executive management as well as a large part of the employee base. In addition, we will reduce our sales commission program for the third and fourth quarters of fiscal 2009. During the second quarter of fiscal 2009, we reversed incentive compensation accrued for the first quarter of fiscal 2009 of $0.9 million, which was included in our cost of sales and all of our operating expense categories.

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from our interim condensed consolidated statements of operations expressed in dollars, as a percentage of net sales and as a percentage of change from period-to-period for the periods indicated (dollars in thousands):

	Three months ended March 31,				% increase (decrease)	Six months ended March 31,				% increase (decrease)
	2009		2008			2009		2008		
Net sales	$ 40,085	100.0%	$ 43,070	100.0%	(6.9)%	$ 81,446	100.0%	$ 87,644	100.0%	(7.1)%
Cost of sales (exclusive of amortiza- tion of purchased and core technology shown separately below)	19,908	49.7	18,986	44.1	4.9	38,977	47.9	38,529	44.0	1.2
Amortization of purchased and core technology	1,008	2.5	907	2.1	11.1	2,052	2.5	2,043	2.3	0.4
Gross profit	19,169	47.8	23,177	53.8	(17.3)	40,417	49.6	47,072	53.7	(14.1)
Operating expenses:										
Sales and marketing	8,976	22.4	9,034	21.0	(0.6)	18,601	22.8	17,720	20.2	5.0
	6,196	15.4	6,529	15.1	(5.1)	13,170	16.2	13,118	15.0	0.4

Research and development										
General and administrative	3,398	8.5	3,941	9.2	(13.8)	7,281	8.9	7,982	9.1	(8.8)
Total operating expenses	18,570	46.3	19,504	45.3	(4.8)	39,052	47.9	38,820	44.3	0.6
Operating income	599	1.5	3,673	8.5	(83.7)	1,365	1.7	8,252	9.4	(83.5)
Interest income and other, net	395	1.0	989	2.3	(60.1)	654	0.8	2,048	2.3	(68.1)
Income before income taxes	994	2.5	4,662	10.8	(78.7)	2,019	2.5	10,300	11.7	(80.4)
Income tax provision	279	0.7	1,565	3.6	(82.2)	288	0.4	3,533	4.0	(91.8)
Net income	$ 715	1.8%	$ 3,097	7.2%	(76.9)%	$ 1,731	2.1%	$ 6,767	7.7%	(74.4)%

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

NET SALES

The following summarizes our net sales for the periods indicated:

($ in thousands)	Three months ended March 31, 2009		2008		% increase (decrease)	Six months ended March 31, 2009		2008		% increase (decrease)
Non-embedded	$ 22,715	56.7%	$ 21,358	49.6%	6.4%	$ 46,055	56.5%	$ 45,215	51.6%	1.9%
Embedded	17,370	43.3	21,712	50.4	(20.0)	35,391	43.5	42,429	48.4	(16.6)
Total net sales	$ 40,085	100.0%	$ 43,070	100.0%	(6.9)%	$ 81,446	100.0%	$ 87,644	100.0%	(7.1)%

Non-embedded

Our non-embedded revenue increased by $1.3 million or 6.4% for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 and increased by $0.8 million or 1.9% for the six months ended March 31, 2009 compared to the six months ended March 31, 2008. The increases resulted primarily from an increase in cellular products and incremental net sales of Sarian-branded products, which were offset by decreases in net sales of serial cards, serial server and USB products. Most of the increase in our non-embedded net sales took place in the European, Middle Eastern and African (EMEA) region due to the acquisition of Sarian which provided net sales of $5.0 million and $8.1 million for the three and six month periods ended March 31, 2009, respectively, offset by a decrease in the North American, Asian Pacific and Latin American regions. Without the Sarian acquisition, our non-embedded revenue would have decreased 17.0% and 16.1% for the three and six months ended March 31, 2009, respectively. Sarian was acquired during the third quarter of fiscal 2008.

Embedded

Our embedded revenue decreased by $4.3 million or 20.0% for the three months ended March 31, 2009 compared to the three months ended March 31, 2008, and decreased by $7.0 million or 16.6% for the six months ended March 31, 2009 compared to the six months ended March 31, 2008. The decreases resulted primarily from decreases in net sales of modules. Most of the decrease in our embedded net sales took place in the North American, EMEA and Latin American regions. Spectrum net sales of $1.2 million and $2.2 million for the three and six months ended March 31, 2009, respectively, are included in the North American embedded product sales. Without the Spectrum acquisition our embedded revenue would have decreased 25.3% and 21.7% for the three and six months ended March 31, 2009, respectively. Spectrum was acquired during the fourth quarter of fiscal 2008.

