

KWG Kommunale Wohnen

Buy (unchanged) **Target: Euro 8.00** (old: Euro 7.50)



Der Spezialist für Finanzaktien

07 | March | 12

Price (Euro)	5.18			
52 weeks range	5.70 / 4.50			
Key Data				
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)	63.7			
Number of shares (million)	12.3			
Free Float	35%			
Free Float MCap (million)	22.3			
CAGR pre tax profits 09-12e	78.5%			
Multiples				
	2011e	2012e	2013e	2014e
MarketCap/ Sales	2.0	1.6	1.7	1.5
PE-Ratio	6.4	3.9	4.7	3.2
Dynamic PE-Ratio	0.08	0.05	0.06	0.04
Dividend Yield	0.0%	2.9%	3.9%	4.8%
Price-to-Book ratio	64.4%	57.0%	53.9%	46.1%
Key Data per Share (Euro)				
	2011e	2012e	2013e	2014e
Earnings per Share (EPS)	0.81	1.33	1.10	1.61
Dividends per Share (DPS)	0.00	0.15	0.20	0.25
Book Value per Share (BVPS)	8.04	9.08	9.61	11.23
Financial Data (Euro '000)				
	2011e	2012e	2013e	2014e
Revenues (rental income)	21,584	26,980	29,678	34,130
Other income (incl. revaluations)	10,580	13,500	7,000	9,000
Total operating income	32,164	40,480	36,678	43,130
Operating profit (EBITDA)	18,191	25,130	22,278	28,780
Operating Profit (EBIT)	18,013	24,951	22,059	28,521
Pre-tax profit (EBT)	11,444	18,377	15,504	21,921
Net profit (after minorities)	8,793	16,347	13,554	19,846
Adjusted Shareholders' Equity	86,892	111,739	118,292	138,138
RoE after tax	10.7%	16.5%	11.8%	15.5%
Financial Calendar				
Annual Report 2011			30 April 2012	
1Q 2012 Key Data			7 May 2012	
AGM			31 July 2012	
SRC Forum Financials & Real Estate			12 Sept 2012	
Main Shareholders				
Group of core shareholders			65%	
Analysts				
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KWG acquires Barmer Wohnungsbau – very value accretive deal which opens the way for more deals – target up to 8.00 Euros

Yesterday, KWG reported the acquisition of a 77.3% majority stake in Barmer Wohnungsbau AG. The Barmer portfolio comprises a total of 1,400 flats with 90,600 sqm in Wuppertal, a medium-sized city with 350,000 inhabitants, located in the heart of North-Rhine-Westphalia. The purchase price was not disclosed but we estimate only 11x of 4.8m net cold rent (ca. 41m for 77% stake). KWG was allowed to pay the lion's share of the equity stake in this deal by issuing 1.5m new KWG shares from authorised capital at a price of 7.54 Euros very near to the Euro 8.00 NAV. With this acquisition, KWG more than doubles the number of managed units within the NRW region and significantly lifts the total portfolio by 26% to 6,800 units. With Barmer there is tremendous synergy potential for KWG. Free cash flows will grow quickly with the fully refurbished and fully let Wuppertal units.

Net Cold Rents amounted to Euro 4m in 4Q on a KWG stand-alone basis, which served as the basis for our 2012 forecast before this acquisition. As we stated in our update from last week, we already expected the firm to expand its portfolio within the first half of 2012. However, the volume of the BWAG acquisition exceeded our forecast. As a result, we lift now our cash flow and earnings projections for the next years. Using our DCF, we have a higher fair value of Euro 9.01 per share. In addition, NNNNAV after the Barmer deal will step up by 1 Euro to about 9 Euros per share. FFO from Barmer is an additional Euro 1.1m p.a. Average vacancy of KWG's core portfolio was down to only 2.7%. With the new portfolio (< 1% vacancy) this figure will decline even more. Moreover, BWAG has very little financial debt of only Euro 13m which translates into a very low LTV of 20%. Due to this excellent BWAG balance, KWG will be able to lift the leverage and thereby free up capital for new deals. Assuming a target LTV of 60% this would translate to at least Euro 20m. These funds will allow to boost the growth by another 2,500 to 3,000 flats near the 10,000 target. **The deal was value accretive at a very good price and thru the strong BWAG balance it opens the way to quickly double portfolio. We strongly confirm our Buy and lift TP to € 8.00.**

