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CYBERLUX CORP
Form SB-2/A
July 13, 2005

As filed with the Securities and Exchange Commission on July 13, 2005
An Exhibit List can be found on page II-7.
Registration No. 333-125111

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

AMENDMENT NO. 1
TO

FORM SB-2
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

CYBERLUX CORPORATION
(Name of small business issuer in its charter)

Nevada	3674	91-2048178
----- (State or other Jurisdiction of Incorporation or Organization)	----- (Primary Standard Industrial Classification Code Number)	----- (I.R.S. Employer Identification No.)

4625 Creekstone Drive, Suite 100
Research Triangle Park
Durham, North Carolina 27703
(919) 474-9000
(Address and telephone number of principal executive offices and
principal place of business)

Don F. Evans, Chief Executive Officer
CYBERLUX CORPORATION
4625 Creekstone Drive, Suite 100
Research Triangle Park
Durham, North Carolina 27703
(919) 474-9000
(Name, address and telephone number of agent for service)

Copies to:
Gregory Sichenzia, Esq.
Sichenzia Ross Friedman Ference LLP
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New York, New York 10018
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APPROXIMATE DATE OF PROPOSED SALE TO THE PUBLIC:
From time to time after this Registration Statement becomes effective.

If any securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: [X]

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. _____

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. _____

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. _____

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. _____

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CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered (1)	Proposed maximum offering price per share (2)	Proposed maximum aggregate offering price	Amount registered
Common stock, \$.001 par value issuable upon conversion of Secured Convertible Notes	300,000,000 (3)	\$.02	\$6,000,000	
Common Stock, \$.001 par value issuable upon exercise of Warrants	25,000,000 (4)	\$.03	\$750,000	
Total	325,000,000		\$6,750,000	

(1) Includes shares of our common stock, par value \$0.001 per share, which may be offered pursuant to this registration statement, which shares are issuable upon conversion of secured convertible notes and the exercise of warrants held by the selling stockholders. In addition to the shares set forth in the table, the amount to be registered includes an indeterminate number of shares issuable upon conversion of the secured convertible notes and exercise of the warrants, as such number may be adjusted as a result of stock splits, stock dividends and similar transactions in accordance with Rule 416. The number of shares of common stock registered hereunder represents a good faith estimate by us of the number of shares of common stock issuable upon conversion of the secured convertible

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notes and upon exercise of the warrants. For purposes of estimating the number of shares of common stock to be included in this registration statement, we calculated a good faith estimate of the number of shares of our common stock that we believe will be issuable upon conversion of the secured convertible notes and upon exercise of the warrants to account for market fluctuations, and antidilution and price protection adjustments, respectively. Should the conversion ratio result in our having insufficient shares, we will not rely upon Rule 416, but will file a new registration statement to cover the resale of such additional shares should that become necessary. In addition, should a decrease in the exercise price as a result of an issuance or sale of shares below the then current market price, result in our having insufficient shares, we will not rely upon Rule 416, but will file a new registration statement to cover the resale of such additional shares should that become necessary.

(2) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(c) and Rule 457(g) under the Securities Act of 1933, using the average of the high and low price as reported on the Over-The-Counter Bulletin Board on May 19, 2005, which was \$.02 per share.

(3) Includes a good faith estimate of the shares underlying secured convertible notes to account for market fluctuations.

(4) Includes a good faith estimate of the shares underlying warrants exercisable at \$.03 per share to account for antidilution protection adjustments.

(5) \$441.38 fee previously paid.

PURSUANT TO RULE 429 PROMULGATED UNDER THE SECURITIES ACT OF 1933, THE ENCLOSED PROSPECTUS CONSTITUTES A COMBINED PROSPECTUS ALSO RELATING TO AN AGGREGATE OF UP TO 64,567,319 SHARES OF OUR COMMON STOCK THAT WERE PREVIOUSLY REGISTERED FOR SALE IN A REGISTRATION STATEMENT, AS AMENDED, ON FORM SB-2, REGISTRATION NO. 333-119716. AS SUCH, THIS PROSPECTUS ALSO CONSTITUTES POST-EFFECTIVE AMENDMENT NO. 1 TO THE REGISTRATION STATEMENT ON FORM SB-2, REGISTRATION NO. 333-119716, WHICH SHALL HEREAFTER BECOME EFFECTIVE CONCURRENTLY WITH THE EFFECTIVENESS OF THIS REGISTRATION STATEMENT ON FORM SB-2 IN ACCORDANCE WITH SECTION 8(C) OF THE SECURITIES ACT OF 1933.

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THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

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PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED JULY 13, 2005

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CYBERLUX CORPORATION

325,000,000 SHARES OF

COMMON STOCK

This prospectus relates to the resale by the selling stockholders of up to 325,000,000 shares of our common stock, including up to 300,000,000 shares of common stock underlying secured convertible notes in a principal amount of \$1,500,000 and up to 25,000,000 issuable upon the exercise of common stock purchase warrants. The secured convertible notes are convertible into our common stock at the lower of \$0.03 or 50% of the average of the three lowest intraday trading prices for the common stock on the Over-The-Counter Bulletin Board for the 20 trading days before but not including the conversion date. The selling stockholders may sell common stock from time to time on the Over-The-Counter Bulletin Board at the prevailing market price or in negotiated transactions. The selling stockholders may be deemed underwriters of the shares of common stock which they are offering. We will pay the expenses of registering these shares.

Our common stock is registered under Section 12(g) of the Securities Exchange Act of 1934 and is listed on the Over-The-Counter Bulletin Board under the symbol "CYBL". The last reported sales price per share of our common stock as reported by the Over-The-Counter Bulletin Board on July 11, 2005, was \$.08.

Investing in these securities involves significant risks. See "Risk Factors" beginning on page 4.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2005.

The information in this Prospectus is not complete and may be changed. This Prospectus is included in the Registration Statement that was filed by Cyberlux Corporation with the Securities and Exchange Commission. The selling stockholders may not sell these securities until the registration statement becomes effective. This Prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the sale is not permitted.

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PROSPECTUS SUMMARY

The following summary highlights selected information contained in this prospectus. This summary does not contain all the information you should consider before investing in the securities. Before making an investment decision, you should read the entire prospectus carefully, including the "risk factors" section, the financial statements and the notes to the financial statements.

CYBERLUX CORPORATION

We are in the development stage and our efforts have been principally devoted to designing, developing and marketing advanced lighting systems that utilize white (and other) light emitting diodes as illumination elements. We are

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developing and marketing new product applications of diodal illumination(TM) that demonstrate added value over traditional lighting systems. Using proprietary technology, we are creating a family of products for emergency and security lighting offer extended light life and greater cost effectiveness than other existing forms of illumination. We are expanding our marketing activity into channels of retail, commercial and institutional sales.

For the year ended December 31, 2004, we generated \$23,803 in revenue and a net loss of \$6,025,848. For the quarter ended March 31, 2005, we generated \$13,568 in revenue and a net loss of \$423,660. As a result of recurring losses from operations and a net deficit in both working capital and stockholders' equity, our auditors, in their report dated March 17, 2005, have expressed substantial doubt about our ability to continue as going concern.

Our principal offices are located at 4625 Creekstone Drive, Suite 100, Research Triangle Park, Durham, North Carolina 27703, and our telephone number is (919) 474-9000. We are a Nevada corporation.

The Offering

Common stock offered by
selling stockholders..... Up to 325,000,000 shares, including the
following:

- up to 300,000,000 shares of common stock underlying secured convertible notes in the principal amount of \$1,500,000 (includes a good faith estimate of the shares underlying secured convertible notes to account for market fluctuations and antidilution protection adjustments, respectively), and
- up to 25,000,000 shares of common stock issuable upon the exercise of common stock purchase warrants at an exercise price of \$.03 per share (includes a good faith estimate of the shares underlying warrants to account for antidilution protection adjustments).

Common stock to be outstanding
after the offering..... Up to 397,525,001 shares

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Use of proceeds..... We will not receive any proceeds from the sale of the common stock. However, we will receive the sale price of any common stock we sell to the selling stockholders upon exercise of the warrants. We expect to use the proceeds received from the exercise of the warrants, if any, for general working capital purposes. However, AJW Partners,

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LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., and New Millennium Partners II, LLC will be entitled to exercise up to 18,333,333 warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event that AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., or New Millennium Partners II, LLC exercise the warrants on a cashless basis, then we will not receive any proceeds from the exercise of those warrants. In addition, we have received gross proceeds \$1,100,000 from the sale of the secured convertible notes and the investors are obligated to provide us with an additional \$400,000 within five days of this prospectus being declared effective. The proceeds received from the sale of the secured convertible notes will be used for business development purposes, working capital needs, pre-payment of interest, payment of consulting and legal fees and purchasing inventory.

Over-The-Counter Bulletin Board
Symbol..... CYBL

The above information regarding common stock to be outstanding after the offering is based on 72,525,001 shares of common stock outstanding as of July 11, 2005 and assumes the subsequent conversion of our issued secured convertible notes and exercise of warrants by our selling stockholders.

APRIL 2005 SECURITIES PURCHASE AGREEMENT

To obtain funding for our ongoing operations, we entered into a Securities Purchase Agreement with four accredited investors on April 22, 2005 for the sale of (i) \$1,500,000 in secured convertible notes and (ii) warrants to buy 25,000,000 shares of our common stock, exercisable for five years from the date of issuance at a purchase price of \$0.03 per share of common stock.

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This prospectus relates to the resale of the common stock underlying these secured convertible notes and warrants. The investors are obligated to provide us with an aggregate of \$1,500,000 as follows:

- o \$600,000 was disbursed on April 22, 2005;
- o \$500,000 was disbursed on May 24, 2005; and
- o \$400,000 will be disbursed within five days of the effectiveness of this prospectus.

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Accordingly, we have received a total of \$1,100,000 pursuant to the Securities Purchase Agreement.

The secured convertible notes bear interest at 10%, mature three years from the date of issuance, and are convertible into our common stock, at the selling stockholders' option, at the lower of (i) \$0.03 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the Over-The-Counter Bulletin Board for the 20 trading days before but not including the conversion date. Accordingly, there is in fact no limit on the number of shares into which the notes may be converted. As of July 12, 2005, the average of the three lowest intraday trading prices for our common stock during the preceding 20 trading days as reported on the Over-The-Counter Bulletin Board was \$.02 and, therefore, the conversion price for the secured convertible notes was \$.01. Based on this conversion price, the \$1,500,000 secured convertible notes, excluding interest, were convertible into 150,000,000 shares of our common stock.

AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and New Millennium Partners II, LLC have contractually agreed to restrict their ability to convert or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock.

See the "Selling Stockholders" and "Risk Factors" sections for a complete description of the secured convertible notes.

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RISK FACTORS

This investment has a high degree of risk. Before you invest you should carefully consider the risks and uncertainties described below and the other information in this prospectus. If any of the following risks actually occur, our business, operating results and financial condition could be harmed and the value of our stock could go down. This means you could lose all or a part of your investment.

Risks Relating to Our Business:

WE HAVE A HISTORY OF LOSSES WHICH MAY CONTINUE, WHICH MAY NEGATIVELY IMPACT OUR ABILITY TO ACHIEVE OUR BUSINESS OBJECTIVES.

We incurred net losses of \$6,025,848 for the year ended December 31, 2004 and \$1,494,556 for the year ended December 31, 2003. For the three months ended March 31, 2005, we incurred a net loss of \$423,660. As of March 31, 2005, we had an accumulated deficit of \$11,271,343. We cannot assure you that we can achieve or sustain profitability on a quarterly or annual basis in the future. Our operations are subject to the risks and competition inherent in the establishment of a business enterprise. There can be no assurance that future operations will be profitable. Revenues and profits, if any, will depend upon various factors, including whether we will be able to continue expansion of our revenue. We may not achieve our business objectives and the failure to achieve such goals would have an adverse impact on us.

IF WE ARE UNABLE TO OBTAIN ADDITIONAL FUNDING OUR BUSINESS OPERATIONS WILL BE HARMED AND IF WE DO OBTAIN ADDITIONAL FINANCING OUR THEN EXISTING SHAREHOLDERS

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MAY SUFFER SUBSTANTIAL DILUTION.

We will require additional funds to sustain and expand our sales and marketing activities. We anticipate that we will require up to approximately \$900,000 to fund our continued operations for the next twelve months, depending on revenue from operations. Additional capital will be required to effectively support the operations and to otherwise implement our overall business strategy. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all. The inability to obtain additional capital will restrict our ability to grow and may reduce our ability to continue to conduct business operations. If we are unable to obtain additional financing, we will likely be required to curtail our marketing and development plans and possibly cease our operations. Any additional equity financing may involve substantial dilution to our then existing shareholders.

OUR INDEPENDENT AUDITORS HAVE EXPRESSED SUBSTANTIAL DOUBT ABOUT OUR ABILITY TO CONTINUE AS A GOING CONCERN, WHICH MAY HINDER OUR ABILITY TO OBTAIN FUTURE FINANCING.

In their report dated March 17, 2005, our independent auditors stated that our financial statements for the year ended December 31, 2003 were prepared assuming that we would continue as a going concern. Our ability to continue as a going concern is an issue raised as a result of losses for the years ended December 31, 2004 and 2003 in the amounts of \$6,025,848 and \$1,494,556, respectively. We continue to experience net operating losses. Our ability to continue as a going concern is subject to our ability to generate a profit and/or obtain necessary funding from outside sources, including obtaining additional funding from the sale of our securities, increasing sales or obtaining loans and grants from various financial institutions where possible. Our continued net operating losses increase the difficulty in meeting such goals and there can be no assurances that such methods will prove successful.

IF WE ARE UNABLE TO RETAIN THE SERVICES OF MESSRS. EVANS, SCHMIDT OR RINGO, OR IF WE ARE UNABLE TO SUCCESSFULLY RECRUIT QUALIFIED MANAGERIAL AND SALES PERSONNEL HAVING EXPERIENCE IN BUSINESS, WE MAY NOT BE ABLE TO CONTINUE OUR OPERATIONS.

Our success depends to a significant extent upon the continued service of Mr. Donald F. Evans, our Chief Executive Officer, Mr. Mark D. Schmidt, our President and Mr. John Ringo, our Secretary and Corporate Counsel. Loss of the services of Messrs. Evans, Schmidt or Ringo could have a material adverse effect on our growth, revenues, and prospective business. We do not maintain key-man insurance on the life of Messrs. Evans or Ringo. In addition, in order to successfully implement and manage our business plan, we will be dependent upon, among other things, successfully recruiting qualified managerial and sales personnel having experience in business. Competition for qualified individuals is intense. There can be no assurance that we will be able to find, attract and retain existing employees or that we will be able to find, attract and retain qualified personnel on acceptable terms.

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MANY OF OUR COMPETITORS ARE LARGER AND HAVE GREATER FINANCIAL AND OTHER RESOURCES THAN WE DO AND THOSE ADVANTAGES COULD MAKE IT DIFFICULT FOR US TO COMPETE WITH THEM.

The lighting and illumination industry is extremely competitive and includes several companies that have achieved substantially greater market shares than we have, and have longer operating histories, have larger customer bases, and have substantially greater financial, development and marketing

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resources than we do. If overall demand for our products should decrease it could have a materially adverse affect on our operating results.

OUR TRADEMARK AND OTHER INTELLECTUAL PROPERTY RIGHTS MAY NOT BE ADEQUATELY PROTECTED OUTSIDE THE UNITED STATES, RESULTING IN LOSS OF REVENUE.

We believe that our trademarks, whether licensed or owned by us, and other proprietary rights are important to our success and our competitive position. In the course of our international expansion, we may, however, experience conflict with various third parties who acquire or claim ownership rights in certain trademarks. We cannot assure that the actions we have taken to establish and protect these trademarks and other proprietary rights will be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as a violation of the trademarks and proprietary rights of others. Also, we cannot assure you that others will not assert rights in, or ownership of, trademarks and other proprietary rights of ours or that we will be able to successfully resolve these types of conflicts to our satisfaction. In addition, the laws of certain foreign countries may not protect proprietary rights to the same extent, as do the laws of the United States.

OUR PRINCIPAL STOCKHOLDERS, OFFICERS AND DIRECTORS OWN A CONTROLLING INTEREST IN OUR VOTING STOCK AND INVESTORS WILL NOT HAVE ANY VOICE IN OUR MANAGEMENT.

We have issued 800,000 shares of Series B Convertible Preferred Stock to our officers and directors which are convertible into 8 million shares of common stock and, in the aggregate, have the right to cast 80 million votes in any vote by our shareholders. Combined with the number of shares of common stock held by our officers and directors, they have the right to cast approximately 70% of all votes by our shareholders. As a result, these stockholders, acting together, will have the ability to control substantially all matters submitted to our stockholders for approval, including:

- o election of our board of directors;
- o removal of any of our directors;
- o amendment of our certificate of incorporation or bylaws; and
- o adoption of measures that could delay or prevent a change in control or impede a merger, takeover or other business combination involving us.

As a result of their ownership and positions, our directors and executive officers collectively are able to influence all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. In addition, sales of significant amounts of shares held by our directors and executive officers, or the prospect of these sales, could adversely affect the market price of our common stock. Management's stock ownership may discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, which in turn could reduce our stock price or prevent our stockholders from realizing a premium over our stock price.

RISKS RELATING TO OUR CURRENT FINANCING ARRANGEMENT:

THERE ARE A LARGE NUMBER OF SHARES UNDERLYING OUR SECURED CONVERTIBLE NOTES AND WARRANTS THAT MAY BE AVAILABLE FOR FUTURE SALE AND THE SALE OF THESE SHARES MAY DEPRESS THE MARKET PRICE OF OUR COMMON STOCK.

As of July 11, 2005, we had 72,525,001 shares of common stock issued and outstanding, secured convertible notes outstanding pursuant to our securities purchase agreement dated April 22, 2005, that may be converted into an estimated

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110,000,000 shares of common stock at current market prices and outstanding warrants pursuant to our securities purchase agreement dated April 22, 2005, to purchase 18,333,333 shares of common stock. Additionally, we have an obligation pursuant to our securities purchase agreement dated April 22, 2005, to sell secured convertible notes that may be converted into an estimated 40,000,000 shares of common stock at current market prices and issue warrants to purchase 6,666,667 shares of common stock in the near future. Additionally, pursuant to our securities purchase agreement dated September 23, 2004, with the selling stockholders, we still have outstanding secured convertible notes that may be converted into an estimated 93,938,467 shares of common stock at current market prices and outstanding warrants to purchase 2,250,000 shares of common stock. In addition, the number of shares of common stock issuable upon conversion of the outstanding secured convertible notes issued pursuant to the securities purchase agreements dated September 23, 2004 and April 22, 2005 may increase if the market price of our stock declines. All of the shares, including all of the shares issuable upon conversion of the secured convertible notes and upon exercise of our warrants, may be sold without restriction. The sale of these shares may adversely affect the market price of our common stock.

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THE CONTINUOUSLY ADJUSTABLE CONVERSION PRICE FEATURE OF OUR SECURED CONVERTIBLE NOTES COULD REQUIRE US TO ISSUE A SUBSTANTIALLY GREATER NUMBER OF SHARES, WHICH WILL CAUSE DILUTION TO OUR EXISTING STOCKHOLDERS.

Our obligation to issue shares upon conversion of our secured convertible notes is essentially limitless. The following is an example of the amount of shares of our common stock that are issuable, upon conversion of our secured convertible notes (excluding accrued interest), based on market prices 25%, 50% and 75% below the market price, as of July 11, 2005 of \$0.08.

% Below Market -----	Price Per Share -----	With Discount at 50% -----	Number of Shares Issuable -----	% of Outstanding Stock -----
25%	\$.06	\$.03	50,000,000	40.81%
50%	\$.04	\$.02	75,000,000	50.84%
75%	\$.02	\$.01	150,000,000	67.41%

As illustrated, the number of shares of common stock issuable upon conversion of our secured convertible notes will increase if the market price of our stock declines, which will cause dilution to our existing stockholders.

THE CONTINUOUSLY ADJUSTABLE CONVERSION PRICE FEATURE OF OUR SECURED CONVERTIBLE NOTES MAY HAVE A DEPRESSIVE EFFECT ON THE PRICE OF OUR COMMON STOCK.

The secured convertible notes are convertible into shares of our common stock at a 50% discount to the trading price of the common stock prior to the conversion. The significant downward pressure on the price of the common stock as the selling stockholders convert and sell material amounts of common stock could have an adverse effect on our stock price. In addition, not only the sale of shares issued upon conversion or exercise of secured convertible notes, series A convertible preferred stock and warrants, but also the mere perception that these sales could occur, may adversely affect the market price of the

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common stock.

THE ISSUANCE OF SHARES UPON CONVERSION OF THE SECURED CONVERTIBLE NOTES AND EXERCISE OF OUTSTANDING WARRANTS MAY CAUSE IMMEDIATE AND SUBSTANTIAL DILUTION TO OUR EXISTING STOCKHOLDERS.

The issuance of shares upon conversion of the secured convertible notes and exercise of warrants may result in substantial dilution to the interests of other stockholders since the selling stockholders may ultimately convert and sell the full amount issuable on conversion. Although AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., and New Millennium Partners II, LLC may not convert their secured convertible notes and/or exercise their warrants if such conversion or exercise would cause them to own more than 4.9% of our outstanding common stock, this restriction does not prevent AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., and New Millennium Partners II, LLC from converting and/or exercising some of their holdings and then converting the rest of their holdings. In this way, AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., and New Millennium Partners II, LLC could sell more than this limit while never holding more than this limit. There is no upper limit on the number of shares that may be issued which will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering.

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IN THE EVENT THAT OUR STOCK PRICE DECLINES, THE SHARES OF COMMON STOCK ALLOCATED FOR CONVERSION OF THE SECURED CONVERTIBLE NOTES AND REGISTERED PURSUANT TO THIS PROSPECTUS MAY NOT BE ADEQUATE AND WE MAY BE REQUIRED TO FILE A SUBSEQUENT REGISTRATION STATEMENT COVERING ADDITIONAL SHARES. IF THE SHARES WE HAVE ALLOCATED AND ARE REGISTERING HERewith ARE NOT ADEQUATE AND WE ARE REQUIRED TO FILE AN ADDITIONAL REGISTRATION STATEMENT, WE MAY INCUR SUBSTANTIAL COSTS IN CONNECTION THEREWITH.

Based on our current market price and the potential decrease in our market price as a result of the issuance of shares upon conversion of the secured convertible notes, we have made a good faith estimate as to the amount of shares of common stock that we are required to register and allocate for conversion of the secured convertible notes. Accordingly, we have allocated and registered 300,000,000 shares to cover the conversion of the secured convertible notes. In the event that our stock price decreases, the shares of common stock we have allocated for conversion of the secured convertible notes and are registering hereunder may not be adequate. If the shares we have allocated to the registration statement are not adequate and we are required to file an additional registration statement, we may incur substantial costs in connection with the preparation and filing of such registration statement.

IF WE ARE REQUIRED FOR ANY REASON TO REPAY OUR OUTSTANDING SECURED CONVERTIBLE NOTES, WE WOULD BE REQUIRED TO DEplete OUR WORKING CAPITAL, IF AVAILABLE, OR RAISE ADDITIONAL FUNDS. OUR FAILURE TO REPAY THE SECURED CONVERTIBLE NOTES, IF REQUIRED, COULD RESULT IN LEGAL ACTION AGAINST US, WHICH COULD REQUIRE THE SALE OF SUBSTANTIAL ASSETS.

In April 2005, we entered into a Securities Purchase Agreement for the sale of an aggregate of \$1,500,000 principal amount of secured convertible notes. The secured convertible notes are due and payable, with 10% interest, three years from the date of issuance, unless sooner converted into shares of our common stock. Although we currently have \$1,100,000 secured convertible

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notes outstanding, the investors are irrevocably obligated to purchase additional secured convertible notes of \$400,000 within five days of the effectiveness of this registration statement. In addition, any event of default under our secured convertible notes issued pursuant to our September 23, 2004 or April 22, 2005 securities purchase agreements, such as our failure to repay the principal or interest when due, our failure to issue shares of common stock upon conversion by the holder, our failure to timely file a registration statement or have such registration statement declared effective, breach of any covenant, representation or warranty in the Securities Purchase Agreement or related convertible note, the assignment or appointment of a receiver to control a substantial part of our property or business, the filing of a money judgment, writ or similar process against our company in excess of \$50,000, the commencement of a bankruptcy, insolvency, reorganization or liquidation proceeding against our company and the delisting of our common stock could require the early repayment of the secured convertible notes, including a default interest rate of 15% on the outstanding principal balance of the notes if the default is not cured with the specified grace period. We anticipate that the full amount of the secured convertible notes will be converted into shares of our common stock, in accordance with the terms of the secured convertible notes. If we were required to repay the secured convertible notes, we would be required to use our limited working capital and raise additional funds. If we were unable to repay the notes when required, the note holders could commence legal action against us and foreclose on all of our assets to recover the amounts due. Any such action would require us to curtail or cease operations.