The following summarizes our net sales by geographic region:

($ in thousands)	Three months ended March 31, 2009	2008	$ increase (decrease)	% increase (decrease)	Six months ended March 31, 2009	2008	$ increase (decrease)	% increase (decrease)
North America (1)	$ 20,724	$ 23,959	$ (3,235)	(13.5)%	$ 43,869	$ 52,083	$ (8,214)	(15.8)%
EMEA (2)	14,934	12,785	2,149	16.8	28,262	23,929	4,333	18.1
Asia Pacific	3,776	4,621	(845)	(18.3)	7,610	9,150	(1,540)	(16.8)
Latin America (including Mexico)	651	1,705	(1,054)	(61.8)	1,705	2,482	(777)	(31.3)
Total net sales	$ 40,085	$ 43,070	$ (2,985)	(6.9)%	$ 81,446	$ 87,644	$ (6,198)	(7.1)%

(1)

Includes Spectrum net sales of $1,143,047 and $2,191,457 for the three and six months ended March 31, 2009, respectively.

(2) Includes Sarian net sales of $4,996,951 and $8,107,598 for the three and six months ended March 31, 2009, respectively.

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

NET SALES (CONTINUED)

The strengthening of the U.S. dollar compared to the Euro, British Pound and Japanese Yen for the three and six month periods ended March 31, 2009 compared to the same periods in the prior year had an unfavorable impact on net sales of $2.6 million and $4.0 million, respectively.

GROSS MARGIN

Gross margins for the three and six months ended March 31, 2009 was 47.8% and 49.6%, respectively, compared to 53.8% and 53.7% for the three and six months ended March 31, 2008, respectively. The decrease in the gross margin for the three months ended March 31, 2009 as compared to the same period a year ago was due to unfavorable product mix within primarily the non-embedded products, including sales of Sarian non-embedded products which provide lower gross margins. The strengthening of the U.S. dollar compared to the Euro and British Pound had an unfavorable impact on gross margin of approximately 1.1% and 0.6% for the three and six months ended March 31, 2009, respectively, as compared to the same periods a year ago.

OPERATING EXPENSES

Total operating expenses decreased by $0.9 million and increased by $0.2 million for the three and six months ended March 31, 2009 as compared to the same periods a year ago as follows:

($ in thousands)	Three months ended March 31, 2009		2008		$ increase (decrease)	Six months ended March 31, 2009		2008		$ increase (decrease)
Sales and marketing	$ 8,976	22.4%	$ 9,034	21.0%	$ (58)	$ 18,601	22.8%	$ 17,720	20.2%	$ 881
Research and development	6,196	15.4	6,529	15.1	(333)	13,170	16.2	13,118	15.0	52
General and administrative	3,398	8.5	3,941	9.2	(543)	7,281	8.9	7,982	9.1	(701)
Total operating expenses	$ 18,570	46.3%	$ 19,504	45.3%	$ (934)	$ 39,052	47.9%	$ 38,820	44.3%	$ 232

The net decrease of $0.1 million in sales and marketing expenses for the three months ended March 31, 2009 as compared to March 31, 2008 was primarily due to a decrease of $0.2 million in compensation-related expenses, a reduction of $0.2 million for advertising costs and a $0.2 million reduction for recruiting fees and travel costs, offset by an increase due to the incremental ongoing costs related to the Sarian and Spectrum acquisitions of $0.5 million. For the six months ended March 31, 2009 as compared to March 31, 2008, the net increase in sales and marketing expenses was $0.9 million primarily due to $1.2 million of incremental ongoing costs due to the acquisition of Sarian and Spectrum, offset by a reduction of $0.3 million of advertising and marketing expenses.

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

OPERATING EXPENSES (CONTINUED)

The net decrease of $0.3 million in research and development expenses for the three months ended March 31, 2009 compared to March 31, 2008 was due primarily to a decrease of $0.7 million for compensation-related expenses, offset by an increase of $0.2 million of outside service expense primarily for certification of wireless products and incremental ongoing expenses of $0.2 million related to the acquisition of Sarian and Spectrum. Research and development expenses for the six months ended March 31, 2009 increased $0.1 million compared to the same period a year ago due primarily to an increase of $0.4 million in outside service expense primarily for certification of wireless products and incremental ongoing expenses of $0.4 million related to the acquisitions of Sarian and Spectrum, offset by a decrease of $0.5 million of compensation-related expenses and a decrease of $0.2 million pertaining to agency testing and various development projects.

