FLAHERTY & CRUMRINE/CLAYMORE TOTAL RETURN FUND INC
Form N-CSR
January 29, 2009

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

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT
INVESTMENT COMPANIES

Investment Company Act file number 811-21380

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
(Exact name of registrant as specified in charter)

301 E. Colorado Boulevard, Suite 720
Pasadena, CA 91101
(Address of principal executive offices) (Zip code)

Donald F. Crumrine
Flaherty & Crumrine Incorporated
301 E. Colorado Boulevard, Suite 720
Pasadena, CA 91101
(Name and address of agent for service)

registrant's telephone number, including area code: 626-795-7300

Date of fiscal year end: November 30

Date of reporting period: November 30, 2008

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. Section 3507.

ITEM 1. REPORTS TO STOCKHOLDERS.

The Report to Shareholders is attached herewith.

FLAHERTY & CRUMRINE/CLAYMORE TOTAL RETURN FUND

To the Shareholders of Flaherty & Crumrine/Claymore Total Return Fund:

There can be no mincing words. The preferred market had an awful year. As the table demonstrates, the environment has been extremely difficult for FLC, which must invest most of its assets in preferred securities and which utilizes leverage to achieve its goal of producing a high level of current income. The most positive thing we can say about these numbers stems from our fervent belief that, at present, preferred securities prices have simply fallen too much, and, over time, will recover.

TOTAL RETURN ON NET ASSET VALUE(1)
FOR PERIODS ENDED NOVEMBER 30, 2008

	ACTUAL RETURNS			AVERAGE ANNUALIZED RETURNS		
	THREE MONTHS	SIX MONTHS	ONE YEAR	THREE YEARS	FIVE YEARS	LIFE OF FUND(2)
Flaherty & Crumrine/Claymore Total Return Fund	-37.1%	-44.0%	-49.2%	-19.9%	-11.1%	-10.1%
Lipper Domestic Investment Grade Funds(3)	-15.2%	-17.1%	-17.6%	-2.8%	0.2%	0.8%

----

(1) Based on monthly data provided by Lipper Inc. in each calendar month during the relevant period. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice, which differs from the methodology used elsewhere in this report.

(2) Since inception on August 26, 2003.

(3) Reflects the equally-weighted average performance returns of all closed-end funds in Lipper's Domestic Investment-Grade funds category in each month during the period. The category currently includes closed-end funds in the U.S. Mortgage and Corporate Debt BBB Rated sub-categories and has included other sub-categories in prior periods. Although the investment strategies used by the Fund differ significantly from the strategies used by these other fixed-income funds, the Fund seeks to accomplish a similar objective.accomplish a similar objective.

We encourage you to read the "Discussion Topics" that follow for a more thorough analysis of the Fund's investment performance. We've also included the performance of several preferred market indices for further comparison.

Once more we struggle to find appropriate words to describe events in the financial markets. Although evidence of market troubles first appeared in mid-2007, there can be little doubt that in recent months we have witnessed the worst fallout from the financial crisis. Over a ten day period in September, the government placed Fannie Mae and Freddie Mac into conservatorship, Lehman Brothers filed for bankruptcy and AIG required the first of two massive doses of government assistance. Like a financial earthquake, these events sent tremors throughout the financial system, with the preferred market situated near the epicenter.

In response, the Federal Reserve has flooded the system with liquidity, and numerous new government programs designed to stabilize the financial system have been created. The critical objective of each program is to restore confidence in the system, and to that end no amount of effort (or money) has been spared. Many of these efforts appear to be taking hold, and while we are clearly in the midst of a severe economic slowdown, the foundation for recovery is being established.

Of these government programs, the Capital Purchase Program ("CPP") launched in mid-October had the greatest significance for the Fund. Through this program, the government injected almost $350 billion of capital into qualifying banks and finance companies by purchasing newly issued preferred securities. The preferred market got a boost when it was disclosed that existing preferred securities of companies that participate in the program will typically RANK EQUAL or senior to those held by the government.

Most of the new government programs are aimed at shoring up the financial industry (commercial banks, investment banks and insurance companies). Despite having disproportionately less exposure to financials when compared to the overall preferred universe(1), the Fund's performance has been hurt badly by the industry downturn. At their lowest levels, prices on some financial issues had fallen by over 75%. Once the lifeline of government aid reaches a particular company, prices on its securities tend to rebound, but they remain well below earlier levels. Of the 23 bank and finance companies owned in the Fund, 17 have received government assistance or have been acquired by stronger institutions.

Much of the price decline can be attributed to concerns about credit quality, but as we've discussed in the past, technical factors like the ongoing massive, economy-wide deleveraging and a dramatic decline in market liquidity have hurt valuations as well. Issues of utility and energy companies, which comprise most of the non-financial portion of the portfolio, also experienced substantial price declines during the period. While concerns about credit quality may have contributed to these price declines, technical factors have played a major role.

Market conditions have made it necessary to reduce the amount of leverage employed by the Fund. As the value of the Fund's investment portfolio declined, the ratio of assets to liabilities fell below required levels. The only remedy has been to redeem a portion of the leverage. To date the Fund has redeemed 46.3%, or $59.5 million, of the leverage in place at the beginning of the year. Leverage is critical for enabling the Fund to achieve its goal of providing high current income - we encourage you to carefully read the discussion topics that follow.

An unavoidable consequence of deleveraging has been a reduction in the amount of income available to shareholders in the form of monthly dividends. Simply put, the Fund sold assets in order to redeem leverage, and fewer assets mean less income generated. Since the beginning of fiscal 2008, market conditions have required us to reduce the monthly dividend several times, for a total reduction of 13.7%. Again, this important topic is addressed more fully in the discussion topics.

The unprecedented turbulence in financial markets also prompted the Fund to modify its interest-rate hedging strategy this year. As the credit crisis intensified in 2008, the normal relationship between the prices of preferred securities and the Fund's interest rate hedge positions (primarily options on Treasury bond futures and interest rate swaps) weakened or even reversed, so that the hedge could not be used effectively to help stabilize the Fund's NAV. At the same time, the yield curve steepened and option prices rose, increasing the cost of hedging. As these conditions developed, the Fund scaled back its interest rate hedge positions, removing them entirely by the end of 2008. We continue to review the effectiveness of the Fund's hedging strategies, and we anticipate using some hedging instruments when we believe it can accomplish its goals. For the most part, that means markets returning to more normal relationships. We don't know when that day will come, but we remain confident that it will.

----

(1) According to the Flaherty & Crumrine website, www.preferredstockguide.com, preferred securities issued by financial companies comprise 85% of the face value of the overall preferred market. As of November 30, 2008, 58% of the market value of FLC's portfolio was in financials.

Where do we go from here? Just about any fixed-income investment that doesn't have "US Treasury" in its name has likely declined substantially in price over recent months, but the market for preferred securities has been particularly hard hit. Price declines of 50-75% on investment grade preferreds have not been unusual. We believe the preferred market is significantly undervalued at this time and that long-term investors will be rewarded handsomely for their patience. This conclusion is based upon our analysis described in the discussion topics and on the Fund's website.

Finally, we know this has been an extremely difficult year for shareholders, and while we might like to say we have been here before, we can't because we haven't. We believe that our fundamental approach to portfolio management has helped us avoid most of the credit casualties (the biggest exception being our exposure to Lehman Brothers Holdings). We also believe the current portfolio is comprised of survivors. The steps taken by the Fed and Treasury are starting to gain traction and will help. Economic downturns are always followed by recoveries and the incoming administration has indicated that stabilizing the economy is its highest priority. Although we cannot say exactly when the preferred market will recover, we look forward to a much happier 2009!

Sincerely,

/s/ Donald F. Crumrine	/s/ Robert M. Ettinger
Donald F. Crumrine Chairman of the Board	Robert M. Ettinger President

January 13, 2009

DISCUSSION TOPICS

THE FUND'S PREFERRED SECURITIES PORTFOLIO AND COMPONENTS OF TOTAL RETURN ON NAV

It's pretty safe to say the preferred securities market suffered its worst year in history in 2008. While no index comprehensively reflects the preferred market, Merrill Lynch publishes four different indices which attempt to measure performance of some sectors of the investment-grade preferred securities market: the Merrill Lynch 8% Capped DRD Preferred Stock Index (which includes traditional tax-advantaged preferred stocks); the Merrill Lynch 8% Capped Hybrid Preferred Securities Index (which includes fully-taxable, exchange-traded preferred securities); the Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index (which includes fully taxable capital securities); and the Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index (which includes both tax-advantaged and taxable preferred securities with adjustable dividends).

Set forth below are the six month and twelve month total returns of these indices:

TOTAL RETURNS OF MERRILL LYNCH PREFERRED SECURITIES INDICES*
FOR PERIODS ENDED NOVEMBER 30, 2008

	SIX MONTHS	ONE YEAR
Merrill Lynch 8% Capped DRD Preferred Stock Index(SM)	-41.5%	-41.9%
Merrill Lynch 8% Capped Hybrid Preferred Securities Index(SM)	-25.7%	-21.9%
Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index(SM) ..	-32.2%	-35.9%
Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index(SM) ...	-51.4%	-54.4%

* The Merrill Lynch 8% Capped DRD Preferred Index(SM) includes investment grade preferred securities issued by both corporations and government agencies that qualify for the corporate dividends received deduction with issuer concentration capped at a maximum of 8%. The Merrill Lynch 8% Capped Hybrid Preferred Index(SM) includes taxable, fixed-rate, U.S. dollar-denominated investment-grade, preferred securities listed on a U.S. exchange with issuer concentration capped at 8%. The Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index(SM) includes investment grade fixed rate or fixed-to-floating rate $1,000 par securities that receive some degree of equity credit from the rating agencies or their regulators with issuer concentration capped at a maximum of 8%. The Merrill Lynch 7% Capped Adjustable Rate Preferred Securities Index(SM) includes adjustable rate preferred securities issued by US corporations and government agencies with issuer concentration capped at a maximum of 7%. All index returns include interest and dividend income and, unlike the Fund's returns, are unmanaged and do not reflect any expenses.

While we realize it's only small consolation, as set forth in the table below, the Fund's total return on its securities portfolio before leverage exceeded most of these indices. Unfortunately, the Fund's strategy of using leverage to increase current income amplified its negative returns, and coupled with its expenses and hedging strategy, caused the NAV of the Fund to underperform most of the unleveraged indices.

The table below reflects performance of each investment tool used by the Fund to achieve its objective, namely: (a) investing in a portfolio of securities; (b) hedging that portfolio of securities against significant increases in long-term interest rates; and (c) issuing an auction-rate preferred stock or debt to leverage and enhance returns to Common Stock shareholders. The table then adjusts for the impact of the Fund's operating expenses excluding the cost of debt leverage to arrive at a total return on NAV (which factors in all of these items).

COMPONENTS OF FLC'S TOTAL RETURN ON NAV
FOR PERIODS ENDED NOVEMBER 30, 2008

	SIX MONTHS	ONE YEAR

Total Return on Unleveraged Securities Portfolio (including principal and income)	-26.3%	-29.3%
Return from Interest Rate Hedging Strategy	-0.5%	-0.4%
Impact of Leverage	-16.4%	-17.7%
Expenses	-0.8%	-1.8%
TOTAL RETURN ON NAV	-44.0%	-49.2%

TOTAL RETURN ON MARKET PRICE OF FUND SHARES

While our focus is primarily on managing the Fund's portfolio, an investor's actual return is comprised of monthly dividend payments plus changes in the Fund's market price. The loss-of-confidence factors that hurt prices of securities in the Fund's portfolio also caused selling of shares of the Fund itself that widened the Fund's market-price discount to NAV. This double negative resulted in a total return on market value for the year ended November 30, 2008 of -51.4%. During the fourth fiscal quarter alone, total return on MARKET VALUE was -41.8%.

Of course, the factors impacting prices of securities in the Fund's portfolio also drove down the price of the Fund. The market price hit a low of $4.51 on October 10th. As of December 31st, subsequent to the Fund's fiscal year end the price had recovered some, closing the calendar year at $8.05.

As can be seen from the chart below, the gap between the price of the Fund and the intrinsic value of the Fund (NAV) reached its widest level ever during October. No surprise, the record discount coincided with share price closing lows.

FLAHERTY & CRUMRINE/CLAYMORE TOTAL RETURN FUND (FLC)
PREMIUM/DISCOUNT OF MARKET PRICE TO NAV THROUGH 1/9/2009

(PERFORMANCE GRAPH)

8/29/03	0.0491
9/5/03	0.0477
9/12/03	0.0408
9/19/03	0.0362
9/26/03	0.0249
10/3/03	0.0275
10/10/03	0.0305
10/17/03	0.0428
10/24/03	0.0377
10/31/03	0.0466
11/7/03	0.0678
11/14/03	0.0453
11/21/03	0.0482
11/28/03	0.0341
12/5/03	0.036
12/12/03	0.0365
12/19/03	0.0287
12/26/03	0.0477
1/2/04	0.0444
1/9/04	0.0373
1/16/04	0.064
1/23/04	0.0465
1/30/04	0.0467
2/6/04	0.0647

2/13/04	0.0581
2/20/04	0.0597
2/27/04	0.0461
3/5/04	0.0312
3/12/04	0.0487
3/19/04	0.0486
3/26/04	0.0444
4/2/04	0.066
4/9/04	0.0363
4/16/04	0.0107
4/23/04	0.0017
4/30/04	-0.0325
5/7/04	-0.0729
5/14/04	-0.033
5/21/04	-0.0305
5/28/04	0.0017
6/4/04	0.0034
6/11/04	-0.0056
6/18/04	0.006
6/25/04	-0.031
7/2/04	0.0039
7/9/04	0.0009
7/16/04	-0.0191
7/23/04	-0.027
7/30/04	-0.0253
8/6/04	0.0077
8/13/04	-0.0072
8/20/04	-0.006
8/27/04	-0.0085
9/3/04	0.0115
9/10/04	-0.0021
9/17/04	0.0188
9/24/04	-0.0195
10/1/04	-0.0063
10/8/04	-0.0117
10/15/04	-0.0004
10/22/04	0.0198
10/29/04	0.021
11/5/04	0.0244
11/12/04	0.0055
11/19/04	0.0147
11/26/04	0.0214
12/3/04	0.0228
12/10/04	0.0163
12/17/04	0.0266
12/24/04	0.0197
12/31/04	0.0299
1/7/05	0.025
1/14/05	0.0145
1/21/05	0.0066
1/28/05	0.0004
2/4/05	0.0053
2/11/05	-0.0037
2/18/05	-0.0353
2/25/05	-0.028
3/4/05	-0.0291
3/11/05	-0.0379
3/18/05	-0.071
3/25/05	-0.0939
4/1/05	-0.0907
4/8/05	-0.0967
4/15/05	-0.0987

4/22/05	-0.0953
4/29/05	-0.0873
5/6/05	-0.0793
5/13/05	-0.0827
5/20/05	-0.0736
5/27/05	-0.0716
6/3/05	-0.0771
6/10/05	-0.0655
6/17/05	-0.0603
6/24/05	-0.0781
7/1/05	-0.0642
7/8/05	-0.0601
7/15/05	-0.0559
7/22/05	-0.0757
7/29/05	-0.0632
8/5/05	-0.0678
8/12/05	-0.0767
8/19/05	-0.0696
8/26/05	-0.0712
9/2/05	-0.0618
9/9/05	-0.0463
9/16/05	-0.0531
9/23/05	-0.0571
9/30/05	-0.0983
10/7/05	-0.0971
10/14/05	-0.1032
10/21/05	-0.098
10/28/05	-0.0873
11/4/05	-0.0888
11/11/05	-0.0945
11/18/05	-0.1144
11/25/05	-0.1089
12/2/05	-0.1157
12/9/05	-0.1334
12/16/05	-0.1596
12/23/05	-0.1469
12/30/05	-0.1518
1/6/06	-0.1196
1/13/06	-0.1079
1/20/06	-0.0947
1/27/06	-0.0955
2/3/06	-0.0971
2/10/06	-0.0855
2/17/06	-0.0899
2/24/06	-0.0885
3/3/06	-0.0764
3/10/06	-0.1242
3/17/06	-0.1178
3/24/06	-0.101
3/31/06	-0.116
4/7/06	-0.1166
4/14/06	-0.1465
4/21/06	-0.128
4/28/06	-0.1231
5/5/06	-0.1334
5/12/06	-0.1309
5/19/06	-0.133
5/26/06	-0.1255
6/2/06	-0.1116
6/9/06	-0.1114
6/16/06	-0.105
6/23/06	-0.1089

6/30/06	-0.1281
7/7/06	-0.1323
7/14/06	-0.1218
7/21/06	-0.1132
7/28/06	-0.1023
8/4/06	-0.0895
8/11/06	-0.0695
8/18/06	-0.0806
8/25/06	-0.0899
9/1/06	-0.086
9/8/06	-0.0885
9/15/06	-0.0804
9/22/06	-0.1009
9/29/06	-0.1069
10/6/06	-0.0895
10/13/06	-0.0844
10/20/06	-0.0833
10/27/06	-0.078
11/3/06	-0.0929
11/10/06	-0.0871
11/17/06	-0.0843
11/24/06	-0.0719
12/1/06	-0.0567
12/8/06	-0.0522
12/15/06	-0.0437
12/22/06	-0.0543
12/29/06	-0.0657
1/5/07	-0.0532
1/12/07	-0.0521
1/19/07	-0.0564
1/26/07	-0.0533
2/2/07	-0.0555
2/9/07	-0.0533
2/16/07	-0.0716
2/23/07	-0.0693
3/2/07	-0.0747
3/9/07	-0.0692
3/16/07	-0.0684
3/23/07	-0.0231
3/30/07	-0.0227
4/5/07	-0.0206
4/13/07	-0.0224
4/20/07	-0.0429
4/27/07	-0.0521
5/4/07	-0.0587
5/11/07	-0.0623
5/18/07	-0.0527
5/25/07	-0.0786
6/1/07	-0.0664
6/8/07	-0.0754
6/15/07	-0.0802
6/22/07	-0.095
6/29/07	-0.0832
7/6/07	-0.0876
7/13/07	-0.0852
7/20/07	-0.0971
7/27/07	-0.0937
8/3/07	-0.1017
8/10/07	-0.1121
8/17/07	-0.136
8/24/07	-0.1229
8/31/07	-0.113

9/7/07	-0.1049
9/14/07	-0.0859
9/21/07	-0.097
9/28/07	-0.1197
10/5/07	-0.1154
10/12/07	-0.1296
10/19/07	-0.1425
10/26/07	-0.1238
11/2/07	-0.1273
11/9/07	-0.1368
11/16/07	-0.1477
11/23/07	-0.1539
11/30/07	-0.1375
12/7/07	-0.1195
12/14/07	-0.1185
12/21/07	-0.1169
12/28/07	-0.1122
1/4/08	-0.1142
1/11/08	-0.0879
1/18/08	-0.094
1/25/08	-0.0648
2/1/08	-0.0759
2/8/08	-0.0619
2/15/08	-0.0726
2/22/08	-0.0705
2/29/08	-0.0751
3/7/08	-0.0458
3/14/08	-0.0714
3/20/08	-0.0873
3/28/08	-0.0914
4/4/08	-0.1074
4/11/08	-0.1037
4/18/08	-0.0941
4/25/08	-0.061
5/2/08	-0.0851
5/9/08	-0.0867
5/16/08	-0.0727
5/23/08	-0.0717
5/30/08	-0.066
6/6/08	-0.0767
6/13/08	-0.0598
6/20/08	-0.0816
6/27/08	-0.0842
6/30/08	-0.0696
7/3/08	-0.1145
7/11/08	-0.0909
7/18/08	-0.0841
7/25/08	-0.1027
8/1/08	-0.1127
8/8/08	-0.1128
8/15/08	-0.1061
8/22/08	-0.1044
8/29/08	-0.1139
9/5/08	-0.1186
9/12/08	-0.0953
9/19/08	-0.1644
9/26/08	-0.2156
10/3/08	-0.2808
10/10/08	-0.5297
10/17/08	-0.2229
10/24/08	-0.2394
10/31/08	-0.0733

11/7/08	-0.1705
11/14/08	-0.2197
11/21/08	-0.3503
11/28/08	-0.1911
12/5/08	-0.2959
12/12/08	-0.2721
12/19/08	-0.2035
12/26/08	-0.1712
12/31/08	-0.1544
1/2/09	-0.0972
1/9/09	-0.1273

We have often observed year-end selling pressure in the Fund as investors attempt to realize gains or losses for tax purposes. Given the sharp decline in the Fund's price, this year appeared to be no different. We were heartened to see some price recovery in December, which probably means the Fund's high current yield on market price, 16.4% as of December 31st, has attracted new investors.

