

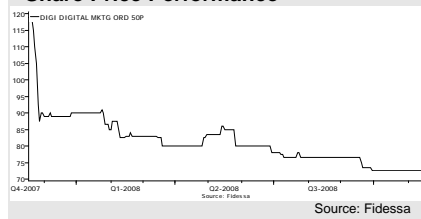
24 NOVEMBER 2008

BUY

Price at 21 Nov 2008 (p) 72
Price Target (p) 150
52-week range (p) 120 - 72

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

Share Price Performance



Performance(%)	1m	3m	12m
Absolute	0	-5	-39

Stock Data

Market cap (£'m)	49.0
Shares outstanding (m)	67.6

Key Indicators

Net cash/(debt) (£'m) – Mar 09	(7.0)
EBITDA margin (%)	22

Activities

Digital direct marketing services; online communications

Executive Directors

Stephen Davidson	Chairman
Ben Langdon	CEO
Sarah Guest	CFO
Gary Stevens	ED

Significant Share Holders

Mayfair Ltd	24.4%
G & H Stevens	10.4%
M Boddy	7.3%
A Gardner	7.3%
J Riddell	5.0%
Insight AM	4.3%
Tudor Cap	3.1%
Total	61.8%

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INTERIM RESULTS AND UPDATE •

Digital Marketing Group

Digital growth continues

Digital Marketing Group (DIGI) have reported another strong set of results for the six months to September 2008. On a pro forma basis PBT grew 17% to £3.37m (£2.89m). Gross Profits grew 12% to £18.72m (£16.70m) and EBITDA by 10% to £3.85m (£3.49m). The PBT of £3.4m represents 42% of our FY 09 forecast of £8.1m, similar to the H1 / H2 split for FY08, indicating that the Group are on track.

From an operational perspective H1 2009 was equally impressive, with new client accounts, the acquisition of Cybercom and Gasbox and recognition by NMA Magazine that DIGI is now the third largest digital marketing agency in the UK. Several studies have shown that the current economic headwinds are accelerating the trend towards digital marketing and e-commerce. We therefore expect DIGI to continue their strong performance over the course of the current downturn.

H1 FY 09 results

Operational highlights include the addition of a string of blue chip clients to their stable including Danone, Mothercare and Regus Group. Cross referral sales increased, accounting for 13% of gross profits versus 7% in 07/08. All but one of the companies under the DIGI umbrella performed well:

- **Online Marketing & Media** EBITDA grew by 19% on a pro forma basis to £1.9m (£1.6m). This division was bolstered by the addition of Cybercom in October this year. Management are particularly confident of organic growth from cross referrals from within this division as Cybercom, Graphico, Inbox, Cheeze and Hyperlaunch will be able to tap into each other's extensive client networks and complementary areas of expertise.
- **Data Services** reported 58% pro forma EBITDA growth to £1.8m (£1.2m). This impressive performance owes much to the investment made in client acquisition over the last twelve months.
- **Direct Marketing** was the only blemish, which saw EBITDA contract by 18% to £1m (£1.2m). However, the problem was isolated to HSM as Dig for Fire continued to perform well. The problems at HSM relate primarily to the loss of two financial services clients that were flagged at the FY 08 results in June. Since then HSM has begun to replace this business and management changes have recently taken place. The acquisition of Gasbox which strengthens the division's selling proposition will also help to reverse fortunes.

Forecasts and ratios

Year End March	2007A	2008A	2009E
Gross profit (£'m)	8.4	33.1	43.6
Gross profit proforma (£'m)	29.4	35.0	48.3
EBITDA (£'m)**	2.3	7.4	9.8
PBT* (£'m)	1.7	6.3	8.1
PBT proforma* (£'m)	4.7	6.7	8.6
EPS (p)*	5.1	7.3	8.7
% Change	-	42	19
PER (x)	14	10	8

Source: Cenkos securities estimates, company data

DIGI finished H1 09 with net debt of £1.8m compared with £4.3m for H1 08. This position has changed following the acquisitions of Cybercom and Gasbox and the earn out which resulted in net debt of £9.4m, falling to £7.0m by March 09. The drop in net debt prior to the acquisitions in October shows that the Group is highly cash generative and can easily manage the current levels of gearing. It is also worth mentioning that all the earn-out liabilities in respect of prior years' acquisitions have now been settled.

Online marketing is even more compelling in a downturn

Marketing spend has always been a bellwether for the general economy. This time will be no different. However, the trend of switching marketing spend to on-line advertising is expected to accelerate over the downturn. There are two reasons for this:

- 1 it is easier to measure the returns on on-line marketing spend than other forms of advertising such as TV or print; and
- 2 commentators expect cost-conscious consumers to purchase more on-line as price comparison is easier and products are often cheaper on-line than on the high street. A recent study by Twenga suggested that 50% of all Britons are planning to use the internet for Christmas shopping in order to cut back on costs.

A recent study by PWC showed that internet advertising spend had risen 21% from H1 07 to H1 08 reaching £1.6bn and now accounts for 18.7% of overall advertising spend from 14.7% at the same time last year.

Forecasts

The combination of the first half's results weighting which is similar to H1 08 and the expected buoyant on-line sales this Christmas gives us a high degree of confidence in our FY 09 forecasts. The integration of Gasbox and Cybercom is proceeding well and the following table shows how we recently adjusted our forecasts following these acquisitions.

Forecasts and ratios

Year End March	2009E (Old)	2009E (C&G)
Gross profit	39.0	43.6
Gross profit proforma	39.0	48.3
EBITDA (£'m)**	8.7	9.8
PBT* (£'m)	7.4	8.1
PBT proforma*	7.4	8.6
EPS (p)*	7.9	8.7
% Change	8	19
PER (x)	9.1	8.4

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

Conclusion

Investors have been suspicious of forecasts of buy-and-build companies such as DIGI. However, these results, along with those of H1 08 and FY 08, illustrate that DIGI provide conservative guidance and meet expectations. Management have consistently delivered on their strategy and demonstrated their ability to generate growth.

The following table outlines our financial forecasts for the Group.

Digital Marketing Group financial forecasts

Year end March (£'000)	2007A	2008A	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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