

DIGI INTERNATIONAL INC

Form 10-Q

May 06, 2011

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

FORM 10-Q

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

For the quarterly period ended: March 31, 2011

OR

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

For the transition period from _____ to _____.

Commission file number: 1-34033

DIGI INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Delaware

41-1532464

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

11001 Bren Road East

Minnetonka, Minnesota 55343

(Address of principal executive offices) (Zip Code)

(952) 912-3444

(Registrant's telephone number, including area code)

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

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 No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

On April 30, 2011, there were 25,338,874 shares of the registrant's \$.01 par value Common Stock outstanding.

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

	Three months ended March 31,		Six months ended March 31,	
	2011	2010	2011	2010
	(in thousands, except per common share data)			
Net sales	\$ 49,716	\$ 45,076	\$ 98,050	\$ 88,044
Cost of sales (exclusive of amortization of purchased and core technology shown separately below)	23,212	21,254	46,032	41,417
Amortization of purchased and core technology	853	1,074	1,701	2,166
 Gross profit	 25,651	 22,748	 50,317	 44,461
Operating expenses:				
Sales and marketing	9,532	9,603	19,330	18,843
Research and development	7,849	7,078	15,657	13,564
General and administrative	4,628	4,224	9,073	8,382
Restructuring	(20)	(352)	(70)	(352)
Total operating expenses	21,989	20,553	43,990	40,437
 Operating income	 3,662	 2,195	 6,327	 4,024
Other (expense) income, net:				
Interest income	69	90	126	183
Interest expense	(27)	(32)	(53)	(84)
Other (expense) income	(223)	301	(235)	263
Total other (expense) income, net	(181)	359	(162)	362
 Income before income taxes	 3,481	 2,554	 6,165	 4,386
Income tax provision	1,242	868	1,610	1,501
 Net income	 \$ 2,239	 \$ 1,686	 \$ 4,555	 \$ 2,885
 Net income per common share:				
Basic	\$ 0.09	\$ 0.07	\$ 0.18	\$ 0.12
Diluted	\$ 0.09	\$ 0.07	\$ 0.18	\$ 0.12

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Weighted average common shares:

Basic	25,230	24,816	25,169	24,758
Diluted	25,692	25,213	25,562	25,072

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

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DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2011	September 30, 2010
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 57,282	\$ 50,943
Marketable securities	34,135	36,634
Accounts receivable, net	26,116	24,090
Inventories	25,758	26,550
Deferred tax assets	3,362	3,344
Other	2,918	2,141
Total current assets	149,571	143,702
Marketable securities, long-term	4,507	
Property, equipment and improvements, net	16,058	16,396
Identifiable intangible assets, net	16,869	19,851
Goodwill	86,527	86,210
Deferred tax assets	3,295	320
Other	506	486
Total assets	\$ 277,333	\$ 266,965
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 6,862	\$ 7,449
Accrued compensation	6,537	5,850
Deferred payment on acquisition	2,966	2,914
Other	5,793	5,384
Total current liabilities	22,158	21,597
Income taxes payable	2,337	2,838
Deferred tax liabilities	1,083	1,457
Other noncurrent liabilities	410	517
Total liabilities	25,988	26,409
Commitments and contingencies (see Note 11)		
Stockholders equity:		
Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Common stock, \$.01 par value; 60,000,000 shares authorized; 28,827,170 and 28,666,311 shares issued	288	287
Additional paid-in capital	190,478	185,427

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Retained earnings	96,204	91,649
Accumulated other comprehensive loss	(8,845)	(9,589)
Treasury stock, at cost, 3,526,467 and 3,584,215 shares	(26,780)	(27,218)
Total stockholders' equity	251,345	240,556
Total liabilities and stockholders' equity	\$ 277,333	\$ 266,965

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

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

	Six months ended March 31,	
	2011	2010
	(in thousands)	
Operating activities:		
Net income	\$ 4,555	\$ 2,885
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation of property, equipment and improvements	1,453	1,334
Amortization of identifiable intangible assets	3,393	3,869
Stock-based compensation	1,713	1,824
Excess tax benefits from stock-based compensation	(226)	(39)
Deferred income tax benefit	(1,296)	(848)
Inventory obsolescence	836	309
Restructuring	(70)	(352)
Other	6	(312)
Changes in operating assets and liabilities	(2,844)	285
Net cash provided by operating activities	7,520	8,955
Investing activities:		
Purchase of marketable securities	(28,999)	(28,510)
Proceeds from maturities of marketable securities	26,950	4,334
Acquisition of business, net of cash acquired		(3,000)
Purchase of property, equipment, improvements and certain other intangible assets, net of proceeds from sale	(1,421)	(1,469)
Net cash used in investing activities	(3,470)	(28,645)
Financing activities:		
Payments on capital lease obligations		(7)
Excess tax benefits from stock-based compensation	226	39
Proceeds from stock option plan transactions	1,119	1,032
Proceeds from employee stock purchase plan transactions	486	445
Net cash provided by financing activities	1,831	1,509
Effect of exchange rate changes on cash and cash equivalents	458	(820)
Net increase (decrease) in cash and cash equivalents	6,339	(19,001)
Cash and cash equivalents, beginning of period	50,943	48,434

Cash and cash equivalents, end of period	\$	57,282	\$	29,433
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The accompanying notes are an integral part of the condensed consolidated financial statements.

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

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

Basis of Presentation

The interim unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared by Digi International Inc. (the Company, Digi, we, our, or us) pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto, including (but not limited to) the summary of significant accounting policies, presented in our Annual Report on Form 10-K for the year ended September 30, 2010 as filed with the SEC (2010 Financial Statements). The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated financial position and the condensed consolidated results of operations and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year. The year-end condensed balance sheet data were derived from our 2010 Financial Statements, but do not include all disclosures required by accounting principles generally accepted in the United States of America.

