

6 JULY 2009

UNITED KINGDOM •

BUY

Price at 5 Jul 2009 (p) 40
 Price Target (p) 80
 52-week range (p) 39 - 78

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

Digital Marketing Group

Another excellent set of results

Digital Marketing Group (DIGI) has delivered another excellent set of results despite the significant deterioration in the advertising market over the past year. Gross profits grew 26% to £41.6m (£33.1m) and EBITDA grew by 25% to £9.3m (£7.4m). PBT grew by 27% to £8.0m (£6.3m) which fed through to EPS growth of 20% to 8.6p (7.1p). These results reflect six month contributions from Gasbox and Cybercom but also organic growth of 11% at the gross profit level. The management continued to succeed in cross-selling its products across its client base with cross-referrals contributing £3.9m to gross profits. The group finished the year with net debt of £5.8m versus our forecast of £7m.

There are three reasons why we believe that DIGI will continue to outperform. First, advertising spend continues to switch to digital formats. Second, DIGI is widely recognised as the largest and one of the best operators in the industry and so will proportionately benefit from any recovery. Finally, DIGI is actively launching new products that enable clients to extract more value from their digital marketing spend, which makes its offering more relevant in this environment.

The shares trade on an EV/EBITDA multiple of 3.2x FY10. Most commentators expect a return to growth in the economy within the next 18 months, in which case the shares offer even better value on an FY11 multiple.

FY09 results

DIGI results are strong both on a reported basis as shown above and on a proforma basis. Proforma numbers reflect 12 months for Cybercom and Gasbox. On a proforma basis, DIGI's gross profit grew by 13% to £11.8m (£9.8m) and EBITDA by 18% to £10.22m (£8.67m). DIGI is organised into three divisions; Online Marketing and Media, Direct Marketing and Data Services.

- **Online Marketing and Media** – delivered the strongest performance of the three divisions. Gross profit grew by 60% to £16.0m and EBITDA by 55% to £4.2m. Budgets for the front end of digital marketing (i.e. website design etc.) do not appear to be as impacted as other areas of marketing spend.
- **Direct Marketing** – this division grew by 14% at the gross profit level to £12.6m, which fed through to EBITDA of £2.7m (£2.4m). This is an outstanding performance given that DIGI reported problems with HSM at the Interims and Gasbox lost the Kaupthing Edge contract shortly after being acquired.

Forecasts and ratios

Year End March	2008A	2009A	2010E
Gross profit (£'m)	33.1	41.6	45.5
EBITDA (£'m)	7.4	9.3	8.8
PBT* (£'m)	6.3	8.0	7.4
Basic EPS (p)	7.3	8.6	8.0
Diluted EPS (p)	5.8	7.2	6.3
% Change	42	19	-8
PER (x) (Diluted eps)	6.9	5.6	6.3

- **Data Services** - this division is at the heart of DIGI's combined product. The division delivered a good performance in H1 09 but struggled in the latter half following cut backs in investment within the financial services industry.

DIGI has proactively managed its cost base in response to the economic environment and as part of its ongoing effort to integrate its businesses and increase efficiency. Over the year, the Company took measures that resulted in a £150,000 of annualised savings. DIGI has continued to demonstrate their ability to convert profits into cash. The group finished the year with net debt of £5.8m. This is ahead of expectations. Net debt peaked in September 2008 at £10.6m following the acquisitions of Cybercom and Gasbox. At the time we had anticipated net debt would fall to £7m by the year end.

Continued innovation

Product innovation is an important component of DIGI's strategy. The Company recognises the fast moving nature of the online space and the need to deliver higher value added services to its clients.

- **eSP** - During the year DIGI launched eSP, an online sales promotion service that uses digital campaigns, viral marketing and customer relationship management to distribute promotional offers including mobile couponing.
- **Digital Brain: Search** - DIGI recently launched Digital Brain: Search, a revolutionary search product which allows marketers to use the information derived from a customer's online journey towards a purchasing decision as opposed to the "last click" and tailor their search criteria and expenditure accordingly. The Company believes that Digital Brain:Search can materially increase its clients' ROI. Initial clients have experienced efficiency improvements of c. 15% after a few weeks.
- **Demograph: DMG** - DIGI recently launched Demograph: DMG, a digital research business providing qualitative and quantitative research, digital pre-testing and concept testing, online brand health benchmarking and research on web usability.

DIGI's broad product platform positions it strongly to compete in this environment and to benefit from an upturn in the market.

FY10

We are leaving our forecasts unchanged. We have budgeted for a PBT of £7.4m for FY2010. This represents a 6% contraction on FY2009. This figure simply reflects a cautious approach to advertising spend over the next twelve months and the impact that the financial services sector has had on Jaywing's results. However, we are encouraged by DIGI's response to the current market which has been to carefully manage its cost base, to continue to invest in new products and to continue to diversify its client base.

Conclusion

DIGI's shares have fallen from 78p in June 2008 to 40p today. This values the Company on a prospective EV/EBITDA of 3.2x. This presents an excellent buying opportunity as DIGI has made considerable progress over the year and is well positioned to benefit from a recovery in the market:

- DIGI's direct marketing division has been strengthened through the addition of Gasbox and now has a more technical offering with Cybercom.
- The financial services sector will recover.
- As the biggest digital marketing agency in the UK, DIGI will benefit proportionately from the recovery.
- DIGI enjoys good cashflows and minimal net debt of £5.8m.
- DIGI is launching new products which will increase its market share.

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