WOOD & COMPANY

Arena Hospitality Group

Buy

Initiation of coverage

Price: HRK 236
Price target: HRK 320

Vacation – all I ever wanted

We initiate coverage of Arena Hospitality Group with a BUY recommendation and a price target (PT) of HRK 320/share. Thanks to the proceeds of the c.EUR 100m capital increase completed in mid-2017, we believe Arena is well-positioned to weather the hit to European tourism from COVID-19. Additionally, Arena is well-positioned geographically to capture a larger share of the summer tourism spending, we believe. Compared to Italy or Spain, the COVID-19 cases in Croatia have been low and the large majority of guests arrive by personal car, a relative advantage over taking a plane to Greece or Turkey. In our base-case assumptions, where occupancy at Arena's resorts falls by half in a truncated summer season, we expect the company to post a 2020E loss on the EBITDA line. Nonetheless, it has the cash to continue investing in refurbishments and new room growth, which should boost its average daily rates (ADRs) materially, when we assume that the business fully recovers for the 2022E season.

Our base case for 2020E is a partial summer season. Arena will generate losses in 2020E, we believe; however, thanks to the proceeds from the 2017 capital increase, the business should emerge from the next couple of years in good health, while continuing to invest. Our base case is that all of Arena's properties remain closed until end-June, and that its occupancy rates for 3Q20E and 4Q20E are half of the 2018-19 levels. We also assume a 15% haircut on ADRs in 2H20E to capture the possible risk of discounting by peers. On the costs side, we expect wages to drop by c.25% on a fall of c.57% in revenues. Overall, we expect the total opex to fall by c.29%.

For 2021E, we conservatively pencil in group room occupancy at 85-90% of the 2019 levels; from 2022E-onwards, back to pre-COVID-19 levels. On these assumptions, we forecast 2021E EBITDA of HRK 183m and net profit of HRK 37m – still c.20% and c.63% below the 2019 levels, adjusted for the investment tax incentives. For 2022E, we assume a fully normalised environment, with EBITDA of HRK 286m and net profit of HRK 129m. This assumes a group occupancy rate of 55.6% (a 46bps improvement over the 2019 level) and an ADR some 12% higher than in 2019, which reflects both the repricing of rates at the refurbished properties and inflation-like growth for the remainder.

Valuations: at a 2021E EV/EBITDA of 11.1x, Arena trades in line with our peer group (and similar to its historic trading range); and, at 6.8x in 2022E, at a 21% discount. On our 2021E PER, Arena still trades at a significant 46% premium, but at a 2022E PER of 9.4x, it trades at a 32% discount. On our PT of HRK 320/share, Arena would at 2021-22E EV/EBITDAs of 13.5x and 8.3x. On this basis, the stock would still trade at significant premiums on our 2021E numbers, but in line with its peers on our 2022E estimates (7% and 3% discounts on PER and EV/EBITDA, respectively).

Risks: the main risk for our estimates is a permanent change in European business travel and holiday habits as a result of social distancing.

Expected events

1Q20 results	28 April
AGM	29 April
2Q20 results	27 July
3Q20 results	28 October

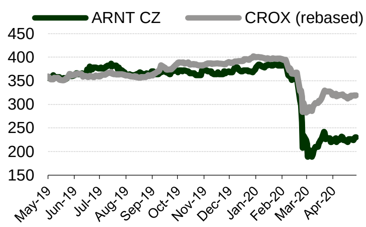
Key data

Market Cap	EUR 160m
Free float	47.1%
3M ADTV	EUR 85.4k
Shares outstanding	5.119m
Major Shareholder	PPHE (52.9%)
Reuters Code	AREN.ZA
Bloomberg Code	ARNT CZ
CROBEX Index	970

Price performance

52-w range	HRK 388-189
52-w performance	-33.7%
Relative performance	-22.7%

Arena 12M share price performance



Year	Sales HRK m	EBITDA HRK m	Net profit HRK m	EPS HRK	EPS %yoy	DPS HRK	P/E (x)	EV/EBITDA (x)	P/CE (x)	Div yield %
2017	717	212.9	88.1	20.99	n.m.	0.00	22.8	10.0	9.3	0.0%
2018	758	214.7	88.7	17.29	-18%	5.00	23.1	10.2	9.7	1.3%
2019	778	229.5	149.0	29.10	68%	0.00	12.2	10.0	7.9	0.0%
2020E	325	-56.5	-182.2	-35.59	n.m.	0.00	n.m.	n.m.	n.m.	0.0%
2021E	774	182.6	37.3	7.28	n.m.	5.50	32.4	11.1	6.7	2.3%
2022E	914	286.1	129.1	25.23	247%	6.00	9.4	6.8	4.2	2.5%

EQUITY RESEARCH

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Closing Prices as of 15 May 2020

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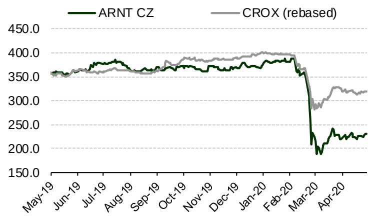
Company snapshot – BUY, PT HRK 320

Arena Hospitality Group

BUY

Bloomberg ticker	**ARNT CZ**
Closing price (HRK)	**236**
Price target (HRK)	**320**
Upside to PT	**35.6%**
Shares outstanding (m)	**5.1**
MCAP (EUR m)	**160**
Free float	**47.1%**
ADTV (EUR '000)	**85.4**
52 Week Range (HRK)	**388-189**



COMPANY DESCRIPTION

Arena is a traditional summer resort operator, with assets based on the southern tip of the Istrian peninsula, and it also operates year-round hotels in Germany and Budapest, since the end of 2016, which were acquired from its majority owner, PPHE Hotel Group (PPH LN). In Croatia, Arena operates c.8.7k rooms, of which c.35% are hotels and self-catering apartments (but c.75% of its revenues), and c.65% campsites (c.25% of its revenues). Most properties are 4* and 3*, and the segment is mid-way through an investment programme of refurbishments, aimed at increasing the average daily room rates (ADRs). Arena's year-round hotels account for roughly one-third of its revenues and c.30% of the group's EBITDA; nevertheless, the business remains highly seasonal, with the key 3Q summer season typically generating around 100% of the total annual EBITDAR and 170% of the net profit. In the near term, Arena is well-positioned geographically to capture a larger share of summer tourism spending, we believe. Croatian COVID-19 infections have been limited, so it may be seen as a safer destination than Italy or Spain. Moreover, tourists to Croatia arrive overwhelmingly by personal car, not by plane or bus. This as an advantage over the more remote seaside destinations in Greece or Turkey, the country's major competitors to the southeast.

