DIGI INTERNATIONAL INC
Form 10-K
November 22, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended: September 30, 2017
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)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ
Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes þ No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth 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
Emerging growth company	o		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. o

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

The aggregate market value of voting stock held by non-affiliates of the Registrant as of the last business day of the Registrant's most recently competed second fiscal quarter was $310,320,069 based on a closing price of $11.90 per common share as reported on the NASDAQ Global Select Market. (For purposes of this calculation all of the registrant's directors and executive officers are deemed affiliates of the registrant.)

Shares of common stock outstanding as of November 17, 2017: 26,664,418

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its 2018 Annual Meeting of Stockholders are incorporated by reference into Part III hereto.

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PART I.

ITEM 1. BUSINESS

General Background and Product Offerings

Digi International Inc. ("Digi," "we," "our," or "us") was incorporated in 1985 as a Minnesota corporation. We were reorganized as a Delaware corporation in 1989 in conjunction with our initial public offering. Our common stock is traded on the NASDAQ Global Select Market under the symbol DGII. Our World Headquarters is located at 11001 Bren Road East, Minnetonka, Minnesota 55343. The telephone number at our World Headquarters is (952) 912-3444.

We are a leading global provider of business and mission-critical and Internet of Things (IoT) connectivity products and services. We help our customers create next-generation connected products and deploy and manage critical communications infrastructures in demanding environments with high levels of security and reliability. As of the fiscal quarter ended June 30, 2017, we determined that we have two reportable operating segments for purposes of ASC 280-10-50 "Segments Reporting": (i) machine-to-machine (M2M), and (ii) Solutions.

Our M2M segment consists primarily of distinct communications products and communication product development services. Among other things, these products and services help our customers create next generation connected products and deploy and manage critical communications infrastructures in demanding environments with high levels of security and reliability. This segment creates secure, easy to implement embedded solutions and services to help customers build IoT connectivity. It also deploys ready to use, complete box solutions to connect remote equipment. The M2M segment also offers dedicated professional services for the design of specialized wireless communications products for customers. Finally, this segment offers managed cloud services that enable customers to capture and manage data from devices they connect to networks. M2M products and services are used by a wide range of businesses and institutions.

Our Solutions segment offers wireless temperature and other environmental condition monitoring services as well as employee task management services. These products and services are provided to food service, transportation, education, healthcare and pharma, and industrial markets and are marketed as Digi Smart Solutions™. We have formed and expanded the Solutions segment primarily through four acquisitions: the October 2015 acquisition of Bluenica Corporation (Bluenica), the November 2016 acquisition of FreshTemp, LLC (FreshTemp), the January 2017 acquisition of SMART Temps, LLC (SMART Temps) and the October 2017 acquisition of TempAlert, LLC (TempAlert). Because the acquisition of TempAlert was subsequent to September 30, 2017, it's results are not included in our Consolidated Financial Statements (see Note 19 to our Consolidated Financial Statements).

For more in-depth descriptions of our primary products and services, please refer to the heading "Listing of Principal Products and Services" at the end of Part I, Item 1 of this Form 10-K.

In October 2015, we sold our Etherios, Inc. customer relationship management (CRM) consulting services business (Etherios), which focused on integration and configuration of enterprise resource management (ERM) systems, including CRM systems. This part of our business principally provided integration and configuration of salesforce.com products. As a result of the sale of Etherios, we have accounted for it as a discontinued operation. Accordingly, amounts in the Consolidated Statement of Operations, the Consolidated Balance Sheets and notes thereto, for all periods affected, have been reclassified to reflect discontinued operations accounting for that business. For more information on this divestiture see Note 3 to the Consolidated Financial Statements.

Our M2M revenue represented 95.9%, 99.6% and 100.0% of our total revenue during the fiscal years ended September 30, 2017, 2016 and 2015, respectively. Solutions revenue represented 4.1% and 0.4% of our total revenue in fiscal 2017 and 2016, respectively. We had no Solutions revenue in fiscal 2015.

Our corporate website address is www.digi.com. In the "Company - Investor Relations" section of our website, we make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, our proxy statement and any amendments to these reports available free of charge as soon as reasonably practicable after these reports are filed with or furnished to the United States Securities and Exchange Commission (SEC). Each of these documents can also be obtained free of charge (except for a reasonable charge for duplicating exhibits to our reports on Form 10-K, 10-Q or 8-K) in print by any stockholder who requests them from our investor relations personnel. The

Investor Relations email address is ir@digi.com and its mailing address is: Investor Relations Administrator, Digi International Inc., 11001 Bren Road East, Minnetonka, Minnesota 55343. These reports can also be accessed via the SEC website, www.sec.gov, or via the SEC's Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Information concerning the operation of the SEC's Public Reference Room can be obtained by calling 1-800-SEC-0330.

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Information on our website is not incorporated by reference into this report or any other report we file with or furnish to the SEC.

Industry and Marketplace Conditions

Current Market Conditions and Status of Our Business

We believe the marketplace for IoT products and services will continue to expand generally.

Despite this expected expansion, our M2M segment contracted in fiscal 2017. Our M2M segment sells both wired and wireless products that are either embedded into the products of original equipment manufacturers (OEMs) or stand-alone to provide connectivity to stand-alone assets of customers. Certain of these products have been sold for many years, are in the mature phase of their life cycle and have been experiencing declining sales for several years. In fiscal 2017, sales of these legacy products experienced larger than expected declines largely because a long-term customer of certain of these products significantly curtailed its purchase of our products in fiscal 2017. These declines were not offset by increases in sales of other products, which, among other issues, were hampered by delays in the release of new products. While we generally expect the trend of marketplace growth to continue, it is susceptible to downturns either because of general economic conditions, the continued development of technology and uncertainty or changes in the regulatory environments. Relative to our own M2M segment business, sales of many of our products are subject to large project-based customer deployments. As such, if we are unable to identify and commence new deployments with equal or greater significance than completed projects, our growth from period to period may be inconsistent and our M2M segment may in any given period contract.

While the performance of our M2M segment, which is the significant majority of our sales, was less than anticipated in fiscal 2017, our Solutions segment experienced significant growth as we completed the acquisitions of FreshTemp and SMART Temps in our first and second fiscal quarters, respectively. We continue to see steadily growing demand for our Solutions products and services and presently expect this trend to continue.

Strategy

We continue to take significant steps to transform Digi into a company that can deliver consistent long-term growth with higher levels of profitability. This transformation began when we appointed Ronald E. Konezny as our Chief Executive Officer in December 2014 and today is centered on managing each of our operating segments towards different primary objectives.

M2M Segment

Our M2M segment, which represents the significant majority of our revenues is being managed for modest revenue growth and higher levels of profitability through greater operating expense leverage. A significant part of this business remains based in legacy networking products that are in the mature phase of their product life cycles. For many years these products have been experiencing year over year revenue declines that create a natural headwind to driving significant growth in this operating segment as a whole. In addition, sales of many of our products throughout this segment are based on significant one time projects. As a result, for many years Digi has experienced inconsistent revenue growth as project based revenues have fluctuated.

In this operating environment we have taken the following steps to meet our aims:

- We sold our Etherios CRM consulting business in 2015. This business initially was acquired with the expectation it would drive engagements with companies that utilize the salesforce.com platform and were looking to deploy solutions within their businesses. We were not, however, rewarded in the marketplace as we had expected. As a result, we disposed of a consulting business that was losing money and not fully tied to our core hardware expertise.
- We significantly reduced the number of hardware product stock keeping units (SKUs) we produce in order to simplify our operations, improve our ability to manage inventory effectively, improve channel stocking strategies and control costs. At present, SKUs have been reduced from close to 5,000 at the beginning of fiscal 2016 to approximately 1,400.
- We consolidated and relocated office locations to improve efficiencies and provide costs savings. In the first quarter of fiscal 2016, we moved our Digi Wireless Design Services team from an office in downtown Minneapolis to our World Headquarters in suburban Minnetonka. In the third quarter of fiscal 2016, we closed our office in Dortmund,

Germany and moved the corresponding positions to our existing office in Munich, Germany. In the third quarter of fiscal 2017, we announced the closure of our Paris, France office to further consolidate European operations in

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Munich, Germany. These moves improved our operating expenses and better position our employees to drive positive results in our operations through increased collaboration.

- In October 2017, we have added new leadership to our M2M team in the areas of product management and research and development to drive greater alignment around the products we bring to market to meet the needs and desires of potential customers in key markets in a timely manner. We believe this increased alignment can greater lever our technical capabilities to drive more consistent growth.

Solutions Segment

Our Solutions segment, which has grown from no revenue during fiscal 2015 to almost 5% of our total revenue in fiscal 2017, is being managed primarily for revenue growth. The segment was formed and has been grown primarily through our acquisitions of Bluenica in October 2015, FreshTemp in November 2016, SMART Temps in January 2017 and, most recently, TempAlert in October 2017. Following our acquisition of TempAlert we believe in fiscal 2018 this business will deliver between 10-15% of our revenues.

This business helps businesses track the completion of employee tasks and monitor environmental conditions (most notably, temperature) of perishable or sensitive inventories. Our efforts have created a market-leading, high-growth hardware enabled service business with significant recurring revenue potential. Following our recent TempAlert acquisition we now serve over 35,000 customer sites for many leading brands in the foodservice, transportation, education, healthcare and pharma and industrial marketplaces.

