

KWG Kommunale Wohnen

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



19 | May | 11

■ **Price (Euro)** **5.30**
52 weeks range 6.20 / 3.60

■ **Key Data**

Segment	Open Market (Entry Standard)
ISIN	DE0005227342
WKN	522734
Reuters	BIWG.DE
Bloomberg	BIW GY
Reporting Standard	IFRS
IPO	2001
Ø Daily Turnover in € (3M)	15,500
Market Cap (EUR million)	57.2
Number of shares (million)	10.8
Free Float	35.0%
Free Float MCap (million)	20.0
CAGR pre tax profits 09-12e	53.7%

■ Multiples	2010	2011e	2012e	2013e
MarketCap/ Sales	2.4	1.9	1.8	1.8
PE-Ratio	6.1	5.9	5.7	5.3
Dynamic PE-Ratio	0.11	0.11	0.11	0.10
Dividend Yield	0.0%	0.0%	4.2%	5.2%
Price-to-Book ratio	73.3%	67.1%	60.0%	53.9%

■ Key Data per Share (Euro)	2010	2011e	2012e	2013e
Earnings per Share (EPS)	0.87	0.90	0.93	1.00
Dividends per Share (DPS)	0.00	0.22	0.28	0.35
Book Value per Share (BVPS)	7.23	7.90	8.83	9.83

■ Financial Data (Euro '000)	2010	2011e	2012e	2013e
Revenues (rental income)	19,765	23,500	26,000	27,500
Net revaluation result	9,865	8,000	6,100	6,500
Total operating income	29,630	31,500	32,100	34,000
Operating profit (EBITDA)	16,756	17,634	17,960	19,120
Operating Profit (EBIT)	16,583	17,484	17,780	18,900
Pre-tax profit (EBT)	10,742	11,173	11,730	12,900
Net profit (after minorities)	8,584	10,016	10,320	11,139
Adjusted Shareholders' Equity	78,099	88,115	98,435	109,574
RoE after tax	12.0%	12.1%	11.1%	10.7%

■ **Financial Calendar**

1Q 2011	May 2011
AGM	28 June 2011
2Q 2011	August 2011
SRC Forum Financials & Real Estate	7 Sept. 2011

■ **Main Shareholders**

Group of core shareholders 65%

■ **Analysts**

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KWG with Euro 8.6m net profit and two-digit RoE in 2010 – Bright outlook for 2011 – Buy!

Today, Hamburg-based residential player KWG published its annual report for 2010. With net profit of Euro 8.6m, corresponding to 87 Cents per share, the company slightly exceeded the prelim figure published in March and clearly more than doubled its 2009 net profit of Euro 3.3m. Revenues remained unchanged at Euro 19.8m while pre-tax result even more than tripled from Euro 3.2 to Euro 10.7m in 2010. The steep hike in profitability was mainly due to the positive revaluation gains that entered the books in 2010 after the comprehensive refurbishments on several portfolio properties, particularly in the Celle- and Gelsenkirchen-based properties of the group.

KWG was able to both increase rents and decrease the vacancy throughout the portfolio. Therefore, the firm's strategy to build up a long-term buy-and-hold portfolio by acquiring objects that lack maintenance and have a high vacancy for cheap and then quickly conduct the refurbishments needed paid out in 2010. Upside is then created by both surging occupancy as well as increased rents as the objects meet significantly better standards after refurbishment.

Another positive aspect of the operational development in 2010 was the continued internalization of all property management services. By 1Q 2011, the company will manage the vast majority of all properties entirely in-house which will further increase profitability in the next years.

After the acquisition of a residential portfolio of more than 500 apartments in December 2010, the company is owner and operator of about 5,400 units as of now. In the course of this transaction, the vendor accepted KWG shares at a price of about 7 Euros as part of his compensation, this shows that the current stock market valuation does not reflect KWG's potential. We see KWG to continue its growth both organically and via acquisitions in 2011 while maintaining the excellent profitability achieved last year.

