CANACCORD Adams

Equity Research

Alan Howard, CFA
44.20.7050.6644
alan.howard@canaccordadams.com

Anthony Chow, MBA
44.20.7050.6637
anthony.chow@canaccordadams.com

BUY

DIGI : AIM : 90p

TARGET PRICE: 112p

Inside

Technology -- eMarketing

Digital Marketing Group

Specialist in Digital Direct Marketing

Specialist UK agency with integrated approach to direct marketing

Digital Marketing Group ("DIGI") is a leading independent UK direct marketing agency, offering its clients an integrated approach that combines traditional and digital direct marketing services with database marketing expertise. As spending on online advertising and marketing continues to post significant growth, DIGI looks well positioned to compete against traditional agencies, given its recognised expertise in online marketing solutions and focus on offering integrated direct marketing campaigns.

Significant upside expected from post-acquisition revenue synergies

Since its admission to AIM in 2006, DIGI has continued to pursue a strategy of acquiring other UK agencies that specialise in individual areas of digital marketing. The group now consists of seven agencies with complementary products enabling DIGI to offer clients a wide range of marketing services (from digital media buying to outbound telemarketing). In our view, there is significant scope for future synergies between these various agencies from cross-selling complementary services as part of an integrated product offering.

Strong and experienced management with outstanding track record

Not only do the individual agency chiefs within the group have excellent track records in their own right, but the group CEO, Ben Langdon, has an outstanding record of building agency businesses, first as EMEA Regional Director at McCann-Erickson, and then as Chairman of Havas-owned Euro RSCG Group UK.

Initiating coverage with BUY recommendation

We expect DIGI to post underlying F08 pre-tax profit of £6.11 million on a 17% rise in pro-forma gross profit to £34.3 million. Double-digit earnings growth in the next three years should be driven by market-led organic growth and acquisition-related synergies. We are initiating coverage on Digital Marketing Group with a BUY recommendation and a 12-month price target of 112p, based primarily on a DCF analysis. Our price target values DIGI at a calendarised 09E PER of 11.8 times, a 23% premium to the traditional UK agency sector, which, in our view, is justified by the company's superior growth prospects (23% earnings growth in F08E-F10E versus 11% for the sector average).

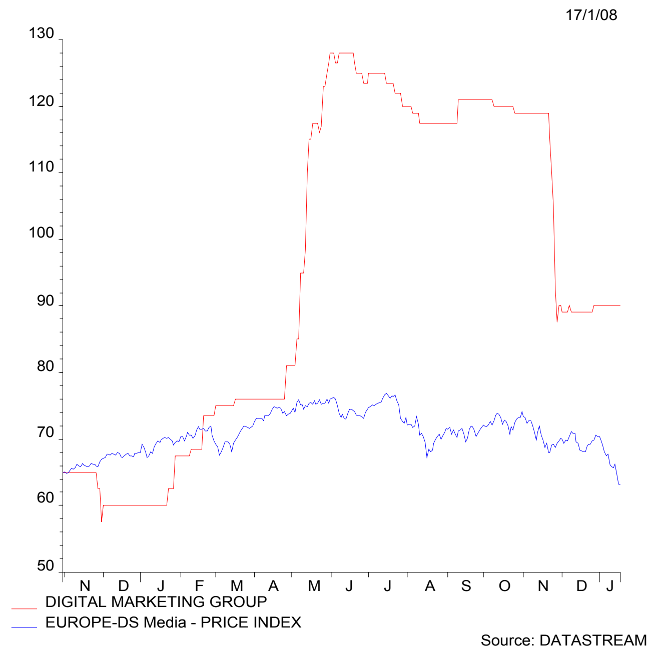
21 January 2008 2007-015

Company Statistics

Share price:	90p
52-week Range:	60p – 128p
Avg. Daily Vol. (000):	23.1
Shares outstanding (M)	65.3
Market Capitalization (M):	£58.8

Share price data COB 18 January 2008.

Price Chart



Source: Datastream

Earnings Summary

FYE March (£m)	2007A	2008E	2009E	2010E
Revenue (£M)	13.06	50.47	63.89	72.99
Gross Profit (£M)	8.39	32.49	40.01	45.79
EBITDA (£M)	2.00	7.24	8.58	10.09
Pre-Tax Profit (£M)	1.73	6.11	7.54	9.26
Headline Earnings (£M)	1.19	4.27	5.28	6.48
EPS (p)	6.39	6.70	7.96	9.65
P / E (x)		13.4	11.3	9.3
EV / EBITDA (x)	31.0	8.6	7.2	6.2
EV / Sales (x)	4.8	1.2	1.0	0.9
Debt / Equity (%)	13.5%	5.7%	cash	cash

Company Description

Digital Marketing Group is a group of seven UK advertising and marketing agencies, specialising in digital direct marketing. The company offers a range of direct marketing solutions, including media buying and planning, e-mail marketing, direct mail, telemarketing and database marketing services. The company has been built through a series of accretive acquisitions since its admission to the AIM in October 2006.

Figure 1: Summary sheet

DIGITAL MARKETING GROUP — BUY

Activities

Digital Marketing Group is a group of seven UK advertising and marketing agencies specialising in digital direct marketing. The company offers a range of direct marketing solutions, including media buying and planning,e-mail marketing, direct mail, telemarketing and database marketing services. The company has been built through a series of accretive acquisitions, since its admission to the AIM in October 2006.

Profit and Loss forecasts

Y/E Mar, £M	2007A	2008E	2009E	2010E
Turnover	**13.06**	**50.47**	**63.89**	**72.99**
Gross Profit	8.39	32.49	40.01	45.79
EBITDA	**2.00**	**7.24**	**8.58**	**10.09**
Depreciation	(0.17)	(0.52)	(0.78)	(0.78)
Operating Profit	1.84	6.72	7.80	9.32
Interest payable etc.	(0.11)	(0.61)	(0.26)	(0.06)
Pre-Tax Profit	**1.73**	**6.11**	**7.54**	**9.26**
Taxation	(0.54)	(1.83)	(2.26)	(2.78)
Net Income (Headline)	1.19	4.27	5.28	6.48
Exceptional Items	(0.98)	0.00	0.00	0.00
Share expenses	(0.27)	(2.30)	(2.62)	(2.69)
Net Income (Reported)	0.22	4.27	5.28	6.48
Dividends	0.00	0.00	0.00	0.00
Retained Earnings	0.22	4.27	5.28	6.48
EPS (Headline) (p)	**6.39**	**6.70**	**7.96**	**9.65**
EPS (Reported) (p)	**1.17**	**6.70**	**7.96**	**9.65**
TSO (average) (m)	18.69	63.83	66.31	67.12

Balance Sheet

As of 30-Mar, £M	2007A	2008E	2009E	2010E
Tangible Fixed Assets	0.71	2.27	2.21	2.23
Goodwill (net of def cons)	40.95	47.14	45.73	44.32
Working Capital	**3.21**	**5.21**	**5.59**	**5.88**
Cash	5.57	1.63	6.59	12.76
Debt	(13.48)	(5.00)	(5.00)	(5.00)
Net Cash/(Debt)	**(7.91)**	**(3.37)**	**1.59**	**7.76**
Minorities	0.00	0.00	0.00	0.00
Other Liabilities	(8.13)	(11.84)	(14.46)	(17.15)
Shareholders Funds	**28.84**	**39.40**	**40.65**	**43.03**

Financial Ratios

Y/E Mar	2007A	2008E	2009E	2010E
P/E	49.2x	13.4x	11.3x	9.3x
EV/FCF	36.4x	29.1x	12.5x	10.1x
Yield	0.0%	0.0%	0.0%	0.0%
EV/Sales	4.8x	1.2x	1.0x	0.9x
EV/EBITDA	31.0x	8.6x	7.2x	6.2x
EV/EBIT	33.8x	9.3x	8.0x	6.7x
P/Book Value	2.0x	1.5x	1.4x	1.4x
ROE:	4.1%	10.8%	13.0%	15.1%
ROCE (pre-tax)	5.0%	15.7%	20.0%	26.4%
Gearing:	27.4%	8.6%	cash	cash
Interest cover:	17.3x	11.0x	30.4x	151.5x

Cash Flow forecasts

Y/E Mar, £M	2007A	2008E	2009E	2010E
Net Income	1.19	4.27	5.28	6.48
Depreciation	0.17	0.52	0.78	0.78
Change in working cap	(3.40)	(2.00)	(0.38)	(0.29)
Other non-cash	2.59	0.00	0.00	0.00
Operating cashflow	**0.55**	**2.80**	**5.68**	**6.97**
Capital Expenditure	1.16	(0.66)	(0.73)	(0.80)
Free Cash Flow	**1.71**	**2.14**	**4.96**	**6.17**
Acquisitions/Disposals	(20.66)	(7.60)	0.00	0.00
Dividends	7.48	10.00	0.00	0.00
Share Issues	0.00	0.00	0.00	0.00
Other	(0.00)	0.00	0.00	0.00
Net Cash Flow	**(11.47)**	**4.54**	**4.96**	**6.17**

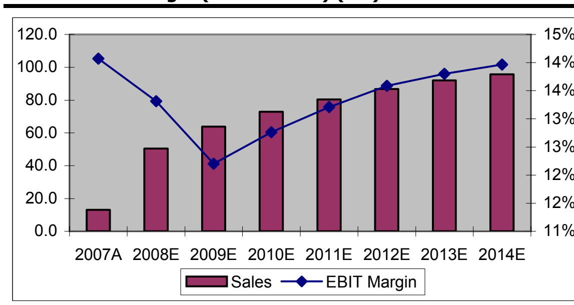
Major Shareholders

Shareholder	% of ord. Share capital
Lord Ashcroft	25.4%
Martin Boddy	7.6%
Andrew Gardner	7.6%

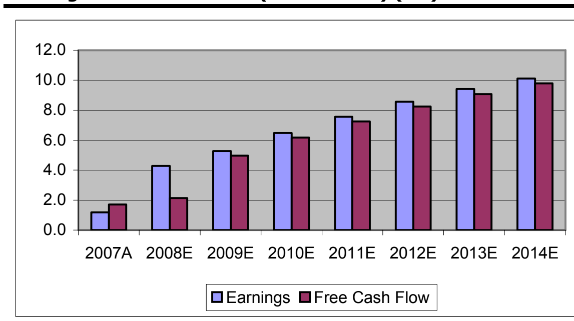
Relative price performance

	1m	3m	12m
vs. Bloomberg Media	12.5%	-10.4%	92.2%

Sales & EBIT Margin (2007-2014E) (£M)



Earnings & Free Cash Flow (2007-2014E) (£M)



Source: Company data, Canaccord Capital estimates

Source: Company reports; Canaccord Adams estimates

EXECUTIVE SUMMARY

Digital Marketing Group ("DIGI") is a leading independent UK direct marketing agency, offering its clients a uniquely integrated approach to direct marketing campaigns that combines offline, online and database marketing techniques. The company was built through a series of accretive acquisitions on and since its admission to the AIM in October 2006. Today, the group consists of seven UK agencies, offering a range of services, including digital media buying and planning, e-mail marketing, viral advertising, traditional direct marketing, tele-marketing, web design and data services.