We have chosen to enter this marketplace aggressively for several reasons. First, it provides us with the opportunity to develop a recurring revenue business that is focused on a large addressable market that has not been penetrated significantly. Restaurants, pharmacies, hospitals and other businesses that maintain significant inventories of perishable or other sensitive goods are a large part of the market. These businesses by and large presently rely primarily on employees to log the temperature or other environmental conditions of these goods as well as the completion of other tasks using pencil and paper. This is not as cost effective or secure as using wireless communications sensors to track conditions automatically and provide real time alerts if established parameters are breached. It also is not as effective for tracking the completion of other tasks as using an application enabled smart phone or other wireless communications device. Second, at present this marketplace primarily is served by smaller companies that lack the infrastructure to provide hardware enabled service to customers in as effective and efficient a manner as we are able to do because of our long-standing history as an IoT hardware provider. Third, we believe customers in this marketplace will not require significant customization or development of existing products before they will commit to purchase the solution. This differs from many of our hardware customers who often ask us to create a highly customized product that cannot be easily sold to other parties. This potential for repeatable sales of an established product suite appeals to us. Fourth, by protecting valuable goods that impact health and safety, the solution provides a clear return on investment for potential customers whose business and reputation is highly reliant on maintaining safe operations that will not harm customers.

We believe this marketplace represents an opportunity for significant revenue growth for Digi that is both recurring and high-margin in nature. To that end at present our primary aim with this business is to manage it for customer acquisition and revenue growth while assuring we do not negatively impact the overall profitability of the Company in any material way.

In summary, we intend to continue to take steps to simplify our operations, improve operating expenses to increase our profit leverage and expand our business in ways that we believe can drive long-term profitable growth. We will continue to seek and evaluate acquisitions that will further enhance our Solutions segment as we believe this marketplace offers a path to a significant base of recurring revenue that can provide both stability and significant growth for us. We may also seek to acquire hardware or other businesses that we believe can improve our market position in our M2M segment.

Acquisitions and Dispositions

Acquisitions

Since fiscal 2015 we have acquired four businesses that form the basis of our Solutions segment.

In October 2015, we acquired Ontario based Bluenica, a company focused on temperature monitoring of perishable goods in the food industry by using wireless sensors which are installed in grocery and convenience stores, restaurants, and in products during shipment and storage to ensure that quality, freshness and public health requirements are met (see Note 2 to our Consolidated Financial Statements).

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In November 2016, we acquired Pittsburgh based FreshTemp. FreshTemp offered restaurants, convenience stores and other retailers the ability to monitor the temperature of food products automatically through the use of wireless sensors. The company also enabled these businesses to track the completion of operational tasks by their employees that could impact human health and safety in real time - a capability that we believe significantly enhanced our product offering (see Note 2 to our Consolidated Financial Statements).

In January 2017, we acquired Indiana based SMART Temps. SMART Temps provided real-time foodservice temperature management for restaurant, grocery, education and hospital settings as well as real-time temperature management for pharmacy, blood bank and laboratory environments. The acquisition significantly expanded our customer base, especially in the pharmacy and education marketplaces (see Note 2 to our Consolidated Financial Statements).

On October 20, 2017, subsequent to the end of fiscal 2017, we acquired TempAlert, a provider of automated, real-time temperature monitoring and task management solutions for the healthcare, industrial and foodservice industries. This acquisition more than doubled the number of customer sites we monitor while enhancing our ability to analyze data collected from our services. Because the acquisition of TempAlert was subsequent to September 30, 2017, TempAlert is not included in our Consolidated Financial Statements (see Note 19 to our Consolidated Financial Statements).

Disposition

On October 23, 2015, we entered into a stock purchase agreement with West Monroe Partners, LLC, pursuant to which they acquired our Etherios CRM consulting services business. We sold Etherios as part of a strategy to focus on providing highly reliable machine connectivity solutions for business and mission-critical application environments (see Note 3 to our Consolidated Financial Statements).

These are the only acquisitions and dispositions we have completed in the past five years. We will continue to evaluate strategic opportunities to acquire businesses as they arise and may seek to divest businesses or assets we no longer consider appropriate to our long-term strategy.

Sales Channels

We sell our products through a global network of distributors, systems integrators and value added resellers (VARs) which accounted for 61.5%, 66.1% and 61.8% of our total revenue in fiscal 2017, 2016 and 2015, respectively. We also complete sales through our own dedicated sales organization to OEMs and other customers which accounted for 38.5%, 33.9% and 38.2% of our total revenue in fiscal 2017, 2016 and 2015, respectively.

Distributors

Our larger distributors, based on sales we make to them, include Anewtech Systems Pte Ltd., Arrow Electronics, Inc., Astone Technologies, Atlantik Elektronik GmbH, Avnet, Digi-Key Corporation, Express Systems & Peripherals, Future Electronics, Ingram Micro, Mouser Electronics, Novotech, Sapply Pty. Ltd., Solid State Supplies, Ltd., Sphinx Computer Vertriebs GmbH, Synnex, Tech Data Corporation and Tokyo Electron Device Ltd. We also maintain relationships with many other distributors in the U.S., Canada, Europe, Asia Pacific and Latin America.

Strategic Sales Relationships

We maintain alliances with other industry leaders to develop and market technology solutions. These include many major communications hardware and software vendors, operating system suppliers, computer hardware manufacturers, enterprise application providers and cellular carriers. Among others, partners include: AT&T, Bell Mobility, NXP, Telit, Rogers, Silicon Laboratories, Sprint, Telus, Verizon and several other cellular carriers worldwide. Furthermore, we maintain a worldwide network of authorized developers that extends our reach into certain other technology applications and geographical regions.

We have established relationships with equipment vendors in a range of industries such as energy, industrial, retail, transportation, medical, and government that allow the vendors to ship our products and services as component parts of their overall solutions. Our products are used by many of the world’s leading telecommunications companies and Internet service providers, including AT&T Inc., Sprint Corporation and Verizon Communications Inc.

No single customer comprised more than 10% of our consolidated revenue for any of the years ended September 30, 2017, 2016 or 2015.

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Competition

We compete primarily in the communications technology industry, which is characterized by rapid technological advances and evolving industry standards. The market can be affected significantly by new product introductions and marketing activities of industry participants. In addition, we may compete with other companies to acquire new businesses or technologies and the competition to secure such assets may be intense. We compete for customers on the basis of existing and planned product features, service and software application capabilities, company reputation, brand recognition, technical support, alliance relationships, quality and reliability, product development capabilities, price and availability. While no competitor offers a comparable range of products and services, various companies do compete with us with respect to one or more of our products or solutions. With respect to many of our product and service offerings, we face competition from companies who dedicate more resources and attention to that particular offering than we are able to do given the breadth of our business. As the marketplace for IoT connectivity products and solutions continues to grow, we expect to encounter increased competition. Some of these competitors may have access to significantly more financial and technical resources than we possess.

Manufacturing Operations

Our manufacturing operations are conducted through a combination of internal manufacturing and external subcontractors specializing in various parts of the manufacturing process. We rely on third party foundries for our semiconductor devices that are Application Specific Integrated Circuits (ASICs) and we outsource printed circuit board production. This approach allows us to reduce our fixed costs, maintain production flexibility and optimize our profits.

Our products are manufactured to our designs with standard and custom components. Most of the components are available from multiple vendors. We have several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us. If these suppliers are unable to provide a timely and reliable supply of components, we could experience manufacturing delays that could adversely affect our consolidated results of operations in a material way.

Seasonality

In general, our business is not considered to be highly seasonal, although our first fiscal quarter revenue is often less than other quarters due to holidays and fewer shipping days.

Working Capital

We fund our business operations through a combination of cash and cash equivalents, marketable securities and cash generated from operations. We believe that our current financial resources, cash generated from operations, and our capacity for debt and/or equity financing will be sufficient to fund our business operations for the next twelve months and beyond.

Research & Development and Intellectual Property Rights

During fiscal 2017, 2016 and 2015, our research and development expenditures were $28.6 million, $31.0 million and $29.9 million, respectively.

Due to rapidly changing technology in the communications technology industry, we believe a large part of our success depends upon the product and service development skills of our personnel as well as our ability to integrate any acquired technologies with organically developed technologies. While we dedicate significant resources to research and development, many of our competitors are focused on a smaller set of products than us and are likely able to dedicate more resources than us toward the portions of the market in which we compete.

Our proprietary rights and technology are protected by a combination of copyrights, patents, trade secrets and trademarks.

We have established common law and registered trademark rights on a family of marks for a number of our products. Our products and services primarily are sold under the Digi, Rabbit® and Xbee® brands. We believe that the Digi and Rabbit® brands have established strong identities with our targeted customer base and our customers associate the Digi brand with "reliability" and the Rabbit® brand with "ease of integration." We believe that our customers associate Xbee® with "ease of use." Many of our customers choose us because they are building a very complex system solution and they want the highest level in product reliability and ease of integration and use. Our Etherios® brand was sold in connection with the sale of Etherios in October 2015.

Our patents are applicable to specific technologies and are valid for varying periods of time based on the date of patent application or patent grant in the U.S. and the legal term of patents in the various foreign countries where patent protection is

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obtained. We believe our intellectual property has significant value and is an important factor in the marketing of our company and products.

Backlog

Backlog as of both September 30, 2017 and 2016 was $25.3 million. The majority of the backlog at September 30, 2017 is expected to be shipped in fiscal 2018. Backlog as of any particular date is not necessarily indicative of our future sales trends.

Employees

We had 514 employees on September 30, 2017. We consider our relations with our employees to be good.