The net decrease in general and administrative expenses of $0.5 million for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 is primarily due to a decrease of compensation-related expenses of $0.6 million, a $0.3 million reduction in depreciation and amortization expenses and a $0.5 million reduction in legal fees and other general and administrative expenses, offset by an increase of $0.3 million related to the loss of sublease income due to the sale of the Dortmund building and $0.6 million of incremental ongoing expenses due to the acquisitions of Sarian and Spectrum. For the six months ended March 31, 2009 compared to March 31, 2008, the net decrease in general and administrative expenses of $0.7 million was due primarily to a decrease of $0.9 million in compensation-related expenses, $0.6 million in reduced depreciation and amortization as the Dortmund building was sold and certain intangibles became fully amortized, $0.4 million in reduced professional fees and outside consulting fees, and a reduction of $0.7 million in other miscellaneous general and administrative expenses. This was offset by an increase of $1.5 million in incremental ongoing expenses related to the Sarian and Spectrum acquisitions, and $0.4 million of increased rent due mostly to the elimination of a sublease income and recognized gain on the sale of the Dortmund building.

INTEREST INCOME AND OTHER, NET

Other income, net was $0.4 million and $0.7 million for the three and six months ended March 31, 2009 compared to $1.0 million and $2.1 million for the three and six months ended March 31, 2008, respectively. The decrease of $0.6 million and $1.4 million for the three and six months ended March 31, 2009, respectively, as compared to the same periods a year ago, was due mostly to a reduction in interest income. We earned a lower average interest rate of 2.8% and 3.3% for the three and six months ended March 31, 2009, respectively, compared to 4.7% and 4.9% for the three and six months ended March 31, 2008. The average invested balance for the three and six months ended March 31, 2009 was $53.5 million and $57.1 million, respectively, and for the three and six months ended March 31, 2008 was $86.1 million and $84.6 million, respectively.

INCOME TAXES

For the six month period ended March 31, 2009, income taxes have been provided at an effective rate of 14.3% compared to 34.3% for the six month period ended March 31, 2008. On October 3, 2008 the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was signed into law. That act retroactively extended the research and development tax credit until December 31, 2009. As a result, we recorded a discrete tax benefit of $0.4 million during the first quarter of fiscal 2009 for research and development credits earned during the last three quarters of fiscal 2008. The total discrete tax benefits for the six months ended March 31, 2009 reduced the effective tax rate by 20.5 percentage points. We expect our annualized 2009 income tax rate, before the impact of discrete items, to be approximately 29% to 32%.

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

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally with funds generated from operations. At March 31, 2009, we had cash, cash equivalents and short-term marketable securities of $61.1 million compared to $73.5 million at September 30, 2008, a decrease of $12.4 million. Our working capital (total current assets less total current liabilities) decreased $9.8 million to $102.4 million at March 31, 2009 compared to $112.2 million at September 30, 2008.

Consolidated Statement of Cash Flow Highlights (in thousands)

	Six months ended March 31, 2009	Six months ended March 31, 2008	Change
Operating activities	$ (798)	$ 9,333	$ (10,131)
Investing activities	22,750	(1,631)	24,381
Financing activities	(5,598)	1,961	(7,559)
Effect of exchange rate changes on cash and cash equivalents	(1,989)	(903)	(1,086)
Net increase in cash and cash equivalents	$ 14,365	$ 8,760	$ 5,605

Reconciliation of Net Income to Cash Inflows (Outflows) from Operating Activities (in thousands)

	Six months ended March 31, 2009	Six months ended March 31, 2008	Change
Net income	$ 1,731	$ 6,767	$ (5,036)
Deferred income tax benefit	(1,540)	(1,920)	380
Depreciation and amortization	4,865	4,792	73
Stock-based compensation	1,842	1,776	66
Excess tax benefits from stock-based compensation	(42)	(165)	123
Other reconciling items	40	32	8
Changes in working capital	(7,694)	(1,949)	(5,745)
Cash flows (used in) provided by operating activities	$ (798)	$ 9,333	$ (10,131)

The decrease in net cash provided by operating activities of $10.1 million for the comparable six month periods ended March 31, 2009 and 2008 is primarily due to a decrease in net income of $5.0 million and a net increase in cash outflows due to changes in working capital of $5.7 million at March 31, 2009 as compared to March 31, 2008. The increase in working capital cash outflows was primarily due to inventory increases as certain forecasted sales were deferred to future quarters in addition to pre-builds of new products and strategic inventory purchases and lower accounts payable than the same six month period a year ago, partially offset by a decrease in accounts receivable primarily due to lower revenue in fiscal 2009.