RISKS RELATING TO OUR COMMON STOCK:

WE HAVE ISSUED A LARGE AMOUNT OF STOCK IN LIEU OF CASH FOR PAYMENT OF EXPENSES AND EXPECT TO CONTINUE THIS PRACTICE IN THE FUTURE. SUCH ISSUANCES OF STOCK WILL CAUSE DILUTION TO OUR EXISTING STOCKHOLDERS.

Due to our limited economic resources, we try to issue stock in lieu of cash for payment of expenses and services provided for us. In 2004, we issued 6,335,000 shares of common stock in exchange for expenses and services rendered, and we issued 800,000 shares of series B convertible preferred stock to officers and directors in exchange for the retirement of debt owed to them. We anticipate issuing shares of common stock whenever possible in lieu of cash to conserve our financial position. The number of shares of common stock issued is directly related to our stock price at the time of issuance. In the event that our stock price drops, we will be required to issue larger amounts of shares for expenses and services rendered, if the other party is willing to accept stock at all. The issuance of shares of common stock will have the effect of diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering.

IF WE FAIL TO REMAIN CURRENT ON OUR REPORTING REQUIREMENTS, WE COULD BE REMOVED FROM THE OTC BULLETIN BOARD WHICH WOULD LIMIT THE ABILITY OF BROKER-DEALERS TO SELL OUR SECURITIES AND THE ABILITY OF STOCKHOLDERS TO SELL THEIR SECURITIES IN THE SECONDARY MARKET.

Companies trading on the OTC Bulletin Board, such as us, must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTC Bulletin Board. If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board. As

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a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

OUR COMMON STOCK IS SUBJECT TO THE "PENNY STOCK" RULES OF THE SEC AND THE TRADING MARKET IN OUR SECURITIES IS LIMITED, WHICH MAKES TRANSACTIONS IN OUR STOCK CUMBERSOME AND MAY REDUCE THE VALUE OF AN INVESTMENT IN OUR STOCK.

The Securities and Exchange Commission has adopted Rule 15c-9 which establishes the definition of a "penny stock," for the purposes relevant to us, as any equity security that has a market price of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

- o that a broker or dealer approve a person's account for transactions in penny stocks; and
- o the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

In order to approve a person's account for transactions in penny stocks, the broker or dealer must:

- o obtain financial information and investment experience objectives of the person; and
- o make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the Commission relating to the penny stock market, which, in highlight form:

- o sets forth the basis on which the broker or dealer made the suitability determination; and
- o that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the "penny stock" rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the selling stockholders. We will not receive any

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proceeds from the sale of shares of common stock in this offering. However, we will receive the sale price of any common stock we sell to the selling stockholders upon exercise of the warrants. In connection with the securities purchase agreement dated April 22, 2005, we are obligated to issue to the investors 25 million warrants, which are exercisable at \$0.03 per share for a period of five years from issuance. If the investors were to exercise all 25 million warrants issued pursuant to the securities purchase agreement, we would receive \$750,000. In the event that our stock price does not exceed the warrant exercise price of \$0.03 per share, it is unlikely that the investors would exercise the warrants, in which case would we not receive any of the proceeds from the sale of the warrants. We expect to use the proceeds received from the exercise of the warrants, if any, for general working capital purposes. However, AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., and New Millennium Partners II, LLC will be entitled to exercise up to 18,333,333 warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event that AJW Partners, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd., or New Millennium Partners II, LLC exercise the warrants on a cashless basis, then we will not receive any proceeds from the exercise of those warrants. In addition, we have received gross proceeds \$1,100,000 from the sale of the secured convertible notes and the investors are obligated to provide us with an additional \$400,000 within five days of this prospectus being declared effective. The proceeds received from the sale of the secured convertible notes will be used for business development purposes, working capital needs, pre-payment of interest, payment of consulting and legal fees and purchasing inventory.

SECURITIES PURCHASE AGREEMENT

To obtain funding for our ongoing operations, we entered into a Securities Purchase Agreement with four accredited investors on April 22, 2005 for the sale of (i) \$1,500,000 in secured convertible notes and (ii) warrants to purchase 25,000,000 shares of our common stock.

This prospectus relates to the resale of the common stock underlying these secured convertible notes and warrants. The investors are obligated to provide us with an aggregate of \$1,500,000 as follows:

- o \$600,000 was disbursed on April 22, 2005;
- o \$500,000 was disbursed on May 24, 2005;
- o \$400,000 will be disbursed within five days of the effectiveness of this prospectus.

Accordingly, we have received a total of \$1,100,000 pursuant to the Securities Purchase Agreement.

The secured convertible notes bear interest at 10%, mature three years from the date of issuance, and are convertible into our common stock, at the investors' option, at the lower of:

- o \$0.03; or
- o 50% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before but not including the conversion date.

We have a call option under the terms of the secured convertible notes. The call option provides us with the right to prepay all of the outstanding secured convertible notes at any time, provided we are not in default and our stock is trading at or below \$.03 per share. Prepayment of the notes is to be made in cash equal to either (i) 125% of the outstanding principal and accrued

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interest for prepayments occurring within 30 days following the issue date of the secured convertible notes; (ii) 135% of the outstanding principal and accrued interest for prepayments occurring between 31 and 60 days following the issue date of the secured convertible notes; and (iii) 150% of the outstanding principal and accrued interest for prepayments occurring after the 60th day following the issue date of the secured convertible notes.

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Our right to repay the notes is exercisable on not less than ten trading days prior written notice to the holders of the secured convertible notes. For notice purposes, a trading day is any day on which our common stock is traded for any period on the OTC Bulletin Board. Notwithstanding the notice of prepayment, the holders of the secured convertible notes have the right at all times to convert all or any portion of the secured convertible notes prior to payment of the prepayment amount.

We also has a partial call option under the terms of the secured convertible notes in any month in which the current price of our common stock is below \$0.03. Under the terms of the partial call option, we have the right to pay the outstanding principal amount of the secured convertible notes plus one-month's interest for that month, which will stay any conversions of the secured convertible notes by the holders for that month. The principal amount of the secured convertible notes to be repaid is determined by dividing the then outstanding principal amount of the notes by the maturity of the notes in months, or 36.

The full principal amount of the secured convertible notes is due upon default under the terms of secured convertible notes. In addition, we have granted the investors a security interest in substantially all of our assets and intellectual property and registration rights. We are liable for breach of any covenant, representation or warranty contained in the Securities Purchase Agreement for a period of two years from the date that the investors distributed the final \$400,000. In the event that we breach any representation or warranty regarding the condition of our company as set forth in the Securities Purchase Agreement, we are liable to pay liquidated damages in shares or cash, at the election of the investors, equal to three percent of the outstanding amount of the secured convertible notes per month plus accrued and unpaid interest. In the event that we breach any covenant as set forth in the Securities Purchase Agreement, including the failure to comply with blue sky laws, timely file all public reports, use the proceeds from the sale of the secured convertible notes in the agreed upon manner, obtain written consent from the investors to negotiate or contract with a party to for additional financing, reserve and have authorized the required number of shares of common stock or the maintenance of our shares of common stock on an exchange or automated quotation system, then we are liable to pay liquidated damages in shares or cash, at the election of the investors, equal to three percent of the outstanding amount of the secured convertible notes per month plus accrued and unpaid interest.

In connection with the Securities Purchase Agreement, we executed a Security Agreement and an Intellectual Property Security Agreement in favor of the investors granting them a first priority security interest in all of our goods, inventory, contractual rights and general intangibles, receivables, documents, instruments, chattel paper, and intellectual property. Under the Security Agreement and Intellectual Property Security Agreement, events of default occur upon:

- o The occurrence of an event of default (as defined in the secured convertible notes) under the secured convertible notes;
- o Any representation or warranty we made in the Security Agreement or

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in the Intellectual Property Security Agreement shall prove to have been incorrect in any material respect when made;

- o The failure by us to observe or perform any of our obligations under the Security Agreement or in the Intellectual Property Security Agreement for ten (10) days after receipt of notice of such failure from the investors; and
- o Any breach of, or default under, the Warrants.

An event of default under the secured convertible notes occurs if we:

- o Fail to pay the principal or interest when due;
- o Do not issue shares of common stock upon receipt of a conversion notice;
- o Fail to file a registration statement within 45 days after April 22, 2005 or fail to have the registration statement effective within 90 days after April 22, 2005;
- o Breach any material covenant or other material term or condition in the secured convertible notes or the Securities Purchase Agreement;
- o Breach any representation or warranty made in the Securities Purchase Agreement or other document executed in connection therewith;

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- o Apply for or consent to the appointment of a receiver or trustee for us or any of our subsidiaries or for a substantial part of our of our subsidiaries' property or business, or such a receiver or trustee shall otherwise be appointed;
- o Have any money judgment, writ or similar process shall be entered or filed against us or any of our subsidiaries or any of our property or other assets for more than \$50,000, and shall remain unvacated, unbonded or unstayed for a period of twenty (20) days unless otherwise consented to by the investors;
- o Institute or have instituted against us or any of our subsidiaries any bankruptcy, insolvency, reorganization or liquidation proceedings or other proceedings for relief under any bankruptcy law or any law for the relief of debtors;
- o Fail to maintain the quotation of our common stock on one of the OTCBB or an equivalent replacement exchange, the Nasdaq National Market, the Nasdaq SmallCap Market, the New York Stock Exchange, or the American Stock Exchange; or
- o Default under any other secured convertible note issued pursuant to the Securities Purchase Agreement.

Upon occurrence of any event of default under either the Security Agreement or the Intellectual Property Security Agreement, the investors shall have the right to exercise all of the remedies conferred under the Security Agreement, the Intellectual Property and under the secured convertible notes, and the investors shall have all the rights and remedies of a secured party under the Uniform Commercial Code and/or any other applicable law (including the Uniform Commercial Code of any jurisdiction in which any collateral is then located). The investors shall have the following rights and powers:

- o To take possession of the collateral and, for that purpose, enter, with the aid and assistance of any person, any premises where the collateral, or any part thereof, is or may be placed and remove the same, and we shall assemble the collateral and make it available to the investors at places which the investors shall reasonably select, whether at our premises or elsewhere, and make available to the investors, without rent, all of our respective premises and

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- facilities for the purpose of the investors taking possession of, removing or putting the collateral in saleable or disposable form; and
- o To operate our business using the collateral and shall have the right to assign, sell, lease or otherwise dispose of and deliver all or any part of the collateral, at public or private sale or otherwise, either with or without special conditions or stipulations, for cash or on credit or for future delivery, in such parcel or parcels and at such time or times and at such place or places, and upon such terms and conditions as the investors may deem commercially reasonable, all without (except as shall be required by applicable statute and cannot be waived) advertisement or demand upon or notice to us or our right of redemption, which we expressly waived. Upon each such sale, lease, assignment or other transfer of collateral, the investors may, unless prohibited by applicable law which cannot be waived, purchase all or any part of the collateral being sold, free from and discharged of all trusts, claims, right of redemption and equities by us, which we waived and released.

The warrants are exercisable until five years from the date of issuance at a purchase price of \$0.03 per share. The selling stockholders will be entitled to exercise the warrants on a cashless basis if the shares of common stock underlying the warrants are not then registered pursuant to an effective registration statement. In the event that the selling stockholder exercises the warrants on a cashless basis, then we will not receive any proceeds. In addition, the exercise price of the warrants will be adjusted in the event we issue common stock at a price below market, with the exception of any securities issued as of the date of this warrant or issued in connection with the secured convertible notes issued pursuant to the Securities Purchase Agreement, dated April 22, 2005.

Upon the issuance of shares of common stock below the market price, the exercise price of the warrants will be reduced accordingly. The market price is determined by averaging the last reported sale prices for our shares of common stock for the five trading days immediately preceding such issuance as set forth on our principal trading market. The exercise price shall be determined by multiplying the exercise price in effect immediately prior to the dilutive issuance by a fraction. The numerator of the fraction is equal to the sum of the number of shares outstanding immediately prior to the offering plus the quotient of the amount of consideration received by us in connection with the issuance divided by the market price in effect immediately prior to the issuance. The denominator of such issuance shall be equal to the number of shares outstanding after the dilutive issuance.

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The conversion price of the secured convertible notes and the exercise price of the warrants may be adjusted in certain circumstances such as if we pay a stock dividend, subdivide or combine outstanding shares of common stock into a greater or lesser number of shares, or take such other actions as would otherwise result in dilution of the selling stockholder's position.

The selling stockholders have contractually agreed to restrict their ability to convert their secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates in the aggregate after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock.

A complete copy of the Securities Purchase Agreements and related

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documents are incorporated by reference as exhibits to our Form SB-2 registration statement relating to this prospectus.

Sample Conversion Calculation

The number of shares of common stock issuable upon conversion of the notes is determined by dividing that portion of the principal of the notes to be converted and interest, if any, by the conversion price. For example, assuming conversion of \$1,500,000 of notes on July 12, 2005, a conversion price of \$0.01 per share, the number of shares issuable upon conversion would be:

$$\$1,500,000 / \$0.01 = 150,000,000 \text{ shares}$$

The following is an example of the amount of shares of our common stock that are issuable, upon conversion of the principal amount of our secured convertible notes, based on market prices 25%, 50% and 75% below the market price, as of July 11, 2005 of \$0.08.

% Below Market -----	Price Per Share -----	With Discount at 50% -----	Number of Shares Issuable -----	% of Outstanding Stock -----
25%	\$.06	\$.03	50,000,000	40.81%
50%	\$.04	\$.02	75,000,000	50.84%
75%	\$.02	\$.01	150,000,000	67.41%

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is quoted on the OTC Bulletin Board under the symbol "CYBL".

For the periods indicated, the following table sets forth the high and low bid prices per share of common stock. These prices represent inter-dealer quotations without retail markup, markdown, or commission and may not necessarily represent actual transactions.

	High (\$) -----	Low (\$) -----
2003		
Third Quarter (1)	1.05	0.10
Fourth Quarter	0.55	0.12
2004		
First Quarter	0.53	0.19
Second Quarter	0.85	0.27
Third Quarter	0.55	0.23
Fourth Quarter	0.35	0.06
2004		
First Quarter	0.07	0.02
Second Quarter	0.20	0.02
Third Quarter (2)	0.12	0.07

(1) Our stock first traded on July 13, 2003.

(2) As of July 11, 2005.

HOLDERS

As of July 11, 2005, we had approximately 368 holders of our common stock. The number of record holders was determined from the records of our transfer agent and does not include beneficial owners of common stock whose shares are held in the names of various security brokers, dealers, and registered clearing agencies. The transfer agent of our common stock is Pacific Stock Transfer Company, 500 E. Warm Springs Road, Suite 240, Las Vegas, Nevada 89119.

We have never declared or paid any cash dividends on our common stock. We do not anticipate paying any cash dividends to stockholders in the foreseeable future. In addition, any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, and such other factors as the Board of Directors deem relevant.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

Some of the information in this Form SB-2 contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue," or similar words. You should read statements that contain these words carefully because they:

- o discuss our future expectations;
- o contain projections of our future results of operations or of our financial condition; and
- o state other "forward-looking" information.

We believe it is important to communicate our expectations. However, there may be events in the future that we are not able to accurately predict or over which we have no control. Our actual results and the timing of certain events could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors," "Business" and elsewhere in this prospectus. See "Risk Factors."

OVERVIEW

We are in the development stage and our efforts have been principally devoted to designing, developing and marketing advanced lighting systems that utilize white (and other) light emitting diodes as illumination elements.

We are developing and marketing new product applications of diodal illumination (TM) that demonstrate added value over traditional lighting systems. Using proprietary technology, we are creating a family of products for emergency and security lighting offer extended light life and greater cost effectiveness than other existing forms of illumination. We are expanding our marketing activity into channels of retail, commercial and institutional sales.

Our target markets include long-term interim lighting needs in hotels,

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hospitals, nursing homes, airports, shopping centers and multiple family complexes; long-term evacuation solutions for theaters, office and public buildings; reduced maintenance cost solutions for property managers as applied to walkway, corridor or landscape lighting; and certain sensitive applications for the military.

During the second quarter of 2004, we met with officials from the State of New York who expressed interest in our long-term interim lighting solutions. We also met with security administrators of the Metropolitan Transit Authority and the Port Authority in the City of New York. The Metropolitan Transit Authority requested that we submit a proposal to provide long term interim lighting pilot installations in New York City's subway system to include passenger platforms, rail cars and tunnel accesses. In June 2004, we submitted a proposal to the MTA for a pilot program. As a result of our meeting with the Port Authority, we anticipate a similar proposal request related to Newark, LaGuardia and JFK airports and the Holland Tunnel system, although we have not received a proposal request as of the date of this filing and no assurance can be given that we will receive a proposal request. In March 2005, we submitted an implementation proposal for subway cars and stairwells. In March of 2005, we submitted a revised proposal to the MTA that reduce the scope to providing emergency lighting for only the subway cars and platforms. The proposal also called for an initial subway car installation trial to prove the capability and value of our technology. In April of 2005, we met with the Vice President of Engineering for the MTA and discussed our proposal and the timing for a trial within the subway system. Based on this meeting and the resulting discussions of the time period required to accomplish our trial objectives, we understand the MTA is still evaluating the trial proposal but this is not a priority at this point and no determination can be made at this time as to when the MTA will make a decision on our proposal. Therefore, we plan to re-address the Port Authority with a similar proposal for an initial subway car installation trial to prove the capability and value of our technology. This program will be formally submitted in the third quarter of 2005.

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CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and judgments that affect our reported assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience and on various other assumptions we believe to be reasonable under the circumstances. Future events, however, may differ markedly from our current expectations and assumptions. While there are a number of significant accounting policies affecting our financial statements; we believe the following critical accounting policies involve the most complex, difficult and subjective estimates and judgments:

- o stock-based compensation; and
- o revenue recognition.

STOCK-BASED COMPENSATION

In December 2002, the FASB issued SFAS No. 148 - Accounting for Stock-Based Compensation - Transition and Disclosure. This statement amends SFAS No. 123 - Accounting for Stock-Based Compensation, providing alternative methods of voluntarily transitioning to the fair market value based method of accounting

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for stock based employee compensation. FAS 148 also requires disclosure of the method used to account for stock-based employee compensation and the effect of the method in both the annual and interim financial statements. The provisions of this statement related to transition methods are effective for fiscal years ending after December 15, 2002, while provisions related to disclosure requirements are effective in financial reports for interim periods beginning after December 31, 2002.

The Company elected to continue to account for stock-based compensation plans using the intrinsic value-based method of accounting prescribed by APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Under the provisions of APB No. 25, compensation expense is measured at the grant date for the difference between the fair value of the stock and the exercise price.

REVENUE RECOGNITION

For revenue from product sales, the Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectibility of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2004

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REVENUES

Revenues for the three months ended March 31, 2005 were \$ 13,568 and compares to \$9,968 for the same period ended March 31, 2004. Included in sales for the quarter is a \$10,000 contract with Kings Park School District of Long Island, New York for the installation of our ELS products in a local middle school.

COST OF SALES

Cost of sales for the first quarter were \$6,369 and produced a gross margin on sales of 53%. This compares to \$8,395 in cost of sales for the quarter ended March 31, 2004 which produced a gross margin of 16%.

OPERATING EXPENSES

Operating expenses for the quarter ended March 31, 2005 were \$388,153 and compares to \$287,089 for the same period ended March, 31, 2004. Included in the Quarter ended March 31, 2005 are \$21,323 in expenses for market development and

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literature. This compares to \$0 for the first quarter of 2004.

As a result of limited capital resources and minimal revenues from operations from our inception, we have relied on the issuance of equity securities to non-employees in exchange for services. Our management enters into equity compensation agreements with non-employees if it is in our best interest under terms and conditions consistent with the requirements of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation. In order to conserve our limited operating capital resources, we anticipate continuing to compensate non-employees for services during the next twelve months. This policy may have a material effect on our results of operations during the next twelve months.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003 COMPARED.

Revenues for the year ended December 31, 2004 were \$23,803 and include \$9,974 for the pilot installation of our new ELS product for the City of Cleveland, Ohio. This compares to revenues of \$74,238 for the year ended December 31, 2003.

Cost of goods sold were \$160,260 for 2004 compared with \$161,984 for 2003. Much of the design effort on the ELS product was costed into the product installation for the City of Cleveland.

Operating expenses for the year ended December 31, 2004 were \$4,098,444 compared with \$1,268,802 for the year ended December 31, 2003. Operating expenses for consulting services for the year ended December 31, 2004 were \$2,116,672 and most of this expense was the result of issuance of common stock of the Company, recorded at the market price on the date of the awards, in lieu of cash payments. The parties who received services provided either market development or capital fund-raising services.

	Market Development -----	Fund Raising -----	Serv Perfo -----
Cash Payments			
New Edison	72,900.00		Marketin
Dudgeon Enterprises	15,000.00		Business
Geiger & Associates	21,000.00		Business
Burns & Associates	11,756.25		Business
Phil Snowden	11,756.25		Business
Miscellaneous	14,800.85		Business

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Stock Payments			
Greenfield Capital		125,000.00	Investme
Sichenzia Ross et al.		25,000.00	Legal Se
Current Capital		243,750.00	Investor

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Advisory Group, Ltd.	93,750.00	Investor
David Bromberg	40,000.00	Investor
Phil Snowden	10,000.00	Business
Clark Burns	10,000.00	Business
Frank Marasca	15,000.00	Business
William Schnell	15,000.00	Business
Bruce Geiger	15,000.00	Business
NIR Warrants	216,285.00	Investme
Black-Scholes Calculation	182,969.00	**

Note** These entries were recorded based on the Black-Scholes calculations that were performed to establish the fair market value of stock awarded in exchange for services.

The other \$1,981,722 million in Operating expenses for the year ended December 31, 2004 included:

	Year Ended	12/31/2004

Salaries & Benefits		977,529
Marketing and advertising		109,651
Rent		35,954
Insurance		8,389
Depreciation and amortization		47,686
Research and development		391,421
Legal Expense		64,229
Accounting Services		63,915
Investor Relations		62,354
Travel, Living and Entertainment		167,035
Office Expenses		53,609

		1,981,772

Operating expenses for 2004 also include \$296,008 representing costs incurred in the design and pre-production of three products to be marketed during the second quarter of 2005. Accounting practices have historically attempted to match revenues and costs; however, in compliance with the requirements of FASB number 2, we have taken these costs to expense during the year 2004.

Interest expense for 2004 was \$1,600,087 compared to \$138,008 for 2003. Included in interest expense for 2004 is \$1,500,000 which was booked to recognize the imbedded beneficial conversion feature of the \$1,500,000 convertible notes payable entered into during the 3rd and 4th quarters of 2004.

The net loss realized for 2004 was \$6,825,848, or \$0.41 per share on an average of 16,701,174 shares outstanding and compares to a net loss of \$2,230,806, or \$0.29 per share on an average of 7,652,012 shares outstanding for the year 2003.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2005, we had a working capital deficit of \$875,666. This compares to a working capital deficit of \$ 442,303 as of December 31, 2004. As a result of our operating losses for the first three months ended March 31, 2005,

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we generated a cash flow deficit of \$326,442 from operating activities. Cash flows used in investing activities was \$963 during the quarter. Cash flows used in financing activities were \$77,510 on payment of short-term notes payable for the first three months ended March 31, 2005.

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While we have raised capital to meet our working capital and financing needs in the past, additional financing is required in order to meet our current and projected cash flow deficits from operations and development.

By adjusting our operations and development to the level of capitalization, we believe we have sufficient capital resources to meet projected cash flow deficits through the next twelve months. However, if thereafter, we are not successful in generating sufficient liquidity from operations or in raising sufficient capital resources, on terms acceptable to us, this could have a material adverse effect on our business, results of operations, liquidity and financial condition.

Our independent certified public accountant has stated in their report, dated as of March 17, 2005, that we have incurred operating losses in the last two years, and that we are dependent upon management's ability to develop profitable operations. These factors among others may raise substantial doubt about our ability to continue as a going concern.

September 2004 Securities Purchase Agreement

To obtain funding for our ongoing operations, we entered into a Securities Purchase Agreement with four accredited investors, AJW Partners, LLC, AJW Qualified Partners LLC, AJW Offshore, Ltd. and New Millennium Capital Partners II, LLC, on September 23, 2004 for the sale of (i) \$1,500,000 in secured convertible notes and (ii) warrants to buy 2,250,000 shares of our common stock. The investors provided us with an aggregate of \$1,500,000 as follows:

- o \$500,000 was disbursed on September 23, 2004;
- o \$500,000 was disbursed on October 20, 2004; and
- o \$500,000 was disbursed on November 18, 2004.

The proceeds received from the sale of the secured convertible notes were used for business development purposes, working capital needs, pre-payment of interest, payment of consulting and legal fees and purchasing inventory. As of July 11, 2005, \$560,615.33 of the convertible debentures has been converted, resulting in the issuance of 46,352,210 shares of common stock and \$939,384.67 remains outstanding.