The vision of an integrated approach to direct marketing

Fundamental to the company's strategy and market positioning is the management's conviction that there is a growing demand in the marketplace for an integrated approach to direct marketing that allows consumer-facing clients to run campaigns that simultaneously exploit offline and online marketing channels. No other UK agency is simultaneously as focused on direct marketing and as specialised in digital marketing as DIGI. The company appears likely to develop this competitive edge further by continuing to develop its "Digital Brain" concept, which provides an integrated direct marketing platform for campaign management and delivery, and produces integrated reporting and analysis tools.

The backdrop of a high-growth market environment

DIGI looks well positioned to benefit from the rapid growth of online marketing expenditure in the UK, which is now forecast to grow from US$2.0 billion in 2006 to US$3.4 billion in 2009 [Source: IAB], representing compound annual growth of 18.9% per annum over the period, driven by increasing levels of internet usage and continuing focus from advertisers on ROI. In the area of direct marketing, the digital channel offers significant benefits over traditional offline techniques. Online campaigns are typically cheaper and faster; they offer innovative ways to interact and build new relationships with consumers; and they provide advertisers with superior techniques for measuring response and tracking consumer behaviour. Campaigns can be adapted at very short notice, potentially in real time, providing increasing levels of personalisation.

Significant upside expected from post-acquisition revenue synergies

Since its admission to the AIM in October 2006, DIGI has continued to pursue a strategy of acquiring other UK agencies that specialise in key areas of direct and database marketing. The group now consists of seven separate agencies with complementary products that enable the group to offer clients a wide range of marketing services (from digital media buying to outbound telemarketing). In our view, there is significant scope for future synergies between these various agencies, not just in the area of cost centralisation, but more importantly in the incremental growth from cross-selling complementary services as part of an integrated product offering. We are forecasting an increase in EBITDA margin from 13.4% in F09 to 14.0% in F14, and a compound annual growth rate in sales of 8.4% during the same period.

Strong and experienced management with outstanding track record

Critical to the successful execution of the company's strategy is its strong and experienced management team. Not only do the individual agency chiefs have excellent track records in their own right, but the group CEO, Ben Langdon, has an outstanding record of building agency businesses, first as EMEA Regional Director at McCann-Erickson, and then as Chairman of Havas-owned Euro RSCG Group UK.

We expect DIGI to grow pre-tax profit by 23% per annum over the next three years

Without assuming any further acquisitions, we expect DIGI to post F08 pre-tax profit of £6.11 million (pre share expenses) on a 17% increase in pro-forma gross profit to £32.5 million. Double-digit earnings growth in the next three years should be achievable, through a combination of strong market-led organic sales growth and a significant boost from acquisition-related synergies.

We recommend investors BUY shares in DIGI at current levels

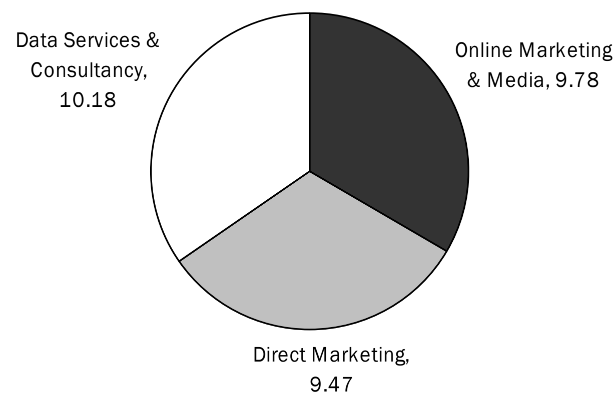
We are initiating coverage on Digital Marketing Group with a BUY recommendation and a 12-month price target of 112p, based principally on a DCF analysis. Our price target offers investors 24% potential upside from current levels, and values DIGI at a calendarised 09 PER of 11.8 times, a 23% premium to the traditional UK agency sector, which we believe is fully justified given the company's superior growth prospects. Over the 2008-2010 period, we are forecasting 23% per annum growth in headline earnings, compared with an average 11% for the UK agency sector as a whole.

INVESTMENT CASE

BUSINESS MODEL

Digital Marketing Group specialises in "online direct marketing", defined by management as "the integration of online marketing and traditional direct marketing". Direct marketing is a specific advertising category typically involving an individual consumer "call-to-action" eliciting a measurable individual direct consumer response. Traditional direct marketing typically includes postal advertising, telemarketing, inserts and catalogues, where consumers identify themselves through the use of coupons, order forms or by telephone response. It is distinct from other forms of broadcast advertising in which direct response is more difficult to monitor. Similarly, online direct marketing is conducted through a number of equivalent online techniques including email, promotional websites and interactive forms of advertising, such as search marketing and viral advertising. It also includes several emerging technologies, such as mobile marketing, search engine optimisation and interactive television.

Figure 2: F07 Pro-forma gross profit growth by division (£ millions)



Source: Company reports

Digital Marketing Group is currently composed of seven separate agencies each offering a variety of services, either purely online or integrating online and traditional offerings. The group organises its services in three separate categories:

Online marketing and media

Digital Marketing Group offers its various online marketing services through Inbox Digital, Cheeze and its Graphico and Hyperlaunch agencies, which were acquired on 2 July 2007. Graphico is a full service creative digital and mobile marketing agency that specialises in the design, development and maintenance of websites including retail eCommerce sites. Hyperlaunch is a digital creative marketing agency composed of creative and development services, online public relations and buzz marketing services. This agency specialises in entertainment, youth and lifestyle brands.

Through its operations at Cheeze, Digital Marketing Group is a leading UK provider of online media planning and buying services. Media buying and planning involves selecting the best digital channels for a client's business and recommending the best formats within those channels. The group then monitors and analyses the performance of the media campaign using proprietary software systems. Management believes that Cheeze has developed a reputation as an expert in Web 2.0, advertising involving user generated content and is ranked as the UK's fifth-largest search marketing specialist. We are expecting gross profit for the overall division to grow 17.7% pro forma in F08 and contribute 33.4% of total group gross profit.

Direct marketing services

The group offers its direct marketing services primarily through its HSM and Dig for Fire operations. These services include both traditional and online direct marketing, which includes web design and build, viral advertising, banner advertising, direct mail, direct response press communications as well as both online and traditional press relations. Although Dig for Fire is ranked within the top 100 UK digital agencies, only 20% of the operation's gross profit is derived from online marketing. Clients include Tesco, The Cooperative Bank and AXA PPP Healthcare. We are expecting the division to grow 14.9% in F08 and contribute 31.6% of total group revenues.

HSM offers integrated outbound telemarketing that combines the personalisation of email marketing and outbound telemarketing with innovative website design. The agency uses a proprietary email marketing technology that delivers targeted email campaigns and then allows related websites to be personalised when a consumer responds to an email, creating a more relevant consumer experience. In response to the consumer's actions, the data can then be used to trigger outbound telemarketing. With the platform's ability to track online interaction, detailed campaign reporting can be carried out which can then further refine future activity.

Data services and consultancy

The company's data and data consultancy services are primarily offered through its Jaywing operations and form the "heart" of the group's direct marketing services. These consultancy led data services include marketing, credit and fraud analysis, and also provide database hosting and campaign management. Clients depend on Jaywing for its list broking and list management services, which support the rental of targeted email databases between organisations. We are expecting the division to grow 18.1% in F08 and contribute 35.0% of total group revenues. The agency's services have evolved to include a number of specific software and data products including:

- Signals: Consumer data marketed by various "life events", including child birth, product renewal, birthdays and rejected credit applications.
- Smart decisions: An online credit checking service based on expanded consumer information and expert risk assessment models.
- Digital Brain: A marketing decision engine that coordinates communication based on a full assessment of an individual consumer relationship.

Figure 3: Offering by agency

Online and viral advertising	Inbox Digital
eMail marketing	Inbox Digital
Search marketing	Cheeze
Digital media planning and buying	Cheeze
Web 2.0	Cheeze
Direct marketing	Dig for Fire
Telemarketing	HSM
Data services	Jaywing
Web design and build / Online PR	Hyperlaunch
Mobile	Graphico

Source: Company reports

Figure 4: Inbox Digital awards

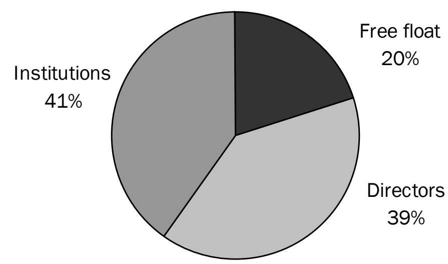
NMA Effectiveness Awards 2007 - Winner - Best Game	**Viral Chart Awards** 2006 - Winner - Hottest Christmas viral	**Favourite Website Awards** 2006 - Site of the day
Net Imperative Awards 2007 - Winner - Best Use of Viral	**IMAA Awards** 2006 - Shortlisted - Best Use of Viral Marketing	**BIMA Awards** 2006 - Finalist - Best Use of Viral
Fresh Awards 2006 - Winner and runner-up of Best Email or Viral campaign	**Revolution Awards** 2007 - Shortlisted- Best Retail	**Killer Viral awards** 2006 - Nominated - Best viral game of the year
YDA Awards 2006 - Winner of Best Viral Campaign	**Channel 4 Germ awards** 2006 - Winner of Best Interactive Viral	**Campaign Digital Awards** 2006 - Finalist in Health & Beauty
NMA Effectiveness Awards 2006 - Commended - Best Use of Viral	**NMA Effectiveness Awards** 2005 – Winner – Red Nose Day viral award	**Revolution Awards** 2003 – Winner – Best email campaign 2004 – Commended – Best email campaign 2005 - Commended - Best Use of Email
Direct Response Smart Awards 2002 – Winner – Best use of e-marketing 2003 – Finalists – Best work in e-marketing	**Marketing Direct Awards** 2002 – Winner – Best multi-channel campaign 2003 – Finalist in 5 categories 2004 – Finalist in 5 categories	**Campaign Direct Awards** 2005 - Finalist - Best use of digital media
The DMA Awards Silver Award - Best use of email or mobile campaign	**Marketing Connection Awards** 2003 – Winner – Best use of technology for new business leads 2003 – Winner – Best use of Internet for B2B communications	**Media Week Awards** 2002 – Winner – Best use of communications technology 2003 – Finalist – Best use of communications technology