Geographic Areas and Currency Risks

Our customers are located throughout North America, Europe, Middle East & Africa (EMEA), Asia Pacific and Latin America. We are exposed to foreign currency transaction risk associated with certain sales being denominated in Euros, British Pounds, Japanese Yen and Canadian Dollar 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 manage our net asset or net liability position for U.S. dollar accounts in our foreign locations to reduce our foreign currency risk. We have not implemented a formal hedging strategy to reduce foreign currency risk.

During 2017, we had approximately $63.9 million of revenue related to foreign customers including export sales, of which $18.2 million was denominated in foreign currency, predominantly the Euro and British Pound. During fiscal 2016 and 2015, we had approximately $71.5 million and $76.2 million, respectively of revenue to foreign customers including export sales, of which $22.9 million and $21.3 million, respectively, were denominated in foreign currency, predominantly the Euro and British Pound. In future periods, we expect that the majority of our sales will be in U.S. Dollar.

Financial information about geographic areas appears in Note 5 to our Consolidated Financial Statements in this Form 10-K.

PRINCIPAL PRODUCTS AND SERVICES

Our primary products and services for each operating segment are as follows:

M2M Segment

Hardware Products

Cellular routers and gateways - Cellular routers provide connectivity for devices over a cellular data network. They can be used as a cost effective alternative to landlines for primary or backup connectivity for remote locations and devices. These products have been certified by the major wireless providers in North America and abroad, including, among others, AT&T®, Verizon Wireless®, Sprint®, Bell Mobility, Rogers and Vodafone. Cellular gateway products enable devices or groups of devices to be networked in locations where there is no existing network or where access to a network is prohibited. All of our cellular products include a unique remote management platform that provides secure management of devices across remote networks and can all use the Digi Remote Manager® for remote management. In addition, application connectivity, management and customization are enabled via the Digi Remote Manager® platform for many of these products.

Radio Frequency (RF) - Our RF products are small box or module products that utilize a variety of wireless protocols for PC-to-device or device-to-device connectivity, often in locations where deploying a wired network is not possible either because of cost, disruption or impracticality. By supporting ZigBee®, Wi-Fi® and other radio frequency (RF) technologies, we can meet most customer application requirements. In conjunction with one of our gateways, RF products can be connected into the Digi Remote Manager® for remote management, application connectivity and customization.

Embedded - Our Connect, Rabbit®, and ARM-based embedded systems on module, and single board computers are designed and developed with small footprints, low power consumption and software, making them ideal for medical, transportation and industrial device manufacturers. A number of these modules can be connected directly to the Digi Remote Manager® or other similar platforms, enabling remote management and remote application connectivity. Also included in our embedded grouping are our chips (or microprocessors) that provides the "brains" and processing power of an intelligent electronic device or communication sub-system. Some of our higher volume customers choose to purchase chips and build their own products. Chips are low cost but require the highest level of development expertise. Chip development is not part of our strategy; instead we use commercial-off-the-shelf technology from companies such as Freescale and Ember for our products.

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Network - Our network product category consists of:

- Console servers - Our console servers provide a secure remote graphical access to computer systems and network equipment that can communicate with virtually any server or device.
- Serial servers - Our serial servers (also known as device servers and terminal servers) provide secure, reliable and flexible serial-to-Ethernet integration of most devices into wired Ethernet networks. They are used for a variety of applications such as automation, robotics control, centralized device monitoring and management, data acquisition and point-of-sale applications.
- USB - Our Universal Serial Bus (USB) solutions include USB-to-serial converters that offer instant Input/Output (I/O) expansion for peripheral device connectivity. We also offer USB over Internet Protocol (IP) products that connect USB and serial devices on a wired or wireless Local Area Network (LAN), while eliminating the need for locally-attached host PCs. In addition, we also offer multiport USB hubs that offer a simple solution for adding switched USB ports to a PC, server or thin client.

Services

Digi Wireless Design Services - Our Digi Wireless Design Services provide customers turn-key wireless networking product designs, testing, and certification for a wide range of wireless technology platforms and applications.

Digi Support Services - Our Digi Support Services provide various levels of technical support to customers with programming and implementation challenges related to Digi products. We offer base support up to our highest level of professional support, which includes implementation planning, application development, on-site support, installation and customer training. These support services help minimize design risk and ensure optimal performance.

Digi Remote Manager® - Digi Remote Manager® is a complete centralized remote device management solution, which extends Digi's platform as-a-service (PaaS) offering previously known as Digi Device Cloud™. Digi Remote Manager® provides a secure environment for customers to aggregate their interaction with a large number of disparate devices and connect them to enterprise applications. It allows customers to meet service level commitments and stay compliant with Payment Card Industry (PCI) standards and also allows customers to monitor, diagnose and fix remote devices without sending a technician on site. While Digi Remote Manager® is marketed toward Digi devices, it supports non-Digi hardware as with the previous Device Cloud brand.

SOLUTIONS SEGMENT

Digi Smart Solutions™ - Our Digi Smart Solutions™ is an end-to-end, cost-effective system that uses sensors, gateways and cloud based applications to enable customers such as restaurants, groceries, convenience stores, pharmacies, schools, hospitals and industrial sites to (i) monitor wirelessly the temperature of food and other perishable or sensitive goods, and (ii) track the completion of operating tasks by employees. Our Digi Smart Solutions™ was introduced as a result of our acquisition of Bluenica on October 5, 2015. Our acquisitions of FreshTemp in November 2016 and SMART Temps in January 2017 further expanded our product suite and customer base in this space (see Note 2 to our Consolidated Financial Statements). In addition, subsequent to the end of fiscal 2017, we acquired TempAlert in October 2017 (see Note 19 to our Consolidated Financial Statements).

ITEM 1A. RISK FACTORS

Multiple risk factors exist which could have a material effect on our operations, results of operations, financial position, liquidity, capital resources and common stock.

Risks Relating to Our Business

We face intense competition from established companies that may have significant advantages over us and our products.

The market for our products is intensely competitive. Certain of our competitors and potential competitors have or may develop greater financial, technological, manufacturing, marketing, and personnel resources than us either generally or relative to the product sets they sell in competition to us. Further, there are numerous companies competing with us in various segments of the market for our products, and their products may have advantages over our products in areas such as conformity to existing and emerging industry standards, interoperability with other products, management and security capabilities, performance, price, ease of use, scalability, reliability, flexibility, product features and technical support.

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Our current and potential competitors have or may develop one or more of the following significant advantages over us in the product areas where they compete with us:

- tighter focus on an individual product or product category;
- greater financial, technical and marketing resources;
- barriers to transition to our products;
- higher brand recognition across larger geographic regions;
- more comprehensive functionality;
- longer-standing cooperative relationships with OEM and end-user customers;
- superior customer service capacity and quality;
- longer operating history; and
- larger customer base.

We cannot provide assurance that we will be able to compete successfully with our current and potential competitors. Such competitors may be able to more quickly develop or adapt to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products. Additionally, it is probable that new competitors or new alliances among existing competitors could emerge and rapidly acquire significant market share.

Our dependence on new product development and the rapid technological change that characterizes our industry makes us susceptible to loss of market share resulting from competitors’ product introductions and enhancements, service capabilities and similar risks.

Our industry is characterized by rapidly changing technologies, evolving industry standards, frequent new product introductions, short product life cycles in certain instances and rapidly changing customer requirements. The introduction of products and enhancements embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable.

Our future success will depend on our ability to enhance our existing products, to introduce new products to meet changing customer requirements and emerging technologies, and to demonstrate the performance advantages and cost-effectiveness of our products over competing products. Failure by us to modify our products to support new alternative technologies or failure to achieve widespread customer acceptance of such modified products could cause us to lose market share and cause our revenue to decline. Further, if competitors offer better service capabilities associated with the implementation and use of products in communication networks, our business could be impacted negatively.

We may experience delays in developing and marketing product enhancements or new products that respond to technological change, evolving industry standards and changing customer requirements. For instance, we experienced delays in the introduction of certain new products in fiscal 2017 that impacted our financial results for the year. There can be no assurance that we will not experience difficulties that could delay or prevent the successful development, introduction, and marketing of these products or product enhancements, or that our new products and product enhancements will meet the requirements of the marketplace adequately and achieve any significant or sustainable degree of market acceptance in existing or additional markets. In addition, the future introductions or announcements of products by us or one of our competitors embodying new technologies or changes in industry standards or customer requirements could render our then-existing products obsolete or unmarketable. This risk may become more pronounced as new competitors enter the marketplace, especially if these competitors have more resources than us to develop and market new products and technologies and provide related services. There can be no assurance that the introduction or announcement of new product offerings by us or one or more of our competitors will not cause customers to defer their purchase of our existing products, which could cause our revenue to decline.

We intend to continue to devote significant resources to our research and development, which, if not successful, could cause a decline in our revenue and harm our business.

We intend to continue to devote significant resources to research and development in the coming years to enhance and develop additional products. For fiscal 2017, 2016, and 2015, respectively, our research and development expenses were 15.7%, 15.2% and 14.7% of our revenue. If we are unable to develop new products, applications and services as a result of our research and

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development efforts, if we encounter delays in deploying these new products, applications and services, or if the products, applications and services we develop are not successful, our business could be harmed. Even if we develop new products, applications and services that are accepted by our target markets, the net revenue from these products, applications and services may not be sufficient to justify our investment in research and development.

