

# KWG Kommunale Wohnen

**Buy** (unchanged) **Target: Euro 7.50** (unchanged)



09 | November | 11

■ <b>Price (Euro)</b>	<b>4.99</b>			
52 weeks range	6.20 / 4.50			
■ <b>Key Data</b>				
Country	Germany			
Industry	Real Estate			
Segment	Open Market (Entry Standard)			
ISIN	DE0005227342			
WKN	522734			
Reuters	BIWG.DE			
Bloomberg	BIW GY			
Internet	www.kwg-ag.de			
Reporting Standard	IFRS			
Fiscal Year	31/12			
Ø Daily Turnover in € (3M)	4,382			
Market Cap (EUR million)	53.9			
Number of shares (million)	10.8			
Free Float	35%			
Free Float MCap (million)	18.9			
CAGR pre tax profits 09-12e	50.8%			
■ <b>Multiples</b>				
	<b>2010</b>	<b>2011e</b>	<b>2012e</b>	<b>2013e</b>
MarketCap/ Sales	2.3	1.8	1.7	1.7
<b>PE-Ratio</b>	<b>5.7</b>	<b>6.1</b>	<b>5.8</b>	<b>5.0</b>
<b>Dynamic PE-Ratio</b>	<b>0.11</b>	<b>0.12</b>	<b>0.11</b>	<b>0.10</b>
Dividend Yield	0.0%	0.0%	3.4%	5.0%
<b>Price-to-Book ratio</b>	<b>69.0%</b>	<b>62.0%</b>	<b>56.0%</b>	<b>50.4%</b>
■ <b>Key Data per Share (Euro)</b>				
	<b>2010</b>	<b>2011e</b>	<b>2012e</b>	<b>2013e</b>
<b>Earnings per Share (EPS)</b>	<b>0.87</b>	<b>0.82</b>	<b>0.86</b>	<b>1.00</b>
Dividends per Share (DPS)	0.00	0.00	0.17	0.25
Book Value per Share (BVPS)	7.23	8.05	8.91	9.91
■ <b>Financial Data (Euro '000)</b>				
	<b>2010</b>	<b>2011e</b>	<b>2012e</b>	<b>2013e</b>
<b>Revenues (rental income)</b>	<b>19,765</b>	<b>23,200</b>	<b>25,752</b>	<b>27,297</b>
Net revaluation result	9,865	9,180	6,500	6,700
Total operating income	29,630	32,380	32,252	33,997
Operating profit (EBITDA)	16,756	17,267	17,206	19,050
<b>Operating Profit (EBIT)</b>	<b>16,584</b>	<b>17,118</b>	<b>17,027</b>	<b>18,831</b>
<b>Pre-tax profit (EBT)</b>	<b>10,743</b>	<b>11,140</b>	<b>11,086</b>	<b>12,781</b>
<b>Net profit (after minorities)</b>	<b>8,583</b>	<b>8,874</b>	<b>9,261</b>	<b>10,831</b>
Adjusted Shareholders' Equity	78,099	86,973	96,234	107,064
<b>RoE after tax</b>	<b>12.0%</b>	<b>10.8%</b>	<b>10.1%</b>	<b>10.7%</b>
■ <b>Financial Calendar</b>				
Annual report 2011		May 2012		
1Q 2012 key data		May 2012		
AGM		June 2012		
■ <b>Main Shareholders</b>				
Group of core shareholders		65%		
■ <b>Analysts</b>				
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## KWG lifted guidance as firm is on track with portfolio refurbishments – Buy confirmed

Yesterday, Hamburg-based residential player KWG released some key figures for 3Q. The published results match our assumptions and reveal that the company is on track. The transformation from investment properties to the core portfolio has shown a good progress. Units within the core portfolio increased from 3,074 in 3Q 2010 to 3,725 by 3Q 2011. In particular the legal and financial incorporation of 442 units located in Delmenhorst (near Bremen) on 1 July makes up a large share. The deal was originally announced in December last year. Total portfolio amounts to 5,419 units by now compared to 4,872 in the previous year.