Source: Inbox Digital

COMPANY BACKGROUND

Following the 23 October 2006 merger of Digital Marketing Group and Seashell II, the newly formed digital direct marketing company acquired HSM, an integrated outbound telemarketing and online marketing organisation, and Dig for Fire, a provider of traditional and online direct marketing. The group began trading on the AIM on 26 October 2006. On 26 January 2007 the group acquired two more agencies, Cheeze, an online buying and planning agency, and Jaywing, which provides data and data consulting services. Following a £10.0 million capital raise in April 2007, the company made its two most recent acquisitions, Graphico and Hyperlaunch on 2 July 2007. The group's future plans include a continued acquisition strategy coupled with the organic growth of its existing businesses, which seek to provide clients with "personalised communications across all digital and direct marketing channels, enabling clients to coordinate their online and offline direct marketing strategy".

Figure 5: Major shareholder structure, 2008



Source: Company reports

INVESTMENT DRIVERS AND RISKS

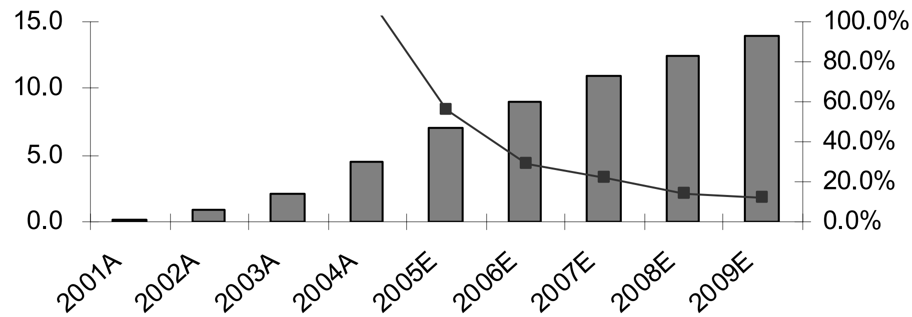
Digital Marketing Group is a leading UK digital agency that looks well positioned to benefit from the shift in advertising spend from traditional media to internet marketing, a trend driven by growing broadband penetration, increasing consumer comfort with online shopping and the growing proportion of consumer media time being spent online. The company was recently created during a series of accretive acquisitions of undervalued digital marketing agencies and we believe management has the ability to continue to deliver on its strategy of building scale through a combination of transactions and organic growth. We believe this growth, coupled with the advantages of centralised cost saving and cross-selling opportunities, should allow the group to achieve sufficient size to attract the attention of potential acquirers.

Growing broadband penetration

We believe DIGI looks well positioned to benefit from increasing UK spending on online advertising, forecast to grow from US$2.01 billion in 2006 to US$3.39 billion in 2009 at a CAGR or 18.9%, driven by increasing levels of internet usage and broadband penetration, which is forecast to grow at a CAGR 15.9% from 2007-2009 (Source: IAB). During 2006, online adSpend represented 11.4% of all UK advertising spending, up 41.2% Y/Y. Growing levels of broadband penetration are creating the opportunity for advertisers to make greater use of rich media advertising, including banners, audio, graphics, video and animation. It has made internet advertising more appealing for

FMCG organisations that find rich media advertising more relevant to their brand and product promotions.

Figure 6: Growth in UK broadband subscribers [millions]

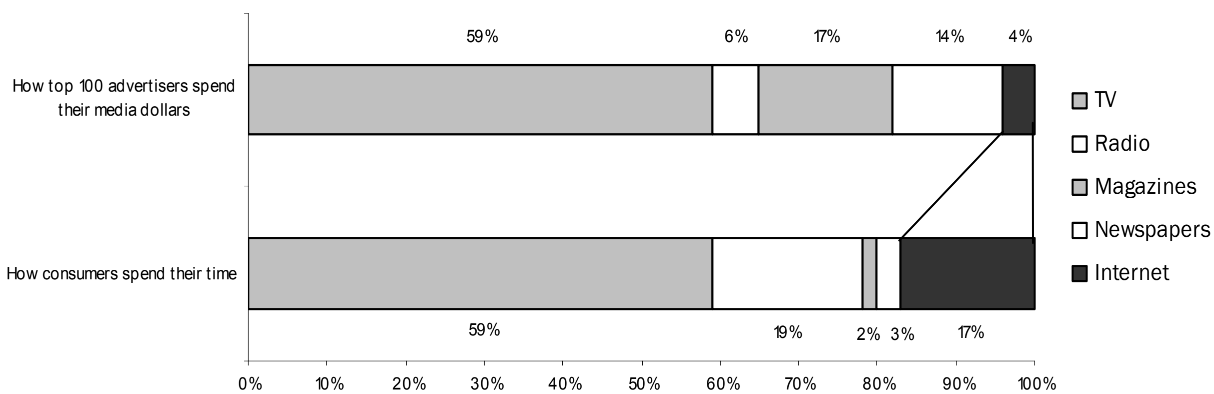


Source: Interactive Advertising Bureau UK, PricewaterhouseCoopers LLP, Wilkofsky Gruen Associates

Online adSpend disproportional to consumer online "Media Time"

A 2006 study revealed that US households spent approximately 17.0% of their total media consumption time online, while online adSpend only accounted for 4.0% of advertisers' marketing budgets. Management believes there are similar discrepancies in the UK, where a 2005 IAB (UK) report estimates that approximately 20% of media time is spent online, compared with online adSpend of approximately 7.8% of total advertising expenditure. We believe that as consumers begin to spend even larger portions of their media time online for work, socialising, entertainment and shopping, advertisers should come under increasing pressure to shift their advertising budgets away from traditional media such as television and newspapers and towards the internet.

Figure 7: Consumer media time versus advertising budgets

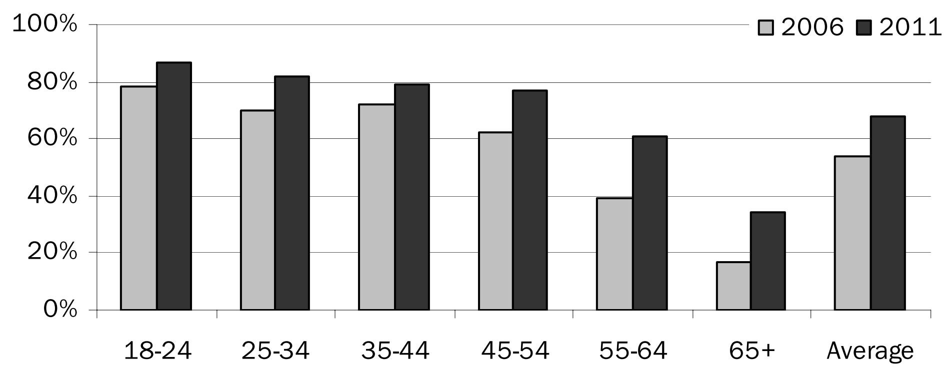


Source: "Time and Money", Ball State University "Media Consumption Trends and the Ascendancy of the Internet, 2006

Increasing consumer comfort with shopping online

We believe that advertisers may be coming under increasing pressure to reallocate larger portions of their advertising budgets onto the internet as more consumers begin to do their banking and shopping online. A recent IAB (UK) study suggests that consumers are becoming increasingly confident shopping online: 18.5 million people now shop online in the UK, while 13.3 million do their banking over the Internet[1]. A 2007 PWC study forecasts that UK online retail should reach £35 billion by 2011, approximately three times current levels, and equivalent to 10% of the entire retail market, while a more aggressive IAB (UK) study estimates that eCommerce could increase to £60 billion by 2010, accounting for 20% of all UK retail spending[2].

Figure 8: Portion of shopping population who shop online



Source: PwC primary research with c. 1,500 UK consumers conducted in February/March 2007

Figure 9: The UK online retail market (2001 – 2011) (£ billion)

Source: PwC analysis

Online direct marketing enjoys advantages over traditional

Online direct marketing offers a number of distinct advantages over traditional offline direct marketing. It provides advertisers with more opportunities to monitor consumer behaviour during the various stages of a purchase decision, as well as the ability to track performance and response to a marketing campaign, which is important information for improving the effectiveness of future marketing initiatives. It provides increased flexibility and is able to respond much more intelligently to consumers' demands. Digital

[1] IAB Online Facts and Figures, BMRB Internet Monitor, Q3/05
[2] IAB Online Facts and Figures, Future Foundation, Aug 2005

marketing also provides better mechanisms to segment an advertiser's customer base and provide an individual personalised response.

- **Improved tracking and better measurement:** Internet advertising technology provides advertisers with better tools for measuring the impact of a marketing campaign. Advertisers are able to track consumer behaviour and transactions often in real time, recording when consumers open emails, view banner ads and clicks through to websites.
- **Increased opportunities for data capture:** Online advertising has made it cost effective for advertisers to develop regular direct communications with consumers, creating an opportunity to gather a greater level of consumer data than through traditional advertising channels, some of which have no data capture opportunities. Detailed consumer data better allows advertisers to personalise their communication and product offerings.
- **Improved flexibility:** Unlike postal shots and television ads, an online campaign can be modified and redeployed very rapidly, possibly even in real time in response to recent developments or early feedback, increasing opportunities for personalisation and improving effectiveness in the short-term at low cost.
- **Better intelligence:** Interactive advertising is better able to use consumer data, allowing advertisers to respond more intelligently to consumers, offering personalised strategies and more relevant communication. Online consumers are now frequently marketed based on their previous purchases, declared interests and browsing history.

