

DIGI INTERNATIONAL INC

Form DEF 14A

December 06, 2007

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant   
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**Digi International Inc.**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

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1) Amount Previously Paid:

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**DIGI INTERNATIONAL INC.  
11001 Bren Road East  
Minnetonka, Minnesota 55343  
952/912-3444**

December 6, 2007

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders to be held at the Minneapolis Marriott Southwest, 5801 Opus Parkway, Minnetonka, Minnesota, commencing at 3:30 p.m., Central Standard Time, on Thursday, January 24, 2008.

The Secretary's Notice of Annual Meeting and the Proxy Statement which follow describe the matters to come before the meeting. We hope that you will be able to attend the meeting in person and we look forward to seeing you. Please mark, date and sign the enclosed proxy and return it in the accompanying postage-paid reply envelope as quickly as possible, even if you plan to attend the Annual Meeting. If you later desire to revoke the proxy, you may do so at any time before it is exercised.

Sincerely,

Joseph T. Dunsmore  
*Chairman of the Board*

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**DIGI INTERNATIONAL INC.  
Notice of Annual Meeting of Stockholders  
to be held on  
January 24, 2008**

The Annual Meeting of Stockholders of Digi International Inc. will be held at the Minneapolis Marriott Southwest, 5801 Opus Parkway, Minnetonka, Minnesota, at 3:30 p.m., Central Standard Time, on Thursday, January 24, 2008, for the following purposes:

1. To elect two directors for a three-year term.
2. To ratify the appointment of PricewaterhouseCoopers LLP as independent registered public accounting firm of the Company for the fiscal year ending September 30, 2008.
3. To transact such other business as may properly be brought before the meeting.

The Board of Directors has fixed November 26, 2007 as the record date for the meeting, and only stockholders of record at the close of business on that date are entitled to receive notice of and vote at the meeting.

**Your proxy is important to ensure a quorum at the meeting. Even if you own only a few shares, and whether or not you expect to be present at the meeting, please mark, date and sign the enclosed proxy and return it in the accompanying postage-paid reply envelope as quickly as possible. You may revoke your proxy at any time prior to its exercise, and returning your proxy will not affect your right to vote in person if you attend the meeting and revoke the proxy.**

By Order of the Board of Directors,

James E. Nicholson  
*Secretary*

Minnetonka, Minnesota  
December 6, 2007

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**PROXY STATEMENT**

**GENERAL INFORMATION**

The enclosed proxy is being solicited by the Board of Directors of Digi International Inc., a Delaware corporation ( Digi, we, us or our ), for use in connection with the Annual Meeting of Stockholders to be held on Thursday, January 24, 2008, at the Minneapolis Marriott Southwest, 5801 Opus Parkway, Minnetonka, Minnesota, commencing at 3:30 p.m., Central Standard Time, and at any adjournments thereof. Only stockholders of record at the close of business on November 26, 2007 will be entitled to vote at such meeting or adjournments.

The address of our principal executive office is 11001 Bren Road East, Minnetonka, Minnesota 55343 and our telephone number is (952) 912-3444. The mailing of this Proxy Statement and form of proxy to stockholders will commence on or about December 11, 2007.

Stockholder proposals intended to be presented at the 2009 Annual Meeting of Stockholders must be received by us at our principal executive office no later than August 12, 2008, for inclusion in the Proxy Statement for that meeting. Any other stockholder proposals for our 2009 Annual Meeting of Stockholders must be received by us at our principal executive office not less than 60 days prior to the date fixed for such annual meeting, unless we give less than 75 days prior public disclosure of the date of the meeting, in which case we must receive notice from the stockholder not later than the close of business on the fifteenth day following the day on which we make such public disclosure. The notice must set forth certain information concerning such proposal, including a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, the name and record address of the stockholder proposing such business, the class and number of our shares which are beneficially owned by the stockholder, and any material interest of the stockholder in such business.

Under our Bylaws, nominations of persons for election as a director at any meeting of stockholders must be made pursuant to timely notice in writing to our President. To be timely, a stockholder's notice must be delivered to, or mailed to and received at, our principal executive offices not less than 60 days prior to the date fixed for the meeting, unless we give less than 75 days prior public disclosure of the date of the meeting, in which case we must receive notice from the stockholder not later than the close of business on the fifteenth day following the day on which we make such public disclosure.

We will pay the cost of soliciting proxies in the accompanying form. In addition to solicitation by the use of the mails, certain of our directors, officers and employees may solicit proxies by telephone, telegram or personal contact, and have requested brokerage firms and custodians, nominees and other record holders to forward soliciting materials to the beneficial owners of our stock and will reimburse them for their reasonable out-of-pocket expenses in so forwarding such materials.

A plurality of the votes of our outstanding shares of Common Stock present in person or represented by proxy at the meeting and entitled to vote on the election of directors is required for the election of directors. The affirmative vote of the holders of a majority of the outstanding shares of Common Stock present in person or represented by proxy at the meeting and entitled to vote is required for approval of the proposal to ratify the appointment of auditors. Abstentions and broker non-votes will be counted as present for purposes of determining the existence of a quorum at the meeting. However, shares of a stockholder who abstains, withholds authority to vote for the election of directors or does not otherwise vote in person or by proxy (including broker non-votes) will not be counted for the election of directors or approval of the proposals.

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Our Common Stock, par value \$.01 per share, is our only authorized and issued voting security. At the close of business on November 26, 2007, there were 25,652,529 shares of Common Stock outstanding, each of which is entitled to one vote. Holders of Common Stock are not entitled to cumulate their votes for the election of directors.



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**HOW TO VOTE**

*Your vote is important.* We encourage you to vote promptly. Internet and telephone voting is available through 12:00 p.m. Central Time on Wednesday January 23, 2008. You may vote in one of the following ways:

*By Telephone.* If you are located in the United States or Canada, you can vote your shares by calling the toll-free telephone number on your proxy card or in the instructions that accompany your proxy materials. You may vote by telephone 24 hours a day. The telephone voting system has easy-to-follow instructions and allows you to confirm that the system has properly recorded your votes. If you vote by telephone, you do not need to return your proxy card or your voting instruction form.

*By Internet.* You can also vote your shares by the Internet. Your proxy card indicates the Web site you may access for Internet voting. You may vote by the Internet 24 hours a day. As with telephone voting, you will be able to confirm that the system has properly recorded your votes. If you hold your shares in street name, please follow the Internet voting instructions that accompany your proxy materials. You may incur telephone and Internet access charges if you vote by the Internet. If you vote by the Internet, you do not need to return your proxy card or your voting instruction form.

*By Mail.* If you are a holder of record, you can vote by marking, dating, and signing your proxy card and returning it by mail in the enclosed postage-paid envelope. If you hold your shares in street name, you can vote by completing and mailing the voting instruction form.

*At the Meeting.* The way you vote your shares now will not limit your right to change your vote at the meeting if you attend in person. If you hold your shares in street name, you must obtain a proxy, executed in your favor, from the holder of record if you wish to vote these shares at the meeting.

All shares that have been properly voted and not revoked will be voted as you have directed at the meeting. If you sign and return your proxy card without any voting instructions, your shares will be voted as the Board of Directors recommends.

*Revocation of Proxies.* You can revoke your proxy at any time before your shares are voted if you (1) submit a written revocation to our corporate secretary at our executive offices before the meeting, or at the meeting, (2) submit a timely later-dated proxy (or voting instruction form if you hold shares in street name), (3) provide timely subsequent telephone or Internet voting instructions, or (4) vote in person at the meeting.