MONTHLY DISTRIBUTIONS TO FUND SHAREHOLDERS

The monthly distribution paid to shareholders is intended to reflect current market conditions, but we also must make assumptions about the future. We begin with an estimate of the sustainable income generated from the investment portfolio, and end with a forecast of expenses. While it sounds simple, in periods of rapid change, forecasting income and expenses becomes more art than science. As a result, the monthly dividend rate changed several times this year. A portion of the distributions in calendar year 2008 were classified as a tax return of capital rather than ordinary income.

Since the beginning of fiscal 2008, the monthly dividend has been reduced from $0.1275 to $0.11. Most of the dividend reduction in 2008 can be attributed to deleveraging. The reasons for deleveraging are discussed in detail below, but the impact on the Fund's monthly dividend is fairly obvious - in order to redeem or purchase a portion of its outstanding leverage, the Fund had to sell assets. As a result, the smaller portfolio generated less income; and while a smaller leverage balance helped reduce expenses, the net result was less income available to common shareholders.

THE FUND'S LEVERAGE

Let's start with, "Why does the Fund use leverage?" The answer is that the cost of leverage typically is lower than the yield on the Fund's portfolio and provides a valuable net addition to income for common shareholders. FLC began the year with $128.5 million of Auction Market Preferred Stock ("AMPS") outstanding. Since the Fund's inception, AMPS have been the most effective form of leverage for closed-end funds such as FLC, and an integral component of the Fund's income objective. However, earlier this year the auction process became a casualty of the liquidity crisis, and by February auctions were "failing". (This unfortunate terminology is used when there are not enough new investors to absorb the shares available for sale at or below the issue's maximum dividend rate. It should not be confused with a default by the issuer.)

This past May, in response to problems in the auction market, the Fund entered into a committed financing agreement (this is a fancy way of saying the Fund borrowed from a financial institution) to replace a portion of the outstanding AMPS. Funds have always had the ability to create leverage by borrowing or issuing debt or preferred securities (or both), but until the collapse of the auction preferred market, preferred was used much more widely.

As of November 30th, the Fund's leverage consists of $39.5 million of AMPS and $29.5 million of bank borrowings. As a percentage of total net assets, these amounts represent 25.2% and 18.7%, respectively, and 43.9% in the aggregate. Notes 6 and 7 of the financial statements detail how the rates being paid on both types of leverage are set. For our purposes here, it is only necessary to know the rates move up and down with other types of short-term interest rates.

Fortunately, as Federal Reserve efforts to lower short-term interest rates (including the benchmark commercial paper index) have finally started to work, rates being paid by the Fund have dropped as well, and are now well below where they were a year ago.

When the Fund was created, certain requirements designed to protect the interest of lenders and AMPS investors were established. Among these, the Fund must meet certain asset coverage requirements. Essentially, this calculation compares the Fund's asset values (discounted according to a specific set of rules) to the liquidation value of the AMPS plus the Fund's other liabilities. If this discounted asset value does not meet or exceed this amount, the Fund may not set aside, declare or pay dividends to common stock shareholders, and it must take steps to "cure" this coverage test. To do this, the Fund may adjust holdings (certain assets receive better asset coverage treatment than others) and sell assets to raise cash. Proceeds from asset sales may be invested in higher quality, lower yielding securities or held in cash, or in some cases used to reduce leverage, to restore the required level of asset coverage. If market values continue to decline, additional sales may be needed. If asset values move higher, the asset coverage will improve and additional asset sales will not be required.

If the Fund fails to meet this asset coverage test for ten business days, it is required to declare its intention to redeem at least enough shares of AMPS to once again pass the test (if you can't raise the bridge, you must lower the water). In addition, the Fund has the OPTION of redeeming AMPS on any given auction date or purchasing shares directly from AMPS holders in private transactions. The Fund may also pay down debt balances at any time.

In order to pay common stock dividends, the Fund must also meet certain requirements under the Investment Company Act of 1940. Among other things, the Act requires the Fund to have at least 200% asset coverage for its AMPS and 300% asset coverage for its debt before it may declare a dividend to be paid to common stock shareholders. In other words, before declaring its dividend, a Fund has to have at least $2 of assets for every $1 of AMPS outstanding and $3 for every $1 of debt outstanding.

While we were able to make significant progress in meeting the asset coverage tests by changing the composition of the portfolio, the Fund has redeemed AMPS and debt over the past several months.

PREFERRED MARKET CONDITIONS

As we've mentioned, prices on almost all preferred securities are down in recent months, and in some instances the declines are hard to fathom. Traditional valuation techniques have not been very useful in this environment, but one tool that helps frame the discussion is called DEFAULT tolerance.

We've posted a thorough discussion of our analysis on the Fund's website under the heading PREFERRED VALUATION AFTER THE TARP, and we encourage shareholders to check it out. For our purposes here, a summary will suffice.

The objective of the analysis is to answer the question "GIVEN CURRENT VALUATIONS, WHAT PERCENTAGE OF THE PORTFOLIO WOULD HAVE TO DEFAULT TO LEAVE YOU WORSE OFF THAN BUYING A TEN-YEAR US TREASURY NOTE?" As with any model, there are assumptions made, but even with conservative assumptions, over the ten years beginning December 31, 2008 51% of the Fund's current portfolio would have to default in order for the Treasury note to produce a better return. This is an extraordinarily high default rate.

Looking rationally at preferred securities valuation leads us to the firm conclusion that preferreds are cheap. They are at historically wide spreads to benchmark fixed-income asset classes. They can tolerate very high default rates and still generate positive returns, and the government's actions to limit the severity of the recession should substantially reduce the risk that defaults get that severe. At more-reasonable default rates, preferreds can provide common equity-like returns with lower risk. We believe that preferred securities remain extremely attractive for long-term investors.

However, we recognize that markets today are far from completely rational. Stung by losses, some leveraged preferred investors have been forced to exit the market, and many will not come back. Others see short-term risk that they feel outweighs preferreds' long-term potential, or they fear that new issue supply will prevent preferreds from recovering. Still others genuinely fear that the U.S. economy is headed for another Great Depression, despite all efforts to prevent it.

We do not know precisely how this recession will play itself out. We can only assess the factors that we think will affect preferred valuation and act accordingly. All investing entails taking risks. Intelligent long-term investing entails taking risks when the potential payoffs are high and the probability of poor outcomes is low. We believe that in the preferred market, now is such a time.

Although all companies have felt some strain from the recession and credit crunch, banks, finance companies, broker-dealers and, more recently, insurance companies have been most affected, given their direct and indirect exposure initially to the problems in housing and subsequently to financial markets. The pressure on preferred security valuations, especially those of financial issuers, intensified in early September with the federal government taking conservatorship of Fannie Mae and Freddie Mac (the GSEs), investing at a position senior to existing preferred holders and suspending the payment of preferred dividends. This proved a major catalyst for the collapse of preferred valuations (most dramatically for DRD eligible issues) beginning in September. These developments were closely followed by the bankruptcy of Lehman Brothers Holdings and the rescue of AIG. The surviving major broker-dealers reacted accordingly, with Merrill Lynch arranging a quick marriage with Bank of America and Goldman Sachs and Morgan Stanley converting to bank holding company registration, mandating a more conservative capital structure.

Beginning in mid-September, the federal government response to these developments has been significant. After some resistance, Congress approved the Treasury's Trouble Assets Relief Program (TARP). Although the funding was initially envisioned to support asset valuations, on October 14th the Treasury announced the Capital Purchase Program for banks and thrifts under the TARP, with clarification that the government's equity investment will rank equal with (and not rank senior than) existing DRD eligible preferred shareholders and junior to taxable preferred securities. This restored confidence in a preferred market that had been weakened significantly by the events beginning with the GSE conservatorship, and should facilitate the eventual restoration of private equity into these companies.

More recently, the Treasury announced a second round of preferred equity financing for Citigroup under the TARP, in addition to joining various other government agencies guaranteeing $306 billion of this systemically important institution's troubled assets. In doing so, the Treasury returned to the original focus of the TARP - stabilizing asset valuations. Having committed the entire first tranche of TARP funding, the Treasury is now requesting the additional funds included in the initial legislation from Congress.

In consultation with Treasury, over the same period the Federal Reserve and the FDIC have established or announced a variety of funding facilities or guarantee programs to help stabilize financial markets, the magnitude of which dwarf the size of TARP. These include liquidity facilities for banks, primary dealers, money market funds (using banks as intermediaries), commercial paper issuers and, most recently, asset-backed commercial paper issuers. Recent guarantee programs support intermediate bank debt issuers and money market funds. Announced for February 2009 are the Term Asset-backed Securities Loan Facility and the Government Sponsored Entities Purchase Program, to provide liquidity for consumer lending and to holders of GSE debt.

The speed and magnitude of the federal government's response to developments which climaxed in September have been unprecedented. While all issuers of preferred securities face a difficult operating environment over the next several years, this will be especially true for banks and other financial companies. However, the federal government's prompt recent actions provide some assurance that the financial system will continue to function.

TAX ADVANTAGES OF 2008 CALENDAR YEAR DISTRIBUTIONS

In 2008, the Fund passed on a portion of its income to individuals in the form of qualified dividend income or QDI. QDI is taxed at a maximum 15% rate instead of an individual's ordinary income tax rate. In calendar year 2008, approximately 30.5% of distributions made by the Fund was eligible for QDI treatment. For an individual in the 28% tax bracket, this means that the Fund's total distributions will only be taxed at a blended 25.9% rate versus the 28% rate which would apply to distributions by a fund containing traditional corporate bonds. This tax advantage means that, all other things being equal, an individual in the 28% tax bracket who held 100 shares of Common Stock of the Fund for the calendar year would have had to receive approximately $163 in distributions from a traditional corporate bond fund to net the same after-tax amount as the $154 in distributions paid by the Fund.

For detailed information about the tax treatment of the particular distributions received from the Fund, please see the Form 1099 you receive from either the Fund or your broker.

Corporate shareholders also receive a federal tax benefit from the 19.1% of distributions that were eligible for the inter-corporate dividends received deduction or DRD.

It is important to remember that the composition of the portfolio and the income distributions can change from one year to the next, and that the QDI or DRD portions of next year's distributions may not be the same (or even similar) to this year's.

RISKS OF THE FUND'S USE OF BORROWING FOR LEVERAGE

The use of leverage can be beneficial on a longer term basis depending on a number of variables and market conditions. The following describes risks associated with leveraging the common stock through the use of a combination of AMPS and borrowing, which do not materially differ from the risks the Fund previously faced through leveraging using only AMPS.

Because the investment risk associated with assets purchased with borrowed money is borne solely by the Fund's common stock shareholders, resulting in greater risk to these shareholders. Leverage creates risks for the Fund's common stock shareholders, including the likelihood of greater volatility of the Fund's net asset value and the market price of its shares, and the risk that fluctuations in interest rates on borrowings or in the dividend rates on any outstanding AMPS may affect the return to common stock shareholders. If the income from the securities purchased with such funds is not sufficient to cover the cost of leverage, the net income of the Fund would be less than if leverage had not been used, and therefore the amount available for distribution to common stock shareholders as dividends would be reduced. In such an event, the Fund might nevertheless maintain its leveraged position to avoid capital losses on securities purchased with the leverage that would need to be sold to generate cash used to reduce the leverage. Further, all expenses associated with borrowing, such as interest expenses and transaction costs, are borne solely by the Fund's common stock shareholders.

Similarly, if the asset coverage for borrowing declines below the limits specified in the the 1940 Act or, in the terms of the AMPS or, the financing arrangement, the Fund may be forced to sell a portion of its investments when it may not be advantageous to do so. In the extreme, sales of investments required to meet asset coverage tests imposed by the Investment Company Act could also cause a Fund to lose its status as a regulated investment company under the Internal Revenue Code. If a Fund were unable to make adequate distributions to shareholders because of asset coverage or other restrictions, it could fail to qualify as a regulated investment company for federal income tax purposes and, even if it did not fail to so qualify, it could become liable for income and excise tax on the portion of its earnings which are not distributed on a timely basis in accordance with applicable provisions of the Internal Revenue Code.

Pursuant to Rule 23c-1 under the Investment Company Act of 1940, the Fund is authorized to repurchase AMPS on the open market or through negotiated private transactions. Purchases of AMPS, if any, will be executed as market and business conditions warrant on the open market or in negotiated or block trades. The Fund is not obligated to repurchase any dollar amount or number of AMPS, and the timing and amount of any AMPS repurchased will depend on market conditions, share price, corporate and regulatory requirements, capital availability and other factors. Authorization to repurchase AMPS is at the discretion of the Fund's Board of Directors and may be limited or terminated at any time without prior notice.

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
PORTFOLIO OVERVIEW
NOVEMBER 30, 2008 (UNAUDITED)

FUND STATISTICS ON 11/30/08

Net Asset Value	$ 9.00
Market Price	$ 7.28
Discount	19.11%
Yield on Market Price	20.19%
Common Stock Shares Outstanding	9,776,333

MOODY'S RATINGS	% OF PORTFOLIO
AA	5.4%
A	12.2%
BBB	48.5%
BB	22.0%
Below "BB"	0.3%
Not Rated	4.3%
Below Investment Grade*	15.7%

* BELOW INVESTMENT GRADE BY BOTH MOODY'S AND S&P.

(PIE CHART)

INDUSTRY CATEGORIES	% OF PORTFOLIO
Banking	32%
Utilities	27%
Insurance	21%
Financial Services	5%
Energy	5%
Other	10%

TOP 10 HOLDINGS BY ISSUER	% OF PORTFOLIO
Banco Santander	5.4%
Liberty Mutual Group	5.4%
Midamerican Energy	4.9%
National City	3.8%
Sovereign Bancorp	3.8%
Unum Group	3.3%
AON Corp	3.1%
Astoria Financial	3.1%
Entergy Louisiana	3.0%
Merrill Lynch	2.9%

	% OF PORTFOLIO**
Holdings Generating Qualified Dividend Income (QDI) for Individuals	27%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	20%

** THIS DOES NOT REFLECT YEAR-END RESULTS OR ACTUAL TAX CATEGORIZATION OF FUND DISTRIBUTIONS. THESE PERCENTAGES CAN, AND DO, CHANGE, PERHAPS SIGNIFICANTLY, DEPENDING ON MARKET CONDITIONS. INVESTORS SHOULD CONSULT THEIR TAX ADVISOR REGARDING THEIR PERSONAL SITUATION. SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS FOR THE TAX CHARACTERIZATION OF 2008 DISTRIBUTIONS.

11

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
PORTFOLIO OF INVESTMENTS
NOVEMBER 30, 2008

SHARES/$ PAR	
PREFERRED SECURITIES -- 83.4%	
	BANKING -- 31.9%
$ 5,750,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B ....
	Banco Santander:
401,100	6.50% Pfd. ....
155,320	6.80% Pfd. ....
$ 8,218,000	Capital One Capital III, 7.686% 08/15/36 ....
$ 10,000,000	CBG Florida REIT Corporation, 7.114%, 144A**** ....
40,000	Citizens Funding Trust I, 7.50% Pfd. 09/15/66 ....
40,000	Cobank, ACB, 7.00% Pfd., 144A**** ....
7,200	Colonial Capital Trust IV, 7.875% Pfd. 10/01/33 ....
$ 7,000,000	Comerica Capital Trust II, 6.576% 02/20/37 ....
7,000	FBOP Corporation, Adj. Rate Pfd., 144A**** ....
$ 400,000	First Empire Capital Trust I, 8.234% 02/01/27 ....
$ 1,900,000	First Hawaiian Capital I, 8.343% 07/01/27, Series B ....
1,000	First Tennessee Bank, Adj. Rate Pfd., 144A**** ....
$ 100,000	First Tennessee Capital I, 8.07% 01/06/27, Series A ....
$ 600,000	First Union Capital II, 7.95% 11/15/29 ....
2	FT Real Estate Securities Company, 9.50% Pfd., 144A**** ....
$ 1,729,000	Goldman Sachs Capital II, 5.793% ....
$ 1,000,000	HBOS PLC, 6.657%, 144A**** ....
$ 855,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A**** ....
82,000	Keycorp Capital IX, 6.75% Pfd. 12/15/66 ....
54,995	National City Corporation, 9.875% Pfd. ....
$ 2,500,000	National City Preferred Capital Trust I, 12.00% ....
151,059	PFGI Capital Corporation, 7.75% Pfd. ....
$ 1,000,000	Regions Financing Trust II, 6.625% 05/15/47 ....
93,100	Sovereign Bancorp, 7.30% Pfd., Series C ....

191,525	Sovereign Capital Trust V, 7.75% Pfd. 05/22/36 ....
2,000	Sovereign REIT, 12.00% Pfd., Series A, 144A**** ....
	U.S. Bancorp, Auction Pass-Through Trust, Cl. B:
15	Series 2006-5, Variable Rate Pfd., 144A**** ....
15	Series 2006-6, Variable Rate Pfd., 144A**** ....
$ 850,000	Wachovia Capital Trust III, 5.80% ....
84,900	Wachovia Preferred Funding, 7.25% Pfd., Series A ....
$ 2,800,000	Webster Capital Trust IV, 7.65% 06/15/37 ....

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

SHARES/$ PAR	
PREFERRED SECURITIES -- (CONTINUED)	
	FINANCIAL SERVICES -- 4.7%
	CIT Group, Inc.:
13,900	5.189% Pfd., Series B ....
$ 3,250,000	6.10% 03/15/67 ....
68,800	6.35% Pfd., Series A ....
2,000	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A**** ....
	Goldman Sachs:
28,000	Cabco Trust Capital I, Adj. Rate Pfd. 02/15/34 ....
1,500	STRIPES Custodial Receipts, Pvt. ....
$ 3,000,000	Gulf Stream-Compass 2005 Composite Notes, 144A**** ....
	Lehman Brothers Holdings, Inc.:
20,000	5.67% Pfd., Series D ....
85,000	7.95% Pfd. ....
	Merrill Lynch:
160,000	6.25% Pfd. ....
80,000	Adj. Rate Pfd., Series 5 ....
20,000	Fixed Income Pass-Through 2007-A, Cl. B, Adj. Rate Pfd., 144A**** ....
3,000	Series II STRIPES Custodial Receipts, Pvt.,**** ....
	INSURANCE -- 14.4%
$ 9,511,000	AON Capital Trust A, 8.205% 01/01/27 ....
	Arch Capital Group Ltd.:
27,150	7.875% Pfd., Series B ....
47,100	8.00% Pfd., Series A ....
	Axis Capital Holdings:
19,433	7.25% Pfd., Series A ....
66,600	7.50% Pfd., Series B ....
160,000	Delphi Financial Group, 7.376% Pfd. 05/15/37 ....
$ 5,500,000	Everest Re Holdings, 6.60% 05/15/37 ....
	Liberty Mutual Group:

$ 6,200,000	7.80% 03/15/37, 144A**** ....
$ 1,000,000	10.75% 06/15/58, 144A**** ....
$ 1,500,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A**** ....
13,200	MetLife, Inc., 6.50% Pfd., Series B ....

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
PORTFOLIO OF INVESTMENTS (CONTINUED)
NOVEMBER 30, 2008

SHARES/$ PAR	
PREFERRED SECURITIES -- (CONTINUED)	
	INSURANCE -- (CONTINUED)
$ 300,000	PartnerRe Finance II, 6.44% 12/01/66 ....
109,000	Scottish Re Group Ltd., 7.25% Pfd. ....
$ 3,615,000	USF&G Capital, 8.312% 07/01/46, 144A**** ....
$ 1,500,000	ZFS Finance USA Trust V, 6.50% 05/09/37, 144A**** ....
	UTILITIES -- 26.8%
33,700	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993 ....
205,000	Calenergy Capital Trust III, 6.50% Pfd. 09/01/27 ....
$ 2,375,000	COMED Financing III, 6.35% 03/15/33 ....
66,170	Constellation Energy Group, Inc., 8.625% Pfd. 06/15/63, Series A ....
$ 2,000,000	Dominion Resources Capital Trust I, 7.83% 12/01/27 ....
$ 2,250,000	Dominion Resources, Inc., 7.50% ....
83,000	Entergy Arkansas, Inc., 6.45% Pfd. ....
50,000	Entergy Louisiana, Inc., 6.95% Pfd. ....
87,423	FPC Capital I, 7.10% Pfd., Series A ....
	FPL Group Capital, Inc.:
$ 750,000	6.35% 10/01/66 ....
$ 350,000	6.65% 06/15/67 ....
2,500	Georgia Power Company, 6.50% Pfd., Series 07-A ....
30,445	Indianapolis Power & Light Company, 5.65% Pfd. ....
$ 5,000,000	PECO Energy Capital Trust IV, 5.75% 06/15/33 ....
$ 4,250,000	Puget Sound Energy, Inc., 6.974% 06/01/67 ....
15,000	Southern California Edison, 6.00% Pfd., Series C ....
$ 1,500,000	Southern Union Company, 7.20% 11/01/66 ....
5,000	Union Electric Company, $7.64 Pfd. ....
$ 4,500,000	Wisconsin Energy Corporation, 6.25% 05/15/67 ....
85,137	Wisconsin Power & Light Company, 6.50% Pfd. ....
	ENERGY -- 3.4%
$ 4,900,000	Enbridge Energy Partners LP, 8.05% 10/01/37 ....
$ 4,000,000	Enterprise Products Partners, 7.034% 01/15/68 ....