We also believe there are a number of emerging trends supporting a continued shift towards online direct marketing and away from more traditional methods of reaching consumers. These include the fragmentation of mass media, increasing focus on measurable results by advertisers, the introduction of new and innovative technology and the growing acceptance of the online medium by FMCG providers.

- **Fragmentation of Traditional Mass Media:** We believe that as the number of television channels have increased, the audiences that view them has fragmented while the ability of the medium to deliver the same mass market audience has declined. Similarly, the gradual decline of newspaper and magazine readership has forced advertisers to consider other marketing channels to promote their brands to consumers.
- **Advertisers Focus on Measurable Results:** We believe that advertisers are being drawn increasingly to online marketing by its ability to deliver measurable results. By directly monitoring the level of online interaction between a brand and a consumer, an advertiser is able to gauge its return on investment and make better informed decisions about its media spend, timing and allocation.
- **Emerging Technologies:** Recently introduced technologies, including search and viral marketing, have emerged over the past few years that target different types of consumers in innovative and different ways. We anticipate other new and emerging technologies, including mobile marketing, advertising exchanges and interactive television will offer brands new ways to reach and interact with their customers.
- **Growing acceptance by FMCG advertisers:** During 2006, online advertising represented 11.4% of all UK advertising spending and we believe is now recognised

by many advertisers as a necessary component of any integrated marketing campaign. In addition, increased penetration of broadband technology has made possible rich-media advertising, including video and many forms of viral advertising, channels more applicable to the FMCG sector.

RECENT FINANCIALS

H1/08 interim results

On 10 December 2007, Digital Marketing Group reported interim revenues of £22.14 million, gross profit of £14.77 million and EBITDA of £3.06 million for the six months ended 30 September 2007. On a pro-forma basis, the company's Online Marketing & Media operations reported gross profit of £5.95 million, up 27.7% pro forma Y/Y, while its Direct Marketing business reported gross profit of £5.52 million, up 22.7% pro forma Y/Y, and its Data business reported gross profit of £5.23 million, up 9.0% pro forma Y/Y.

Digital Marketing Group finished the period with £5.77 million of cash and a net debt position of £4.33 million, down from a net debt position of £7.91 million at the end of the year, after generating free cash flow of £1.36 million during the period. Management stated its focus on digital direct marketing allowed the company to "attract new blue chip clients" as well as "generate incremental business" from its existing client base.

Figure 10: Illustrative pro-forma results versus historical (£ millions)

	Gross profit			EBITDA		
	H1/08	H1/07	%ch	H1/08	H1/07	%ch
Online media & marketing	5.95	4.66	27.7%	1.56	0.95	64.2%
Direct marketing	5.52	4.50	22.7%	1.19	0.95	25.3%
Data services	5.23	4.80	9.0%	1.11	0.88	26.1%
	16.70	13.96	19.6%	3.48	2.36	47.5%

Source: Company reports

RECENT EVENTS AND ACQUISITIONS

Acquisition of HSM/Inbox and Dig for Fire

On 26 October 2006, the first agencies to be acquired by the Digital Marketing Group were HSM and Dig for Fire. HSM was founded in 1991 and based in Swindon. The company is composed of two divisions: HSMT, a provider of outbound telemarketing and database management, and Inbox, a full service digital marketing business. Management has stated that the two divisions are highly integrated, enabling direct marketing through a number of digital channels, across a proprietary technology platform encompassing email, internet and telephone.

For the year ended 31 December 2005, HSM reported revenues of £4.2 million, comprising £2.9 million from HSMT and £1.3 million from Inbox. Operating profit was £0.3 million and net profit for the year was £0.3 million. The company was purchased for a total consideration of £8.0 million plus a deferred consideration based on any surplus cash over net assets. The payment was composed of £4.0 million shares, with the balance in cash, corresponding to 1.9 times F05 revenues and 26.7 times F05 earnings. HSM/Inbox provides online advertising, email marketing, viral advertising, website design and build, and campaign reporting.

Dig for Fire was acquired at the same time as HSM/Inbox. Management believes that Dig for Fire is the largest direct marketing agency operating exclusively outside London. The agency was established in Sheffield in 1979 and offers end-to-end integrated direct marketing services accommodating both online and offline direct marketing, including web design and build, viral advertising, banner advertising, direct mail, direct response press communication and online and offline press relations. The agency also offers strategic planning services and "Dig Research", a stand alone market research service.

For the year ended 31 March 2006, Dig for Fire reported revenues of £6.9 million, operating profit of £0.6 million and net profit for the year was £0.4 million. The agency was purchased for a total consideration of £7.8 million plus a deferred consideration based on net assets. The consideration was composed of £3.9 million in shares with the remainder in cash, which corresponds to 1.13 times F06 revenue and 9.75 times F06 earnings. The acquisitions coincided with the group's admission onto AIM.

Acquisition of Cheeze and Jaywing

On 26 January 2007, Digital Marketing Group acquired Cheeze and Jaywing. Cheeze is a digital media planning and buying agency based in Ipswich with offices in London and Leeds. Before its acquisition the agency worked extensively with both HSM and Inbox Digital. In addition to its core agency services, the company offers search engine marketing, customer relationship marketing, Web 2.0 services and digital direct marketing consulting.

For the year ended December 2006, Cheeze reported revenues of £10.5 million and PBT of £0.77 million. The company was acquired for an initial consideration of £9.5 million, composed of £6.0 million in cash and 6.1 million shares and a potential earn out of up to 1.75 million shares. The initial consideration corresponds to 0.9 times F06 revenue and 12.3 times PBT.

Jaywing was acquired at the same time as Cheeze. The agency specialises in data analysis and is a provider of database marketing and credit and fraud consultancy services. The company was started in 1999 and has offices in Derby, Harrow, Wakefield and Witney. The company has developed a number of proprietary database marketing products and software. Jaywing reported revenues of £10.8 million for the year ended March 2006 with EBIT of £1.3 million. The company was acquired for an initial consideration of £14.5 million, composed of £8.6 million in cash and 9.8 million shares, corresponding to 1.34 times F06 revenue and 11.2 times EBIT.

Placing of 14.3 million shares to raise £10.0 million

On 26 April 2007, Digital Marketing Group announced the placing of 14.3 million shares at 70p per share, raising £10.0 million. The proceeds of the raise allowed the company to repay existing debt inherited during the acquisitions of Cheeze and Jaywing.

Acquisition of Graphico and Hyperlaunch

On 2 July 2007 Digital Marketing Group announced the acquisition of Graphico and Hyperlaunch. Graphico is a full service creative digital and mobile marketing agency. Graphico specialises in design, development and maintenance of websites including eCommerce sites and is based in Newbury. The company employs approximately 70 people and was founded in 1990. The company has developed a bespoke mobile platform supporting integrated SMS, WAP, Voice and ECRM solutions. Graphico reported revenues of £4.1 million for the year ended December 2006, with an adjusted operating profit of £0.18 million. The agency was acquired for a maximum consideration of £8.6 million, composed of £4.0 million in cash and earns outs of up to £1.5 million in loan notes and £3.1 million in shares based on EBITDA performance targets. The maximum consideration corresponds to 2.1 times F06 revenue and 47.8 times adjusted operating profit.

Hyperlaunch is also a digital creative marketing agency. The company is composed of creative/development, online public relations and "buzz marketing" divisions and specialises in entertainment, youth and lifestyle brands. The company was founded in 2001 and is based in Clifton, Bristol. Hyperlaunch recorded revenue of £1.6 million and operating profit of £0.33 million for the year ending 5 April 2007. Hyperlaunch was acquired for £2.7 million, of which £1.6 million was cash and the remainder was shares, representing an EBIT multiple of 7.25 for the period ending June 2007.

Figure 11: Summary of acquisitions

Date	Agency	Consideration	Valuation
26 Oct 06	HSM	£8.0m plus deferred consideration; £4.0m in shares and £4.0m in cash	1.90x F05 Revenue 26.7x F05 Earnings
26 Oct 06	Dig for Fire	£7.8m plus deferred consideration; £3.9m in shares and £3.9m in cash	1.13x F06 Revenue 9.75x F06 Earnings
26 Jan 07	Cheeze	£9.5m plus earn out of up to 1.75m shares; £6.0m in cash and 6.1m shares (not including earn out)	0.90x F06 Revenue 12.3x F06 PBT
26 Jan 07	Jaywing	£14.5m composed of £8.6m in cash and 9.8 million shares	1.34x F06 Revenue 11.2x F06 EBIT
02 Jul 07	Graphico	Maximum consideration of £8.6m composed of £4.0m in cash and an earn out of £1.5m in loan notes and £3.1m in shares	2.10x F06 Revenue 47.8x F06 Adj. Operating profit
02 Jul 07	HyperLaunch	£2.7m composed of £1.6m in cash and 0.9 million shares	7.25x F07 EBIT

Source: Company reports; Canaccord Adams

FINANCIAL OUTLOOK

Our financial forecasts for DIGI are based on our conviction that the company will continue to benefit from the ongoing shift of marketing budgets towards internet-based solutions; to gain further market share as a result of its strong competitive positioning; and to lift proft margins as a consequence of acquisition-related synergies.

In particular, we would highlight a number of key assumptions underlying our financial model:

We forecast DIGI to enjoy double-digit growth across all of its divisions for the next three years, driven by growth in the underlying market and upside from cross-selling services. In terms of gross profit, we are looking for compound annual growth between FY08-FY11 of 13.5% for online marketing and media, 10.0% for direct marketing services and 16.6% for data services and consultancy

In terms of profitability, we are forecasting operating expenses to decrease over the long run in relation to gross profit as the company enjoys both revenue and cost synergies from recent acquisitions. We expect the group EBITDA margin to rise from 20.8% in H1/08 to 22.6% in FY11.