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The following table sets forth the beneficial ownership of our Common Stock, as of November 26, 2007, by each of our directors or nominees for director, by each of our executive officers named in the Summary Compensation Table herein, by all directors, nominees and executive officers as a group, and by each stockholder who is known by us to own beneficially more than 5% of our outstanding Common Stock.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percentage Outstanding Shares
Directors, nominees and executive officers:		
Joseph T. Dunsmore	520,868(2)	1.99%
Lawrence A. Kraft	115,458(3)	*
Subramanian Krishnan	338,949(4)	1.26%
Joel K. Young	171,820(5)	*
Guy C. Jackson	85,500(6)	*
Kenneth E. Millard	22,000(7)	*
Ahmed Nawaz	18,918(8)	*
William N. Priesmeyer	36,750(9)	*
Bradley J. Williams	106,000(10)	*
All directors, nominees and executive officers as a group (9 persons)	1,416,263(11)	5.25%
Other beneficial owners:		
Munder Capital Management Munder Capital Center 480 Pierce Street Birmingham, MI 48009	1,920,530(12)	7.49%
Barclays Global Investors, NA. 45 Fremont Street San Francisco, CA 94105	1,822,503(13)	7.10%
Dimensional Fund Advisors LP 1299 Ocean Avenue Santa Monica, CA 90401	1,540,909(14)	6.01%
Royce & Associates, LLC 1414 Avenue of the Americas New York, NY 10019	2,947,493(15)	11.49%
John P. Schinas 6214 Pasadena Point Blvd. Gulfport, FL 33707	1,374,085(16)	5.36%

\* Less than one percent.

- (1) Unless otherwise indicated in footnote below, (i) the listed beneficial owner has sole voting power and investment power with respect to such shares, and (ii) no director or executive officer has pledged as security any shares shown as beneficially owned.
- (2) Includes 511,667 shares covered by options which are exercisable within 60 days of the record date.
- (3) Includes 115,458 shares covered by options which are exercisable within 60 days of the record date.
- (4) Includes 322,353 shares covered by options which are exercisable within 60 days of the record date.
- (5) Includes 170,292 shares covered by options which are exercisable within 60 days of the record date.
- (6) Includes 80,500 shares covered by options which are exercisable within 60 days of the record date.
- (7) Includes 22,000 shares covered by options which are exercisable within 60 days of the record date
- (8) Includes 18,918 shares covered by options which are exercisable within 60 days of the record date.

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- (9) Includes 36,750 shares covered by options which are exercisable within 60 days of the record date.
- (10) Includes 65,000 shares covered by options which are exercisable within 60 days of the record date.
- (11) Includes 223,168 shares covered by options which are exercisable within 60 days of the record date held by five non-employee directors and 1,119,770 shares covered by options which are exercisable within 60 days of the record date held by four executive officers.
- (12) Based on the information contained in Form 13G, amendment #2, filed with the SEC on February 14, 2007 reflecting the stockholder's beneficial ownership as of December 31, 2006. Munder Capital Management had sole voting power over 1,902,102 shares and sole investment power over 1,920,530 shares.
- (13) Includes shares owned through affiliates of Barclays Global Investors, NA. Based on the information contained in a Form 13G filed with the SEC on January 23, 2007 reflecting the stockholder's beneficial ownership as of December 31, 2006. Barclays Global Investors, NA had sole voting power over 1,759,313 shares and sole investment power over 1,822,503 shares.
- (14) Based on the information contained in a Form 13G filed with the SEC on February 9, 2007 reflecting the stockholder's beneficial ownership as of December 31, 2006.
- (15) Based on the information contained in a Form 13G, amendment #4, filed with the SEC on January 19, 2007 reflecting the stockholder's beneficial ownership as of December 31, 2006.
- (16) Based on the information contained in a Form 13G, amendment #16, filed with the SEC on February 14, 2007 reflecting the stockholder's beneficial ownership as of December 31, 2006.

**ELECTION OF DIRECTORS**

Our business is managed by or under the direction of a Board of Directors with a number of directors, not less than three, fixed from time to time by the Board of Directors. The Board is divided into three classes as nearly equal in number as possible, and directors of one class are elected each year for a term of three years. Each class consists of at least one director. The Board of Directors has fixed at two the number of directors to be elected to the Board at the 2008 Annual Meeting of Stockholders. The Nominating and Governance Committee has nominated Messrs. Dunsmore and Williams to stand for election for a three-year term. Proxies solicited by the Board of Directors will, unless otherwise directed, be voted to elect the nominees named below.

Each of the nominees named below is currently a director of our company, and each has indicated a willingness to serve as a director. The Nominating and Governance Committee of the Board of Directors selected each of the nominees named below. In case any nominee is not a candidate for any reason, the proxies named in the enclosed form of proxy may vote for a substitute nominee selected by the Nominating and Governance Committee.

Following is certain information regarding the nominees for the office of director and the current directors whose terms expire after the 2008 Annual Meeting:

**Nominees for Term Expiring in 2011:**

*Joseph T. Dunsmore, age 49*

Mr. Dunsmore joined our company in October 1999 as President and Chief Executive Officer and a member of the Board of Directors and was elected Chairman of the Board in May 2000. Prior to joining us, Mr. Dunsmore had been Vice President of Access for Lucent Microelectronics, a telecommunications company now known as Agere Systems Inc., since June 1999. From October 1998 to June 1999, he acted as an independent consultant to various high technology companies. From February 1998 to October 1998, Mr. Dunsmore was Chief Executive Officer of NetFax, Inc., a telecommunications company. From October 1995 to February 1998, he held executive management positions at US Robotics and then at 3COM after 3COM acquired US Robotics in June 1997. Prior to that, Mr. Dunsmore held various marketing management positions at AT&T Paradyne Corporation from May 1983 to October 1995.

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*Bradley J. Williams, age 47*

Mr. Williams has been a member of our Board of Directors since June 2001. Since February 2007, Mr. Williams has been the Vice President of Sales for Doextra Corporation, a customer relationship management software reseller and professional services firm. From October 2005 to February 2007, Mr. Williams was the President of Catalyst Resources, L.C., a management consulting firm specializing in business development for entrepreneurs and small business owners. Prior to that, Mr. Williams was the Vice President of Sales for On Demand Technologies, a provider of technology driven communications products, from February 2004 to October 2005. Mr. Williams was the President of Relationship Marketing, Inc., a provider of marketing communications solutions, from August 2003 to February 2004 and he previously served as Executive Vice President, Sales of Relationship Marketing commencing June 2002. In January 2000, Mr. Williams co-founded Raviant Networks, Inc., a provider of comprehensive software solutions and professional services to the telecommunications industry, where he served as its Chief Operating Officer from April 2000 until June 2002. He also served as a director of Raviant from April 2000 to August 2002. From August 1996 to December 1999, Mr. Williams worked for Integrated Network Solutions, a value-added reseller of hardware, software and network services, where he started a telecommunications consulting division that was eventually spun off as Raviant Networks.

**Directors Whose Terms Expire in 2009:**

*Kenneth E. Millard, age 61*

Mr. Millard has been a member of our Board of Directors since October 1999. Mr. Millard was Chairman, Chief Executive Officer, President and a director of Telular Corporation, a telecommunications company, until February 2005, after serving as President and Chief Executive officer since April 1996 and Chairman since 2001. Prior to that, Mr. Millard was the President and Chief Operating Officer of Oncor Communications, a telecommunications company, from February 1992 to January 1996. Prior to that, he held various executive management positions at Ameritech Corporation and worked as an attorney for AT&T and Wisconsin Bell. Mr. Millard serves as chairman and a director of Dascom Systems Group LLC, a private corporation, and chairman and a director of FirstHand Technologies Inc., a private corporation.

*William N. Priesmeyer, age 62*

Mr. Priesmeyer has been a member of our Board of Directors since November 2005. He has been the Chief Executive Officer of Cymbet Corporation, a manufacturer of thin film energy cells for the semiconductor industry, since November 2001. Mr. Priesmeyer served as Senior Vice President and Chief Financial Officer of Jostens Inc., a producer of educational products, from August 1997 to June 2001. Prior to that, he held Chief Financial Officer positions at Waldorf Corporation, DataCard Corporation and Onan Corporation and was a Vice President at The Pillsbury Company. Mr. Priesmeyer began his career at Xerox Corporation.

**Directors Whose Terms Expire in 2010:**

*Guy C. Jackson, age 65*

Mr. Jackson has been a member of our Board of Directors since November 2003. In June 2003, Mr. Jackson retired from the accounting firm of Ernst & Young LLP after 35 years with the firm and one of its predecessors, Arthur Young & Company. During his career, he served as the audit partner on numerous public companies in Ernst & Young's New York and Minneapolis Offices. Mr. Jackson also serves as a director and member of the audit committee of Cyberonics, Inc., EpiCept Corporation, Life Time Fitness, Inc. and Urologix, Inc.