Net cash provided by investing activities was $22.8 million during the six months ended March 31, 2009 compared to net cash used by investing activities of $1.6 million during the same period in the prior fiscal year. The net increase of $24.4 million was primarily due to $28.9 million related to net settlements of marketable securities during the six months ended March 31, 2009 compared to net purchases of marketable securities during the same period one year ago. Purchases of property, equipment, improvements and certain other intangible assets decreased $0.3 million in the first half of fiscal 2009 as compared to the same period a year ago. We spent $1.3 million for a contingent purchase price payment related to the FS Forth acquisition in the first quarter of fiscal 2008. In the second quarter of fiscal 2008, we used $0.4 million for a deposit on the Dortmund building leaseback and we received $6.5 million for the Dortmund building sale. We anticipate total fiscal 2009 capital expenditures will be approximately $3.3 million.

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

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

We used $5.6 million for financing activities during the six months ended March 31, 2009 compared to a cash inflow of $1.9 million during the same period a year ago, or a net decrease of $7.5 million. We used $6.1 million for the purchase of treasury stock during the six months ended March 31, 2009 and also received $1.4 million less in proceeds from stock option and employee stock purchase plan transactions during the first half of fiscal 2009 as compared to the same period a year ago.

We had cash provided by operating activities in excess of $20.0 million during each of the last three fiscal years. In addition, we believe that our current cash balance and our potential capacity for additional debt and/or equity financing would be sufficient to fund our business for the next twelve months.

There have been no material changes in our contractual obligations disclosed in our Annual Report on Form 10-K for the year ended September 30, 2008.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP SFAS 157-4). FSP SFAS 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, Fair Value Measurements , when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP SFAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP SFAS 157-4 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009, and shall be applied prospectively. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position No. 115-2 and No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP SFAS 115-2). FSP SFAS 115-2 amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments in the financial statements. FSP SFAS 115-2 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009 and shall be applied to new and existing investments held by us as of April 1, 2009. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP SFAS 107-1). FSP SFAS 107-1 amends SFAS No. 107 Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements and also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. FSP SFAS 107-1 applies to all financial statements within the scope of SFAS No. 107 and requires all entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. FSP SFAS 107-1 is effective beginning with our quarterly report on Form 10-Q for the period ending June 30, 2009. We do not believe that the implementation of this standard will have a material impact on our consolidated financial statements.

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). FSP SFAS 142-3 intends to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flow used to measure the fair value of the asset under SFAS No. 141 (Revised 2007), Business Combinations and other accounting principles generally accepted in the United States. This statement is effective for financial statements issued for fiscal years and interim periods within those years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the impact of FSP SFAS 142-3 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)). This Statement retained the fundamental requirements in the former Statement that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defined the acquirer as the entity that obtains control of one or more businesses in the business combination and established the acquisition date as the date that the acquirer achieves control. The new standard requires the acquiring entity in a business combination to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This Statement also makes certain other modifications to the former Statement. SFAS 141(R) is effective for business combinations that are consummated by us beginning October 1, 2009. Early adoption is not permitted. SFAS 141(R) is expected to have a material impact on how we will identify, negotiate, and value future acquisitions and how such acquisitions will affect our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13 (FSP 157-1) and FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-1 amends SFAS 157 to exclude various accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13, with the exception of assets or liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141 or SFAS 141(R). FSP 157-2 defers the effective date of SFAS 157 to our fiscal years beginning October 1, 2009 for all nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued FASB Staff Position No. 157-3 (FSP 157-3) which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. We adopted the required provisions of SFAS 157 for our financial assets and liabilities at the beginning of our fiscal year 2009 (see Note 7) and the remaining provisions for nonfinancial assets and liabilities will be adopted by us for our fiscal years beginning October 1, 2009. We are currently evaluating the impact of FSP 157-2 on our consolidated financial statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. The majority of our marketable securities are classified as held-to-maturity and are carried at amortized cost. Beginning October 1, 2008, newly acquired marketable securities are classified as available-for-sale and any unrealized gain or loss is included in accumulated other comprehensive income within stockholders equity. Marketable securities consist of commercial paper, government municipal bonds and corporate bonds. Our credit policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. Our portfolio contains no auction rate securities. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than a year. A change in interest rates would not have a material effect on our consolidated financial statements.