Many of our products, applications and services have been developed through a combination of internally developed technologies and acquired technologies. Our ability to continue to develop new products, applications and services could be partially dependent on finding and acquiring new technologies in the marketplace. Even if we identify new technologies that we believe would be complementary to our internally developed technologies, we may not be successful in obtaining those technologies or we may not be able to acquire the technologies at a price that is acceptable to us.

A substantial portion of our development efforts have been directed toward the development of new products targeted to manufacturers of intelligent, network-enabled devices and other embedded systems in various markets, including markets in which networking solutions for embedded systems have not historically been sold, such as markets for industrial automation equipment and medical equipment.

Our participation in a services and solutions model, using hardware and cloud-based services, presents execution and competitive risks.

We are deploying a services and solutions model. Our Digi Smart Solutions™ offerings deploy hardware, software and cloud-based hosting. In other parts of our business we also offer our own internally developed hosted services and cloud-based platform, software applications, and supporting products and services. We are employing significant human and financial resources to develop and deploy these offerings. As we work to grow and scale these offerings, these investments have impacted our gross margins and profitability adversely in the past and may continue to do so in the future. While we believe we have a strong foundation to compete, it is uncertain whether our strategies will attract the users or generate the revenue required to be successful. We have and will encounter competition from other solutions providers, many of whom may have more significant resources than us with which to compete. Whether we are successful in this business model depends on a number of factors, including:

- our ability to put in place the infrastructure to deploy and evolve our solutions effectively and continuously;
- the features and functionality of our offerings relative to competing offerings as well as our ability to market effectively;
- our ability to engage in successful strategic relationships with third parties such as telecommunications carriers, component makers and systems integrators;
- competing effectively for market share; and
- deploying complete end-to-end solutions that meet the needs of the marketplace generally as well as the particular requirements of our customers more effectively and efficiently than competitive solutions.

Our ability to sustain and grow our business depends in large part on the success of our channel partner distributors and resellers.

A substantial part of our revenue is generated through sales by channel partner distributors and resellers. Sales through our channel partners accounted for 61.5%, 66.1% and 61.8% of our total revenue in fiscal 2017, 2016 and 2015, respectively. Further, in recent years we have been taking steps to expand our relationship with certain distributors who have global reach, an effort that may increase the percent of our revenue driven through channel partners or our reliance on certain channel partners to drive sales. To the extent our channel partners are unsuccessful in selling our products or if we are unable to obtain and retain a sufficient number of high-quality channel partners, our operating results could be materially and adversely affected. In addition, our channel partners may also market, sell and support products and services that are competitive with ours, and may devote more resources to the marketing, sales and support of such products. They also may have incentives to promote our competitors' products in lieu of our products, particularly for our competitors with larger volumes of orders, more diverse product offerings and a longer relationship with our distributors and resellers. In these cases, one or more of our important channel partners may stop selling our products completely. Our channel partner sales structure also could subject us to lawsuits, potential liability and reputational harm if, for example, any of our channel partners misrepresents the functionality of our products or services to customers, or violates laws or our corporate policies. If we fail to manage our existing or future sales channel partners effectively, our business and operating results could be materially and adversely affected.

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Our gross margins may be subject to decline.

Our gross margins may be subject to decline which could decrease our overall profitability and impact our financial performance adversely. Many of the hardware products we sell are approaching the end of their product life cycles. These mature hardware products typically sell at higher gross margins than our other product and service offerings. In fiscal 2017, sales of mature hardware products represented about 35.7% of our overall revenue. While these products experienced decreased year over year sales in excess of 20% in fiscal 2017, in general, revenues from the sale of these mature hardware products have been declining for several years at a rate of between 1% and 10%. We expect this trend to continue and it is uncertain whether fiscal 2017 represented an ongoing acceleration in the decline of these products. In addition, ongoing cost pressures in our industry create downward pressure on the prices at which we and other manufacturers can sell hardware products. We also have indicated that we would be willing to realize lower levels of gross margins from customers in return for long-term, binding purchase commitments, a strategy that, if successful, could also put downward pressure on our gross margins. While part of our longer term strategy is to sell software applications and IoT solutions such as Digi Smart Solutions™ which can provide recurring revenues at relatively high gross margin, these types of offerings are at early stages of adoption by customers and their sales growth is not necessarily predictable or assured. As such, our gross margins may be subject to decline unless we can implement cost reduction initiatives effectively to offset the impact of these factors.

Our revenue may be subject to fluctuations based on the level of significant one time purchases.

No single customer has represented more than 10% of our revenue in any of the last three fiscal years. However, many of our customers make significant one-time hardware purchases for large projects that are not repeated. As a result, our revenue may be subject to significant fluctuations based on whether we are able to close significant sales opportunities. Our failure to complete one or a series of significant sales opportunities in a particular fiscal period could have a material adverse effect on our revenue for that period.

Certain of our products are sold into mature markets, which could limit our ability to continue to generate revenue from these products.

Many of our hardware products are sold into mature markets that are characterized by a trend of declining demand. As the overall market for these mature hardware products decreases due to the adoption of new technologies, we expect that our revenue from these products will continue to decline. As a result, our future prospects depend in part on our ability to acquire or develop and successfully market additional products that address growth markets.

Our ability to grow our business is dependent in part on strategic relationships we develop and maintain with third parties as well as our ability to integrate and assure use of our products and services in coordination with the products and services of certain strategic partners in a commercially acceptable manner.

We believe that our ability to increase our sales depends in part on maintaining and strengthening relationships with parties such as telecommunications carriers, systems integrators, enterprise application providers, component providers and other strategic technology companies. Once a relationship is established, we likely will dedicate significant time and resources to it in an effort to advance our business interests and there is no assurance any strategic relationship will generate enough revenue to offset the significant resources we use to advance the relationship. Parties with whom we establish strategic relationships may also work with companies that compete with us. We also have limited, if any, control as to whether these parties devote adequate resources to promoting, selling, and implementing our products. Further, new or emerging technologies, technological trends or changes in customer requirements may result in certain companies with whom we maintain strategic relationships de-emphasizing their dealings with us or becoming potential competitors in the future. We also have limited, if any, control as to other business activities of these parties and we could experience reputational harm because of our association with such parties if they fail to execute on business initiatives, are accused of breaking the law or otherwise suffer reputational harm for other reasons. All of these factors could materially and adversely impact our business and results of operations.

In some cases we expect the establishment of a strategic relationship with a third party to result in integrations of our products or services with those of other parties. Identifying appropriate parties for these relationships as well as negotiating and documenting business agreements with them requires significant time and resources. We expect these agreements typically to be non-exclusive and not to prohibit the other party from working with our competitors or offering competing services. Once the relationship is established we may also encounter difficulties in combining our products and services in a commercially acceptable manner. We expect this type of dynamic, whereby our ability to realize sales opportunities is dependent on how our products and services interact with those sold by third parties, may become more common as the marketplace in our industry evolves. There can be no guarantee in any particular instance that we will be successful in making our products interact with those of other parties in a commercially acceptable manner and, even if we do, we cannot guaranty the resulting products and services will be marketed or sold effectively via the relationship.

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Our failure to compete successfully in our highly competitive market could result in reduced prices and loss of market share.

The market in which we operate is characterized by rapid technological advances and evolving industry standards. The market can be affected significantly by new product introductions and marketing activities of industry participants. In addition, the amount of competition we face in the marketplace may change and grow as the market for our industry grows and new entrants enter the marketplace. Present and future competitors may be able to identify new markets and develop products more quickly, which are superior to those developed by us. They may also adapt new technologies faster, devote greater resources to research and development, promote products more aggressively, and price products more competitively than us. Competition may also intensify or we may no longer be able to compete effectively in the markets in which we compete.

Our failure to anticipate or manage product transitions effectively could have a material adverse effect on our revenue and profitability.

From time to time, we or our competitors may announce new products, capabilities, or technologies that may replace or shorten the life cycles of our existing products. Announcements of currently planned or other new products may cause customers to defer or stop purchasing our products until new products become available. Furthermore, the introduction of new or enhanced products requires us to manage the transition from older product inventories and ensure that adequate supplies of new products can be delivered to meet customer demand. Our failure to anticipate the revenue declines associated with older products or manage transitions from older products effectively could result in inventory obsolescence and also have a material adverse effect on our revenue and profitability.

Acquisitions could disrupt our business and seriously harm our financial condition.

We will continue to consider acquisitions of complementary businesses, products or technologies. In the event of any future acquisitions, we could issue stock that would dilute our current stockholders’ percentage ownership, incur debt, assume liabilities, or incur large and immediate write-offs.

Our operation of any acquired business also involves numerous risks, including but not limited to:

- problems combining the purchased operations, technologies, or products;
- unanticipated costs;
- diversion of management’s attention from our core business;
- difficulties integrating businesses in different countries and cultures;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees, particularly those of the purchased organization.

We cannot assure that we will be able to successfully integrate any businesses, products, technologies, or personnel that we have acquired or that we might acquire in the future and any failure to do so could disrupt our business and have a material adverse effect on our consolidated financial condition and results of operations. Moreover, from time to time, we may enter into negotiations for a proposed acquisition, but be unable or unwilling to consummate the acquisition under consideration. This could cause significant diversion of management’s attention and out-of-pocket expenses for us. We could also be exposed to litigation as a result of any consummated or unconsummated acquisition.

We are subject to various cybersecurity risks, which are particularly acute in the cloud-based technologies operated by us and other third parties that form a part of our solutions. These risks may increase our costs and could damage our brand and reputation.