*Ahmed Nawaz, age 58*

Mr. Nawaz has been a member of our Board of Directors since October 2006. Since November 2006, Mr. Nawaz has been the Executive Vice President for the Wireless Solutions Division of Spansion Inc. Mr. Nawaz was a management consultant from January 2006 to November 2006. Prior to that, Mr. Nawaz was Executive Vice President, Worldwide Sales, of Agere Systems Inc. a provider of integrated circuit solutions, from March 2001 to December 2005. Mr. Nawaz was President of Worldwide Sales, Strategy and Business Development, from

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April 2000 to March 2001, and President, Integrated Circuits Division, from June 1998 to April 2000, of Lucent's Microelectronics and Communications Technologies Group. He joined AT&T in 1992 and moved to Lucent following its spin-off from AT&T in 1996. Mr. Nawaz was Vice President of Lucent's Network Communications business unit from January 1996 to July 1998. While at AT&T, he was Vice President of the Applications business unit from 1994 to 1995. Prior to joining AT&T, Mr. Nawaz was at Texas Instruments, where he was responsible for the personal computer business unit from 1990 to 1992 and also held various marketing and product management positions.

## **Director Independence**

None of the directors is related to any other director or to any executive officer of our company. The Board of Directors has determined that Messrs. Jackson, Millard, Nawaz, Priesmeyer and Williams, who constitute a majority of the Board of Directors, are independent as defined in the applicable listing standards of the Nasdaq Stock Market (Nasdaq). In making the independence determinations, our Board of Directors considered the following relationship: Mr. Nawaz, who has served as a director of our company since October 2006, is Executive Vice President of Spansion Inc.'s Wireless Solutions Division. During fiscal 2007 Digi purchased an aggregate of \$58,836 of Spansion components exclusively through independent third party distributors in the ordinary course of business. Mr. Nawaz's responsibilities at Spansion are unrelated to sales of products to distributors.

## **Committees of the Board of Directors and Meeting Attendance**

The Board of Directors met seven times during fiscal 2007. All directors attended at least 75% of the meetings of the Board and of the Committees on which they served during fiscal 2007. We have an Audit Committee, a Compensation Committee and a Nominating and Governance Committee. Following is a description of the functions performed by each of these Committees.

### *Audit Committee*

Our Audit Committee presently consists of Messrs. Jackson (Chairman), Millard and Priesmeyer. The Board of Directors has determined that all members of the Audit Committee are independent as that term is defined in the applicable Nasdaq listing standards and regulations of the SEC and all members are financially literate as required by the applicable Nasdaq listing standards. In addition, the Board of Directors has determined that Messrs. Jackson, Millard and Priesmeyer have the financial experience required by the applicable Nasdaq listing standards and that each is an audit committee financial expert as defined by applicable regulations of the SEC. The Audit Committee oversees our accounting, internal controls and financial reporting process by, among other things, taking action to oversee the independence of and annual audit by the independent registered public accounting firm and selecting and appointing the independent registered public accounting firm. The Audit Committee met ten times during fiscal 2007, as discussed below under the Related Person Transaction Approval Policy. The Audit Committee is also responsible for the receiving and approval or ratifications of transactions under our Related Person Transaction Approval Policy. The responsibilities of the Audit Committee are set forth in the Audit Committee Charter, a copy of which is available on the Investor Relations section of our website, [www.digi.com](http://www.digi.com). The Audit Committee reviews the Audit Committee Charter annually and may make additional recommendations to the Board of Directors for further revision of the Audit Committee Charter to reflect changing circumstances and requirements.

### *Compensation Committee*

We have a Compensation Committee presently consisting of Messrs. Millard (Chairman), Jackson and Williams. The Board of Directors has determined that all members of the Compensation Committee are independent as that term is defined in the applicable Nasdaq listing standards. The Compensation Committee determines the compensation of the Chief Executive Officer and all other executive officers. With respect to employees other than executive officers, the



Compensation Committee oversees general compensation policies and reviews the annual incentive compensation structure. The Compensation Committee also oversees our benefit plans and administers the Digi International Inc. Stock Option Plan, the Digi International Inc. Non-Officer Stock Option Plan, the Digi International Inc. Employee Stock Purchase Plan and the Digi International Inc. 2000 Omnibus Stock

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Plan. The Compensation Committee met eight times during fiscal 2007. The responsibilities of the Compensation Committee are set forth in the Compensation Committee Charter, a copy of which is available on the Investor Relations Section of our website, *www.digi.com*. The Compensation Committee reviews the Compensation Committee Charter annually and may recommend to the Board of Directors revisions to the Compensation Committee Charter to reflect changing circumstances and requirements. The processes and procedures used by the Compensation Committee for considering and determining executive and director compensation are described below under Executive Compensation Compensation Discussion and Analysis on pages 9 through 20.

*Nominating and Governance Committee*

We have a Nominating and Governance Committee, presently consisting of Messrs. Williams (Chairman), Nawaz and Priesmeyer. The Board of Directors has determined that all members of the Nominating and Governance Committee are independent as that term is defined in the applicable Nasdaq listing standards. The Nominating and Governance Committee selects candidates as nominees for election as directors. The Nominating and Governance Committee met three times during fiscal 2007. The responsibilities of the Nominating and Governance Committee are set forth in the Nominating and Governance Committee Charter, a copy of which is available on the Investor Relations Section of our website, *www.digi.com*. The Nominating and Governance Committee reviews the Nominating and Governance Committee Charter annually and may recommend to the Board of Directors revisions to the Nominating and Governance Committee Charter to reflect changing circumstances and requirements.

*Director Nominee Selection Process and Criteria*

The Nominating and Governance Committee generally identifies director candidates based upon suggestions from current directors and senior management, recommendations by shareholders and/or use of a director search firm. Stockholders who wish to suggest qualified candidates should write to: Digi International Inc., 11001 Bren Road East, Minnetonka, MN 55343, Attention: Chairman, Nominating and Governance Committee. All recommendations should state in detail the qualification of such persons for consideration by the Committee and should be accompanied by an indication of the person's willingness to serve. The Nominating and Governance Committee will consider candidates recommended by stockholders in the same manner that it considers all director candidates.

Candidates for director nominees are reviewed in the context of the current composition of the Board, our operating requirements and the long-term interests of our stockholders. The Nominating and Governance Committee will consider, at a minimum, the following factors in nominating existing and potential new members of the Board of Directors, in addition to other factors it deems appropriate based on the current needs and desires of the Board of Directors:

demonstrated character and integrity, an inquiring mind, experience at a strategy/policy setting level, sufficient time to devote to our affairs, and high-level managerial experience;

whether the member/potential member is subject to a potentially disqualifying factor, such as, relationships with competitors, customers, suppliers, contractors, counselors or consultants, or recent previous employment with us;

the member's/potential member's independence;

whether the member/potential member assists in achieving a mix of members on the Board of Directors that represents a diversity of background and experience, including with respect to age, gender, international background, race and specialized experience;

whether the member/potential member has general and strategic business management experience and financial experience with companies of a similar size that operate in the same general industry as us;

whether the member/potential member, by virtue of particular experience, technical expertise, or specialized skills, will add specific value as a member of the Board of Directors; and

any factors related to the ability and willingness of a new member to serve, or an existing member to continue his/her service.

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*Stockholder Communications with the Board of Directors*

Stockholders may communicate with the Board of Directors by addressing correspondence to Digi International Inc., 11001 Bren Road East, Minnetonka, MN 55343, Attention: Lead Director. Mr. Millard currently serves as the Lead Director. All such communications will be forwarded directly to the Chairman. The Chairman will forward communications directed at particular members of the Board of Directors directly to the particular members. Communications directed to the Board of Directors in general will be handled by the Lead Director.

We do not have a policy regarding attendance of members of the Board of Directors at annual meetings of our stockholders. One director attended the January 2007 Annual Meeting of Stockholders.

**Compensation Committee Interlocks and Insider Participation**

The Compensation Committee is comprised entirely of independent, outside directors. None of our employees serve on the Committee. The Committee members have no interlocking relationships as defined by the SEC.

**Report of the Audit Committee**

The role of our Audit Committee, which is composed of three independent non-employee directors, is one of oversight of our management and our independent registered public accounting firm in regard to our financial reporting and our internal controls respecting accounting and financial reporting. The Audit Committee also considers and pre-approves any non-audit services provided by our independent registered public accounting firm to ensure that no prohibited non-audit services are provided by the independent registered public accounting firm and that the independent registered public accounting firm's independence is not compromised. In performing its oversight function, the Audit Committee relies upon advice and information received in its discussions with our management and independent registered public accounting firm.

