

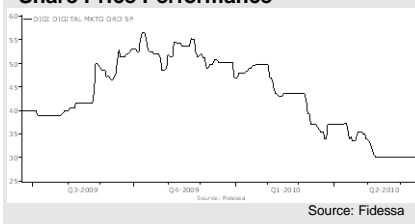
2 JULY 2010

BUY

Price at 1 Jul 2010 (GBP) 28
Price Target (GBP) 60
52-week range (GBP) 28 - 57

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

Share Price Performance



Performance(%)	1m	3m	12m
Absolute	-7	-24	-30

Stock Data

Market cap (£'m)	20.7
Shares outstanding (m)	74.1

Key Indicators

Net debt Mar 2010 (£'m)	7.25
EBITDA margin (%)	18.4

Activities

Digital marketing services

Directors

Stephen Davidson	Chairman
Ben Langdon	CEO
Keith Sadler	CFO

Significant Share Holders

Mayfair Ltd	24.46%
G & H Stevens	10.42%
M Boddy	7.30%
A Gardner	7.30%
C Buddery	5.69%
J Riddell	5.00%
Total	60.2%

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FULL YEAR RESULTS •

Digital Marketing Group

Well positioned to benefit from the recovery

Digital Marketing Group (DIGI), the UK's largest digital marketing agency, has delivered another set of results that are in line with our expectations despite facing the worst economic environment in decades. EBITDA of £8.3m is marginally ahead of Cenkos forecast whilst the PBT of £7.2m (including the £1.7m exceptional gain) was in line. Net debt of £7.25m was slightly ahead of our estimates due to a decrease in trade payables relating to a one-off issue.

FY10 was important year for DIGI in terms of developing its offering in digital marketing and e-commerce which continue to grow at the expense of traditional media and retailing. The addition of Cybercom to the Group has meant that DIGI can now offer clients a complete solution from data collection and analysis through to designing, building and maintaining e-commerce sites. DIGI has many leading consumer brands as clients and its profile will rise further following the integration of 20:20, the recently acquired high profile and award winning agency.

DIGI currently trades on c. 5x FY 2011. It enjoys a strong balance sheet with a FY11 net debt to EBITDA ratio of 0.5x and is well positioned to benefit from the recovery in this growing market. As a result, we believe that DIGI should comfortably command a rating of 10x giving a price target of c. 60p.

Financial results

Performance was not uniform across the DIGI Group. On one end of the spectrum, e-commerce had an outstanding year with a 52% yoy PBT growth. E-commerce now represents 17% of DIGI's business and is expected to reach 25% over the next two years. In contrast, the data division suffered from its substantial exposure to the financial sector, delivering £900k PBT versus £3.5m in FY 2009. We expect the data division to show some recovery in the next 12 months both as a result of management's efforts to diversify into non-financial areas and some improvement in general economic conditions. Our take on DIGI's divisional performance is that the broad range of products and low concentration of revenues has made the Group resilient even in the worst of times. In addition, DIGI enjoys a good level of recurring revenue from its e-commerce business and has a stable client base (60% of Group revenues are derived from existing clients), both of which put DIGI in a strong position within its peer group.

The net debt of £7.25m was ahead of forecasts. This is due to the fall in creditors which is a one-off factor relating to a contractual arrangement that is no longer in place, a rise in debtors and the purchase of 20:20. Working capital is expected to remain relatively constant going forward.

Forecasts and ratios

Year End March	2009A	2010A*	2011E	2012E
Gross profit (£'m)	41.6	35.5	38.5	46.2
EBITDA (£'m)	9.3	8.3	7.1	8.4
PBT (£'m)	8.0	7.2	6.0	7.2
Basic EPS (p)	8.6	7.5	5.8	7.0
Diluted EPS (p)	7.2	6.8	5.1	6.1
% Change		-28	-2	+20
PER (x) (Diluted eps)	3.9	4.1	5.4	4.6

Source: Cenkos securities estimates, company data – NOTE * 2010 includes £1.7m exceptional income

Strategy and Outlook

Integration - DIGI has acquired nine businesses since inception. The nine businesses have now been integrated into two divisions, 20:20 and DMG. The reorganisation has resulted in important benefits including a simplified management which frees up resources for business development, a structure that encourages cross-selling and stronger brand presence. The Group has started to see evidence of the benefits in new business wins.