As we continue to direct a substantial portion of our sales and development efforts toward broader based solutions, such as Digi Smart Solutions™ and the Digi Remote Manager®, we expect to store, convey and potentially process significant amounts of data produced by devices. This data may include confidential or proprietary information, intellectual property or personally identifiable information of our customers or other third parties with whom they do business. It is important for us to maintain solutions and related infrastructure that are perceived by our customers and other parties with whom we do business to provide a reasonable level of reliability and security. Despite available security measures and other precautions, the infrastructure and transmission methods used by our products and services may be vulnerable to interception, attack or other disruptive problems.

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Continued high-profile data breaches at other companies evidence an external environment that is becoming increasingly hostile to information security. Improper disclosure of data or perception that our data security is insufficient could harm our reputation, give rise to legal proceedings, or subject our company to liability under laws that protect data, any of which could result in increased costs and loss of revenue.

If a cyberattack or other security incident were to allow unauthorized access to or modification of our customers' data or our own data, whether due to a failure with our systems or related systems operated by third parties, we could suffer damage to our brand and reputation. The costs we would incur to address and fix these incidents could significantly increase our expenses. These types of security incidents could also lead to lawsuits, regulatory investigations and increased legal liability, including in some cases contractual costs related to customer notification and fraud monitoring. Further, as regulatory focus on privacy and data security issues continues to increase and worldwide laws and regulations concerning the protection of information become more complex, the potential risks and costs of compliance to our business will intensify.

Digi Smart Solutions™ is a new business line for us and is subject to the risks faced by a new business.

Digi Smart Solutions™ was formed through acquisitions of various businesses and represents a new business line for our company. Our management has limited experience in this marketplace. The operation of Digi Smart Solutions™ will be subject to significant additional risks that are not necessarily related to our legacy products and services.

Additional risks that relate to Digi Smart Solutions™, include, but are not limited to:

- We have not traditionally sold products or services to restaurants, pharmacies, hospitals and other similar businesses, which are a focus for Digi Smart Solutions™.
- Digi Smart Solutions™ offerings are deployed in part to help assure perishable goods are safely preserved. This presents a risk of loss in the event of a malfunction or failure of our offerings.
- Although we have retained several key employees with extensive experience in operating companies we have acquired to date, Digi Smart Solutions™ represents a new line of business in a marketplace that is nascent in its development and has numerous competitors. We cannot provide assurances we will be successful in operating and growing this business.
- Our ability to succeed with the Digi Smart Solutions™ offerings will depend in large part on our ability to provide customers with hardware and software products that are easy to deploy and offer features and functionality that address the needs of particular businesses. We may face challenges and delays in the development of this business as the marketplace for products and services evolves to meet the needs and desires of customers.

In light of these risks and uncertainties, we may not be able to establish or maintain Digi Smart Solutions™' market share, integrate it successfully into our other operations or take full advantage of businesses we have acquired or may acquire in the future. There can be no assurance that we will recover our investments in this new business, that we will realize a profit from this new business or that diverting our management's attention to this new business will not have a material adverse effect on our existing businesses, any of which may have a material adverse effect on our results of operations, financial condition and prospects.

Our consolidated operating results and financial condition may be adversely impacted by worldwide economic conditions and credit tightening.

If worldwide economic conditions experience a significant downturn, these conditions may make it difficult or impossible for our customers and suppliers to accurately forecast and plan future business activities, which may cause them to slow or suspend spending on products and services. Our customers may find it difficult to gain sufficient credit in a timely manner, which could result in an impairment of their ability to place orders with us or to make timely payments to us for previous purchases. If this occurs, our revenue may be reduced, thereby having a negative impact on our results of operations. In addition, we may be forced to increase our allowance for doubtful accounts and our days sales outstanding may increase, which would have a negative impact on our cash position, liquidity and financial condition. We cannot predict either the timing or duration of an economic downturn in the economy, should one occur.

The long and variable sales cycle for certain of our products makes it more difficult for us to predict our operating results and manage our business.

The sale of our products and services can involve a significant technical evaluation and commitment of capital and other resources by potential customers and end users, as well as delays frequently associated with end users' internal procedures to deploy new technologies within their products and to test and accept new technologies. For these and other reasons, the sales

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cycle associated with certain of our products is typically lengthy and is subject to a number of significant risks, such as end users' internal purchasing reviews, that are beyond our control. Because of the lengthy sales cycle and the large size of certain customer orders, if orders forecasted for a specific customer are not realized or delayed, our operating results could be materially adversely affected.

We depend on manufacturing relationships and on limited-source suppliers, and any disruptions in these relationships may cause damage to our customer relationships.

We procure all parts and certain services involved in the production of our products and subcontract most of our product manufacturing to outside firms that specialize in such services. Although most of the components of our products are available from multiple vendors, we have several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us. There can be no assurance that our suppliers will be able to meet our future requirements for products and components in a timely fashion. In addition, the availability of many of these components to us is dependent in part on our ability to provide our suppliers with accurate forecasts of our future requirements. Delays or lost revenue could be caused by other factors beyond our control, including late deliveries by vendors of components, or force majeure events. For instance, a fire in November 2014 disrupted the operations at one of our contract manufacturers in Thailand. If we are required to identify alternative suppliers for any of our required components, qualification and pre-production periods could be lengthy and may cause an increase in component costs and delays in providing products to customers. Any extended interruption in the supply of any of the key components currently obtained from limited sources could disrupt our operations and have a material adverse effect on our customer relationships and profitability.

Our inability to obtain the appropriate telecommunications carrier certifications or approvals from governmental regulatory bodies could impede our ability to grow revenue in our wireless products.

The sale of our wireless products in certain geographical markets is sometimes dependent on the ability to gain telecommunications carrier certifications and/or approvals by certain governmental bodies. Failure to obtain these approvals, or delays in receiving the approvals, could impact our ability to enter our targeted markets or to compete effectively or at all in these markets and could have an adverse impact on our revenue.

We are dependent on wireless communication networks owned and controlled by others.

Our revenue could decline if we are unable to deliver continued access to digital cellular wireless carriers that we depend on to provide sufficient network capacity, reliability and security to our customers. Our financial condition could be impacted if our wireless carriers were to increase the prices of their services, or to suffer operational or technical failures.

The impact of natural disasters could negatively impact our supply chain and customers resulting in an adverse impact to our revenue and profitability.

Certain of our components and other materials used in producing our products are from regions susceptible to natural disasters. If we are unable to procure necessary materials, we could experience a disruption to our supply chain that would hinder our ability to produce our products in a timely manner, or cause us to seek other sources of supply, which may be more costly or which we may not be able to procure on a timely basis. We also risk damage to any tooling, equipment or inventory at the supplier's facilities. For instance, flooding in October 2011 and a fire in November 2014 disrupted the operations at one of our contract manufacturers in Thailand. In addition, our customers may not follow their normal purchasing patterns or temporarily cease purchasing from us due to impacts to their businesses in the region, creating unexpected fluctuations or decreases in our revenue and profitability. Natural disasters in other parts of the world on which our operations are reliant also could have material adverse impacts on our business.

Our use of suppliers in other parts of the world involves risks that could negatively impact us.

We purchase a number of components from suppliers in other parts of the world. Product delivery times may be extended due to the distances involved, requiring more lead time in ordering. In addition, ocean freight delays may occur as a result of labor problems, weather delays or expediting and customs issues. Any extended delay in receipt of the component parts could eliminate anticipated cost savings and have a material adverse effect on our customer relationships and profitability.

Our ability to compete could be jeopardized if we are unable to protect our intellectual property rights.

Our ability to compete depends in part on our proprietary rights and technology. Our proprietary rights and technology are protected by a combination of copyrights, patents, trade secrets and trademarks. We enter into confidentiality agreements with our employees, and sometimes with our customers, potential customers and other third parties, and limit access to the distribution of our proprietary information. There can be no assurance that the steps taken by us in this regard will be adequate to prevent the misappropriation of our technology. Our pending patent applications may be denied and any patents, once issued, may be circumvented by our competitors. Furthermore, there can be no assurance that others will not develop technologies that are superior to our technologies. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competing companies will not independently develop similar technologies. Our failure to adequately protect our proprietary rights could have a material adverse effect on our competitive position and result in loss of revenue.

From time to time, we are subject to claims and litigation regarding intellectual property rights or other claims, which could seriously harm us and require us to incur significant costs.

The communications technology industry is characterized by frequent litigation regarding patent and other intellectual property rights. From time to time, we receive notification of a third-party claim that our products infringe other intellectual property rights. Any litigation to determine the validity of third-party infringement claims, whether or not determined in our favor or settled by us, may be costly and divert the efforts and attention of our management and technical personnel from productive tasks, which could have a material adverse effect on our ability to operate our business and service the needs of our customers. There can be no assurance that any infringement claims by third parties, regardless if they have merit, will not materially adversely affect our business, operating results or financial condition. In the event of an adverse ruling in any such matter, we may be required to pay substantial damages, cease the manufacture, use and sale of infringing products, discontinue the use of certain processes or be required to obtain a license under the intellectual property rights of the third party claiming infringement. There can be no assurance that a license would be available on reasonable terms or at all. Any limitations on our ability to market our products, or delays and costs associated with redesigning our products or payments of license fees to third parties, or any failure by us to develop or license a substitute technology on commercially reasonable terms could have a material adverse effect on our business, operating results and financial condition.

We face risks associated with our international operations and expansion that could impair our ability to grow our revenue abroad as well as our overall financial condition.