Within the last months, free-float increased to over 40% and the share has picked up substantially since the second half of 2010. Nevertheless we still see upside in the share as the current market price implies a discount of about 25% to the company's NAV. **When looking at the increased profitability and the refurbishment measures under way, we expect another jump in net profit for 2011. We stick to our Euro 7.50 TP and confirm our Buy rating!**

Company Profile

KWG Kommunale Wohnen AG

Industry:	Real Estate	Management Board of KWG Kommunale Wohnen	
Sub-segment:	Residential RE	Stavros Efremidis (CEO)	
Country:	Germany	Torsten P. Hoffmann (CFO)	
Headquarter:	Hamburg	Supervisory Board of KWG Kommunale Wohnen	
Foundation:	2001	Prof. Dr. Peer Witten (Chairman)	
Employees:	40	Franz-Josef Gesinn	Thies-Martin Brandt
IR Contact		Björn Engholm	Hans-Michael Porwoll
Stavros Efremidis		Patrik Zeigherman	
(Mail: efremidis@kwg-ag.de)			

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 (initial multiplier: 11.6). 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 6.3% 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 40 people.

SWOT – Analysis

Strengths

- Management and core investors (in particular Ehlerding family) have a broad and long-term experience in the German real estate market.
- 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 38.1% as of year-end 2010 and comfortable cash position with c. 9m at the moment.
- 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. But after new capital increase free float slightly went up to 41%.

Opportunities

- Positive cash earnings property portfolio with further upside potential as KWG for instance already let > 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 tight financial conditions of most German municipalities. This should increase the willingness of municipalities to sell their housing companies/portfolios.
- 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 to further enhance the company's visibility and investor base.
- KWG started to set up its own property management in 2010. From 1Q 2011 on, 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.

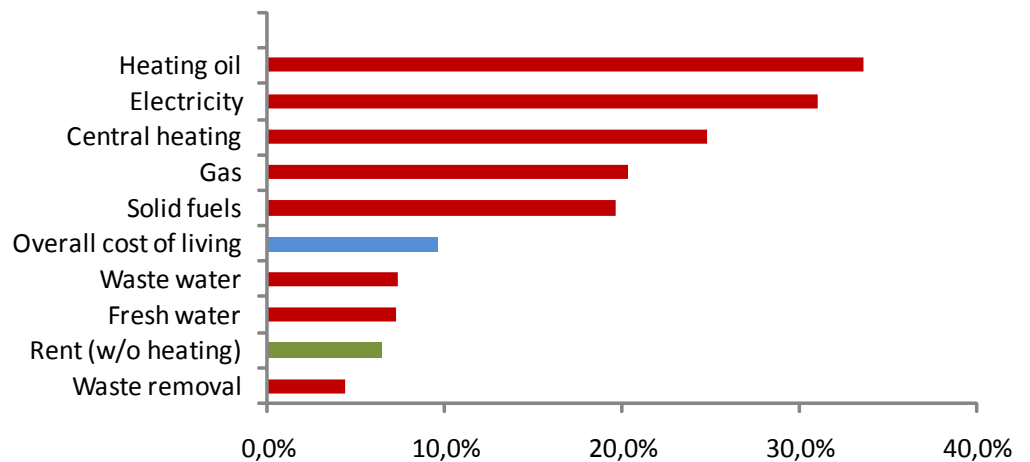
Threats

- 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).

The surging energy costs speak for KWG's strategy

Another trend that benefits KWG's strategy of refurbishments is the surge in heating/energy costs. Below you can see that the so-called "second rent", meaning the sum of additional costs of living increased significantly stronger within the last five years than the rent without heating cost.

Price development of Rents and Energy Prices (2005 - 2010)