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
PORTFOLIO OF INVESTMENTS (CONTINUED)
NOVEMBER 30, 2008

SHARES/$ PAR	
PREFERRED SECURITIES -- (CONTINUED)	
	MISCELLANEOUS INDUSTRIES -- 2.2%
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A**** ....
	TOTAL PREFERRED SECURITIES (Cost $218,476,605) ....
CORPORATE DEBT SECURITIES -- 9.3%	
	FINANCIAL SERVICES -- 0.2%
$ 4,726,012	Lehman Brothers, Guaranteed Note, Variable Rate, 12/16/16, 144A**** ....
	INSURANCE -- 6.5%
15,000	AAG Holding Company, Inc., 7.25% Pfd. ....
$ 7,577,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A**** ....
$ 7,000,000	UnumProvident Corporation, 7.25% 03/15/28, Senior Notes ....
	ENERGY -- 1.6%
$ 4,000,000	Noble Energy, Inc., 7.25% 08/01/97 ....
	MISCELLANEOUS INDUSTRIES -- 1.0%
16,500	Corp-Backed Trust Certificates, 7.00% 11/15/28, Series Sprint ....
	Pulte Homes, Inc.:
25,844	7.375% 06/01/46 ....
$ 2,160,000	7.875% 06/15/32 ....
	TOTAL CORPORATE DEBT SECURITIES (Cost $26,958,355) ....

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

15

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
PORTFOLIO OF INVESTMENTS (CONTINUED)
NOVEMBER 30, 2008

SHARES/$ PAR		
MONEY MARKET FUND -- 1.7%		
2,712,994	BlackRock Provident Institutional, T-Fund	
	TOTAL MONEY MARKET FUND (Cost $2,712,994)	
TOTAL INVESTMENTS (Cost $248,147,954***)		94.4%
OTHER ASSETS AND LIABILITIES (Net)		5.6%
NET ASSETS BEFORE LOAN AND AMPS		100.0%+++
LOAN PRINCIPAL BALANCE		
AUCTION MARKET PREFERRED STOCK (AMPS) REDEMPTION VALUE		
TOTAL NET ASSETS AVAILABLE TO COMMON STOCK		

----

* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

** Securities distributing Qualified Dividend Income only.

*** Aggregate cost of securities held.

**** Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

(1) All or a portion of this security is pledged as collateral for the Fund's loan. The total value of such securities was $79,596,043 at November 30, 2008.

(2) Foreign Issuer.

\+ Non-income producing.

++ The issuer has filed for bankruptcy protection. As a result, the Fund may not be able to recover the principal invested and also does not expect to receive income on this security going forward.

+++ The percentage shown for each investment category is the total value of that category as a percentage of total net assets before the loan and AMPS.

ABBREVIATIONS:

CABCO -- Corporate Asset Backed Corporation
PFD. -- Preferred Securities
PVT. -- Private Placement Securities
STRIPES -- Structured Residual Interest Preferred Enhanced Securities

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
STATEMENT OF ASSETS AND LIABILITIES
NOVEMBER 30, 2008

ASSETS:		
Investments, at value (Cost $248,147,954)		$148,187,885
Receivable for investments sold		5,872,000
Dividends and interest receivable		3,112,048
Prepaid expenses		71,783
Total Assets		157,243,716
LIABILITIES:		
Loan Payable	$29,500,000	
Dividends payable to Common Stock Shareholders	231	
Investment advisory fee payable	75,643	
Administration, Transfer Agent and Custodian fees payable	26,904	
Servicing agent fees payable	3,289	
Professional fees payable	78,897	
Directors' fees payable	872	
Accrued expenses and other payables	45,318	
Accumulated undeclared distributions to Auction Market Preferred Stock Shareholders	10,111	
Total Liabilities		29,741,265
AUCTION MARKET PREFERRED STOCK (1,580 SHARES OUTSTANDING) REDEMPTION VALUE		39,500,000
NET ASSETS AVAILABLE TO COMMON STOCK		$ 88,002,451
NET ASSETS AVAILABLE TO COMMON STOCK consist of:		
Distributions in excess of net investment income		$ (434,755)
Accumulated net realized loss on investments sold		(42,491,181)
Unrealized depreciation of investments		(99,960,069)
Par value of Common Stock		97,763
Paid-in capital in excess of par value of Common Stock		230,790,693
Total Net Assets Available to Common Stock		$ 88,002,451
NET ASSET VALUE PER SHARE OF COMMON STOCK:		
Common Stock (9,776,333 shares outstanding)		$ 9.00

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
STATEMENT OF OPERATIONS
FOR THE YEAR ENDED NOVEMBER 30, 2008

INVESTMENT INCOME:		
Dividends+		$ 11,760,937
Interest		11,006,729
Total Investment Income		22,767,666
EXPENSES:		
Investment advisory fee	$1,483,134	
Servicing agent fee	121,456	
Administrator's fee	230,513	
Auction Market Preferred Stock broker commissions and auction agent fees	215,476	
Professional fees	182,030	
Insurance expense	133,905	
Transfer Agent fees	66,040	
Directors' fees	73,090	
Custodian fees	32,667	
Compliance fees	37,715	
Interest expense	1,173,471	
Commitment fee	227,500	
Other	125,300	
Total Expenses		4,102,297
NET INVESTMENT INCOME		18,665,369
REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS		
Net realized loss on investments sold during the year		(25,533,127)
Net realized loss from written options during the year		(96,597)
Change in unrealized appreciation/depreciation of investments		(78,210,324)
NET REALIZED AND UNREALIZED LOSS ON INVESTMENTS		(103,840,048)
DISTRIBUTIONS TO AUCTION MARKET PREFERRED STOCK SHAREHOLDERS:		
From net investment income (including changes in accumulated undeclared distributions)		(4,264,640)
NET DECREASE IN NET ASSETS TO COMMON STOCK RESULTING FROM OPERATIONS		$ (89,439,319)

\+ For Federal income tax purposes, a significant portion of this amount may not qualify for the inter-corporate dividends received deduction ("DRD") or as qualified dividend income ("QDI") for individuals.

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK(1)

	YEAR ENDED NOVEMBER 30, 2008	YEAR NOVEMBE
OPERATIONS:		
Net investment income	$ 18,665,369	$ 21,
Net realized loss on investments sold during the year	(25,629,724)	(2,
Change in net unrealized depreciation of investments	(78,210,324)	(32,
Distributions to AMPS* Shareholders from net investment income, including changes in accumulated undeclared distributions ...	(4,264,640)	(6,
NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS	(89,439,319)	(19,
DISTRIBUTIONS:		
Dividends paid from net investment income to Common Stock Shareholders(1)	(15,043,583)	(14,
Tax return of capital to Common Stock Shareholders	(251,490)	
TOTAL DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS	(15,295,073)	(14,
NET DECREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE YEAR	$(104,734,392)	$(34,
NET ASSETS AVAILABLE TO COMMON STOCK:		
Beginning of year	$ 192,736,843	$227,
Net decrease in net assets during the year	(104,734,392)	(34,
End of year (including distributions in excess of net investment income of $(434,755) and of $(290,982), respectively)	$ 88,002,451	$192,

----

*   Auction Market Preferred Stock.

(1) May include income earned, but not paid out, in prior fiscal year.

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED NOVEMBER 30, 2008

INCREASE (DECREASE) IN CASH	
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net decrease in net assets resulting from operations	$ (89,439,319)
ADJUSTMENTS TO RECONCILE NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS TO NET CASH USED IN OPERATING ACTIVITIES:	
Purchase of investment securities	(118,044,452)
Proceeds from disposition of investment securities	187,782,036
Purchase of purchased option securities	(2,124,545)
Proceeds from disposition of purchased option securities	932,559

Premiums received for written options	700,617
Payments to close written options	(797,214)
Sale of short-term investment securities, net	(3,121,570)
Decrease in securities lending collateral	4,905,720
Decrease in dividends and interest receivable	756,327
Increase in receivable for investments sold	(5,750,752)
Decrease in Prepaid expenses	2,979
Net amortization/(accretion) of premium/(discount)	216,387
Decrease in payable for securities lending collateral	(4,905,720)
Decrease in accrued expenses and other liabilities	(56,266)
Unrealized depreciation on securities	78,210,324
Net realized loss from investments and written options	25,629,724
Net cash provided in operating activities	74,896,835
CASH FLOWS FROM FINANCING ACTIVITIES:	
Increase in Loan payable	29,500,000
Decrease in Auction Market Preferred Stock (AMPS)	(89,000,000)
Decrease in payable for AMPS	(36,278)
Decrease in dividend payable to common stock shareholders	(65,484)
Distributions to common stock shareholders from net investment income	(15,295,073)
Net cash used by financing activities	(74,896,835)
Net increase in cash	--
CASH:	
Beginning of the year	--
End of the year	$ --
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Interest paid during the year	1,143,725

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

20

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
FINANCIAL HIGHLIGHTS
FOR A COMMON STOCK SHARE OUTSTANDING THROUGHOUT EACH YEAR.

Contained below is per share operating performance data, total investment returns, ratios to average net assets and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

	YEAR E	
	2008	2007
PER SHARE OPERATING PERFORMANCE:		
Net asset value, beginning of year	$ 19.71	$ 23.29
INVESTMENT OPERATIONS:		
Net investment income	1.91	2.24

Net realized and unrealized gain/(loss) on investments	(10.62)	(3.59)
DISTRIBUTIONS TO AMPS* SHAREHOLDERS:		
From net investment income	(0.44)	(0.70)
Total from investment operations	(9.15)	(2.05)
COST OF ISSUANCE OF AMPS*	--	--
DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:		
From net investment income	(1.53)	(1.53)
From return of capital	(0.03)	--
Total distributions to Common Stock Shareholders	(1.56)	(1.53)
Net asset value, end of year	$ 9.00	$ 19.71
Market value, end of year	$ 7.28	$ 17.00
Total investment return based on net asset value**	(48.17%)	(8.71%)
Total investment return based on market value**	(51.39%)	(16.95%)
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:		
Total net assets, end of year (in 000's)	$ 88,002	$192,737
Operating expenses including interest expense(1)	2.67%	--
Operating expenses excluding interest expense	1.91%	1.51%
Net investment income +	9.37%	6.94%
SUPPLEMENTAL DATA:++		
Portfolio turnover rate	46%	57%
Total net investments, end of year (in 000's)	$157,002	$321,237
Ratio of operating expenses including interest expense(1)(2) to net assets before loan and AMPS	1.54%	--
Ratio of operating expenses excluding interest expense to net assets before loan and AMPS	1.10%	0.95%

* Auction Market Preferred Stock.

** Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment and Cash Purchase Plan.

+ The net investment income ratios reflect income net of operating expenses, including interest expense, and payments to AMPS Shareholders.

++ Information presented under heading Supplemental Data includes AMPS and loan principal balance.

(1) See Note 7.

(2) Does not include distributions to AMPS Shareholders.

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

21

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
FINANCIAL HIGHLIGHTS (CONTINUED)
PER SHARE OF COMMON STOCK

	TOTAL DIVIDENDS PAID+	NET ASSET VALUE	NYSE CLOSING PRICE	DIVIDEND REINVESTMENT PRICE (1)
December 31, 2007	$0.1300	$18.98	$16.88	$16.96
January 31, 2008	0.1300	19.35	17.97	18.09
February 29, 2008	0.1300	18.92	17.50	17.52
March 31, 2008	0.1300	17.21	15.69	15.84
April 30, 2008	0.1300	17.47	15.94	16.10
May 30, 2008	0.1300	17.12	15.99	15.88
June 30, 2008.	0.1300	16.10	14.98	14.59
July 31, 2008	0.1365	14.94	13.24	13.27
August 29, 2008	0.1365	14.84	13.15	13.28
October 6, 2008 (2)	0.1365	10.97	7.13	6.94
October 31, 2008	0.1225	9.82	9.10	8.82
November 28, 2008	0.1225	9.00	7.28	6.97

\+ May include distributions classified as a tax return of capital.

(1) Whenever the net asset value per share of the Fund's Common Stock is less than or equal to the market price per share on the reinvestment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of common stock will be purchased in the open market.

(2) September 30, 2008 distribution delayed; paid on October 6, 2008.

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

The table below sets out information with respect to Auction Market Preferred Stock (AMPS) currently outstanding.

DATE	TOTAL SHARES OUTSTANDING (1)	ASSET COVERAGE PER SHARE (2)	INVOLUNTARY LIQUIDATION PREFERENCE PER SHARE (3)
11/30/08	1,580	$80,704	$25,000
11/30/07	5,140	62,506	25,000
11/30/06	5,140	69,301	25,000
11/30/05	5,140	67,650	25,000
11/30/04	5,140	69,732	25,000

----

(1) See note 6.

(2) Calculated by subtracting the Fund's total liabilities (excluding the AMPS)

from the Fund's total assets and dividing that amount by the number of AMPS shares outstanding.

(3) Excludes accumulated undeclared dividends.

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

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION

Flaherty & Crumrine/Claymore Total Return Fund Incorporated (the "Fund") was incorporated as a Maryland corporation on July 18, 2003, and commenced operations on August 29, 2003 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). The Fund's primary investment objective is to provide its common shareholders with high current income. The Fund's secondary investment objective is capital appreciation.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of the financial statements is in conformity with U.S. generally accepted accounting principles ("US GAAP") and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

PORTFOLIO VALUATION: The net asset value of the Fund's Common Stock is determined by the Fund's Administrator no less frequently than on the last business day of each week and month in accordance with the policies and procedures approved by the Board of Directors of the Fund. It is determined by dividing the value of the Fund's net assets available to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund's net assets available to Common Stock is deemed to equal the value of the Fund's total assets less (i) the Fund's liabilities and (ii) the aggregate liquidation value of its Auction Market Preferred Stock ("AMPS").

The Fund's preferred and debt securities are valued on the basis of current market quotations provided by independent pricing services or dealers approved by the Board of Directors of the Fund. Each quotation is based on the mean of the bid and asked prices of a security. In determining the value of a particular preferred or debt security, a pricing service or dealer may use information with respect to transactions in such investments, quotations, market transactions in comparable investments, various relationships observed in the market between investments, and/or calculated yield measures based on valuation technology commonly employed in the market for such investments. Common stocks that are traded on stock exchanges are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available mean price. Futures contracts and option contracts on futures contracts are valued on the basis of the settlement price for such contracts on the primary exchange on which they trade. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon ("swaptions"), are valued using prices supplied by a pricing service, or if such prices are unavailable, prices provided by a single broker or dealer that is not the counterparty or, if no such prices are available, at a price at which the counterparty to the contract would repurchase the instrument or terminate the contract. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type.

Investments in money market instruments and all debt and preferred securities which mature in 60 days or less are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157 "Fair Value Measurements" ("SFAS 157") effective for fiscal years beginning after November 15, 2007. This standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements. The Fund has adopted SFAS 157 as of December 1, 2007. The three levels of the fair value hierarchy under SFAS 157 are described below:

- Level 1 - quoted prices in active markets for identical securities
- Level 2 - other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 - significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. A summary of the inputs used to value the Fund's net assets as of November 30, 2008 is as follows:

VALUATION INPUTS	INVESTMENTS IN SECURITIES (MARKET VALUE)	OTHER FINANCIAL INSTRUMENTS (UNREALIZED APPRECIATION/ DEPRECIATION)*
Level 1 - Quoted Prices	$ 27,582,284	$--
Level 2 - Other Significant Observable Inputs	119,309,657	--
Level 3 - Significant Unobservable Inputs	1,295,944	--
TOTAL	$148,187,885	$--

* Other financial instruments are derivative instruments not reflected in the Portfolio of Investments, such as futures, forwards and swaps which are valued at the unrealized appreciation/depreciation on the investment. As of November 30, 2008 the Fund does not have any other financial instruments.

Following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

	INVESTMENTS IN SECURITIES (MARKET VALUE)	OTHER FINANCIAL INSTRUMENTS (UNREALIZED APPRECIATION/ DEPRECIATION)
BALANCE AS OF 11/30/07.	$6,945,554	$--
Accrued discounts/premiums	--	--
Realized gain (loss)	--	--
Change in unrealized appreciation (depreciation)	(5,649,610)	--
Net purchases (sales)	--	--
Transfers in and/or out of Level 3	--	--
BALANCE AS OF 11/30/08	$1,295,944	$--

SECURITIES TRANSACTIONS AND INVESTMENT INCOME: Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the specific identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis. The Fund also amortizes premiums and accretes discounts on fixed income securities using the effective yield method.

OPTIONS: Purchases of options are recorded as an investment, the value of which is marked-to-market at each valuation date. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability, the value of which is marked-to-market at each valuation date. When a written option expires, the Fund realizes a gain equal to the amount of the premium originally received. When the Fund enters into a closing purchase transaction, the Fund realizes a gain (or loss if the cost of the closing purchase transaction exceeds the premium received when the option was written) without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When a call option is exercised, the Fund realizes a gain or loss from the sale of the underlying security and the proceeds from such sale are increased by the amount of the premium originally received. When a put option is exercised, the amount of the premium originally received will reduce the cost of the security which the Fund purchased upon exercise.

The risk in writing a call option is that the Fund may forego the opportunity for profit if the market price of the underlying security increases and the option is exercised. The risk in writing a put option is that the Fund may incur a loss if the market price of the underlying security decreases and the option is exercised.

REPURCHASE AGREEMENTS: The Fund may engage in repurchase agreement transactions. The Fund's investment adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

FEDERAL INCOME TAXES: The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no federal income tax provision will be required.

In June 2006, the FASB issued FASB Interpretation 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." This standard defines the threshold for recognizing the benefits of tax-return positions in the financial statements as "more-likely-than-not" to be sustained upon challenge by the taxing authority and requires measurement of a tax position meeting the more-likely-than-not criterion, based on the largest benefit that is more than 50 percent likely to be realized. FIN 48 became effective as of the beginning of the first fiscal year beginning after December 15, 2006, with early application permitted if no interim financial statements have been issued. At adoption, companies must adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. The tax periods open to examination by the Internal Revenue Service include the fiscal years ended November 30, 2008, 2007, 2006 and 2005. The Fund's major tax jurisdictions are federal and California. As of November 30, 2008, the Fund has evaluated the adoption of FIN 48 and determined that there is no material impact on the financial statements.

DIVIDENDS AND DISTRIBUTIONS TO SHAREHOLDERS: The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock ("Shareholders"). Distributions to Shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to Shareholders at least annually. Any net realized long-term capital gains may be distributed to Shareholders at least annually or may be retained by the Fund as determined by the Fund's Board of Directors. Capital gains retained by the Fund are subject to tax at the capital gains corporate tax rate. Subject to the Fund qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term capital gains may be used by the Fund's Shareholders as a credit against their own tax liabilities. The Fund may pay distributions in excess of the Fund's net investment company taxable income and this excess would be a tax-free return of capital distributed from the Fund's assets.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from US GAAP. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportionate allocation of income and gains to all classes of shareholders.

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium on certain fixed income securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid, including changes in accumulated undeclared distributions to AMPS Shareholders, during 2008 and 2007 was as follows:

	DISTRIBUTIONS PAID IN FISCAL YEAR 2008			DISTRIBUTIONS PAID IN FISCAL YEAR 2007	
	ORDINARY INCOME	LONG-TERM CAPITAL GAINS	RETURN OF CAPITAL	ORDINARY INCOME	LONG-TERM CAPITAL GAINS
Common	$15,043,583	$0	$251,490	$14,957,790	$0
Preferred	4,264,640	$0	$ 0	$ 6,874,365	$0

As of November 30, 2008, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common and Preferred Stock shareholders, on a tax basis were as follows:

CAPITAL (LOSS) CARRYFORWARD	UNDISTRIBUTED ORDINARY INCOME	UNDISTRIBUTED LONG-TERM GAIN	NET UNREALIZED APPRECIATION/(DEPRECIATION)
($41,609,014)	$0	$0	($100,842,236)

At November 30, 2008, the composition of the Fund's $41,609,014 accumulated realized capital losses was $573,838, $8,529,240, $943,555, $1,648,329, $3,780,448 and $26,133,604 incurred in 2003, 2004, 2005, 2006, 2007 and 2008, respectively. These losses may be carried forward and offset against any future capital gains through 2011, 2012, 2013, 2014, 2015 and 2016, respectively.

