

Digi International Inc. (Nasdaq: DGII)

Rating: Buy

Price Target: \$45.00

Share Price: \$32.18

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May 8, 2025 (Intraday)

Company Data		
Average Daily Volume (M)	0.211	
52-Week Range	20.17-37.07	
Shares Outstanding (M)	37.50	
Market Cap (M)	1,187	
Enterprise Value (M)	1,231	
Total Cash (M), mrq	26.30	
Total Debt (M)	70.01	
Total Debt to Cap	15.5%	

Estimates		
FYE: Sep	2025E	2026E
EPS	Q1	0.50 A
	Q2	0.51 A
	Q3	\$0.50
	Q4	\$0.51
	FY	\$2.01
		\$2.16
P/E		16.0x
Rev (M)	Q1	103.87A
	Q2	104.50A
	Q3	\$106.76
	Q4	\$108.46
	FY	\$423.63
		\$443.30
EV/Sales		2.9x
		2.8x

One-Year Performance Chart		
	\$35.00	\$32.50

As of May 8, 2025. Source: E-Trade.

Adjusting Digi Estimates to Account for Improving Operational Efficiencies

Maintaining Buy rating and \$45 price target

Summary

Digi International's F'2Q 2025 earnings results underscored three key aspects to the story: (1.) The company continues a rather successful transition to an ARR-driven, subscription-based business model; (2.) Digi's operational leverage and EBITDA-generation continues to improve, and; (3.) The company's revenue growth continues to stagnate in a market that we believe remains poised for continued innovation and growth. In the short term, this combination will continue to propel the story forward, we believe. However, a longer-term absence of meaningful revenue growth will eventually begin to weigh on Digi's valuation and share price appreciation. That notwithstanding, DGII's near-term fundamentals are pointing in the right direction, we believe.

Digi's F'2Q results highlights.

- Revenue was \$104.5 million, a y/y decrease of 3%.
- Gross profit margin was 62.1%, a y/y increase of 420 basis points.
- Net income was \$10.5 million, compared to \$4.0 million in F'2Q 2024.
- Non-GAAP EPS per diluted share was \$0.51, compared to \$0.49 in F'2Q 2024.
- Adjusted EBITDA was \$26.0 million, a y/y increase of 9%.
- Annualized Recurring Revenue (ARR) was \$123 million at quarter end, an increase of 12%.
- Long-term debt stood at \$70.0 million, vs. \$123.2 million at the end of FY'24.

- **Digi's Annualized Recurring Revenue (ARR) growth continues to drive the story.** The company continues to shift towards a subscription model for ongoing services including software updates and device management, creating a steady revenue stream and fostering long-term customer relationships. The subscription model allows customers to scale their IoT deployments as needs grow. Annualized recurring revenue (ARR) that represents the annualized monthly value of all billable subscription contracts, at the end of a fiscal period, is the metric Digi uses to measure the scale of its subscription revenue business. ARR is less subject to seasonality and contract term changes than other metrics, and has higher margins. In F'2Q ARR was \$123 million at quarter end, an increase of 12% y/y.
- **Digi's subscription model fuels recurring revenue, targeting \$200 million annualized recurring revenue (ARR) by FY28.** Digi continues to transition towards a subscription model for services including software updates and device management, creating a steady revenue stream and fostering long-term customer relationships. Consequently, the company has seen its ARR grow from 4% to 27% of total revenue over the last six years. ARR further increased to ~28% of total revenue, or a record \$120 million, outpacing the topline revenue of \$104 million, in 1Q25. Management expects this percentage to continue growing as the company shifts toward a more software-centric business model. By FY28, the company expects to have \$200 million in ARR, vs. the current \$123 million (as of F'2Q 2025).
- **Gross and adjusted EBITDA margins improving despite sluggish revenue growth.** Despite revenue falling 5% in FY24 due to a weak global economy and chip set supply issues, gross margins improved 420 basis points in F'2Q to 62.1% while adjusted EBITDA margins improved to 24.9%. Management provided guidance on the F'2Q call, and increased its profit outlook for fiscal 2025. The outlook for revenue and ARR remains unchanged, with revenue projected to be roughly flat year over year while ARR is expected to grow 10%. Management now expects Adjusted EBITDA to grow 5% year-over-year, up from its past outlook of approximately flat year-over-year.
- **Digi's IoT Solutions segment driving growth.** IoT Solutions segment revenue of \$26.7 million increased \$2.4 million, as compared to the same period in the prior fiscal year, consisting of a \$2.4 million increase in recurring revenue that was driven by growth in both SmartSense and Ventus. Segment ARR as of the end of the second fiscal quarter was \$95 million, an increase of 9% from the prior fiscal year driven by growth in both SmartSense and Ventus. Gross margins increased 40 basis points to 71.4% in F'2Q, the result of growth in higher margin ARR subscription revenues.

Meanwhile, Digi's legacy IoT Products and Services segment revenues of \$77.8 million decreased \$5.6 million year-over-year. This decrease consisted of a \$6.8 million decline in one-time sales, with no significant impact from pricing. The decline was driven by lower demand for some products, as some customers are consuming

stockpiled inventory, partially offset by increased demand for some products from new project-based customer initiatives.

- **Changes to our estimates.** We are fine-tuning our estimates to account for the operational improvements outlined by management, including a slight increase to our Adjusted EBITDA estimate of \$102.7 million (previously \$99.6 million). We are not changing our FY'25 revenue assumptions, as we see Digi's revenue growth continuing to stagnate in the short-term. We are increasing our FY'26 non-GAAP EPS estimate slightly from \$2.13 to \$2.16, to account for Digi International's improving operational leverage and margin profile.
- **Digi shares remain conservatively valued, we believe.** Shares are currently trading at ~16x our FY26 non-GAAP EPS estimate of \$2.16, below its peer group average. Our \$45 price target assumes a full valuation P/E multiple of 21x our FY26 estimate, which is still below the current peer group average forward P/E multiple of over 25x.