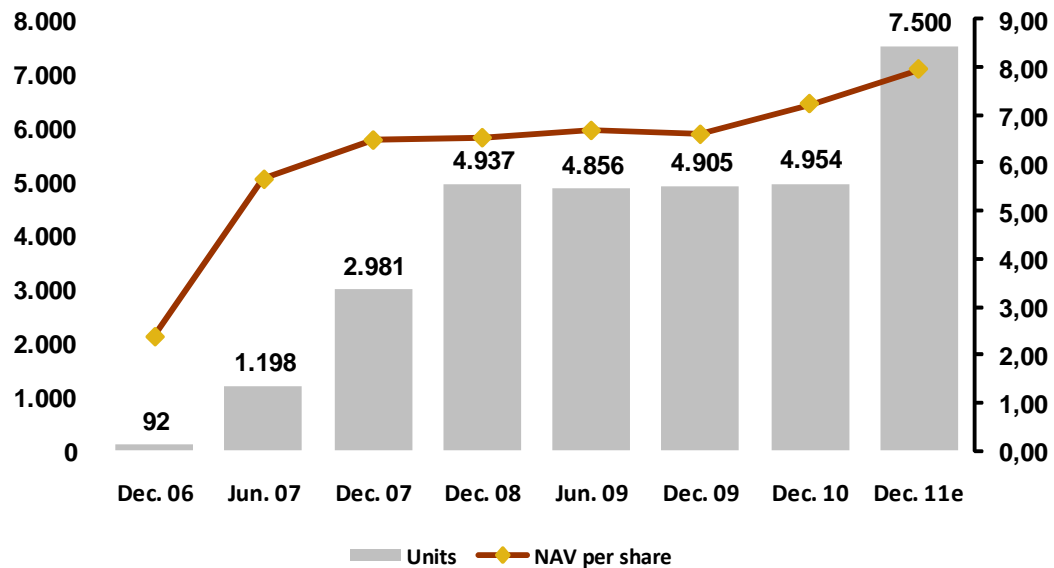
Source: Stat. Bundesamt

Sound liability structure

Moreover, the company benefits from low-interest loans provided by state-owned German KfW-Bank. Depending on the energy-standard met after the refurbishment, there are attractive discounts on the respective loans. At the moment, KWG pays an attractive average interest rate of 4.88% on the Euro 119m of liabilities, translating into an equity ratio of 38.1%. For the year 2011, there are only minor prolongations of loans, but in 2012 the company has the option to either refinance a loan of about Euro 30m or to prolong it with the existing conditions. The next major prolongations will be in 2015 with a volume of about Euro 20m. On average, KWG has a fixed interest rate for the next 4.3 years on their liabilities.

KWG Kommunale Wohnen AG 31/12 IFRS (Euro '000)	2008	2009	2010	2011e	2012e	2013e	CAGR '09e - '12e
Revenues	13,706	19,759	19,765	23,500	26,000	27,500	9.6%
↳ thereof rental income residential	13,706	19,759	19,765	23,320	24,968	24,969	
other oper. income (mainly net revaluation result)	10,406	4,184	9,865	8,000	6,100	6,500	
Total operating income	24,112	23,943	29,630	31,500	32,100	34,000	
Expenses for investment properties	-3,856	-3,653	-2,999	-3,700	-3,800	-3,900	
Cost of material	-4,995	-7,336	-6,236	-5,987	-6,340	-6,780	
Personnel expenses	-1,377	-1,488	-1,773	-1,879	-2,000	-2,100	
Other operating expenses	-8,463	-2,334	-1,866	-2,300	-2,000	-2,100	
Operating profit (EBITDA)	5,421	9,132	16,756	17,634	17,960	19,120	25.3%
Amortization of intangible assets and depreciation of property, plant and equipment and investment properties	-49	-103	-173	-150	-180	-220	
Operating profit (EBIT)	5,372	9,029	16,583	17,484	17,780	18,900	25.3%
<i>EBIT margin</i>	22.3%	37.7%	56.0%	55.5%	55.4%	55.6%	
Income from securities in financial assets	68	0	0	50	50	50	
Other interest and similar income	432	72	26	320	450	600	
Interest and similar expenditure	-4,897	-5,865	-5,861	-6,634	-6,500	-6,600	
Minority interests of other shareholders	-6	-3	-6	-47	-50	-50	
Pre-tax Profit (EBT)	969	3,233	10,742	11,173	11,730	12,900	53.7%
tax expenses and other expenses	-197	87	-2,158	-1,117	-1,325	-1,677	
<i>Tax rate</i>	20.3%	15.8%	7.5%	10.0%	11.3%	13.0%	
Minorities	0	0	0	-40	-85	-84	
Net Profit after minorities	772	3,320	8,584	10,016	10,320	11,139	45.9%
Number of shares (at year-end)	7,490	9,822	10,800	11,150	11,150	11,150	
Earnings per share (Euro)	0.10	0.34	0.87	0.90	0.93	1.00	
Dividends per Share (DPS) in Euro	0.00	0.00	0.00	0.22	0.28	0.35	
Book Value per Share (BVPS) in Euro	7.50	6.59	7.23	7.90	8.83	9.83	
Adjusted Shareholders' Equity							
without minorities	56,143	64,735	78,099	88,115	98,435	109,574	15.0%
RoE after Tax	1.6%	5.5%	12.0%	12.1%	11.1%	10.7%	
Key ratios & figures	2008	2009	2010	2011e	2012e	2013e	
Growth rates in %							
Revenues	354.0%	44.2%	0.0%	18.9%	10.6%	5.8%	
EBITDA	58.3%	68.5%	83.5%	5.2%	1.8%	6.5%	
EBIT	58.3%	68.1%	83.7%	5.4%	1.7%	6.3%	
EBT	-63.3%	233.6%	232.3%	4.0%	5.0%	10.0%	
Net profit after minorities	-75.1%	329.9%	158.6%	16.7%	3.0%	7.9%	
Margins in %							
EBITDA	22.5%	38.1%	56.6%	56.0%	56.0%	56.2%	
EBIT	22.3%	37.7%	56.0%	55.5%	55.4%	55.6%	
EBT	7.1%	16.4%	54.3%	47.5%	45.1%	46.9%	
Expense ratios in %							
Personnel costs quote	5.7%	6.2%	6.0%	6.0%	6.2%	6.2%	
Cost of material to sales	20.7%	30.6%	21.0%	19.0%	19.8%	19.9%	
Depreciation to sales	0.2%	0.4%	0.6%	0.5%	0.6%	0.6%	
Tax rate	20.3%	15.8%	7.5%	10.0%	11.3%	13.0%	
Profitability in %							
net profit to sales ratio	5.6%	16.8%	43.4%	42.6%	39.7%	40.5%	
return on equity (ROE) after tax	1.6%	5.5%	12.0%	12.1%	11.1%	10.7%	
Valuation							
PE-ratio	51.41	15.68	6.09	5.90	5.73	5.31	
Price/BVpS	7.50	6.59	7.23	7.90	8.83	9.83	
Dividend yield in %	0.0%	0.0%	0.0%	4.2%	5.2%	6.6%	
EV/ Sales	2.37	2.39	1.93	1.82	1.78	1.68	
EV/ EBITDA	10.56	6.27	3.42	3.25	3.19	2.99	