Figure 12: Pro-forma divisional split

FYE Mar	2007A	H1/08A	2008E	2009E	2010E	2011E
Gross Profit						
Online marketing and media	9.78	5.95	11.51	13.60	15.30	16.83
% growth		*27.7%*	*17.7%*	*18.2%*	*12.5%*	*10.0%*
Direct marketing services	9.47	5.52	10.88	11.97	13.17	14.49
% growth		*22.7%*	*14.9%*	*10.0%*	*10.0%*	*10.0%*
Data services and consultancy	10.18	5.23	12.03	14.43	17.32	19.05
% growth		*9.0%*	*18.1%*	*20.0%*	*20.0%*	*10.0%*
Total Gross Profit	29.43	16.70	**34.42**	**40.01**	**45.79**	**50.37**
% growth		19.6%	*16.9%*	*16.2%*	*14.5%*	*10.0%*
E B I T D A						
Online marketing and media	1.93	1.56	3.24	3.74	4.13	4.63
% of GP	*19.7%*	*26.2%*	*28.1%*	*27.5%*	*27.0%*	*27.5%*
Direct marketing services	2.11	1.19	2.49	2.63	3.03	3.40
% of GP	*22.3%*	*21.6%*	*22.9%*	*22.0%*	*23.0%*	*23.5%*
Data services and consultancy	2.48	*1.11*	2.71	3.20	3.98	4.48
% of GP	*24.4%*	*21.2%*	*22.5%*	*22.2%*	*23.0%*	*23.5%*
Central Costs	(0.85)	(0.38)	(0.78)	(1.00)	(1.05)	(1.10)
Total EBITDA	5.67	3.48	**7.66**	**8.58**	**10.09**	**11.41**
% of GP	*19.3%*	*20.8%*	*22.3%*	*21.4%*	*22.0%*	*22.6%*

Source: Company reports, Canaccord Adams estimates

We estimate that the share option expense makes up approximately 9% of the company's total operating expenses and are forecasting the expense to grow 14.0% in F09 and at approximately 2.5% per annum over the long-term.

We have included a 30% tax rate in our model and are not expecting the company to pay a dividend in the near future.

Management has publicly stated a number of performance goals for divisions. The agencies are expected to “achieve 25% CAGR in EPS between March 2007 and March 2010” and to “achieve top line revenue growth that allows the company to deliver this EPS performance without having to rely on cutting costs.” Management believes these goals are reasonable and achievable and we have incorporated them as guidance in our model.

We are expecting the various earn outs created by the recent acquisitions to increase the company’s diluted share count to 80.4 million shares over the next two years.

Figure 13: Forecasts for reported gross profit by division FY07A-FY12E (£ millions)

FYE Mar	2007A	H1/08A	2008E	2009E	2010E	2011E	2012E
Online marketing and media	3.82	4.02	9.58	13.60	15.30	16.83	18.18
Direct marketing services	2.91	5.52	10.88	11.97	13.16	14.48	15.64
Data services and consultancy	1.66	5.23	12.03	14.44	17.32	19.06	20.58
Gross profit	**8.39**	**14.77**	**32.49**	**40.01**	**45.79**	**50.37**	**54.40**
Operating expenses	(6.39)	(11.71)	(25.25)	(31.43)	(35.70)	(38.96)	(41.78)
E B I T D A	2.00	3.06	**7.24**	**8.58**	**10.09**	**11.41**	**12.63**

Source: Company reports, Canaccord Adams estimates

We have not assumed any further acquisitions in our estimates. However, DIGI’s strategy is to grow both organically and by acquiring businesses with complementary skills in digital direct marketing. We expect the company to make further acquisitions in the digital marketing area.

Below we show our forecasts for the group’s reported financial statements in greater detail:

Figure 14: Digital Marketing Group Financial Forecasts 2007A-2012E

(£'000) Y/E Mar 31	2007A	H1/08A	H2/08E	2008E	2009E	2010E	2011E	2012E
Profit and Loss Account								
Total Revenues	13.06	22.14	28.34	50.47	63.89	72.99	80.34	86.80
% growth			*117.0%*	*286.5%*	*26.6%*	*14.3%*	*10.1%*	*8.0%*
Cost of Sales	(4.67)	(7.37)	(11.54)	(18.91)	(24.85)	(28.22)	(31.04)	(33.53)
Gross Profit	8.39	14.77	17.72	32.49	40.01	45.79	50.37	54.41
% margin	*64.2%*	*66.7%*	*62.5%*	*287.3%*	*62.6%*	*62.7%*	*62.7%*	*62.7%*
Other operating expenses	(6.39)	(11.71)	(13.54)	(25.25)	(31.43)	(35.70)	(38.96)	(41.78)
% growth			*112.0%*	*295.3%*	*24.5%*	*13.6%*	*9.1%*	*7.2%*
E B I T D A	2.00	3.06	4.18	7.24	8.58	10.09	11.41	12.63
% margin	*15.3%*	*13.8%*	*14.7%*	*14.3%*	*13.4%*	*13.8%*	*14.2%*	*14.5%*
Depreciation	(0.17)	(0.25)	(0.27)	(0.52)	(0.78)	(0.78)	(0.80)	(0.83)
Operating Profit	1.84	2.81	3.91	6.72	7.80	9.32	10.61	11.79
% margin	*14.1%*	*12.7%*	*13.8%*	*13.3%*	*12.2%*	*12.8%*	*13.2%*	*13.6%*
Interest income/(expense)	(0.11)	(0.32)	(0.30)	(0.61)	(0.26)	(0.06)	0.17	0.44
Pre-tax Profit	1.73	2.49	3.61	6.11	7.54	9.26	10.79	12.24
Current tax charge	(0.54)	(0.30)	(1.53)	(1.83)	(2.26)	(2.78)	(3.24)	(3.67)
% tax rate	*31.0%*	*12.1%*	*42.4%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*
Headline Earnings	1.19	2.19	2.08	4.27	5.28	6.48	7.55	8.57
% margin	*9.1%*	*9.9%*	*7.3%*	*8.5%*	*8.3%*	*8.9%*	*9.4%*	*9.9%*
Exceptional costs	(0.98)			0.00	0.00	0.00	0.00	0.00
Share based payments	(0.27)	(1.01)	(1.29)	(2.30)	(2.62)	(2.69)	(2.75)	(2.82)
Goodwill amortisation	(0.32)	(0.65)	(0.76)	(1.41)	(1.41)	(1.41)	(1.41)	(1.41)
Reported Earnings	(0.37)	0.54	0.03	0.56	1.25	2.38	3.39	4.33
Dividends								
Retained Earnings	(0.37)	0.54	(0.34)	0.20	0.69	2.55	3.86	5.46
TSO (m)	*18.69*	*56.27*	*64.50*	*63.83*	*66.31*	*67.12*	*67.12*	*67.12*
Earnings per share (p)	*6.39*	*3.90*	*3.23*	*6.70*	*7.96*	*9.65*	*11.25*	*12.76*

(£'000) as of Mar 31	2007A	H1/08A	H2/08E	2008E	2009E	2010E	2011E	2012E
Balance Sheet								
PP&E	0.71	2.13	2.27	2.27	2.21	2.23	2.31	2.45
Goodwill (net of def cons)	40.95	49.70	47.14	47.14	45.73	44.32	42.91	41.50
Inventories	0.17	0.56	0.66	0.66	0.81	0.86	0.84	0.78
Trade Debtors	5.39	5.39	7.01	7.01	7.36	7.73	8.12	8.52
Trade Creditors	(2.35)	(2.35)	(2.46)	(2.46)	(2.59)	(2.72)	(2.85)	(2.99)
Net Working Capital	3.21	3.61	5.21	5.21	5.59	5.88	6.11	6.31
Cash	5.57	5.77	1.63	1.63	6.59	12.76	19.99	28.22
Borrowings	(13.48)	(10.10)	(5.00)	(5.00)	(5.00)	(5.00)	(5.00)	(5.00)
Net Cash / (Debt)	(7.91)	(4.33)	(3.37)	(3.37)	1.59	7.76	14.99	23.22
Deferred tax	(3.07)	(3.94)	(3.07)	(3.07)	(3.07)	(3.07)	(3.07)	(3.07)
Minorities	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other assets/liabilities	(5.06)	(6.26)	(8.77)	(8.77)	(11.39)	(14.08)	(16.83)	(19.66)
Net Assets	28.84	40.91	39.40	39.40	40.65	43.03	46.42	50.75

(£'000) Y/E Mar 31	2007A	H1/08A	H2/08E	2008E	2009E	2010E	2011E	2012E
Cash Flow Statement								
Operating Profit	1.84	2.81	3.91	6.72	7.80	9.32	10.61	11.79
Depreciation	0.17	0.25	0.27	0.52	0.78	0.78	0.80	0.83
Tax paid	(0.29)	(0.44)	(1.39)	(1.83)	(2.26)	(2.78)	(3.24)	(3.67)
Interest paid	(0.11)	(0.32)	(0.30)	(0.61)	(0.26)	(0.06)	0.17	0.44
Change in working capital	(3.40)	*(0.40)*	(1.60)	(2.00)	(0.38)	(0.29)	(0.23)	(0.20)
Other timing differences	2.34	(0.22)	0.22					
Operating Cash Flow	0.55	1.69	1.10	2.80	5.68	6.97	8.12	9.20
Capital Expenditure	1.16	(0.33)	(0.33)	(0.66)	(0.73)	(0.80)	(0.88)	(0.97)
Free Cash Flow	1.71	1.36	0.78	2.14	4.96	6.17	7.24	8.23
Acquisitions/Disposals	(20.66)	(6.38)	(1.22)	(7.60)	0.00	0.00	0.00	0.00
Share Issues	7.48	9.46	0.54	10.00	0.00	0.00	0.00	0.00
Dividends paid	0.00	0.00	0.00					
Other	(0.00)	(0.87)	0.87					
Net Cash Flow	(11.47)	3.58	0.96	4.54	4.96	6.17	7.24	8.23

Source: Company reports; Canaccord Adams estimates

VALUATION AND RECOMMENDATION

We are initiating coverage on Digital Marketing Group with a BUY recommendation and a 12-month price target of 112p based on our DCF analysis and supported by our peer group analysis and analysis of recent acquisitions.

Our price target equates to a calendarised PE of 14.5 times and 11.8 times our 2008 and 2009 EPS forecasts.