The Audit Committee has (i) reviewed and discussed our audited consolidated financial statements for the fiscal year ended September 30, 2007 with our management; (ii) discussed with PricewaterhouseCoopers LLP, our independent registered public accounting firm, the matters required to be discussed by Statement on Auditing Standards No. 61 (Codification of Statements on Auditing Standards, AU § 380), as amended, regarding communication with audit committees; and (iii) received the written disclosures and the letter from our independent registered public accounting firm required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with PricewaterhouseCoopers LLP their independence.

Based on the review and discussions with management and our independent registered public accounting firm referred to above, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007 for filing with the SEC.

Guy C. Jackson (Chairman)

Kenneth E. Millard

William N. Priesmeyer

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The following table presents fees for fiscal 2007 and 2006 for professional audit services performed by PricewaterhouseCoopers for the audit of our annual consolidated financial statements, the review of our interim consolidated financial statements for each quarter in fiscal 2007 and 2006 and all other services performed:

	<b>Year Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Audit Fees	\$ 570,061	\$ 760,060
Audit-Related Fees		
Tax Fees(1)	32,500	48,500
All Other Fees		
<b>Total</b>	<b>\$ 602,561</b>	<b>\$ 808,560</b>

(1) Tax Fees in fiscal 2007 and 2006 consisted primarily of fees associated with extraterritorial tax exclusions.

The Audit Committee pre-approved all of the services described above pursuant to engagements that occurred in fiscal 2007 and 2006. The Audit Committee has determined that the provision of the above non-audit services was compatible with maintaining the independence of our independent registered public accounting firm.

The Audit Committee's current practice on pre-approval of services performed by the independent registered public accounting firm is to approve annually all audit services and each recurring permissible non-audit service to be provided by the independent registered public accounting firm during the fiscal year. In addition, the Audit Committee may pre-approve other non-audit services during the year on a case-by-case basis, and delegates authority to grant such pre-approvals during the year between Audit Committee meetings to the Audit Committee Chairman. The Audit Committee reviews each non-audit service to be provided and assesses the impact of the service on the independent registered public accounting firm's independence.

**EXECUTIVE COMPENSATION****Compensation Discussion and Analysis***Overview*

The goal of our compensation program for our four executives identified on the Summary Compensation Table on page 21 (whom we refer to as our Named Officers elsewhere) is the same as our goal for operating our company to foster profitable growth and create long-term value for our shareholders. We believe that the ability, performance and commitment of our executives are essential factors contributing to the quality of leadership that drives our shareholder value. We have designed and implemented a pay-for-performance compensation program that rewards sustained financial and operating performance and the creation of shareholder value, that aligns the interests of our named executives with those of our shareholders and that encourages them to remain with us. We believe that these same attributes will also serve to attract qualified executive talent when that is necessary.

Our compensation elements are designed to simultaneously fulfill one or more of our performance, alignment, and attraction and retention objectives. These elements consist of base salary, annual and quarterly cash incentive and equity incentive compensation. In determining the mix of compensation for each executive, we place less emphasis on base salary and greater emphasis on the opportunity for cash incentive compensation contingent upon quarterly and annual operating results and long-term equity compensation tied to stock price performance.

Our Compensation Committee, which is composed of three independent, non-employee directors, discharges our board of directors' responsibilities with respect to all forms of compensation for our executive officers as well as general oversight of our compensation plans. The Compensation Committee has the authority to retain outside counsel, experts and other advisors as it determines appropriate to assist it in the performance of its functions.

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The purpose of this discussion and analysis is to summarize the compensation objectives, decision-making process, specific program elements and factors we considered in making decisions about executive compensation during fiscal 2007.

### ***Compensation Objectives***

#### *Performance*

Key elements of compensation that depend in part upon the performance of the named executive and our performance include:

Annual and quarterly cash incentives that are based on performance against pre-determined quantitative objectives; achievement of these objectives is dependent upon our overall performance against elements of the board-approved business plan for the year. The objectives include quarterly and annual revenue (net sales) and earnings before taxes, depreciation and amortization (EBTDA) goals, calculated on an organic basis that excludes the impact of acquisitions completed during the year, as well as goals for completed acquisitions that meet certain parameters for projected revenues (and, for fiscal 2008, projected gross margin).

Equity incentive compensation in the form of stock options, the value of which is ultimately contingent upon the performance of Digi's share price and which are subject to vesting schedules that require continued service with us (see further discussion below under the heading *Attraction and Retention*).

Base salary is designed to be commensurate with the executive's scope of responsibilities, demonstrated leadership abilities, and management experience and effectiveness, and thus has a performance component. Base salary is also designed to be competitive in relation to comparable benchmarks. Our other elements of compensation focus on motivating and challenging the executive to achieve superior, longer-term results.

#### *Alignment*

We seek to align the interests of the named executives with those of our investors.

Key elements of compensation that align the interests of the named executives with shareholders include:

Annual and quarterly cash incentives as described earlier that compensate the executive for the achievement of key financial and strategic goals which we believe closely correlate to creating shareholder value.

Equity incentive compensation in the form of stock options, which link a significant portion of potential compensation to increases in shareholder value because the total value of those awards corresponds to stock price appreciation subsequent to the date of grant.

#### *Attraction and Retention*

The four named executives collectively have 27 years of combined service with us and have been together as a team for nearly five years, during which time we experienced substantial increases in revenues and operating profitability, as measured by earnings before taxes, depreciation and amortization, or EBTDA, and stock price appreciation. We attempt to retain our executives by using long-term, stock appreciation-based incentives as a significant determinant of the total compensation opportunity. We utilize stock options with extended four-year vesting as the long-term, stock appreciation-based element of total compensation.

To a lesser extent, the annual cash incentive program supports the retention objective as it is designed to pay out only if the executive remains with us for the full year unless the executive is terminated without cause during the year. In that event, a pro-rated annual bonus is earned based on number of months of service during the year and our actual financial performance against plan.

Our severance arrangements and change in control option acceleration for named executives are likewise designed primarily to help achieve the goal of retaining executives by providing contractual arrangements that address the consequences of a change in control and thereby eliminating some of the uncertainty of such an event.



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***Compensation Determination Process***

We use a variety of compensation elements to achieve our compensation objectives, currently consisting of base salary, annual and quarterly cash incentives and long-term equity incentive awards. The Compensation Committee does not use a specific formula to set compensation elements under each component, but instead attempts to achieve the appropriate balance between short-term cash compensation and long-term equity compensation and to reflect the level of responsibility of the executive officer. The factors the Compensation Committee considers when determining each compensation element include, but are not limited to, the following:

the executive's current total compensation and the appropriate portion of the total compensation that should be performance-based;

the executive's performance;

the qualifications of the executive and his potential for development and performance in the future;

compensation levels of comparable jobs at companies in our broad technology industry category with comparable annual revenues, and compensation relative to that of our other executive officers other than our Chief Executive Officer;

the strategic goals and responsibilities for which the executive has responsibility; and

the recommendations of the Chief Executive Officer (except with respect to his own compensation).

The Compensation Committee reviews the overall executive compensation program and specific compensation elements each year in the period of September through November. The Compensation Committee begins this review process by determining the total cash compensation to be paid to an executive based on a review of the executive pay levels for comparable jobs at companies in our broad technology industry category with comparable annual revenues, as described below, in addition to considering the other factors listed above. For fiscal 2008 the Committee also considered the report of our compensation consultant, Pearl Meyer and Partners, and compensation data for a small group of peer companies selected by the consultant, as discussed more fully below, in addition to the compensation data of companies in our broad technology industry category with comparable annual revenues.

After total cash compensation has been determined, our Compensation Committee determines the appropriate mix of base salary and performance-based compensation for each executive using the factors listed above. It has been the practice of the Compensation Committee to assign a higher percentage of total cash compensation targets to performance-based cash compensation than base salaries, a practice generally not found in the companies to which our compensation is compared. Consequently, the named executives have base salaries that are generally below the median relative to comparable companies, while having cash incentive opportunities which, if earned, would generally result in actual cash compensation above the median. When the compensation of a particular executive is out of alignment with these principles, it is the Committee's practice to bring compensation into alignment over time.