We believe that our future growth is dependent in part upon our ability to increase sales in international markets. These sales are subject to a variety of risks, including fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers, unexpected changes in regulatory requirements, longer accounts receivable payment cycles, potentially adverse tax consequences, and export license requirements. In addition, we are subject to the risks inherent in conducting business internationally, including political and economic instability and unexpected changes in diplomatic and trade relationships. In many markets where we operate business and cultural norms are different than those in the United States and practices that may violate laws and regulations applicable to us like the Foreign Corrupt Practices Act (FCPA) and the UK Anti-Bribery Act (UKBA) are more commonplace. Although we have implemented policies and procedures with the intention of ensuring compliance with these laws and regulations, our employees, contractors and agents, as well as channel partners involved in our international sales, may take actions in violation of our policies. Many of our vendors and strategic business allies also have international operations and are subject to the risks described above. Even if we are able to successfully manage the risks of international operations, our business may be adversely affected if one or more of our business partners are not able to successfully manage these risks. There can be no assurance that one or more of these factors will not have a material adverse effect on our business strategy and financial condition.

Our failure to comply effectively with regulatory laws pertaining to our foreign operations could have a material adverse effect on our revenue and profitability.

We are required to comply with U.S. government export regulations in the sale of our products to foreign customers, including requirements to properly classify and screen our products against a denied parties list prior to shipment. We are also required to comply with the provisions of the FCPA and all other anti-corruption laws, such as UKBA, of all other countries in which we do business, directly or indirectly, including compliance with the anti-bribery prohibitions and the accounting and recordkeeping requirements of this law. Violations of the FCPA or other similar laws could trigger sanctions, including ineligibility for U.S. government insurance and financing, as well as large fines. Failure to comply with the aforementioned regulations could also deter us from selling our products in international jurisdictions, which could have a material adverse effect on our revenue and profitability.

Foreign currency exchange rates may adversely affect our operating results.

We are exposed to a variety of market risks, including the effects of changes in foreign currency exchange rates on transactions that are denominated in foreign currencies. Because our financial statements are denominated in U.S. Dollars and approximately 11% of our revenue is denominated in a currency other than U.S. Dollars, such as Euros, British Pounds, Yen and Canadian Dollars, our revenues and earnings may be adversely impacted if the U.S. dollar strengthens significantly against these foreign currencies.

The loss of key personnel could prevent us from executing our business strategy.

Our business and prospects depend to a significant degree upon the continuing contributions of our executive officers and key technical and other personnel. Competition for such personnel is intense, and there can be no assurance that we will be successful in attracting and retaining qualified personnel. Failure to attract and retain key personnel could result in our failure to execute our business strategy.

Our failure to comply effectively with the requirements of applicable environmental legislation and regulation could have a material adverse effect on our revenue and profitability.

Production and marketing of products in certain states and countries may subject us to environmental and other regulations. In addition, certain states and countries may pass new regulations requiring our products to meet certain requirements to use environmentally friendly components. The European Union has issued two directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive (WEEE) makes producers of certain electrical and electronic equipment financially responsible for collection, reuse, recycling, treatment and disposal of equipment placed in the European Union market. The Restrictions of Hazardous Substances Directive (RoHS) bans the use of certain hazardous materials in electric and electrical equipment which are put on the market in the European Union. In the future, China and other countries including the United States may adopt further environmental compliance programs. If we fail to comply with these regulations, we may not be able to sell our products in jurisdictions where these regulations apply, which could have a material adverse effect on our revenue and profitability.

Negative conditions in the global credit markets may impair a portion of our investment portfolio.

Our investment portfolio consists of certificates of deposit, commercial paper, money market funds, corporate bonds and government municipal bonds. These marketable securities are classified as available-for-sale and are carried at fair market value. Some of our investments could experience reduced liquidity and could result in an impairment charge should the impairment be considered as other-than-temporary. This loss would be recorded in our consolidated statement of operations, which could materially adversely impact our consolidated results of operations and financial condition.

Unanticipated changes in our tax rates could affect our future results.

Our future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or our interpretation of such laws. In addition, we may be subject to the examination of our income tax returns by the Internal Revenue Service and other U.S. and international tax authorities. We regularly assess the potential outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an adverse effect on our consolidated operating results and financial condition.

We may have additional tax liabilities.

We are subject to income taxes in the United States and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, including our reserves for uncertain tax positions. In the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. We regularly are under audit by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits could be materially different from our historical income tax provisions and accruals. The results of an audit could have a material effect on our consolidated financial position, results of operations, or cash flows in the period or periods for which that determination is made.

Risks Related to Our Common Stock

Unsolicited takeover proposals, governance change proposals, proxy contests and resulting litigation may adversely impact our operations, create uncertainty and affect the market price and volatility of our securities.

In fiscal 2017, we received an unsolicited takeover proposal and other companies in our industry have been the target of unsolicited takeover proposals in the past. In the event that a third party, such as a competitor, private equity firm or activist investor makes an unsolicited takeover proposal, or proposes to change our governance policies or board of directors, or makes

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other proposals concerning our ownership structure or operations, our review and consideration of such proposals may be a significant distraction for our management and employees, and could require us to expend significant time and resources. Such proposals may create uncertainty for our employees and this uncertainty may adversely affect our ability to retain key employees, to hire new talent or to complete acquisitions we may desire to make. Similar uncertainty among our customers, suppliers and other business partners could cause them to terminate, or not to renew or enter into, arrangements with us. Certain proposals may result in costly proxy contests or litigation that can disrupt our business operations or result in an adverse effect on our operating results. Management and employee distraction related to any such proposals also may adversely impact our ability to conduct our business optimally and pursue our strategic objectives. Such proposals, or their withdrawal, could create uncertainty among investors and potential investors as to our future direction and affect the market price of our common stock without regard to our operational or financial performance.

Certain provisions of the Delaware General Corporation Law and our charter documents have an anti-takeover effect.

There exist certain mechanisms under the Delaware General Corporation Law and our charter documents that may delay, defer or prevent a change of control. For instance, under Delaware law, we are prohibited from engaging in certain business combinations with interested stockholders for a period of three years after the date of the transaction in which the person became an interested stockholder unless certain requirements are met, and majority stockholder approval is required for certain business combination transactions with interested parties.

Our Certificate of Incorporation contains a "fair price" provision requiring majority stockholder approval for certain business combination transactions with interested parties, and this provision may not be changed without the vote of at least 80% of the outstanding shares of our voting stock. Other mechanisms in our charter documents may also delay, defer or prevent a change of control. For instance, our Certificate of Incorporation provides that our Board of Directors has authority to issue series of our preferred stock with such voting rights and other powers as the Board of Directors may determine. Furthermore, we have a classified board of directors, which means that our directors are divided into three classes that are elected to three-year terms on a staggered basis. Since the three-year terms of each class overlap the terms of the other classes of directors, the entire board of directors cannot be replaced in any one year. Under Delaware law, directors serving on a classified board may not be removed by shareholders except for cause. Also, pursuant to the terms of our shareholder rights plan, each outstanding share of common stock has one attached right. The rights will cause substantial dilution of the ownership of a person or group that attempts to acquire us on terms not approved by the Board of Directors and may have the effect of deterring hostile takeover attempts.

The effect of these anti-takeover provisions may deter business combination transactions not approved by our Board of Directors, including acquisitions that may offer a premium over the market price to some or all stockholders.

The price of our common stock has been volatile and could continue to fluctuate in the future.

The market price of our common stock, like that of many other high-technology companies, has fluctuated significantly and is likely to continue to fluctuate in the future. During fiscal 2017, the closing price of our common stock on the NASDAQ Global Select Market ranged from $8.60 to $14.10 per share. Our closing sale price on November 20, 2017 was $10.15 per share. Announcements by us or others regarding the receipt of customer orders, quarterly variations in operating results, departures of key personnel, acquisitions or divestitures, additional equity or debt financings, results of customer field trials, scientific discoveries, technological innovations, litigation, product developments, patent or proprietary rights, government regulation and general market conditions and risks may, for example, have a significant impact on the market price of our common stock.

If our stock price declines over a sustained period of time or our profits significantly decrease, we may need to recognize an impairment of our goodwill.

The price of our common stock could decline. If such a decline continued over a sustained period of time, we could have an impairment of our goodwill. Our market value is dependent upon certain factors, including continued future growth of our products and solutions. If such growth does not materialize or our forecasts are not met, our profits could be significantly reduced and our market value may decline, which could result in an impairment of our 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The following table contains a listing of our significant property locations as of September 30, 2017:

Location of Property	Use of Facility	Approximate Square Footage	Ownership or Lease Expiration Date
Minnetonka, MN (Corporate headquarters)	Research & development, sales, sales support, marketing and administration	130,000	Owned
Eden Prairie, MN	Manufacturing and warehousing	58,000	Owned
Mishawaka, IN	Sales, technical support and administration	12,412	April, 2023
Waltham, MA	Research & development, sales and sales support	4,249	October 2020
Rochester, MN	Engineering services	3,090	September 2018
Lindon, UT	Sales, technical support, research & development and administration	11,986	December 2020
St. Catharines, Ontario, Canada	Sales and technical support	1,179	June 2019
Hong Kong, China	Sales, marketing and administration	1,656	April 2019
Beijing, China	Sales, marketing and administration	1,617	October 2019
Shanghai, China	Sales, marketing and administration	1,991	May 2019
Ismaning, Germany	Sales, sales support and administration	6,878	September 2019
Logrono, Spain	Sales, research & development and administration	3,229	January 2020
Tokyo, Japan	Sales	1,371	Perpetual
Singapore	Sales, marketing and administration	3,498	April 2019

In addition to the above locations, we perform sales activities in various other locations in Europe that are not deemed to be principal locations and are not listed above.