Recently Issued Accounting Pronouncements

There have been no accounting pronouncements recently issued that will affect our Condensed Consolidated Financial Statements.

2. COMPREHENSIVE INCOME (LOSS)

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

	Three months ended March		Six months ended March 31,	
	2011	2010	2011	2010
Net income	\$ 2,239	\$ 1,686	\$ 4,555	\$ 2,885
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	2,777	(2,136)	769	(2,846)
Change in unrealized (loss) gain on investments	(34)	(52)	(41)	7
Less income tax benefit (provision)	13	20	16	(3)
Reclassification of gain included in net income		(36)		(36)
Less income tax benefit		14		14
Comprehensive income (loss)	\$ 4,995	\$ (504)	\$ 5,299	\$ 21

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****3. EARNINGS PER SHARE**

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

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

	Three months ended March 31,		Six months ended March 31,	
	2011	2010	2011	2010
Numerator:				
Net income	\$ 2,239	\$ 1,686	\$ 4,555	\$ 2,885
Denominator:				
Denominator for basic net income per common share weighted average shares outstanding	25,230	24,816	25,169	24,758
Effect of dilutive securities:				
Employee stock options and employee stock purchase plan	462	397	393	314
Denominator for diluted net income per common share adjusted weighted average shares	25,692	25,213	25,562	25,072
Net income per common share, basic	\$ 0.09	\$ 0.07	\$ 0.18	\$ 0.12
Net income per common share, diluted	\$ 0.09	\$ 0.07	\$ 0.18	\$ 0.12

Potentially dilutive shares related to stock options to purchase common shares were not included in the computation of diluted earnings per common share set forth above because the options exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive. For the three and six month periods ended March 31, 2011 there were 1,856,496 and 2,006,496 potentially dilutive shares related to stock options, respectively. For the three and six month periods ended March 31, 2010 there were 2,495,421 and 2,865,921 potentially dilutive shares related to stock options, respectively.

4. SELECTED BALANCE SHEET DATA

(in thousands)

	March 31, 2011	September 30, 2010
Accounts receivable, net:		
Accounts receivable	\$ 26,409	\$ 24,639
Less allowance for doubtful accounts	(293)	(549)
	\$ 26,116	\$ 24,090

Inventories:

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Raw materials	\$	19,880	\$	21,678
Work in process		454		418
Finished goods		5,424		4,454
	\$	25,758	\$	26,550

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. ACQUISITION

Spectrum Design Solutions, Inc.

On July 23, 2008, we acquired Spectrum Design Solutions, Inc. (Spectrum), a wholly owned subsidiary of Digi International Inc. that performs wireless design services. The acquisition was structured as a merger with a cash purchase price of \$10.0 million. Of this amount, \$4.0 million was paid on the acquisition date, \$3.0 million was paid in January 2010, and the remaining \$3.0 million will be paid in July 2011. The remaining deferred payment of \$3.0 million is recorded as a liability on our consolidated balance sheet at its current net present value, on which implied interest is accrued up until the time of payment.

6. MARKETABLE SECURITIES

Our marketable securities consist of certificates of deposit, commercial paper, corporate bonds and government municipal bonds.

We analyze our available-for-sale investments for impairment on an ongoing basis. We consider factors in determining whether an unrealized loss is a temporary loss or an other-than-temporary loss such as: (a) whether we have the intent to sell the security or (b) whether it is more likely than not that we will be required to sell the security before its anticipated recovery. We also consider factors such as the length of time and extent to which the securities have been in an unrealized loss position and the trend of any unrealized losses.

In order to estimate the fair value for each security in our investment portfolio, we obtain quoted market prices and trading activity for each security, where available, and review the financial solvency of each security issuer and obtain other relevant information from our investment advisor. As of March 31, 2011, 29 of our securities were trading below our amortized cost basis. We determined each decline in value to be temporary based upon the above described factors. We expect to realize the fair value of these securities, plus accrued interest, either at the time of maturity or when the security is sold.

All of our current holdings are classified as available-for-sale marketable securities and are recorded at fair value on our balance sheet with the unrealized gains and losses recorded in accumulated other comprehensive income (loss).

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At March 31, 2011 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses (2)	Fair Value (1)
Current marketable securities:				
Corporate bonds	\$ 13,588	\$ 2	\$ (19)	\$ 13,571
Government municipal bonds	12,830	1	(6)	12,825
Certificates of deposit	3,751		(7)	3,744
Commercial paper	3,997		(2)	3,995
Current marketable securities	34,166	3	(34)	34,135
Non-current marketable securities:				
Corporate bonds	2,136			2,136
Government municipal bonds	1,874		(1)	1,873
Certificates of deposit	500		(2)	498
Non-current marketable securities	4,510		(3)	4,507
Total marketable securities	\$ 38,676	\$ 3	\$ (37)	\$ 38,642

(1) Included in amortized cost and fair value is purchased and accrued interest of \$409.

(2) The aggregate related fair value of securities with unrealized losses as of March 31, 2011 was \$28,922.

At September 30, 2010 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses (2)	Fair Value (1)
Current marketable securities:				
Corporate bonds	\$ 26,163	\$ 7	\$ (9)	\$ 26,161
Government municipal bonds	\$ 5,463	\$ 5	\$ (2)	5,466
Certificates of deposit	5,001	6		5,007
Current marketable securities	\$ 36,627	\$ 18	\$ (11)	\$ 36,634