Vacancy of the core portfolio decreased to 3.9% (9M 2010: 6.1%) and is supposed to reach 3.5% by year-end. That is indeed a remarkable progress and is based on comprehensive refurbishments and extensive work within the portfolio. Investment volume to achieve the progress amounts to some Euro 6m to this day.

Furthermore, net sqm rent for re-lettings increased from Euro 5.05 to Euro 5.30, which is an enhancement of 5% compared to previous year.

All measures mentioned lead to an increase of revenues by 9% to Euro 15.8m (9M 2010: Euro 14.5m). Net income increased from Euro 0.4m to Euro 4.5m. This steep increase was mainly driven by a positive revaluation result which reflects the lower vacancy rates in the core portfolio and the improved cash earnings. The management lifted the guidance for annual net rent from Euro 14m to Euro 15m. The net income is expected to stay at least on last year's level of about Euro 8.6m despite a lower revaluation result as KWG managed to quickly bring up its cash earnings.

Thus, company's operating business runs well, however total acquisitions in this year were below our expectations so far. We expected KWG to lift number of residential units by at least 30% (+1,500) this year and double it (another +3,500 units) until end of 2012. As we have still 8 weeks to go in 2011 we wait for more news flow to come.

**All in all with 3Q we see a good full year result and expect a net income of Euro 8.9m above last year (Euro 8.6m). The net rental income we expect at almost Euro 16m slightly above the new guidance. We stick to our Buy and TP.**

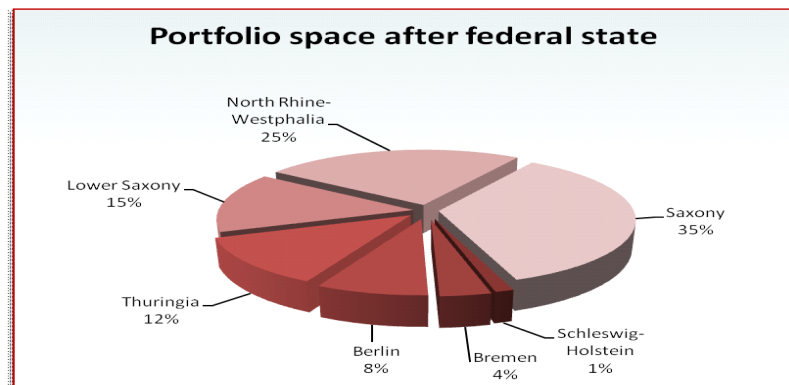
## Investment Case

### KWG Kommunale Wohnen AG

<b>Industry:</b>	Real Estate	<b>Management Board of KWG Kommunale Wohnen</b>
<b>Sub-segment:</b>	Residential RE	Stavros Efremidis (CEO)
<b>Country:</b>	Germany	Torsten P. Hoffmann (CFO)
<b>Headquarter:</b>	Hamburg	
<b>Foundation:</b>	2006	<b>Supervisory Board of KWG Kommunale Wohnen</b>
<b>Employees:</b>	49	Prof. Dr. Peer Witten (Chairman)
		Franz-Josef Gesinn
		Thies-Martin Brandt
<b>IR Contact</b>		Hans-Michael Porwoll
Jan Hutterer		Björn Engholm
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KWG Kommunale Wohnen AG is a long-term oriented owner and manager of German residential properties, with a value-add approach. The company has a portfolio of about 5,400 units with a space of more than 300k sqm in Germany. The investment focus is on neglected portfolios in fundamentally good regions, which offer relatively low prices per square meter (currently the average price per sqm in KWG's portfolio is at Euro 600 ) and low buying multipliers. The sub-portfolios of Saxony (25%) and NRW (24%) represent about 50% of the portfolio. On the upside, the locations invested in show a solid local economy and a stable population, ensuring a constant demand from tenants. Indeed, these circumstances can mostly be found in so-called B- and C- locations where KWG is represented mainly.