The secured convertible notes bear interest at 10%, mature two years from the date of issuance, and are convertible into our common stock, at the investors' option, at the lower of (i) \$0.72 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the Over-The-Counter Bulletin Board for the 20 trading days before but not including the conversion date. The full principal amount of the secured convertible notes is due upon default under the terms of secured convertible notes. The warrants are exercisable until five years from the date of issuance at a purchase price of \$0.50 per share. In addition, the conversion price of the secured convertible

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notes and the exercise price of the warrants will be adjusted in the event that we issue common stock at a price below the fixed conversion price, below market price, with the exception of any securities issued in connection with the Securities Purchase Agreement. The conversion price of the secured convertible notes and the exercise price of the warrants may be adjusted in certain circumstances such as if we pay a stock dividend, subdivide or combine outstanding shares of common stock into a greater or lesser number of shares, or take such other actions as would otherwise result in dilution of the selling stockholder's position. As of the date of this filing, the conversion price for the secured convertible debentures and the exercise price of the warrants have not been adjusted. The selling stockholders have contractually agreed to restrict their ability to convert or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock. In addition, we have granted the investors a security interest in substantially all of our assets and intellectual property and registration rights.

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Since the conversion price was less than the market price of the common stock at the time the secured convertible notes are issued, we recognized a charge relating to the beneficial conversion feature of the secured convertible notes during the quarter in which they are issued, including the third quarter of fiscal 2004 when \$1,500,000 of secured convertible notes were issued.

April 2005 Securities Purchase Agreement

To obtain funding for our ongoing operations, we entered into a Securities Purchase Agreement with four accredited investors, AJW Partners, LLC, AJW Qualified Partners LLC, AJW Offshore, Ltd. and New Millennium Capital Partners II, LLC, on April 22, 2005 for the sale of (i) \$1,500,000 in secured convertible notes and (ii) warrants to buy 25,000,000 shares of our common stock. The investors are obligated to provide us with an aggregate of \$1,500,000 as follows:

- o \$600,000 was disbursed on April 22, 2005;
- o \$500,000 was disbursed on May 24, 2005; and
- o \$400,000 will be disbursed within five days of the effectiveness of this prospectus.

Accordingly, we have received a total of \$1,100,000 pursuant to the April 2005 Securities Purchase Agreement.

The proceeds received from the sale of the secured convertible notes were used for business development purposes, working capital needs, pre-payment of interest, payment of consulting and legal fees and purchasing inventory.

The secured convertible notes bear interest at 10%, mature three years

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from the date of issuance, and are convertible into our common stock, at the investors' option, at the lower of (i) \$0.03 or (ii) 50% of the average of the three lowest intraday trading prices for the common stock on the Over-The-Counter Bulletin Board for the 20 trading days before but not including the conversion date. The full principal amount of the secured convertible notes is due upon default under the terms of secured convertible notes. The warrants are exercisable until five years from the date of issuance at a purchase price of \$0.03 per share. In addition, the conversion price of the secured convertible notes and the exercise price of the warrants will be adjusted in the event that we issue common stock at a price below the fixed conversion price, below market price, with the exception of any securities issued in connection with the Securities Purchase Agreement. The conversion price of the secured convertible notes and the exercise price of the warrants may be adjusted in certain circumstances such as if we pay a stock dividend, subdivide or combine outstanding shares of common stock into a greater or lesser number of shares, or take such other actions as would otherwise result in dilution of the selling stockholder's position. As of the date of this filing, the conversion price for the secured convertible debentures and the exercise price of the warrants have not been adjusted. The selling stockholders have contractually agreed to restrict their ability to convert or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock. In addition, we have granted the investors a security interest in substantially all of our assets and intellectual property and registration rights.

Since the conversion price will be less than the market price of the common stock at the time the secured convertible notes are issued, we anticipate recognizing a charge relating to the beneficial conversion feature of the secured convertible notes during the quarter in which they are issued, including the second quarter of fiscal 2005 when \$1,100,000 of secured convertible notes were issued.

We will still need additional investments in order to continue operations to cash flow break even. Additional investments are being sought, but we cannot guarantee that we will be able to obtain such investments. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. However, the trading price of our common stock and the downturn in the U.S. stock and debt markets could make it more difficult to obtain financing through the issuance of equity or debt securities. Even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, fail to collect significant amounts owed to us, or experience unexpected cash requirements that would force us to seek alternative financing. Further, if we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations again.

RECENT ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 141, "Business Combinations" (SFAS No. 141), and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). The FASB also issued Statement of Financial Accounting Standards No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets" (SFAS No. 143),

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and Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144) in August and October 2001, respectively.

SFAS No. 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method. The adoption of SFAS No. 141 had no material impact on the Company's financial statements.

Effective January 1, 2002, the Company adopted SFAS No. 142. Under the new rules, the Company will no longer amortize goodwill and other intangible assets with indefinite lives, but such assets will be subject to periodic testing for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets must be tested for impairment, and write-downs to be included in results from operations may be necessary. SFAS No. 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption.

Any goodwill impairment loss recognized as a result of the transitional goodwill impairment test will be recorded as a cumulative effect of a change in accounting principle no later than the end of fiscal year 2002. The adoption of SFAS No. 142 had no material impact on the Company's financial statements

SFAS No. 143 establishes accounting standards for the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. It also provides accounting guidance for legal obligations associated with the retirement of tangible long-lived assets. SFAS No. 143 is effective in fiscal years beginning after June 15, 2002, with early adoption permitted. The Company expects that the provisions of SFAS No. 143 will not have a material impact on its results of operations and financial position upon adoption. The Company plans to adopt SFAS No. 143 effective January 1, 2003.

SFAS No. 144 establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. SFAS No. 144 superseded Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS No. 121), and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". The Company adopted SFAS No. 144 effective January 1, 2002. The adoption of SFAS No. 144 had no material impact on Company's financial statements.

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This Statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements" and FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers". This Statement amends FASB Statement No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that a similar to sale-leaseback transactions. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

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In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In October 2002, the FASB issued Statement No. 147, "Acquisitions of Certain Financial Institutions—an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9", which removes acquisitions of financial institutions from the scope of both Statement 72 and Interpretation 9 and requires that those transactions be accounted for in accordance with Statements No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets. In addition, this Statement amends SFAS No. 144, Accounting for the Impairment or Disposal of

Long-Lived Assets, to include in its scope long-term customer relationship intangible assets of financial institutions such as depositor- and borrower-relationship intangible assets and credit cardholder intangible assets. The requirements relating to acquisitions of financial institutions are effective for acquisitions for which the date of acquisition is on or after October 1, 2002. The provisions related to accounting for the impairment or disposal of certain long-term customer-relationship intangible assets are effective on October 1, 2002. The adoption of this Statement did not have a material impact to the Company's financial position or results of operations as the Company has not engaged in either of these activities.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure", which amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of Statement 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of this statement did not have a material impact on the Company's financial position or results of operations as the Company has not elected to change to the fair value based method of accounting for stock-based employee compensation.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of Interpretation 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning

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after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

PRODUCT RESEARCH AND DEVELOPMENT

We anticipate incurring approximately \$500,000 in research and development expenditures in connection with the development of our Wireless Lighting System, Aeon cabinet lighting and Cyclone Power Light Plant during the next twelve months.

These projected expenditures are dependent upon our generating revenues and obtaining sources of financing in excess of our existing capital resources. There is no guarantee that we will be successful in raising the funds required or generating revenues sufficient to fund the projected costs of research and development during the next twelve months.

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ACQUISITION OR DISPOSITION OF PLANT AND EQUIPMENT

We do not anticipate the sale of any significant property, plant or equipment during the next twelve months. We do not anticipate the acquisition of any significant property, plant or equipment during the next 12 months.

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BUSINESS

OVERVIEW

We are a Nevada corporation that was incorporated on May 17, 2000. We were founded to design, develop, market and sell advanced lighting systems that utilize Gallium Nitride light emitting diodes as illumination elements. White diodes are a relatively new phenomenon that offers major advances in illumination technology. Our Gallium Nitride diodes consume 92% less energy than incandescent or fluorescent counterparts to produce comparable light output. In electrochemical (battery powered) applications, this diminution of energy consumption positions our lighting solutions as more durable and reliable than other interim lighting alternatives. In standard alternating current electrical applications, the calculated life of Gallium Nitride diodes as lighting elements is over 20 years versus 750 hours for traditional incandescent light bulbs. These exceptional performance characteristics, diminutive energy consumption and extended life, have prompted Gallium Nitride diode implementation in traffic lights and automotive brake lights, but have not yet significantly occurred in our area of focus, diodal illumination (tm). Diodal illumination is the production of light through the use of white light emitting diodes. A light emitting diode is a chemical compound (gallium nitride, GaN) that produces a visible light when an electrical current is applied. This production of light through a diode is contrasted with light from a typical light bulb, in which light is produced as a by-product of a burning filament contained within a vacuum globe. The diode uses 92% less energy to produce comparable light to that of a traditional light bulb. Our diodal illumination differs from traditional

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LEDs, or light emitting diodes in several ways, such as:

- (a) traditional LEDs involve the use of colored lights, including blue, red, green and amber while our diodal illumination involves only white light;
- (b) our diodal illumination uses only gallium nitride, while traditional LEDs use multiple gases and chemical compounds; and
- (c) traditional LEDs cannot produce large amounts of wattage while our diodal illumination can create wattage equal to or in excess of current fluorescent lighting.

PRINCIPAL PRODUCTS AND PRINCIPAL MARKETS

We have introduced our first product, the Cyberlux Home Safety Light. Our Home Safety Light accounted for 58% of revenues in 2004 and 0% for the period of January 1, 2005 to date. Our production strategy has required the identification, qualification and engagement of a variety of talents in industrial design, integrated circuit board production, multi-cavity steel injection mold fabrication, component part assembly, performance testing and packaging to fulfill the tasks associated with finished goods delivery.. We are now planning to broaden our product line into optoelectronic technology and expand our marketing activity into various channels of retail and institutional sales. Our product line, consisting of the Home Safety Light, the Cyclone PLP (Power Light Plant), the Power-Outage Adapter, the Task & Accent Light and the KeyCap LockLight, employ single use standard alkaline or lithium ion constant charge reusable batteries in different applications. These fixtures express superior characteristics in brightness, extended light life and durability through diodal(TM) illumination, an optoelectronic descriptor trademarked by Cyberlux.

During the early stages of research for long-term interim light solutions, all experimentation was confined to incandescent, fluorescent and, to a more limited extent, fiber optics as illumination sources. The recurring problem with these lighting elements was the inefficient use of electrical energy. For example, in an incandescent bulb, 95% of the electrical energy consumed is dissipated as radiant heat, not light. The discovery of the bright white Gallium Nitride diode provides an alternative that can produce the long-term interim light source that was to be the objective of our product development activities. Unlike light bulbs that are brittle glass globes surrounding a fragile wire filament in a vacuum, light emitting diodes are extraordinarily efficient solid state semiconductors that are practically indestructible. Diodes are manufactured from chemical compounds mixed with phosphors, which transform electrical energy to visible light without heat. When electrical current is applied to a diode, the energy creates electromagnetic radiation, which occurs as light.

The power outage that struck the Midwest to the Northeastern United States and parts of Canada in August of 2003 dramatized the absence of realistic emergency lighting solutions in North America. This event was followed by the hurricane season of 2004 during which millions of property owners in Florida were without conventional power for days up to several weeks. The recurring power losses are directly attributable to the grid system which delivers electrical power to the North American Continent. Storm activity or power surges may cause electrical power line damage which then causes grid collapse due to the domino effect of failing systems. Typically, in the event of a power outage, "emergency lighting" is utilized, which is short-term evacuation lights in public and private buildings which perform for 60 to 90 minutes. Long-term electrical power grid failure is a far different problem. We have developed an alternative to typical "emergency lighting" for grid failure blackouts with

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long-term emergency lighting using its Reliabrighttm family of battery powered products that provide 60 hours (3,600 minutes) of bright light from one battery charge.

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Shortly after the blackout of August 2003, we were invited to propose an emergency lighting redundancy system for the City of Cleveland, Ohio where the power-outage darkened most of the city's buildings and homes. We reviewed existing systems and then demonstrated our Reliabrighttm Emergency Lighting System (ELS) over a three-month period beginning in December, 2003. In March of 2004, we were awarded a non-competitive bid contract by the City to begin implementation of our Reliabrighttm ELS and ELU products in Cleveland's Public Utilities Building. The nature and purpose of Reliabrighttm is its ability to provide 60 hours of light during blackouts in bathrooms, stairwells, elevators, corridors, equipment rooms and interior offices from its custom sealed constant-charge battery pack and expandable diodaltm lighting element configuration. The Reliabrighttm ELS retrofits into existing ceiling tiles in bathrooms, elevators or offices and the ELU is wall mounted in corridors, stairwells and equipment rooms. Our Reliabrighttm Emergency Lighting System accounted for 42% of our revenues in 2004 and 100% for the period of January 1, 2005 to date.

Our initial product, the Home Safety Light (HSL), is an efficient portable fixture that provides a full week of light from one set of AA batteries compared to over 20 sets of replacement batteries required by other portable lights to produce comparable light life. A proprietary intelligent circuit board provides three levels of light intensity controlled by a simple push button. The parabolic reflector broadcasts a blanket of light that can illuminate an entire room, corridor, stairwell or other strategic location. The unit may be hand-held, placed on a level platform or suspended from a wall-mounted hook. At the moderate light level, it provides a full week of reliable bright light. Because the patented HSL's performance characteristics are ideal for recreational boating and camping as well as home safety, certain modifications and package designs were implemented to create the CampLamptm which address the needs of outdoor markets.

The Cyclone PLP (Power Light Plant) is a heavy-duty, rugged, portable fixture that is actually a "perpetual source of light". The Cyclone is powered by our proprietary sealed ConstaChargetm lead-acid battery that is maintained at full charge by linkage to a standard electrical wall outlet or by linkage to a vehicle's charge port or its cigarette lighter. The fixture operates its articulated lens head for 60 hours of light from one charge session and can be renewed to full charge in approximately 4 hours. The PLP has an integrated charge port to enable recharge of a cell phone or other DC device and a reverse current flow switch that can trickle charge a disabled automobile battery through connection to the vehicle's internal charge port. The articulated lens head arm has the ability to rotate through graduated ratchet points to provide rigid focus of a powerful beam in task related applications. A 180 degree rotation of the lens head when the fixture is upended to a vertical stance positions the light source as a useful table lamp.

Our Power-Outage Adapter is a patented "intelligent electrical wall outlet" that replaces an existing wall outlet, continues to perform as an electrical outlet used by a variety of power cords, but now provides a new dimension of service as an emergency lighting system. The Adapter contains a constant charge battery, three sensors and three diodaltm lighting elements. One sensor detects motion in a darkened space and illuminates one diode in the lower lens to provide a guide light for movement; a second sensor detects loss of

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power in the building's electrical system and illuminates two ultra-bright diodes in the upper lens to wash the attendant wall with light; and a third sensor detects ambient light in the space and deactivates the system. The Power Outage Adapter will be marketed to hospitals, eldercare facilities and hotels in the third quarter of 2005.

The "Heatless" new Task & Accent light is a fixture of several different lengths which offer alternatives for its application in closets, cabinets and under cabinet counter lighting. This product has the potential to become the favorite of kitchen and interior designers owing to its remarkable performance characteristics of several optional shades of white light, three levels of light intensity and its "cool to the touch" safety feature. The choice of electrical connections as plug-in, hard-wired or battery powered adds to the fixture's flexibility and its light life of 75,000 hours contributes to its leadership role in energy efficiency, durability and longevity.

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Our patented KeyCaptm LockLight provides an inexpensive solution for a key chain light source. This unique fixture is encased in an elastic fabric that easily fits over the head of any variety of keys. The slender circuitry is positioned to reside at the side of the key with the diode facing the lockset entry down the shaft of the key which brightly, and precisely, illuminates the keyhole. The KeyCaptm, which will be marketed three to a package surrounding plastic facsimiles of keys, is a practical, lightweight, addition to every consumer's key chain.

CUSTOMERS

Our major customers to date include the City of Cleveland and the Kings Park, New York school district. We have previously sold our Home Safety Light to QVC in 2003, and we are in discussions with them for the purchase and sale of our Home Safety Light for the third quarter of 2005, although no agreement has been reached and no assurances can be given that we will reach an agreement with QVC.

Our Home Safety Light is targeted to all consumers to be used in the event of emergency. The Home Safety Light is designed to provide extended lighting from two AA batteries for use during blackouts, hurricanes, power failures or in areas of the house where traditional lighting is either not required or needed, such as attics. Our Reliabright Emergency Lighting System is targeted to corporations, building owners, school districts, governments and the military to provide long-term emergency lighting solutions. Our Power Outage Adapter will be marketed to hospitals, eldercare facilities and hotels. Our Aeon "Task & Accent" lighting products will be targeted to home, office and business owners as well as residential and commercial builders.

DISTRIBUTION METHODS OF OUR PRODUCTS

Consistent with our sales objectives, the reliable manufacture and distribution of proprietary component parts and assembly of finished products required exacting coordination of resources to provide detailed working drawings to tool manufacturers for injection molded parts and optics; precise circuitry diagrams to receive diodes, resistors and capacitors into the electronics platform; source identification for volume supplies of batteries and diodes; packaging considerations for presentation of product and corresponding dimensions of containment's for shipping and display; and an experienced

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contract assembly organization with an extensive infrastructure capable of collation and inventory of all component parts.

Robrady Design, Inc., our industrial design firm, provides detailed working drawings for injection molded parts to tool manufacturers in the US and abroad. Our products are manufactured both in the United States and abroad. We have contracted on a per-order basis with manufacturing facilities in China, Taiwan, Mexico, Puerto Rico and Canada. We are responsible for choosing our manufacturing facilities. We have no standing contracts with any manufacturing facilities, and we engage such facilities on an as-needed basis.

We contract for our diodes with Nichia Corporation, Lumileds, Inc. and Cree, Inc. Plastic parts and production molds are contracted for on a product by product basis with MegaHertz Magnetics Corporation which has offices in Boulder, CO and Shanghai, China. Packaging design is contracted with Phillipe Becker Design in San Francisco, CA where prototype clamshell and blister pack packages are produced for duplication by printers and plastic mold fabricators in China.

During the Fall of 2000, we identified Shelby County Community Services, Shelbyville, Illinois, as a contract manufacture and assembly organization that was positioned to meet our requirements for assembly and distribution of our products. Shelby County Community Services has over a decade of successful performance on behalf of Fortune 100 companies and represented the quality of management, performance and fiscal stability that we sought to employ in the distribution process.

We have a Proprietary Product Manufacturing Agreement with Shelby County Community Services that provides for Shelby County Community Services to assemble, test, package, warehouse finished good inventory, palletize and ship per purchase orders for shipment FOB Shelbyville. In the Summer of 2004, we renewed our relationship with Shelby County Community Services. Shelby County Community Services will continue to serve as the warehousing and distribution center for our products, which are to be manufactured abroad. Shelby County Community Services coordinates customs protocols and manages incoming inventories.

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Our internet site is serviced by Shelby County Community Services through a fulfillment operations agreement whereby Shelby County Community Services receives a daily batched summary of internet sales through an email link established by us and United Parcel Service. The software validates the address of the customer and advises shipping mode (next day, two day or ground), computes shipping and handling charges then prints the appropriate waybill at the shipping office of Shelby County Community Services. Packages are shipped within 24 hours of receipt of the email summary of business for the preceding day's orders. Shelby County Community Services coordinates materials inventory with our approved vendors based upon purchase orders or blanket orders for products. SCCS can currently assemble and ship 80,000 product units per month, which can be increased by 50% with a four month lead time to undertake expansion of facilities.

We have engaged Forma Designs, Inc. to produce, coordinate and manage our corporate and product marketing activities. Forma Designs, Inc. has broad-based experience in developing the corporate and product marketing required to launch technology companies. The role of Forma Designs, Inc. is to integrate marketing, sales, product and customer support activities and messages to optimize customer acquisition and retention. Forma Designs, Inc. serves as the liaison for the

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preparation and delivery of selling materials to the individual selling firms and an information conduit to management for production and finished goods inventory issues.

We have retained Capstrat, Inc. as our public relations firm responsible for the strategic and tactical communications for Cyberlux. Capstrat is a marketing communications firm that assists Cyberlux in communicating to our target audiences of customers, prospects, the media, policymakers, employees, opinion leaders and shareholders. Capstrat draws on a wide array of disciplines, fueled by strategy and creativity, to aid Cyberlux in achieving our tactical and strategic goals.

We have retained two technology product sales firms, Smart Products, Inc., Westwood, NJ, and New Edison, LLC, Longmont, CO, to represent our product line over the range of channels addressed for distribution. The individual firms have been selected based upon established relationships with certain commercial and retail channels and proven track records of sales to those channels.

INDUSTRY BACKGROUND

A research study by Research Econometrics, LLP in April 1999 attempted to identify a new approach to the development of an electrochemical (battery powered), portable, interim lighting system capable of providing safe illumination for extended periods of time to property owners deprived of electrical service caused by power outages. Although power outages have come to be a recurring phenomenon due to anomalies in electrical service distribution networks, the focus of the initial study was on disruptions caused by severe storm activity along the Atlantic and Gulf States' coastlines and the corresponding affected inland electrical grids. The National Weather Service labels annual storm activity as the Hurricane Season, which is officially monitored from June 1st to November 30th each year. Other deficiency outages not related to weather have been labeled by the press as rolling blackouts. The loss of electrical power related to tropical and subtropical storms can be wide spread and cover extensive regional segments surrounding the matrix of the storm. It is the incidence of power outages that identified the need for a reliable, durable, safe and economical interim lighting system for property owners and the general population in areas affected by these seasonally severe weather systems. The research conducted to identify an optimum interim lighting system led to the discovery of a new illumination technology (optoelectronics).

REGULATION

Our advertising and sales practices concerning the Home Safety Light and the Wireless Interim Lighting Systems are regulated by the Federal Trade Commission and state consumer protection laws. Such regulations include restrictions on the manner that we promote the sale of our products. We believe we are in material compliance with such regulations. We believe that we will be able to comply in all material respects with laws and regulations governing the conduct of business operations in general. We are not aware of any pending government regulations that may adversely affect our business.

RESEARCH AND DEVELOPMENT ACTIVITIES

We anticipate continuing to incur research and development expenditures in connection with the development of our Wireless Lighting System during the next twelve months.

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These projected expenditures are dependent upon our generating revenues and obtaining sources of financing in excess of our existing capital resources. There is no guarantee that we will be successful in raising the funds required or generating revenues sufficient to fund the projected costs of research and development during the next twelve months.

COMPETITION

The lighting and illumination industry is extremely competitive. Our ReliaBright products address the long-term blackout emergency lighting needs with battery powered (60 hours) lighting solutions for hotels, hospitals, adult care centers and high-rise apartments, and long-term evacuation lighting solutions for commercial buildings. The ReliaBright products are competitively positioned as a price-competitive, new technology introduction into an existing product category, where General Electric, Bodine and Lithonia are the key competitors with products that use traditional lighting technology. The Aeon "Task & Accent" lighting products address residential closet lighting, interior cabinet accent lighting and under cabinet counter lighting as heatless long-term (75,000 hours of life) lighting solutions for the homeowner. This unique lighting resource for cabinetmakers, contractors and do-it-yourselfers offers three levels of light from soft white diodal(TM) elements that are cool to the touch and easy to install. The Aeon products are competitively positioned as a premium priced new technology introduction into an existing product category, where General Electric, Philips and Sea Gull Lighting are the key competitors with products that use traditional lighting technology. We believe that our lighting solid-state technology will provide a 40 to 60 percent reduction in maintenance costs for property managers through replacement of walkway, corridor or landscape lighting elements and 68 percent reduction in energy costs for those fixtures.

EMPLOYEES

We currently have eight (8) full time employees. Our employees are primarily at the executive level based upon our role in coordination of outsource contracts for manufacturing and other production considerations. Currently, there exist no organized labor agreements or union agreements between us and our employees. We have employment agreements with the following executive officers: Donald F. Evans, Chairman and CEO, Mark D. Schmidt, President and COO, Alan H. Ninneman, Senior Vice President and John W. Ringo, Secretary and Corporate Counsel. We believe that our relations with our employees are good.

DESCRIPTION OF PROPERTIES

We maintain our principal office at 4625 Creekstone Drive, Suite 100, Research Triangle Park, Durham, North Carolina 27703. Our telephone number at that office is (919) 474-9700 and our facsimile number is (919) 474-9712. We lease 2,405 square feet of office space. The lease expires on December 31, 2008. The monthly rent is \$3,457, subject to an annual cost of living increase. We believe that our current office space and facilities are sufficient to meet our present needs and do not anticipate any difficulty securing alternative or additional space, as needed, on terms acceptable to us.

LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal

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proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. Except as disclosed below, we are currently not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

On April 18, 2001, we filed a civil complaint against Light Technology, Inc., Ervin J. Rachwal, Safe-Light Industries, LLC a/k/a JFER Innovations Group, LLC, James Meyer and John Fleming alleging fraud, breach of contract, monies lent, misappropriation of trade secrets, conspiracy and sought injunctive relief against the defendants to prevent them from misappropriating trade secrets as well as to recover monetary damages. On May 11, 2001, the Court granted a temporary injunction against the Defendants. On June 5, 2001, the Defendants filed their Answer denying the allegations of the Complaint and filed a counterclaim alleging fraud, violation of Trade Secret Act, breach of contract and money lent.