RATIOS

PER SHARE RATIOS	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
EPS	21.0	17.3	29.1	-35.6	7.3	25.2
CEPS	51.4	41.0	45.2	-11.2	35.5	55.8
BVPS	373.2	321.4	343.1	307.5	309.3	328.5
DPS	0.0	5.0	0.0	0.0	5.5	6.0

FINANCIAL RATIOS	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
EBITDA margin	29.7%	28.3%	29.5%	n.m.	23.6%	31.3%
EBIT margin	21.0%	19.2%	16.7%	n.m.	9.1%	18.8%
Net margin	12.3%	11.7%	19.1%	n.m.	4.8%	14.1%
ROE	7.4%	5.5%	8.8%	n.m.	2.4%	7.9%
ROCE	7.6%	6.3%	8.6%	n.m.	2.5%	6.2%
Net debt/EBITDA	0.6x	0.7x	2.1x	n.m.	4.5x	2.5x
Net debt/(cash) to equity	0.1x	0.1x	0.3x	0.5x	0.5x	0.4x

VALUATION RATIOS	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
P/E	22.8x	23.1x	12.2x	n.m.	32.4x	9.4x
EV/EBITDA	10.0x	10.2x	10.0x	n.m.	11.1x	6.8x
P/CF	9.3x	9.7x	7.9x	n.m.	6.7x	4.2x
P/BV	1.3x	1.2x	1.0x	0.8x	0.8x	0.7x
EV/Capital Employed	1.2x	1.2x	1.0x	0.8x	0.8x	0.8x
EV/Sales	3.0x	2.9x	3.0x	6.2x	2.6x	2.1x
EV/EBIT	14.2x	15.0x	17.7x	n.m.	29.0x	11.3x
Cash flow from ops, HRK m	216	210	232	-57	182	286
EV, HRK m	2,131	2,186	2,304	2,031	2,034	1,936
FCF, HRK m	-427.1	-18.8	-36.2	-261.5	-123.3	-36.2
FCF yield	-21.2%	-0.9%	-2.0%	-21.6%	-10.2%	-3.0%
Dividend yield	0.0%	1.3%	0.0%	0.0%	2.3%	2.5%

COMPANY FINANCIALS

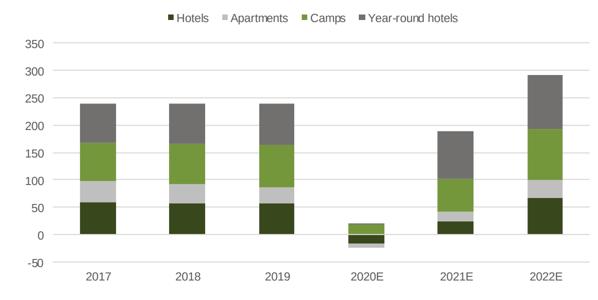
INCOME STATEMENT, HRK m	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Revenues	717	758	778	325	774	914
Operating expenses	-467	-508	-535	-369	-578	-614
EBITDA	213	215	230	-56	183	286
Depreciation	-62	-69	-99	-110	-112	-115
EBIT	150	145	130	-167	70	172
Financial revenues	6	1	1	1	1	0
Financial expenses	-40	-32	-30	-27	-28	-27
Other income and expenses	-4	-2	7	-3	-3	-2
Share in result of joint ventures	-1	1	2	2	2	2
Profit before tax	112	114	109	-194	42	144
Income tax benefit/expense	-23	-25	40	12	-5	-15
Profit/loss	88	89	149	-182	37	129

CASH FLOW, HRK m	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Profit/(loss) for the year	88.1	88.7	149.0	-182.2	37.3	129.1
Income tax (benefit)/charge	23.5	25.2	-40.2	-12.0	4.8	15.3
Financial expense (income)	34.7	21.4	28.7	26.5	27.1	26.6
Depreciation and amortisation	62.5	69.2	99.5	110.2	112.5	114.6
Other	7.1	5.6	-5.4	0.0	0.0	0.0
Cash flow from operating activities	215.8	210.2	231.6	-57.5	181.6	285.6
Change in working capital	16.2	-8.8	-8.2	-1.1	1.0	0.3
Taxes (paid)/received	-1.3	-32.9	0.4	12.0	-4.8	-15.3
Financial income (expense)	-42.1	-25.4	-27.2	-27.1	-27.5	-27.0
Net cash from operating activities	215.8	210.2	231.6	-57.5	181.6	285.6
CAPEX	-642.8	-229.0	-267.8	-204.0	-305.0	-321.8
CF from Investments	-458.4	-160.9	-226.3	-286.6	-173.9	-136.6
Change in debt	266.2	21.5	12.1	35.7	42.8	-52.2
Dividends and buybacks	0.0	0.0	-42.0	0.0	0.0	-28.2
Proceeds from share issuance	741.7	0.0	0.0	0.0	0.0	0.0
Purchase of shares in minorities	-68.3	0.0	0.0	0.0	0.0	0.0
Cash from financing activities	939.5	21.5	-29.9	35.7	42.8	-80.4

BALANCE SHEET, HRK m	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Current Assets	824	827	746	411	441	470
Cash and equivalents	800	803	719	394	414	440
Trade receivables	13	14	15	6	15	17
Inventories	9	9	9	4	9	11
Other	3	2	3	7	3	2
Non-current assets	1,852	1,934	2,349	2,502	2,521	2,523
PP&E	1,778	1,850	2,012	2,193	2,229	2,251
Interest in joint ventures	34	36	39	39	39	39
Deferred tax asset	28	24	59	59	59	59
Other	12	24	240	211	195	174
Total Assets	2,676	2,761	3,095	2,913	2,962	2,993
Total Current Liabilities	166	149	167	144	162	182
Trade payables	24	20	29	12	29	34
ST loans	38	52	58	51	52	67
Other	104	77	80	80	81	81
Total Non-current Liabilities	945	963	1,172	1,195	1,217	1,129
Long-term debt	882	892	920	963	1,005	938
Other	63	72	252	232	212	192
Total shareholders' equity	1,566	1,648	1,756	1,574	1,583	1,682
Total liab. & equity	2,676	2,761	3,095	2,913	2,962	2,993
Net Debt/(Cash)	120	141	481	822	826	728
Net Working Capital	-103	-73	-62	-56	-62	-64
Capital Employed, HRK m	1,749	1,862	2,287	2,446	2,459	2,459