In terms of vacancy, KWG regards a moderate or even middle level of vacancies at the time of purchase as an opportunity to increase the cash flow through proactive asset management. Here a major factor of success is to make the properties more attractive, thus increasing tenant satisfaction and reducing fluctuation. Therefore, the acquired portfolios usually show an investment backlog and vacancy to work on. Currently the portfolio can be divided into core and an investment portion, with a vacancy rate of 3.9% and 33.8% respectively.



Bearing in mind, that the transaction prices are usually dependent on rental income multiplied with the market factor, KWG usually does not pay any multiple for vacancy at acquisition, but has the potential upside through reducing vacancy and enhancing value. This is the main trigger of the company. The company generates value in its portfolio by purchasing at attractive prices on the one hand, and then developing and improving the individual properties. Due to its active asset management, KWG was quite successful within its portfolio in the past. Originally, KWG was created from the shell of the former Carthago Biotech AG. In mid 2006, the company has been restructured to change its field of business and renamed as KWG Kommunale Wohnen AG. The company commenced business operations in August 2006 and has meanwhile a team of experienced real estate and financial experts of some 50 people.

Source: Company Data, SRC Research

## SWOT – Analysis

### Strengths

- Management and core investors (in particular Ehlerding family) have a broad and long-term experience in the German real estate arena
- Excellent network and relationships combined with a proven track record will enhance further deal flow with municipalities.
- High yielding residential portfolio in fundamentally solid regions with a proven track record for rental success and new acquisitions like in Dec. 2010
- Strong equity ratio of 37% as of June 2011 and cash still at now approx. €4m
- Very good inner-city locations like for instance in Bochum and Gelsenkirchen

### Weaknesses

- Small market capitalization of the company leads to limited visibility at investors with high investment volume. But market cap already strongly went up in the last year from Euro 40m to now about Euro 55m
- Low trading volume of the stock, and therefore reserve of investors that fear illiquidity.

### Opportunities

- Positive cash earnings property portfolio with further upside potential as KWG for instance already rented > 50 flats from its newest Celle refurbishment activities for more than Euro 6.00 per sqm (from Euro 4.35 before)
- Proven track record makes municipalities confident for further deals with KWG as reliable partner. This gives the chance for off-market transactions.
- The market for deals with municipalities has some future potential, due to the weak general economic conditions and the mostly lower tax income. This should increase the willingness to sell municipal housing companies.
- The recent change into the Entry Standard will lead to higher visibility and broader potential investor base. The next step would be the change into the Prime Standard, which would foster the company visibility and investor base
- KWG started to set up its own property management in 2010. From 1Q 2011 on even more than 90% of all rental units will be managed by KWG itself. This will lead to a reduced cost base (€0.2m p.a.) and also to a better tenant structure and improved rental success.

### Threats

- Funding of acquisitions and refurbishment projects could become problematic if the financial market crisis re-emerges. But there are no significant refinancing needs until the year 2012 and the equity position was just now fostered by the capital increase of approx. 1 million new shares in December 2010.
- Typical risks of purchasing properties (higher costs than originally planned).

## Discounted Cashflow for KWG Kommunale WohnenAG (Entity WACC Method)

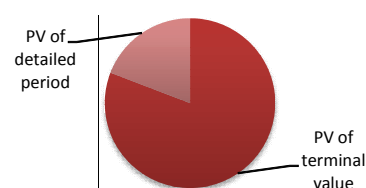
### Assumptions:

Equity ratio longterm	38%	Beta factor	0.902
CoE Cost of Equity	8.0%	Risk-free return	3.0%
CoL Cost of Liability	4.9%	Market risk premium	5.0%
Weighted Average Cost of Capital (WACC)	6.1%		
Years until first pay-out	0.13		
Growth in Terminal Value	1.0%		