On January 18, 2002, the Court granted the Defendants' Motion to Dissolve the Injunction. On January 28, 2002, we filed a Motion for Rehearing or Clarification of the Motion to Dissolve. A hearing on our Motion for Rehearing or Clarification of the Motion to Dissolve was scheduled for March 18, 2002, but was cancelled by the Court and has not been rescheduled. In accordance with Florida's Rules of Civil Procedure, when a Motion to dissolve is granted, this order is stayed and the injunction remains in effect until the Court rules on a Motion for Rehearing or Clarification of the Motion to Dissolve. Therefore, the injunction still remains in effect until the Court rules on this Motion.

BACKGROUND:

We came into contact with Light Technology, Inc. and Rachwal in early 2000. We were seeking someone with the knowledge and expertise to assist us in the development of an emergency light using white LEDs. Light Technology, Inc. and Rachwal represented that they had such knowledge and expertise and could finalize the development of our emergency light by September 30, 2000 so that we could begin manufacturing and selling the emergency light by New Roman" SIZE="2">

Total annual cash incentives were paid at 33% of target, consistent with our lower than expected performance against annual financial metrics; an

Stock option grants considered market practices and our fiscal 2011 performance against our goals, our relative performance against our peer group and our desire to incent Named Executives for the long-term with options that require our share price to increase to create value and align the interests of Named Executives with our stockholders.

As discussed in further detail in this CD&A, we believe we exercise sound executive compensation management practices, including:

Independent oversight of compensation programs by our Compensation Committee and their use of external consultants as needed;

Balanced compensation programs that emphasize pay-for-performance, alignment with stockholder value creation, and attraction and retention of key talent without placing undue emphasis on risk;

Competitive compensation levels that are supported by our peer group compensation practices;

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Multiple compensation program elements that emphasize short and long term business strategies and performance; and

At our annual stockholders meeting in January 2012, 97.1% of the votes cast approved, on an advisory basis, the compensation of our named executive officers as disclosed in the proxy statement for that annual meeting. Our compensation committee has considered the results of that vote in its subsequent deliberations, and no changes have been made in compensation policies or practices as a result of the vote.

Compensation Philosophy

The philosophies that drive our compensation program design and objectives are:

Incent Named Executives to advance the Company's business and financial objectives through a pay-for-performance culture that tightly ties the rewards of our Named Executives to the performance of the individual, the Company, and the price of our Common Stock.

Attract and retain qualified executive talent by providing competitive compensation packages.

Align Named Executive focus on Company financial performance and stockholder value creation by providing balanced compensation programs. Balance is achieved through plans that reward for the advancement of long term strategic business objectives and annual financial objectives.

Ensure that the design of our compensation program does not encourage Named Executives to take unnecessary or undesirable risks.

Responsibility for Determining Executive Compensation

Our Compensation Committee (referred to in this CD&A as the Committee) reviews and approves all executive compensation programs and the specific compensation arrangements with each of our Named Executives. The Committee also provides general oversight of our compensation plans. The Committee is composed of three independent, non-employee directors as defined by the SEC and the Nasdaq Global Select

Market. The Committee maintains responsibility for overseeing the independence of any compensation consultant that it retains. A brief summary of the role of the Committee is found in *Committees of the Board of Directors and Meeting Attendance* in this Proxy Statement.

The Committee retains the services of a third party consultant to provide guidance and recommendations on compensation strategy, program design, peer group selection, and market compensation trends. The Committee also has utilized a third party consultant to recommend peer group companies and to determine peer group and/or larger market compensation levels. In fiscal 2012, the Committee retained the consulting division of Radford to provide competitive benchmarking and market trend data in support of compensation decisions. Our management also utilized the survey division of Radford to purchase industry compensation surveys to help assess compensation trends for our overall employee population, the value of which is below \$10,000. Radford provides no other services to management and the Committee believes that Radford meets all criteria for independence and is free of any conflict of interest.

Members of management participate in Committee meetings at the Committee's request. Our Vice President of Human Resources contributes analysis on market trends, peer group compensation levels and compensation levels of companies in our broad technology industry category to the Committee. Our Chief Executive Officer provides recommendations on the compensation of other Named Executives. Our Vice President, General Counsel and Corporate Secretary generally serves as Secretary of Committee meetings.

Compensation Determination Process

Compensation targets are set for each Named Executive based on a number of factors, including:

Compensation levels of comparable positions at companies in our targeted peer group and our broad technology industry with comparable annual revenues and compensation of each Named Executive;

Each Named Executive's performance against annual objectives;

The qualifications of the Named Executive and the potential for positive performance in the future;

The achievement of strategic goals to which the Named Executives are held accountable;

The recommendations of the Chief Executive Officer (except with respect to his own compensation); and

Current financial conditions, goals and performance of the Company.

Compensation Benchmarking

To determine a range of competitive compensation for comparable jobs, the Committee reviews compensation data for a targeted group of peer companies. The Committee also has considered third party survey data of companies in our broad technology industry category with comparable annual revenues to supplement peer group data.

Cash Compensation

The Committee generally sets base salaries for Named Executives to fall between the 25th and 60th percentile of comparable positions at peer group companies. Determination of the base salary level is based on the compensation determination factors listed above, with specific focus on the nature of the position, the Named Executives' skills and potential, and past performance results. Currently, the base salaries of our Named Executives comprise 50% to 70% of their total annual cash compensation target, which places significant emphasis on annual incentive compensation. This supports our pay-for-performance philosophy as the Company will need to meet or exceed Company financial targets for Named Executives to realize their full annual cash compensation potential.

Total cash compensation, when earned, typically will result in Named Executive total cash compensation falling on average between the 25th and 75th percentile of the comparable peer group positions if all financial metrics associated with annual incentive compensation are achieved or exceeded. Actual total cash compensation for Named Executives has fallen as low as the 25th percentile in past years in reflection of our performance against financial targets. In fiscal 2012, Named Executives earned 33% of their total annual cash incentives as our Company did not perform well against our targets.

Equity Compensation

The Committee awards stock options to Named Executives based on the following factors:

The value of equity awards within our peer group for comparable positions. The Committee considers ranges of equity between the 25th and 75th percentile;

Each Named Executive's past performance and potential for Executive to contribute to Company success in the future; and

The strategic impact of the Named Executive's position and necessity to retain the Named Executive.

Actual stock option awards for Named Executives in fiscal 2012 and fiscal 2013 have fallen between peer group 25th and 75th percentile.

Fiscal 2012 Compensation Benchmarking

For fiscal 2012, the Committee considered a competitive analysis report prepared by our Vice President of Human Resources that reviewed the base salary, annual cash incentives and long-term equity incentive elements and levels for our Named Executives against comparable positions in our peer group and companies in our broad technology industry category. Our fiscal 2012 peer group was updated from the fiscal 2011 peer group to remove Adaptec due to its acquisition. The fiscal 2012 peer group was composed of Anaren, Inc., BigBand Networks, Inc., CalAmp Corp., Communications Systems Inc., Echelon Corp., EMS Technologies Inc., Extreme Networks Inc., Globecom Systems, Inc., Ixia, Network Engines, Inc., Network Equipment Technologies, Inc., Neutral Tandem, Inc., Oplink Communications, Inc., Orbcomm Inc., Seachange International, Inc., Shoretel Inc., Sierra Wireless Inc., Silicon Laboratories, Inc., and Symmetricom, Inc. The Committee considered this competitive analysis report, in addition to the compensation determination factors described above, to determine the appropriate base salary, annual cash incentive targets and equity incentive awards for fiscal 2012.

Fiscal 2013 Compensation Benchmarking

For fiscal 2013, the Committee reviewed a competitive analysis of the base salary, annual cash incentives and equity incentive elements and levels for our Named Executives. This assessment was compiled and presented by Radford Consulting:

1. A review of our fiscal 2012 peer group and industry to assess whether modifications were appropriate based on acquisitions or significant changes in the financial metrics of the companies in our peer group. Eleven peer group companies were retained, eight were removed and eight new companies were added. These changes, recommended by Radford Consulting, were made to better align our peer group with Digi International's business and financial metrics. These changes resulted in the fiscal 2013 peer group that consists of the following companies:

Anaren
Aruba Networks
Calamp
Echelon

NetScout Systems
Neutral Tandem
Novatel Wireless
Oplink Communications

Emulex	Radsys
EnerNOC	Shoretel Inc.
Extreme Networks	Sierra Wireless, Inc.
Globecomm Systems	Symmetricom, Inc.
Ixia	TeleNav
LogMein	

2. A comparison of our compensation elements and levels against the fiscal 2013 peer group to determine our overall market percentile position on each element as well as our total cash compensation and total equity compensation.
3. A comparison of our compensation elements and levels against companies in our broad technology industry category as reported by Radford Consulting, based on data obtained from Radford's independent third party compensation survey. This survey data contained competitive information for high technology companies in our broader industry and revenue categories. This broader survey data was used in conjunction with the peer group data.

Compensation Program Elements

Total Cash Compensation

To determine the allocation of cash compensation among each of our cash compensation program elements, we consider the practices of companies within our peer group as well as our compensation philosophy of maintaining a strong pay for performance environment. The portion of the Named Executive's total cash compensation dependent on annual incentive will differ by position. For instance, while we want our Chief Financial Officer to be concerned with our financial performance, an important part of his job is to oversee our financial controls and reporting. Similarly, while we want our Vice President, General Counsel and Corporate Secretary to be concerned with our financial performance, an important part of his job is to oversee corporate legal compliance issues. As such, their targeted level of annual incentive is lower than that of other Named Executives, and a higher emphasis is placed on base salary.

The target total cash compensation for Named Executives in fiscal 2012 was:

Name	Annual Base Salary (\$)	Target Annual Cash Incentive (\$)	Target Annual Cash Incentive as % of Base Salary	Target Total Cash Compensation (\$)
Joseph T. Dunsmore	436,000	436,000	100%	872,000
Steven E. Snyder	281,000	153,000	54%	434,000
Lawrence A. Kraft	243,500	243,500	100%	487,000
David H. Sampsell	238,408	107,283	45%	345,691
Joel K. Young	268,000	179,000	67%	447,000

After a review of our compensation targets against our peer group and broader survey group practices, cash compensation targets for Named Executives for fiscal 2013 were set to be the same as fiscal 2012.

Base Salaries

Base salary levels reflect the Committee's compensation philosophy of favoring compensation, as appropriate, that is contingent on the achievement of performance objectives while providing a market competitive level of salary that will allow us to attract and retain talent. This translates to base salary levels for our Named Executives that fall between the 25th and 60th percentile of our peer group. Base salaries are reviewed annually but are not automatically increased. Adjustments are approved by the Committee based upon changes in competitive market data and the compensation determination factors listed earlier in this CD&A.

Base salaries for Named Executives other than Mr. Young increased in fiscal 2012 from 1% to 3%. Mr. Young's base salary increased by 11% due to a realignment of his total compensation to place a slightly higher emphasis on base salary. Mr. Young's total targeted compensation increased by 3% in fiscal 2012.

For fiscal 2013, the Committee did not increase the base salary of any Named Executives. This action was based on the Company's lower than expected financial performance in fiscal 2012.

Annual Cash Incentives

Our annual cash incentive program provides Named Executives the opportunity to receive quarterly and annual cash incentive payments depending on the degree to which we achieve quarterly and annual financial goals. This incentive typically has been divided into one or more specific financial metrics. Each metric has a minimum threshold of performance against goal required for any payment, and a maximum payment opportunity. Each metric is measured independently such that achievement of the minimum goal for any metric will trigger a payment. Annual cash incentives are paid following the release of our audited consolidated financial statements. Quarterly cash incentives are paid upon the release of our quarterly unaudited consolidated financial statements.

Cash incentive plan metrics and potential cash incentive amounts are determined by the Committee near the start of each fiscal year based upon elements of our board-approved operating plan for that year. In some years, the metrics have included other objective measurements of quarterly or annual financial success as approved by the Committee. The Committee approves plan elements and targets that they believe will support continued growth and creation of stockholder value.

The annual cash incentive component pays out based on performance if the Named Executive remains employed with us for the full year. A pro-rated cash incentive is paid based on the number of months of service during the year and our actual financial performance against our operating plan, in the event the employment of a Named Executive is terminated without cause during the year.

The Committee also reserves the right to award discretionary cash bonuses based upon its assessment of a Named Executive's performance and contributions.

Fiscal 2012 Incentive Compensation

For fiscal 2012, the Committee set a cash incentive plan for Named Executives on performance against quarterly and annual revenue and earnings before taxes, interest, depreciation and amortization (EBITDA) goals, which were deemed to be aggressive but attainable. Forty percent (40%) of the annual cash incentive was dependent on achievement of quarterly financial goals, 30% dependent on achievement of annual revenue goal and 30% dependent on achievement of annual EBITDA goal. The 40% tied to quarterly financial performance divided equally between quarterly revenue and EBITDA goals, resulting in 5% of target incentive tied to each quarter's revenue and EBITDA goals. There was a minimum achievement of 80% required to earn any payment for a financial component on both the quarterly and annual components. The plan also contained an opportunity to earn up to 120% of the target incentive amount tied to each quarterly component for overachievement of the goal and up to 150% of the target incentive amount tied to each annual component for overachievement of the goals. The revenue and EBITDA components of the annual cash incentive plan are set and measured on EBITDA exclusive of the impact of any acquisition we may complete during the fiscal year.

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The cash incentive plan metrics and achievement percentages for the 2012 plan for Named Executives were:

Quarter Ended	Revenue Goal (in 000 s) (\$)	Actual Revenue (in 000 s) (\$)	Percent of Revenue Target Achieved	Percent of Incentive Target tied to this Component Earned	EBITDA ¹ Goal (in 000 s) (\$)	Actual EBITDA ¹ (in 000 s) (\$)	Percent of EBITDA Target Achieved	Percent of Incentive Target tied to this Component Earned
12/31/2011	53,500	46,662	87.20%	77.20%	6,193	2,992	48.30%	0%
3/31/2012	55,700	49,016	88.00%	78.00%	7,006	5,462	77.96%	0%
6/30/2012	58,500	47,632	81.40%	71.40%	8,105	3,867	44.70%	0%
9/30/2012	62,300	47,248	76.00%	0.00%	10,796	6,136	57.00%	0%

Fiscal Year Ended	Revenue Goal (in 000 s) (\$)	Actual Revenue (in 000 s) (\$)	Percent of Revenue Target Achieved	Percent of Incentive Target tied to this Component Earned	EBITDA ¹ Goal (in 000 s) (\$)	Actual EBITDA ¹ (in 000 s) (\$)	Percent of EBITDA Target Achieved	Percent of Incentive Target tied to this Component Earned
9/30/2012	230,000	190,558	82.85%	72.85%	32,100	18,446	57.46%	0%

¹ EBITDA is a non-GAAP financial measure that can be calculated from our audited financial statements by adding interest, depreciation of property, equipment and improvements plus amortization of identifiable intangible assets and other assets, both of which are located on the Consolidated Statements of Cash Flows, to income before income taxes, located on the consolidated Statements of Operations. EBITDA net of the impact of any acquisitions made during the current fiscal year is calculated by subtracting that portion of EBITDA pertaining to income before taxes, depreciation and identifiable intangible assets amortization for any businesses acquired in the current fiscal year from the consolidated EBITDA. We use this metric because it believes it provides a clear view of operations that were ongoing throughout the entire fiscal year as well as a better comparison of performance year over year. Since we completed no acquisitions in fiscal 2012, there is no adjustment to EBITDA for acquisitions.

The actual incentives earned for fiscal 2012 were:

Name	Total Target Annual Cash Incentive (\$)	Total Target Incentive Tied to Quarterly Performance (\$)	Actual Incentive Earned for Quarterly Performance (\$)	Total Target Incentive Tied to Annual Performance (\$)	Actual Incentive Earned for Annual Performance (\$)	Actual Annual Cash Incentive (\$)	Percent of Target Annual Cash Incentive Earned
Joseph T. Dunsmore	436,000	174,400	49,404	261,600	95,290	144,694	33.2%
Steven E. Snyder	153,000	61,200	17,337	91,800	33,439	50,776	33.2%
Lawrence A. Kraft	243,500	97,400	27,592	146,100	53,218	80,810	33.2%
David H. Sampsell	107,283	42,912	12,156	64,370	23,447	35,603	33.2%
Joel K. Young	179,000	71,600	20,282	107,400	39,121	59,403	33.2%

The low cash incentive plan payments earned in fiscal 2012 reflect our lower than expected performance against key financial measurements and are consistent with our pay for performance philosophy. A more detailed analysis of our financial and operational performance is contained in the Management's Discussion & Analysis section of our 2012 Annual Report on Form 10-K filed with the SEC.

Fiscal 2013 Cash Incentives

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For fiscal 2013, the Committee established an annual cash incentive plan for Named Executives based on achievement of quarterly and annual revenue and EBITDA goals. As in fiscal 2012, 40% of the annual cash incentive for fiscal 2013 is dependent on achievement of quarterly financial goals, 30% dependent on achievement of annual revenue goal and 30% dependent on achievement of the annual EBITDA goal. The 40% tied to quarterly financial performance is divided equally between quarterly revenue and EBITDA goals, resulting in 5% of target incentive tied to each quarter's revenue and EBITDA goals. There is a minimum

achievement of 80% required to earn any payment for a financial component on both the quarterly and annual components. The plan also contains an opportunity to earn up to 120% of the target incentive amount tied to each quarterly component for over-achievement of the goal and up to 150% of the target incentive amount tied to each annual component for over-achievement of the goals. The revenue and EBITDA components of the annual cash incentive plan are set and will be measured exclusive of the impact of our acquisition of Etherios, Inc. and any other acquisition we may complete during the fiscal year.

These quarterly and annual financial objectives, approved by the Committee, are considered confidential commercial and financial data, the disclosure of which would result in competitive harm to the Company. The quarterly objectives were determined after taking into account historical seasonal patterns in quarterly performance and projected revenue opportunity. The annual targets are a sum of the quarterly targets. These objectives are deemed to be aggressive, but attainable.

Equity Incentive Compensation

Equity incentive compensation, in the form of stock options, is designed to reward demonstrated performance and leadership, motivate future superior performance that drives overall Company growth, align the interests of the Named Executive with our stockholders, and allow us to attract and retain talent through the long-term reward potential of this program. We currently provide non-statutory stock options as our only equity vehicle. Stock option awards are made to Named Executives annually and on other dates that generally correspond to the Named Executive's start date with us, promotions or, in rare cases, an extraordinary performance award. Stock option grant amounts have historically been based upon competitive equity compensation within our peer group and/or survey group along with the above listed individual factors. Existing ownership levels generally are not a factor in award determinations as we do not want to discourage Named Executives from accumulating Digi stock; however, the Committee may take into consideration a Named Executive's previous option awards and may approve larger awards to newer Named Executives with fewer options by reason of their shorter tenure.

Stock options have an exercise price equal to the closing price of a share of Digi Common Stock on the grant date. As a result, stock options only have value to the extent the price of Digi stock on the date of exercise exceeds the exercise price on the date of the grant. For this reason the Committee believes that stock options are a motivational tool to drive stockholder value.

Generally stock options granted become exercisable as to one-fourth of the shares beginning one year after the grant date and in 36 monthly installments as to the remainder, and have a maximum ten-year term. This vesting schedule aids us in retaining our Named Executives and motivating long-term performance. Under our current practice, options awarded to our Named Executives include a provision for accelerated vesting upon the permanent disability or death of the executive. In addition, options awarded to our Named Executives include a provision for accelerated vesting either upon a change in control or upon termination of employment either without cause by the Company or for good reason by the Named Executive following a change in control. From time to time, at the discretion of the Committee, a stock option grant may contain different terms for vesting or term if the Committee deems, that by doing so, we will better achieve our compensation objectives.

The exercise price of each stock option awarded to the Named Executives and other employees under our equity incentive plans is the closing price of Digi stock on the date of grant. Grants generally are made annually on a date after we announce earnings for our fiscal fourth quarter and full fiscal year. Awards for new hires or for promotions and other performance-related awards are also made during the course of the year on a date after we have announced quarterly earnings. In all instances, the grant date for awards is on a date when the Company's trading window is open.

Fiscal 2012 Equity Awards

In fiscal 2012, the following equity awards were made to our Named Executives. To determine the size of these awards, the Committee reviewed equity and long term incentive practices of equivalent positions within our

peer group positions. In the case of Mr. Sampsell, the Committee also considered that he served in his position for only a portion of fiscal 2011 as his employment with the Company commenced on April 25, 2011. The value of the awards was deemed to fall between the 50th and 75th percentile of peer group reported equity and long-term incentive actual awards for the most recent fiscal year. The selection of the value of each award between the 50th and 75th percentile was based on compensation determination factors listed above, most notably, individual performance, long-term potential and retention goals.

Name	Option Award
Joseph T. Dunsmore	165,000
Steven E. Snyder	60,000
Lawrence A. Kraft	60,000
David H. Sampsell	15,000
Joel K. Young	60,000

Fiscal 2013 Equity Awards

For fiscal 2013, the Committee reviewed equity and long term incentive practices of equivalent positions within our peer group positions, and for certain positions, the practices within the broader survey group. The Committee approved option awards that were deemed as falling between the 25th and 50th percentile of reported equity and long-term incentive awards for the most recent fiscal year of companies in our peer group and our broad technology industry category. The selection of award size between the 25th and 50th percentile was based on the Company's fiscal 2012 performance and the individual factors listed above, most notably, individual performance, long-term potential and retention goals. This resulted in the following option awards on November 20, 2012:

Name	Option Award
Joseph T. Dunsmore	165,000
Steven E. Snyder	55,000
Lawrence A. Kraft	50,000
David H. Sampsell	25,000
Joel K. Young	55,000

Other Compensation

We provide our Named Executives with perquisites and benefits that we believe are reasonable and aligned with our overall Executive compensation program objectives. Named Executives receive the same benefits that are available to all regular full-time employees with the sole addition of a \$500,000 supplemental life insurance policy. The Company purchases season tickets for certain sporting events for marketing purposes. Named Executives, along with other regular full-time employees, may be entitled to the use of these tickets when they remain unused for business related purposes.

As described below in the section entitled Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements, we have entered into severance arrangements with Named Executives to align their interests with stockholders and attract and retain executives by providing contractual arrangements that address the consequences of significant organizational changes.

Assessing Risk in our Executive Compensation Program

The Committee reviews an annual compensation plan risk assessment provided by management. This assessment includes a review of each cash and equity incentive compensation plan within the Company, a discussion on potential risks, and a review of any process controls for effective plan administration. The Committee believes it has implemented an executive compensation program that provides our Named Executives with incentives to drive business and financial results, but not in a manner that encourages excessive or unnecessary risk taking behaviors. This is demonstrated by the following design features:

Having base salaries that are competitive;

Utilizing a rigorous process to establish annual and quarterly financial performance metrics for our cash incentive plan that are challenging but achievable;

For our annual and quarterly cash incentives, utilizing more than one financial metric with an opportunity for payment under each component without regard to the performance of the other. In addition, each component has a minimum and maximum payment that can be earned. This assures Named Executives are not focused on limited aspects of business performance; and

Providing Named Executives with an opportunity for an annual stock option award that vests over a period of four years. This equity accumulation opportunity incents Named Executives to take actions that promote longer term sustainability of our business.

Employment Agreements and Change-in-Control Provisions

As discussed in greater detail under Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements on page 27, the Company and our Chief Executive Officer, Mr. Dunsmore, are parties to an employment agreement. That agreement provides that, if we terminate Mr. Dunsmore's employment without cause: (1) he will receive a lump sum equal to one year's base salary and commencing, 12 months after termination, he will receive monthly base salary payments for an additional year (for a total of two years); and (2) in addition to the base salary continuation for two years, Mr. Dunsmore will receive a bonus based on the number of months that he was employed by us during the year in which his employment was terminated and our actual performance against the annual objectives set by the Committee.

We also have severance agreements with our other Named Executives. See Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements on pages 27-28. Messrs. Snyder, Young and Kraft each have a letter agreement that provides that if his employment is terminated by us without cause at any time, he will be entitled to receive severance equal to one year's base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and our actual financial performance against plan as determined through his annual cash incentive compensation plan. Mr. Sampsell has a letter agreement that provides that if his employment is terminated by us without cause at any time, he will be entitled to receive severance equal to six months' base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and our actual financial performance against plan as determined through his annual cash incentive compensation plan.

We also have awarded stock options containing a provision for accelerated vesting upon a change in control of our Company for all options granted to Mr. Dunsmore. For Messrs. Young and Kraft, this provision is included in agreements for awards made on or after November 26, 2007. Mr. Snyder has received this provision for all awards made on or after his date of employment with the Company. Mr. Sampsell has received this provision for an award made on April 27, 2011 in connection with the commencement of his employment and the award made on November 20, 2012.

Accounting and Tax Impacts of Executive Compensation

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

Our Committee considers our ability to fully deduct compensation in accordance with the one million dollar limitations of Section 162(m) in structuring our compensation programs. However, the Committee retains the authority to authorize the payment of compensation that may not be deductible if it believes such payments would be in the best interests of the Company and our stockholders.