OPERATIONS	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Accommodations - Group total						
Total revenue	717.2	757.7	778.1	325.2	774.4	914.0
Accommodation revenue	576.3	614.7	637.7	264.3	639.7	757.6
EBITDAR	250.5	250.0	243.3	-43.8	196.6	300.1
EBITDA	212.9	214.7	229.5	-56.5	182.6	286.1
Rooms Available	1,934	1,976	1,909	1,912	1,991	2,005
Occupancy	53.2%	54.0%	55.1%	22.4%	48.3%	55.6%
Average daily rate	560.1	576.2	606.2	618.3	665.7	679.9
RevPAR	298.8	311.3	334.1	138.3	321.3	377.8
Variance analysis						
Rooms Available	84.0	12.9	-22.3	0.4	25.5	5.4
Occupancy	73.1	8.9	13.2	-386.5	329.7	98.8
Average daily rate	65.7	16.6	32.0	12.8	20.2	13.6
Chng accommodation revenue	**222.7**	**38.4**	**22.9**	**-373.3**	**375.4**	**117.9**

EBITDAR (HRKm) contribution by segment



Investment case

We initiate coverage of Arena Hospitality Group with a BUY recommendation and a price target (PT) of HRK 320/share. Thanks to the proceeds of the c.EUR 100m capital increase in mid-2017, we believe Arena is well-positioned to weather the hit to European tourism from COVID-19. Additionally, Arena is well-positioned geographically to capture a larger share of summer tourism spending, we believe. Compared to Italy or Spain, COVID-19 cases in Croatia have been low and the large majority of guests arrive by personal car, a relative advantage over taking a plane to Greece or Turkey. In our base-case assumptions, where the occupancy at Arena's resorts falls by half in a truncated summer season, we expect the company to post a 2020E loss on the EBITDA line and it would be likely to be in technical breach of loan covenants next spring. Nonetheless, it has the cash to continue investing in refurbishments and new room growth, which should boost average daily rates (ADRs) materially, when we assume business fully recovers for the 2022E season.

Arena is a traditional summer resort operator, with assets based on the southern tip of the Istrian peninsula, and it also operates year-round hotels in Germany and Budapest, since the end of 2016, which were acquired from its majority owner, PPHE Hotel Group (PPH LN). In Croatia, Arena operates c.8.7k rooms, of which c.35% are hotels and self-catering apartments (but c.75% of its revenues), and c.65% campsites (c.25% of its revenues). Most properties are 4* and 3*, and the segment is mid-way through an investment programme of refurbishments, aimed at increasing the average daily room rates (ADRs). Arena's year-round hotels account for roughly one-third of its revenues and c.30% of the group's EBITDA; nevertheless, the business remains highly seasonal, with the key 3Q summer season typically generating around 100% of the total annual EBITDAR and 170% of the net profit.

In the near term, Arena is well-positioned geographically to capture a larger share of summer tourism spending, we believe. Croatia has not, so far, emerged as a COVID-19 hotspot on the continent – to the contrary, according to the European Centre for Disease Prevention and Control (ECDC) data, its reported cases are among the lowest in Europe, at just 54 per 100k residents, one-quarter of the level in Germany and one-tenth of Spain's. As travel restrictions are being lifted gradually (already the case with neighbouring Austria and Slovenia), we suspect that Croatia will be seen as a safer destination than Italy or Spain, otherwise both popular destinations for northern European tourists. Moreover, tourists to Croatia arrive overwhelmingly by personal car, not by plane or bus. When factoring in that Europeans are likely to be more mindful about social distancing, Croatia then is at a great advantage over more remote seaside destinations in Greece or Turkey, the country's major competitors to the southeast.

Our base case for 2020E is a partial summer season. We expect Arena's results to be affected strongly by the ongoing COVID-19 pandemic but, thanks to the proceeds from the 2017 capital increase, the business should emerge from the next couple years in good health, while still being able to invest in refurbishments (e.g., higher average daily rates) and new room growth. **Our base case for 2020E is that all of Arena's properties remain closed until the end of June and that occupancy rates for 3Q20E and 4Q20E are half of their 2017-18 levels. We also assume a 15% haircut on average daily rates in 2H20E, to capture the possible risk of discounting by peers. On the costs side, we expect the total opex to fall by 29% yoy on a drop in revenues of c.57% (including a c.25% drop in wages, to HRK 187m, vs. last year's HRK 251m).**

Assuming that Arena has at least a partial season, we would still it expect to post a FY20E EBITDA loss of HRK 56.5m and a net loss of HRK 182m, but that it can be profitable on the EBITDA level for 3Q, with c.HRK 68m of earnings, about 30% of a usual season. **In this scenario, we believe that Arena's c.HRK 719m of cash reserves (at end-2019) should see it through the year – including all principle, interest and lease payments, plus planned capex (below) – although it is clear that, when the bank covenants are tested next February, the company will need to renegotiate terms / waivers with its banks.** This year's DSCR and net debt/EBITDA covenants on Arena's largest loans are ≥ 1.2x and ≤ 5.0x, respectively; while, for end-2020E, we see the DSCR at -0.6x and the gearing at -14.6x. In the current, pro-stimulus environment, however, we fully expect covenants to be waived and/or loosened; therefore, by spring 2022E, the business should again be compliant on both the DSCR (we expect 1.9x for 2021E) and net debt/EBITDA at 4.5x vs. the covenant level of 4.5x.

For 2021E, we pencil in group room occupancy at 85-90% of the 2019 levels and, from 2022E-onwards, back to pre-COVID levels. Right now, we expect 2021E to still be a "rebuilding year" for the tourism industry; with some luck, a COVID-19 vaccine will have become available, but there are likely to still be some reluctance among Europeans to travel, even within the EU. Keeping this in mind, we assume that Arena's occupancy rate will still be about 15% below the 2019 level (48.3% vs. 55.1%), which implies 2021E EBITDA of HRK 183m and net profit of HRK 37m – still c.20% and c.63% below the 2019 levels, adjusting for investment tax incentives. For 2022E, we assume a fully normalised environment, with EBITDA of HRK 286m and net profit of HRK 129m. This assumes an occupancy rate of 55.6% (a 46bps improvement over the 2019 level) and an ADR some 12% higher than 2019 (a CAGR of 4.0%), which reflects both the repricing of rates at refurbished properties and inflation-like growth for the remainder. Only then do we expect to see the impact of the ongoing investments reflected in profitability; our 2022E forecasts imply a 31.3% EBITDA margin vs. 29.5% in 2019.

