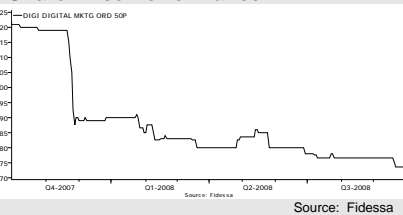


3 October 2008

BUY

Price at 30 Sept 2008 (p) 73
Price Target (p) 160
52-week range (p) 72 - 125
Reuter: DIGI.L **Bloomberg:** DIGI LN
Exchange: AIM **Ticker:** DIGI

Share Price Performance



Performance(%)	1m	3m	12m
Absolute	-5	-7	-40

Stock Data

Market cap (£'m)	49.0
Shares outstanding (m)	67.3

Key Indicators

Net cash/(debt) (£'m) – Mar 09	(7.3)
EBITDA margin (%)	22

Activities

Digital direct marketing services; online communications

Directors

Stephen Davidson	Chairman
Ben Langdon	CEO
Sarah Guest	CFO
Andrew Wilson	NED
Ian Robinson	NED
Barry Jenner	NED
Gary Stevens	ED

Significant Share Holders

Mayfair Ltd	25.3%
Gary & Helena Stevens	10.8%
Martin Boddy	7.5%
Andrew Gardner	7.5%
Total	51.1%

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Acquisition and Update

Digital Marketing Group

Continued Growth

Following its recent announcement that the business is on track to make its full year profit forecast to March 2009, Digital Marketing Group has completed the acquisition of Cybercom, a Tier 1 supplier of IBM's e-commerce infrastructure, and Gasbox, a direct marketing company specialising in voice solutions.

Cybercom has been bought for an initial consideration of £6.0m and a deferred performance related element of £3m. Assuming that all performance targets are met this equates to a PBT multiple of 5.75x 2010.

Gasbox has been bought for an initial consideration of £1.0m with a further maximum payment of £9.0m subject to meeting certain profit targets. This translates to 4.6x 2010 PBT multiple assuming that all performance targets are met.

On a stand-alone basis the acquisitions will be earnings enhancing by 11% for the year to March 2009 and above 15% for 2010.

The two companies will bring substantial strategic and operational benefits to the Group:

- Cybercom will allow DIGI to tap directly into e-commerce which represents a significant growth opportunity
- Gasbox enhances DIGI's existing presence in the integration of telemarketing services and online marketing solutions

The acquisitions have been financed through a banking facility with Barclays. The net debt following the acquisitions will be £10.6m, falling to £7m by March 2009 – under 1x prospective EBITDA. The shares are now trading on 8.4x which neither reflects the progress or potential of the Group. BUY.

Cybercom

Cybercom has been the UK arm of Swedish high tech consultancy group Cybercom AG. The business was put up for sale following a review of operations which resulted in a focus on Scandinavian and Asian markets. Cybercom is a Tier 1 supplier of IBM's e-commerce infrastructure to blue-chip clients including Waitrose, Speedo and John Lewis.

Cybercom has been bought on the basis of its earnings history and forecasts as a stand-

Forecasts and ratios

Year End March	2005A	2006A	2007A	2008A	2009E
Gross profit		-	8.4	33.1	43.6
Gross profit proforma	14.3	19.1	29.4	35.0	48.3
EBITDA (£'m)**			2.3	7.4	9.8
PBT* (£'m)			1.7	6.3	8.1
PBT proforma*			4.7	6.7	8.6
EPS (p)*	-	-	5.1	7.3	8.7
% Change	-	-	-	42	8
PER (x)			14	10	8.4

Source: Cenkos Securities estimates, company data - *less amortisation and share based payment charges; **less charges for share options

alone entity. However, the operational rationale for the purchase is an expectation that a significant amount of cross-referral sales can be generated by collaborating with other businesses in the Group and in particular with those agencies in DIGI's on-line media and marketing segment specialising in the design and build of transactional websites.

DIGI have paid an initial consideration of £6m (net of debt) with a further £3m available to senior management and key employees subject to meeting demanding performance criteria. Assuming full payout of the contingent consideration, the transaction price represents a multiple of 5.75x 2010 forecast PBT. The following table shows the earnings history for Cybercom over the past three years and the year to date.

Cybercom will become part of DIGI's online media and marketing business segment.

Cybercom financials (£'000)

Year end Dec	2005	2006	2007	8m to Aug 08
Gross Profit	1,556	2,139	4,445	4,455
EBITDA	38	272	733	721

We have assumed that Cybercom meets its performance targets and receives their full deferred entitlement. The conditional element is structured as follows:

Cybercom deferred consideration structure* (£'000)

Period	6m to March 09	6m to March 09	12m to March 10	12m to March 10
EBIT Target	503.5	530	1,380	1,565
Consideration	400	600	1,585	2,400

*straight line calculation between defined targets

Gasbox

Gasbox sells a voice marketing solution. In layman's terms, its system aggregates information on a potential customer obtained from different media channels in order to enable telesales people to effect a transaction. This information may be obtained through email campaigns, viral marketing or interaction with a company's website. It began trading in September 2006 and is part owned by the founders of Jaywing – DIGI's data analytics arm. Gasbox will become part of DIGI's direct marketing business segment.

As the table below illustrates, Gasbox has enjoyed spectacular growth since the outset.

Gasbox financials (£'000)

Year end Mar	2007A*	2008A	5 m to Aug 08
Gross Profit	331	1,333	1,161
EBITDA	-259	-44	358

* six months

Gasbox has been bought for an initial consideration of £1.0m. A further £1.5m will be paid if Gasbox achieves minimum sustainable gross profits in the 6 months to March 2009. The £2.5m maximum consideration payable by March 2009 represents 2.7x 2009 forecast PBT.