Portfolio Overview



Source: KWG reports, SRC estimates

KWG has a portfolio of about 312,000 sqm as of 31 March 2011 with an average vacancy of only 6.3% on their core-portfolio. Not included herein are the properties currently undergoing refurbishment as they are not on the market within that period of time.

With 5,357 residential units and only some 44 retail units, Kommunale Wohnen has a clear focus on residential portfolios in northern Germany. Over the past years, the group was able to create a solid track record regarding portfolio deals with German municipalities which is a significant competitive advantage in the sourcing process of new deals at the moment.

As the vast majority of German municipalities have serious financial issues, more and more public real estate holdings will be either closed or entirely sold to private investors. Therefore, having the right network and a proven track record in successfully conducting refurbishments is quintessential in order to become the partner of choice here.

Location	Units	sqm	Market Value [Euro m]	% of Portfolio
Berlin	414	24,232	18.5	9%
Bremen	590	32,291	22.6	11%
Lower Saxony	737	47,656	37.7	18%
North Rhine-Westphalia	1,049	69,378	50.8	24%
Saxony	1,854	100,308	52.2	25%
Schleswig-Holstein	89	3,780	2.0	1%
Thuringia	668	34,478	25.2	12%
Total	5,401	312,123	209.0	100%

Source: Company presentation as of 31 March 2011

KWG plans to double its portfolio volume in 2011

According to the company's management, there will be a significant expansion of the portfolio within this year. Potential properties are all situated in the northern part of Germany, KWG's preferred region, e.g. in Berlin, Erfurt and Braunschweig. If all potential deals are closed within the year, the group's portfolio will grow to about 7,500 residential units, representing more than 500,000 sqm of lettable area.

Potential Pipeline for acquisitions

Location	Units	sqm	Market Value [Euro m]
Berlin I	330	22,000	17.0
Berlin II	530	24,000	23.0
Braunschweig	2,000	131,000	105.0
Erfurt	720	39,000	36.0
Total	3,580	216,000	181.0

Source: Company presentation as of 31 March 2011

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Rating Chronicle	Date	rating	former share price	former target
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 19 May 2011.
KWG mandated SRC Research for mentoring the KWG share.

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