On a 2021E EV/EBITDA of 11.1x, Arena trades in line with our peer group (and similar to its historic trading range) and at 6.8x in 2022E, at a 21% discount. The consensus estimates both for Arena's domestic and Croatian peers, as well as for the Greek or Turkish hotel operators, are limited, unfortunately. Compared to Valamar Riviara, which has a similar portfolio of properties and is Croatia's largest listed resort company, we see Arena trading at significant discounts of 76% and 17% on PER and EV/EBITDA, respectively, on our 2022E earnings. This, in part, reflects the earnings growth at Arena driven by new renovations and new properties, as well as our view that 2022E should be a normalised year, i.e., similar to 2018-19.

Compared to its European peer Melia, which is significantly larger and more geographically diversified, but again with a broadly similar operating profile, we see Arena trading roughly in line on our 2022E PER discount of 17%, but at a 15% premium on our 2022E EV/EBITDA. Other peers in our group – including Arena's 52.9% owner PPHE – are arguably less directly comparable, operating mainly year-round hotels. This said, we see Arena trading roughly in line with this group on 2021E EV/EBITDA and at a 22% discount on 2022E EV/EBITDA. On our PT of HRK 320/share, Arena would trade at 2021-22E PERs of 44x and 12.7x, respectively, and at EV/EBITDAs of 13.5x and 8.3x. On this basis, the stock would still trade at significant premiums on our 2021E numbers, but in line with its peers (7% and 3% discounts on PER and EV/EBITDA, respectively) on our 2022E estimates.

We assume that the planned capex will continue and that FCF will return to around breakeven in 2021E. Arena is roughly in the middle of a four-year c.HRK 900m capex cycle, supported by the c.HRK 740m capital increase in 2017. In 2018-19, the company spent c.HRK 380m on: 1) the renovations of the Arena One 99 and Kazela campsites; plus 2) another estimated HRK 100m of maintenance capex. For 2020-21E, the key projects are the Verudela apartment complex renovation (largely completed), the renovation of Brioni for c.HRK 240m, the acquisition of Hotel 88 in Belgrade (c.HRK 50m, or EUR 6.3m) and the conversion of a building in the historic centre of Zagreb into a 115-room hotel (c.HRK 80m, we estimate). Including maintenance, we expect Arena to invest HRK 287m and HRK 174m in 2020E and 2021E, respectively. **On these assumptions, we expect the 2020E FCF to be deeply in the red, to the tune of c.HRK 360m (vs. last year's HRK 53m), but roughly breakeven by the end of 2021E. Current investment plans notwithstanding, we estimate that the business will still have HRK 414m cash on hand at end-2021E** (vs. HRK 719m at end-2019, including new financing for c.60% of the cost of the Brioni and Zagreb projects).

Company description

Arena Hospitality Group and its Croatian assets are located on the southern tip of the Istrian peninsula, in and around the ancient Roman city of Pula (the company's name refers to Pula Arena, the world's sixth-largest surviving Roman amphitheatre, constructed between 27 BC-68 AD). Istria county, of which Pula is the capital, is one of the country's top tourist destinations, accounting for 23% of the total Croatian tourist arrivals last year (including domestic tourists) and 29% of total tourist nights; the average length of stay in the county is 37% higher than the rest of the country, at 5.9 vs. 4.3 nights.

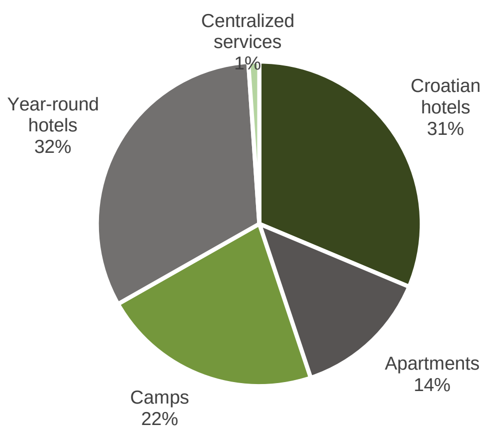
The company's controlling shareholder is the London-listed PPHE Hotel Group (PPH LN), which owns a 52.5% stake currently, achieved over several transactions. In April 2008, PPHE first paid EUR 22.4m for a 20% stake in Arena's 74.1% owner at the time (Goldman Sachs, by way of managed funds), giving it management rights over the properties. In April 2016, PPHE acquired the remainder of the Goldman Sachs stake for EUR 51m and subsequently sold a total of c.12% to two Croatian funds (AZ and PBZ) for c.EUR 10m, or HRK 285/share. After this, followed a mandatory takeover offer, after which PPHE controlled 65.6%. At the end of 2016, PPHE made the capital contribution of Sugarhill (i.e., the German and Hungarian operations), whereby its stake increased to 77.1%. In May 2017, new shares were issued to raise c.EUR 100m in equity proceeds and PPHE's stake was diluted to 52.5%.

At the end of 2016, PPHE increased Arena's share capital by HRK 460m (HRK 421.54/share) and its stake in the business to 77.1%, the proceeds of which to were used to finance Arena's acquisition of PPHE's Park Plaza and art'otel assets and business in Germany and Hungary. Finally, in June 2017, Arena completed the first international public offering by a Croatian tourism company, selling 1,855k new shares for HRK 425/share and raising HRK 788.4m in gross proceeds (HRK 742m, or EUR 100m in net proceeds). The offering diluted PPHE's stake in the business to the current 52.5%.

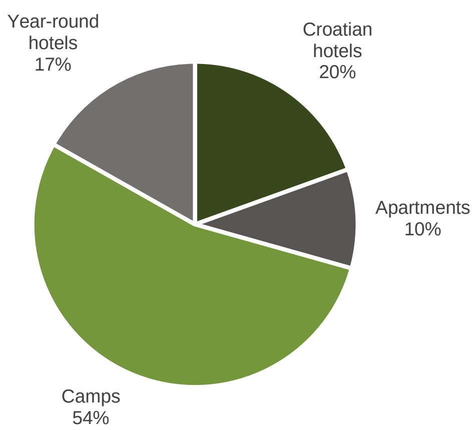
At the end of 2019, Arena operated around 10k rooms, of which c.8.7k in Croatia and 1.3k in Germany, and Hungary. The company's five operating segments are:

- ✓ **Croatian hotels:** Arena operates seven hotels in Pula and Medulin (on the far southern tip of the Istrian peninsula), with 372k available room nights, which represented c.20% of the total room inventory for the Croatian business and 31% of total revenues last year. The Park Plaza Histria, Park Plaza Arena and Brioni are located on a small peninsula adjacent to the Pula Yacht Club, while Guest House Riviera is in the city centre. The three Medulin hotels are just outside the city along the coast and in close proximity to the other Arena resorts and campsite.
- ✓ **Croatian self-catering holiday apartment complexes.** With c.189k available room nights, this segment represented 10% of annual inventory and 14% of total revenues last year. The segment consists of four self-catering apartment complexes with pools and other amenities, of which two are 4* and the rest 3* and 2* resorts. Most are situated in proximity to the Arena hotels.
- ✓ **Croatian campsites:** c.1,050 available room nights, or 54% of its room inventory and 22% of its total revenues. Arena's campsites offer both self-catered mobile homes, and pitches for RVs and tents. In 2018, it opened its first site under the glamping or "glamourous camping" concept, offering 4* quality tents and associated services; and, for the 2020 season, it has fully renovated the Kazela campsite, with 209 premium mobile homes, repositioned pitches, swimming pools and other expanded amenities. The first phase of the repositioning was completed ahead of the 2019 summer season.