No further consideration will be paid unless the business proves that it can deliver a minimum sustainable PBT in the year to March 2010 of £1,000,000. Above that level additional consideration (part shares, part options, part cash) will be paid to a maximum of £7.5m.

Gasbox deferred consideration structure* (£'000)

Period	12m Mar '10	Mar '10	Mar '10	Mar '10
PBT Target	1,000	1,600	1,850	2,183
Consideration	2,500	5,500	6,500	7,500

*Straight line calculation between individual targets

From an operational perspective Gasbox complements DMG's existing voice marketing business, HSM, and the acquisition will enable the Group to offer clients an integrated voice and data business with both B2B and B2C offerings.

Financial forecasts

The following table shows the gross profit (GP) and PBT at a Group level on a pro-forma and actual basis:

	March 08 (£'000)		March 09 (£'000)	
	GP	PBT	GP	PBT
P&L Actual Impact				
DMG	33,079	6,314	39,033	7,367
Gasbox			1,725	544
Cybercom			2,904	530
Additional interest			0	-363
Market forecast plus acquisitions			43,662	8,078
P&L Pro-forma Impact				
DMG pro-forma - pre Gasxbox & Cybercom	35,007	6,686	39,033	7,367
12mths Gasbox	1,333	-103	3,206	923
12mths Cybercom	5,036	834	6,056	1,055
Interest	0	-725	0	-725
DMG pro-forma - inc Gasbox & Cybercom	41,376	6,692	48,295	8,619

Source: Cenkos Securities

We expect the purchase of Cybercom and Gasbox to be earnings enhancing by 11% for the year to March 2009 and even more so in 2010.

EPS Accretion

Period (12 m to)	Mar '09		
	PAT	Shares*	EPS
Pre-acquisitions	5,304	66,926,706	7.9
Proforma	5,816	66,926,706	8.7
EPS Accretion			11%

*Weighted average number of shares

We now expect DIGI to report the following segmental results for the year to March 2009:

DIGI Pro-forma 2009 segmental breakdown (including Gasbox and Cybercom)

Segment	GP	EBITDA	PBT
Online marketing	20,906	4,938	4,945
Direct marketing	14,489	3,171	3,103
Data services	12,900	3,496	3,500
Gross	48,295	11,606	11,548
Central costs	-	-1,585	-2,928
Net	48,295	10,021	8,619

Source: Cenkos Securities

Both transactions have been financed through a facility with Barclays. This is a strong indication of Barclays' confidence in the business particularly given the current market environment. The net debt post the transaction will be £10.6m not including the c. £4m of cashflow they will have generated in H1 this year. This is broken down as follows: £200k of cash at the year-end, an out-flow of £3.8m for the payment of the deferred consideration for Hyperlaunch and Graphico and £7.0m for the initial consideration for Cybercom and Gasbox. We expect DIGI to have a net debt position of £7m by March 2009, which includes a cash consideration of £1.5m for the first part of the deferred consideration of Gasbox. This leaves plenty of headroom given that the DIGIs currently have facilities of £16.6m with Barclays.

The combined deferred consideration for Gasbox and Cybercom, presuming all targets are met, is £12m, of which £11.8m can be paid in shares or cash at the Company's discretion. DIGI's high profit to cash conversion combined with its low gearing level gives the Group the flexibility to make the contingent payments in cash without straining its balance sheet and minimising dilution.

DIGI has consistently delivered on its strategy and demonstrated its ability to generate growth. It is already recognised as the UK's third largest digital marketing agency (NMA September 2008). The acquisitions of Cybercom and Gasbox complement its product offering and strengthen its position to continue to take advantage of the significant opportunity that digital direct marketing and e-commerce represent.

The following table outlines our financial forecasts for the Group.

Year end March (£'000)	2007	2008	2009E
Gross Profit	8,389	33,079	43,662
Operating costs	-6,115	-25,648	-33,883
EBITDA	2,274	7,431	9,779
Depreciation	-166	-586	-761
EBITA	2,108	6,845	9,018
Net interest	-106	-531	-940
Cenkos PBT	2,002	6,314	8,078
Tax @ 28%	-561	-1,768	-2,262
Cenkos PAT	1,441	4,546	5,816
Minority interest	0	0	0
Profit attributable to shareholders	1,441	4,546	5,816
Basic Weighted average shares in issue ('000)	63,830	63,653	66,927
Diluted Weighted average shares in issue ('000)	71,365	78,875	84,469
Cenkos EPS Basic	2.26	7.14	8.69
Cenkos EPS Diluted	2.02	5.76	6.89
Adjustment			
Amortisation	-321	-1,407	-1,400
Operating profit	1,787	5,438	7,618
Exceptional Items	-336	0	0
Share based payments	-271	-2,758	0
Other non operating items	0	0	0
Net interest	-106	-531	-940
Profit before tax	1,074	2,149	6,678
Tax	-537	-1,013	-966
PAT	537	1,136	5,713
Cashflow			
Operating Profit	1,787	5,438	7,618
Amortisation	321	1,407	1,400
Depreciation	166	586	761
Working Capital	-359	2,015	-1,000
Other	-336	0	0
Net cash flow from operating activities	1,579	9,446	8,779
Opening net cash / debt	3,564	-7,908	184
Net cash flow from operating activities	1,579	9,446	8,779
Interest (Net)	-106	-465	-940
Tax	-288	-1,194	-2,000
Capex	1,163	-747	-750
Acquisitions	-20,662	-8,021	-12,300
Issue of new shares	7,532	9,463	0
New finance leases	-690	-390	0
Dividend	0	0	0
Closing net cash / debt	-7,908	184	-7,027

Source: Cenkos Securities

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