A summary of our valuation methodologies appears in the table below:

Figure 15: Summary of valuations

FYE Mar	CY08E		CY09E	
Gross profit (£m)	38.6		44.3	
EBITDA (£m)	8.3		9.7	
Headline Earnings (£m)	5.0		6.2	
	CY08E	Target Price	CY09E	Target Price
Peer group analysis				
EV/Sales (x)	0.9x	68p	0.9x	79p
EV/EBITDA (x)	5.7x	58p	5.4x	66p
PE (x)	11.6x	90p	9.6x	91p
DCF model analysis				
PE (x)	*14.5x*	112p	*11.8x*	112p
Acquisition multiples				
EBITDA	15.0x	177p		
Current trading	CY08E	Current Price	CY09E	Current Price
EV/EBITDA (x)	7.0x	90p	6.0x	90p
PE (x)	11.7x	90p	9.5x	90p

Source: Company reports; Canaccord Adams estimates

DCF analysis

Our three-stage DCF analysis of Digital Marketing Group is based on our explicit short-term forecasts (2008-2009) and our long-term revenue CAGR expectations of 8.4% (2009-2014) based on industry growth forecasts followed by a terminal growth rate of 2.5%. We have discounted the future expected cash flows using a WACC of 11.3% based on a beta of 1.40. Our WACC calculation is based on a market risk premium and risk-free rate published by Bloomberg for the UK. This analysis yields a total equity value of £72.9 million and a share price of 112p.

Figure 16: DCF Analysis (£ millions)

DCF Analysis (£ millions)	2007A	2008E	2009E	2010E	2011E	2012E	2013E	2014E
EBITDA	2.00	7.24	8.58	10.09	11.41	12.63	13.59	14.32
Cash taxes	(0.29)	(1.83)	(2.26)	(2.78)	(3.24)	(3.67)	(4.03)	(4.33)
Changes in working capital	(3.40)	(2.00)	(0.38)	(0.29)	(0.23)	(0.20)	(0.16)	(0.12)
Capital expenditure	1.16	(0.66)	(0.73)	(0.80)	(0.88)	(0.97)	(1.06)	(1.17)
Unlevered Free Cash Flow	**(0.53)**	**2.75**	**5.21**	**6.23**	**7.06**	**7.79**	**8.33**	**8.70**

NPV FCF (2008-2013)	28.85
Terminal growth	0.03
Terminal value	51.99
Enterprise value	80.84
Cash	1.63
Debt	(5.00)
Deferred consideration	(4.60)
Equity value	72.87
Shares outstanding (M)	65.30
per share (GBp)	**112p**

		Discount Rate				
	11159%	**10.3%**	**10.8%**	**11.3%**	**11.8%**	**12.3%**
Terminal Growth Rate	**1.5%**	118p	110p	104p	98p	92p
	2.0%	123p	115p	108p	101p	95p
	2.5%	129p	120p	112p	105p	98p
	3.0%	135p	125p	117p	109p	102p
	3.5%	143p	132p	122p	114p	106p

Beta	1.4	Tax rate	30.0%
Risk-free	4.4%	Kd	4.8%
MRP	5.4%	Ke	12.0%
Spread	2.5%	D/E	10.0%
WACC		**11.3%**	

Source: Company report, Canaccord Adams estimates

Peer group analysis

Our peer group analysis is based on a group of comparable quoted companies and uses a PE based on our annualised forecast C08 EPS for Digital Marketing Group. Our group of publicly listed marketing agencies is currently trading on a C08E average PE of 11.6 times, which would imply a price target of 90p, below our DCF analysis. Similarly, our peer group is trading on a C08E EV/EBITDA of 5.7 times, which would imply a price target of just 58p.

Digital Marketing Group is currently trading on a calendarised C08E PE of 11.7 times, in line with its F08E comparables. However, we believe that a significant premium to the peer group is justified for several reasons:

- Commitment to online advertising;
- Commitment to maintaining a lower cost base;
- Management's ability to make future accretive acquisitions.

Despite appearing overvalued on its F08E comparables in terms of PE and EV/EBITDA, Digital Marketing Group is currently trading at a C08E PEG of less than 0.1 times, significantly below its peer group at 1.0 times. We believe the focus on online advertising channels should result in higher revenue and earnings growth for the company than its various peers.

Figure 17: Peer group analysis

		Price	MCAP (£m)	EV/Sales F08E	EV/EBITDA F08E	P/E F08E	EV/Sales F09E	EV/EBITDA F09E	P/E F09E
Aegis	AGS LN	101.5	1,177.3	1.0	6.1	12.2	0.9	5.7	11.2
Creston	CRE LN	77	42.8	0.5	2.9	(17.6)	0.6	2.7	5.4
Havas	HAV FP	2.88	838.7	0.9	6.0	12.0	0.9	5.4	9.6
Interpublic	IPG US	7.65	1,794.2	0.6	4.5	11.6	0.6	4.4	7.9
LBI	LBI SS	28.9	129.2	0.8	5.2	8.0	0.7	4.6	6.8
Omnicom Group	OMC US	43.81	7,154.9	1.1	7.8	13.4	1.1	7.4	12.7
Publicis	PUB FP	21.71	2,944.9	0.8	4.5	8.2	0.8	4.2	7.6
Sapient	SAPE US	6.77	422.2	1.1	10.4	23.2	0.9	7.2	19.9
WPP	WPP LN	574	6,965.9	1.0	5.7	11.2	1.0	5.4	10.3
			Median	**0.9**	**5.7**	**11.6**	**0.9**	**5.4**	**9.6**
Digital Mktg Gp	DIGI LN	90	58.8	1.1	8.0	11.5	0.9	6.8	9.4

Source: Bloomberg; Canaccord Adams

Recent acquisitions of digital marketing agencies

The first half of 2007 witnessed a dramatic rise in eMarketing valuations in response to an M&A frenzy as over US$12 billion worth of assets changed hands, including the acquisitions of two leading digital agencies, the US$637 million acquisition of 24/7 Real Media by WPP and the US$6.0 billion acquisition of aQuantive by Microsoft, which followed last year's US$1.3 billion acquisition of Digitas by Publicis. We expect this activity to continue, although at a slower pace, driven by two main factors: a shift in focus towards display advertising, as producers of FMCG increase their use of online advertising and a need by traditional media to gain exposure to rapidly growing online marketing space.

Although a desire to acquire one of a limited number of popular AdServer technologies may have been a major factor in a number of the transactions, we also view many of the acquisitions as positioning for a potentially revolutionary shift in online ad spending toward display advertising, as an increasing number of FMCG brands, currently with limited exposure to the internet, begin advertising online. Text based keyword search marketing, despite being one of the largest and fastest growing categories of online marketing, is not a medium that is relevant to producers of FMCG, more likely to concentrate on brand building rich media and banner advertising.

We believe that the acquisitions of digital agencies are motivated by traditional media's need to gain exposure to the rapidly growing eMarketing space. Traditional media's interest in online advertising is understandable, given the increasing popularity of internet marketing, currently estimated at 6.6% of total global adspend and expected to have increased 8.1% in 2007 [Source: ZenithOptimedia]. We see the various transactions as a clear signal of a significant increase in the focus on online advertising, especially on display advertising by traditional media organisations.

The shrinking number of popular independent digital agencies may pressure other large organisations to make similar acquisitions. There are a number of companies of a size that either a large advertising agency, such as WPP Group (WPP : NYSE : US$7.88 | Not rated), Publicis Group (PUB : NYSE : US$39.65 | Not rated), Omnicom Group (OMC : NYSE : US$43.87 | Not rated), Interpublic Group (IPG : NYSE : US$17.51 | Not rated), Havas (HAV : Euronext : €2.94 | Not rated), or a large traditional media player such as

Time Warner (TWX : NYSE : US$15.49 | Not rated) or Viacom (VIA : NYSE : US$39.06 | Not rated) could acquire. In the UK, we consider these potential companies include LBI (LBI : Amsterdam : €3.27 | Not rated) and Digital Marketing Group.

Figure 18: Related acquisitions

Date	Acquirer	Target	Consideration	Valuation
20 Dec, 2006	Publicis	Digitas	US$1.3 billion	17x F07E EBITDA
11 Apr, 2007	Interpublic	RepriseMedia	Not disclosed	
17 May, 2007	WPP	24/7 Real Media	US$637 million	19x F07E EBITDA
18 May, 2007	Microsoft	aQuantive	US$6.0 billion	33x F07E EBITDA
15 Jun, 2007	Publicis	Business Interactif	€137 million	15x F07E EBITDA
05 Jul, 2007	WPP	Refinery	Not disclosed	
06 Sep, 2007	Publicis	Phonevalley	Not disclosed	
10 Sep, 2007	WPP	Schematic	Not disclosed	

Source: Canaccord Adams

MANAGEMENT TEAM

Stephen Davidson, Chairman (aged 52)

Stephen is Chairman of SPG Media plc and Enteraction TV Ltd and Deputy Chairman of Datatec. He is also a non-executive director of Inmarsat plc and various other public companies. Stephen has held various positions in Investment Banking, most recently at WestLB Panmure where he was Global Head of Media and Telecoms, Investment Banking, then Vice Chairman of Investment Banking. From 1993-1998 Stephen was Finance Director, then CEO of Telewest Communications plc.

He was Chairman of the Cable Communications Association from 1996-1998. Stephen holds a 1st Class Honours in Mathematics and Statistics from the University of Aberdeen.

Ben Langdon, Chief Executive (aged 44)

Ben was previously Chairman of Euro RSCG UK, one of the country's largest marketing service groups including businesses in digital and direct marketing, advertising, public relations, sales promotion, and design.

From 1996-2003 Ben worked at McCann-Erickson where he was promoted from Chief Executive of the London business to UK Group Chairman. In 2000 he was promoted to European Regional Director of Universal McCann the media planning and buying business, and then in late 2001 at the age of 38, to Regional Director for McCann-Erickson WorldGroup, Europe, Middle East and Africa (''EMEA'').

Ben holds an Honours degree in Modern History from Oxford University.

Sarah Guest, Finance Director (aged 32)

Sarah is a qualified Chartered Accountant (ACA). Her previous roles included the UK Financial Controller at George Wimpey Plc and prior to this, she worked at Clear Channel Entertainment (CCE) as European Director of Accounting and Control and UK Financial Controller. Sarah has over seven years of financial experience post ACA qualification and has a broad range of financial accounting experience from UK GAAP, IFRS & US GAAP. She trained and qualified at Ernst & Young LLP.