RECLASSIFICATION OF ACCOUNTS: During the year ended November 30, 2008, reclassifications were made in the Fund's capital accounts to report these balances on a tax basis, excluding temporary differences, as of November 30, 2008. Additional adjustments may be required in subsequent reporting periods. These reclassifications have no impact on the net asset value of the Fund. The calculation of net investment income per share in the financial highlights excludes these adjustments. Below are the reclassifications:

PAID-IN CAPITAL	UNDISTRIBUTED NET INVESTMENT INCOME	ACCUMULATED NET REALIZED GAIN ON INVESTMENTS
$39,432	$499,081	$(538,513)

EXCISE TAX: The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and its capital gains (both long-term and short-term) for its fiscal year and (2) certain undistributed amounts from previous years. The Fund paid $20,284 of Federal excise taxes attributable to calendar year 2007 in March 2008.

ADDITIONAL ACCOUNTING STANDARDS: In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. SFAS 161 requires enhanced disclosures about the Fund's derivative and hedging activities.

Management is currently evaluating the impact the adoption of SFAS 161 will have on the Fund's financial statement disclosures.

3. INVESTMENT ADVISORY FEE, SERVICING AGENT FEE, ADMINISTRATION FEE, TRANSFER AGENT FEE, CUSTODIAN FEE, DIRECTORS' FEES AND CHIEF COMPLIANCE OFFICER FEE

Flaherty & Crumrine Incorporated (the "Adviser") serves as the Fund's investment adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.575% of the first $200 million of the Fund's average weekly total managed assets, 0.50% of the next $300 million of the Fund's average weekly total managed assets, and 0.45% of the Fund's average weekly total managed assets above $500 million.

For purposes of calculating the fees payable to the Adviser, Servicing Agent, Administrator and Custodian, the Fund's average weekly total managed assets means the total assets of the Fund (including any assets attributable to any Fund auction market preferred stock that may be outstanding or otherwise attributable to the use of leverage) minus the sum of accrued liabilities (other than debt, if any, representing financial leverage). For purposes of determining total managed assets, the liquidation preference of any preferred shares issued by the Fund is not treated as a liability.

Claymore Securities, Inc. (the "Servicing Agent") serves as the Fund's shareholder servicing agent. As compensation for its services, the Fund pays the Servicing Agent a fee computed and paid monthly at the annual rate of 0.025% of the first $200 million of the Fund's average weekly total managed assets, 0.10% of the next $300 million of the Fund's average weekly total managed assets and 0.15% of the Fund's average weekly total managed assets above $500 million.

PNC Global Investment Servicing (U.S.) Inc. ("PNC"), formerly known as PFPC Inc., serves as the Fund's Administrator. As Administrator, PNC calculates the net asset value of the Fund's shares attributable to Common Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for PNC's services as Administrator, the Fund pays PNC a monthly fee at an annual rate of 0.10% of the first $200 million of the Fund's average weekly total managed assets, 0.04% of the next $300 million of the Fund's average weekly total managed assets, 0.03% of the next $500 million of the Fund's average weekly total managed assets and 0.02% of the Fund's average weekly total managed assets above $1 billion.

PNC also serves as the Fund's Common Stock dividend-paying agent and registrar (Transfer Agent). As compensation for PNC's services, the Fund pays PNC a fee at an annual rate of 0.02% of the first $150 million of the Fund's average weekly net assets attributable to Common Stock, 0.0075% of the next $350 million of the Fund's average weekly net assets attributable to Common Stock, and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above $500 million, plus certain out-of-pocket expenses. For purposes of calculating such fee, the Fund's average weekly net assets attributable to the Common Stock are deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding Fund preferred shares and the loan principal balance.

PFPC Trust Company ("PFPC Trust") serves as the Fund's Custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.010% of the first $200 million of the Fund's average weekly total managed assets, 0.008% of the next $300 million of the Fund's average weekly total managed assets, 0.006% of the next $500 million of the Fund's average weekly total managed assets, and 0.005% of the Fund's average weekly total managed assets above $1 billion.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser or the Servicing Agent a fee of $9,000 per annum, plus $500 for each in-person meeting of the Board of Directors or any committee and $150 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of $2,500. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

The Fund currently pays the Adviser a fee of $37,500 per annum for Chief Compliance Officer services and reimburses out-of-pocket expenses incurred in connection with providing services in this role.

4. PURCHASES AND SALES OF SECURITIES

For the year ended November 30, 2008 the cost of purchases and proceeds from sales of securities excluding short-term investments, aggregated $120,168,997 and $188,714,595, respectively.

At November 30, 2008, the aggregate cost of securities for federal income tax purposes was $249,030,121, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was $1,502,500 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was $102,344,736.

Written option transactions during the year ended November 30, 2008 are summarized as follows:

	CONTRACT AMOUNTS	PREMIUMS RECEIVED
Written options outstanding at beginning of year.....	0	$ 0
Options Opened....................................	400	700,617
Options Exercised.................................	0	0
Options Expired...................................	(0)	(0)
Options Closed....................................	(400)	(700,617)
Written options outstanding at end of year..........	0	$ 0

5. COMMON STOCK

At November 30, 2008, 240,000,000 shares of $0.01 par value Common Stock were authorized. Common Stock Transactions were as follows:

	YEAR ENDED 11/30/08		YEAR ENDED 11/30/07	
	SHARES	AMOUNT	SHARES	AMOUNT
Shares issued under the Dividend Reinvestment and Cash Purchase Plan.........................	--	$--	--	$--

6. AUCTION MARKET PREFERRED STOCK (AMPS)

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of $0.01 par value preferred stock. The AMPS, which consists of Series T7 and W28, are senior to the Common Stock and result in the financial leveraging of the Common Stock. Such leveraging tends to magnify both the risks and opportunities to Common Stock Shareholders. Dividends on shares of AMPS are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the AMPS. If the Fund fails to meet these requirements and does not correct such failure, the Fund may be required to redeem, in part or in full, AMPS at a redemption price of $25,000 per share plus an amount equal to the accumulated and unpaid dividends on such shares in order to meet these requirements. Additionally, failure to meet the foregoing asset requirements could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could lead to sales of portfolio securities at inopportune times.

An auction of the AMPS is generally held every 7 days for Series T7 and every 28 days for Series W28. Existing AMPS Shareholders may submit an order to hold, bid or sell such shares at par value on each auction date. AMPS Shareholders may also trade shares in the secondary market, if any, between auction dates. Since mid-February 2008, the normal functioning of the market for auction market preferred stock of U.S. closed-end funds, including the Fund, has been disrupted, and the Fund's AMPS holders have not been able to sell their shares through the auction process.

On May 1, 2008, the Fund announced the redemption of approximately 70% of each series of its outstanding AMPS at a redemption price equal to the liquidation preference of $25,000 per share, plus the amount of accumulated but unpaid dividends. Redemption of 1,780 shares of Series T7 was completed on May 21, and redemption of 1,780 shares of Series W28 was completed on June 12. Total consideration for the liquidation preference of the redemptions was $89 million (See Note 7).

At November 30, 2008, 790 shares of Series T7 and 790 shares of Series W28 of AMPS were outstanding at the annualized rate of 3.51% and 3.95% for each of Series T7 and W28, respectively. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. As a result of ongoing disruptions in the auction market, the Fund is paying a dividend rate equal to the maximum rate, as defined in the Fund's Articles Supplementary. The maximum rate is equal to the greater of (i) 175% of the reference rate and (ii) 2.50% plus the reference rate. "Reference Rate" means the

applicable "AA" Financial Composite Commercial Paper Rate. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

7. COMMITTED FINANCING AGREEMENT

The Fund entered into a committed financing agreement ("Financing Agreement") on May 1, 2008 which allows the Fund to borrow up to $91 million on a secured basis. The primary use of the proceeds was to redeem a portion of the outstanding shares of AMPS (See Note 6), although the balance may be utilized by the Fund in the normal course of business as financial leverage. As of November 30, 2008, the amount borrowed under the Financing Agreement was $29.5 million.

Under the original terms of the Financing Agreement, the lender charged an annualized rate of 0.60% on the undrawn (committed) balance ("Commitment Fee"), and the Overnight London Interbank Offered Rate ("Overnight LIBOR") PLUS 0.70% on the drawn (borrowed) balance. The terms of the Financing Agreement were subsequently renegotiated and became effective as of October 20, 2008. Under the new terms of the Financing Agreement, the lender will charge an annualized rate of 1.00% on the undrawn (committed) balance, and Three-Month London Interbank Offered Rate - reset every three months - PLUS 1.10% on the drawn (borrowed) balance. The renegotiation of the terms of the Financing Agreement was necessitated by the violation of a net asset value covenant in the Financing Agreement by the Fund as a result of the substantial decline in the value of the Fund's assets. The renegotiation resulted in these limits being reset to then-current market levels, changes in financing rates noted above, and the establishment of a new six-month rolling term to the Financing Agreement. None of the other financial covenants or asset coverage requirements changed materially.

For the period beginning on May 20, 2008 (initial use of the facility) and ending on November 30, 2008, the daily weighted average annualized interest rate on the drawn balance was 3.60% and the average daily loan balance was $56,120,513. In addition, the Fund paid the Lender an arrangement fee (at the origination of the facility on May 1, 2008) equal to 0.25% of the committed amount of $91 million. The arrangement fee was amortized to expense over a period of six months. LIBOR rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders.

The Fund is required to meet certain asset coverage requirements under the Financing Agreement and under the 1940 Act. In accordance with the asset coverage requirements, approximately two-thirds of the Fund's assets are expected to be pledged as collateral assuming the full committed amount is drawn. Securities pledged as collateral are identified in the portfolio of investments. If the Fund fails to meet these requirements, or maintain other financial covenants required under the Financing Agreement, the Fund may be required to repay immediately, in part or in full, the amount borrowed under the Financing Agreement. Additionally, failure to meet the foregoing requirements or covenants could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could necessitate sales

of portfolio securities at inopportune times. The Financing Agreement has no stated maturity, but may be terminated by either party without cause with six months' advance notice.

8. PORTFOLIO INVESTMENTS, CONCENTRATION AND INVESTMENT QUALITY

The Fund invests primarily in a diversified portfolio of preferred and debt securities. This includes fully taxable preferred securities and traditional preferred stocks eligible for the inter-corporate dividends received deduction ("DRD"). Under normal market conditions, at least 50% of the value of the Fund's total assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its total assets in securities issued by companies in the utilities industry and at least 25% of its total assets in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives.

The Fund may invest up to 20% of its total assets in securities rated below investment grade. These securities must be rated at least either "Ba3" by Moody's Investors Service, Inc. or "BB-" by Standard & Poor's or, if unrated, judged to be comparable in quality by the Adviser, in any case, at the time of purchase. However, these securities must be issued by an issuer having a class of senior debt rated investment grade outstanding.

The Fund may invest up to 15% of its total assets in common stocks, which total includes those convertible securities that trade in close relationship to the underlying common stock of an issuer Certain of its investments in hybrid, i.e., fully taxable, preferred securities will be considered debt securities to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like (a) if an issuer can defer payment of income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

In addition to foreign money market securities, the Fund may invest up to 30% of its total assets in the securities of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars.

9. SPECIAL INVESTMENT TECHNIQUES

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its investment policies, involving any or all of the following: short sales of securities, purchases of securities on margin, futures contracts, interest rate swaps, swap futures, options on futures contracts, options on securities, swaptions, and certain credit derivative transactions, including, but not limited to, the purchase and sale of credit protection. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps, swaptions, and credit default swaps may expose the Fund to greater credit, operations, liquidity, and valuation risk than is the case with regulated, exchange traded futures and options. These transactions are used for hedging or other appropriate risk-management purposes, or, under certain other circumstances, to increase return. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

10. SECURITIES LENDING

The Fund may lend up to 15% of its total assets (including the value of the loan collateral) to certain qualified brokers in order to earn additional income. The Fund receives compensation in the form of fees or interest earned on the investment of any cash collateral received. The Fund also continues to receive interest and dividends on the securities loaned. The Fund receives collateral in the form of cash or securities with a market value at least equal to the market value of the securities on loan, including accrued interest. In the event of default or bankruptcy by the borrower, the Fund could experience delays and costs in recovering the loaned securities or in gaining access to the collateral. The Fund has the right under the lending agreement to recover the securities from the borrower on demand. As of November 30, 2008, there were no securities on loan by the fund. Income from securities lending for the year ended November 30, 2008, was $19,435 and is included in interest income on the Statement of Operations.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Flaherty & Crumrine/Claymore Total Return Fund Incorporated

We have audited the accompanying statement of assets and liabilities of Flaherty & Crumrine/Claymore Total Return Fund Incorporated, including the portfolio of investments, as of November 30, 2008, and the related statement of operations for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, the statement of cash flows for the year then ended, and the financial highlights for each of the years in the five-year period then ended. These financial statements and financial highlights are the responsibility of management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2008 by correspondence with the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Flaherty & Crumrine/Claymore Total Return Fund Incorporated as of November 30, 2008, and the results of its operations for the year then ended, the changes in its net assets for each of the years in the two-year period then ended, its cash flows for the year then ended, and the financial highlights for each of the years in the five-year period then ended, in conformity with U.S. generally accepted accounting principles.

(KPMG LLP)

Boston, Massachusetts
January 23, 2009

Flaherty & Crumrine/Claymore Total Return Fund Incorporated
SUPPLEMENTARY TAX INFORMATION (UNAUDITED)

Distributions to Common Stock and Auction Market Preferred Stock (AMPS)

Shareholders are characterized as follows for purposes of Federal income taxes (as a percentage of total distributions, including any tax return of capital):

FISCAL YEAR 2008

	INDIVIDUAL SHAREHOLDER			CORPORATE SHAREHOLDER		
	QDI	ORDINARY INCOME	TAX RETURN OF CAPITAL	DRD	ORDINARY INCOME	TAX RETURN OF CAPITAL
AMPS	30.91%	69.09%	0.00%	19.36%	80.64%	0.00%
Common Stock	30.38%	67.90%	1.72%	19.03%	79.25%	1.72%

CALENDAR YEAR 2008

om:2px;padding-right:2px;"> 26,390

Diluted27,764
26,956
27,002
27,110

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

1

Table of Contents

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(UNAUDITED)

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Net income (loss)	$2,621	$1,335	$(2,305)	$5,023
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment	(3,116)	2,535	(1,058)	57
Change in net unrealized (loss) gain on investments	(1)	8	(41)	(2)
Less income tax benefit (expense)	1	(3)	9	1
Reclassification of realized loss on investments included in net income (1)	—	—	31	—
Less income tax benefit (2)	—	—	(8)	—
Other comprehensive (loss) income, net of tax	(3,116)	2,540	(1,067)	56
Comprehensive (loss) income	$(495)	$3,875	$(3,372)	$5,079

(1) Recorded in Other income (expense), net on our Condensed Consolidated Statements of Operations.
(2) Recorded in Income tax provision (benefit) in our Condensed Consolidated Statements of Operations.
The accompanying notes are an integral part of the condensed consolidated financial statements.

2

Table of Contents

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2018	September 30, 2017
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$47,694	$ 78,222
Marketable securities	4,763	32,015
Accounts receivable, net	48,246	28,855
Inventories	41,782	30,238
Receivable from sale of business	—	1,998
Other	3,554	3,032
Total current assets	146,039	174,360
Marketable securities, long-term	2,243	4,753
Property, equipment and improvements, net	11,474	12,801
Identifiable intangible assets, net	41,778	11,800
Goodwill	154,565	131,995
Deferred tax assets	3,665	9,211
Other	462	269
Total assets	$360,226	$ 345,189
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$10,849	$ 6,240
Accrued compensation	6,245	4,325
Accrued warranty	1,295	987
Accrued professional fees	1,019	928
Accrued restructuring	666	1,656
Unearned revenue	3,710	1,343
Contingent consideration on acquired businesses	4,440	388
Other	2,270	2,113
Total current liabilities	30,494	17,980
Income taxes payable	699	877
Deferred tax liabilities	422	534
Contingent consideration on acquired businesses	4,581	6,000
Other non-current liabilities	608	654
Total liabilities	36,804	26,045
Contingencies (see Note 12)		
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; 33,646,457 and 33,007,993 shares issued	337	330
Additional paid-in capital	253,037	245,528
Retained earnings	148,140	150,478
Accumulated other comprehensive loss	(23,726)	(22,659)
Treasury stock, at cost, 6,403,764 and 6,436,578 shares	(54,366)	(54,533)

Total stockholders' equity	323,422	319,144
Total liabilities and stockholders' equity	$360,226	$ 345,189

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

3

Table of Contents

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

	Nine months ended June 30,	
	2018	2017
	(in thousands)	
Operating activities:		
Net (loss) income	$(2,305)	$5,023
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation of property, equipment and improvements	2,140	2,187
Amortization of identifiable intangible assets	6,866	1,842
Stock-based compensation	3,598	3,502
Excess tax benefits from stock-based compensation	—	(326)
Deferred income tax provision	2,551	(648)
Change in fair value of contingent consideration	333	(1,330)
Bad debt/product return provision	404	338
Inventory obsolescence	1,550	1,030
Restructuring charges	190	2,515
Other	(66)	138
Changes in operating assets and liabilities (net of acquisitions)	(24,105)	(14,729)
Net cash used in operating activities	(8,844)	(458)
Investing activities:		
Purchase of marketable securities	—	(33,469)
Proceeds from maturities and sales of marketable securities	29,752	76,149
Proceeds from sale of Etherios	2,000	3,000
Acquisition of businesses, net of cash acquired	(56,588)	(30,111)
Purchase of property, equipment, improvements and certain other identifiable intangible assets	(963)	(1,577)
Net cash (used in) provided by investing activities	(25,799)	13,992
Financing activities:		
Acquisition earn-out payments	—	(518)
Excess tax benefits from stock-based compensation	—	326
Proceeds from stock option plan transactions	3,871	3,264
Proceeds from employee stock purchase plan transactions	892	686
Purchases of common stock	(730)	(922)
Net cash provided by financing activities	4,033	2,836
Effect of exchange rate changes on cash and cash equivalents	82	(45)
Net (decrease) increase in cash and cash equivalents	(30,528)	16,325
Cash and cash equivalents, beginning of period	78,222	75,727
Cash and cash equivalents, end of period	$47,694	$92,052
Supplemental schedule of non-cash investing and financing activities:		
Liability related to acquisition of businesses	$(2,300)	$(1,310)

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

Table of Contents
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 (the “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 (“U.S. GAAP”), 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, 2017, as filed with the SEC (“2017 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 presentation of the condensed consolidated balance sheets and condensed consolidated statements of operations, comprehensive income 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 consolidated balance sheet data were derived from our 2017 Financial Statements, but do not include all disclosures required by U.S. GAAP.
Recently Issued Accounting Pronouncements
Not Yet Adopted
In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-09, “Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting.” ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The amendments in this update should be applied prospectively to an award modified on or after the adoption date. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2017, which for us is the first quarter ending December 31, 2018. Early adoption is permitted. We do not expect the adoption of this guidance to have a material impact to our consolidated financial statements.
In January 2017, FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 eliminates the second step in the goodwill impairment test which requires an entity to determine the implied fair value of the reporting unit’s goodwill. Instead, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The standard, which should be applied prospectively, is effective for fiscal years beginning after December 15, 2019, which for us is our fiscal year ending September 30, 2021. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2017-04 on our consolidated financial statements.
In August 2016, FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments.” The amendments in this update provide guidance on eight specific cash flow issues, thereby reducing the diversity in practice in how certain transaction are classified in the statement of cash flows. This ASU is effective for annual periods and interim periods for those annual periods beginning after December 15, 2017, which for us is the first quarter ending December 31, 2018. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-15 on our consolidated financial statements.

In June 2016, FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments." The amendments in this update replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses. This ASU is effective for annual periods and interim periods for those annual periods beginning after December 15, 2019, which for us is the first quarter ending December 31, 2020. Entities may early adopt beginning after December 15, 2018. We are currently evaluating the impact of the adoption of ASU 2016-13 on our consolidated financial statements.