Total revenues by segment (2019)



Room inventory by segment (2019)



Source: Company data, WOOD Research

- ✓ **Year-round hotels:** with c.353k available room nights (from 2H20E), its year-round hotels represented 17% of its room inventory and 32% of its revenues last year. The segment comprises seven city hotels for business and leisure travellers, of which all are 4*. Of these, three are fully owned (Park Plaza Nuremberg, art'otel cologne and art'otel berlin kudamm), two are leased (Park Plaza Wallstreet and art'otel Budapest) and two (art'otel berlin mitte and Park Plaza Berlin Kudamm) are jointly owned with a third party and are reflected in Arena's consolidated results below the EBIT line under the heading "Share in result of joint ventures". In January, the group entered a 45-year lease to develop and operate a 115-room hotel in the centre of Zagreb; the units are planned to be launched in 2022E. By 2021E, this, together with a city-hotel, in Belgrade, transaction (expected to be closed during 2020E), should boost the available rooms in the segment by 23% vs. 2019.
- ✓ **Managed and centralised services:** since 2016, a subsidiary of the group, Arena Hospitality Management d.o.o., has had management agreements with all the properties owned, partially owned, leased or managed by the group in Croatia, Germany and Hungary. Arena Hospitality Management provides management services to all these properties and generates management fee revenues of about a mid-single digit percentage of the property revenues on an unconsolidated level.

Arena Hospitality Group's properties

	Rooms / Pitches	Stars	TripAdvisor rating	TripAdvisor local ranking	Location
Park Plaza Histria Pula	368	4.0	4.5	3 of 32	Pula
Park Plaza Arena Pula	175	3.0	4.5	2 of 32	Pula
Hotel Brioni (under renovation)	228	2.0 (4.0)	3.0	15 of 32	Pula
Guest House Riviera	120	2.0	2.5	26 of 32	Pula
Sensimar Medulin	184	4.0	4.5	1 of 10	Medulin
Park Plaza Belvedere Medulin	428	4.0	4.5	2 of 10	Medulin
Arena Hotel Holiday	192	3.0	4.0	3 of 10	Medulin
Hotels	**1,695**				
Park Plaza Verudela Pula	385	4.0	4.0	5 of 32	Pula
Verudela Beach / Verudela Villas (renovated)	196	4.0	4.0	7 of 32	Pula
Splendid Resort[1]	218	3.0	3.5	16 of 32	Pula
Horizont Resort[1]	103	2.0	3.0	24 of 32	Pula
Ai Pini Resort	64	3.0	4.0	4 in 10	Medulin
Kazela Resort[2]	99	2.0	n.a.	n.a.	Medulin
Apartment complexes	**1,065**				
Arena One 99 Glamping	264	4.0	4.5	1 of 16	Pomer
Arena Stoja Campsite	714	3.0	3.5	5 in 526	Pula
Arena Kazela Campsite (under renovation)	1,664	2.5 (4.0)	3.5	5 of 10	Medulin
Arena Medulin Campsite	949	2.0	3.5	1 of 200	Medulin
Arena Stupice Campsite	920	2.0	3.5	2 of 70	Premantura
Arena Indije Campsite	399	1.0	3.5	3 of 55	Banjole
Arena Tašalera Campsite	100	n.a.	3.5	4 of 70	Premantura
Arena Runke Campsite	248	n.a.	3.5	8 of 70	Premantura
Campsites	**5,258**				
art'otel berlin mitte (owned w/third party)	109	4.0	4.0	52 of 636	Berlin
Park Plaza Wallstreet Berlin Mitte (leased)	167	4.0	4.0	91 of 636	Berlin
art'otel berlin kudamm	152	4.0	4.0	248 of 636	Berlin
Park Plaza Berlin Kudamm (owned w/third party)	133	4.0	4.0	254 of 636	Berlin
art'otel cologne	218	4.0	4.0	40 of 274	Cologne
art'otel budapest (leased)	165	4.0	4.5	55 of 372	Budapest
Park Plaza Nuremberg	177	4.0	4.5	13 of 127	Nuremberg
Arena Hotel 88 (from 2H20)	88	4.0	4.5	23 of 117	Belgrade
Year-round hotels	**1,209**				

Source: Company data, TripAdvisor, WOOD Research; note: 1) Splendid and Horizont are technically one unit for management purposes; 2) Kazela Resort apartments are on the site of the Kazela campsite and, for management purposes, are included in the camp segment

Inasmuch as Arena's Croatian business represents about two-thirds of total revenues and just over 70% of the group's EBITDAR, the company's earnings are highly seasonal. In Croatia, the season runs from Easter to the last week in October, so c.94% of rooms sold are in the second and third quarters (3Q alone accounts for 63% rooms sold and c.70% of revenues in the resorts segments). Moreover, prices in 3Q are 20-25% higher than the annual average. This seasonality is only partly offset by earnings from year-round hotels, which cater to both business and leisure travellers, and where revenues are spread fairly evenly across the year. Regardless, as a whole, Arena will be loss making on the EBITDAR line in 1Q and 4Q. Losses from the shoulder quarters are offset by 2Q earnings, with the key 3Q summer season typically generating around 100% of the total annual EBITDAR and 170% of the net profit.