' 000 Euro	2011e	2012e	2013e	2014e	2015e	Terminal Value
<b>Rental income from properties</b>	<b>23,100</b>	<b>25,494</b>	<b>27,024</b>	<b>27,565</b>	<b>28,116</b>	<b>28,397</b>
Sales revenues growth	16.9%	10.4%	6.0%	2.0%	2.0%	1.0%
Cash margin on revenues	48.9%	44.2%	45.0%	45.0%	45.0%	45.0%
<b>Operating cash-profit</b> after staff and material expenses and other expenses	<b>11,286</b>	<b>11,267</b>	<b>13,001</b>	<b>12,404</b>	<b>12,652</b>	<b>12,779</b>
Tax rate on operating cash profit	10.0%	11.3%	11.3%	11.3%	11.3%	15.8%
<b>Net operating profit after tax (NOPAT)</b>	<b>10,157</b>	<b>9,994</b>	<b>11,532</b>	<b>11,002</b>	<b>11,222</b>	<b>10,760</b>
+/- Changes in Working Capital	-1,700	-300	-300	-730	-954	-200
+/- Changes in Others UV	-192	-123	-109	-115	-115	-292
<b>Free cash flow</b>	<b>8,265</b>	<b>9,571</b>	<b>11,123</b>	<b>10,157</b>	<b>10,153</b>	<b>10,268</b>
<b>Present value of free cash flows</b>	<b>8,202</b>	<b>8,954</b>	<b>9,809</b>	<b>8,445</b>	<b>7,958</b>	<b>149,390</b>

PV of detailed period	43,367
PV of terminal value	149,390
<b>Sum of free cash flows / Enterprise Value</b>	<b>192,756</b>
+ market value of assets that are not necessary for operating business	0
+ cash / cash equivalents (as of Dec. 2010)	8,736
- interest bearing liabilities / long-term provisions (as of Dec. 2010)	-119,146
<b>Market value of equity</b>	<b>82,346</b>
Number of shares in million	10,805
<b>Fair market value per share in Euro</b>	<b>7.62</b>

### Enterprise value breakdown



Development of value drivers	2011e	2012e	2013e	2014e	2015e	Terminal Value
Sales growth	16.9%	10.4%	6.0%	2.0%	2.0%	1.0%
Cash margin on revenues	48.9%	44.2%	45.0%	45.0%	45.0%	45.0%
Changes in Working Capital quota	-7.4%	-1.2%	-1.1%	-2.6%	-3.4%	-0.7%

### Sensitivity analysis (per share)

		Cash Margin in Terminal Value				
		40.0%	42.5%	45.0%	47.5%	50.0%
Growth in Terminal Value	0.5%	4.86	5.59	6.32	7.05	7.77
	0.5%	4.86	5.59	6.32	7.05	7.77
	1.0%	6.01	6.82	7.62	8.43	9.23
	1.5%	7.42	8.31	9.21	10.11	11.01
	2.0%	9.17	10.18	11.19	12.20	13.21
		WACC				
		5.1%	5.6%	6.1%	6.6%	7.1%
Growth in Terminal Value	0.0%	8.24	6.60	5.23	4.07	3.07
	0.5%	9.89	7.93	6.32	4.97	3.84
	1.0%	11.95	9.55	7.62	6.04	4.73
	1.5%	14.58	11.57	9.21	7.32	5.77
	2.0%	18.07	14.15	11.19	8.88	7.03

		Cash Margin in Terminal Value				
		40.0%	42.5%	45.0%	47.5%	50.0%
WACC	5.1%	9.85	10.90	11.95	13.00	14.05
	5.6%	7.72	8.63	9.55	10.46	11.38
	6.1%	6.01	6.82	7.62	8.43	9.23
	6.6%	4.61	5.33	6.04	6.76	7.47
	7.1%	3.44	4.08	4.73	5.37	6.01