We believe none of our Named Executives have been compensated in a manner that would be non-deductible under Section 162(m), although for fiscal 2013 the Committee established performance-based goals for our Chief Executive Officer which, if fully achieved, would result in annual base salary and other cash compensation exceeding the one million dollar deductible maximum.

Report of the Compensation Committee

The Compensation Committee has reviewed the above Compensation Discussion and Analysis and discussed that analysis with management. Based on its review and discussions with management, the Compensation Committee recommended to our Board of Directors that the Compensation Discussion and Analysis be included in Digi s Annual Report on Form 10-K for the year ended September 30, 2012 and this Proxy Statement. This report is provided by the following independent directors, who comprise the Compensation Committee:

Kenneth E. Millard (Chairman)

Guy C. Jackson

Ahmed Nawaz

Summary Compensation Table

The following Summary Compensation Table contains information for the last three fiscal years concerning all compensation provided to the individuals who served at any time during our fiscal 2012 as Chief Executive Officer or Chief Financial Officer as well as our other three most highly compensated executive officers (whom we have referred to in the CD&A and here as the Named Executives).

Summary Compensation Table

Name and Principal Position	Year	Salary (\$) ¹	Option Awards (\$) ²	Non-Equity Incentive Plan Compensation (\$) ³	All Other Compensation (\$) ⁴	Total (\$)
Joseph T. Dunsmore Chairman of the Board, President and Chief Executive Officer	2012	436,000	732,782	144,694	10,567	1,324,043
	2011	422,250	751,602	415,072	10,291	1,599,215
	2010	406,000	607,966	121,496	9,799	1,145,261
Steven E. Snyder Senior Vice President, Chief Financial Officer and Treasurer ⁵	2012	281,000	266,466	50,776	10,850	609,092
	2011	231,635	572,730	123,488	11,311	939,164
Lawrence A. Kraft Senior Vice President of Sales and Marketing	2012	243,500	266,466	80,810	8,844	599,620
	2011	237,750	276,906	233,709	10,643	759,008
	2010	226,500	213,610	67,782	11,346	519,238
David H. Sampsell Vice President, General Counsel and Corporate Secretary	2012	238,408	66,617	35,603	4,672	345,300
Joel K. Young Senior Vice President of Research and Development, and Chief Technical Officer	2012	268,000	266,466	59,403	9,355	603,224
	2011	241,000	276,906	189,720	10,781	718,407
	2010	234,000	213,610	56,111	11,189	514,910

¹ The Salary column presents the pre-tax base salary earned during the fiscal year.

² The **Option Awards** column presents the aggregate grant date fair value of stock option awards granted in the respective year as computed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 718, Compensation Stock Compensation. The fair value of each stock option award is estimated on the date of grant using a Black-Scholes option valuation model. We calculated these amounts based on the grant date fair value of the awards using the valuation assumptions set forth in Note 11 to our fiscal 2012 audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

³ The **Non-Equity Incentive Plan Compensation** column presents cash incentives earned during fiscal 2010, 2011 and 2012 under our annual cash incentive plan.

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

Name	Year	Digi Contribution to 401(k) Plan (\$)	Value of Supplemental Life Insurance Premiums (\$)	Total (\$)
Joseph T. Dunsmore	2012	10,082	485	10,567
	2011	9,806	485	10,291
	2010	9,314	485	9,799
Steven E. Snyder	2012	9,362	1,488	10,850
	2011	9,823	1,488	11,311
Lawrence A. Kraft	2012	8,604	240	8,844
	2011	10,403	240	10,643
	2010	11,106	240	11,346
David H. Sampsell	2012	4,004	668	4,672
Joel K. Young	2012	9,065	290	9,355
	2011	10,491	290	10,781
	2010	10,899	290	11,189

* In addition to the amounts set forth above, our Named Executives received perquisites for which there was no incremental cost to our Company. These perquisites include use of season tickets at certain venues that Digi subscribes for or leases for business-related entertainment. Tickets for individual events that remain unused by Digi for business-related entertainment periodically are made available to Named Executives and other employees for personal use. However, as such subscriptions and leases are made for entire seasons or annual periods rather than individually by event, there is no incremental cost to Digi associated with periodically providing such tickets for personal use.

⁵ Effective November 15, 2010, Steven E. Snyder was elected to the position of Senior Vice President, Chief Financial Officer and Treasurer. In connection with the commencement of his employment on November 30, 2010, he received a new hire option grant of 150,000 shares.

Grants of Plan-Based Awards

For services during fiscal 2012, the Named Executives received two types of plan-based awards: (i) cash awards under the annual incentive plan, and (ii) non-qualified stock option awards granted on November 22, 2011. Each stock option vests as to 25% of the shares subject to the option one year after the date of grant and in 36 monthly installments thereafter as to the rest of the shares, has a ten year term, and has an exercise price equal to the closing price of a share of our Common Stock on the date of grant. The annual incentive plan is described on pages 13 – 23 in the Compensation Discussion and Analysis.

Grants of Plan-Based Awards in Fiscal 2012

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards ¹			All Other Option Awards:	Exercise or Base Price of Option Awards (\$/Sh) ²	Grant Date Fair Value of Option Awards (\$) ³
		Threshold(\$)	Target(\$)	Maximum(\$)	Number of Securities Underlying Options (#)		
Joseph T. Dunsmore	11/22/11	305,200	436,000	872,000	165,000	10.63	732,782
Steven E. Snyder	11/22/11	107,100	153,000	306,000	60,000	10.63	266,466
Lawrence A. Kraft	11/22/11	107,450	243,500	487,000	60,000	10.63	266,466
David H. Sampsell	11/22/11	75,098	107,283	214,566	15,000	10.63	66,617
Joel K. Young	11/22/11	125,300	179,000	358,000	60,000	10.63	266,466

¹ These columns present possible payments under the annual incentive plan for fiscal 2012. See the Summary Compensation Table for fiscal 2012 (under the column Non-Equity Incentive Plan Compensation) for the actual amount paid to each Named Executive under the annual incentive plan for fiscal 2012. Threshold refers to the minimum amount payable if all of the annual incentive plan components performed at the minimum threshold level required to earn any incentive. Target refers to the amount payable under all components if specified targets are reached. Maximum refers to the maximum payout possible under the plan.

² The exercise price for the options granted was the closing price of our Common Stock on the Nasdaq Global Select Market on November 22, 2011.

³ This column shows the grant date fair value under authoritative guidance issued by FASB ASC Topic 718, Compensation – Stock Compensation of the stock options granted to the Named Executives in fiscal 2012.

Outstanding Equity Awards at Fiscal 2012 Year-End

The table below provides information on each Named Executive's outstanding equity awards as of September 30, 2012. The equity awards consist solely of stock options.

Outstanding Equity Awards at Fiscal 2012 Year-End

Name	Grant Date	Number of Securities	Option Awards	Option Exercise Price (\$)	Option Expiration Date
		Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable ¹		
Joseph T. Dunsmore	11/22/11		165,000	10.63	11/22/21
	11/23/10	87,083	102,917	9.68	11/23/20
	11/24/09	131,042	53,958	8.03	11/24/19
	11/25/08	143,750	6,250	8.49	11/25/18
	11/27/07	90,000		15.23	11/27/17
	9/27/05	80,000		10.44	9/27/15
	9/07/04	80,000		10.78	9/07/14
	11/05/03	60,000		9.65	11/05/13
Total		671,875	328,125		
Steven E. Snyder	11/22/11		60,000	10.63	11/22/21
	11/30/10	68,750	81,250	9.60	11/30/20
Total		68,750	141,250		
Lawrence A. Kraft	11/22/11		60,000	10.63	11/22/21
	11/23/10	32,083	37,917	9.68	11/23/20
	11/24/09	46,042	18,958	8.03	11/24/19
	11/25/08	47,917	2,083	8.49	11/25/18
	11/27/07	35,000		15.23	11/27/17
	11/27/06	35,000		13.41	11/27/16
	11/28/05	35,000		12.73	11/28/15

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	11/22/04	30,000		14.74	11/22/14
	11/05/03	14,000		9.65	11/05/13
Total		275,042	118,958		
David H. Sampsell	11/22/11		15,000	10.63	11/22/21
	4/27/11	17,708	32,292	12.07	4/27/21
Total		17,708	47,292		
Joel K. Young	11/22/11		60,000	10.63	11/22/21
	11/23/10	32,083	37,917	9.68	11/23/20
	11/24/09	46,042	18,958	8.03	11/24/19
	11/25/08	47,917	2,083	8.49	11/25/18
	11/27/07	35,000		15.23	11/27/17
	11/27/06	35,000		13.41	11/27/16
	11/28/05	25,000		12.73	11/28/15
	11/22/04	25,000		14.74	11/22/14
	11/05/03	20,000		9.65	11/5/13
Total		266,042	118,958		

¹ All options vest as to 25% of the shares one year after the date of grant and in 36 equal monthly installments thereafter as to the rest of the shares.

Options Exercised and Stock Vested During Fiscal 2012

The table below provides information regarding stock option exercises by the Named Officers during the fiscal year ended September 30, 2012. None of the Named Executive Officers had any other form of stock award that vested during the most recent fiscal year.

Option Exercises and Stock Vested During Fiscal 2012

Name	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$) ¹
Joseph T. Dunsmore		
Steven E. Snyder		
Lawrence A. Kraft		
David H. Sampsell		
Joel K. Young	18,000	110,340

¹ Represents the difference between the market value of the shares acquired upon exercise and the aggregate exercise price of the shares acquired.

Employment Contracts; Severance; Termination of Employment and Change-in-Control Arrangements

Joseph T. Dunsmore. We and Mr. Dunsmore are parties to an employment agreement dated September 27, 2006, which set the minimum level of Mr. Dunsmore's base salary at \$375,000 and provides that if we terminate Mr. Dunsmore's employment without cause he will receive: (1) his base salary for two years; and (2) a bonus based on the number of months that he was employed by us during the year in which his employment was terminated and our actual performance against the objectives set by the Committee.

The employment agreement also provides that the Committee will review Mr. Dunsmore's base salary annually and may, in its sole discretion, increase it to reflect performance and other factors. Under the employment agreement, Mr. Dunsmore is entitled to a cash bonus equal to 100% of his base salary, provided that the objectives set by the Committee are met. If some or all of the objectives are not met for a fiscal year, then the Committee shall determine the actual bonus earned based on actual performance against plan as determined through his annual cash incentive plan. If the objectives set by the Committee for a cash performance bonus are exceeded for a fiscal year, the Committee may, in its discretion, award Mr. Dunsmore a bonus in addition to any other bonus to which he is otherwise entitled.

The employment agreement also provides that Mr. Dunsmore is entitled to the benefits and perquisites which we generally provide to our other employees under our applicable plans and policies. The stock options awarded to him vest upon a change-in-control of our Company or termination of employment due to death or disability.

Steven E. Snyder. We and Mr. Snyder are parties to a letter agreement dated November 5, 2010. Under this agreement, if Mr. Snyder's employment is terminated by us without cause at any time, he will be entitled to receive severance equal to twelve months' base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and our actual financial performance against plan as determined through his annual cash incentive compensation plan. The stock options awarded to Mr. Snyder vest upon his termination of employment due to death or disability. Stock options awarded to Mr. Snyder in fiscal 2011 vest upon a change-in-control of our Company and those awarded to him in fiscal 2012 vest in the event the Company terminates his employment without cause or he terminates his employment for good reason within twelve months of a change-in-control of the Company.

Lawrence A. Kraft. We and Mr. Kraft are parties to a letter agreement dated July 30, 2007. Under this agreement, if Mr. Kraft's employment is terminated by us without cause at any time, he will be entitled to receive severance equal to twelve months' base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and our actual financial performance against plan as determined through his annual cash incentive compensation plan. The vesting of stock options awarded to Mr. Kraft accelerates upon his termination of employment due to death or disability. Stock options awarded to Mr. Kraft from November 2007 through November 2010 also vest upon a change-in-control of our Company. Stock options awarded to him in fiscal 2012 vest in the event the Company terminates his employment without cause or he terminates his employment for good reason within twelve months of a change-in-control of the Company.

David H. Sampsell. We and Mr. Sampsell are parties to a letter agreement dated April 8, 2011. The letter agreement provides that if Mr. Sampsell's employment is terminated by us without cause at any time, he will be entitled to receive severance equal to six months' base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and actual financial performance against plan as determined through his annual cash incentive compensation plan. The vesting of stock options awarded to Mr. Sampsell on April 27, 2011 will accelerate upon a change in control and the options awarded to him on November 20, 2012 will accelerate if the Company terminates his employment without cause or he terminates his employment for good reason within twelve months of a change-in-control of our Company.

Joel K. Young. We and Mr. Young are parties to a letter agreement dated July 30, 2007. The letter agreement provides that if Mr. Young's employment is terminated by us without cause at any time, he will be entitled to receive severance equal to twelve months' base salary and a bonus that will be based on the number of months of service during the fiscal year in which his employment was terminated and actual financial performance against plan as determined through his annual cash incentive compensation plan. The vesting of stock options awarded to Mr. Young accelerates upon his termination of employment due to death or disability. Stock options awarded to Mr. Young from November 2007 to November 2010 also vest upon a change-in-control of our Company. Stock options awarded to him in fiscal 2012 vest in the event the Company terminates his employment without cause or he terminates his employment for good reason within twelve months of a change-in-control of the Company.

Potential Payments Upon Termination or Change in Control

The table that follows provides the estimated payments and benefits that would be provided to our Named Executives or their beneficiaries under the employment agreements and equity compensation plans described above under various scenarios involving a termination of employment and/or a change in control, and assuming that the event(s) occurred on September 30, 2012. For these purposes, cause generally refers to acts by an executive that result in a felony conviction, willful non-performance of material employment duties, or willfully engaging in fraud or gross misconduct that is materially detrimental to our financial interests.

Compensation Element	Involuntary Termination Without Cause (\$)	Death, Disability or Change in Control (Single Trigger) ¹ (\$)
Severance ²		
Joseph T. Dunsmore	872,000	
Steven E. Snyder	281,000	
Lawrence A. Kraft	243,500	
David H. Sampsell	119,204	
Joel K. Young	268,000	
Pro Rata Bonus ³		
Joseph T. Dunsmore	144,694	
Steven E. Snyder	50,776	
Lawrence A. Kraft	80,810	
David H. Sampsell	35,603	
Joel K. Young	59,403	
Accelerated Stock Options ⁴		
Joseph T. Dunsmore		174,768
Steven E. Snyder		45,500
Lawrence A. Kraft		62,059
David H. Sampsell		
Joel K. Young		62,059
Total	1,016,694	174,768
Joseph T. Dunsmore	331,776	45,500
Steven E. Snyder	324,310	62,059
Lawrence A. Kraft	154,807	
David H. Sampsell	327,403	62,059

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Joel K. Young

- ¹ Situation in which there is a change in control but the individual continues in his job.
- ² Severance arrangements generally provide Mr. Dunsmore with two years of base salary, Messrs. Kraft, Young and Snyder with one year of base salary, and Mr. Sampsell with six months of base salary.
- ³ Pro rata bonus is based on the number of months that the individual was employed during the year in which his employment was terminated and our actual performance against the annual objectives set by the Committee. For purposes of this presentation, since the assumed date of termination was September 30, 2012, the bonus amount shown is the actual cash incentive earned for all of fiscal 2012.
- ⁴ Amounts represent the intrinsic value of stock option awards as of September 30, 2012 for which the vesting was accelerated. The value entered is based on the difference between \$10.16, the closing price of our Common Stock on September 28, 2012 (the last trading day of the fiscal year), and the option exercise price.

COMPENSATION OF DIRECTORS

The current director compensation program is designed to provide non-employee directors with a combination of cash and options that have resulted in an annual aggregate value ranging from approximately \$110,000 – \$125,000 per director depending on committee service in fiscal 2012.

The Compensation Committee conducts periodic competitive reviews of the compensation plan of non-employee directors. For fiscal 2012, a competitive analysis of director compensation as compared to our peer group was provided by our Vice President of Human Resources. This analysis provided details on total compensation levels and committee service fees for directors in our peer group as well as the allocation of compensation between cash and equity. As a result of this analysis, the Compensation Committee implemented a \$2,500 cash fee increase in the chair fee for the Audit Committee and a \$1,000 cash fee increase for members of the Audit Committee. The Compensation Committee felt that these increases aligned us with market practices in this area, while maintaining an overall compensation target between the 50th and 70th percentile of its relative peer group (described above) compensation levels. For fiscal 2013, the Compensation Committee did not implement any changes in the total compensation targets or fee amounts and expects that we will fall between the 25th and 50th percentile of the fiscal 2013 peer group (as described earlier). For fiscal 2013 the Committee has decided to implement a change in equity award structure by granting restricted stock units instead of our historic practice of granting stock options. The change was made in response to the more predominant market practice and the practices of our peer group in the use of restricted stock units as a primary equity award vehicle for directors.

In January 2012, the Compensation Committee awarded annual option awards to non-employee directors per the compensation plan for non-employee directors. Options awarded become fully vested after one year. Other than in the case of an outside director who is elected at other than an annual meeting, options are awarded to directors at a regularly scheduled meeting of the Compensation Committee in January following the annual meeting of stockholders and the public announcement of first fiscal quarter financial results. The Compensation Committee presently expects to continue to make a one-time stock option award, restricted stock unit award, or a combination of stock options and restricted stock units to any newly elected director, as well as to continue to compensate newly elected directors ratably for service during any stub term.

The following table describes the compensation arrangements with our non-employee directors during fiscal 2012:

Compensation Element	Amount Payable (\$)
Annual Cash Retainers ¹	
Board Member	30,000
Audit Committee Chair	17,500
Compensation Committee Chair	10,000
Nominating & Governance Committee Chair	6,500
Lead Director	10,000
Audit Committee Member	9,000
Compensation Committee Member	5,000
Nominating & Governance Committee Member	3,000
Annual Equity Award ²	70,000 ²
New Director Equity Award ³	100,000 ³

¹ Retainers are paid in quarterly installments each representing 25% of total annual retainer amount.

- ² An annual equity award is provided to each non-employee director on or near the date of the annual meeting of stockholders and each such award becomes fully vested after one year. This traditionally has been delivered in the form of stock options, however, this is expected to be delivered in the form of restricted stock units in the future. A director who is first elected to the Board between annual meetings of stockholders receives an equity award covering a prorated number of shares. The amount of the annual equity award indicated in the table represents the target valuation of the equity award. For fiscal 2012 the actual number of stock option shares awarded was determined by dividing the targeted option award value of \$70,000 by a Black-Scholes valuation per share (utilizing the Company's current model for determination of the value per share as approved by the Compensation Committee). The exercise price of options awarded was the closing price per share on the date of grant. The number of any restricted stock units awarded in the future is expected to be determined by dividing the target valuation of the award by the closing price of the Company's common stock on the date the award is granted.
- ³ A one-time equity award received by each director elected for the first time to the Board. The amount indicated in the table represents the valuation target of the equity award. If options are provided, the actual number of shares will be determined by dividing the targeted option award value of \$100,000 by a Black-Scholes valuation per share (utilizing the Company's current model for determination of the value per share as approved by the Compensation Committee). The exercise price of any options awarded will be the closing price per share on the date of grant. The number of any restricted stock units awarded in the future is expected to be determined by dividing the target valuation of the award by the closing price of the Company's common stock on the date the award is granted.

The following table summarizes compensation provided to each non-employee director for services provided during fiscal 2012:

Director Compensation for Fiscal 2012

Name	Fees		Total (\$)
	Earned or Paid in Cash (\$)	Option Awards (\$) ¹	
Guy C. Jackson	52,500	72,216	124,716
Kenneth E. Millard	43,000	72,216	115,216
Ahmed Nawaz	45,000	72,216	117,216
William N. Priesmeyer	45,500	72,216	117,716
Bradley J. Williams	42,000	72,216	114,316

- ¹ The Option Awards column presents the aggregate grant date fair value of stock option awards granted to each non-employee director during fiscal 2012 as computed in accordance with FASB ASC Topic 718, Compensation - Stock Compensation. The fair value of each stock option award is estimated on the date of grant using a Black-Scholes option valuation model using the valuation assumptions set forth in Note 11 to our fiscal 2012 audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012. The amounts reported have been adjusted to eliminate service-based forfeiture assumptions used for financial reporting purposes. Information regarding the stock option awards made to the non-employee directors during fiscal 2012, and their aggregate option awards outstanding at September 30, 2012, is contained in the following table:

Name	Grant Date	Number of Shares Underlying Option Award (#)	Option Exercise Price (\$)	Grant Date Fair Value of Option Award (\$) ¹	Total Number of Shares Underlying Options at 9/30/12 (#) ²
Guy C. Jackson	1/24/12	15,250	11.30	72,616	168,181
Kenneth E. Millard	1/24/12	15,250	11.30	72,616	109,681
Ahmed Nawaz	1/24/12	15,250	11.30	72,616	112,515
William N. Priesmeyer	1/24/12	15,250	11.30	72,616	124,431
Bradley J. Williams	1/24/12	15,250	11.30	72,616	132,164

- ¹ This column shows the full grant date fair value under authoritative guidance issued by FASB ASC Topic 718, Compensation - Stock Compensation related to stock-based compensation of the stock options granted to the non-employee directors in fiscal 2012.
- ² All options granted to non-employee directors have an exercise price equal to the closing price of our Common Stock on the date of grant. Options granted become fully vested on the date of the annual meeting of stockholders the year following the date of grant.

RELATED PERSON TRANSACTION APPROVAL POLICY

Our Board of Directors has adopted a written policy (the Related Person Transaction Approval Policy) regarding transactions with any Related Person, which is defined to include any of our directors or nominees for directors, executive officers and greater than five percent stockholders and any of their respective immediate family members. In accordance with the policy, the Audit Committee is responsible for the review and approval or ratification of all transactions with Related Persons that are required to be disclosed under the rules of the Securities and Exchange Commission.

The Related Person Transaction Approval Policy covers Related Person Transactions (as defined below) between us and any Related Person. Related Person Transactions include any transactions, arrangements or relationships involving the payment of money or other value involving us and in which a Related Person has a direct or indirect interest. A Related Person Transaction does not include:

payments of compensation to Related Persons for the Related Person's service to us as a director, officer or employee;

transactions available to all employees or all stockholders on the same terms; or

transactions, which when aggregated with the amount of all other transactions between us and the Related Person or any entity in which the Related Person has an interest, involve less than \$120,000 in a fiscal year.

The Audit Committee must approve a Related Person Transaction prior to commencement of the transaction, except where the transaction is identified after it has commenced or first becomes a Related Person Transaction, in which case the Related Person Transaction will be brought before the Audit Committee for ratification. Our executives are responsible for disclosing all material information pertaining to any Related Person Transaction to the Audit Committee prior to entering into the transaction. The Audit Committee Chairperson has been granted the authority to approve transactions that arise between Audit Committee meetings provided that any actions taken by the Chairperson pursuant to such authority must be reported to the Audit Committee at its next regularly scheduled meeting.

While the Audit Committee is permitted to use any factors it deems appropriate in determining whether to approve a Related Person Transaction, the Related Person Transaction Approval Policy requires the Audit Committee, at a minimum, to consider:

the fairness of the terms to us;

materiality of the transaction to us;

the role of the Related Person in arranging the Related Person Transaction;

the structure of the Related Person Transaction; and

the interests of all Related Persons in the Related Person Transaction.

The Audit Committee will only approve a Related Person Transaction if the Committee determines it is beneficial and fair to us.

For fiscal 2012, the Audit Committee did not evaluate any Related Party Transactions.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the 1934 Act requires that our directors and executive officers file initial reports of ownership and reports of changes in ownership with the SEC. Directors and executive officers are required to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such forms furnished to us and written representations from our directors and executive officers, all Section 16(a) filing requirements were met for the fiscal year ended September 30, 2012, except that late filings were made for option awards granted on November 22, 2011 to each of Messrs. Dunsmore, Kraft, Snyder and Young.

Equity Compensation Plan Information

The following table gives information as of September 30, 2012 about the Company's equity compensation plans, under which shares of its Common Stock may be issued.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted- Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity Compensation Plan Approved by Security Holders	5,195,594	\$ 10.67	1,040,127 ¹
Equity Compensation Plans Not Approved by Security Holders ²	557,699	\$ 11.53	-0-
Total	5,753,293	\$ 10.76	1,040,127

¹ Includes the following securities available for future issuance under stockholder approved compensation plans other than upon the exercise of options, warrants or rights: 840,447 shares under the Company's 2000 Omnibus Stock Plan and 199,680 shares under the Company's Employee Stock Purchase Plan. No further awards will be made under the 2000 Omnibus Stock Plan if the 2013 Omnibus Incentive Plan is approved as set forth in Proposal 2.

² Relates to the Digi International Inc. Non-Officer Stock Option Plan only.

Equity Compensation Plan Not Approved by Stockholders Digi International Inc. Non-Officer Stock Option Plan

In April 1998, the Board adopted the Digi International Inc. Non-Officer Stock Option Plan (the Non-Officer Plan). The Non-Officer Plan has not been approved by the stockholders of the Company.

Plan Administration

The Non-Officer Plan is administered by the Compensation Committee.