Table of Contents

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

In February 2016, FASB issued ASU 2016-02, "Leases (Topic 842)", which amends the existing guidance to require lessees to recognize lease assets and lease liabilities from operating leases on the balance sheet. This ASU is effective using the modified retrospective approach for annual periods and interim periods within those annual periods beginning after December 15, 2018, which for us is the first fiscal quarter ending December 31, 2019. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 on our consolidated financial statements.

In January 2016, FASB issued ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 will require equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. The amendments in this update will also simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, eliminate the requirement for public business entities to disclose the method and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet and require these entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. This ASU would also change the presentation and disclosure requirements for financial instruments. In addition, this ASU clarifies the guidance related to valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, which for us is the first fiscal quarter ending December 31, 2018. Early adoption is permitted for financial statements of fiscal years and interim periods that have not been issued. We are currently evaluating the impact of the adoption of ASU 2016-01.

In May 2014, FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This guidance provides a five-step analysis in determining when and how revenue is recognized so that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods and services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, FASB issued ASU 2015-14 "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" which approved a one-year deferral of the effective date of ASU 2014-09. As a result of this deferral, ASU 2014-09 is effective for our fiscal year ending September 30, 2019, including interim periods within that reporting period. In addition, FASB issued ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2017-14, to provide interpretive clarifications on the new guidance in Accounting Standards Codification ("ASC") Topic 606. We are currently working through an adoption plan and have identified our revenue streams and completed a preliminary analysis of how we currently account for revenue transactions compared to the revenue accounting required under the new standard. We intend to complete our adoption plan during the fourth quarter of fiscal 2018. This plan includes a review of transactions supporting each revenue stream to determine the impact of accounting treatment under ASC 606, evaluation of the method of adoption, and completing a rollout plan for implementation of the new standard with affected functions in our organization. Because of the nature of the work that remains, at this time we are unable to reasonably estimate the impact of adoption on our consolidated financial statements. We plan to adopt the new guidance beginning with our fiscal quarter ending December 31, 2018.

2. ACQUISITIONS

Acquisition of Accelerated Concepts, Inc.

On January 22, 2018, we purchased all the outstanding stock of Accelerated Concepts, Inc. ("Accelerated"), a Tampa-based provider of secure, enterprise-grade, cellular (LTE) networking equipment for primary and backup connectivity applications. This acquisition is included with our IoT Products and Services segment.

The terms of the acquisition include an upfront cash payment together with future earn-out payments. Cash of $16.8 million (excluding cash acquired of $0.3 million) was paid at the time of closing. The earn-out payments are scheduled to be paid in two installments and the payment amount, if any, will be calculated based on the revenue performance of Accelerated products. The first installment will be based on revenues from January 22, 2018 through January 21, 2019 (the "2018 period") and the second installment will be based on revenues from January 22, 2019 through January 21, 2020 (the "2019 period"). The cumulative amount of these earn-outs will be $4.5 million, if certain revenue thresholds are met. Additional payments, not to exceed $2.0 million for both installments, may also be due depending on revenue performance. The fair value of this contingent consideration was $2.3 million at the date of acquisition and $3.3 million at June 30, 2018 (see Note 7 to the

Table of Contents

2. ACQUISITIONS (CONTINUED)

Condensed Consolidated Financial Statements). We have determined that the fair value of the earn-out on the acquisition date will be considered as part of the purchase price consideration as there are no continuing employment requirements associated with the earn-out.

The purchase price was allocated to the estimated fair value of assets and liabilities assumed. The purchase price allocation resulted in the recognition of $5.9 million of goodwill. For tax purposes, this acquisition is treated as a stock acquisition, therefore the goodwill is not deductible. We believe this is a complementary acquisition for us as it significantly enhances our existing cellular product lines and immediately extends our market reach with a line of commercial routers and network appliance products. This acquisition will further enhance and expand the capabilities of the IoT Products and Services segment (see Note 9 to our Condensed Consolidated Financial Statements).

The Accelerated acquisition has been accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed pursuant to the purchase agreement be recognized at fair value as of the acquisition date.

The following table summarizes the preliminary values of Accelerated assets acquired and liabilities assumed as of the acquisition date (in thousands):

Cash	$16,759
Fair value of contingent consideration on acquired business	2,300
Total purchase price consideration	$19,059
Fair value of net tangible assets acquired	$826
Fair value of identifiable intangible assets acquired:	
Customer relationships	6,500
Purchased and core technology	3,000
Trade name and trademarks	1,000
Order backlog	1,800
Goodwill	5,933
Total	$19,059

Operating results for Accelerated after January 22, 2018 are included in our Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheet as of June 30, 2018 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The net working capital values are preliminary and we expect to finalize them in the fourth quarter of fiscal 2018.

The weighted average useful life for all the identifiable intangibles listed above is 5.5 years. For purposes of determining fair value, the purchased and core technology identified above is assumed to have a useful life of five years, the customer relationships are assumed to have useful lives of seven years, the trade name and trademarks are assumed to have useful lives of five years and the order backlog is assumed to have a useful life of one year. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which we expect to derive benefits from the identifiable intangible assets.

The amounts of revenue and net income included in the Condensed Consolidated Statements of Operations from the acquisition date of January 22, 2018 were $14.2 million and $1.8 million, respectively. Costs directly related to the acquisition of $0.3 million incurred in the first nine months of fiscal 2018 have been charged directly to operations and are included in general and administrative expense in our Condensed Consolidated Statements of Operations. These acquisition costs include legal, accounting and valuation fees.

Acquisition of TempAlert LLC

On October 20, 2017, we purchased all the outstanding interests of TempAlert LLC (“TempAlert”), a Boston-based provider of automated, real-time temperature monitoring and task management solutions. The purchase price was $45.0 million in cash adjusted for certain net working capital adjustments. We believe this is a complementary acquisition for us as the acquired

7

Table of Contents

2. ACQUISITIONS (CONTINUED)

technology will continue to be supported to further enhance and expand the capabilities of the IoT Solutions segment (see Note 9 to our Condensed Consolidated Financial Statements).

The terms of the acquisition included an upfront cash payment together with future earn-out payments. Cash of $40.7 million (excluding cash acquired of $0.6 million) was paid at the time of closing. The earn-out payments are scheduled to be paid after December 31, 2018 and December 31, 2019 which is the end of the earn-out periods. The cumulative amount of these earn-outs for the periods ended December 31, 2018 and 2019, will not exceed $35.0 million and $45.0 million, respectively. The fair value of this contingent consideration was zero at the date of acquisition and at June 30, 2018 (see Note 7 to the Condensed Consolidated Financial Statements).

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in the recognition of $17.6 million of goodwill. For tax purposes, this acquisition is treated as an asset acquisition, therefore the goodwill is deductible. We believe that the acquisition resulted in the recognition of goodwill because this is a complementary acquisition for us and will provide a source of recurring revenue in a new vertically focused solutions business.

The TempAlert acquisition has been accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed pursuant to the purchase agreement be recognized at fair value as of the acquisition date.

The following table summarizes the preliminary values of TempAlert assets acquired and liabilities assumed as of the acquisition date (in thousands):

Cash	$40,741
Fair value of contingent consideration on acquired business	—
Total purchase price consideration	$40,741
Fair value of net tangible assets acquired	$(1,111)
Fair value of identifiable intangible assets acquired:	
Customer relationships	18,300
Purchased and core technology	4,000
Trade name and trademarks	2,000
Goodwill	17,552
Total	$40,741

Operating results for TempAlert after October 20, 2017 are included in our Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheet as of June 30, 2018 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The net working capital values are preliminary and we expect to finalize them in the fourth fiscal quarter of 2018.

The weighted average useful life for all the identifiable intangibles listed above is 6.5 years. For purposes of determining fair value, the purchased and core technology identified above is assumed to have a useful life of five years, the customer relationships are assumed to have useful lives of seven years and the trade name and trademarks are assumed to have useful lives of five years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which we expect to derive benefits from the identifiable intangible assets.

The amount of revenue included in the Condensed Consolidated Statements of Operations from the acquisition date of October 20, 2017 was $11.4 million. Costs directly related to the acquisition of $1.4 million incurred in the first nine months of fiscal 2018 and $0.4 million incurred in fiscal 2017 have been charged directly to operations and are included in general and administrative expense in our Condensed Consolidated Statements of Operations. These acquisition costs include legal, accounting, valuation and success fees.

Table of Contents

2. ACQUISITIONS (CONTINUED)

Pro Forma Financial Information

The following consolidated pro forma information is as if the Accelerated and TempAlert acquisitions had occurred on October 1, 2016 (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Revenue	$62,716	$52,309	$168,127	$157,658
Net income (loss)	$2,622	$670	$(2,294)	$(1,172)

Pro forma net loss was adjusted to exclude interest expense related to debt that was paid off prior to acquisition, interest income related to promissory note that was settled prior to acquisition, adjust amortization to the fair value of the intangibles acquired and remove any costs associated with the sale transaction.

3. SALE OF BUSINESS

On October 23, 2015, we sold all the outstanding stock of our wholly owned subsidiary, Etherios Inc. ("Etherios") to West Monroe Partners, LLC. We sold Etherios as part of a strategy to focus on providing highly reliable machine connectivity solutions for business and mission-critical application environments. Etherios was included in our single operating segment prior to fiscal 2017.

The terms of the sale agreement provided that West Monroe Partners, LLC would pay us $3.0 million on October 23, 2016 and $2.0 million on October 23, 2017. The present value of these amounts was included within the total fair value of consideration received. These receivable amounts were unsecured and non-interest bearing. We received $3.0 million in October 2016 and $2.0 million in October 2017.

4. EARNINGS PER SHARE

Basic net income (loss) 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 shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares result from dilutive common stock options and restricted stock units. Diluted net loss per common share is computed by dividing net loss by the weighted average number of common shares. All potentially dilutive common equivalent shares are excluded from the calculations of net loss per diluted share due to their anti-dilutive effect for the nine month period ended June 30, 2018.

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

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss)	$2,621	$1,335	$(2,305)	$5,023
Denominator:				
Denominator for basic net income (loss) per common share — weighted average shares outstanding	27,177	26,522	27,002	26,390
Effect of dilutive securities:				
Stock options and restricted stock units	587	434	—	720
Denominator for diluted net income (loss) per common share — adjusted weighted average shares	27,764	26,956	27,002	27,110
Net income (loss) per common share, basic	$0.10	$0.05	$(0.09)	$0.19
Net income (loss) per common share, diluted	$0.09	$0.05	$(0.09)	$0.19

9

Table of Contents

4. EARNINGS PER SHARE (CONTINUED)

For the three months ended June 30, 2018 and 2017, there were 770,178 and 1,910,081 potentially dilutive shares, respectively, and for the nine months ended June 30, 2018 and 2017, there were 977,828 and 1,169,422 potentially dilutive shares, respectively, related to stock options to purchase common shares that were not included in the above computation of diluted earnings per common share. This is because the options' exercise prices were greater than the average market price of our common shares. In addition, due to the net loss for the nine month period ended June 30, 2018, there were 440,002 common stock options and restricted stock units, respectively, that were not included in the above computation of diluted earnings per share.

5. SELECTED BALANCE SHEET DATA

The following table shows selected balance sheet data (in thousands):

	June 30, 2018	September 30, 2017
Accounts receivable, net:		
Accounts receivable	$51,241	$ 31,365
Less allowance for doubtful accounts	563	341
Less reserve for future returns and pricing adjustments	2,432	2,169
Accounts receivable, net	$48,246	$ 28,855
Inventories:		
Raw materials	$25,734	$ 24,050
Work in process	375	484
Finished goods	15,673	5,704
Inventories	$41,782	$ 30,238

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

6. MARKETABLE SECURITIES

Our marketable securities may consist of certificates of deposit, commercial paper, corporate bonds and government municipal bonds. We analyze our available-for-sale marketable securities for impairment on an ongoing basis. When we perform this analysis, we 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. We also consider whether an unrealized loss is a temporary loss or an other-than-temporary loss based on factors such as: (a) whether we have the intent to sell the security, (b) whether it is more likely than not that we will be required to sell the security before its anticipated recovery, or (c) permanent impairment due to bankruptcy or insolvency.

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. We obtain relevant information from our investment advisor and, if warranted, also may review the financial solvency of certain security issuers. As of June 30, 2018, 28 of our 28 securities that we held 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 consolidated balance sheet with the unrealized gains and losses recorded in accumulated other comprehensive income (loss). All of our current marketable securities will mature in less than one year and our non-current marketable securities will mature in less than two years. Our balance sheet classification of available for sale securities is based on our best estimate of when we expect to liquidate such investments and, presently, is consistent with the stated maturity dates of such investments. However, we are not committed to holding these investments until their maturity and may determine to liquidate some or all of these investments earlier based on our liquidity and other needs. During the nine months ended June 30, 2018 and 2017, we received proceeds from our available-for-sale marketable securities of $29.8 million and $76.1 million, respectively.

10

Table of Contents

6. MARKETABLE SECURITIES (CONTINUED)

At June 30, 2018 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Certificates of deposit	$ 4,773	$ —	$ (10)	$4,763
Non-current marketable securities:				
Certificates of deposit	2,262	—	(19)	2,243
Total marketable securities	$ 7,035	$ —	$ (29)	$7,006

(1) Included in amortized cost and fair value is purchased and accrued interest of $35.

At September 30, 2017 our marketable securities were (in thousands):

	Amortized Cost (1)	Unrealized Gains	Unrealized Losses	Fair Value (1)
Current marketable securities:				
Corporate bonds	$ 28,275	$ —	$ (20)	$28,255
Certificates of deposit	3,756	4	—	3,760
Current marketable securities	32,031	4	(20)	32,015
Non-current marketable securities:				
Certificates of deposit	4,757	—	(4)	4,753
Total marketable securities	$ 36,788	$ 4	$ (24)	$36,768

(1) Included in amortized cost and fair value is purchased and accrued interest of $211.

The following tables show the fair values and gross unrealized losses of our available-for-sale marketable securities that have been in a continuous unrealized loss position deemed to be temporary, aggregated by investment category (in thousands):

	June 30, 2018			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Certificates of deposit	6,755	(29)	—	—
Total	$6,755	$ (29)	$ —	$ —

	September 30, 2017			
	Less than 12 Months		More than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$26,196	$ (20)	$ —	$ —
Certificates of deposit	3,751	(4)	—	—
Total	$29,947	$ (24)	$ —	$ —

7. FAIR VALUE MEASUREMENTS

Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. This standard also establishes a hierarchy for inputs used in measuring fair value. This standard maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the factors market participants would use in valuing the asset or liability based upon the best information available in the circumstances.

Table of Contents

7. FAIR VALUE MEASUREMENTS (CONTINUED)

The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The hierarchy is broken down into three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable for the asset or liability and their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 may also include certain investment securities for which there is limited market activity or a decrease in the observability of market pricing for the investments, such that the determination of fair value requires significant judgment or estimation.

Fair value is applied to financial assets such as our marketable securities, which are classified and accounted for as available-for-sale and to financial liabilities for contingent consideration. These items are stated at fair value at each reporting period using the above guidance. The following tables provide information by level for financial assets and liabilities that are measured at fair value on a recurring basis (in thousands):

	Total Fair Value at June 30, 2018	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets:				
Money market	$9,954	$9,954	$—	$—
Certificates of deposit	7,006	—	7,006	—
Total assets measured at fair value	$16,960	$9,954	$7,006	$—
Liabilities:				
Contingent consideration on acquired businesses	$9,021	$—	$—	$9,021
Total liabilities measured at fair value	$9,021	$—	$—	$9,021

	Total Fair Value at September 30, 2017	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
Assets:				
Money market	$ 39,524	$39,524	$—	$—
Corporate bonds	28,255	—	28,255	—
Certificates of deposit	8,513	—	8,513	—
Total assets measured at fair value	$ 76,292	$39,524	$36,768	$—
Liabilities:				
Contingent consideration on acquired businesses	$ 6,388	$—	$—	$6,388
Total liabilities measured at fair value	$ 6,388	$—	$—	$6,388

Our money market funds, which have been determined to be cash equivalents, are measured at fair value using quoted market prices in active markets for identical assets and are therefore classified as Level 1 assets. We value our Level 2 assets using inputs that are based on market indices of similar assets within an active market. There were no transfers into or out of our Level 2 financial assets during the nine months ended June 30, 2018.

The use of different assumptions, applying different judgment to matters that inherently are subjective and changes in future market conditions could result in different estimates of fair value of our securities or contingent consideration, currently and in the future. If market conditions deteriorate, we may incur impairment charges for securities in our investment portfolio. We may also incur changes to our contingent consideration liability as discussed below.

We are required to make contingent payments for our acquisitions. In connection with the October 2015 acquisition of Bluenica Corporation ("Bluenica"), we are required to make contingent payments over a period of up to four years, subject to achieving specified revenue thresholds for sales of Bluenica products. The fair value of the liability for contingent payments recognized upon acquisition was $10.4 million and was $5.5 million at June 30, 2018. We paid $0.5 million for the period ended September 30, 2016 and zero for the period ended September 30, 2017.

Table of Contents

7. FAIR VALUE MEASUREMENTS (CONTINUED)

In connection with the November 2016 acquisition of FreshTemp, LLC ("FreshTemp"), we are required to make a contingent payment after June 30, 2018, for revenue related to specific customer contracts signed by June 30, 2017. The fair value of the liability recognized upon acquisition was $1.3 million and was $0.2 million at June 30, 2018.

For the January 2017 acquisition of SMART Temps LLC ("SMART Temps"), we were required to make a contingent payment after December 31, 2017 based on achieving specified revenue thresholds. Since the revenue threshold was not met, no payment was made. The fair value of the liability for contingent payments recognized upon acquisition of SMART Temps was $10,000 and was zero at June 30, 2018.

For the TempAlert acquisition, we are required to make contingent payments for the twelve month periods ending December 31, 2018 and December 31, 2019 based on the total Digi IoT Solutions segment revenue. The fair value of the liability for contingent payments recognized upon acquisition of TempAlert and at June 30, 2018 was zero.

For the Accelerated acquisition, we are required to make contingent payments for the twelve month periods ending January 21, 2019 and January 21, 2020, based upon certain thresholds. The fair values of the liability for contingent payments recognized upon acquisition of Accelerated and at June 30, 2018 was $2.3 million and was $3.3 million, respectively. As of June 30, 2018, the fair value of the liability for contingent payments increased $1.0 million as Accelerated is currently outperforming initial revenue expectations.

The fair value of these contingent payments was estimated by discounting to present value the probability-weighted contingent payments expected to be made. Assumptions used in these calculations include the discount rate and various probability factors. This liability is considered to be a Level 3 financial liability that is re-measured each reporting period as a charge or credit to general and administrative expense within the Condensed Consolidated Statements of Operations.

The following table presents a reconciliation of the contingent consideration liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Fair value at beginning of period	$8,263	$10,068	$6,388	$9,960
Purchase price contingent consideration	—	—	2,300	1,310
Contingent consideration payments	—	—	—	(518)
Change in fair value of contingent consideration	758	(646)	333	(1,330)
Fair value at end of period	$9,021	$9,422	$9,021	$9,422

The change in fair value of contingent consideration relates to the acquisitions of Bluenica, FreshTemp and Accelerated and is included in general and administrative expense. The change in fair value of contingent consideration reflects our estimate of the probability of achieving the relevant targets and is discounted based on our estimated discount rate. We have estimated the fair value of the contingent consideration based on the probability of achieving the specified revenue thresholds at 93.5% to 98.5% for Bluenica, 100% for FreshTemp, 0% for both SMART Temp and TempAlert, and 34.0% to 70.0% for Accelerated. A significant change in our estimates of achieving the relevant targets could materially change the fair value of the contingent consideration liability.

Table of Contents

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS, NET

Amortizable identifiable intangible assets were (in thousands):

	June 30, 2018			September 30, 2017		
	Gross carrying amount	Accum. amort.	Net	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$58,048	$(47,983)	$10,065	$51,292	$(46,304)	$4,988
License agreements	102	(39)	63	18	(17)	1
Patents and trademarks	15,612	(11,965)	3,647	12,484	(11,280)	1,204
Customer relationships	46,569	(19,886)	26,683	21,914	(16,817)	5,097
Non-compete agreements	600	(180)	420	600	(90)	510
Order backlog	1,800	(900)	900	—	—	—
Total	$122,731	$(80,953)	$41,778	$86,308	$(74,508)	$11,800

Amortization expense was $2.6 million and $0.9 million for the three month periods ended June 30, 2018 and 2017, respectively, and $6.9 million and $1.8 million for the nine month periods ended June 30, 2018 and 2017, respectively. Amortization expense is recorded on our consolidated statements of operations within cost of sales and in general and administrative expense.