Gary Stevens, Executive Director (aged 38)

Gary is a marketing professional with over 16 years' experience in direct marketing. Gary started his marketing career at Teledata, a London-based telemarketing agency. In 1991 he left Teledata and co-founded HSM and has been pivotal in its development. Gary is a member of the Institute of Direct Marketing and manages the Inbox Digital division within HSM. Gary will remain the Chief Executive of HSM.

Andrew Wilson, Non-Executive Director (aged 47)

Andrew is currently Chairman of London Town Plc and a non-executive director of The Corporate Services Group plc, Watford Leisure plc and Wraith plc. Previously he was an investment banker with UBS Warburg specialising in mergers and acquisitions.

Ian Robinson, Non-Executive Director (aged 60)

Ian is currently a director of Strand Associates Limited and London Town plc. Previously he was Chief Financial Officer of Carlisle Group's UK staffing and facilities services operations. Ian qualified as a chartered accountant having trained with KPMG in London. He has held other senior financial appointments in UK service group companies and has spent several years overseas in both Chief Executive and Chief Financial Officer roles of a quoted international services group.

Barry Jenner, Non-Executive Director (aged 49)

Barry was formerly Director of global human resources for Gallaher Limited ("Gallaher"). Prior to this he was Managing Director of the UK division of Gallaher (2000-2006) managing the sales, marketing, trade marketing and distribution functions. Barry joined Gallaher as a management trainee in 1979 and held a series of sales positions until entering brand management/marketing in 1985. He was appointed trade Marketing Manager in 1987, before assuming responsibility for the flagship brand Benson & Hedges in 1988. Barry was appointed head of cigarette marketing in 1991, before becoming Marketing Director, UK in 1994.

INVESTMENT RISKS

Acquisition strategy

Digital Marketing Group has a strategy to develop its business through a series of targeted acquisitions. These acquisitions could introduce a risk that the company is unable to successfully integrate a new company that has been acquired. Either key staff or clients from the acquired business could be lost during the acquisition. There is also the risk that management could expend time and cost during the due diligence process for an acquisition that fails to take place.

Dependence on the global internet advertising market

Digital Marketing Group's business is highly dependent on the continued growth of the online advertising market. Although there are clearly positive trends in both internet usage and the acceptance of the medium amongst advertisers, there remains the risk that the market may be impacted by a short-term cyclical downturn as a result of wider economic difficulties.

Key personnel

Digital Marketing Group's success depends to a significant extent on the continued services of its core senior management team and being able to attract and retain new senior personnel. The company's business may be disrupted, additional costs may be incurred, or the future of the company may be jeopardised by a loss of or failure to retain sufficient numbers and quality senior personnel.

Increased competition

Digital Marketing Group operates in a highly competitive environment. Some of the company's potential international competitors have longer operating histories, greater brand recognition and greater financial and other resources. As a result, these competitors may be able to undertake more extensive sales and marketing campaigns, adopt more competitive pricing policies, and make more attractive offers to potential employees, strategic partners and advertisers.

Rapidly changing and dynamic industry

Internet marketing is a rapidly changing and dynamic industry characterised by new technologies, evolving industry standards, frequent product and service introduction and evolving web publisher and advertiser demands. The success of the company will depend on its ability to modify its products and services to respond in a timely and cost-effective manner to new technologies and changing web publisher and advertiser demands.

Increasing governmental regulation

Due to the increasing popularity and use of the Internet, various laws and regulations may be adopted covering issues such as pricing, content, database protection, unsolicited commercial email and taxation. Due to the global nature of the Internet, multiple jurisdictions might adopt laws or regulations that relate to the company's business.

NOTES

APPENDIX: IMPORTANT DISCLOSURES

Analyst Certification: Each authoring analyst of Canaccord Adams whose name appears on the front page of this investment research hereby certifies that (i) the recommendations and opinions expressed in this investment research accurately reflect the authoring analyst's personal, independent and objective views about any and all of the designated investments or relevant issuers discussed herein that are within such authoring analyst's coverage universe and (ii) no part of the authoring analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the authoring analyst in the investment research.

Site Visit: An analyst has not visited the issuer's material operations in the United Kingdom.

Price Chart:*

* Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:
Global Stock Ratings
(as of 2 January 2008)

	Coverage Universe		IB Clients
Rating	#	%	%
Buy	294	61.8%	43.9%
Speculative Buy	57	12.0%	70.2%
Hold	112	23.5%	33.0%
Sell	13	2.7%	0.0%
	476	100.0%	

Canaccord Ratings System:

BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.
HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.
SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.
NOT RATED: Canaccord Adams does not provide research coverage of the relevant issuer.

"Risk-adjusted return" refers to the expected return in relation to the amount of risk associated with the designated investment or the relevant issuer.

Risk Qualifier: SPECULATIVE: Stocks bear significantly higher risk that typically cannot be valued by normal fundamental criteria. Investments in the stock may result in material loss.

Canaccord Research Disclosures as of 29 January 2008

Company	Disclosure
Digital Marketing Group	7

1	The relevant issuer currently is, or in the past 12 months was, a client of Canaccord Adams or its affiliated companies. During this period, Canaccord Adams or its affiliated companies provided the following services to the relevant issuer: A. investment banking services. B. non-investment banking securities-related services. C. non-securities related services.
2	In the past 12 months, Canaccord Adams or its affiliated companies have received compensation for Corporate Finance/Investment Banking services from the relevant issuer.
3	In the past 12 months, Canaccord Adams or any of its affiliated companies have been lead manager, co-lead manager or co-manager of a public offering of securities of the relevant issuer or any publicly disclosed offer of securities of the relevant issuer or in any related derivatives.
4	Canaccord Adams acts as corporate broker for the relevant issuer and/or Canaccord Adams or any of its affiliated companies may have an agreement with the relevant issuer relating to the provision of Corporate Finance/Investment Banking services.
5	Canaccord Adams or any of its affiliated companies is a market maker or liquidity provider in the securities of the relevant issuer or in any related derivatives.
6	In the past 12 months, Canaccord Adams, its partners, affiliated companies, officers or directors, or any authoring analyst involved in the preparation of this investment research has provided services to the relevant issuer for remuneration, other than normal course investment advisory or trade execution services.
7	Canaccord Adams intends to seek or expects to receive compensation for Corporate Finance/Investment Banking services from the relevant issuer in the next six months.
8	The authoring analyst, a member of the authoring analyst's household, or any individual directly involved in the preparation of this investment research, has a long position in the shares or derivatives, or has any other financial interest in the relevant issuer, the value of which increases as the value of the underlying equity increases.

9	The authoring analyst, a member of the authoring analyst's household, or any individual directly involved in the preparation of this investment research, has a short position in the shares or derivatives, or has any other financial interest in the relevant issuer, the value of which increases as the value of the underlying equity decreases.
10	Those persons identified as the author(s) of this investment research, or any individual involved in the preparation of this investment research, have purchased/received shares in the relevant issuer prior to a public offering of those shares, and such person's name and details are disclosed above.
11	A partner, director, officer, employee or agent of Canaccord Adams and its affiliated companies, or a member of his/her household, is an officer, or director, or serves as an advisor or board member of the relevant issuer and/or one of its subsidiaries, and such person's name is disclosed above.
12	As of the month end immediately preceding the date of publication of this investment research, or the prior month end if publication is within 10 days following a month end, Canaccord Adams or its affiliate companies, in the aggregate, beneficially owned 1% or more of any class of the total issued share capital or other common equity securities of the relevant issuer or held any other financial interests in the relevant issuer which are significant in relation to the investment research (as disclosed above).
13	As of the month end immediately preceding the date of publication of this investment research, or the prior month end if publication is within 10 days following a month end, the relevant issuer owned 1% or more of any class of the total issued share capital in Canaccord Adams or any of its affiliated companies.
14	Other specific disclosures as described above.

Canaccord Adams is the business name used by certain subsidiaries of Canaccord Capital Inc., including Canaccord Adams Inc., Canaccord Adams Limited, and Canaccord Adams, a division of Canaccord Capital Corporation. Clients of Canaccord Adams, in the past 12 months, may have been clients of Canaccord Capital Corporation, Canaccord Capital (Europe) Limited, Canaccord Capital Corporation USA Inc., and/or Adams Harkness Financial Group Ltd.

The authoring analysts who are responsible for the preparation of this investment research are employed by Canaccord Adams, a securities broker-dealer with principal offices located in Vancouver, Calgary, Toronto, Montreal (all Canada), Boston, New York, San Francisco (all US) and London (UK).

In the event that this is compendium investment research (covering six or more relevant issuers), Canaccord Adams and its affiliated companies may choose to provide specific disclosures of the subject companies by reference, as well as its policies and procedures regarding the dissemination of investment research. To access this material or for more information, please send a request to Canaccord Adams Research, Attn: Disclosures, P.O. Box 10337 Pacific Centre, 2200-609 Granville Street, Vancouver, BC, Canada V7Y 1H2 or disclosures@canaccordadams.com.

The authoring analysts who are responsible for the preparation of this investment research have received (or will receive) compensation based upon (among other factors) the Corporate Finance/Investment Banking revenues and general profits of Canaccord Adams. However, such authoring analysts have not received, and will not receive, compensation that is directly based upon or linked to one or more specific Corporate Finance/Investment Banking activities, or to recommendations contained in the investment research.

Canaccord Adams and its affiliated companies may have a Corporate Finance/Investment Banking or other relationship with the company that is the subject of this investment research and may trade in any of the designated investments mentioned herein either for their own account or the accounts of their customers, in good faith or in the normal course of market making. Accordingly, Canaccord Adams or their affiliated companies, principals or employees (other than the authoring analyst(s) who prepared this investment research) may at any time have a long or short position in any such designated investments, Related designated investments or in options, futures or other derivative instruments based thereon.

Some regulators require that a firm must establish, implement and make available a policy for managing conflicts of interest arising as a result of publication or distribution of investment research. This investment research has been prepared in accordance with Canaccord Adams' policy on managing conflicts of interest, and information barriers or firewalls have been used where appropriate. Canaccord Adams' policy is available upon request.