Rooms available and sold, by quarter (2019)

Croatian portfolio	**1Q19**	**2Q19**	**3Q19**	**4Q19**
Rooms available ('000)	50.1	654.4	786.7	96.7
Room nights sold ('000)	**21.3**	**245.0**	**497.2**	**27.3**
% of rooms sold by quarter	*3%*	*31%*	*63%*	*3%*
Average daily rate (HRK)	**379.4**	**416.6**	**674.4**	**472.6**
vs annual average	*-31%*	*-24%*	*23%*	*-14%*
Year-round hotels	**1Q19**	**2Q19**	**3Q19**	**4Q19**
Rooms available ('000)	79.1	80.0	80.9	80.9
Room nights sold ('000)	**58.9**	**66.1**	**69.1**	**66.7**
% of rooms sold by quarter	*23%*	*25%*	*26%*	*26%*
Average daily rate (HRK)	**800.6**	**755.8**	**759.4**	**831.3**
vs annual average	*2%*	*-4%*	*-3%*	*6%*

Source: Company data, WOOD Research

Financial forecasts

We expect Arena's results to be affected by the ongoing COVID-19 pandemic but, thanks to the proceeds from the 2017 capital increase, the business should emerge from the next couple of years in good health, while still being able to invest in new room growth and refurbishments (e.g., higher average daily rates). Our base case for 2020E is that all of Arena's properties remain closed until the end of June, and that occupancy rates for 3Q20E and 4Q20E are half of the 2017-18 levels. On top of this, we also assume a 15% haircut on average daily rates in 2H20E vs. 2H19, capturing the risk that Croatian resorts as a whole might turn to promotional pricing to fill rooms; for instance, "last-minute" discounts. On the costs side, we expect the FY20E wages to drop by c.25%, to HRK 187m, vs. last year's HRK 251m, on a drop of c.57% in revenues.

Our assumption that occupancy rates fall by only half may seem optimistic, but we believe that: 1) Croatia has not emerged as a COVID-19 hotspot on the continent (unlike Spain or Italy), so it may be seen as a safer destination; and 2) visitors arrive overwhelmingly by personal car, not by plane or bus, which puts Croatia, in our view, at a great advantage over seaside destinations in Greece or Turkey, Croatia's major competitors to the southeast.

On the pricing side, Arena's management has emphasised that it will not enter the season offering discounts; it has a broad enough portfolio that its can manage fixed costs by keeping some properties shut and does not wish to dilute the brand by pitching itself as a "cheap" destination. Other resort chains are likely to follow the same strategy, but this still leaves smaller hoteliers and the owners of private accommodation (which, altogether, represent about half of the total rooms available). If this segment decides collectively to compete on price, then Arena may, to a certain extent, be forced to follow. As noted above, we assume a 15% haircut on average daily rates in 2H20E vs. 2H19. On a full-year basis, however, our average 2020E ADR is 2% higher yoy. The reason is that we expect properties to be shut during the "low-season" months of April through June, when ADRs are c.25% lower, on average. With properties open only for the high-season months, it pushes up the FY20E average.

Assuming that Arena has at least a partial season, we would still expect it to post a FY20E EBITDA loss of HRK 56.5m and a net loss of HRK 182m, but it could be profitable on the EBITDA level for 3Q, with c.HRK 68.4m of earnings, about 31% of a typical season.

In this scenario, we believe that Arena's c.HRK 719m cash reserves should see it comfortably through the year – including all principle, interest and lease payments (c.HRK 93m), plus planned capex (c.HRK 287m) – although it is clear that, before debt covenants are tested at the end of next February, the company will need to renegotiate terms / waivers with its banks. This year's debt service coverage ratio (DSCR) and net debt/EBITDA covenants on Arena's largest loans (with UniCredit's Zagrebacka Banka) are 1.2x and 5.0x, respectively; while, at end-2020E, we see the DSCR at -0.6x and the gearing at -14.6x. In the current, pro-stimulus environment, however, we fully expect the covenants to be waived and/or loosened; therefore, by spring 2022E, the business should again be compliant on both the DSCR (we expect 1.9x for 2021E) and the net debt/EBITDA (4.5x vs. the covenant level of 4.5x). According to management, the initial discussions with the banks have begun already and, in view of the wholly extraordinary situation facing both borrowers and lenders, it is confident an accommodation will be found.

Key financial and operating data

in HRK m	2018	2019	2020E	2021E	2022E	2023E
Total revenues	757.7	778.1	325.2	774.4	914.0	935.5
EBITDA	**214.7**	**229.5**	**-56.5**	**182.6**	**286.1**	**293.2**
EBIT	145.4	130.0	-166.7	70.1	171.6	177.1
Profit before tax	113.8	108.8	-194.2	42.0	144.4	151.7
Profit/loss	**88.7**	**149.0**	**-182.2**	**37.3**	**129.1**	**135.7**
Accommodation revenue	**614.7**	**637.7**	**264.3**	**639.7**	**757.6**	**778.1**
Rooms Available ('000)	1,975.7	1,908.9	1,911.9	1,991.2	2,005.5	2,005.5
Occupancy	54.0%	55.1%	22.4%	48.3%	55.6%	55.6%
Average daily rate (HRK)	576.2	606.2	618.3	665.7	679.9	697.3
Variance analysis						
Rooms Available	12.9	-22.3	0.4	25.5	5.4	0.0
Occupancy	8.9	13.2	-386.5	329.7	98.8	1.2
Average daily rate	16.6	32.0	12.8	20.2	13.6	19.4
Change in accommodation revenue	**38.4**	**22.9**	**-373.3**	**375.4**	**117.9**	**20.5**

Source: Company data, WOOD Research

2020E key financial and operating data by quarter

in HRK m	1Q20	2Q20E	1H20E	3Q20E	9M20E	4Q20E	2020E
Total revenues	56.5	0.0	56.5	218.0	274.5	50.8	325.2
EBITDA	**-19.7**	**-65.5**	**-85.2**	**68.4**	**-16.9**	**-39.6**	**-56.5**
Accommodation revenue	**40.7**	**0.0**	**40.7**	**183.0**	**223.7**	**40.6**	**264.3**
Rooms Available ('000)	126.4	737.0	863.4	869.2	1,732.6	179.3	1,911.9
Occupancy	49.4%	0.0%	7.2%	35.7%	21.5%	30.5%	22.4%
Average daily rate (HRK)	650.8	652.0	651.8	589.6	600.0	743.5	618.3
Variance analysis							
Rooms Available	-0.9	0.0	0.0	0.3	0.2	0.4	0.4
Occupancy	-10.7	-202.8	-214.3	-151.1	-350.9	-29.9	-386.5
Average daily rate	-3.0	46.5	47.5	-40.7	3.7	3.7	12.8
Change in accommodation revenue	**-14.6**	**-156.3**	**-166.8**	**-191.5**	**-347.0**	**-25.9**	**-373.3**

Source: Company data, WOOD Research

For 2021E, we assume occupancy for the Croatian business at 85% of our pre-COVID assumptions, but with normalised ADRs and normalised environment occupancy rates**. Our 2021E EBITDA forecast of HRK 183m is c.20% below the 2019 level and nearly 30% below our pre-COVID assumption, but should ensure that the company is +/- breakeven on FCF.** By 2022-23E, moreover, we expect to start to see the payoff of the ongoing and planned investments in refurbishment (e.g., Brioni, Verudela, Kazela) and new properties (e.g., the recently leased hotel in Zagreb and the property in Belgrade) in the form of higher ADRs and/or new room inventory. So, while occupancy will be, overwhelmingly, the main driver of accommodation revenues for the next three years, we expect higher ADRs to contribute about one-quarter of the top-line growth in 2022E and be the major driver for 2023E-onwards.