ITEM 3. LEGAL PROCEEDINGS

On June 19, 2017, Weatherproof Wireless, LLC filed a complaint against Digi International Inc. in federal court in the District of Delaware. The complaint includes allegations against us pertaining to the infringement of Weatherproof Wireless, LLC patents by our access gateway and wireless router pods for public safety communications structures, including the Digi Utility Communication Hub with 4G LTE. On September 26, 2017 we signed a settlement and license agreement for an immaterial amount.

In addition to the matters discussed above, in the normal course of business, we are subject to various claims and litigation, which may include, but are not limited to, patent infringement and intellectual property claims. While we are unable to predict the outcome of any potential claims or litigation due to the inherent unpredictability of these matters, we believe that it is possible that we could, in the future, incur judgments or enter into settlements of claims that could have a material adverse effect on our operations in any particular period.

ITEM 4. MINE SAFETY DISCLOSURES

None.

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PART II.

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Stock Listing

Our common stock trades under the symbol DGII on the NASDAQ Global Select Market tier of The NASDAQ Stock Market LLC. On November 17, 2017 there were 118 stockholders of record.

The high and low sale prices for our common stock for each quarter during the years ended September 30, 2017 and 2016, as reported by The NASDAQ Stock Market, were:

Stock Prices

2017	First	Second	Third	Fourth
High	$14.15	$14.00	$12.53	$11.05
Low	$9.00	$11.60	$9.00	$8.50

2016	First	Second	Third	Fourth
High	$13.53	$12.23	$11.69	$12.49
Low	$11.14	$7.70	$8.37	$9.79

On November 13, 2016 Digi confirmed that it received an unsolicited, conditional and non-binding proposal from Belden Inc. to acquire the Company for $13.82 per share in cash. Our Board of Directors unanimously rejected the proposal on November 8, 2016 and again on November 11, 2016. This proposal was rescinded by Belden, Inc. on May 5, 2017.

Dividend Policy

We have never paid cash dividends on our common stock. Our Board of Directors presently intends to retain all earnings for use in our business, except for periodic stock repurchases, and does not anticipate paying cash dividends in the foreseeable future.

Issuer Repurchases of Equity Securities

On May 2, 2017, our Board of Directors authorized a program to repurchase up to $20.0 million of our common stock primarily to return capital to shareholders. This repurchase authorization expires on May 1, 2018. Shares repurchased under this program will be made through open market and privately negotiated transactions from time to time and in amounts that management deems appropriate. The amount and timing of share repurchases depends upon market conditions and other corporate considerations.

The following table presents the information with respect to purchases made by or on behalf of Digi International Inc. or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the fourth quarter of fiscal 2017:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
July 1, 2017 - July 31, 2017	292	$9.90	—	$19,725,797.42
August 1, 2017 - August 31, 2017	1,316	$9.95	—	$19,725,797.42
September 1, 2017 - September 30, 2017	—	—	—	$19,725,797.42

Total	1,608	$9.94	—	$19,725,797.42

(1) All shares reported were forfeited by employees in connection with the satisfaction of tax withholding obligations related to the vesting of restricted stock units.

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ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES (CONTINUED)

Performance Evaluation

The graph below compares the total cumulative stockholders’ return on our Common Stock for the period from the close of the NASDAQ Stock Market - U.S. Companies on September 28, 2012 to September 29, 2017, the last day of fiscal 2017, with the total cumulative return for the NASDAQ U.S. Benchmark TR Index (the U.S. Benchmark Index) and the NASDAQ Telecommunications Index (the Peer Index) over the same period. We have determined that our line of business is mostly comparable to those companies in the Peer Index. The index level for the graph and table was set to $100 on September 28, 2012, for our Common Stock, the U.S. Benchmark Index and the Peer Index and assumes the reinvestment of all dividends.

	FY12	FY13	FY14	FY15	FY16	FY17
Digi International Inc.	$100.00	$98.33	$73.82	$116.04	$112.20	$104.33
NASDAQ U.S. Benchmark TR Index	$100.00	$121.50	$143.19	$142.18	$163.83	$194.50
NASDAQ Telecommunications Index	$100.00	$101.70	$115.28	$107.06	$134.94	$136.52

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ITEM 6. SELECTED FINANCIAL DATA

(in thousands, except per common share data amounts and number of employees)

For Fiscal Years Ended September 30,	2017	2016	2015	2014	2013
Revenue	$181,634	$203,005	$203,847	$183,173	$184,420
Gross profit	$87,174	$99,680	$97,121	$90,377	$95,325
Sales and marketing	33,955	33,847	37,574	38,751	39,229
Research and development	28,566	30,955	29,949	28,912	29,082
General and administrative (1)	13,331	17,026	18,306	18,244	19,417
Restructuring charges, net	2,515	747	403	81	313
Operating income	8,807	17,105	10,889	4,389	7,284
Total other income (expense), net (2)	684	(415)	2,228	672	695
Income before income taxes	9,491	16,690	13,117	5,061	7,979
Income tax provision (3)	125	3,212	3,684	568	2,330
Income from continuing operations	9,366	13,478	9,433	4,493	5,649
Income (loss) from discontinued operations, after income taxes	—	3,230	(2,845)	(2,742)	156
Net income	$9,366	$16,708	$6,588	$1,751	$5,805
Basic net income (loss) per common share:					
Continuing operations	$0.35	$0.52	$0.38	$0.18	$0.22
Discontinued operations	$—	$0.13	$(0.12)	$(0.11)	$0.01
Net income (4)	$0.35	$0.65	$0.27	$0.07	$0.22
Diluted net income (loss) per common share:					
Continuing operations	$0.35	$0.51	$0.37	$0.17	$0.22
Discontinued operations	$—	$0.12	$(0.11)	$(0.11)	$0.01
Net income (4)	$0.35	$0.64	$0.26	$0.07	$0.22
Balance sheet data as of September 30,					
Working capital (current assets less current liabilities)	$156,380	$171,837	$136,996	$125,927	$127,672
Total assets	$345,189	$336,166	$300,360	$290,459	$299,930
Stockholders' equity	$319,144	$300,029	$274,938	$265,298	$274,243
Book value per common share (stockholders' equity divided by outstanding shares)	$12.01	$11.52	$10.98	$10.88	$10.73
Number of employees as of September 30	514	515	515	571	621

(1) Included in general and administrative expense in fiscal 2013 is $1.5 million ($1.0 million after tax) related to the patent infringement lawsuit settlement with U.S. Ethernet Innovations.

(2) Included in total other income (expense), net for fiscal 2015 is a $1.4 million gain from the settlement of a property and casualty insurance claim related to the replacement of our capital equipment destroyed in the fire at our subcontract manufacturer's location in Thailand.

(3) In fiscal 2017, 2016 and 2015, we recorded net tax benefits of $1.0 million, $1.5 million and $0.8 million, respectively (see Note 11 to our Consolidated Financial Statements). In fiscal 2014 we recorded $1.5 million related to the re-measurement and reversal of certain income tax reserves as a result of a federal income tax audit of fiscal 2012, the reassessment of state research and development tax credits and the release of income tax reserves due to the expiration of statute of limitations from U.S. and foreign tax jurisdictions. In fiscal 2013 we recorded net tax benefits of $0.8 related to the January 2, 2013 enactment of the American Taxpayers Relief Act of 2012 extending the research and development tax credit for the last three quarters of fiscal 2012 and the release of

income tax reserves due to the expiration of the statute of limitations from various U.S. and foreign tax jurisdictions.

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

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ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our management’s discussion and analysis should be read in conjunction with our consolidated financial statements and other information in this Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

FORWARD-LOOKING STATEMENTS

This Annual Report 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.

Words such as "assume," "believe," "anticipate," "intend," "estimate," "target," "may," "will," "expect," "plan," "project," "should," or "continue" or the 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. Among other items, these statements relate to expectations of the business environment in which the company operates, projections of future performance, perceived marketplace opportunities and statements regarding our mission and vision. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, including risks related to the highly competitive market in which our company operates, rapid changes in technologies that may displace products sold by us, declining demand for and prices of networking products, our reliance on distributors and other third parties to sell our products, delays in product development efforts, uncertainty in user acceptance of our products, the ability to integrate our products and services with those of other parties in a commercially accepted manner, potential liabilities that can arise if any of our products have design or manufacturing defects, our ability to defend or settle satisfactorily any litigation, uncertainty in global economic conditions and economic conditions within particular regions of the world which could negatively affect product demand and the financial solvency of customers and suppliers, the impact of natural disasters and other events beyond our control that could negatively impact our supply chain and customers, potential unintended consequences associated with restructuring or other similar business initiatives that may impact our ability to retain important employees, the ability to achieve the anticipated benefits and synergies associated with acquisitions or divestitures, and changes in our level of revenue or profitability which can fluctuate for many reasons beyond our control.