Shares Subject to the Non-Officer Plan

As of September 30, 2012, 557,699 shares of the Company's common stock were subject to outstanding awards granted under the Non-Officer Plan. No shares are available for future award grants, and no additional awards may be made under this Plan. Pursuant to the Non-Officer Plan, the Compensation Committee must adjust the number of shares and the purchase price per share to give effect to adjustments made in the number of outstanding shares of Common Stock of the Company pursuant to mergers, consolidations, splits, combinations, or other changes in capitalization as described in the Non-Officer Plan.

Eligibility

All employees of the Company and its subsidiaries who are not also officers or directors of the Company, and consultants to the Company or its subsidiaries, were eligible to receive awards under the Non-Officer Plan.

Incentive and Non-Statutory Stock Options

The Non-Officer Plan authorizes the grant of non-statutory stock options. Because the Non-Officer Plan has not been approved by the Company's stockholders, under the Internal Revenue Code of 1986, as amended, incentive stock options were not granted under the Non-Officer Plan. The exercise price of an option was determined by the Compensation Committee. The exercise price could not be less than 50% of the fair market value, as defined in the Non-Officer Plan, of the Company's Common Stock on the date the option is granted. Stock options could be granted and exercised at such times as the Compensation Committee may determine, provided that the term could not exceed ten years from the date of grant. The purchase price for Common Stock upon the exercise of stock options may be payable in cash, bank draft or money order, by delivery of shares of Company Common Stock having a fair market value on the date the option is exercised equal to all or any part of the option price of the Common Stock being purchased or any combination of the above.

Transferability and Termination of Options

The Non-Officer Plan allows the recipient to transfer options to members of his or her immediate family under certain circumstances. Other than such transfers to family members, no option shall be assignable or transferable by the recipient other than by will or the laws of descent and distribution. If a recipient's employment or other relationship with the Company or its affiliates is terminated for any reason other than death or disability, then any unexercised portion of such recipient's award will generally be forfeited, except as provided in the Non-Officer Plan or such recipient's agreement or by the Compensation Committee. Upon death or disability, any unexercised portion of such recipient's award will automatically vest. Upon a change in control as described in the Non-Officer Plan, the Compensation Committee shall declare all outstanding options cancelled at the time of the change in control in exchange for cash in the amount described in the Non-Officer Plan unless appropriate provisions have been made for the protection of the outstanding options by the substitution of such options for options to purchase appropriate stock of the surviving entity in the change in control.

Adjustments, Modifications, Termination

The Non-Officer Plan gives the Board the right to amend, suspend or discontinue the Non-Officer Plan. Amendments to the Non-Officer Plan are subject to stockholder approval, however, if needed to comply with applicable laws or regulations. The Compensation Committee may generally also alter or amend any agreement covering an award granted under the Non-Officer Plan to the extent permitted by law.

PROPOSAL NO. 2

TO APPROVE THE DIGI INTERNATIONAL INC.

2013 OMNIBUS INCENTIVE PLAN

Introduction

On November 20, 2012, our Board of Directors, upon recommendation of the Compensation Committee (as used in this section of the Proxy Statement, the Committee), approved the Digi International Inc. 2013 Omnibus Incentive Plan (as used in this section of the Proxy Statement, the 2013 Plan), subject to stockholder approval. The purpose of the 2013 Plan is to provide long-term incentives to persons with responsibility for success and growth at our Company. The 2013 Plan authorizes the issuance of up to 1,750,000 shares of our Common Stock pursuant to awards granted under the 2013 Plan. As provided in the 2013 Plan, we will cease making awards under the 2000 Omnibus Stock Plan, as Amended and Restated as of December 4, 2009 (as used in this section of the Proxy Statement, the Prior Plan) upon stockholder approval of the 2013 Plan.

Why We Believe You Should Vote for the 2013 Plan

Our Board of Directors believes that equity-based incentives are an important part of total compensation for our executives as well as for employees and our non-employee directors. We believe that stockholders should approve this new plan for the following reasons:

Compensation Philosophy. As described in our CD&A, our compensation includes rewarding our executives for positive developments in the results of our Company and the price of our Common Stock over time. We believe that equity compensation is one of the most effective tools to achieve these goals. In the past, we have historically used stock options to achieve this goal because the employee only receives value if the price of our Common Stock increases. Consistent with our goals for the future, we believe that equity-based incentives will continue to play an important role in our ability to incentivize our executives and other employees.

Plan Provisions Designed to Serve Stockholders' Interests and Promote Effective Corporate Governance. The 2013 Plan, which is summarized in more detail below, includes several provisions that are designed to serve the interests of our stockholders and promote effective corporate governance, including:

The 2013 Plan is administered by our independent Compensation Committee.

The 2013 Plan recognizes the value delivered with full value awards (awards other than stock options and stock appreciation rights (SARs)) and counts each full value award as 2 shares against the shares available for issuance under the 2013 Plan (the Prior Plan counts full value shares as 1.3 shares against the shares available).

The 2013 Plan does not permit liberal share counting. Shares delivered or withheld to pay the exercise price or satisfy a tax withholding obligation in connection with any award and shares subject to a SAR that are not issued in connection with the stock settlement of SARs may not be used again for new grants. We also may not use shares repurchased using option exercise proceeds for new grants.

We cannot issue stock options or SARs at an exercise price that is less than the fair market value of our Common Stock on the date of grant.

Stock options and SARs cannot have a term longer than eight years from the date of grant. The term has been reduced from the Prior Plan in which the term could not be longer than 10 years from the date of grant.

Time-based restricted shares and stock units generally must vest over a period of at least three years and performance-awards generally must vest over a period of at least one year, subject to certain exceptions when determined by the Committee.

The 2013 Plan generally provides for the forfeiture of outstanding awards if the Committee determines that the employee has engaged in certain misconduct, including commission of a felony or other serious crime, substantial and repeated failures to perform his or her duties, acting with gross negligence or willful misconduct, breach of an agreement with the Company, and certain other inappropriate behaviors.

Dividends or dividend equivalents payable on restricted shares and stock units will be subject to the same restrictions as the underlying shares or units.

The 2013 Plan prohibits any repricing of stock options or SARs without prior stockholder approval. Unlike the Prior Plan, the 2013 Plan specifically provides that cash buy-outs are prohibited repricings.

We cannot materially modify the 2013 Plan without prior stockholder approval, which includes amendments to increase the number of shares, extend the period for granting awards, add new award types, change the performance measures for performance-based awards and modify the eligibility requirements.

Unlike the Prior Plan, the 2013 Plan provides that awards granted under the 2013 Plan will be subject to any recoupment policy we adopt. We anticipate adopting a recoupment policy after issuance of final stock exchange rules on this topic that implements the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The descriptions set forth below are in all respects qualified by the terms of the 2013 Plan, which is attached to this Proxy Statement as [Appendix A](#).

Purpose

The purpose of the 2013 Plan is to promote the interests of our Company and our stockholders by providing key personnel of our Company and our affiliates with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of our Company and our affiliates. In addition, the opportunity to acquire a proprietary interest in our Company will aid in attracting and retaining key personnel of outstanding ability. The 2013 Plan is also intended to provide non-employee directors of the Company with an opportunity to acquire a proprietary interest in the Company, to compensate non-employee directors for their contributions to the Company and to aid in attracting and retaining non-employee directors.

Administration

The 2013 Plan is administered by our Compensation Committee. The Committee has the authority to adopt, revise and waive rules relating to the 2013 Plan and to determine the timing and identity of participants, the amount of any awards and other terms and conditions of awards. The Committee may delegate its responsibilities under the 2013 Plan to members of management of the Company or to others with respect to the selection and grants of awards to employees of the Company who are not deemed to be officers, directors or 10% stockholders of the Company under applicable Federal securities laws.

Eligibility

All employees of our Company and 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 are eligible to receive awards under the 2013 Plan at the discretion of the Committee. Incentive stock options under the 2013 Plan may

be awarded by the Committee only to employees. There are approximately 650 total employees, non-employee directors and others who provide services to us and our affiliates, any or all of whom may be considered for the grant of awards under the 2013 Plan at the discretion of the Committee.

Shares Available

The total number of shares of Company Common Stock available for distribution under the 2013 Plan is 1,750,000, subject to adjustment for future stock splits, stock dividends and similar changes in the capitalization of the Company.

Shares that are subject to awards of options or SARs granted under the 2013 Plan will be counted against this limit as one (1) share for every one (1) share granted. Shares that are subject to awards granted under the 2013 Plan other than options or SARs will be counted against this limit as two (2) shares for every one (1) share granted. The shares of our Common Stock covered by the 2013 Plan may be treasury shares, authorized but unissued shares, or shares purchased in the open market.

Any shares subject to an award under the 2013 Plan or the Prior Plan that are forfeited, cancelled, returned to the Company for failure to satisfy vesting requirements, settled for cash or otherwise terminated without payment being made thereunder shall, to the extent of such expiration, forfeiture, cancellation, return, cash settlement or termination, again be available for grant under the 2013 Plan. The following shares will, however, continue to be charged against the foregoing maximum share limitations and will not again become available for grant: (i) shares tendered by the participant or withheld by us in payment of the purchase price of an Option, (ii) shares tendered by the participant or withheld by us to satisfy any tax withholding obligation with respect to an Award, (iii) shares subject to a SAR that are not issued in connection with the settlement of the SAR upon its exercise and (iv) shares repurchased by us with proceeds received from the exercise of a stock option issued under the 2013 Plan or the Prior Plan. Any shares that again become available for grant will be added back as (i) one (1) share if such shares were subject to an option or SAR granted under the 2013 Plan, (ii) as two (2) shares if such shares were subject to awards other than options or SARs granted under the 2013 Plan or (iii) as one and three-tenths (1.3) shares if such shares were subject to awards other than options or SARs granted under the Prior Plan.

Types of Awards

The 2013 Plan allows us to grant stock options, SARs, restricted stock, stock units and other stock-based awards. The Committee may provide that the vesting or payment of any award will be subject to the attainment of certain performance objectives established by the Committee, in addition to completion by the plan participant of a specified period of service. The Committee may amend the terms of any award previously granted, but no amendment may materially impair the rights of any participant with respect to an outstanding award without the participant's consent, unless such amendment is necessary to comply with applicable laws or stock exchange rules.

Stock Options

Stock options granted under the 2013 Plan may be either incentive or nonqualified stock options. The exercise price of options may not be less than the fair market value of our Common Stock on the date of grant. The closing sale price of a share of our Common Stock on the Nasdaq Global Select Market on November 29, 2012 was \$9.75 per share. The exercise price must be paid in full at the time of exercise and may be paid in cash or such other manner as permitted by the Committee, including by withholding shares issuable upon exercise or by delivery of shares already owned by a participant. The maximum number of shares that may be issued upon the exercise of incentive stock options under the 2013 Plan is 1,750,000.

Stock Appreciation Rights

SARs provide for payment to the participant of all or a portion of the excess of the fair market value of a specified number of shares of our Common Stock on the date of exercise over a specified exercise price, which may not be less than the fair market value of our Common Stock on the date of grant. Payment may be made in cash or shares of our Common Stock or a combination of both, as determined by the Committee.

Restricted Stock

Restricted stock awards are awards of shares of our Common Stock that are subject to vesting conditions, and the corresponding lapse or waiver of forfeiture conditions and other restrictions, based on such factors and occurring over such period of time as the Committee may determine.

Stock Units

Stock units provide a participant with the right to receive, in cash or shares of our Common Stock or a combination of both, the fair market value of a specified number of shares of our Common Stock, and will be subject to such vesting and forfeiture conditions and other restrictions as the Committee determines.

Other Stock-Based Awards

The Committee may grant other awards under the 2013 Plan that are valued by reference to and/or payable in whole or in part in shares of our Common Stock.

Cash Incentive Awards

Cash incentive awards permit a participant to receive cash or other forms of awards upon the satisfaction of one or more performance goals over a specified performance cycle as determined by the Committee.

Terms of Awards and Plan Provisions

Performance-Based Compensation

For purposes of any 2013 Plan awards (other than stock options and SARs) that are intended to qualify as performance-based compensation for Section 162(m) purposes, the lapsing of restrictions, vesting and payment of such awards, as applicable, will be subject to the achievement of one or more performance goals over a specified performance period, all as determined by the Committee. The vesting and exercisability of stock options and SARs need not be made subject to the achievement of one or more performance goals in order to be considered performance-based compensation for purposes of Code Section 162(m). The performance measures upon which such performance goals may be based shall be limited to one or a combination of two or more of the following business criteria: revenue or net sales; gross profit; operating profit; net income; earnings before one or more of interest, taxes, depreciation, amortization and other adjustments; profitability as measured by return ratios (including, but not limited to, return on assets, return on equity, return on investment and return on revenues or gross profit) or by the degree to which any of the foregoing earnings measures exceed a percentage of revenues or gross profit; cash flow; market share; margins (including one or more of gross, operating and net earnings margins); stock price; total stockholder return; asset quality; non-performing assets; operating assets; operating expenses; balance of cash, cash equivalents and marketable securities; improvement in or attainment of expense levels or cost savings; operating asset turnover; accounts receivable levels (including measured in terms of days sales outstanding); economic value added; improvement in or attainment of working capital levels; employee retention; customer satisfaction; implementation or completion of critical projects; and growth in customer base.

Any performance goal utilized may be expressed in absolute amounts, on a per share basis, relative to one or more other performance measures, as a growth rate or change from preceding periods, or as a comparison to the performance of specified companies or other external measures, and may relate to one or any combination of corporate or business performance. The Committee will specify the manner of calculating the performance goals it establishes for any performance period. The Committee will select the applicable performance measures and establish the corresponding performance goals for any performance period, and certify any amount payable in connection with an award intended to qualify as performance-based compensation, within the time periods prescribed by and consistent with the other requirements of Code Section 162(m). The Committee may adjust downward, but not upward, any amount determined to be otherwise payable in connection with such an award.

Maximum Award Amounts

The aggregate number of shares that may be subject to certain awards during any calendar year to any one participant under the 2013 Plan shall not exceed 350,000 shares with respect to stock options, 175,000 shares with respect to SARs and 175,000 shares with respect to other awards intended to qualify as performance-based compensation for Section 162(m) purposes.

Substitute Awards

Awards may be granted under the 2013 Plan in substitution for awards granted by another entity acquired by our company or with which our company combines. The terms and conditions of these substitute awards will be comparable to the terms of the awards replaced, and may therefore differ from the terms and conditions otherwise set forth in the 2013 Plan. Shares subject to substitute awards will not count against the 2013 Plan share reserve.

Repricing of Awards

The Committee may not reduce the exercise price of stock options or SARs granted under the 2013 Plan, exchange outstanding stock options or SARs with new stock options or SARs with a lower exercise price or a new full value award, repurchase underwater stock options or SARs or take any other action that would constitute a repricing, unless such action is first approved by our stockholders.

Transferability of Awards

Except as noted below, during the lifetime of a person to whom an award is granted, only that person, or that person's legal representative, may exercise an option or SAR, or receive payment with respect to performance units or any other award. No award may be sold, assigned, transferred, exchanged or otherwise encumbered other than to a successor in the event of a participant's death or pursuant to a qualified domestic relations order. However, the Committee may provide that awards, other than incentive stock options, may be transferable to members of the participant's immediate family or to one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners, if the participant does not receive any consideration for the transfer.

Termination of Service

Unless otherwise provided in an award agreement, upon termination of a participant's service with us, all unvested and unexercisable portions of the participant's outstanding awards will immediately be forfeited. If a participant's service with us terminates other than for cause, death or disability, the vested and exercisable portions of the participant's outstanding stock options and SARs generally will remain exercisable for three months after termination, except in the case of a stock option or SAR held by a non-employee director, in which case the vested and exercisable portion shall remain exercisable through the original term of the award. If a participant's service terminates due to death or disability, the vested and exercisable portions of the participant's outstanding stock options and SARs generally will remain exercisable for one year after termination. Upon termination for cause, all unexercised stock options and SARs will be forfeited.

Unless otherwise provided in an agreement with respect to performance awards or restricted stock, or under other circumstances provided by the Committee, if a participant's service with us terminates due to death or disability, the participant shall be entitled to (i) a payment with respect to performance units at the end of the performance cycle based upon the achievement of performance targets at the end of such period and prorated for the portion of the performance cycle during which the participant was employed and/or (ii) receive a number of shares of restricted stock or time-based stock units under outstanding awards that has been prorated for the term of the participant's employment and for which portion the restrictions shall lapse.

Withholding

The 2013 Plan permits us to withhold from cash awards, and to require a participant receiving Common Stock under the 2013 Plan to pay us in cash, an amount sufficient to cover any required withholding taxes. In lieu of cash, the Committee may permit a participant to cover withholding obligations through a reduction in the number of shares delivered to such participant or a surrender of shares then owned by the participant.

Fundamental Change

Unless otherwise provided in an award agreement, in the event of a sale of all or substantially all of our assets or a merger, consolidation, or share exchange involving our company (any such event referred to as a fundamental change), the surviving or successor entity may continue, assume or replace some or all of the outstanding awards under the 2013 Plan. Award agreements with our executive officers will typically provide that if an award is continued, assumed or replaced in connection with a corporate transaction and if within one year after the transaction the executive officer's employment is involuntarily terminated other than for cause or the executive officer terminates his or her employment for good reason, the award will immediately vest in full or become fully exercisable. If awards granted to any participant are not continued, assumed or replaced in connection with a corporate transaction, the Committee may accelerate the vesting and exercisability of any award or require the surrender of any outstanding award in exchange for payment to the participant of the intrinsic value of the award.

Adjustment of Awards

In the event of an equity restructuring, such as a stock dividend or stock split, that affects the per share value of our Common Stock, the Committee will make appropriate adjustment to: (i) the number and kind of securities reserved for issuance under the 2013 Plan, (ii) the number and kind of securities subject to outstanding awards under the 2013 Plan, (iii) the exercise price of outstanding options and SARs, and (iv) any maximum limitations prescribed by the 2013 Plan as to grants of certain types of awards. The Committee may also make similar adjustments in the event of any other change in our company's capitalization, including a merger, consolidation, reorganization or liquidation.

Amendment and Termination

The 2013 Plan has a term of ten years from its effective date, or the earlier termination of the plan by our board of directors. Our board of directors may amend the 2013 Plan at any time, but no amendment may materially impair the rights of any participant with respect to outstanding awards without the participant's consent. Stockholder approval of any amendment of the 2013 Plan will be obtained if required by applicable law or the rules of the Nasdaq Stock Market. Awards that are outstanding on the plan's termination date will remain in effect in accordance with the terms of the plan and the applicable award agreements.

New Plan Benefits

No benefits or amounts have been granted, awarded or received under the 2013 Plan that were subject to stockholder approval. In addition, the Committee will determine the number and types of awards that will be granted under the 2013 Plan. Thus, it is not possible to determine the benefits that will be received by eligible participants if the 2013 Plan is approved by our stockholders.

Voting Requirements, Recommendation

The affirmative vote of the holders of a majority of the outstanding shares of Common Stock of the Company entitled to vote on this item and present in person or by proxy at the annual meeting of stockholders is required for approval of the 2013 Plan and the shares authorized under the 2013 Plan. Proxies solicited by the Board will be voted for approval of the proposal, unless stockholders specify otherwise in their proxies.

THE BOARD OF DIRECTORS RECOMMENDS THE STOCKHOLDERS VOTE FOR APPROVAL OF THE DIGI INTERNATIONAL INC. 2013 OMNIBUS STOCK PLAN.

PROPOSAL NO. 3

ADVISORY VOTE ON EXECUTIVE COMPENSATION

We are seeking a non-binding advisory vote from stockholders to approve the compensation as disclosed in the CD&A, tabular disclosures and related narrative of this Proxy Statement.

Our compensation programs are structured to align the interests of our executives with the interests of our stockholders by rewarding sustained financial and operating performance and the creation of stockholder value. More specifically, our programs:

Utilize a mix of cash and equity compensation with varying time triggers for payment and financial measures that reward sustained financial performance; and

Place a significant emphasis on the opportunity for incentive compensation, thus aligning total direct compensation with Company performance.

Our Compensation Committee, composed of three independent, non-employee directors, discharges the Board of Directors' responsibilities with respect to all forms of compensation for Named Executives as well as general oversight of compensation plans. The Compensation Committee has the authority to retain outside counsel, experts and other advisors as it determines appropriate.

Stockholders are urged to read the CD&A, which discusses in-depth how our compensation programs are aligned with our performance and the creation of stockholder value. The Compensation Committee and the Board of Directors believe that the policies and practices described in the CD&A effectively implement our pay-for-performance compensation philosophy.

THE BOARD OF DIRECTORS, UPON RECOMMENDATION OF THE COMPENSATION COMMITTEE, RECOMMENDS THAT STOCKHOLDERS VOTE FOR APPROVAL OF THE FOLLOWING NON-BINDING RESOLUTION:

RESOLVED, that the stockholders approve the compensation awarded to the Named Executives, as described in the CD&A, tabular disclosures, and other narrative executive compensation disclosures in this Proxy Statement.

Effect of Proposal

The Say-on-Pay resolution is non-binding. The approval or disapproval of this proposal by stockholders will not require the Board of Directors or the Compensation Committee to take any action regarding our executive compensation practices. The final decision on the compensation and benefits of our executive officers and on whether, and if so, how, to address any stockholder disapproval remains with the Board of Directors and the Compensation Committee.

The Board believes that the Compensation Committee is in the best position to consider the extensive information and factors necessary to make independent, objective, and competitive compensation recommendations and decisions that are in the best interest of our Company and its stockholders.

The Board values the opinions of our stockholders as expressed through their votes and other communications. Although the resolution is non-binding, the Board and the Compensation Committee will carefully consider the outcome of the advisory vote on executive compensation and stockholder opinions received from other communications when making future compensation decisions.

PROPOSAL NO. 4**RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The firm of PricewaterhouseCoopers LLP, independent registered public accounting firm, or one of its predecessors, has been the independent registered public accounting firm for us since 1986. The Audit Committee has again selected PricewaterhouseCoopers LLP to serve as our independent registered public accounting firm for the fiscal year ending September 30, 2013, subject to ratification by the stockholders. While it is not required to do so, the Audit Committee is submitting the selection of that firm for ratification in order to ascertain the view of the stockholders. If the selection is not ratified, the Audit Committee will reconsider its selection.

A representative of PricewaterhouseCoopers LLP will be present at the annual meeting and will be afforded an opportunity to make a statement if such representative so desires and will be available to respond to appropriate questions during the meeting.

Audit and Non-Audit Fees

The following table presents fees for fiscal 2012 and 2011 for professional audit services performed by PricewaterhouseCoopers for the audit of our annual consolidated financial statements, the review of our interim consolidated financial statements for each quarter in fiscal 2012 and 2011 and all other services performed:

	Year Ended September 30,	
	2012	2011
Audit Fees	\$ 768,133	\$ 674,205
Audit-Related Fees	58,229	
Tax Fees	198,689	3,308
All Other Fees		
Total	\$ 1,025,051	\$ 677,513

The Audit Committee pre-approved all of the services described above pursuant to engagements that occurred in fiscal 2012 and 2011.

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

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR THE RATIFICATION OF THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2013.

ADDITIONAL MATTERS

Our Annual Report on Form 10-K for the fiscal year ended September 30, 2012, including our consolidated financial statements, is being mailed or made available with this Proxy Statement.

As of the date of this Proxy Statement, management knows of no matters that will be presented for determination at the annual meeting other than those referred to herein. If any other matters properly come before the annual meeting calling for a vote of stockholders, it is intended that the shares represented by the proxies solicited by the Board of Directors will be voted by the persons named therein in accordance with their best judgment.

By Order of the Board of Directors,

David H. Sampsell

Vice President, General Counsel & Corporate Secretary

Dated: December 5, 2012

Digi International Inc.

2013 Omnibus Incentive Plan

1. *Purpose.* The purpose of the Digi International Inc. 2013 Omnibus Incentive Plan (the *Plan*) is to promote the interests of the Company and its stockholders by providing key personnel of the Company and its Affiliates and Non-Employee Directors with an opportunity to acquire a proprietary interest in the Company and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its Affiliates. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel and Non-Employee Directors of outstanding ability.

2. *Definitions.*

2.1 The capitalized terms used elsewhere in the Plan have the meanings set forth below.

(a) *Affiliate* means any corporation that is a parent corporation or subsidiary corporation of the Company, as those terms are defined in Code Sections 424(e) and (f), or any successor provisions, and, for purposes other than the grant of Incentive Stock Options, any entity in which the Company or any such subsidiary corporation owns at least 20% of the combined voting power of the entity's voting securities and which is designated by the Committee as covered by the Plan.

(b) *Agreement* means a written or electronic contract (i) entered into between the Company and a Participant and (ii) containing the terms and conditions of an Award in such form and not inconsistent with the Plan as the Committee shall approve from time to time, together with all amendments thereto, which amendments may be unilaterally made by the Company (with the approval of the Committee) unless such amendments are deemed by the Committee to be materially adverse to the Participant and not required to comply with applicable law or stock exchange rules.

(c) *Award* or *Awards* means a grant made under the Plan in the form of Restricted Stock, Options, Stock Appreciation Rights, Stock Units, an Other Stock-Based Award or a Cash Incentive Award.