From the standpoint of cash incentive compensation, the Compensation Committee regards the executive management as a team, with common goals, and consequently has a practice of compensating them based largely on performance against these common goals, measured by revenues, EBTDA and acquisitions.

The Compensation Committee awards stock options based on the same principles of market comparisons of total compensation including long-term incentives combined with the remaining factors listed above.

In connection with the compensation applicable to our 2007 fiscal year for executives, the Compensation Committee reviewed the base salary, annual incentives and long-term equity incentive elements and levels for our executives after consulting independent third-party data to which we subscribe, as presented by our Vice President of Human Resources. This general review compared these compensation elements against a large group of other companies in our broad technology industry category with revenues between \$50 million and \$199 million as set forth in survey data. The Compensation Committee considered this information in addition to the factors described above when determining that base salary, annual cash incentives and equity incentive awards were appropriate compensation elements and when setting the corresponding compensation levels to be paid to our executives for fiscal 2007.

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In connection with the compensation process for our named executives for fiscal 2008, our Compensation Committee engaged the services of Pearl Meyer & Partners and instructed them to provide a competitive assessment of our base salary, annual incentive and long-term incentive elements. As part of this study, Pearl Meyer & Partners compared our base salary, annual incentives and long-term incentive award elements primarily against 12 publicly traded U.S. companies selected by Pearl Meyer as comparable to Digi on the basis of criteria selected by Pearl Meyer, namely strong technology industry/product similarity, revenues between \$55 million and \$480 million, and market capitalization between \$110 million and \$1 billion. The comparable companies selected by Pearl Meyer through this process were Acme Packet, Adaptec, Adtran, Avocent, C-Cor, Communications Systems, Extreme Networks, Foundry Networks, Network Engines, Network Equipment Tech, Pctel, Inc. and Stratos International Inc.

Pearl Meyer also presented information comparing a large number of public companies, with revenues from \$50 million to \$200 million, whose compensation data were digested in compensation surveys. From this information Pearl Meyer presented market composite data that reflected the average of the peer group and the survey group. The Compensation Committee considered this information, in addition to the factors described above, when determining the compensation of our executives in fiscal 2008 in a manner consistent with the compensation philosophy discussed above.

### *Equity Grant Practices*

The exercise price of each stock option awarded to our named executives and other employees under our equity incentive plans is the closing price of Digi stock on the date of grant, which, for executive officers, is scheduled for the date of the November meeting of the Compensation Committee at which equity awards for senior executives are determined, following the public announcement of our year-end results. Equity awards for other employees are generally made at the same time, although awards for new hires and for promotions and other performance-related awards are also made during the course of the year. Board and Committee meetings are generally scheduled several months in advance. Scheduling decisions are made without regard to anticipated earnings or other major announcements by us. We prohibit the repricing of stock options. Options awarded to our Chief Executive Officer and Chief Financial Officer have historically included a provision for accelerated vesting upon a change in control, and beginning in November 2007 that practice now extends to our other named executives.

### *Management Participation*

Members of executive management participate in the Compensation Committee's meetings at the Committee's request. Management's role is to contribute input and analysis to the Committee's discussions. Management does not participate in the final determination or recommendation of the amount or form of executive compensation, except that our Chief Executive Officer does participate in the final recommendation, but not determination, of the amount and form of compensation to be paid to the other named executives.

### *Use of Consultants*

From time to time, as noted above, the Compensation Committee uses outside compensation consultants to assist it in analyzing our compensation programs and determining appropriate levels of compensation and benefits. The decision to retain consultants and, if so, which consultants to retain, is made solely by the Compensation Committee.

### *Total Compensation Elements Used to Achieve Compensation Objectives*

#### *Annual cash compensation*

Base salary. Base salaries need to be competitive to attract and retain key talent. Base salaries for our named executives depend on the scope of their responsibilities, their performance, and level of contribution to the business. Decisions regarding base salary increases also take into account the executive's current salary and the amounts paid to the executive's peers within and outside our company. Base salaries are reviewed annually. However, the base salaries of our named executives are not automatically increased annually. Rather, adjustments are approved by the Committee based upon changes in competitive market data and the other factors noted above, or for changes in

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responsibilities due to promotion. Base compensation also reflects the Committee's compensation philosophy of favoring compensation that is contingent on the achievement of performance objectives and de-emphasizing fixed compensation in the form of base salaries as discussed above.

Performance-Based Cash Incentives. This is the element of compensation paid in cash that rewards executive officers for their performance in achieving financial goals and other key measures that will create shareholder value, and it encompasses three components:

The *financial objectives component* provides the opportunity to receive quarterly and annual incentive payments depending on the degree to which we achieve quarterly and annual organic revenue and EBTDA goals, as well as additional financial goals such as our cash balance at fiscal year end (for Messrs. Dunsmore and Krishnan) and sales related goals (for Mr. Kraft). These sales related goals are, for fiscal 2007, emerging technology revenue, and, for fiscal 2007 and 2008, design wins. Design wins are a leading indicator of future revenue streams, since our products are designed into customer products for future production. The maximum payout for the financial objectives component is expressed in terms of a percentage of a named executive's base salary (ranging from 80% to 100% for the named executives), and is allocated (on a 40%/60% basis) between quarterly payouts for achieving quarterly financial goals and an annual payout for achieving the annual financial goals. Threshold performance equal to 90% of a specified goal must be achieved for any payout to occur, and the payout for performance between the 90% and 100% level is ratably scaled.

EBTDA can be calculated from our audited financial statements by adding depreciation of property, equipment and improvements plus amortization of identifiable intangible assets and other assets, both of which are located on the Consolidated Statements of Cash Flows, to income before income taxes, located on the consolidated Statements of Operations. Organic EBTDA is calculated by subtracting that portion of EBTDA pertaining to income before income taxes, depreciation, and identifiable intangible assets amortization for businesses acquired in the current fiscal year from the consolidated EBTDA.

The *excess revenues component* provides the opportunity to receive an additional annual incentive payment depending on the degree to which our annual organic revenue exceeds the annual organic revenue goal for the fiscal year, coupled with a requirement of incremental profitability to ensure the incentives will be self-funding. The excess revenues component payment can range from 2.5% to 50% of a named executive's maximum financial objectives component (i.e., up to 50% of annual base salary for most of the named executives) depending on the degree to which organic revenues exceed the annual organic revenue goals.

The *acquisition component* provides the opportunity to receive an additional annual incentive payment depending on the degree to which we successfully completed, during the fiscal year, acquisitions meeting specified parameters for projected revenues. For fiscal 2007, the acquisition component payment could range from 10% to 50% of a named executive's maximum financial objectives component (i.e., up to 50% of annual base salary for most of the named executives) depending on the degree to which acquisitions were completed during the year. For fiscal 2008, this component has been modified to include a gross profit margin multiplier to particularly incent the named executives to acquire businesses with projected gross profit margins above 60% (calculated before amortization of identifiable intangible assets for purchased and core technology). Projected gross profit margins would be prepared by management but subject to Board review and scrutiny in connection with the process of approving an acquisition. The application of this multiplier can potentially increase or decrease the acquisition payout by as much as 50%, resulting in potential fiscal 2008 payouts ranging from 5% to 75% of the maximum financial objectives component (i.e., up to 75% of annual base salary for most of the named executives).

Collectively, the components of the performance-based cash incentive program provide an annual maximum cash incentive opportunity to the named executives ranging between 180% and 225% of a named executive's annual base salary. If performance does not reach the specified threshold level for any component, that component will not be paid.

The Committee has structured the performance-based cash incentive program in this manner to link a significant portion of executive compensation to the achievement of key financial and strategic goals which we believe closely correlate to creating shareholder value. The excess revenues and acquisition components have been

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designed to benefit us by emphasizing accelerated revenue growth, both organic and external, while also maintaining a focus on incremental profitability, included through the addition for fiscal 2008 of incentives to acquire businesses with relatively high projected gross profit margins, to help drive future profitability.

Annual incentives are paid annually following the release of final audited consolidated financial statements. Quarterly incentives are paid quarterly upon the release of quarterly consolidated financial statements.

Incentive targets and potential incentive amounts are determined by the Committee prior to the start of each fiscal year based upon elements of our board-approved business plan for that year and may include other objective measurements of quarterly or annual financial success as the Committee determines to approve. These may include specific financial targets for emerging product technologies, customer design wins or additional measurements of our financial performance. The Committee receives and considers the input of the Chief Executive Officer in regard to setting annual bonus incentives for the other named executives.

