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CENKOS

10 DECEMBER 2007

UNITED KINGDOM • MARKETING SERVICES

BUY

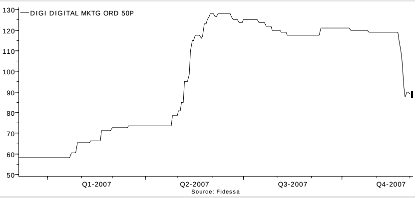
Price at 7 Dec 2007 (GBP)	90
Price Target (GBP)	140
52-week range (GBP)	58 - 130

Reuter: DIGI.L **Bloomberg:** DIGI LN
Exchange: AIM **Ticker:** DIGI

Digital Marketing Group

On track

Share Price Performance



Source: Fidessa

Performance(%)	1m	3m	12m
Absolute	-25	-24	+53

Stock Data

Market cap (£'m)	58.1
Shares outstanding (m)	65.3

Key Indicators

Net debt (£'m)	4.3m
EBITDA margin (%)	21

Activities

On-line marketing services

Directors

Stephen Davidson	Chairman
Ben Langdon	CEO
Sarah Guest	CFO

Significant Share Holders

Mayfair Ltd	25.6%
Gary & Helena Stevens	11.0%
Martin Boddy	7.6%
Andrew Gardner	7.6%
Charles & Kathleen Buddery	6.0%
Tudor Capital	3.3%
Total	**61.1%**

Digital Marketing Group (DMG) reported gross profits of £14.8m for the six months to September 2007, EBITDA before charges for share options of £3.06m and PBT before charges for share options and amortisation of £2.5m. These results, coupled with its rising profile within the industry, demonstrate DMG's excellent progress towards achieving their goal to become the premier digital marketing agency in the UK. We reiterate our BUY recommendation.

Results

DMG was formed after 30 September 2006, and therefore there is no published comparative financial information available. In order to track progress against the same period last year, the Company has prepared pro forma figures to show what the group's results would have been for the 6 month period to 30 September 2006 had the group been in existence. The pro forma figures further demonstrate the growth that the group is delivering both at the top line level and in terms of profitability. On a pro forma basis gross profits were up by 20% from £13.96m in 2006 to £16.7m in 2007 while EBITDA after central costs but before charges for share options was up 47% from £2.36m in 2006 to £3.48m in 2007. Pro forma PBT before charges for share options and amortisation was up 52% from £1.9m in 2006 to £2.89m in 2007.

DMG results give us a high degree of comfort that the Company will meet our full year forecasts. Gross profits of £14.8 m for the six months to September represent 41% of our full year forecast of £35.9m. PBT of £2.5m represents 42% of our full year forecast of £5.9m. This weighting towards H2 is consistent with historic trends. Organic growth is strong as the agencies continue to take advantage of buoyant expenditure through digital channels. In addition, the company has benefited from good levels of cross referral sales. These have, in part, helped the company to improve margins as these cross referral sales have not required the company to invest as heavily in new business pitching costs.

DMG already the fourth largest digital marketing agency in the UK

Evidence of how far DMG has come in a relatively short period of time was recently made clear in trade magazine Campaign. It published a survey of the top digital marketing agencies in the UK. DMG ranked fourth behind LBI, AKQA and Agency.Com. Importantly for shareholders, it ranked DMG as the most profitable based on operating profit before central costs (though the year ends were not reconciled). Agency location seems to be a significant driver of profitability (all other agencies in the survey are based in London) which endorses DMG's strategy of using regional offices

DMG voted the best in the industry

DMG's profile was given another boost in October when it received the pretigious 'Digital Direct Marketing Services of the Year' award. This accolade was awarded on the basis of

Forecasts and ratios

Year End March	2005A	2006A	2007A	2008E	2009E
Gross profit (£'m)	14.3	19.1	23.9	35.9	41.0
EBITDA (£'m)	2.2	3.6	4.7	6.7	8.4
PBT* (£'m)	2.2	3.6	3.9	5.9	7.4
EPS (p)	-	-	5.4	6.5	7.8
% Change	-	-	-	20.3	20.0
PER (x)			16.7	13.8	11.5

Source: Cenkos Securities estimates, company data - **less amortisation and share based payment charges* votes from both clients and other industry players. DMG have also won other awards throughout the year including:

- Graphico – New Media Age Award 6th most respected agency; Best Innovation at the BT Digital Music Awards 2007; 2007 BIMA's winner for Best Community Website
- Inbox – New Media Age Effectiveness Award; BIMA's winner for Best Online Game; 2007 Fresh Awards for Best Integrated Marketing and Best e-marketing Campaign/Viral
- Hyperlaunch - Peoples Choice Award for Best Official Music Site by BT Digital Music Awards

Forecasts

These results give us a high degree of confidence that DMG will meet our PBT forecasts of £5.9m for the full year and we are not making any revisions at this stage. However, as this will be the first full year for Cheeze, Jaywing, Inbox and HSM as part of the Group there maybe a requirement to tweak the margin mix going forward. Specifically, we have been relatively aggressive on the sales growth and the associated pitching costs. Recent discussions with management suggest that they are winning more business through extensions of existing contracts and cross referrals which do not require the same investment. Hence, the full year results could show higher profitability than we anticipate.

Valuation

Like many small cap stocks, DMG's share price has come under pressure of late. The stock now trades on 13.8x 2008e earnings, falling to 11.5x 2009e earnings. This presents a good opportunity for investors as much of the initially perceived risks have been addressed.

- It is now indisputable that this is the growth area of the advertising industry.
- The platform that management set out to build is in place and they have no weakness in the necessary skill sets to successfully exploit this market.
- Management have shown that they can integrate the acquired companies and work as a homogenous group.
- The business is well capitalised with net debt at £4.3m, less 1x prospective EBITDA.
- Management are delivering on the growth profile and margin mix that we expected.

As a result we conclude that 13.8x 2008 is a good opportunity.