Estimated amortization expense related to identifiable intangible assets for the remainder of fiscal 2018 and the five succeeding fiscal years is (in thousands):

2018 (three months)	$2,466
2019	8,356
2020	7,592
2021	7,126
2022	6,754
2023	4,751

The changes in the carrying amount of goodwill are (in thousands):

	Nine months ended June 30,	
	2018	2017
Beginning balance, October 1	$131,995	$109,448
Acquisitions	23,485	21,206
Foreign currency translation adjustment	(915)	(733)
Ending balance, June 30	$154,565	$129,921

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. The calculation of goodwill impairment requires us to make assumptions about the fair value of our reporting unit(s), which historically has been approximated by using our market capitalization plus a control premium for our reporting unit(s). Control premium assumptions require judgment and actual results may differ from assumed or estimated amounts.

We have two reportable operating segments, our IoT Solutions segment and our IoT Products & Services segment (see Note 9 to the Condensed Consolidated Financial Statements). As a result, we concluded that the IoT Solutions segment and the IoT Products & Services segment constitute separate reporting units for purposes of the ASC 350-20-35 "Goodwill Measurement of Impairment" assessment and both units were tested individually for impairment. Our test for potential goodwill impairment is a two-step approach. First, we estimate the fair values for each reporting unit by comparing the fair value to the carrying value. If the carrying value of the reporting unit exceeds its estimated fair value, then we conduct the second step, which requires us to measure the amount of the impairment loss. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to its carrying amount. To calculate the implied fair value of goodwill, the fair value of the reporting unit's assets and liabilities, excluding goodwill, is estimated. The excess of the fair

14

Table of Contents

8. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS, NET (CONTINUED)

value of the reporting unit over the amount assigned to its assets and liabilities, excluding goodwill, is the implied fair value of the reporting unit's goodwill.

At June 30, 2018, we had a total of $104.6 million of goodwill on our Condensed Consolidated Balance Sheet for the IoT Products & Services reporting unit and the implied fair value of this reporting unit exceeded its carrying value by approximately 36%. At June 30, 2018, we had a total of $50.0 million of goodwill on our Condensed Consolidated Balance Sheet for the Solutions reporting unit and the implied fair value of this reporting unit exceeded its carrying value by approximately 7%. Based on that data, we concluded that no impairment was indicated for either reporting unit and we were not required to complete the second step of the goodwill impairment analysis. No goodwill impairment charges were recorded.

Implied fair values for both reporting units were each calculated on a standalone basis using a weighted combination of the income approach and market approach.

The income approach indicates the fair value of a business based on the value of the cash flows the business or asset can be expected to generate in the future. A commonly used variation of the income approach used to value a business is the discounted cash flow ("DCF") method. The DCF method is a valuation technique in which the value of a business is estimated on the earnings capacity, or available cash flow, of that business. Earnings capacity represents the earnings available for distribution to stockholders after consideration of the reinvestment required for future growth. Significant judgment is required to estimate the amount and timing of future cash flows for each reporting unit and the relative risk of achieving those cash flows.

The market approach indicates the fair value of a business or asset based on a comparison of the business or asset to comparable publicly traded companies or assets and transactions in its industry as well as prior company or asset transactions. This approach can be estimated through the guideline company method. This method indicates fair value of a business by comparing it to publicly traded companies in similar lines of business. After identifying and selecting the guideline companies, we make judgments about the comparability of the companies based on size, growth rates, profitability, risk, and return on investment in order to estimate market multiples. These multiples are then applied to the reporting units to estimate a fair value.

The implied fair values of each reporting unit were added together to get an indicated value of total equity to which a range of indicated value of total equity was derived. This range was compared to the total market capitalization of $359.6 million as of June 30, 2018, which implied a range of control premiums of 5.7% to 16.4%. This range of control premiums fell below the control premiums observed in the last five years in the communications equipment industry. As a result, the market capitalization reconciliation analysis proved support for the reasonableness of the fair values estimated for each individual reporting unit.

Should the facts and circumstances surrounding our assumptions change, the first step of our goodwill impairment analysis may fail. Assumptions and estimates to determine fair values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. For example, if our future operating results do not meet current forecasts or if we experience a sustained decline in our market capitalization that is determined to be indicative of a reduction in fair value of one or more of our reporting units, we may be required to record future impairment charges for goodwill. An impairment could have a material effect on our consolidated balance sheet and results of operations. We have had no goodwill impairment losses since the adoption of ASC 350, Intangibles-Goodwill and Others, in fiscal 2003.

9. SEGMENT INFORMATION

We have two reportable operating segments for purposes of ASC 280-10-50 "Segment Reporting": (1) IoT Products & Services (formerly M2M), and (2) IoT Solutions (formerly Solutions). Our segments are described below:

IoT Products & Services

Our IoT Products & Services segment is composed of the following communications products and development services and includes our recent acquisition of Accelerated:

- Cellular routers and gateways;

- Radio frequency (RF) which include our XBee® modules as well as other RF solutions;
- Embedded products include Digi Connect® and Rabbit® embedded systems on module and single board computers;

15

Table of Contents

9. SEGMENT INFORMATION (CONTINUED)

- Network products, which has the highest concentration of mature products, including console and serial servers and USB connected products;
- Digi Wireless Design Services;
- Digi Remote Manager®; and
- Support services which offers various levels of technical services for development assistance, consulting and training.

IoT Solutions

We have formed the IoT Solutions segment primarily through four acquisitions: the October 2015 acquisition of Bluenica, the November 2016 acquisition of FreshTemp, the January 2017 acquisition of SMART Temps and the October 2017 acquisition of TempAlert. Our IoT 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 SmartSense by Digi™, formerly Digi Smart Solutions™.

We measure our segment results primarily by reference to revenue and operating income. IoT Solutions revenue includes both product and service revenue. Certain costs incurred at the corporate level are allocated to our segments. These costs include information technology, employee benefits and shared facility services. The information technology and shared facility costs are allocated based on headcount and the employee benefits costs are allocated based on compensation costs.

Summary operating results for each of our segments were as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Revenue				
IoT Products & Services	$54,406	$42,844	$145,111	$131,653
IoT Solutions	8,310	2,895	17,593	4,876
Total revenue	$62,716	$45,739	$162,704	$136,529
Operating income				
IoT Products & Services	$4,544	$1,841	$10,497	$7,638
IoT Solutions	(2,507)	(1,132)	(10,080)	(2,995)
Total operating income	$2,037	$709	$417	$4,643
Depreciation and amortization				
IoT Products & Services	$1,754	$904	$4,332	$2,704
IoT Solutions	1,559	735	4,674	1,325
Total depreciation and amortization	$3,313	$1,639	$9,006	$4,029

Total expended for property, plant and equipment was as follows (in thousand):

	Nine months ended June 30,	
	2018	2017
Expended for property, plant and equipment		
IoT Products & Services	$963	$1,545
IoT Solutions	—	32
Total expended for property, plant and equipment	$963	$1,577

Table of Contents

9. SEGMENT INFORMATION (CONTINUED)

Total assets for each of our segments were as follows (in thousands):

	June 30, 2018	September 30, 2017
Assets		
IoT Products & Services	$210,118	$ 182,555
IoT Solutions	95,408	47,644
Unallocated*	54,700	114,990
Total assets	$360,226	$ 345,189

*Unallocated consists of cash and cash equivalents, current marketable securities and long-term marketable securities.

Total goodwill for each of our segments were as follows (in thousands):

	June 30, 2018	September 30, 2017
Goodwill		
IoT Products & Services	$104,584	$ 98,981
IoT Solutions	49,981	33,014
Total goodwill	$154,565	$ 131,995

10. INCOME TAXES

Income tax provision was $3.0 million for the nine months ended June 30, 2018. Net tax expense discretely related to the nine months ended June 30, 2018 was $3.0 million, primarily as a result of new U.S. tax legislation that was enacted during the first quarter of fiscal 2018 and the adoption of ASU 2016-09 related to the accounting for the tax effects of stock compensation.

The Tax Cuts and Jobs Act of 2017 (the “Act”) was enacted on December 22, 2017. The Act lowered the U.S. federal corporate tax rate from 35% to 21% as of January 1, 2018 and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. Due to our fiscal year end, our statutory rate for fiscal 2018 will be a blend of the new and old tax rates. At June 30, 2018 we had not fully completed our accounting for the tax effects of enactment of the Act; however, in certain cases, as described below, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. For the items for which we were able to determine a reasonable estimate, we recognized a provisional income tax expense amount of $2.7 million which is included as a component of income tax expense.

We remeasured U.S. deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which requires estimates of our changes in deferred tax assets and liabilities before and after the new statutory rate was enacted. As a result, we are still analyzing certain aspects of the legislation and refining our calculations such as, refining current year estimates and filings of tax returns, of which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. As of June 30, 2018, the provisional amount recorded related to the re-measurement of this deferred tax balance was $2.7 million.

In addition, we considered the potential tax expense impacts of the one-time transition tax. The transition tax is based on our total post-1986 earnings and profits (“E&P”) that we previously deferred from U.S. income taxes. We recorded a provisional amount for our one-time transition tax liability for our foreign subsidiaries, resulting in an increase in income tax expense of $0.1 million for the nine months ended June 30, 2018. We have not yet completed the calculation of the post-1986 E&P for these foreign subsidiaries and, further, this transition tax is based in part on the amount of those earnings held in cash and other specified assets. This amount may change when we finalize the calculation of post-1986 foreign E&P previously deferred from U.S. federal taxation, evaluate the testing periods for cash and E&P measurement and finalize substantiation of material foreign taxes paid or accrued. Furthermore, it is expected that further guidance will be forthcoming from U.S. Treasury which may or may not impact the final transition tax required. We continue to review the outside basis differential of our foreign investments. At this point, no additional income taxes have been provided for any undistributed foreign earnings not subject to the transition tax and additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations. Determining the amount of unrecognized deferred tax liability related to any remaining undistributed foreign earnings not subject to the transition tax and additional outside basis difference in these entities (i.e., basis difference in excess of that subject to the one-time transition tax) is not practical at this time, but it is expected that with

17

Table of Contents

10. INCOME TAXES (CONTINUED)
inclusion of the transition tax, the potential outstanding basis difference as of June 30, 2018 is expected to be a deductible temporary difference for which no deferred tax asset would be allowed.
We adopted ASU 2016-09 "Improvements to Employee Share-Based Payment Accounting" on October 1, 2017. As a result of the adoption, we recorded $0.7 million of excess tax expense related to our share-based payments in our provision for income taxes for the nine months ended June 30, 2018. Historically, this was record in additional paid-in capital. The excess tax expense related to share-based payments are recognized as tax expense discretely related to the nine months ended June 30, 2018.
For the nine months ended June 30, 2018, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate due primarily to the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and also due to certain income tax credits generated in the U.S.
Income tax provision was $0.2 million for the nine months ended June 30, 2017. Net tax benefits discretely related to the nine months ended June 30, 2017 were $0.8 million resulting primarily from the reversal of tax reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions. For the nine months ended June 30, 2017, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate primarily due to the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and certain tax credits in the U.S.
Our effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and tax items discretely related to the period, such as settlements of audits. We expect that we may record other benefits or expenses in the future that are specific to a particular quarter such as expiration of statutes of limitation, the completion of tax audits, or legislation that is enacted for both U.S. and foreign jurisdictions.
A reconciliation of the beginning and ending amount of unrecognized tax benefits is (in thousands):

Unrecognized tax benefits as of September 30, 2017	$1,335
Decreases related to:	
Expiration of statute of limitations	(121)
Unrecognized tax benefits as of June 30, 2018	$1,214

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is $1.0 million, after considering the impact of interest and deferred benefit items. We expect that the total amount of unrecognized tax benefits will decrease minimally over the next 12 months.

Table of Contents

11. PRODUCT WARRANTY OBLIGATION

In general, we warrant our products to be free from defects in material and workmanship under normal use and service. The warranty periods generally range from one to five years. We typically have the option to either repair or replace products we deem defective with regard to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidents and are evaluated on an ongoing basis to ensure the adequacy of the warranty accrual.

The following table summarizes the activity associated with the product warranty accrual (in thousands) and is included on our Condensed Consolidated Balance Sheets within current liabilities:

Period	Balance at April 1	Warranties issued	Settlements made	Balance at June 30
Three months ended June 30, 2018	$ 1,348	$ 82	$ (135)	$ 1,295
Three months ended June 30, 2017	$ 892	$ 248	$ (165)	$ 975

Period	Balance at October 1	Warranties issued	Settlements made	Balance at June 30
Nine months ended June 30, 2018	$ 987	$ 798	$ (490)	$ 1,295
Nine months ended June 30, 2017	$ 1,033	$ 479	$ (537)	$ 975

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

12. CONTINGENCIES

In the normal course of business, we are subject to various claims and litigation. There can be no assurance that any claims by third parties, if proven to have merit, will not materially adversely affect our business, liquidity or financial condition.

13. STOCK-BASED COMPENSATION

Stock-based awards were granted under the 2018 Omnibus Incentive Plan (the “2018 Plan”) beginning January 29, 2018 and, prior to that, were granted under the 2017 Omnibus Incentive Plan (the “2017 Plan”). Upon stockholder approval of the 2018 Plan, we ceased granting awards under any prior plan. Shares subject to awards under prior plans that are forfeited, canceled, returned to the Company for failure to satisfy vesting requirements, settled in cash or otherwise terminated without payment also will be available for grant under the 2018 Plan. The authority to grant options under the 2018 Plan and to set other terms and conditions rests with the Compensation Committee of the Board of Directors. The 2018 Plan authorizes the issuance of up to 1,500,000 common shares in connection with awards of stock options, stock appreciation rights, restricted stock, restricted stock units, performance-based full value awards or other stock-based awards. Eligible participants include our employees, our affiliates, non-employee directors of our Company and any consultant or advisor who is a natural person and provides services to us or our affiliates. Options that have been granted under the 2018 Plan typically vest over a four-year period and will expire if unexercised after seven years from the date of grant. Restricted stock unit awards (“RSUs”) that have been granted to directors typically vest in one year. RSUs that have been granted to executives and employees typically vest in January over a four-year period. Awards may be granted under the 2018 Plan until January 28, 2028. Options under the 2018 Plan can be granted as either incentive stock options (“ISOs”) or non-statutory stock options (“NSOs”). The exercise price of options and the grant date price of restricted stock units shall be determined by our Compensation Committee but shall not be less than the fair market value of our common stock based on the closing price on the date of grant. Upon exercise, we issue new shares of stock. As of June 30, 2018, there were approximately 1,473,215 shares available for future grants under the 2018 Plan.

Our equity plans and corresponding forms of award agreements generally have provisions allowing employees to elect to satisfy tax withholding obligations through the delivery of shares, having us retain a portion of shares issuable under the award or paying cash to us for the withholding. During the nine months ended June 30, 2018 and 2017, our employees forfeited

Table of Contents

13. STOCK-BASED COMPENSATION (CONTINUED)

72,918 shares and 48,076 shares, respectively in order to satisfy $0.7 million and $0.6 million, respectively of withholding tax obligations related to stock-based compensation, pursuant to terms of awards under our board and shareholder-approved compensation plans for each respective period.

Cash received from the exercise of stock options was $3.9 million and $3.3 million during the nine months ended June 30, 2018 and 2017, respectively.

We sponsor an Employee Stock Purchase Plan (the "Purchase Plan"), covering all domestic employees with at least 90 days of continuous service and who are customarily employed at least 20 hours per week. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Employee contributions to the Purchase Plan were $0.9 million and $0.7 million during both nine month periods ended June 30, 2018 and 2017. Pursuant to the Purchase Plan, 105,732 and 72,594 common shares were issued to employees during the nine months ended June 30, 2018 and 2017, respectively. Shares are issued under the Purchase Plan from treasury stock. As of June 30, 2018, 335,290 common shares were available for future issuances under the Purchase Plan.

Stock-based compensation expense is included in the consolidated results of operations as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Cost of sales	$49	$52	$145	$168
Sales and marketing	406	348	1,131	1,033
Research and development	168	160	343	497
General and administrative	597	614	1,979	1,804
Stock-based compensation before income taxes	1,220	1,174	3,598	3,502
Income tax benefit	(249)	(383)	(747)	(1,140)
Stock-based compensation after income taxes	$971	$791	$2,851	$2,362

Stock-based compensation cost capitalized as part of inventory was immaterial as of June 30, 2018 and September 30, 2017.

Stock Options

The following table summarizes our stock option activity (in thousands, except per common share amounts):

	Options Outstanding	Weighted Average Exercised Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at September 30, 2017	3,902	$10.54		
Granted	711	10.37		
Exercised	(435)	8.90		
Forfeited / Canceled	(604)	12.65		
Balance at June 30, 2018	3,574	$10.35	4.3	$ 10,318
Exercisable at June 30, 2018	2,350	$10.06	3.4	$ 7,455

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value, based on our closing stock price of $13.20 as of June 30, 2018, which would have been received by the option holders had all option holders exercised their options as of that date. The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price.

The total intrinsic value of all options exercised during the nine months ended June 30, 2018 was $0.7 million and during the nine months ended June 30, 2017 was $0.9 million.

Table of Contents

13. STOCK-BASED COMPENSATION (CONTINUED)

The table below shows the weighted average fair value, which was determined based upon the fair value of each option on the grant date utilizing the Black-Scholes option-pricing model and the related assumptions:

	Nine months ended June 30,	
	2018	2017
Weighted average per option grant date fair value	$3.76	$4.64
Assumptions used for option grants:		
Risk free interest rate	2.12% - 2.88%	1.46% - 1.96%
Expected term	6.00 years	6.00 years
Expected volatility	33% - 34%	33% - 34%
Weighted average volatility	31%	34%
Expected dividend yield	0	0

Expected volatilities are based on the historical volatility of our stock. We use historical data to estimate option exercise and employee termination information within the valuation model. The expected term of options granted is derived from the vesting period and historical information and represents the period of time that options granted are expected to be outstanding. The risk-free rate used is the zero-coupon U.S. Treasury bond rate in effect at the time of the grant whose maturity equals the expected term of the option.

As of June 30, 2018, the total unrecognized compensation cost related to non-vested stock options was $4.3 million and the related weighted average period over which it is expected to be recognized is approximately 2.7 years.

Non-vested Restricted Stock Units

A summary of our non-vested restricted stock units as of June 30, 2018 and changes during the nine months then ended is presented below (in thousands, except per common share amounts):

	Number of Awards	Weighted Average Grant Date Fair Value
Nonvested at September 30, 2017	566	$ 11.28
Granted	360	$ 10.35
Vested	(203)	$ 11.02
Canceled	(90)	$ 11.11
Nonvested at June 30, 2018	633	$ 10.86

As of June 30, 2018, the total unrecognized compensation cost related to non-vested restricted stock units was $5.4 million, and the related weighted average period over which it is expected to be recognized is approximately 1.4 years.

14. RESTRUCTURING

Below is a summary of the restructuring charges and other activity (in thousands) all within our IoT Products and Services segment:

	Manufacturing Transition Employee Termination Costs	2017 Restructuring Employee Termination Costs	Other	Total
Balance at September 30, 2017	$ —	$1,528	$128	$1,656
Restructuring charge	190	—	—	190
Payments	(105)	(971)	(146)	(1,222)
Foreign currency fluctuation	—	38	4	42
Balance at June 30, 2018	$ 85	$595	$(14)	$666

21

Table of Contents

14. RESTRUCTURING (CONTINUED)

Manufacturing Transition

As announced on April 3, 2018, Digi will transfer the manufacturing functions of its Eden Prairie, Minnesota operations facility to existing contract manufacture suppliers. As a result, approximately 53 positions in total have or will be eliminated, resulting in restructuring charges amounting to approximately $0.5 million related to employee costs during the third and fourth quarters of fiscal 2018. The payments associated with these charges are expected to be completed by December 31, 2018. This manufacturing transition is expected to result in total annualized savings of approximately $3.0 million to $5.0 million.

2017 Restructuring

In May 2017, we approved a restructuring plan primarily impacting our France location. We also eliminated certain employee costs in the U.S. The restructuring is a result of a decision to consolidate our France operations to our Europe, Middle East and Africa (“EMEA”) headquarters in Munich. The total restructuring charges amounted to $2.5 million that included $2.3 million of employee costs and $0.2 million of contract termination costs during the third quarter of fiscal 2017. These actions resulted in an elimination of 10 positions in the U.S. and 8 positions in France. The payments associated with these charges are expected to be completed by the end of the fourth quarter ending September 30, 2018.

15. COMMON STOCK REPURCHASE

On April 24, 2018 our Board of Directors authorized a new program to repurchase up to $20.0 million of our common stock primarily to return capital to shareholders. This repurchase authorization began on May 23, 2018 and expires on November 23, 2018. Shares repurchased under the new program may 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. There were no shares repurchased under this program.