From time to time, the Compensation Committee has also awarded discretionary cash bonuses based upon its assessment of an executive's performance and contributions, and may do so in the future. No such discretionary bonuses were awarded for fiscal 2007.

The salaries paid and the annual incentive compensation awarded to the named executives in fiscal 2007 are discussed below and shown in the Summary Compensation Table on page 21.

### *Equity awards*

As administered by the Compensation Committee our equity incentive compensation program is solely in the form of non-statutory stock options, although our stock incentive plans also authorize other forms of equity-based compensation. Stock option awards are made to our named executives annually and on other dates that correspond to the executive's start date with us, promotions or, in rare cases, an extraordinary performance award. Stock options are awarded to recognize scope of responsibilities, reward demonstrated performance and leadership, motivate future superior performance, align the interests of the executive with those of our shareholders and retain the executives through the term of the awards. The amount of stock options granted in fiscal 2007 was based upon our overall strategic, operational and financial performance and the factors for performance based awards listed above and reflects the executives' expected contributions to our future success. Existing ownership levels are generally not a factor in award determinations as we do not want to discourage executives from accumulating Digi stock; however, the Compensation Committee may take into consideration an executive's previous option awards and approve larger awards to newer executives with fewer options by reason of their shorter tenure.

Stock options have an exercise price equal to the closing sale price of a share of Digi common stock on the grant date. As a result, stock options only have value to the extent the price of Digi stock on the date of exercise exceeds the exercise price on grant date, and thus are an effective compensation element only if the stock price grows over the term of the award. For this reason the Committee believes that stock options are a motivational tool to drive shareholder value. Stock options granted in fiscal 2007 become exercisable over four years and have a ten-year term.

Other than Mr. Dunsmore, each of the named executives received grants of stock options in fiscal 2007. The stock options granted become exercisable as to one-fourth of the shares beginning one year after the grant date and in 36 monthly installments as to the remainder, and have a maximum ten-year term. We believe that this vesting schedule aids us in retaining executives and motivating longer-term performance. There are provisions for the acceleration of vesting upon the permanent disability or death of the executive. In addition, all options granted to Messrs. Dunsmore and Krishnan contain an acceleration provision upon a change in control, and the options granted to Messrs. Young and Kraft on November 27, 2007 also contain this same provision.

Stock options awarded to the named executives in fiscal 2007 and the value of such awards are discussed below and shown in the table of Grants of Plan-Based Awards in Fiscal 2007 on page 22.



**Table of Contents***Other compensation*

We provide our executive officers with perquisites and benefits that we believe are reasonable, competitive and consistent with our overall executive compensation program in order to attract and retain talented executives. Our executives receive the same benefits that are available to all regular full-time employees with the sole addition of a supplemental life insurance policy. Executive officers, along with other regular full-time employees, may be entitled to the use of company paid tickets to sporting events.

***Compensation for the Named Executives in Fiscal 2007****Strength of our performance*

The specific compensation paid to each of the named executives for fiscal 2007 reflects our strong performance against key financial measurements established by the Compensation Committee at the beginning of the year. A more detailed analysis of our financial and operational performance is contained in the Management's Discussion & Analysis section of our 2007 Annual Report on Form 10-K filed with the SEC.

*Chief Executive Officer compensation**Base Salary*

Mr. Dunsmore's annual base salary for fiscal 2007 was set at \$375,000, the minimum provided in his employment agreement entered into on September 27, 2006. His base salary was unchanged from fiscal 2006.

*Cash Incentive Compensation*

Mr. Dunsmore's employment agreement dated September 27, 2006 also fixed his annual cash incentive target at not less than 100% of his base salary. Mr. Dunsmore's cash incentive target based on financial objectives was set by the Compensation Committee, at \$375,000, with additional incentives described below for revenues in excess of plan and acquisitions.

For fiscal 2007 Mr. Dunsmore's cash incentive compensation was determined by performance against his financial and strategic goals as follows:

*FINANCIAL OBJECTIVES (based upon organic performance; minimum 90% achievement required; maximum potential payout of \$375,000)*

*Quarterly Financial Objectives (each quarter comprising a cash incentive target of \$37,500, 60% dependent on revenue and 40% on EBTDA(1)):*

<b>Quarter Ended</b>	<b>Goals (In thousands)</b>		<b>Performance (In thousands)</b>		<b>Incentive Payment</b>
	<b>Revenue</b>	<b>EBTDA(1)</b>	<b>Revenue</b>	<b>EBTDA(1)</b>	
December 31, 2006	\$ 41,035	\$ 7,037	\$ 41,811	\$ 7,668	\$ 38,845
March 31, 2007	42,989	8,252	42,855	8,011	35,490
June 30, 2007	44,611	9,224	43,527	8,470	30,300
September 30, 2007	47,808	10,510	45,070	9,740	27,990

Total incentive compensation attributable to achievement of quarterly financial objectives \$ 132,625

*Annual Financial Objectives* (comprising a cash incentive target of \$225,000, 40% dependent on revenue, 40% on EBTDA(1), and 20% on cash balance(2) at September 30, 2007):

Revenue	Goals (In thousands)		Performance (In thousands)			Incentive Payment
	EBTDA(1)	Cash Balance	Revenue	EBTDA(1)	Cash Balance(2)	
\$176,443	\$35,023	\$79,000	\$173,263	\$33,889	\$86,672	\$ 211,370

(1) Earnings before taxes, depreciation and amortization.

(2) Cash balance consists of cash and cash equivalents and marketable securities, including long-term marketable securities, adjusted for acquisitions, stock repurchases and additional indebtedness.

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*REVENUES IN EXCESS OF ANNUAL REVENUE PLAN*

Another feature of Mr. Dunsmore's cash incentive plan for fiscal 2007 was the possibility of an additional cash incentive payment ranging up to 50% of his annual base salary based upon a scale for the achievement of organic revenues of at least \$178,197,330 and up to \$211,731,600 or higher, with a further requirement for self-funding through incremental profitability. As revenues did not exceed \$178,197,330, no bonus was paid under this element of the fiscal 2007 cash incentive plan for Mr. Dunsmore.

*ACQUISITION INCENTIVE*

Another feature of Mr. Dunsmore's compensation plan in fiscal 2007 was an additional potential incentive to reward the additional effort required for acquisitions. The program would have awarded a cash incentive payment ranging up to 50% of his annual base salary based on completed acquisitions meeting specific parameters for projected revenue. As no acquisitions were made in fiscal 2007, there was no compensation attributable to acquisitions in fiscal 2007.

Equity Incentive Compensation. Mr. Dunsmore did not receive an option award in fiscal 2007. In lieu of granting Mr. Dunsmore an annual stock option award, the Committee honored his request to award the equivalent number of shares to our key non-officer employees. The Committee approved Mr. Dunsmore's recommendation that awarded a total of 71,700 options in fiscal 2007 to sixteen key performers within our company.

*Compensation of Chief Financial Officer and other named executives for fiscal 2007*

For fiscal 2007, the Compensation Committee determined not to change the annual base salary or financial objectives cash incentive target for Mr. Krishnan, with each of these elements remaining at \$241,500. For fiscal 2007, Mr. Kraft's annual base salary was increased to \$200,000, and his financial objectives cash incentive target was increased to \$200,000, and Mr. Young's annual base salary was increased to \$208,000, and his financial objectives cash incentive target was increased to \$167,000. These increases were approved in consideration of market benchmarks and continued strong performance by each.

The cash incentive compensation of Messrs. Krishnan, Kraft and Young for fiscal 2007 was determined by achievement against performance objectives established at the beginning of the year. The goals, percentage weightings and performance against plan for Mr. Krishnan were identical to those of Mr. Dunsmore described above.

For fiscal 2007, Mr. Young had the same quarterly and annual revenue and EBTDA goals and performance against plan as Mr. Dunsmore, with different percentage weighting for annual goals:

*Quarterly Financial Objectives* (each quarter comprising a cash incentive target of \$16,700, 60% dependent on revenue and 40% on EBTDA).

*Annual Financial Objectives* (comprising a cash incentive target of \$100,200, 60% dependent on revenue and 40% on EBTDA).