Strengths

SWOT – Analysis

- Management and core investors (in particular the 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. The Barmer deal confirmed the good network to negotiate with a number of shareholders there.
- High yielding residential portfolio in fundamentally solid regions with a proven track record for rental success and attractive acquisitions.
- Strong equity ratio of more than 35% as of year-end 2011e and cash still at least € 3.5m. With the strong Barmer balance (only 20% LTV on IFRS values) there is now even much more financial flexibility to bring up portfolio size
- Very good inner-city locations like for instance in Bochum and Gelsenkirchen.
- The new Barmer deal shows the ability to buy at reasonable prices and to pay with own shares near to NAV values to avoid dilution of existing shareholders

Weaknesses

- Small market cap of the company leads to lower visibility at investors with high investment volume. But market cap already increased with a rising portfolio size and a higher number of shares of now 12.3m shares
- Relatively low liquidity in the KWG share due to market cap and free float.

Opportunities

- Rising cash earnings with further upside as KWG achieved significant increases in rents via comprehensive refurbishment measures in 2011
- 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 financial conditions of most municipalities. This should increase the willingness to sell municipal housing companies.
- The step from Entry Standard to the Prime Standard would foster the company's visibility and attract a broader investor's base
- KWG started its own successful property management in 2010. From 1Q 2011 on, more than 90% of all rental units are managed by KWG itself. This leads to a reduced cost base (€ 0.2m p.a.) and a better tenant structure.

Threats

- Funding of acquisitions and refurbishment projects could become problematic in a rebound of the financial market crisis. But after the Barmer deal there is a reasonable financial cushion to expand portfolio by another 2,500 units.
- Typical risks of property deals such as refurbishment costs getting out of hand. The BWAG portfolio on the other hand, is already fully refurbished.

Transaction Highlights

- BWAG has a property portfolio of 1,391 residential units located in Wuppertal (North-Rhine-Westphalia).
- Deal will be finalized within 2Q 2012. Most significant transaction in KWG's corporate history.
- KWG acquired 77.3% of the company and is currently seeking to further increase its stake. Part of the undisclosed transaction price will be paid by newly issued shares worth Euro 11.3m.
- NNNAV will rise by about 1.00 Euro per share after the transaction.
- Acquisition will increase annual Net Cold Rents by about Euro 4.8m.
- KWG expects valuation of Euro 730 to 750 per sqm for the BWAG portfolio in the medium term.
- High-quality portfolio: BWAG invested in comprehensive refurbishments of its portfolio properties within the last years (2010: 29.43 Euros/sqm).
- Rents within the portfolio are 20% below market prices according to the management of KWG. Therefore we expect significant upside in average rents over the next 2-3 years, also resulting in revaluation gains starting in 2014.
- Due to the higher cash flow, we lifted our projections regarding Net Cold Rent, Book Value and Net Profit for the next years.
- BWAG has a very low LTV of currently about 20%, allowing for higher leverage and thus a comfortable cash situation which suits KWG's plans to further expand the portfolio.
- BWAG's financial liabilities of about Euro 13.3m have an interest rate of only 1.5%, further reducing the average cost of financial liabilities for the KWG group.
- Furthermore, KWG is expecting to receive a dividend of approximately Euro 0.5m for the fiscal year 2011 from BWAG.
- We project a positive "lucky buy" effect for KWG resulting from the IFRS valuation of the BWAG portfolio in the range of Euro 6m to 8m for 2012.

	KWG AG (2011)	BWAG (2010)	Pro-forma Entity
No. of units	5,419	1,391	6,765
sqm	311,250	90,600	401,850
Average rent	4.81	4.07	4.64
Vacancy	2.7%	1.0%	2.3%
Revenues [Euro m]	21.5*	6.3**	27.8

Source: Company Presentation as of 6 March 2012

* prelim figures as of 31 Dec 2011

** as of 31 Dec 2010

**Discounted Cashflow for KWG Kommunale Wohnen AG
(Entity WACC Method)**

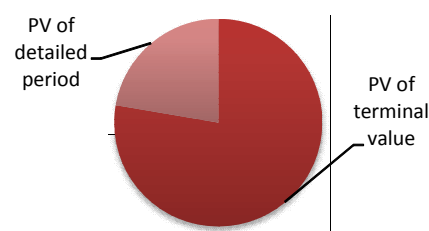
Assumptions:

Equity ratio longterm	38%	Beta factor	0.95
CoE Cost of Equity	8.0%	Risk-free return	1.8%
CoL Cost of Liability	4.2%	Market risk premium	6.5%
Weighted Average Cost of Capital (WACC)	5.6%		
Years until first pay-out	0.81		
Growth in Terminal Value	1.0%		