Current share price (Euro) 4.99  
Up/Downside 52.7%

Source: SRC Research

P&L KWG Kommunale Wohnen AG							
31/12 IFRS (Euro '000)	2008	2009	2010	2011e	2012e	2013e	CAGR '09e - '12e
<b>Revenues</b>	<b>13,706</b>	<b>19,759</b>	<b>19,765</b>	<b>23,200</b>	<b>25,752</b>	<b>27,297</b>	<b>9.2%</b>
↳ thereof rental income from properties	13,706	19,759	19,765	23,100	25,494	27,024	
↳ thereof rental income without costs of material	8,711	12,423	13,529	15,908	18,799	19,927	
other oper. income (mainly net revaluation result)	10,406	4,184	9,865	9,180	6,500	6,700	
<b>Total operating income</b>	<b>24,112</b>	<b>23,943</b>	<b>29,630</b>	<b>32,380</b>	<b>32,252</b>	<b>33,997</b>	
Expenses for investment properties	-3,856	-3,653	-2,999	-2,785	-3,400	-3,100	
Cost of material	-4,995	-7,336	-6,236	-7,192	-6,696	-7,097	
Personnel expenses	-1,377	-1,488	-1,773	-2,274	-2,450	-2,650	
Other operating expenses	-8,463	-2,334	-1,866	-2,862	-2,500	-2,100	
<b>Operating profit (EBITDA)</b>	<b>5,421</b>	<b>9,132</b>	<b>16,756</b>	<b>17,267</b>	<b>17,206</b>	<b>19,050</b>	<b>23.5%</b>
<i>EBITDA margin</i>	<i>39.6%</i>	<i>46.2%</i>	<i>84.8%</i>	<i>74.4%</i>	<i>66.8%</i>	<i>69.8%</i>	
Amortization of intangible assets and depreciation of property, plant and equipment and investment properties	-49	-103	-173	-150	-180	-220	
<b>Operating profit (EBIT)</b>	<b>5,373</b>	<b>9,029</b>	<b>16,584</b>	<b>17,118</b>	<b>17,027</b>	<b>18,831</b>	<b>23.5%</b>
<i>EBIT margin</i>	<i>22.3%</i>	<i>37.7%</i>	<i>56.0%</i>	<i>52.9%</i>	<i>52.8%</i>	<i>55.4%</i>	
Income from securities in financial assets	68	0	0	50	50	50	
Other interest and similar income	432	72	26	65	300	450	
Interest and similar expenditure	-4,897	-5,865	-5,861	-6,047	-6,240	-6,500	
Minority interests of other shareholders	-6	-3	-6	-46	-51	-50	
<b>Pre-tax Profit (EBT)</b>	<b>969</b>	<b>3,233</b>	<b>10,743</b>	<b>11,140</b>	<b>11,086</b>	<b>12,781</b>	<b>50.8%</b>
<i>EBT margin</i>	<i>7.1%</i>	<i>16.4%</i>	<i>54.4%</i>	<i>48.0%</i>	<i>43.0%</i>	<i>46.8%</i>	
tax expenses and other expenses	-197	87	-2,159	-2,255	-1,800	-1,915	
<i>Tax rate</i>	<i>20.3%</i>	<i>15.8%</i>	<i>7.5%</i>	<i>20.2%</i>	<i>16.2%</i>	<i>15.0%</i>	
Minorities	0	0	-1	-11	-25	-35	
<b>Net Profit after minorities</b>	<b>773</b>	<b>3,320</b>	<b>8,583</b>	<b>8,874</b>	<b>9,261</b>	<b>10,831</b>	<b>40.8%</b>
<i>Return on sales</i>	<i>5.6%</i>	<i>16.8%</i>	<i>43.4%</i>	<i>38.2%</i>	<i>36.0%</i>	<i>39.7%</i>	
Number of shares (at year-end, '000)	7,490	9,822	10,805	10,805	10,805	10,805	
<b>Earnings per share (Euro)</b>	<b>0.10</b>	<b>0.34</b>	<b>0.87*</b>	<b>0.82</b>	<b>0.86</b>	<b>1.00</b>	