What-if scenarios. Of the most immediate concern is if the various EU countries do not relax their travel restrictions until well into the summer months, which could effectively wipe out Arena's 2020E summer season. In this case, we expect the 3Q EBITDA loss to look very much like our 2Q forecast, i.e., a loss of c.HRK 60m vs. a HRK 61m EBITDA profit (we assume that the wage support measures – detailed below – remain in place and unchanged). **Losing the whole summer season would imply 2020E losses on the EBITDA and net profit lines of HRK 174m and HRK 290m, respectively.** For 2021E, if we flex our occupancy assumptions of 85% vs. our pre-COVID estimates, or 48.3%, back to 100% (54.2% occupancy), then we would expect 2021E net profit of HRK 123m, or 23% higher than the 2019 level, adjusted for the tax write-back. Similarly, we flex our ADR assumptions by increments of +/-5% vs. our baseline of c.HRK 660/night, indicating that Arena's 2021E ADR could drop by c.10% vs. our baseline assumption and still be around breakeven on the net profit line for the year, for instance.

2021E net profit sensitivity to occupancy and ADR assumptions (HRK m)

Occupancy / ADR	54.2%	52.3%	50.3%	48.3%	46.3%	44.3%	42.3%
681.1	140.7	111.3	81.9	52.5	23.1	-6.3	-35.7
660.3	122.8	94.3	65.8	37.3	8.8	-19.8	-48.3
639.4	104.9	77.3	49.6	22.0	-5.6	-33.2	-60.8
618.6	87.0	60.2	33.5	6.8	-19.9	-46.6	-73.3
597.7	69.0	43.2	17.4	-8.4	-34.2	-60.0	-85.9
576.8	51.1	26.2	1.3	-23.6	-48.6	-73.5	-98.4
556.0	33.2	9.2	-14.8	-38.9	-62.9	-86.9	-110.9

Source: WOOD Research

Revenues and earnings by segment

Croatian hotels

While, in the current environment, earnings growth will be driven by occupation and cost management, we believe, in our pre-COVID modelling, the renovation and repositioning of the Brioni hotel was the main earnings driver for the segment in 202E. Currently a 2* property, the 228-room Brioni should re-open for the 2021E season, after a c.HRK 240m investment, as a 4* property, with an expected ADR of HRK 1,300, higher vs. last year's c.HRK 530/night (we note that the average for other hotel rooms last year was c.HRK. 820/night, or over 50% higher). Following the repositioning, by 2022E, we believe that the ADR for the segment could grow to c.HRK 919, or 16% higher than in 2019 (a CAGR of 5% vs. the underlying 2.2% inflation-like growth we use in our model). Given that it ought to take the hotel around three years to mature, we assume that segment occupancy will dip (in pre-COVID terms) and return to the 64% 2018-19 level, from 2024E-onwards.

Croatia hotels: key financial and operating data

HRK m	2017	2018	2019	2020E	2021E	2022E	2023E
Total revenue	235.8	241.7	243.8	85.0	224.7	271.2	278.2
Accommodation revenue	180.7	185.5	187.8	66.1	173.5	209.7	215.5
EBITDAR	**59.5**	**57.1**	**57.0**	**-15.9**	**24.6**	**67.1**	**68.9**
Rooms Available ('000)	361.0	369.1	372.3	335.9	372.3	372.3	372.3
Occupancy	63.5%	63.7%	64.0%	27.4%	52.8%	62.6%	63.0%
Average daily rate (HRK)	788.3	788.6	788.3	700.6	882.9	900.6	918.6
Variance analysis							
Rooms Available	-5.4	4.1	1.6	-7.0	17.0	0.0	0.0
Occupancy	2.6	0.6	0.9	-95.6	75.4	32.8	1.5
Average daily rate	17.3	0.1	-0.1	-20.9	16.8	3.5	4.2
Accommodation revenue	**14.6**	**4.7**	**2.4**	**-123.5**	**109.1**	**36.2**	**5.7**

Source: Company data, WOOD Research

Croatian self-catering holiday apartment complexes

In the holiday apartment segment, the main project is the renovation of the 196-room Verudela complex for c.HRK 60m, which is expected to be open for the 2020E season. Here, Arena is looking for a c.50% boost in the ADR. In our model, this translates into a c.10% uplift in the segment ADR by 2022E vs. 2019 (a 3.2% CAGR), with the occupancy returning to the run-rate level of 61.6% in 2022E.

Croatia self-catering holiday apartment complexes: key financial and operating data

HRK m	2017	2018	2019	2020E	2021E	2022E	2023E
Total revenue	107.5	109.7	105.4	40.4	94.6	112.4	113.4
Accommodation revenue	85.8	88.4	84.5	32.8	76.9	91.6	92.7
EBITDAR	**38.1**	**34.6**	**30.1**	**-7.6**	**16.1**	**32.9**	**32.9**
Rooms Available ('000)	182.3	191.1	188.1	189.6	189.6	189.6	189.6
Occupancy	62.2%	61.1%	61.5%	21.3%	52.4%	61.6%	61.6%
Average daily rate (HRK)	757.1	757.4	730.7	665.0	774.5	784.2	794.0
Variance analysis							
Rooms Available	-12.6	4.1	-1.4	0.2	0.0	0.0	0.0
Occupancy	19.8	-1.5	0.6	-50.3	45.6	13.7	0.0
Average daily rate	3.0	0.0	-3.1	-7.6	4.4	1.0	1.1
Accommodation revenue	**10.1**	**2.6**	**-3.9**	**-57.7**	**50.0**	**14.7**	**1.1**

Source: Company data, WOOD Research

Croatian camps

In the past couple of years, Arena has invested heavily in its largest campsite, Kazela, spending a total of c.HRK 149m on facilities and new rooms, as well as HRK 70m on the Arena One 99 "glamping" (glamourous camping concept) site in Pomer. This boosted the ADR by 11.5% between 2017 and 2019, to HRK 366, and we expect another 11% increase through to 2022E (a 3.6% CAGR), as the units mature and occupancy normalises.