For fiscal 2007, Mr. Kraft had the same quarterly and annual revenue and EBTDA goals and performance against plan as Mr. Dunsmore with different percentage weightings, and additional sales-related goals:

*Quarterly Financial Objectives* (each quarter comprising a cash incentive target of \$20,000, 50% dependent on revenue, 40% on EBTDA, and 10% based upon emerging technology revenue meeting or exceeding the quarterly plan). Emerging technology revenue exceeded the quarterly goals the first three quarters (114%, 109% and 118%

respectively), and was below the plan minimum in the fourth quarter.

*Annual Financial Objectives* (comprising a cash incentive target of \$120,000, 40% dependent on revenue, 40% on EBTDA, 10% based on emerging technology revenue meeting or exceeding the fiscal 2007 plan, and 10% based on achieving 152 or more design wins). Annual emerging technology revenue performance against plan was 110%, and design wins were 146, or 96.1% of the target.

Messrs. Krishnan, Kraft and Young would also have been entitled to additional cash incentive payment, if earned, based on the achievement of revenues in excess of plan and completed acquisitions, based on the same

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conditions described above for Mr. Dunsmore, in each case in an amount equal to 50% of annual base salary for Messrs. Krishnan and Kraft and 40% for Mr. Young. Because the goals were not achieved, no such payments were made.

Messrs. Krishnan, Kraft and Young each received a stock option award as set forth in the table of Grants of Plan-Based Awards in Fiscal 2007 on page 22.

**Compensation for the Named Executives in Fiscal 2008***Chief Executive Officer compensation*

**Overview.** The combination of base salary and annual cash incentive compensation for financial objectives, if fully achieved, would put Mr. Dunsmore's compensation at the 7<sup>th</sup> percentile relative to the market as determined by the Pearl Meyer study, with even higher achievement possible based on revenues in excess of plan and acquisitions as discussed below.

**Base Salary.** Mr. Dunsmore's annual base salary for fiscal 2008 was set at \$390,000, above the \$375,000 minimum provided in his employment agreement. This represented an increase of \$15,000, or 4%, over his base salary for fiscal 2007.

**Cash Incentive Compensation.** For fiscal 2008, Mr. Dunsmore's annual cash incentive program has the same structure as fiscal 2007. This element of compensation will be determined by performance against his financial and strategic goals as follows:

*FINANCIAL OBJECTIVES (based upon organic performance; minimum 90% achievement required; maximum potential payout of \$390,000)*

*Quarterly Financial Objectives (each quarter comprising a cash incentive target of \$39,000, 60% dependent on revenue and 40% on EBTDA(1)):*

<b>Quarter Ended</b>	<b>Goals (In thousands)</b>	
	<b>Revenue</b>	<b>EBTDA(1)</b>
December 31, 2007	\$ 46,795	\$ 8,591
March 31, 2008	48,430	8,835
June 30, 2008	51,869	10,780
September 30, 2008	55,347	12,736

*Annual Financial Objectives (comprising a cash incentive target of \$234,000, 40% dependent on revenue, 40% on EBTDA(1), and 20% on cash balance(2) at September 30, 2008):*

	<b>Goals (In thousands)</b>		<b>Cash Balance(2)</b>
	<b>Revenue</b>	<b>EBTDA(1)</b>	
	\$202,441	\$ 40,942	\$ 114,000

- (1) Earnings before taxes, depreciation and amortization.
- (2) Cash balance consists of cash and marketable securities, including long-term marketable securities, adjusted for acquisitions, stock repurchases and additional indebtedness.

*REVENUES IN EXCESS OF ANNUAL REVENUE PLAN*

Another feature of Mr. Dunsmore's cash incentive plan for fiscal 2008 is the possibility of an additional bonus ranging from 2.5% up to 50% of his annual base salary based upon a scale for the achievement of organic revenues of at least \$204,465,410 and up to \$242,929,200 or higher, with a further requirement for self-funding through incremental profitability.

**Table of Contents***ACQUISITION INCENTIVE*

As in fiscal 2007, another feature of Mr. Dunsmore's compensation plan in fiscal 2008 is an additional potential incentive to reward the additional effort required for acquisitions. The program provides for a cash incentive payment ranging up to 50% of his annual base salary based on completed acquisitions meeting certain parameters described below. Projected gross profit margin is a new element for fiscal 2008 and reflects the Compensation Committee's view as to the importance of gross profit margin as a metric for successful, profitable acquisitions.

**Acquisition Revenue Size**

<b>(Cumulative for multiple acquisitions)(1) (In millions)</b>	<b>Percent of Annual Base Salary(2)</b>
\$10-20	10%
\$20-30	20%
\$30-50	25%
\$50 or more	50%

- (1) Based on first full year projected revenue post acquisition, determined from time of acquisition forward.
- (2) The acquisition incentive, expressed as a percentage of the annual base salary, is subject to adjustment up or down based upon the first full year projected gross margin post acquisition, calculated in accordance with generally accepted accounting principles consistently applied by Digi (before amortization of identifiable intangible assets for purchased and core technology):

**Gross Margin**

	<b>Multiplier</b>
Below 50%	.5x
50%-60%	1.0x
60.1% - 70%	1.2x
Above 70.1%	1.5x

Equity Incentive Compensation. On November 27, 2007 Mr. Dunsmore was awarded an option to purchase 90,000 shares. The award represented equity compensation at approximately the 65<sup>th</sup> percentile for long-term incentive compensation for the chief executive officer as set forth in the Pearl Meyer study. In making the award, the Compensation Committee took particular note of Mr. Dunsmore's outstanding performance in 2007 and the fact that he had foregone any option award in 2006.

*Compensation of Chief Financial Officer and other named executives for fiscal 2008*

For fiscal 2008, the Compensation Committee determined not to change the annual base salary or financial objectives cash incentive target for Mr. Krishnan, with each of these elements remaining at \$241,500. For fiscal 2008, Mr. Kraft's annual base salary was increased to \$217,500, and his financial objectives cash incentive target was increased to \$217,500. For fiscal 2008 the Compensation Committee increased Mr. Young's annual base salary to \$225,000, and his financial objectives cash incentive target was increased to \$180,000.

The cash incentive compensation of Messrs. Krishnan, Kraft and Young for fiscal 2008 will again be determined by achievement against performance objectives established at the beginning of the year.

The goals and percentage weightings for Mr. Krishnan are identical to those of Mr. Dunsmore described above.

Mr. Young has the same quarterly and annual revenue and EBTDA goals as Mr. Dunsmore, with different percentage weighting for annual goals:

*Quarterly Financial Objectives* (each quarter comprising a cash incentive target of \$18,000, 60% dependent on revenue and 40% on EBTDA).

*Annual Financial Objectives* (comprising a cash incentive target of \$108,000, 60% dependent on revenue and 40% on EBTDA).



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Mr. Kraft has the same quarterly and annual revenue and EBTDA goals and performance against plan as Mr. Dunsmore, with different percentage weightings and an additional sales-related goal:

*Quarterly Financial Objectives* (each quarter comprising a cash incentive target of \$21,750, 60% dependent on revenue and 40% on EBTDA).

*Annual Financial Objectives* (comprising a cash incentive target of \$130,500, 50% dependent on revenue, 40% on EBTDA, and 10% based on 165 or more design wins).

Messrs. Krishnan, Kraft and Young are entitled to additional cash incentive payments, if earned, based on the achievement of revenues in excess of plan and completed acquisitions, based on the same conditions described above for Mr. Dunsmore, in each case up to 50% of such officer's annual base salary (40% for Mr. Young), or greater in the case of the acquisition incentive, if the gross profit margin multiplier described above applies.

Messrs. Krishnan, Kraft and Young each received a stock option award on November 27, 2007 for 30,000 shares, 35,000 shares and 35,000 shares, respectively. These awards are approximately between the 55<sup>th</sup> and 65<sup>th</sup> percentile for long-term incentive compensation for senior vice presidents as set forth in the Pearl Meyer study. In approving relatively larger awards to Messrs. Kraft and Young, the Compensation Committee reviewed the history of their option awards and was particularly influenced by a desire to incrementally increase the equity position of these executives. Mr. Kraft and Mr. Young were promoted to senior vice president in November 2005 and October 2006, respectively, and consequently have had fewer years to accumulate options at a level commensurate with their present executive positions. The option awards to Messrs. Kraft and Young in November 2007 also provide for accelerated vesting upon a change in control, as has been the case for options awarded to Messrs. Dunsmore and Krishnan. This change achieves the Compensation Committee's goal of uniformity for option award terms for all executive officers.