(d) *Board* means the Board of Directors of the Company.

(e) *Cash Incentive Award* means an Award described in Section 8.2 of the Plan.

(e) *Code* means the Internal Revenue Code of 1986, as amended and in effect from time to time or any successor statute.

(f) *Committee* means two or more Non-Employee Directors designated by the Board to administer the Plan under Plan Section 3.1, each of whom shall be (i) an independent director within the meaning and rules of the Nasdaq Stock Market, (ii) a non-employee director within the meaning of Exchange Act Rule 16b-3 and (iii) an outside director for purposes of Code Section 162(m). Unless otherwise specified by the Board, the Committee shall be the Compensation Committee of the Board.

(g) *Company* means Digi International Inc., a Delaware corporation, or any successor to all or substantially all of its businesses by merger, consolidation, purchase of assets or otherwise.

(h) *Effective Date* means the date specified in Plan Section 13.1.

(i) *Employee* means an employee (including an officer or director who is also an employee) of the Company or an Affiliate.

- (j) Exchange Act means the Securities Exchange Act of 1934, as amended and in effect from time to time or any successor statute.
- (k) Exchange Act Rule 16b-3 means Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as now in force and in effect from time to time or any successor regulation.
- (l) Fair Market Value as of any date means, unless otherwise expressly provided in the Plan, the fair market value of a Share determined as follows:
- (i) If the Shares are then readily tradable on an established securities market (as determined under Code Section 409A), then Fair Market Value will be the closing sale price for a Share on the principal securities market on which it trades on such date, or if no sale of Shares occurred on that date, on the next preceding date on which a sale of Shares occurred, as reported in *The Wall Street Journal* or such other source as the Committee deems reliable; or
- (ii) If clause (i) is inapplicable, then Fair Market Value will be determined by the Committee as the result of a reasonable application of a reasonable valuation method that satisfies the requirements of Code Section 409A.
- In the case of an Incentive Stock Option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 17.
- (m) Full Value Award means any Award other than an Option Award, Stock Appreciation Rights Award or Cash Incentive Award.
- (n) Fundamental Change means a dissolution or liquidation of the Company, a sale of substantially all of the assets of the Company, a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or a statutory share exchange involving capital stock of the Company.
- (o) Incentive Stock Option means any Option designated as such and granted in accordance with the requirements of Code Section 422 or any successor provision.
- (p) Insider as of a particular date means any person who, as of that date, is a director of the Company or an officer of the Company as defined under Exchange Act Rule 16a-1(f) or its successor provision.
- (q) Non-Employee Director means a member of the Board who is not an Employee.
- (r) Non-Statutory Stock Option means an Option other than an Incentive Stock Option.
- (s) Option means a right to purchase Stock, including both Non-Statutory Stock Options and Incentive Stock Options.
- (t) Other Stock-Based Award means an Award described in Section 8.1 of the Plan.
- (u) Participant means a person to whom an Award is or has been made in accordance with the Plan.
- (v) Performance-Based Compensation means a Full Value or Cash Incentive Award to a person who is, or is determined by the Committee to likely become, a covered employee (as defined in Code Section 162(m)(3)) and that is intended to constitute performance-based compensation within the meaning of Code Section 162(m)(4)(C).

- (w) Performance Cycle means the period of time as specified in an Agreement over which a performance-based Award is to be earned.
- (x) Plan means this Digi International Inc. 2013 Omnibus Incentive Plan, as may be amended and in effect from time to time.
- (y) Prior Plan means the Digi International Inc. 2000 Omnibus Stock Plan, as amended and restated as of December 4, 2009.
- (z) Restricted Stock means Stock granted under Plan Section 7 so long as such Stock remains subject to one or more restrictions.
- (aa) Section 16 or Section 16(b) means Section 16 or Section 16(b), respectively, of the Exchange Act or any successor statute and the rules and regulations promulgated thereunder as in effect and as amended from time to time.
- (bb) Share means a share of Stock.
- (cc) Stock means the common stock, par value \$.01 per share, of the Company.
- (dd) Stock Appreciation Right means a right, the value of which is determined in relation to the appreciation in value of Shares pursuant to an Award granted under Plan Section 10.
- (ee) Stock Unit means an Award described in Section 11 of the Plan.
- (ff) Subsidiary means a subsidiary corporation, as that term is defined in Code Section 424(f) or any successor provision.
- (gg) Substitute Award means an Award granted under the circumstances described in Section 21 of the Plan.
- (hh) Successor with respect to a Participant means the legal representative of an incompetent Participant, and if the Participant is deceased the estate of the Participant or the person or persons who may, by bequest or inheritance, or pursuant to the terms of an Award, acquire the right to exercise an Option or Stock Appreciation Right or to receive cash and/or Shares issuable in satisfaction of an Award in the event of the Participant's death.
- (ii) Term means the period during which an Option or Stock Appreciation Right may be exercised or the period during which the restrictions or terms and conditions placed on Restricted Stock or any other Award are in effect.
- (jj) Transferee means any family member of a Participant as the term is defined in General Instruction A(5) to Form S-8 under the Securities Act of 1933, as amended.

2.2 Gender and Number. Except when otherwise indicated by the context, reference to the masculine gender shall include, when used, the feminine gender and any term used in the singular shall also include the plural.

3. Administration and Indemnification.

3.1 Administration.

- (a) The Committee shall administer the Plan. The Committee shall have exclusive power to (i) make Awards, (ii) determine when and to whom Awards will be granted, the form of each Award, the amount of each

Award, and any other terms or conditions of each Award consistent with the Plan, and (iii) determine whether, to what extent and under what circumstances, Awards may be settled, paid or exercised in cash, Shares or other Awards, or other property or canceled, forfeited or suspended. Each Award shall be subject to an Agreement authorized by the Committee. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Any such action of the Committee shall be valid and effective even if any member of the Committee at the time of the action is later determined not to have satisfied all of the criteria for membership in clauses (i), (ii) and (iii) of Section 2(f). Notwithstanding the foregoing, the Board shall have the sole and exclusive power to administer the Plan with respect to Awards granted to Non-Employee Directors.

(b) Solely for purposes of determining and administering Awards to Participants who are not Insiders, the Committee may delegate all or any portion of its authority under the Plan to one or more persons who are not Non-Employee Directors.

(c) To the extent within its discretion and subject to Plan Sections 16, 17, and 19, the Committee may amend the terms and conditions of any outstanding Award.

(d) It is the intent that the Plan and all Awards granted pursuant to it shall be administered by the Committee so as to permit the Plan and Awards to comply with Exchange Act Rule 16b-3, except in such instances as the Committee, in its discretion, may so provide. If any provision of the Plan or of any Award would otherwise frustrate or conflict with the intent expressed in this Section 3.1(d), that provision to the extent possible shall be interpreted and deemed amended in the manner determined by the Committee so as to avoid the conflict. To the extent of any remaining irreconcilable conflict with this intent, the provision shall be deemed void as applicable to Insiders to the extent permitted by law and in the manner deemed advisable by the Committee.

(e) The Committee's interpretation of the Plan and of any Award or Agreement made under the Plan and all related decisions or resolutions of the Board or Committee shall be final and binding on all parties with an interest therein. Consistent with its terms, the Committee shall have the power to establish, amend or waive regulations to administer the Plan. In carrying out any of its responsibilities, the Committee shall have discretionary authority to construe the terms of the Plan and any Award or Agreement made under the Plan.

(f) The Committee may grant Awards to Employees and other eligible service providers who are foreign nationals, who are located outside of the United States or who are not compensated from a payroll maintained in the United States, or who are otherwise subject to (or could cause the Company to be subject to) legal or regulatory requirements of countries outside of the United States, on such terms and conditions different from those specified in the Plan as may, in the judgment of the Committee, be necessary or desirable to comply with applicable foreign laws and regulatory requirements and to promote achievement of the purposes of the Plan. In connection therewith, the Committee may establish such sub-plans and modify exercise procedures and other Plan rules and procedures to the extent such actions are deemed necessary or desirable, and may take any other action that it deems advisable to obtain local regulatory approvals or to comply with any necessary local governmental regulatory exemptions.

3.2 Indemnification. Each person who is or shall have been a member of the Committee, or of the Board, and any other person to whom the Committee delegates authority under the Plan, shall be indemnified and held harmless by the Company, to the extent permitted by law, against and from any loss, cost, liability or expense that may be imposed upon or reasonably incurred by such person in connection with or resulting from any claim, action, suit or proceeding to which such person may be a party or in which such person may be involved by reason of any action taken or failure to act, made in good faith, under the Plan and against and from any and all amounts paid by such person in settlement thereof, with the Company's approval, or paid by such person in satisfaction of any judgment in any such action, suit or proceeding against such person, provided such person shall give the Company an opportunity, at the Company's expense, to handle and defend the same before

such person undertakes to handle and defend it on such person's own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person or persons may be entitled under the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

4. Shares Available Under the Plan and Maximum Awards.

4.1 Number of Shares Available for Grants. Subject to adjustment as provided in Sections 4.1(a) and 17 herein, the number of Shares that may be the subject of Awards and issued to Participants under the Plan shall be 1,750,000. After the Effective Date, no additional awards may be granted under the Prior Plan. Any Shares that are subject to Awards of Options shall be counted against the maximum Share limitation as one Share for every one Share granted, and Awards of Stock Appreciation Rights shall be counted against this maximum Share limitation as equal to the number of Shares to which such Stock Appreciation Rights relate. Any Shares that are subject to Full Value Awards shall be counted against this maximum Share limitation as 2.0 Shares for every one Share granted. Substitute Awards shall not be counted against this maximum Share limitation, nor shall they reduce the number of Shares authorized for grant to a Participant in any calendar year. The Shares to be delivered under the Plan will be made available from authorized but unissued Shares or issued Shares that are held in the Company's treasury.

(a) Any Shares subject to an Award under this Plan, or to an award granted under the Prior Plan that is outstanding on the Effective Date (a Prior Plan Award), that expires, is forfeited, cancelled, returned to the Company for failure to satisfy vesting requirements, is settled for cash or otherwise terminates without payment being made thereunder shall, to the extent of such expiration, forfeiture, cancellation, return, cash settlement or termination, again be available for grant under the Plan. Each Share that again becomes available for grant pursuant to the preceding sentence shall increase the total number of Shares remaining available for Awards by (i) one Share if such Share was subject to an Option or Stock Appreciation Right granted under the Plan or to a stock option or stock appreciation right granted under the Prior Plan, (ii) 2.0 Shares if such Share was subject to a Full Value Award granted under the Plan, or (iii) 1.3 Shares if such Share was subject to a Full Value Award granted under the Prior Plan. The following Shares will, however, continue to be charged against the foregoing maximum Share limitation and will not again become available for grant: (i) Shares tendered by the Participant or withheld by the Company in payment of the purchase price of an Option, (ii) Shares tendered by the Participant or withheld by the Company to satisfy any tax withholding obligation with respect to an Award, (iii) Shares subject to a Stock Appreciation Right that are not issued in connection with the settlement of the Stock Appreciation Right upon its exercise, and (iv) Shares repurchased by the Company with proceeds received from the exercise of a stock option issued under this Plan or the Prior Plan.

(b) Where two or more types of Awards (all of which are payable in Shares) are granted to a Participant in tandem with each other, such that the exercise of one type of Award with respect to a number of Shares cancels at least an equal number of Shares of the other, the number of Shares to be counted against the maximum Share limitation shall be the maximum number of Shares available under the larger of the two Awards.

(c) If a company acquired by the Company or any Subsidiary or with which the Company or any Subsidiary combines has shares available under a pre-existing plan approved by stockholders and not adopted in contemplation of such acquisition or combination, the number of shares remaining available for grant pursuant to the terms of such pre-existing plan (as adjusted, to the extent appropriate, using the exchange ratio or other adjustment or valuation ratio or formula used in such acquisition or combination to determine the consideration payable to the holders of common stock of the entities party to such acquisition or combination) may be used for Awards under the Plan and shall not reduce the number of Shares authorized for grant under the Plan. Awards using such available shares shall not be made after the date awards or grants could have been made under the terms of the pre-existing plan, absent the acquisition or combination, and shall only be made to individuals who were not Employees or Non-Employee Directors prior to such acquisition or combination.

(d) Additional rules for determining the number of Shares granted under the Plan may be made by the Committee as it deems necessary or desirable.

(e) No fractional Shares may be issued under the Plan; however, cash shall be paid in lieu of any fractional Share in settlement of an Award.

4.2 Individual Award Limitations. Subject to adjustment pursuant to Plan Section 17, the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Options is 350,000, and the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Stock Appreciation Rights is 175,000.

5. Eligibility. Participation in the Plan shall be limited to Employees, Non-Employee Directors and any consultant or advisor who is a natural person and who provides services to the Company or any Affiliate (other than in connection with (i) the offer or sale of securities in a capital-raising transaction or (ii) directly or indirectly promoting or maintaining a market in Company securities). The granting of Awards is solely at the discretion of the Committee, except that Incentive Stock Options may only be granted to Employees. References herein to employed, employment or similar terms (except Employee) shall include the providing of services to the Company or an Affiliate as a Non-Employee Director, consultant or advisor. Neither the transfer of employment of a Participant between any of the Company or its Affiliates, nor a leave of absence granted to such Participant and approved by the Committee, shall be deemed a termination of employment for purposes of the Plan.

6. General Terms of Awards.

6.1 Amount of Award. Each Agreement shall set forth the number of Shares of Restricted Stock, Stock or Stock Units subject to the Agreement, or the number of Shares to which the Option subject to the Agreement applies or with respect to which payment upon the exercise of the Stock Appreciation Right subject to the Agreement is to be determined, as the case may be, together with such other terms and conditions applicable to the Award as determined by the Committee acting in its sole discretion.

6.2 Term. Each Agreement, other than those relating solely to Awards of Shares without restrictions, shall set forth the Term of the Option, Stock Appreciation Right, Restricted Stock, Stock Unit or other Award or the Performance Cycle for any performance-based Award, as the case may be. Acceleration of the expiration of the applicable Term is permitted, upon such terms and conditions as shall be set forth in the Agreement, which may, but need not, include, without limitation, acceleration in the event of the Participant's death or retirement. Acceleration of the Performance Cycle of any performance-based Awards shall be subject to Plan Section 6.6. Each award granted to a Participant shall have such Term as the Committee shall determine at the time of grant; provided, however, that any such Term shall not exceed eight (8) years.

6.3 Transferability. Except as provided in this Section, during the lifetime of a Participant to whom an Award is granted, only that Participant (or that Participant's legal representative) may exercise an Option or Stock Appreciation Right, or receive payment with respect to Stock Units or any other Award. No Award of Restricted Stock (before the expiration of the restrictions), Options, Stock Appreciation Rights or Stock Units or other Award may be sold, assigned, transferred, exchanged or otherwise encumbered other than to a Successor in the event of a Participant's death or pursuant to a qualified domestic relations order as defined in the Code or Title 1 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), or the rules thereunder; any attempted transfer in violation of this Section 6.3 shall be of no effect. Notwithstanding the immediately preceding sentence, the Committee, in an Agreement or otherwise at its discretion, may provide that the Award (other than Incentive Stock Options) may be transferable to a Transferee if the Participant does not receive any consideration for the transfer. Any Award held by a Transferee shall continue to be subject to the same terms and conditions that were applicable to that Award immediately before the transfer thereof to the Transferee. For purposes of any provision of the Plan relating to notice to a Participant or to acceleration or termination of an Award upon the death, disability or termination of employment of a Participant, the references to Participant shall mean the original grantee of an Award and not any Transferee.

6.4 Termination of Employment. Except as otherwise determined by the Committee or provided by the Committee in an Agreement, in case of a Participant's termination of employment (which includes other service relationships as provided in Section 5), the following provisions shall apply:

(a) Options and Stock Appreciation Rights.

(i) If a Participant's employment with the Company and its Affiliates terminates because of the Participant's death, then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment has been continuous between the date the Option or Stock Appreciation Right was granted and a date not more than three months prior to such death, and may be exercised by the Participant's Successor at any time, or from time to time, within one year after the date of the Participant's death.

(ii) If a Participant's employment with the Company and its Affiliates terminates because the Participant is disabled (within the meaning of Section 22(e)(3) of the Code), then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment has been continuous between the date the Option or Stock Appreciation Right was granted and the date of such disability, and the Participant or the Participant's Successor may exercise such Option or Stock Appreciation Right at any time, or from time to time, within one year after the date of the Participant's disability.

(iii) If a Participant's employment terminates for any reason other than death or disability, then any Option or Stock Appreciation Right that has not expired or been terminated shall remain exercisable for three months after termination of the Participant's employment, but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Participant's termination of employment; provided, however, that if the Participant is a Non-Employee Director, the Option or Stock Appreciation Right shall remain exercisable until the expiration of the Term after such Non-Employee Director ceases to be a director of the Company but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Non-Employee Director ceasing to be a director.

(iv) Notwithstanding the foregoing Plan Sections 6.4(a)(i), (ii) and (iii), in no event shall an Option or a Stock Appreciation Right be exercisable after the expiration of the Term of such Award. Any Option or Stock Appreciation Right that is not exercised within the periods set forth in Plan Sections 6.4 (i), (ii) and (iii), except as otherwise provided by the Committee in the Agreement, shall terminate as of the end of the periods described in such Sections.

(b) Performance-Based Full Value Awards. If a Participant's employment with the Company and its Affiliates terminates during a Performance Cycle because of death or disability, or under other circumstances provided by the Committee in its discretion in the Agreement or otherwise, the Participant, unless the Committee shall otherwise provide in the Agreement, shall be entitled to a payment with respect to a performance-based Full Value Award at the end of the Performance Cycle based upon the extent to which achievement of performance goals was satisfied at the end of such period (as determined at the end of the Performance Cycle) and prorated for the portion of the Performance Cycle during which the Participant was employed by the Company or its Affiliates. Except as provided in this Section 6.4(b) or in the Agreement, if a Participant's employment or other service relationship with the Company and its Affiliates terminates during a Performance Cycle, then such Participant shall not be entitled to any payment with respect to that Performance Cycle.

(c) Time Vested Restricted Stock and Stock Unit Awards. Unless otherwise provided in the Agreement, in case of a Participant's death or disability, the Participant shall be entitled to have vest a number of Shares of Restricted Stock or a number of Stock Units under outstanding Awards subject only to service-based vesting that has been prorated for the portion of the Term of the Awards during which the Participant was employed by the Company and its Affiliates, and, with respect to such Shares or Stock Units, all restrictions shall lapse. Any

Shares of Restricted Stock or Stock Units that do not vest and as to which restrictions do not lapse under the preceding sentence shall terminate at the date of the Participant's termination of employment and such Shares of Restricted Stock or Stock Units shall be forfeited to the Company.

6.5 Rights as Stockholder. Each Agreement shall provide that a Participant shall have no rights as a stockholder with respect to any securities covered by an Award unless and until the date the Participant becomes the holder of record of the Stock, if any, to which the Award relates.

6.6 Performance-Based Awards. Any Award may be granted as a performance-based Award if the Committee establishes one or more measures of Company, Subsidiary, business unit or individual performance which must be attained, and the Performance Cycle over which the specified performance is to be attained, as a condition to the vesting, exercisability, lapse of restrictions and/or settlement in cash or Shares of such Award. In connection with any such Award, the Committee shall determine the extent to which performance goals have been attained and other applicable terms and conditions have been satisfied, and the degree to which vesting, exercisability, lapse of restrictions and/or settlement in cash or Shares of such Award has been earned. Any performance-based Award that is intended by the Committee to qualify as Performance-Based Compensation shall additionally be subject to the requirements of Section 12 of this Plan. Except as provided in Section 12 with respect to Performance-Based Compensation, the Committee shall also have the authority to provide, in an Agreement or otherwise, for the acceleration of a Performance Cycle and an adjustment or waiver of the achievement of performance goals upon the occurrence of certain events, which may, but need not include, without limitation, a Fundamental Change, a recapitalization, a change in the accounting practices of the Company, a change in a Participant's title or employment responsibilities, a Participant's death or retirement or, with respect to settlements in Shares with respect to an Award, a reclassification, stock dividend, stock split or stock combination as provided in Plan Section 17. An Agreement also may provide for a limitation on the value of an Award that a Participant may receive.

6.7 Dividends and Dividend Equivalents. Any dividends or distributions paid with respect to Shares that are subject to the unvested portion of a Restricted Stock Award will be subject to the same restrictions as the Shares to which such dividends or distributions relate, except for regular cash dividends on Shares subject to the unvested portion of a Restricted Stock Award that is subject only to service-based vesting conditions. In its discretion, the Committee may provide in an Agreement for a Stock Unit Award or an Other Stock-Based Award that the Participant will be entitled to receive dividend equivalents on the units or other Share equivalents subject to the Award based on dividends actually declared on outstanding Shares. The terms of any dividend equivalents will be as set forth in the applicable Award Agreement, including the time and form of payment and whether such dividend equivalents will be credited with interest or deemed to be reinvested in additional units or Share equivalents. Any dividend equivalents payable with respect to the unvested portion of a Stock Unit Award or an Other Stock-Based Award that is performance-based within the meaning of Section 6.6 will be subject to the same restrictions as the units or other Share equivalents to which such dividend equivalents relate. The Committee may, in its discretion, provide in Award Agreements for restrictions on dividends and dividend equivalents in addition to those specified in this Section 6.7.

6.8 Minimum Vesting Period. The Committee may provide in an Agreement for such vesting conditions as it may determine, subject to the following limitations on Full Value Awards:

- (1) A Full Value Award that vests solely as the result of the passage of time and continued employment by the Participant shall be subject to a vesting period of not less than three years from the grant date of the Award (but permitting pro rata vesting over such vesting period); and
- (2) A Full Value Award whose vesting is subject to the satisfaction of performance goals over a Performance Cycle shall be subject to a Performance Cycle of not less than one year.

The minimum vesting periods specified in clauses (1) and (2) above will not, however, apply in the following situations: (i) an Award made to attract a key executive to join the Company; (ii) upon a Fundamental Change; (iii) upon termination of Service due to death, disability or retirement; (iv) Awards made in payment of or

exchange for other earned compensation (including performance-based Awards); (v) any Substitute Award that does not reduce the vesting period of the award being replaced; (vi) Awards made to Non-Employee Directors; and (vii) Awards involving an aggregate number of Shares not in excess of 10% of the number of Shares specified in the first sentence of Section 4.1.

7. Restricted Stock Awards.

7.1 Nature of Award. An Award of Restricted Stock under the Plan shall consist of Shares subject to restrictions on transfer and conditions of forfeiture, which restrictions and conditions shall be included in the applicable Agreement. The Committee may provide for the lapse or waiver of any such restrictions or conditions and the vesting of the Shares based on such factors or criteria as the Committee, in its sole discretion, may determine.

7.2 Stock Certificates. Except as otherwise provided in the applicable Agreement, each Stock certificate issued with respect to an Award of Restricted Stock shall either be deposited with the Company or its designee, together with an assignment separate from the certificate, in blank, signed by the Participant, or bear such legends with respect to the restricted nature of the Restricted Stock evidenced thereby as shall be provided for in the applicable Agreement.

7.3 Vesting of Awards. The Agreement shall describe the terms and conditions by which the restrictions and conditions of forfeiture upon awarded Restricted Stock shall lapse and the Shares vest. Upon the lapse of the restrictions and conditions, Shares free of restrictive legends, if any, relating to such restrictions shall be issued to the Participant or a Successor or Transferee.

7.4 Rights as a Stockholder. Except as otherwise provided in the Plan, a Participant or a Transferee with a Restricted Stock Award shall have all the rights of a stockholder, including the right to vote the Shares of Restricted Stock.

8. Other Awards.

8.1 Other Stock-Based Awards. The Committee may from time to time grant Stock and other Awards that are valued by reference to and/or payable in whole or in part in Shares under the Plan. The Committee, in its sole discretion, shall determine the terms and conditions of such Awards, provided that such Awards shall not be inconsistent with the terms and purposes of the Plan. The Committee may, at its sole discretion, direct the Company to issue Shares subject to restrictive legends and/or stop transfer instructions that are consistent with the terms and conditions of the Award to which the Shares relate.

8.2 Cash Incentive Awards. A Cash Incentive Award shall be considered a performance-based Award for purposes of, and subject to, Section 6.6, the payment of which shall be contingent upon the degree to which one or more specified performance goals have been achieved over a specified Performance Cycle. Cash Incentive Awards may be granted to any Participant in such amounts and upon such terms and at such times as shall be determined by the Committee, and may be denominated in units that have a dollar value established by the Committee as of the applicable grant date. Following the completion of the applicable Performance Cycle and the vesting of a Cash Incentive Award, payment of the settlement amount of the Award to the Participant shall be made at such time or times in the form of cash or other forms of Awards under the Plan (valued for these purposes at their grant date fair value) or a combination of cash and other forms of Awards as determined by the Committee and specified in the applicable Agreement. If a Cash Incentive Award is not by its terms exempt from the requirements of Code Section 409A, then the applicable Agreement shall contain terms and conditions intended to avoid adverse tax consequences specified in Code Section 409A.