EPS above CoE (8.0%)	-0.41	-0.15	0.29	0.21	0.18	0.25	
Dividends per Share (DPS) in Euro	0.00	0.00	0.00	0.00	0.17	0.25	
<b>Book Value per Share (BVPS) in Euro</b>	<b>7.50</b>	<b>6.59</b>	<b>7.23</b>	<b>8.05</b>	<b>8.91</b>	<b>9.91</b>	
<b>Adjusted Shareholders' Equity</b> without minorities	<b>56,143</b>	<b>64,735</b>	<b>78,099</b>	<b>86,973</b>	<b>96,234</b>	<b>107,064</b>	<b>14.1%</b>
RoE after Tax	1.6%	5.5%	12.0%	10.8%	10.1%	10.7%	
<b>Key ratios &amp; figures</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011e</b>	<b>2012e</b>	<b>2013e</b>	
<b>Growth rates in %</b>							
Revenues	354.0%	44.2%	0.0%	17.4%	11.0%	6.0%	
EBITDA	58.3%	68.5%	83.5%	3.0%	-0.4%	10.7%	
EBIT	58.3%	68.1%	83.7%	3.2%	-0.5%	10.6%	
EBT	-63.3%	233.6%	232.2%	3.7%	-0.5%	15.3%	
Net profit after minorities	-75.0%	329.8%	158.5%	3.4%	4.4%	16.9%	
<b>Margins in %</b>							
Gross							
EBITDA	22.5%	38.1%	56.6%	53.3%	53.4%	56.0%	
EBIT	22.3%	37.7%	56.0%	52.9%	52.8%	55.4%	
EBT	7.1%	16.4%	54.4%	48.0%	43.0%	46.8%	
<b>Expense ratios in %</b>							
Personnel costs quote	5.7%	6.2%	6.0%	7.0%	7.6%	7.8%	
Cost of material to sales	20.7%	30.6%	21.0%	22.2%	20.8%	20.9%	
Depreciation to sales	0.2%	0.4%	0.6%	0.5%	0.6%	0.6%	
Tax rate	20.3%	15.8%	7.5%	20.2%	16.2%	15.0%	
<b>Profitability in %</b>							
Net profit to sales ratio	5.6%	16.8%	43.4%	38.2%	36.0%	39.7%	
Return on equity (ROE) after tax	1.6%	5.5%	12.0%	10.8%	10.1%	10.7%	
<b>Valuation</b>							
PE-ratio	48.38	14.76	5.74	6.08	5.82	4.98	
Price/BVpS	7.50	6.59	7.23	8.05	8.91	9.91	
Dividend yield in %	0.0%	0.0%	0.0%	0.0%	3.4%	5.0%	
EV/ Sales	2.24	2.25	1.82	1.66	1.67	1.59	
EV/ EBITDA	9.94	5.90	3.22	3.12	3.13	2.83	
<b>Data per share</b>							
Number of shares in k	7,490	9,822	10,805	10,805	10,805	10,805	
EpS	0.10	0.34	0.87*	0.82	0.86	1.00	
DpS	0.00	0.00	0.00	0.00	0.17	0.25	
BVpS	7.50	6.59	7.23	8.05	8.91	9.91	

\* EPS with average number of shares of 9.857 million shares

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<b>Rating Chronicle</b>	<b>Date</b>	<b>Rating</b>	<b>Former Price</b>	<b>Former Target</b>
KWG	25. Aug 2011	Buy	5.16 €	7.50 €
KWG	12. Jul 11	Buy	4.61 €	7.50 €
KWG	19. May 11	Buy	5.30 €	7.50 €
KWG	26. Jan 11	Buy	5.45 €	7.50 €
KWG	10. Jan 11	Buy	5.10 €	7.50 €
KWG	5. Nov 10	Buy	4.67 €	7.00 €
KWG	13. Aug 10	Buy	3.70 €	6.50 €
KWG	19. Apr 10	Buy	4.45 €	6.50 €

**Please note:**

The KWG share price mentioned in this report is from closing of 8 November 2011. KWG mandated SRC Research for mentoring the KWG share.

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