FOREIGN CURRENCY RISK

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

For the six months ended March 31, 2009 and 2008, we had approximately $37.6 million and $35.0 million, respectively, of net sales to foreign customers including export sales, of which $18.0 million and $12.4 million, respectively, were denominated in foreign currency, predominantly Euros and British Pounds for the six months ended March 31, 2009 and predominantly Euros for the six months ended March 31, 2008. In future periods, a significant portion of sales will continue to be made in both Euros and British Pounds.

The average monthly exchange rate for the Euro to the U.S. Dollar decreased approximately 10.7% from 1.4723 to 1.3141 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar increased approximately 15.3% from 0.0092 to 0.0106 for the first six months of fiscal year 2009 as compared to the same period one year ago. The average monthly exchange rate for the British Pound to the U.S. Dollar has decreased approximately 25.0% from 2.012 to 1.5087 for the first six months of fiscal year 2009 as compared to the same period one year ago. A 10% change from the first six months of fiscal 2009 average exchange rate for the Euro, British Pound and Japanese Yen to the U.S. Dollar would have resulted in a 2.2% increase or decrease in net sales and a 1.8% increase or decrease in stockholders equity. The above analysis does not take into consideration any pricing adjustments we need to consider in response to changes in the exchange rate.

CREDIT RISK

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

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

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ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective.

There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors provided in Part I, Item 1A of our 2008 Annual Report on Form 10-K as filed with the SEC on December 5, 2008.

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

On July 23, 2008, our Board of Directors authorized an additional 500,000 shares of our common stock for repurchase under our previously announced stock repurchase program. The total number of shares authorized to be repurchased is 1,500,000 shares. There is no expiration date for the program. During the fourth quarter of fiscal 2008, we began to repurchase our common stock in the open market. The following table presents our repurchases during the second quarter of fiscal 2009:

Fiscal Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Number of Shares that May Yet Be Purchased Under the Program
January 1, 2009 January 31, 2009	370,197	$ 7.64	370,197	658,603
February 1, 2009 February 28, 2009	214,293	$ 7.50	214,293	444,310
March 1, 2009 March 31, 2009 (1)	271,666	$ 6.91	271,666	172,644
Total	856,156	$ 7.38	856,156	172,644

(1) Includes 21,966 shares purchased for $165,042 that were not settled by March 31, 2009. Share repurchases are included within the Condensed Consolidated

Statements of Cash Flows based on settlement date.

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PART II. OTHER INFORMATION (CONTINUED)

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

Our Annual Meeting of Stockholders was held on January 26, 2009. Of the 25,383,253 shares of Digi common stock entitled to vote at the meeting, 21,506,653 shares were present at the meeting in person or by proxy. The stockholders voted on the following:

a) The following individuals designated by our Board of Directors as nominees for director were elected for a three-year term, with voting as follows:

Nominee	Total Votes For	Withhold Authority
Kenneth E. Millard	10,121,566	11,385,087
William N. Priesmeyer	10,032,941	11,473,712

b) Proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending September 30, 2009. The proposal passed on a vote of 21,312,237 in favor, 190,928 against, 3,488 abstentions and no broker non-votes.

In addition, the terms of the following directors continued after the meeting:

Directors with a term ending in 2010: Guy C. Jackson and Ahmed Nawaz

Directors with a term ending in 2011: Joseph T. Dunsmore and Bradley J. Williams

ITEM 5. OTHER INFORMATION

None

PART II. OTHER INFORMATION
ITEM 6. EXHIBITS

Exhibit No.	Description
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (1)
3(a)	Restated Certificate of Incorporation of the Company, as amended (2)
3(b)	Amended and Restated By-Laws of the Company (3)
4(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (4)
4(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (5)
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification

(1) Incorporated by reference to Exhibit 2(a) to the Company s Form 10-Q for the quarter ended March 31, 2008 (File No. 1-34033).

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

(3)

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

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

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

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SIGNATURE

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

	DIGI INTERNATIONAL INC.
Date: May 7, 2009	By: /s/ Subramanian Krishnan
	Subramanian Krishnan Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Document Description	Form of Filing
2(a)	Share Purchase Agreement dated April 28, 2008 among Digi International Limited, a subsidiary of Digi International Inc., and all of the shareholders of Sarian Systems Limited (excluding schedules and exhibits which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request)	Incorporated by Reference
3(a)	Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company s Form 10-K for the year ended September 30, 1993 (File No. 0-17972))	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Company	Incorporated by Reference
4(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent	Incorporated by Reference
4(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares	Incorporated by Reference
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32	Section 1350 Certification	Filed Electronically