9. Stock Options.

9.1 Terms of All Options.

(a) An Option shall be granted pursuant to an Agreement as either an Incentive Stock Option or a Non-Statutory Stock Option. The purchase price of each Share subject to an Option shall be determined by the Committee and set forth in the Agreement, but shall not be less than the Fair Market Value of a Share as of the date the Option is granted, except in the case of Substitute Awards.

(b) The purchase price of the Shares with respect to which an Option is exercised shall be payable in full at the time of exercise, provided that to the extent permitted by law, the Agreement may permit some or all Participants to simultaneously exercise Options and sell the Shares thereby acquired pursuant to a brokerage or similar relationship and use the proceeds from the sale as payment of the purchase price of the Shares. The purchase price may be payable in cash or in such other manner as the Committee may permit, including by delivery to the Company of Shares (by actual delivery or attestation) already owned by the Participant or by the Company withholding Shares otherwise issuable to the Participant upon the exercise of the Option (in either case, such Shares delivered or withheld having a Fair Market Value as of the date the Option is exercised equal to the purchase price of the Shares being purchased pursuant to the Option), or a combination thereof, as determined by the Committee, but no fractional Shares will be issued or accepted.

(c) Each Option shall be exercisable in whole or in part on the terms provided in the Agreement. In no event shall any Option be exercisable at any time after the expiration of its Term. When an Option is no longer exercisable, it shall be deemed to have lapsed or terminated.

(d) Each Option granted to a Participant shall expire at such time as the Committee shall determine at the time of grant; provided, however, that no Option shall be exercisable later than the eight (8th) anniversary date of its grant.

9.2 Incentive Stock Options. In addition to the other terms and conditions applicable to all Options:

(a) The maximum number of Shares that may be issued upon the exercise of Incentive Stock Options shall equal the maximum number of Shares that may be the subject of Awards and issued under the Plan as provided in the first sentence of Section 4.1.

(b) The aggregate Fair Market Value (determined as of the date the Option is granted) of the Shares with respect to which Incentive Stock Options held by an individual first become exercisable in any calendar year (under the Plan and all other incentive stock option plans of the Company and its Affiliates) shall not exceed \$100,000 (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. To the extent an Option or Options granted to a Participant exceed this limit, the Option(s) shall be treated as Non-Statutory Stock Option(s).

(c) The Agreement covering an Incentive Stock Option shall contain such other terms and provisions that the Committee determines necessary to qualify this Option as an Incentive Stock Option.

(d) Notwithstanding any other provision of the Plan to the contrary, no Participant may receive an Incentive Stock Option under the Plan if, at the time the Award is granted, the Participant owns (after application of the rules contained in Code Section 424(d), or its successor provision), Shares possessing more than 10% of the total combined voting power of all classes of stock of the Company or its Subsidiaries, unless (i) the exercise price for all Shares subject to that Incentive Stock Option is at least 110% of the Fair Market Value of a Share on the date of grant and (ii) that Option is not exercisable after the date five years from the date that Incentive Stock Option is granted.

10. Stock Appreciation Rights. An Award of a Stock Appreciation Right shall entitle the Participant (or a Successor or Transferee), subject to terms and conditions determined by the Committee, to receive upon exercise of the Stock Appreciation Right all or a portion of the excess of (i) the Fair Market Value of a specified number of Shares as of the date of exercise of the Stock Appreciation Right over (ii) a specified price that shall not be less than 100% of the Fair Market Value of such Shares as of the date of grant of the Stock Appreciation Right. A Stock Appreciation Right may be granted in connection with part or all of, in addition to, or completely independent of an Option or any other Award under the Plan. If issued in connection with a previously or contemporaneously granted Option, the Committee may impose a condition that exercise of a Stock Appreciation Right cancels a pro rata portion of the Option with which it is connected and vice versa. Each Stock Appreciation Right may be exercisable in whole or in part on the terms provided in the Agreement. No Stock Appreciation Right shall be exercisable at any time after the expiration of its Term. When a Stock Appreciation Right is no longer exercisable, it shall be deemed to have lapsed or terminated. Upon exercise of a Stock Appreciation Right, payment to the Participant or a Successor or Transferee shall be made at such time or times as shall be provided in the Agreement in the form of cash, Shares or a combination of cash and Shares as determined by the Committee. The Agreement may provide for a limitation upon the amount or percentage of the total appreciation on which payment (whether in cash and/or Shares) may be made in the event of the exercise of a Stock Appreciation Right. The Term of a Stock Appreciation Right granted under the Plan shall be determined by the Committee, in its sole discretion; provided, however, that such Term shall not exceed eight (8) years.

11. Stock Units.

11.1 Vesting and Consideration. A Stock Unit shall consist of the right to receive, in cash and/or in Shares as determined by the Committee, the Fair Market Value of one or more Shares, with any Stock Unit Award subject to such vesting conditions, and the corresponding lapse of forfeiture conditions and other restrictions, based on such factors and occurring over such period of time as the Committee may determine in its discretion. The Committee may provide whether any consideration other than Services must be received by the Company or any Affiliate as a condition precedent to the settlement of a Stock Unit Award.

11.2 Payment of Award. Following the vesting of a Stock Unit Award, settlement of the Award and payment to the Participant shall be made at such time or times in the form of cash, Shares (which may themselves be considered Restricted Stock under the Plan subject to restrictions on transfer and forfeiture conditions) or a combination of cash and Shares as determined by the Committee. If the Stock Unit Award is not by its terms exempt from the requirements of Code Section 409A, then the applicable Agreement shall contain terms and conditions intended to avoid adverse tax consequences specified in Code Section 409A.

12. Performance-Based Compensation.

12.1 Designation of Awards. If the Committee determines at the time a Full Value Award or a Cash Incentive Award is granted to a Participant that such Participant is, or is likely to be, a covered employee for purposes of Code Section 162(m) as of the end of the tax year in which the Company would ordinarily claim a tax deduction in connection with such Award, then the Committee may provide that this Section 12 will be applicable to such Award, which shall be considered Performance-Based Compensation.

12.2 Compliance with Code Section 162(m). If an Award is subject to this Section 12, then the lapsing of restrictions thereon and the distribution of cash, Shares or other property pursuant thereto, as applicable, shall be subject to the achievement over the applicable Performance Cycle of one or more performance goals based on one or more of the performance measures specified in Section 12.4. The Committee will select the applicable performance measure(s) and specify the performance goal(s) based on those performance measures for any Performance Cycle, specify in terms of an objective formula or standard the method for calculating the amount payable to a Participant if the performance goal(s) are satisfied, and certify the degree to which applicable performance goals have been satisfied and any amount payable in connection with an Award subject to this Section 12, all within the time periods prescribed by and consistent with the other requirements of Code

Section 162(m). In specifying the performance goals applicable to any performance period, the Committee may provide that one or more objectively determinable adjustments shall be made to the performance measures on which the performance goals are based, which may include adjustments that would cause such measures to be considered non-GAAP financial measures within the meaning of Rule 101 under Regulation G promulgated by the Securities and Exchange Commission. The Committee may also adjust performance goals for a Performance Cycle to the extent permitted by Code Section 162(m) in connection with an event described in Section 17 to prevent the dilution or enlargement of a Participant's rights with respect to Performance-Based Compensation. The Committee may adjust downward, but not upward, any amount determined to be otherwise payable in connection with such an Award. The Committee may also provide, in an Agreement or otherwise, that the achievement of specified performance goals in connection with an Award subject to this Section 12 may be waived upon the death or Disability of the Participant or under any other circumstance with respect to which the existence of such possible waiver will not cause the Award to fail to qualify as performance-based compensation under Code Section 162(m).

12.3 Limitations. With respect to Awards of Performance-Based Compensation, the maximum number of Shares that may be the subject of any Full Value Awards that are denominated in Shares or Share equivalents and that are granted to any one Participant during any calendar year shall not exceed 175,000 Shares (subject to adjustment as provided in Section 17). The maximum amount payable with respect to any Cash Incentive Awards and Full Value Awards that are denominated other than in Shares or Share equivalents and that are granted to any one Participant during any calendar year shall not exceed \$1,000,000.

12.4 Performance Measures. For purposes of any Full Value Award or Cash Incentive Award considered Performance-Based Compensation subject to this Section 12, the performance measures to be utilized shall be limited to one or a combination of two or more of the following: revenue or net sales; gross profit; operating profit; net income; earnings before one or more of interest, taxes, depreciation, amortization and other adjustments; profitability as measured by return ratios (including, but not limited to, return on assets, return on equity, return on investment and return on revenues or gross profit) or by the degree to which any of the foregoing earnings measures exceed a percentage of revenues or gross profit; cash flow; market share; margins (including one or more of gross, operating and net earnings margins); stock price; total stockholder return; asset quality; non-performing assets; operating assets; operating expenses; balance of cash, cash equivalents and marketable securities; improvement in or attainment of expense levels or cost savings; operating asset turnover; accounts receivable levels (including measured in terms of days sales outstanding); economic value added; improvement in or attainment of working capital levels; employee retention; customer satisfaction; implementation or completion of critical projects; and growth in customer base. Any performance goal based on one or more of the foregoing performance measures may, in the Committee's discretion, be expressed in absolute amounts, on a per share basis (basic or diluted), relative to one or more other performance measures, as a growth rate or change from preceding periods, or as a comparison to the performance of specified companies or a published or special index (including stock market indices) or other external measures, may relate to one or any combination of Company, Affiliate or business unit performance, and may be expressed in terms of differing levels of achievement, such as threshold, target and maximum levels of achievement.

13. Effective Date and Duration of the Plan.

13.1 Effective Date. The Plan shall become effective on the date it is approved by the Company's stockholders, which shall be considered the date of its adoption for purposes of Treasury Regulation §1.422-2(b)(2)(i). No Awards shall be made under the Plan prior to its Effective Date. If the Company's stockholders fail to approve the Plan within 12 months of its approval by the Board, the Plan shall be of no further force or effect.

13.2 Duration of the Plan. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 16, or the tenth anniversary of the effective date of the Plan, whichever occurs first (the Termination Date). Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date.

unless limited in the Agreement or otherwise. No Award of an Incentive Stock Option shall be made more than 10 years after the Effective Date of the Plan (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. The date and time at which an Award is made or granted shall be the date and time the Committee approves the grant of the Award, or such later date and time as may be specified by the Committee at the time it approves the Award.

14. Plan Does Not Affect Employment Status.

14.1 No Entitlement to Award. Status as an eligible Employee or other service provider shall not be construed as a commitment that any Award will be made under the Plan to that eligible Employee or service provider or to eligible individuals generally.

14.2 No Right to Continued Employment. Nothing in the Plan or in any Agreement or related documents shall confer upon any Participant any right to continue in the employment of the Company or any Affiliate or constitute any contract of employment or affect any right that the Company or any Affiliate may have to change such person's compensation, other benefits, job responsibilities, or title, or to terminate the employment of such person with or without cause.

15. Tax Withholding. The Company shall have the right to withhold from any cash payment under the Plan to a Participant or other person (including a Successor or a Transferee) an amount sufficient to cover any required withholding taxes. The Company shall have the right to require a Participant or other person receiving Shares under the Plan to pay the Company a cash amount sufficient to cover any required withholding taxes before actual receipt of those Shares. In lieu of all or any part of a cash payment from a person receiving Shares under the Plan, the Committee may permit the individual to cover all or any part of the required withholdings (up to the Participant's minimum required tax withholding rate) through a reduction of the number of Shares delivered or delivery or tender to the Company of Shares held by the Participant or other person, in each case valued in the same manner as used in computing the withholding taxes under the applicable laws.

16. Amendment, Modification and Termination.

16.1 Amendment, Modification and Termination of Plan. The Board may at any time and from time to time terminate, suspend or modify the Plan. No termination, suspension, or modification of the Plan may materially and adversely affect any right acquired by any Participant or Successor or Transferee under an Award granted before the date of termination, suspension, or modification, unless (i) otherwise agreed to by the Participant in the Agreement or otherwise, or (ii) such action is necessary to comply with applicable law or stock exchange rules. It will be conclusively presumed that any adjustment for changes in capitalization provided for in Plan Sections 6.6 or 17 does not adversely affect these rights.

16.2 Amendment of Agreement. Subject to Section 19, the Committee may unilaterally amend the terms of any Agreement previously granted, except that no such amendment may materially and adversely affect the rights of any Participant under the applicable Award without the Participant's consent, unless such amendment is necessary to comply with applicable law or stock exchange rules or any compensation recovery policy as provided in Section 20.3.

17. Adjustment for Changes in Capitalization. In the event of any equity restructuring (within the meaning of authoritative guidance issued by the Financial Accounting Standards Board relating to stock-based compensation) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Shares that may be issued under the Plan, (ii) the limitations on the number of Shares that may be issued to an individual Participant as an Option or a Stock Appreciation Right or in the form of Restricted Stock in any calendar year or that may be issued in the form of Restricted Stock or Shares without restrictions and (iii) the number and kind of Shares or, subject to Plan

Section 6.6, Stock Units, subject to and the exercise price (if applicable) of any then outstanding Awards of Options, Stock Appreciation Rights, Restricted Stock, Stock Units or any other Awards related to shares of Stock (to the extent such other Awards would not otherwise automatically adjust in the equity restructuring); provided, in each case, that with respect to Incentive Stock Options, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; provided further, with respect to all Awards, no such adjustment shall be authorized to the extent that such adjustment would cause the Awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), including a Fundamental Change (subject to Plan Section 18), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Shares subject to an Award shall always be a whole number. In no event shall an outstanding Option or Stock Appreciation Right be amended for the sole purpose of reducing the exercise price or grant price thereof.

18. Fundamental Change. In the event of a proposed Fundamental Change, the Committee may, but shall not be obligated to:

(a) if the Fundamental Change is a merger or consolidation or statutory share exchange, make appropriate provision for the protection of the outstanding Options and Stock Appreciation Rights by the substitution of options, stock appreciation rights and appropriate voting common stock of the corporation surviving any merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation; or

(b) at least ten days before the occurrence of the Fundamental Change, declare, and provide written notice to each holder of an Option or Stock Appreciation Right of the declaration, that each outstanding Option and Stock Appreciation Right, whether or not then exercisable, shall be canceled at the time of, or immediately before the occurrence of the Fundamental Change in exchange for payment to each holder of an Option or Stock Appreciation Right, within ten days after the Fundamental Change, of cash equal to (i) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section) per Share exceeds the exercise price per Share covered by such Option or (ii) for each Stock Appreciation Right, the price determined pursuant to Section 10, except that Fair Market Value of the Shares as of the date of exercise of the Stock Appreciation Right, as used in clause (i) of Plan Section 10, shall be deemed to mean Fair Market Value for each Share with respect to which the Stock Appreciation Right is calculated determined in the manner hereinafter referred to in this Section. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option shall immediately become exercisable in full and each person holding an Option or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option or Stock Appreciation Right, to exercise the Option as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to Plan Section 18(b), each outstanding Option and Stock Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Fundamental Change shall be canceled at the time of, or immediately before, the Fundamental Change, as provided in the declaration.

Notwithstanding the foregoing, no person holding an Option or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 18(b) if such Option or Stock Appreciation Right shall have terminated, expired or been cancelled. For purposes of this Section 18 only, Fair Market Value per Share means the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the stockholders of the Company upon the occurrence of the Fundamental Change.

19. Prohibition on Repricing. Except pursuant to Section 17 of the Plan in connection with an equity restructuring, or pursuant to Section 18 of the Plan in connection with a Fundamental Change, in either case in order to prevent dilution or enlargement of the benefits or potential benefits intended to be provided under the Plan, no Option or Stock Appreciation Right granted under the Plan may be amended to decrease the exercise price or grant price thereof, be cancelled in exchange for the grant of any new Option or Stock Appreciation Right with a lower exercise or grant price or any new Full Value Award, be repurchased by the Company or any Affiliate, or otherwise be subject to any action that would be treated under accounting rules or otherwise as a repricing of such Option or Stock Appreciation Right, unless such action is first approved by the Company's stockholders.

20. Forfeitures and Compensation Recovery.

20.1 Forfeiture for Cause. Notwithstanding any other provision of the Plan or an Agreement, if a Participant's employment is terminated for cause as defined in this Section 20.1, then as of the date of such termination, any of the Participant's outstanding Awards that have not vested or been exercised by the Participant will be forfeited to the Company. For purposes of this Section 20.1, cause means the Participant: (i) committed a felony or a crime involving moral turpitude or committed any other act or omission involving fraud, embezzlement or any other act of dishonesty in the course of his employment by the Company or an Affiliate which conduct damaged the Company or an Affiliate; (ii) substantially and repeatedly failed to perform duties of the office held by the Participant as reasonably directed by the Company or an Affiliate; (iii) committed gross negligence or willful misconduct with respect to the Company or an Affiliate; (iv) committed a material breach of any employment agreement between the Participant and the Company or an Affiliate that is not cured within ten (10) days after receipt of written notice thereof from the Company or the Affiliate, as applicable; (v) failed, within ten (10) days after receipt by the Participant of written notice thereof from the Company or an Affiliate, to correct, cease or otherwise alter any failure to comply with instructions or other action or omission which the Board reasonably believes does or may materially or adversely affect the Company's or an Affiliate's business or operations; (vi) committed misconduct which is of such a serious or substantial nature that a reasonable likelihood exists that such misconduct will materially injure the reputation of the Company or an Affiliate; (vii) harassed or discriminated against the Company's or an Affiliate's employees, customers or vendors in violation of the Company's policies with respect to such matters; (viii) misappropriated funds or assets of the Company or an Affiliate for personal use or willfully violated the Company policies or standards of business conduct as determined in good faith by the Board; (ix) failed, due to some action or inaction on the part of the Participant, to have immigration status that permits the Participant to maintain full-time employment with the Company or an Affiliate in the United States in compliance with all applicable immigration law; or (x) disclosed trade secrets of the Company or an Affiliate. The findings and decision of the Committee or the Board, if applicable, with respect to any such matter, including those regarding the acts of the Participant and the damage done to the Company, will be final for all purposes. No decision of the Committee, however, will affect the finality of the discharge of the individual by the Company or an Affiliate.

20.2 Forfeiture Events. The Committee may specify in an Agreement that the Participant's rights, payments and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions of an Award. Such events may include, but shall not be limited to, termination of employment for cause, termination of employment for any other reason, violation of material policies of the Company and its Affiliates, breach of noncompetition, confidentiality, or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company and its Affiliates.

20.3 Compensation Recovery Policy. Awards and any compensation associated therewith may be made subject to forfeiture, recovery by the Company or other action pursuant to any compensation recovery policy adopted by the Board or the Committee at any time, including in response to the requirements of Section 10D of the Exchange Act and any implementing rules and regulations thereunder, or as otherwise required by law. Any Agreement may be unilaterally amended by the Committee to comply with any such compensation recovery policy.

21. Corporate Mergers, Acquisitions, Etc. The Committee may also grant Substitute Awards under the Plan in substitution for, or in connection with the assumption of, existing options, stock appreciation rights, restricted stock or other awards granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to which the Company or a Subsidiary is a party. The terms and conditions of the Substitute Awards may vary from the terms and conditions set forth in the Plan to the extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

22. Unfunded Plan. The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, its Affiliates, the Committee, nor the Board of Directors shall be deemed to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and/or its Affiliates, and a Participant or Successor or Transferee. To the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

23. Limits of Liability.

23.1 Contractual Liability Only. Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.

23.2 Liability Limit. Except as may be required by law, neither the Company nor any member of the Board of Directors or of the Committee, nor any other person participating in any determination of any question under the Plan, or in the interpretation, administration or application of the Plan, shall have any liability to any party for any action taken, or not taken, in good faith under the Plan.

24. Compliance with Applicable Legal Requirements. No certificate for Shares distributable pursuant to the Plan shall be issued and delivered unless the issuance of the certificate complies with all applicable legal requirements including, without limitation, compliance with the provisions of applicable state securities laws, the Securities Act of 1933, as amended and in effect from time to time or any successor statute, the Exchange Act and the requirements of the exchanges on which the Company's Shares may, at the time, be listed.

25. Deferrals and Settlements. The Committee may require or permit Participants to elect to defer the issuance of Shares or the settlement of Awards in cash under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts.

26. Other Benefit and Compensation Programs. Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay laws of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or an Affiliate unless expressly so provided by such other plan, contract or arrangement, or unless the Committee expressly determines that an Award or portion of an Award should be included to accurately reflect competitive compensation practices or to recognize that an Award has been made in lieu of a portion of competitive cash compensation.

27. Beneficiary Upon Participant's Death. To the extent that the transfer of a Participant's Award at his or her death is permitted under an Agreement, a Participant's Award shall be transferable at death to the estate or to the person who acquires the right to succeed to the Award by bequest or inheritance.

28. Requirements of Law.

28.1 Governing Law. To the extent that federal laws do not otherwise control, the Plan and all determinations made and actions taken pursuant to the Plan shall be governed by the laws of the State of Minnesota without regard to its conflicts-of-law principles and shall be construed accordingly.

28.2 Severability. If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

29. Code Section 409A. It is intended that (i) all Awards of Options, Stock Appreciation Rights and Restricted Stock under the Plan will not provide for the deferral of compensation within the meaning of Code Section 409A and thereby be exempt from Code Section 409A, and (ii) all other Awards under the Plan will either not provide for the deferral of compensation within the meaning of Code Section 409A, or will comply with the requirements of Code Section 409A, and the Committee shall endeavor to structure Awards and administer and interpret the Plan in accordance with this intent. The Plan and any Agreement may be unilaterally amended by the Company in any manner deemed necessary or advisable by the Committee or Board in order to maintain such exemption from or compliance with Code Section 409A, and any such amendment shall conclusively be presumed to be necessary to comply with applicable law. Notwithstanding anything to the contrary in the Plan or any Agreement, with respect to any Award that constitutes a deferral of compensation subject to Code Section 409A:

(1) If any amount is payable under such Award upon a termination of employment, a termination of employment will be deemed to have occurred only at such time as the Participant has experienced a separation from service as such term is defined for purposes of Code Section 409A; and

(2) If any amount shall be payable with respect to any such Award as a result of a Participant's separation from service at such time as the Participant is a specified employee within the meaning of Code Section 409A, then no payment shall be made, except as permitted under Code Section 409A, prior to the first business day after the earlier of (i) the date that is six months after the Participant's separation from Service or (ii) the Participant's death. Unless the Committee has adopted a specified employee identification policy as contemplated by Code Section 409A, specified employees will be identified in accordance with the default provisions specified under Code Section 409A.

None of the Company, the Committee nor any other person involved with the administration of this Plan shall in any way be responsible for ensuring the exemption of any Award from, or compliance by any Award with, the requirements of Code Section 409A. By accepting an Award under this Plan, each Participant acknowledges that the Company has no duty or obligation to design or administer the Plan or Awards granted thereunder in a manner that minimizes a Participant's tax liabilities, including the avoidance of any additional tax liabilities under Code Section 409A.

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

DIGI INTERNATIONAL INC.

ATTN: Office of General Counsel

11001 BREN RD. EAST

MINNETONKA, MN 55343

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

For All Withhold All For All Except

To withhold authority to vote for any individual nominee(s), mark **For All Except** and write the number(s) of the nominee(s) on the line below.

The Board of Directors recommends you vote FOR the following:

1. Election of Directors
Nominees:

Edgar Filing: CYBERLUX CORP - Form SB-2/A

01 Guy C. Jackson

02 Ahmed Nawaz

The Board of Directors recommends you vote FOR proposals 2, 3 and 4.

For Against Abstain

- | | |
|--|---|
| <p>2. Company proposal to approve the Digi International Inc. 2013 Ominbus Incentive Plan.</p> <p>3. Company proposal to cast a non-binding advisory vote on executive compensation.</p> <p>4. Ratification of the appointment of PricewaterhouseCoopers LLP as independent registered public accounting firm of the company for the 2013 fiscal year.</p> | <p>.. </p> <p>.. </p> <p>.. </p> |
|--|---|

NOTE: If any other matters properly come before the annual meeting calling for a vote of stockholders, the shares represented by this proxy will be voted by the persons named herein in accordance with their best judgment.

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Signature [PLEASE SIGN WITHIN BOX]
Date

Signature (Joint Owners)
Date

11001 Bren Road East

Minnetonka, Minnesota 55343

Annual Meeting of Stockholders

January 28, 2013

3:30 p.m.

Minneapolis Marriot Southwest

5801 Opus Parkway

Minnetonka, Minnesota

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice & Proxy Statement, Annual Report is/are available at www.proxyvote.com.

DIGI INTERNATIONAL INC.

Annual Meeting of Stockholders

January 28, 2013 3:30 P.M

This proxy is solicited on behalf of the Board of Directors.

The undersigned hereby appoints Joseph T. Dunsmore and David H. Sampsell, and each of them, as Proxies, each with the power to appoint his substitute, and hereby authorizes such Proxies to represent and to vote, as designated on the reverse, all shares of Common Stock of Digi International Inc. held of record by the undersigned at the close of business on November 29, 2012, at the Annual Meeting of Stockholders to be held on January 28, 2013, or any adjournment thereof.

This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors' recommendations.

Continued and to be signed on the reverse side