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 expired on May 1, 2018. Shares repurchased under the program could be made through open market and privately negotiated transactions from time to time and in amounts that management deemed appropriate. The amount and timing of share repurchases depended upon market conditions and other corporate considerations. During the third quarter of fiscal 2017, we began to repurchase our common stock on the open market. During the third quarter of fiscal 2017, we repurchased 28,691 shares for $0.3 million. No further repurchases of common stock were made under this program.

16. SUBSEQUENT EVENTS

On September 7, 2017, we signed a purchase agreement for the sale of our corporate headquarters in Minnetonka, Minnesota to Minnetonka Leased Housing Associates II, LLLP for $10.0 million. The agreement had several contingencies, one of which was dependent upon government and financing approvals. Subsequent to the end of the third fiscal quarter of 2018, the final contingency was satisfied on July 23, 2018 at which time we moved the net book value of the land, building and related leasehold improvements as held-for-sale. The sale of our corporate building is part of our ongoing plan to relocate our corporate headquarters in the Minneapolis area. We expect to close on this transaction by October 2018.

Table of Contents

ITEM 2. 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 Annual Report on Form 10-K for the fiscal year ended September 30, 2017, as well as our subsequent reports on Form 8-K and any amendments thereto.

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

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

Forward-Looking Statements

The words "anticipate," "assume," "believe," "continue," "estimate," "expect," "intend," "may," "plan," "should," or "will" or thereof or other variations thereon or similar terminology, 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 we operate, estimated future values and 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 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 operations and 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, our Annual Report on Form 10-K for the year ended September 30, 2017, and subsequent quarterly reports on Form 10-Q and other filings, could cause the company's 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 Adjusted EBITDA, which is a non-GAAP measure. We understand that there are material limitations on the use of non-GAAP measures. Non-GAAP measures are not substitutes for GAAP measures, such as net (loss) 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 measures are not prepared in accordance with, or as an alternative for measures prepared in accordance with, generally accepted accounting principles and may be different from non-GAAP measures used by other companies or presented by us in prior reports. In addition, non-GAAP measures are not based on any comprehensive set of accounting rules or principles. We believe that non-GAAP 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 measures. Additionally, Adjusted EBITDA 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 Adjusted EBITDA 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. Adjusted EBITDA is used as an internal metric for executive compensation, as well as incentive compensation for the broader employee base, and it is monitored quarterly for these purposes.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, the disclosure of contingent assets and liabilities and the values of purchased assets and assumed liabilities in acquisitions. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

A description of our critical accounting policies and estimates was provided in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended September 30, 2017. There have been no material changes to our critical accounting policies as disclosed in that report, except for the stock-based compensation policy updated below.

Stock-Based Compensation

Stock-based compensation expense represents the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. This cost must be recognized over the period during which an employee is required to provide the service (usually the vesting period). Upon adoption of ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," we will now account for forfeitures as they occur. Previously, we applied an estimated forfeiture rate to awards granted.

OVERVIEW

We are a leading global provider of business and mission-critical Internet-of-Things ("IoT") products, services and solutions. We have two reportable operating segments for purposes of ASC 280-10-50 "Segments Reporting":

- IoT Products & Services (formerly "M2M") segment; and
- IoT Solutions (formerly "Solutions") segment.

Our IoT Products & Services segment consists primarily of distinct communications products and related services. Among other things, these products and services help our customers create next generation connected products to deploy and manage critical communications infrastructures with high levels of security and reliability. On the IoT Products side, we provide both embedded and end user devices that are used by customers to support their connected device strategies. On the IoT Services side, we provide embedded design, technical support, professional services and a software device management platform to support their IoT deployments. 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 product revenue is derived from products included in this segment. Products from our recent acquisition of Accelerated are included in this segment (see Note 2 to the Condensed Consolidated Financial Statements.) These products include our cellular routers and gateways, radio frequency ("RF"), embedded and network products. Our cellular product category includes our cellular routers and all 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 products.

Our IoT Solutions segment offers wireless temperature and other environmental condition monitoring services as well as employee task management services. These offerings are marketed as SmartSense by Digi™ and are provided to food service, transportation, education, healthcare/pharma, and industrial organizations. We have formed, expanded and enhanced the IoT Solutions segment through a series of acquisitions including 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”). 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.

Table of Contents

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

In April 2018, we announced that Digi Smart Solutions was transformed to create SmartSense by Digi™. As part of this transformation, the financial data for our four acquisitions are now blended together as we view these acquisitions as one SmartSense by Digi™ business.

For further detail on segment performance, see Segment Results of Operations section of the management discussion and analysis.

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.

On April 3, 2018, we announced that we will transfer the manufacturing functions of our Eden Prairie, Minnesota operations facility to existing contract manufacture suppliers. As a result, approximately 53 positions have or will be eliminated. This will result in restructuring charges of approximately $0.5 million related to employee costs during the third and fourth quarters of fiscal 2018. The payments associated with these charges are expected to be completed by December 31, 2018. This manufacturing transition is expected to result in total annualized savings of approximately $3.0 million to $5.0 million.

We utilize many financial, operational, and other metrics to evaluate our financial condition and financial performance. Below we highlight the metrics for the third quarter of fiscal 2018 that we feel are most important in these evaluations:

Total Revenue was $62.7 Million. Our revenue was $62.7 million for the third quarter of fiscal 2018 compared to $45.7 million in the third quarter of fiscal 2017, an increase of $17.0 million, or 37.1%.

Product revenue increased by $11.0 million, or 27.1%. This included $8.0 million of incremental revenue related to the January 2018 acquisition of Accelerated. In addition, we experienced increased sales of RF products and terminal servers. This revenue growth was partially offset by a decrease in certain network and embedded products which are in the mature phase of their product life cycle.

Services and solutions revenue increased by $5.9 million, or 117.1%, in the third quarter of fiscal 2018 compared to the same period a year ago. This primarily was driven by the growth of our SmartSense by Digi™ business of $5.4 million, which includes incremental revenue from the October 2017 acquisition of TempAlert. We are now servicing nearly 48,000 sites as of June 30, 2018, which is an increase from nearly 42,000 sites as of March 31, 2018.

Gross Margin was 46.8%. Our gross margin decreased as a percentage of revenue to 46.8% in the third quarter of fiscal 2018 as compared to 49.2% in the third quarter of fiscal 2017. Gross margin was negatively impacted by the manufacturing transition, product and customer mix in both segments and increased amortization expense, primarily related to our acquisitions.

Net income for the third fiscal quarter of 2018 was $2.6 million, or $0.09 per diluted share. Net income for the third fiscal quarter of 2017 was $1.3 million, or $0.05 per diluted share.

Adjusted EBITDA for the third fiscal quarter of 2018 was $7.3 Million, or 11.7% of total revenue. In the third fiscal quarter of fiscal 2017, Adjusted EBITDA was $5.6 million, or 12.3% of total revenue.

Table of Contents

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

Below is a reconciliation of net income to Adjusted EBITDA:

	Three months ended June 30,			
	2018		2017	
($ in thousands)		% of total revenue		% of total revenue
Total revenue	$62,716	100.0%	$45,739	100.0%
Net income	$2,621		$1,335	
Interest income, net	(92)		(153)	
Income tax provision	43		(694)	
Depreciation and amortization	3,313		1,639	
Stock-based compensation	1,220		1,174	
Restructuring charges, net	190		2,515	
Acquisition expense	13		(192)	
Adjusted EBITDA	$7,308	11.7 %	$5,624	12.3 %

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from our interim condensed consolidated statements of operations:

	Three months ended June 30,				% incr.	Nine months ended June 30,				% incr.
($ in thousands)	2018		2017		(decr.)	2018		2017		(decr.)
Revenue:										
Product	$51,691	82.4 %	$40,660	88.9 %	27.1	$137,733	84.7 %	$125,599	92.0 %	9.7
Services and solutions	11,025	17.6	5,079	11.1	117.1	24,971	15.3	10,930	8.0	128.5
Total revenue	62,716	100.0	45,739	100.0	37.1	162,704	100.0	136,529	100.0	19.2
Cost of sales:										
Cost of product	26,639	42.4	20,195	44.1	31.9	68,929	42.4	63,930	46.8	7.8
Cost of services and solutions	6,007	9.6	2,550	5.6	135.6	13,737	8.4	5,727	4.2	139.9
Amortization of intangibles	741	1.2	509	1.1	45.6	2,118	1.3	1,032	0.8	105.2
Total cost of sales	33,387	53.2	23,254	50.8	43.6	84,784	52.1	70,689	51.8	19.9
Gross profit	29,329	46.8	22,485	49.2	30.4	77,920	47.9	65,840	48.2	18.3
Operating expenses	27,292	43.6	21,776	47.6	25.3	77,503	47.6	61,197	44.8	26.6
Operating income	2,037	3.2	709	1.6	187.3	417	0.3	4,643	3.4	(91.0)
Other income (expense), net	627	1.0	(68)	(0.2)	(1,022.1)	294	0.2	599	0.4	(50.9)
Income before income taxes	2,664	4.2	641	1.4	315.6	711	0.5	5,242	3.8	(86.4)
	43	—	(694)	(1.5)	(106.2)	3,016	1.9	219	0.1	1,277.2

Income tax provision (benefit)												
Net income (loss)	$2,621	4.2	%	$1,335	2.9	%	96.3	$(2,305)	(1.4)%	$5,023	3.7	% (145.9)

REVENUE

Product

Product revenue increased by $11.0 million, or 27.1%, in the third fiscal quarter of 2018 compared to the third fiscal quarter of 2017. This included $8.0 million of incremental revenue related to the January 2018 acquisition of Accelerated. In addition, we experienced increased sales of RF products particularly in North America and to distributors in Asia. There was also an increase in sales of terminal servers to certain customers primarily in the North America region. This revenue growth was partially offset by a decrease in certain network and embedded products which are in the mature phase of their product life cycle.

Product revenue increased by $12.1 million, or 9.7%, in the first nine months of fiscal 2018 compared to the first nine months of fiscal 2017. This increase included $14.2 million of incremental revenue related to the January 2018 acquisition of

26

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

Accelerated. We also experienced larger sales of terminal servers to certain customers primarily in the North America region and larger sales of RF products to certain customers in the North America, EMEA and to distributors in Asia. These were offset by decreases in industrial cellular and USB connected products, as we had large sales to significant customers in the prior fiscal year. We also had a decrease in certain embedded products which are in the mature portion of their product life cycle.

In general, we expect our network products, all of which are mature, to decline over time. Our product revenue is subject to large customer projects and deployments that can fluctuate from period to period.

Services and Solutions

Services and solutions revenue increased by $5.9 million, or 117.1%, in the third quarter of fiscal 2018 compared to the same period a year ago. This primarily was driven by the growth of our SmartSense by Digi™ business of $5.4 million, which includes incremental revenue from the October 2017 acquisition of TempAlert. We are now servicing nearly 48,000 sites as of June 30, 2018, which is an increase from nearly 42,000 sites as of March 31, 2018. In addition, our Digi Wireless Design Services revenue increased $0.5 million in the third quarter of fiscal 2018 compared to the same period a year ago.

Services and solutions revenue increased by $14.0 million, or 128.5%, in the first nine months of fiscal 2018 compared to the same period a year ago. This was driven primarily by the growth of our SmartSense by Digi™ business of $12.7 million, which includes incremental revenue from the October 2017 acquisition of TempAlert. In addition, our Digi Wireless Design Services and our Digi Remote Manager® increased $1.5 million in the nine months ended June 30, 2018 compared to the same period a year ago.

We expect our Solutions revenue to increase over time, however, this revenue may be subject to fluctuations from period to period as large-scale deployments to specific customers may take place in compressed time frames and may not occur in every quarter.

Foreign Currency Impacts

Included in revenue performance for the year was a foreign currency translation increase of $0.1 million and $0.7 million for three and nine months ended June 30, 2018, respectively, when compared to the same periods in the prior fiscal year. This primarily was caused by the strengthening of the Euro for the three month and nine month periods against the U.S. dollar.

Revenue by Geographic Location

The following summarizes our revenue by geographic location of our customers:

	Three months ended June 30,		$ incr.	% incr.	Nine months ended June 30,		$ incr.	% incr.
($ in thousands)	2018	2017	(decr.)	(decr.)	2018	2017	(decr.)	(decr.)
North America, primarily United States	$45,184	$30,305	14,879	49.1	$114,175	$89,678	24,497	27.3
Europe, Middle East & Africa	10,216	9,703	513	5.3	29,876	29,059	817	2.8
Asia	5,808	4,508	1,300	28.8	15,114	14,446	668	4.6
Latin America	1,508	1,223	285	23.3	3,539	3,346	193	5.8
Total revenue	$62,716	$45,739	16,977	37.1	$162,704	$136,529	26,175	19.2

Revenue in North America increased by $14.9 million and $24.5 million, or 49.1% and 27.3%, for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago. Revenue for the three and nine months ended June 30, 2018 compared to the same periods a year ago included incremental revenue of $8.0 million and $14.2 million, respectively, from the January 2018 acquisition of Accelerated. In addition, for the three and nine months ended June 30, 2018 compared to the same periods a year ago, our SmartSense by Digi™ revenue increased $5.4 million and $12.7 million, respectively, which includes incremental revenue from the October 2017 acquisition of TempAlert. We also had increased sales of terminal servers and RF products in both comparable periods. We expect North America revenue to increase as a percentage of total revenue as our SmartSense by Digi™ and Accelerated products and services are primarily sold in North America.

Revenue in EMEA increased by $0.5 million and $0.8 million, or 5.3% and 2.8%, for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago. During the three months ended June 30, 2018 compared the same period a year ago, we had an increase in sales of cellular products and embedded modules. During the nine months ended June 30, 2018 compared to the same period a year ago, we had an increase in sales of RF products and embedded modules. Revenue

27

Table of Contents

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

was favorably impacted by $0.1 million and $0.7 million for the three and nine months ended June 30, 2018 compared to the same period a year ago, primarily due to the Euro strengthening against the U.S. Dollar (see Foreign Currency Risk in Part I, Item 3, of this Form 10-Q).

Revenue in Asia increased by $1.3 million and $0.7 million, or 28.8% and 4.6%, for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago. We experienced larger sales of RF products to certain distributors in Asia region for both comparable periods. We also experienced increased sales to certain customers of embedded modules in the nine month period ended June 30, 2018 compared to the same period a year ago.

Revenue in Latin America increased by $0.3 million and $0.2 million, or 23.3% and 5.8%, for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago.

No significant changes were made to our pricing strategy that impacted revenue during the nine months ended June 30, 2018 as compared to the same period in the prior fiscal year. As foreign currency rates fluctuate, we may from time to time adjust the prices of our products, services and solutions.

GROSS PROFIT

Gross profit for the three months ended June 30, 2018 and 2017 was $29.3 million and $22.5 million, respectively, an increase of $6.8 million, or 30.4%. Gross profit for the nine months ended June 30, 2018 and 2017 was $77.9 million and $65.8 million, respectively, an increase of $12.1 million, or 18.3%.

Product gross profit for the three months ended June 30, 2018 and 2017 was $25.1 million, or 48.5%, and $20.5 million, or 50.3%, respectively, an increase of $4.6 million, or 22.4%. Product gross profit for the nine months ended June 30, 2018 and 2017 was $68.8 million, or 50.0%, and $61.7 million, or 49.1%, respectively, an increase of $7.1 million, or 11.6%. The increase in gross profit for both comparable periods was due primarily to the January 2018 acquisition of Accelerated. Gross margin declined due to the manufacturing transition and product and customer mix for the three months ended June 30, 2018 compared to the same period a year ago.

Services and solutions gross profit, across both segments, was $5.0 million, or 45.5%, and $2.5 million, or 49.8%, for the three months ended June 30, 2018 and 2017, respectively. Services and solutions gross profit, across both segments, was $11.2 million, or 45.0% and $5.2 million, or 47.6% for the nine months ended June 30, 2018 and 2017, respectively. The increase in gross profit for both comparable periods was primarily driven by our IoT Solutions segment. Services and solutions gross profit may vary from quarter to quarter, as our wireless product design and development service margins are highly dependent on the utilization rates of our personnel. Gross margin decreased for both the three and nine months ended June 30, 2018 as compared to the same periods a year ago due to the mix of customers in our IoT Solutions segment. As recurring revenue increases and becomes a greater percentage of total revenue, we expect gross margins to increase over time.

Gross profit was negatively impacted by amortization of $0.7 million and $0.5 million for the three months ended June 30, 2018 and 2017, respectively and by $2.1 million and $1.0 million for the nine months ended June 30, 2018 and 2017, respectively. This increase in amortization expense is related primarily to our IoT Solutions segment and the recent acquisition of Accelerated.

OPERATING EXPENSES

The following summarizes our total operating expenses in dollars and as a percentage of total revenue:

	Three months ended June 30,				$ incr.	Nine months ended June 30,				$ incr.
($ in thousands)	2018		2017		(decr.)	2018		2017		(decr.)
Sales and marketing	$11,595	18.5%	$8,504	18.6%	$3,091	$32,530	20.0%	$25,557	18.7%	$6,973
Research and development	8,205	13.1%	7,420	16.2%	785	24,573	15.1%	21,304	15.6%	3,269
General and administrative	7,302	11.7%	3,337	7.3 %	3,965	20,210	12.4%	11,821	8.7 %	8,389
Restructuring charges, net	190	0.3 %	2,515	5.5 %	(2,325)	190	0.1 %	2,515	1.8 %	(2,325)
Total operating expenses	$27,292	43.6%	$21,776	47.6%	$5,516	$77,503	47.6%	$61,197	44.8%	$16,306

Sales and marketing expenses increased $3.1 million and $7.0 million for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago, which included incremental expenses for Accelerated of

$1.2 million

28

Table of Contents

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

and $1.9 million, respectively. The remainder of the increases related primarily to an increase in employee-related expenses of $1.7 million and $4.6 million in other parts of our business for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago. This includes incremental expenses related to the acquisition of TempAlert.

Research and development expenses increased $0.8 million and $3.3 million for the three and nine months ended June 30, 2018, respectively, compared to the same period a year ago. For the three months ended June 30, 2018 compared to the same period a year ago, we incurred incremental expenses related to the recent acquisition of Accelerated of $0.8 million. In addition we had increased compensation-related expenses of $0.4 million, partially offset by decreased outside services of $0.3 million in other parts of our business. For the nine months ended June 30, 2018 compared to the same period a year ago, we incurred expenses related to the recent acquisition of Accelerated of $1.3 million. In other parts of our business we had increased compensation-related expenses of $1.5 million and an increase in outside services of $0.2 million. Compensation-related expenses increased due to additional headcount and increased incentive compensation due to improved company performance in fiscal 2018. The three and nine month periods ended June 30, 2018 includes incremental expenses related to the acquisition of TempAlert.

General and administrative expenses increased $4.0 million and $8.4 million for the three and nine months ended June 30, 2018, respectively, compared to the same periods a year ago. This included incremental expenses for Accelerated of $1.1 and $2.0 million, respectively. In other parts of our business, we had an increase in compensation-related expenses of $0.5 million and $1.5 million for the three and nine months ended June 30, 2018, respectively, primarily related to increased incentive compensation, which includes incremental expenses related to the acquisition of TempAlert. In addition, for the three and nine months ended June 30, 2018 compared to the same period ago, amortization increased by $0.7 million and $2.5 million, respectively, due mostly to the recent acquisitions in our IoT Solutions segment and we also had an increase of $1.4 million and $1.7 million, respectively, related to additional acquisition earn-out expenses.

OTHER INCOME (EXPENSE), NET

We recorded an increase in other income (expense), net of $0.7 million for the three months ended June 30, 2018 compared to the same period a year ago related to additional foreign currency gains recognized in the current fiscal year compared to the prior fiscal year, primarily related to the weakening of the Euro in the current fiscal year. For the nine months ended June 30, 2018 compared to the same period in the prior fiscal year, we recorded a decrease in other income (expense), net of $0.3 million, primarily related to the strengthening of the Japanese Yen against the U.S. dollar, as non-functional currencies were remeasured at the current rate, partially offset by the weakening of the Euro.

INCOME TAXES

Income tax provision was $3.0 million for the nine months ended June 30, 2018. Net tax expense discretely related to the nine months ended June 30, 2018 was $3.0 million, primarily as a result of new U.S. tax legislation that was enacted during the first quarter of fiscal 2018 and the adoption of ASU 2016-09 related to the accounting for the tax effects of stock compensation.