The information contained in this investment research has been compiled by Canaccord Adams from sources believed to be reliable, but (with the exception of the information about Canaccord Adams) no representation or warranty, express or implied, is made by Canaccord Adams, its affiliated companies or any other person as to its fairness, accuracy, completeness or correctness. Canaccord Adams has not independently verified the facts, assumptions, and estimates contained herein. All estimates, opinions and other information contained in this investment research constitute Canaccord Adams' judgement as of the date of this investment research, are subject to change without notice and are provided in good faith but without legal responsibility or liability.

Canaccord Adams salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desk that reflect opinions that are contrary to the opinions expressed in this investment research. Canaccord Adams' affiliates, proprietary trading desk, and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this investment research.

This investment research is provided for information purposes only and does not constitute an offer or solicitation to buy or sell any designated investments discussed herein in any jurisdiction where such offer or solicitation would be prohibited. As a result, the designated investments discussed in this investment research may not be eligible for sale in some jurisdictions. This investment research is not, and under no circumstances should be construed as, a solicitation to act as a securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. This material is prepared for general circulation to clients and does not have regard to the investment objectives, financial situation or particular needs of any particular person. Investors should obtain advice based on their own individual circumstances before making an investment decision. To the fullest extent permitted by law, none of Canaccord Adams, its affiliated companies or any other person accepts any liability whatsoever for any direct or consequential loss arising from or relating to any use of the information contained in this investment research.

For Canadian Residents: This investment research has been approved by Canaccord Adams, a division of Canaccord Capital Corporation, which accepts responsibility for this investment research and its dissemination in Canada. Canadian clients wishing to effect transactions in any Designated Investment discussed should do so through a qualified salesperson of Canaccord Adams, a division of Canaccord Capital Corporation in their particular jurisdiction.

For United Kingdom Residents: This investment research complies with the Financial Services Authority's Conduct of Business Sourcebook and is approved by Canaccord Adams Limited, which is authorized and regulated by the Financial Services Authority, in connection with its distribution in the United Kingdom. This material is not for distribution in the United Kingdom to private customers, as defined under the rules of the Financial Services Authority. Canaccord Adams Limited accepts responsibility for this investment research and its dissemination in the United Kingdom. The information contained in this investment research is only intended for distribution in the UK to persons who qualify as intermediate customers or market counterparties, as defined under the rules of the Financial Services Authority.

For European Residents: If this investment research is intended for disclosure in any jurisdiction other than the United Kingdom, the US or Canada, then the relevant rules and regulatory requirements of that jurisdiction will apply.

Additional information is available on request.

CANACCORD Adams

Sales and Trading

Toronto 1.800.810.8051 London 44.20.7050.6505 Boston 1.800.343.7096 Vancouver 1.604.643.7052
Calgary 1.403.508.3826 Montreal 1.514.284.1476 San Francisco 1.800.830.2608 New York 1.800.818.2196 www.canaccordadams.com

Mark Maybank, CA, CBV Director of Research (Global), Toronto	1.416.869.7922
Peter Misek, CA, CPA, CFA Head of Research (Canada), Toronto	1.416.869.7920
Karl Keegan, MPhil, PhD Head of Research (UK), London	44.20.7050.6633
Eric Ross, MS Head of Research (US), New York	1.212.849.3970

Mining and Metals

Damien Hackett, London	44.20.7050.6641
Steven Butler, MBA, Toronto	1.416.869.7918
Nicholas Campbell, Vancouver	1.604.643.7027
Scott Finlay, London	44.20.7050.6651
Gary Lampard, Toronto	1.416.867.6020
Jim Taylor, London	44.20.7050.6648
Toni Wallis, PGeo, Vancouver	1.604.643.7551
Orest Wowkodaw, CA, CFA, Toronto	1.416.869.3092
Wendell Zerb, PGeol, Vancouver	1.604.643.7485
Nick Chalmers, Associate, London	44.20.7050.6636
Christopher Chang, Associate, Toronto	1.416.869.7299
Gary Hon, CFA, Associate, Toronto	1.416.869.7376
Adam Melnyk, Associate, Vancouver	1.604.643.1655
John Vinnai, Associate, Toronto	1.416.869.7289

Energy

Bill Cruise, MBA, Houston	1.713.331.9446
Irene Haas, MS, MBA, Houston	1.713.331.9443
Rafi Khouri, MBA, London	44.20.7050.6645
Frederick Kozak, Calgary	1.403.508.3836
Wendy Liu, CFA, Calgary	1.403.508.3890
Terry Peters, MBA, Toronto	1.416.869.6597
Richard Wyman, MBA, Calgary	1.403.508.3886
Timothy Clark, Associate, Calgary	1.403.508.3824
Arthur Grayfer, Associate, Calgary	1.403.508.3884
Stephanie Joe, Associate, Houston	1.713.331.9444
Valentino Pintea, Associate, Calgary	1.403.781.1614
Asad Rawra, CA, CPA, Associate, Toronto	1.416.869.7397

Technology

Jeff Rath, CFA, Boston	1.617.371.3891
Richard Baldry, CFA, Boston	1.617.371.3862
Dushan Batrovic, MBA, Toronto	1.416.869.7399
Bobby Burleson, San Francisco	1.415.229.7163
Anthony Chow, MBA, London	44.20.7050.6637
Jonathan Dorsheimer, Boston	1.617.371.3875
Steven Frankel, MBA, Boston	1.617.371.3711
Colin Gillis, MBA, New York	1.212.849.3914
Alan Howard, CFA, MA, London	44.20.7050.6644
Mark Kelleher, MBA, Boston	1.617.371.3726
David Lambert, CFA, Toronto	1.416.869.6592
Bob Liao, CFA, London	44.20.7050.6654
Peter Misek, CA, CPA, CFA, Toronto	1.416.869.7920
Eyal Ofir, CFA, Toronto	1.416.869.7215
Josh Baribeau, Associate, Boston	1.617.371.3892
Andrew Buscaglia, Associate, New York	1.212.849.3957
May Giang, Associate, Montreal	1.514.284.1593
Neal Gilmer, Associate, Toronto	1.416.869.7294
Chelsea Heffernan, Associate, San Francisco	1.415.229.7162
Aron Honig, Associate, Boston	1.617.371.3728
Andrew Jardine, Associate, Boston	1.617.371.3779
Domenic LaCava, Sr. Associate, Boston	1.617.371.3817
Shannon Lynch, Associate, Toronto	1.416.869.7344

Life Sciences

Karl Keegan, MPhil, PhD, London	44.20.7050.6633
Adam Cutler, New York	1.212.849.3907
Jason Mills, San Francisco	1.415.229.7166
Neil Maruoka, Toronto	1.416.869.3073
Joseph Pantginis, PhD, New York	1.212.849.3921
William Plovanic, CFA, Chicago	1.847.864.1137
Matthew Scalo, San Francisco	1.415.229.0649
Ritu Baral, Sr. Associate, New York	1.212.849.3917
Theresa Chu, Associate, San Francisco	1.415.299.0699
Lala Gregorek, Associate, London	44.20.7050.6635
Jamar Ismail, Associate, San Francisco	1.415.229.0683
Anup Mehta, Associate, Chicago	1.847.864.1139
Mark Mitchell, Associate, Toronto	1.416.869.3894
Ben Sun, PhD, Sr. Associate, Boston	1.617.788.1595
Guillaume van Renterghem, MSc, Assoc. London	44.20.7050.6650

Real Estate

Jonathan Kelcher, CFA, MBA, Toronto	1.416.869.3260
Shant Poladian, CA, CPA, Toronto	1.416.869.6595
Yashwant Sankpal, Associate, Toronto	1.416.869.3643
John Travaglini, Associate, Toronto	1.416.869.3650

Consumer

Stephen Colbert, Boston	1.617.788.1573
Scott Van Winkle, CFA, Boston	1.617.371.3759
Diederik Basch, CFA, Sr. Associate, Boston	1.617.371.3764

Industrial Growth

Robert J. Hastings, CFA, Vancouver	1.604.643.0177
Michael Deng, MBA, Calgary	1.403.508.3804
Sara Elford, CFA, Halifax	1.902.442.3161
Tom Varesh, MBA, Toronto	1.416.869.3189
Max Vichniakov, MBA, Toronto	1.416.869.7284
Chip Moore, CFA, Sr. Associate, Boston	1.617.371.3879
Juan Plessis, MBA, CFA, Associate, Vancouver	1.604.643.0181
Christy Taylor, Associate, Vancouver	1.604.643.7034

Sustainability

John Quealy, CPA, Boston	1.617.371.3837
Michael Deng, MBA, Calgary	1.403.508.3804
Sara Elford, CFA, Halifax	1.902.442.3161
Eric Glover, CFA, San Francisco	1.415.229.0669
Yuri Lynk, Msc, CFA, Montreal	1.514.844.3708
Mark Thompson, MSc, CFA, London	44.20.7050.6649
Eric Prouty, Boston	1.617.371.3729
Jeffrey Leung, Associate, Vancouver	1.604.661.7861
Mark Sigal, Associate, Boston	1.617.788.1591

Portfolio Strategy

Nick Majendie, CA, MA, Vancouver	1.604.643.7005
Michael Rudd, CFA, Associate, Vancouver	1.604.643.7421

Vancouver Head Office
P.O. Box 10337 Pacific Centre
2200 – 609 Granville Street
Vancouver, British Columbia
V7Y 1H2
1.604.643.7000

Toronto
BCE Place, 161 Bay Street
Suite 3000, P.O. Box 516
Toronto, Ontario
M5J 2S1
1.416.869.7368

Calgary
TransCanada Tower
450 1st Street SW Suite 2200
Calgary, Alberta
T2P 5P8
1.403.508.3800

Montréal
1010, rue Sherbrooke ouest
Bureau 1100
Montréal, Québec
H3A 2R7
1.514.844.5443

London
7th Floor, Cardinal Place
80 Victoria Street,
London, SW1E 5JL
44.20.7050.6500

Boston
99 High Street
Suite 1200
Boston, MA
02110
1.617.371.3900

New York
535 Madison Avenue
2nd Floor
New York, NY
10022
1.212.849.3900

San Francisco
101 Montgomery Street
Suite 2000
San Francisco, CA
94104
1.415.229.7171