These and other risks, uncertainties and assumptions identified from time to time in our filings with the United States Securities and Exchange Commission, including without limitation, those described in Item 1A, Risk Factors, of this Form 10-K and subsequent quarterly reports of Form 10-Q and other filings, could cause our future results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. Many of such factors are beyond our ability to control or predict. These forward-looking statements speak only as of the date for which they are made. We disclaim any intent or obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

PRESENTATION OF NON-GAAP FINANCIAL MEASURES

This report includes EBITDA from continuing operations, which is a non-GAAP financial measure. Non-GAAP financial measures are not substitutes for GAAP financial measures, such as net income, for the purpose of analyzing financial performance. The disclosure of these measures does not reflect all charges and gains that were actually recognized by the company. Non-GAAP financial measures are not prepared in accordance with, or an alternative for measures prepared in accordance with, generally accepted accounting principles and may be different from non-GAAP financial measures used by other companies. In addition, non-GAAP financial measures are not based on any comprehensive set of accounting rules or principles. We believe that non-GAAP financial measures have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP and that these measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP financial measures. Additionally, we understand that EBITDA from continuing operations does not reflect our cash expenditures, the cash requirements for the replacement of depreciated and amortized assets, or changes in or cash requirements for our working capital needs.

We believe that the presentation of EBITDA from continuing operations as a percentage of revenue is useful because it provides a reliable and consistent approach to measuring our performance from year to year and in assessing our performance against that of other companies. We believe this information helps compare operating results and corporate performance exclusive of the impact of our capital structure and the method by which assets were acquired. EBITDA from continuing operations is used as an internal metric for executive compensation, as well as incentive compensation for the rest of the employee base, and it is monitored quarterly for these purposes.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

OVERVIEW
We are a leading global provider of business and mission-critical machine-to-machine (M2M) and Internet-of-Things (IoT) connectivity products and services. As of the fiscal quarter ended June 30, 2017, we determined that we have two reportable operating segments for purposes of ASC 280-10-50 "Segments Reporting":

- M2M segment; and
- Solutions segment.

Our M2M segment consists primarily of distinct communications products and communication product development services. Among other things, these products and services help our customers create next generation connected products and deploy and manage critical communications infrastructures in demanding environments with high levels of security and reliability. We create secure, easy to implement embedded solutions and services to help customers build IoT connectivity. We also deploy ready to use, complete box solutions to connect remote machinery. We also offer dedicated professional services for the design of specialized wireless communications products for customers. Finally, through this segment we offer managed cloud services that enable customers to capture and manage data from devices they connect to networks. The products and services of this segment are used by a wide range of businesses and institutions.
All of the revenue we report in our consolidated financial statements as hardware product revenue is derived from products included in this segment. These products include our cellular routers and gateways, radio frequency (RF), embedded and network products. Our cellular product category includes our cellular routers and gateways. Our RF product category includes our XBee® modules as well as other RF Solutions. Our Embedded product category includes Digi Connect® and Rabbit® embedded systems on module and single board computers. Our network product category, which has the highest concentration of mature products, includes console and serial servers and USB connected products. Revenues we report as services and solutions revenue in our consolidated financial statements from this segment include Digi Wireless Design Services, Digi Remote Manager® and support services we provide for our hardware products.
Our Solutions segment offers wireless temperature and other environmental condition monitoring services as well as employee task management services. These products and services are provided to food service, transportation, education, healthcare and pharma, and industrial markets and are marketed as Digi Smart Solutions™. We have formed the Solutions segment primarily through a series of acquisitions including the October 2015 acquisition of Bluenica Corporation (Bluenica), the November 2016 acquisition of FreshTemp, LLC (FreshTemp) and the January 2017 acquisition of SMART Temps, LLC (SMART Temps) to enhance and expand the capabilities of the Solutions segment. All revenues from this segment are reported in our consolidated financial statements as services and solutions revenue as customers subscribe for ongoing monitoring services that are enabled by the deployment of hardware and related software. For further detail on segment performance, see Segment Results of Operations section of the management discussion and analysis.
We utilize many financial, operational, and other metrics to evaluate our financial condition and financial performance. Below we highlight the fiscal 2017 metrics that we feel are most important in these evaluations:

- Revenue was $181.6 Million. Our revenue decreased by $21.4 million, or 10.5%, compared to fiscal 2016. This decrease was due to a decrease in product revenue of $29.6 million, offset by an increase in services and solutions revenue of $8.2 million.
- Gross Margin was 48.0%. Our gross margin decreased as a percentage of revenue to 48.0% in fiscal 2017 from 49.1% in fiscal 2016. Hardware product gross margin, excluding amortization, was 48.7% in fiscal 2017, compared to 50.1% in the prior fiscal year. Service gross margin, excluding amortization, for fiscal 2017 was 49.5% compared to 32.5% in the prior fiscal year.
- Income from Continuing Operations was $9.4 Million and Earnings Per Diluted Share from Continuing Operations were $0.35. Our income from continuing operations decreased by $4.1 million, or 30.5%, compared to fiscal 2016. Earnings per diluted share from continuing operations were $0.35 in fiscal 2017, compared to $0.51 in fiscal 2016. The decline in income from continuing operations due primarily to a decline in gross profit of $12.5 million driven by

a decline in the network product category, which includes traditionally higher margin products compared to our other products, partially offset by an increase in services and solutions gross profit. This was partially offset by a decrease in operating expenses of $4.2 million, primarily due to lower incentive-based compensation expense, and benefits due to adjustments to our contingent consideration liability accruals, offset by incremental expenses related to the SMART

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Temps acquisition, merger and acquisition costs and restructuring charges.

- Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) from Continuing Operations was $14.4 Million. Our EBITDA from continuing operations was $14.4 million, or 7.9% of revenue, in fiscal 2017, compared to $21.0 million, or 10.4% of revenue, in fiscal 2016. Below is a table reconciling income from continuing operations to EBITDA from continuing operations (in thousands):

	Year ended September 30,			
	2017		2016	
		% of total revenue		% of total revenue
Total revenue	$181,634	100.0 %	$203,005	100.0 %
Income from continuing operations	$9,366	5.1 %	$13,478	6.6 %
Interest income, net	(608)	(0.3)	(254)	(0.1)
Income tax provision	125	0.1	3,212	1.6
Depreciation and amortization	5,497	3.0	4,584	2.3
Earnings from continuing operations before interest, taxes, depreciation and amortization	$14,380	7.9 %	$21,020	10.4 %

- Our Balance Sheet Position Improved. Our current ratio was 9.7 to 1 at September 30, 2017, compared to 8.2 to 1 at September 30, 2016.

We accomplished a number of key initiatives in fiscal 2017 and also face challenges relative to our business.

Accomplishments

- Our service and solutions revenue increased 119.5% during fiscal 2017 compared to fiscal 2016. The increase was primarily driven by the growth of our Digi Smart Solutions™ business. Services and solutions revenue includes $6.1 million of incremental revenue from the acquisition of SMART Temps and FreshTemp in fiscal 2017. We also had increases to our Digi Wireless Design Services, Digi Remote Manager® platform and support services.
- Our total cash and cash equivalents and marketable securities including long-term marketable securities, amounted to $115.0 million at September 30, 2017, a decrease of $22.7 million from September 30, 2016. We completed two acquisitions in fiscal 2017, for a total cash expenditure of $30.1 million (net of cash acquired of $0.5 million).
- During fiscal 2017, we have continued to reduce the number of product stock keeping units (SKUs) we produce, which we believe will have significant implications on our ability to manage inventory effectively, improve channel stocking strategies and control costs.
- We continued to simplify and scale our business. We reduced the number of office locations by consolidating our France operations into our EMEA Headquarters in Munich, Germany office and closed our France office location.
- In October 2017, subsequent to the end of our fiscal year, we acquired TempAlert, LLC, a Boston-based provider of automated, real-time temperature monitoring and task management solutions. TempAlert will join Digi Smart Solutions™.

Challenges

- Our network products decreased by 26.0% in fiscal 2017 compared to fiscal 2016, which is a more rapid decline than expected. Demand for these products has been declining for several years and we expect revenues for these products will continue to decline in the future at a rate of approximately 10% to 15% annually.
- Our embedded products and RF products revenue declined of 15.0% and 14.6%, respectively, in fiscal 2017 as compared to fiscal 2016. The decline in both product categories is primarily due to significant sales to large customers in the prior fiscal year, which were not repeated.
- Revenue for new product introductions in fiscal 2017 were not met.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

- Revenue expectations for Digi Smart Solutions™ were not met. Although we found the sales cycles to be longer than expected, the segment still has a growing pipeline.

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from our Consolidated Statements of Operations, expressed in dollars and as a percentage of revenue and as a percentage of change from year-to-year for the years indicated.

	Year ended September 30,									% Increase (decrease)	
($ in thousands)	2017			2016			2015			2017 compared to 2016	2016 compared to 2015
Revenue:											
Hardware product	$166,480	91.7	%	$196,101	96.6	%	$195,497	95.9	%	(15.1)%	0.3 %
Services and solutions	15,154	8.3		6,904	3.4		8,350	4.1		119.5	(17.3)
Total revenue	181,634	100.0		203,005	100.0		203,847	100.0		(10.5)	(0.4)
Cost of sales:											
Cost of hardware product	85,369	47.0		97,776	48.2		99,842	49.0		(12.7)	(2.1)
Cost of services and solutions	7,647	4.2		4,662	2.3		5,571	2.7		64.0	(16.3)
Amortization	1,444	0.8		887	0.4		1,313	0.7		62.8	(32.4)
Total cost of sales	94,460	52.0		103,325	50.9		106,726	52.4		(8.6)	(3.2)
Gross profit	87,174	48.0		99,680	49.1		97,121	47.6		(12.5)	2.6
Operating expenses:											