The Tax Cuts and Jobs Act of 2017 (the "Act") was enacted on December 22, 2017. The Act lowered the U.S. federal corporate tax rate from 35% to 21% as of January 1, 2018 and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. Due to our fiscal year end, our statutory rate for fiscal 2018 will be a blend of the new and old tax rates. At June 30, 2018 we had not fully completed our accounting for the tax effects of enactment of the Act; however, in certain cases, as described below, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. For the items for which we were able to determine a reasonable estimate, we recognized a provisional income tax expense amount of $2.7 million which is included as a component of income tax expense.

We remeasured U.S. deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which requires estimates of our changes in deferred tax assets and liabilities before and after the new statutory rate was enacted. As a result, we are still analyzing certain aspects of the legislation and refining our calculations such as, refining current year estimates and filings of tax returns, of which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. As of June 30, 2018, the provisional amount recorded related to the re-measurement of this deferred tax balance was $2.7 million.

In addition, we considered the potential tax expense impacts of the one-time transition tax. The transition tax is based on our total post-1986 earnings and profits ("E&P") that we previously deferred from U.S. income taxes. We recorded a provisional

Table of Contents

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

amount for our one-time transition tax liability for our foreign subsidiaries, resulting in an increase in income tax expense of $0.1 million for the nine months ended June 30, 2018. We have not yet completed the calculation of the post-1986 E&P for these foreign subsidiaries and, further, this transition tax is based in part on the amount of those earnings held in cash and other specified assets. This amount may change when we finalize the calculation of post-1986 foreign E&P previously deferred from U.S. federal taxation, evaluate the testing periods for cash and E&P measurement and finalize substantiation of material foreign taxes paid or accrued. Furthermore, it is expected that further guidance will be forthcoming from U.S. Treasury which may or may not impact the final transition tax required. We continue to review the outside basis differential of our foreign investments. At this point, no additional income taxes have been provided for any undistributed foreign earnings not subject to the transition tax and additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations. Determining the amount of unrecognized deferred tax liability related to any remaining undistributed foreign earnings not subject to the transition tax and additional outside basis difference in these entities (i.e., basis difference in excess of that subject to the one-time transition tax) is not practical at this time, but it is expected that with inclusion of the transition tax, the potential outstanding basis difference as of June 30, 2018 is expected to be a deductible temporary difference for which no deferred tax asset would be allowed.

We adopted ASU 2016-09 "Improvements to Employee Share-Based Payment Accounting" on October 1, 2017. As a result of the adoption, we recorded $0.7 million of excess tax expense related to our share-based payments in our provision for income taxes for the nine months ended June 30, 2018. Historically, this was record in additional paid-in capital. The excess tax expense related to share-based payments are recognized as tax expense discretely related to the nine months ended June 30, 2018.

For the nine months ended June 30, 2018, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate due primarily to the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and also due to certain income tax credits generated in the U.S.

Income tax provision was $0.2 million for the nine months ended June 30, 2017. Net tax benefits discretely related to the nine months ended June 30, 2017 were $0.8 million resulting primarily from the reversal of tax reserves due to the expiration of statutes of limitation from U.S. and foreign tax jurisdictions. For the nine months ended June 30, 2017, our effective tax rate before items discretely related to the period was less than the U.S. statutory rate primarily due to the mix of income between taxing jurisdictions, certain of which have lower statutory tax rates than the U.S., and certain tax credits in the U.S.

Our effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related statutory tax rate in each jurisdiction, and tax items specific to the period, such as settlements of audits. We expect that we may record other benefits or expenses in the future that are specific to a particular quarter such as expiration of statutes of limitation, the completion of tax audits, or legislation that is enacted for both U.S. and foreign jurisdictions.

SEGMENT RESULTS OF OPERATIONS

IoT PRODUCTS & SERVICES

	Three months ended June 30,				% incr.	Nine months ended June 30,				% incr.
($ in thousands)	2018		2017		(decr.)	2018		2017		(decr.)
Revenue:										
Product	$51,691	95.0 %	$40,660	94.9 %	27.1	$137,733	94.9 %	$125,599	95.4 %	9.7
Services	2,715	5.0	2,184	5.1	24.3	7,378	5.1	6,054	4.6	21.9
Total revenue	54,406	100.0	42,844	100.0	27.0	145,111	100.0	131,653	100.0	10.2
Cost of sales:										
Cost of product	26,639	49.0	20,195	47.1	31.9	68,929	47.5	63,930	48.6	7.8
Cost of services	1,655	3.0	1,351	3.2	22.5	4,404	3.0	3,739	2.8	17.8
Amortization of intangibles	219	0.4	91	0.2	140.7	549	0.4	283	0.2	94.0
Total cost of sales	28,513	52.4	21,637	50.5	31.8	73,882	50.9	67,952	51.6	8.7

Gross profit	25,893	47.6		21,207	49.5		22.1	71,229	49.1		63,701	48.4		11.8
Total operating expenses	21,349	39.2		19,366	45.2		10.2	60,732	41.9		56,063	42.6		8.3
Operating income	$4,544	8.4	%	$1,841	4.3	%	146.8	$10,497	7.2	%	$7,638	5.8	%	37.4

30

Table of Contents

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

Revenue

Revenue from our IoT Products & Services segment increased $11.6 million and $13.5 million, or 27.0% and 10.2%, for the three and nine months ended June 30, 2018, respectively, compared to the same periods in the prior fiscal year. Product revenue increased by $11.0 million, or 27.1%, in the third fiscal quarter of 2018 compared to the third fiscal quarter of 2017. This included $8.0 million of incremental revenue related to the January 2018 acquisition of Accelerated. In addition, we experienced increased sales of RF products particularly in North America and to distributors in Asia. There was also an increase in sales of terminal servers to certain customers primarily in the North America region. This revenue growth was partially offset by a decrease in certain network and embedded products which are in the mature phase of their product life cycle. Services revenue from this segment of increased $0.5 million for the three months ended June 30, 2018 compared to the same period a year ago, primarily related to Digi Wireless Design Services.

Product revenue increased by $12.1 million, or 9.7%, in the first nine months of fiscal 2018 compared to the first nine months of fiscal 2017. This increase included $14.2 million of incremental revenue related to the January 2018 acquisition of Accelerated. We also experienced increased sales of terminal servers to certain customers primarily in the North America region and increased sales of RF products to certain customers in the North America, EMEA and to distributors in Asia. These were offset by decreases in industrial cellular and USB connected products, as we had a large sales to a significant customers in the prior fiscal year. We also had a decrease in certain embedded products which are in the mature portion of their product life cycle. Services revenue from this segment of increased $1.3 million for the nine months ended June 30, 2018 compared to the same period a year ago, primarily related to Digi Remote Manager® and Wireless Design Services.

Revenue for this segment was also favorably impacted by $0.1 million and $0.7 million for the three and nine months ended June 30, 2018, respectively, primarily due to the strengthening of the British Pound compared to the U.S. Dollar.

In general, we expect our network products, all of which are mature, to decline over time. Our product revenue is subject to large customer projects and deployments that can fluctuate from period to period.

Operating Income

Operating income increased $2.7 million and $2.9 million, or 146.8% and 37.4%, for the three and nine months ended June 30, 2018 compared to the same periods in the prior fiscal year

The increase for the three months ended June 30, 2018 compared to the prior fiscal year was due to an increase in our gross profit of $4.7 million, or 22.1%, offset by an increase in operating expenses of $2.0 million, or 10.2%. Included in operating income for the three months ended June 30, 2018 is gross profit of $3.4 million and operating expenses of $3.0 million related to Accelerated. Also included in operating income is a reduction in restructuring expenses of $2.3 million, which is partially offset by an increase of $1.4 million in acquisition earn-out adjustments for fair value of contingent considerations.

For the nine months ended June 30, 2018 compared to the same period in the prior fiscal year, the increase in operating income was due to an increase in gross profit of $7.5 million, or 11.8%, offset by an increase in operating expenses of $4.6 million, or 8.3%. Included in operating income for the nine months ended June 30, 2018 is gross profit of $7.0 million and operating expenses of $5.2 million related to Accelerated. Also included in operating income is a reduction in restructuring expenses of $2.3 million, which is partially offset by an increase of $1.7 million in acquisition earn-out adjustments for fair value of contingent consideration.

Table of Contents

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

IoT SOLUTIONS

	Three months ended June 30,				% incr.	Nine months ended June 30,				% incr.
($ in thousands)	2018		2017		(decr.)	2018		2017		(decr.)
Solutions revenue	$8,310	100.0 %	$2,895	100.0 %	187.0	$17,593	100.0 %	$4,876	100.0 %	260.8
Cost of sales:										
Cost of services	4,352	52.4	1,199	41.5	263.0	9,333	53.1	1,988	40.8	369.5
Amortization of intangibles	522	6.3	418	14.4	24.9	1,569	8.9	749	15.3	109.5
Total cost of sales	4,874	58.7	1,617	55.9	201.4	10,902	62.0	2,737	56.1	298.3
Gross profit	3,436	41.3	1,278	44.1	(168.9)	6,691	38.0	2,139	43.9	(212.8)
Total operating expenses	5,943	71.5	2,410	83.2	146.6	16,771	95.3	5,134	105.3	226.7
Operating loss	$(2,507)	(30.2)%	$(1,132)	(39.1)%	121.5	$(10,080)	(57.3)%	$(2,995)	(61.4)%	236.6

Revenue

Revenue from our IoT Solutions segment increased $5.4 million, or 187.0%, for the three months ended June 30, 2018 compared to the same period a year ago. This was driven by the growth of our SmartSense by Digi™ business, which includes incremental revenue from the October 2017 acquisition of TempAlert. We are now servicing nearly 48,000 sites as of June 30, 2018, which is an increase from nearly 42,000 sites as of March 31, 2018.

Revenue from our IoT Solutions segment increased $12.7 million, or 260.8%, for the nine months ended June 30, 2018 compared to the same period a year ago. This was driven by the growth of our SmartSense by Digi™ business, which includes incremental revenue from TempAlert, which was acquired in October 2017.

We expect our Solutions revenue to increase over time, however, this revenue may be subject to fluctuations from period to period as large-scale deployments to specific customers may take place in compressed time frames and may not occur in every quarter.

Operating Loss

Operating loss increased $1.4 million for the three months ended June 30, 2018 as compared to the same period in the prior fiscal year. This increase in operating loss was primarily due to an increase in operating expenses of $3.5 million, which includes incremental expenses from our recent acquisition of TempAlert. This was partially offset by an increase in our gross profit of $2.1 million. We expect our Solutions gross margin to increase in future periods as recurring revenue from this segment increases.

Operating loss increased $7.1 million for the nine months ended June 30, 2018 compared to the same period in the prior fiscal year. This increase in operating loss was primarily due to an increase in operating expenses of $11.6 million, which includes incremental expenses from our recent acquisition of TempAlert. This was partially offset by an increase in our gross profit of $4.5 million.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations and capital expenditures principally with funds generated from operations. At June 30, 2018, cash, cash equivalents and short-term marketable securities were $52.5 million compared to $110.2 million at September 30, 2017. At June 30, 2018, our cash, cash equivalents and marketable securities, including long-term marketable securities, were $54.7 million. Our working capital (total current assets less total current liabilities) was $115.5 million at June 30, 2018. At September 30, 2017, our working capital was $156.4 million. The decrease in cash and working capital is directly related to the purchase price and other costs associated with the TempAlert and Accelerated acquisitions in fiscal 2018 (see Note 2 to the Condensed Consolidated Financial Statements).

We presently anticipate total fiscal 2018 capital expenditures will be approximately $2.2 million, and we have spent $1.0 million as of June 30, 2018.

Net cash used in operating activities was $8.9 million and $0.5 million for the nine months ended June 30, 2018 and 2017, respectively, a net decrease in cash of $8.4 million. This decrease was a result of a net loss of $2.3 million in the first nine months of fiscal 2018 compared to net income of $5.0 million in the first nine months of fiscal 2017, resulting in a net decrease

Table of Contents

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

of $7.3 million. We also had a decrease in restructuring charges of $2.3 million and changes in working capital of $9.4 million. This was partially offset by an increase in depreciation and amortization of $5.0 million due to additional amortization from recent acquisitions, an increase deferred income tax provision of $3.2 million related to the Tax Cuts and Jobs Act of 2017 (see Note 10 to the Condensed Consolidated Financial Statements), and increase in our earn-out provision of $1.7 million and increases in cash related to other non-cash items of $0.8 million.

The changes in working capital that resulted in a decrease in cash of $9.4 million were driven by a decrease of $14.5 million related to accounts receivable due to increased sales and large customer sales with longer terms. We also had a decrease of $2.3 million related to inventory due to the manufacturing transition and strategic purchases of finished goods. In addition, we had a $0.5 decrease related to prepaids and other assets and taxes payable. This was partially offset by a $7.0 million increase related to accrued liabilities and $0.9 million related to accounts payable.

Net cash used in investing activities was $25.8 million during the nine months ended June 30, 2018 and net cash provided by investing activities was $14.0 million during the nine months ended June 30, 2017. This resulted in a net decrease of $39.8 million. The decrease in cash flows from investing activities in the first nine months of fiscal 2018 compared to the same period in the prior fiscal year is primarily related to $26.5 million of additional cash expenditures for acquisitions, as we spent $16.5 million (net of cash acquired of $0.3 million) for the Accelerated acquisition and $40.1 million (net of cash acquired $0.6 million) for the TempAlert acquisition in fiscal 2018. This was offset by the SMART Temp acquisition of $28.3 million (net of cash acquired of $0.5 million) and the FreshTemp acquisition $1.7 million in the same period a year ago. We also had fewer proceeds of $1.0 million from the sale of Etherios and fewer proceeds from marketable securities of $12.9 million. This was partially offset as we spent $0.6 million less on purchases of property, equipment and improvements.

Net cash provided by financing activities was $4.0 million and $2.8 million during the nine months ended June 30, 2018 and 2017, respectively, a net increase of $1.2 million. We spent $0.5 million related to the first earn-out payment to the former shareholders of Bluenica in the first nine months of fiscal 2017 compared to no such payment in the first nine months of fiscal 2018. In addition, we had additional proceeds from employee stock plans of $0.5 million and fewer expenditures of common stock of $0.2 million.

We generally expect positive cash flows from operations and believe that our current cash, cash equivalents and short-term marketable securities balances, cash generated from operations and our ability to secure debt and/or equity financing will be sufficient to fund our business operations, possible acquisitions and capital expenditures for the next twelve months and beyond.

Recently Issued Accounting Pronouncements

For information on new accounting pronouncements, see Note 1 to our Condensed Consolidated Financial Statements.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

Our exposure to interest rate risk relates primarily to our investment portfolio. Our marketable securities are classified as available-for-sale and are carried at fair value. Our investments consist of money market funds, certificates of deposit, commercial paper, corporate bonds and government municipal bonds. Our investment policy specifies the types of eligible investments and minimum credit quality of our investments, as well as diversification and concentration limits which mitigate our risk. We do not use derivative financial instruments to hedge against interest rate risk because the majority of our investments mature in less than one year.

FOREIGN CURRENCY RISK

We are exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros, British Pounds, Japanese Yen or Canadian Dollars and in certain cases, transactions in U.S. Dollars in our foreign entities. We are also exposed to 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 non-functional currency accounts, primarily the U.S. Dollar accounts in our foreign locations to reduce our foreign currency risk. In addition, as foreign currency rates fluctuate, we may from time to time, adjust the prices of our products, services and solutions. We have not implemented a formal hedging strategy.

For the nine months ended June 30, 2018 and 2017, we had approximately $48.5 million and $46.9 million, respectively, of revenue from foreign customers including export sales. Of these sales, $7.8 million and $13.9 million, respectively, were denominated in foreign currency, predominantly Euros, British Pounds and Canadian Dollar. In future periods, we expect a significant portion of sales will continue to be made in both Euros, British Pounds and Canadian Dollar.

Total revenue was favorably impacted by foreign currency translation of $0.1 million and $0.7 million for three and nine months ended June 30, 2018, respectively, as compared to the same periods in the prior fiscal year. This primarily was caused by the strengthening of the Euro against the U.S. dollar.

The table below compares the average monthly exchange rates of the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar:

	Nine months ended June 30,		% increase (decrease)
	2018	2017	
Euro	1.1997	1.0815	10.9 %
British Pound	1.3601	1.2537	8.5 %
Japanese Yen	0.0094	0.0090	4.4 %
Canadian Dollar	0.7835	0.7494	4.6 %

A 10% change from the first nine months of fiscal 2018 average exchange rate for the Euro, British Pound, Japanese Yen and Canadian Dollar to the U.S. Dollar would have resulted in a 0.5% increase or decrease in revenue and a 2.0% increase or decrease in stockholders' equity due to foreign currency translation. The above analysis does not take into consideration any pricing adjustments we might consider in response to changes in such exchange rates.

CREDIT RISK

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

Investments are made in accordance with our investment policy and may consist of money market funds, certificates of deposit, commercial paper, corporate bonds and government municipal bonds. The fair value of our investments contains an element of credit exposure, which could change based on changes in market conditions. If market conditions deteriorate or if the issuers of these securities experience credit rating downgrades, we may incur impairment charges for securities in our investment portfolio. All of our securities are held domestically.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

On January 22, 2018, we completed the acquisition of Accelerated. As permitted for recently acquired businesses, management has excluded the acquired Accelerated business from its assessment of internal control over financial reporting. The excluded Accelerated business represents total assets of 8.3% of our consolidated total assets as of June 30, 2018. We are required to include them in our assessment beginning in the first quarter of fiscal 2019.

On October 20, 2017, we completed the acquisition of the TempAlert business. As permitted for recently acquired businesses, management has excluded the acquired TempAlert business from its assessment of internal control over financial reporting for the first half of fiscal 2018. The excluded TempAlert business represented total assets of 12.8% of our consolidated total assets as of March 31, 2018. As of April 1, 2018, TempAlert is now consolidated with our U.S. Solutions business and will be included in our assessment of internal control over financial reporting for the second half of fiscal 2018.

There were no changes in our internal control over financial reporting that occurred during the quarterly period ended June 30, 2018 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
The disclosures set forth in Note 12 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q are incorporated herein by reference.

ITEM 1A. RISK FACTORS
Except at noted below, there have been no material changes in our risk factors from those previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended September 30, 2017 and Item 1A of Part II of our Quarterly Report on Form 10-Q for the period ended March 31, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
On April 24, 2018 our Board of Directors authorized a new program to repurchase up to $20.0 million of our common stock primarily to return capital to shareholders. This repurchase authorization began on May 23, 2018 and expires on November 23, 2018. Shares repurchased under the new program may 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. There were no shares repurchased under this program.
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 expired on May 1, 2018.
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 second quarter of fiscal 2018:

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
April 1, 2018 - April 30, 2018	4,077	$ 11.30	—	$19,725,797.42
May 1, 2018 - May 31, 2018	230	$ 11.65	—	$20,000,000.00
June 1, 2018 - June 30, 2018	—	$ —	—	$20,000,000.00
Total	4,307	$ 11.32	—	$20,000,000.00

(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.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit No.		Description	Method of Filing
3	(a)	Restated Certificate of Incorporation of the Company, as amended (1)	Incorporated by Reference
3	(b)	Amended and Restated By-Laws of the Company (2)	Incorporated by Reference
4	(a)	Share Rights Agreement, dated as of April 22, 2008, between the Company and Wells Fargo Bank, N.A., as Rights Agent (3)	Incorporated by Reference
4	(b)	Form of Amended and Restated Certificate of Powers, Designations, Preferences and Rights of Series A Junior Participating Preferred Shares (4)	Incorporated by Reference
10	(a)	Offer Letter with Gokul V. Hemmady dated June 11, 2018 (5)*	Incorporated by Reference
31	(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Electronically
31	(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed Electronically
32		Section 1350 Certification	Filed Electronically
101.INS		XBRL Instance Document	Filed Electronically
101.SCH		XBRL Taxonomy Extension Schema Document	Filed Electronically
101.CAL		XBRL Taxonomy Calculation Linkbase Document	Filed Electronically
101.DEF		XBRL Taxonomy Definition Linkbase Document	Filed Electronically
101.LAB		XBRL Taxonomy Label Linkbase Document	Filed Electronically
101.PRE		XBRL Taxonomy Presentation Linkbase Document	Filed Electronically

*Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-Q.

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

(2) Incorporated by reference to Exhibit 3(b) to the Company's Current Report on Form 8-K filed on August 28, 2017 (File No. 1-34033)

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

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

(5) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 15, 2018 (File No. 1-34033)

37

Table of Contents

SIGNATURE

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

		DIGI INTERNATIONAL INC.	
Date:	August 1, 2018	By:	/s/ Gokul V. Hemmady
			Gokul V. Hemmady
			Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer and Authorized Officer)