Euro '000	2012e	2013e	2014e	2015e	2016e	Terminal Value
Rental income from properties	26,500	29,381	33,788	35,478	36,897	35,833
Sales revenues growth	22.8%	10.9%	15.0%	5.0%	4.0%	1.0%
Cash margin on revenues	70.0%	45.0%	45.0%	45.0%	45.0%	45.0%
Operating cash-profit after staff and material expenses and other expenses	18,560	15,724	15,205	15,965	16,604	16,125
Tax rate on operating cash profit	13.0%	13.0%	13.0%	13.0%	13.0%	15.8%
Net operating profit after tax (NOPAT)	16,147	13,680	13,228	13,890	14,445	13,577
+/- Changes in Working Capital	-300	-300	-350	-500	-700	-250
+/- Changes in Others UV	-123	-109	-115	-115	-119	-300
Free cash flow	15,724	13,271	12,763	13,275	13,626	13,027
Present value of free cash flows	15,047	12,026	10,953	10,788	10,487	206,550

PV of terminal value	206,550
PV of detailed period	59,302
Sum of free cash flows / Enterprise Value	265,852
+ market value of assets that are not necessary for operating business	0
+ cash / cash equivalents (as of Dec. 2011e)	5,000
- interest bearing liabilities / long-term provisions (as of Dec. 2011e including BWAG)	-160,000
Market value of equity	110,852
Number of shares in million	12,305
Fair market value per share in Euro	9.01

Enterprise value breakdown



Development of value drivers	2012e	2013e	2014e	2015e	2016e	Terminal Value
Sales growth	22.8%	10.9%	15.0%	5.0%	4.0%	1.0%
Cash margin on revenues	70.0%	45.0%	45.0%	45.0%	45.0%	45.0%
Changes in Working Capital quota	-1.1%	-1.0%	-1.0%	-1.4%	-1.9%	-0.7%