Company Overview

Digi International is a leading provider of Internet of Things (IoT) connectivity hardware and software solutions. Founded in 1985, the company has a long history of innovation in wireless communication and embedded systems. Headquartered in Hopkins, Minnesota, Digi serves OEMs, enterprises and government clients worldwide. The company operates through two segments: IoT Products & Services, providing embedded modules, routers and device management platforms; and IoT Solutions, encompassing SmartSense (condition-based monitoring) and Managed Network-as-a-Service (MNaaS) through the Ventus acquisition. Digi's solutions are used in a variety of industries, including industrial for connecting machines and equipment for automation and monitoring; transportation for enabling fleet tracking, vehicle diagnostics, and connected infrastructure; healthcare for supporting remote patient monitoring, telehealth, and connected medical devices; and retail for powering point-of-sale systems, digital signage, and inventory management. Digi is committed to providing reliable, secure, and scalable connectivity solutions that help businesses and organizations connect their devices and improve their operations.



All figures in millions of U.S. Dollars except % and per share items

Fiscal Year Ends September 30th

All figures in millions of U.S. Dollars except % and per share items

Source: Company reports, Kingswood Capital Partners estimates.

Risks to Price Target

Company-specific risks to the target price include:

Digi's proprietary hardware and software may be difficult and expensive to service, upgrade or replace. Some of the hardware and software that Digi International uses to operate its IoT infrastructure is significantly customized and tailored to meet its network's requirements and specifications and could be difficult and expensive to service, upgrade or replace.

Rapid and significant technological changes in the industrial connectivity industry could negatively impact Digi's competitive position and may require significant additional capital expenditures to address. The industrial communications industry is subject to rapid advances and innovations in technology. The company could face competition in the future from companies using new technologies and new connectivity systems, including new entrants who are developing or have announced alternative technologies, some of which would compete directly with one or more of Digi's existing or planned products and services.

Digi's gross margins may be subject to decline. The company's gross margins may be subject to decline, which could decrease its overall profitability and impact its financial performance adversely. Some of Digi's legacy hardware products are approaching the end of their product life cycles. These mature hardware products have sold historically at higher gross margins than some other product and service offerings. Management expects this general trend of declining sales for many of its mature products to continue, and the pace of the decline may accelerate. In addition, rising prices for goods and services due to inflation along with ongoing cost pressures in the industry create pricing pressure on hardware products. Management has indicated that it is willing to realize lower gross margins in return for longer-term, binding purchase commitments. This could apply downward pressure on corporate gross margins. Part of Digi's strategy is to sell software applications and IoT solutions like SmartSense by Digi, Ventus offerings and hardware bundled with services on a subscription basis. These sales may provide recurring revenue at relatively high gross margins, but these types of offerings are still in the earlier stages of adoption by customers. As such, their sales growth is not necessarily predictable or assured. The company's gross margins therefore may be subject to decline unless Digi can implement cost reduction initiatives effectively to offset the impact of these factors.

The company's revenue may be subject to fluctuations based on the level of significant large project-based purchases. No single customer has represented more than 10% of Digi's revenue in any of the last three fiscal years. However, many customers make significant one-time hardware purchases for large projects that are not repeated. As a result, the company's revenue may be subject to significant fluctuations. In addition, certain customers in the SmartSense by Digi and Ventus businesses have outsized deployments relative to other customers, and it is therefore possible that the company will see revenue fluctuations in these businesses. Digi's failure to complete one or a series of significant sales opportunities in a particular fiscal period could have a material adverse effect on revenue for that period.

Some of Digi's products are sold into mature markets, which could limit its ability to continue to generate revenue from these products. Some of the company's hardware products are sold into mature markets that are characterized by a trend of declining demand. Management has made targeted investments to provide enhanced and new products into these mature markets and believes this could potentially offset declining demand. However, over the longer term, the overall market for these hardware products is expected to decrease due to the adoption of new technologies. As such, management expects that Digi's revenue from these products will continue to decline over time. As a result, the company's prospects depend in part on its ability to acquire or develop and successfully market additional products that address growth markets.

Digi's cloud-based networks and those of third-party service providers may be vulnerable to cybersecurity risks. The secure transmission of confidential information over public networks continues to be a critical element of the company's ability to compete for business, manage risks, and protect its customers and reputation. Digi's network, including third-party service providers and their customers, may be vulnerable to unauthorized access, computer attacks, viruses and other security problems. The company may be required to expend significant resources to respond to, contain, remediate, and protect against these attacks and threats, including compliance with applicable data breach and security laws and regulations, and to alleviate problems, including reputational harm and litigation, caused by such security incidents.

Digi's failure to effectively manage the expansion of its portfolio of products and services could impede the company's ability to execute its business plan. To achieve its anticipated future revenue growth, Digi International must develop and market new products and services. These efforts currently face a variety of challenges, including maintaining the infrastructure and systems necessary to manage the growth of its business. As Digi's product and service portfolio continues to expand, the responsibilities of the management team and demands on company resources also increase. This may further strain management and other company resources with the increased complexities and administrative burdens associated with a larger, more complex portfolio of products and services.



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HOLD	1	12.50	0	0.00
SELL	0	0.00	0	0.00
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As of April 2025.

Digi International Inc. Rating History as of May 8, 2025



Source: E-Trade.

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