*Employment Agreements and Change in Control Provisions*

As discussed in greater detail under Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements on page 24, in September 2006 we entered into a revised employment agreement with our Chief Executive Officer, Mr. Dunsmore, superseding the agreement that governed his employment since joining us in 1999. Mr. Dunsmore's stock options vest upon a change in control of our company.

We also have severance agreements with our other named executives. The Compensation Committee recently approved a revised severance arrangement for Mr. Kraft, and a new severance arrangement for Mr. Young, that align their severance arrangements with the existing arrangements for our other named executive, Mr. Krishnan. See Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements on page 24. Each of these three named executives have a letter agreement that provides that if his employment is terminated by us without cause at any time, he will be entitled to receive severance equal to one year's base salary and a bonus (if earned) that will be based on the number of months of service during the fiscal year and our actual financial performance against plan as determined through their annual incentive compensation plan. The changes for Messrs. Kraft and Young were approved by the Compensation Committee in order to generally align their severance arrangements with those of Mr. Krishnan.

Mr. Krishnan's stock options vest upon a change in control of our company, and the options granted to Messrs. Young and Kraft on November 27, 2007 also vest upon a change in control of our company.

*Accounting and Tax Impacts of Executive Compensation*

Section 162(m) of the Internal Revenue Code generally precludes a public corporation from taking a federal income tax deduction for compensation paid in excess of one million dollars per year to certain covered officers. Under this section, compensation that qualifies as performance-based is excludable in determining what compensation amount shall qualify for tax deductibility.

Our Compensation Committee considers our ability to fully deduct compensation in accordance with the one million dollar limitations of Section 162(m) in structuring our compensation programs. However, the

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Compensation Committee retains the authority to authorize the payment of compensation that may not be deductible if it believes such payments would be in the best interests of us and our shareholders.

None of our executives has ever been compensated in a manner that would be non-deductible under Section 162(m), although for fiscal 2007 and 2008 the Compensation Committee established performance-based goals for our Chief Executive Officer which, if achieved, would result in annual base salary and other cash compensation exceeding the one million dollar deductible maximum.

### *Director Compensation*

As discussed in greater detail on page 26 under the caption Compensation of Directors, Digi's non-employee directors who beneficially own not more than 5% of our common stock are compensated for a year of board service from one annual meeting of stockholders to the next. During fiscal 2007 Digi amended its equity compensation plan, the Digi International Inc. 2000 Omnibus Stock Plan, to give the Compensation Committee discretion in awarding of all stock options to non-employee directors, rather than having most option awards to directors occur automatically.

In January 2007, in the exercise of its discretion, the Committee followed the historic pattern of annual option awards to non-employee directors, except that the options vest after one year rather than two, as the plan had required prior to amendment. Other than in the case of an outside director who is elected at other than an annual meeting, options are awarded to directors at a regularly scheduled meeting of the Compensation Committee in January following the annual meeting of stockholders and the public announcement of first quarter financial results. The Committee presently expects to continue to make a one-time stock option award to any newly elected director, as well as to continue to compensate newly elected directors ratably for service during any stub term.

In October 2007 the Compensation Committee undertook a study of director compensation with the assistance of Pearl Meyer and Partners, the Committee's independent compensation consultant. The Committee presently intends to compensate non-employee directors with a non-elective combination of cash and options having a targeted aggregate value ranging from approximately \$90,000 to \$120,000 per director depending upon committee service. According to the Pearl Meyer study, compensation at this level will put Digi within the 50<sup>th</sup> to 65<sup>th</sup> percentile relative to its peer group (described above) in total direct compensation. Total direct compensation will consist of approximately one-quarter to one-third in cash and the remainder in stock options with an exercise price equal to the closing sale price on the date of grant, valued according to the Black-Scholes method.

The Pearl Meyer report also indicated that the practice of awarding an initial grant of a non-elective option for 7,500 shares to a newly elected non-employee director was substantially below the median of our peer group. This conclusion is based upon the current value of such options as determined by the Black-Scholes method. It is the present intention of the Compensation Committee to award an initial stock option that is more in line with the market at the time that any newly elected non-employee director joins the Board.

### **Report of the Compensation Committee**

The Compensation Committee has reviewed the Compensation Discussion and Analysis and discussed that Analysis with management. Based on its review and discussions with management, the Committee recommended to our Board of Directors that the Compensation Discussion and Analysis be included in Digi's Annual Report on Form 10-K for the year ended September 30, 2007 and Digi's 2007 proxy statement. This report is provided by the following independent directors, who comprise the Committee:

Kenneth E. Millard (Chairman)

Guy C. Jackson

Bradley J. Williams

**Table of Contents****Summary Compensation Table**

The following Summary Compensation Table contains information concerning annual and long-term compensation for the fiscal year ended September 30, 2007 provided to the individuals who served as Chief Executive Officer and Chief Financial Officer during fiscal 2007 and our other two executive officers (the Named Officers ).

**Summary Compensation Table for Fiscal 2007**

<b>Name and Principal Position</b>	<b>Year</b>	<b>Salary \$(1)</b>	<b>Option Awards \$(2)</b>	<b>Non-Equity Incentive Plan Compensation \$(3)</b>	<b>All Other Compensation \$(4)</b>	<b>Total (\$)</b>
Joseph T. Dunsmore Chairman of the Board, President and Chief Executive Officer	2007	375,000	252,046	343,995	9,232	980,273
Subramanian Krishnan Senior Vice President, Chief Financial Officer and Treasurer	2007	241,500	193,011	221,533	9,645	665,689
Larry A. Kraft Senior Vice President of Sales and Marketing	2007	199,712	173,461	180,047	9,185	562,405
Joel K. Young Senior Vice President of Research and Development, and Chief Technical Officer	2007	207,771	134,993	149,803	9,511	502,078

- (1) The Salary column presents the base salary earned during the fiscal year, including any amounts contributed by the Named Officers to our 401(k) plan.
- (2) The Option Awards column presents the dollar amount of compensation expense (without any reduction for forfeiture assumptions related to service-based vesting conditions) recognized by us for financial reporting purposes during fiscal 2007 in connection with all outstanding grants of options (including grants made prior to fiscal 2007) to each of the Named Officers. Mr. Dunsmore did not receive an option grant during fiscal 2007. We calculated these amounts in accordance with SFAS 123R based on the grant date fair value of the awards using the valuation assumptions set forth in Note 9 to our fiscal 2007 audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007. The amounts reported have been adjusted to eliminate service-based forfeiture assumptions used for financial reporting purposes. These amounts reflect our accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Named Officer.
- (3) The Non-Equity Incentive Plan Compensation column presents cash bonuses earned during fiscal 2007 under our annual incentive plan.

(4) Amounts shown in the All Other Compensation column include the following:

<b>Name</b>	<b>Digi Contribution to 401(k) Plan (\$)</b>	<b>Value of Supplemental Life Insurance Premiums (\$)</b>	<b>Total (\$)</b>
Joseph T. Dunsmore	8,747	485	9,232
Subramanian Krishnan	8,650	995	9,645
Larry A. Kraft	8,945	240	9,185
Joel K. Young	9,221	290	9,511

**Table of Contents****Grants of Plan-Based Awards**

For services during fiscal 2007, the Named Officers received two types of plan-based awards: (i) cash awards under the annual incentive plan, and (ii) non-qualified stock option awards granted on November 27, 2007. Each stock option vests as to 25% of the shares subject to the option one year after the date of grant and in 36 monthly installments thereafter as to the rest of the shares, has a ten year term, and has an exercise price equal to the closing price of a share of our common stock on the date of grant. The annual incentive plan is described on pages 13 through 14 in the Compensation Discussion and Analysis.

**Grants of Plan-Based Awards in Fiscal 2007**

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1)			All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards (\$/Sh)(2)	Grant Date Fair Value of Stock and Option Awards (\$)(3)
		Threshold (\$)	Target (\$)	Maximum (\$)			
Joseph T. Dunsmore		225,000	375,000	750,000			
Subramanian Krishnan	11/27/06	144,900	241,500	483,000			