Current share price (Euro) 5.18
Up/Downside 73.9%

P&L KWG Kommunale Wohnen AG

31/12 IFRS (Euro '000)	2008	2009	2010	2011e	2012e	2013e	2014e	CAGR '09e - '12e
Revenues	13,706	19,759	19,765	21,584	26,980	29,678	34,130	10.9%
↳ thereof rental income from properties	13,706	19,759	19,765	21,562	26,500	29,381	33,788	
↳ thereof rental income without costs of material	8,711	12,423	13,529	14,930	19,600	22,881	27,388	
other oper. income (mainly net revaluation result)	10,406	4,184	9,865	10,580	13,500	7,000	9,000	
Total operating income	24,112	23,943	29,630	32,164	40,480	36,678	43,130	
Expenses for investment properties	-3,856	-3,653	-2,999	-2,941	-3,500	-3,300	-3,200	
Cost of material	-4,995	-7,336	-6,236	-6,632	-6,900	-6,500	-6,400	
Personnel expenses	-1,377	-1,488	-1,773	-2,160	-2,450	-2,500	-2,650	
Other operating expenses	-8,463	-2,334	-1,866	-2,240	-2,500	-2,100	-2,100	
Operating profit (EBITDA)	5,421	9,132	16,756	18,191	25,130	22,278	28,780	40.1%
<i>EBITDA margin</i>	<i>39.6%</i>	<i>46.2%</i>	<i>84.8%</i>	<i>84.3%</i>	<i>93.1%</i>	<i>75.1%</i>	<i>84.3%</i>	
Amortization of intangible assets and depreciation of property, plant and equipment and investment properties	-49	-103	-173	-179	-180	-220	-260	
Operating profit (EBIT)	5,373	9,029	16,584	18,013	24,951	22,059	28,521	40.3%
<i>EBIT margin</i>	<i>22.3%</i>	<i>37.7%</i>	<i>56.0%</i>	<i>56.0%</i>	<i>61.6%</i>	<i>60.1%</i>	<i>66.1%</i>	
Income from securities in financial assets	68	0	0	50	50	50	50	
Other interest and similar income	432	72	26	80	300	450	600	
Interest and similar expenditure	-4,897	-5,865	-5,861	-6,656	-6,871	-7,005	-7,250	
Minority interests of other shareholders	-6	-3	-6	-43	-53	-50	0	
Pre-tax Profit (EBT)	969	3,233	10,743	11,444	18,377	15,504	21,921	78.5%
<i>EBT margin</i>	<i>7.1%</i>	<i>16.4%</i>	<i>54.4%</i>	<i>53.0%</i>	<i>68.1%</i>	<i>52.2%</i>	<i>64.2%</i>	
tax expenses and other expenses	-197	87	-2,159	-2,640	-2,005	-1,915	-2,030	
<i>Tax rate</i>	<i>20.3%</i>	<i>15.8%</i>	<i>7.5%</i>	<i>23.1%</i>	<i>10.9%</i>	<i>12.4%</i>	<i>9.3%</i>	
Minorities	0	0	-1	-11	-25	-35	-45	
Net Profit after minorities	773	3,320	8,583	8,793	16,347	13,554	19,846	70.1%
<i>Return on sales</i>	<i>5.6%</i>	<i>16.8%</i>	<i>43.4%</i>	<i>40.7%</i>	<i>60.6%</i>	<i>45.7%</i>	<i>58.1%</i>	
Number of shares (at year-end, '000)	7,490	9,822	10,805	10,805	12,305	12,305	12,305	
Earnings per share (Euro)	0.10	0.34	0.87*	0.81	1.33	1.10	1.61	
EPS above CoE (8.0%)	-0.41	-0.15	0.29	0.20	0.68	0.35	0.78	
Dividends per Share (DPS) in Euro	0.00	0.00	0.00	0.00	0.15	0.20	0.25	
Book Value per Share (BVPS) in Euro	7.50	6.59	7.23	8.04	9.08	9.61	11.23	
Adjusted Shareholders' Equity without minorities	56,143	64,735	78,099	86,892	111,739	118,292	138,138	20.0%
RoE after Tax	1.6%	5.5%	12.0%	10.7%	16.5%	11.8%	15.5%	
Key ratios & figures	2008	2009	2010	2011e	2012e	2013e	2014e	
Growth rates in %								
Revenues	354.0%	44.2%	0.0%	9.2%	25.0%	10.0%	15.0%	
EBITDA	58.3%	68.5%	83.5%	8.6%	38.1%	-11.3%	29.2%	
EBIT	58.3%	68.1%	83.7%	8.6%	38.5%	-11.6%	29.3%	
EBT	-63.3%	233.6%	232.2%	6.5%	60.6%	-15.6%	41.4%	
Net profit after minorities	-75.0%	329.8%	158.5%	2.4%	85.9%	-17.1%	46.4%	
Margins in %								
Gross								
EBITDA	22.5%	38.1%	56.6%	56.6%	62.1%	60.7%	66.7%	
EBIT	22.3%	37.7%	56.0%	56.0%	61.6%	60.1%	66.1%	
EBT	7.1%	16.4%	54.4%	53.0%	68.1%	52.2%	64.2%	
Expense ratios in %								
Personnel costs quote	5.7%	6.2%	6.0%	6.7%	6.1%	6.8%	6.1%	
Cost of material to sales	20.7%	30.6%	21.0%	20.6%	17.0%	17.7%	14.8%	
Depreciation to sales	0.2%	0.4%	0.6%	0.6%	0.4%	0.6%	0.6%	
Tax rate	20.3%	15.8%	7.5%	23.1%	10.9%	12.4%	9.3%	
Profitability in %								
Net profit to sales ratio	5.6%	16.8%	43.4%	40.7%	60.6%	45.7%	58.1%	
Return on equity (ROE) after tax	1.6%	5.5%	12.0%	10.7%	16.5%	11.8%	15.5%	
Valuation								
PE-ratio	50.22	15.32	5.95	6.37	3.90	4.70	3.21	
Price/BVpS	7.50	6.59	7.23	8.04	9.08	9.61	11.23	
Dividend yield in %	0.0%	0.0%	0.0%	0.0%	2.9%	3.9%	4.8%	
EV/ Sales	2.64	2.66	2.15	1.98	1.57	1.74	1.48	
EV/ EBITDA	11.75	6.98	3.80	3.50	2.54	2.86	2.21	
Data per share								
Number of shares in k	7,490	9,822	10,805	10,805	12,305	12,305	12,305	
EpS	0.10	0.34	0.87*	0.81	1.33	1.10	1.61	
DpS	0.00	0.00	0.00	0.00	0.15	0.20	0.25	
BVpS	7.50	6.59	7.23	8.04	9.08	9.61	11.23	

* EPS with average number of shares of 9.857 million shares

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Rating Chronicle	Date	Rating	Former Price	Former Target
KWG	1. Mar 2012	Buy	5.05 €	7.50 €
KWG	9. Nov 2011	Buy	4.99 €	7.50 €
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 6 March 2012.
KWG mandated SRC Research for mentoring the KWG share.

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