Focus on recurring, technology and multi-channel business - The growth strategy is now about supplying clients with complete e-commerce solutions that incorporate the provision of technology as well as data analytics and marketing disciplines (telesales, email, web comms, SMS and direct mail). This is a much more sophisticated offering than other marketing agencies can deliver and has the advantage of higher margins, recurring revenue streams and higher barriers to entry. DIGI already has a high profile client list to which it supplies services in this manner including John Lewis / Waitrose, Thomson Reuters, Pentland and Comet.

Financial forecasts

We have issued FY11 and FY12 forecasts that show we are increasingly confident that marketing budgets will soon recover. We estimate that the group will deliver PBT of £6.0m in FY11 and £7.3m in FY12, growth of 9% and 21% respectively. DIGI is also very cash generative and has a good track record of repaying the debt used to acquire. We estimate that net debt will fall to £2.4m by March 2012 (including remaining deferred consideration payments), providing scope to further expand the group or begin paying a dividend.

Valuation

DIGI currently languishes on the same rating as traditional media agencies such as Cello. This is completely unwarranted and provides an excellent opportunity for investors. We believe that DIGI at the least should command a forward earnings multiple of 10x based on 10% and 20% growth and the strength of its cash flows. This is a 100% premium to the current price. BUY.

Financial forecasts

P&L, Cashflow and Balance sheet Forecasts

Year end	2009A	2010A	2011E	2012E
Sales	56,654	48,464	55,500	64,000
Cost of Sales	-15,101	-13,004	-16,987	-21,627
Gross Profit	41,553	35,460	38,513	42,373
Operating costs	-32,265	-28,873	-31,369	-34,000
EBITDA	9,288	6,587	7,144	8,373
Depreciation	-668	-574	-600	-638
EBITA	8,620	6,013	6,544	7,735
Net interest	-607	-532	-515	-500
Cenkos PBT	8,013	5,481	6,029	7,235
Tax @ 28%	-2,244	-1,535	-1,688	-2,026
Cenkos PAT	5,769	3,946	4,341	5,209
Basic Weighted av. shares ('000)	66,851	69,007	74,140	74,140
Diluted Weighted av shares ('000)	80,492	75,944	84,679	84,679
Cenkos EPS Basic	8.63	5.72	5.85	7.03
Cenkos EPS Diluted	7.17	5.20	5.13	6.15
P&L as reported				
Amortisation	-1,863	-1,938	-1,800	-1,800
Operating profit	6,757	4,075	4,744	5,935
Exceptional Items	0	1,709	0	0
Share based payments	-3,036	-2,874	-2,500	-2,500
Net interest	-607	-532	-515	-500
Profit before tax	3,114	2,378	1,729	2,935
Tax	-1,674	-579	-1,688	-2,026
PAT	1,440	1,799	41	909
EPS	1.79	2.37	0.05	1.07
Cashflow				
Operating Profit	6,757	4,075	4,744	5,935
Amortisation	1,863	1,938	1,800	1,800
Depreciation	668	574	600	638
Working Capital	-700	-3,581	-500	-1,500
Other	-222	1,765	0	0
Net operating cashflow	8,366	4,771	6,644	6,873
Opening net cash / debt	184	-5,882	-7,257	-3,816
Net operating cashflow	8,366	4,771	7,144	7,373
Interest (Net)	-433	-480	-515	-500
Tax	-2,209	-2,355	-1,688	-2,026
Capex	-277	-991	-500	-500
Acquisitions	-11,282	-2,232	-500	-2,400
Issue of new shares	-179	0	0	0
New finance leases	-52	-88	0	0
Closing net cash / debt	-5,882	-7,257	-3,816	-2,369

Source: Digital Marketing Group and Cenkos Securities

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