Croatia camps: key financial and operating data

HRK m	2017	2018	2019	2020E	2021E	2022E	2023E
Total revenue	136.5	152.4	170.4	77.3	160.7	194.3	199.8
Accommodation revenue	130.1	145.4	160.3	72.4	150.2	182.0	187.4
EBITDAR	**70.5**	**73.3**	**77.3**	**17.9**	**61.7**	**92.4**	**95.0**
Rooms Available ('000)	1,070.2	1,094.6	1,027.7	1,048.6	1,048.6	1,048.6	1,048.6
Occupancy	41.3%	41.3%	42.6%	16.9%	36.2%	42.6%	42.6%
Average daily rate (HRK)	294.5	321.2	366.2	333.2	395.5	407.4	419.6
Variance analysis							
Rooms Available	-0.2	3.2	-10.4	1.2	0.0	0.0	0.0
Occupancy	9.2	0.0	5.2	-87.9	80.0	27.3	0.0
Average daily rate	9.4	11.8	20.3	-14.4	11.1	4.5	5.5
Accommodation revenue	**18.4**	**15.0**	**15.1**	**-101.2**	**91.0**	**31.8**	**5.5**

Source: Company data, WOOD Research

Year-round hotels

Arena's year-round hotels should fare relatively better this year than the resort segments, we expect; assuming that the travel restrictions ease this summer, then it could achieve something like "business as usual" already in 4Q20E. We expect the FY20E revenues to fall by only c.50% yoy vs. c.40% for the Croatian business overall. Our forecasts assume the consolidation of the Arena Hotel 88 in Belgrade from 3Q20E and the 115-room Zagreb property from 2Q21E. In total, the two properties should boost available rooms in the segment by 23% vs. 2019. As they mature over the following two-to-three years, we expect them to contribute a small positive impact on the segment ADR and EBITDAR margins; we expect the latter to average c.30.5% from 2021E-onwards.

We note that Arena manages the art'otel berlin mitte and Park Plaza Berlin Kudamm hotels, but these are 50-50% JVs with a third party, so are not consolidated in Arena's results (Arena's share of the net profit appears below EBIT in "share in result of joint ventures").

Year-round hotels: key financial and operating data

HRK m	2017	2018	2019	2020E	2021E	2022E	2023E
Total revenue	227.8	243.2	250.1	116.2	283.7	323.5	331.2
Accommodation revenue	179.9	195.7	205.2	93.0	239.1	274.3	282.5
EBITDAR	**70.7**	**74.1**	**75.8**	**0.3**	**86.5**	**98.7**	**101.0**
Rooms Available ('000)	320.8	320.8	320.8	337.8	380.7	394.9	394.9
Occupancy	76.6%	81.9%	81.3%	34.8%	75.0%	80.5%	80.5%
Average daily rate (HRK)	734.4	744.7	786.8	791.8	837.6	862.7	888.6
Variance analysis							
Rooms Available	15.5	0.0	0.0	4.7	26.9	9.9	0.0
Occupancy	9.3	12.7	-1.5	-118.0	113.6	18.1	0.0
Average daily rate	9.5	2.5	11.1	1.3	5.4	7.2	8.2
Accommodation revenue	**34.3**	**15.2**	**9.5**	**-112.1**	**146.0**	**35.1**	**8.2**

Source: Company data, WOOD Research

Wages and other opex costs

Salaries and related expenses are Arena's single largest cost items (46.5% of total opex over the past three years) and are largely fixed; with the quarantine, state wage support measures and uncertainty over the summer season, this cost line requires special attention. **In total, in our base-case assumptions, we expect the 2020E wages to drop by c.25%, to HRK 187m, vs. last year's HRK 251m, on a drop of c.57% in revenues.** Overall, we expect the total opex to fall by c.29%.

We base our estimates on a total of c.750 full-time employees. The Croatian business employs c.480 full-time, year-round employees, plus another c.110 seasonal full-time staff (with the season running from Easter to early-October). At the peak of the season, total headcount grows by another c.900 part-time workers. Another c.180 employees are at Arena's year-round hotels, predominantly in Germany and mostly full-time. In terms of total annual costs, the split between the salaries attributable to the Croatian business and the year-round hotels is 60/40.

In Croatia, from 2 April, the government is paying businesses HRK 4,000/month (up from HRK 3,250 in March) per employee to retain workers, as well as a holiday from health and social taxes, or an effective subsidy of c.HRK 5,825 per worker. In Germany, the company is taking advantage of the *kurtzarbeit* measures, i.e., it has cut back the hours for its full-time staff to 10 hours per week, with the state paying the other 30 hours at 60-70% of the normal level. We estimate that these measures should, effectively, allow Arena to cut its wage bill outside Croatia by about 70%.

On our assumptions, the business remains shut for 2Q20E, with no part-time workers on the payroll, and we estimate that Arena's wage bill for the quarter in Croatia should be around HRK 28m, of which c.HRK 8m will be paid by the state. At the year-round hotels, we assume another HRK 7m, vs. a run-rate of c.HRK 20m, with the balance being paid by the state directly to employees. This would represent a yoy decline of c.60% vs. 2Q19.

The 3Q20E wage bill is the most difficult to estimate because it will depend on the number of seasonal workers and, therefore, occupancy rates. However, assuming the businesses reopen from June, then the wage bill for full-time employees should return to c.HRK 48m. In terms of part-time seasonal workers, last year, this added around HRK 33m to costs. According to the company, about 80% of those working for the Croatian business live directly in the Pula region, with the rest from eastern Croatia or abroad; we assume that the latter will not be needed this year. Assuming that Arena makes do with about half of the usual number of part-time workers, this implies another HRK 16m in costs, or HRK 64m. Adding another HUK 54m for salaries in 4Q20E brings us to a total of HRK 187m for full-year 2020E.

Overall, we expect the 2020E opex to fall by 29%, to HRK 379m, including a total c.32% drop in opex, excluding personnel costs. Taking a bottom-up view, we estimate the 2020E opex excluding wages at HRK 192m, or -32% yoy. Following wages, the next two largest opex lines – franchise fees, reservation and commissions, and food and beverages, which run at around c.12% of revenues – are largely variable and, here, we are looking for a 59% decline yoy in total, to HRK 39m, from HRK 94m, i.e., broadly in line with revenues. Following this are marketing, utilities and maintenance costs, also at c.12% of revenues, which we see as more fixed; we are looking for these to fall, on average, by c.20%.

Starting with 2021E, we assume that wages and other costs will largely normalise, even if the 2021E revenues remain soft, while tourism normalises. For 2021E, we conservatively assume that the number of seasonal workers returns to pre-COVID levels. Including Arena Hotel 88 in Belgrade, which will be consolidated starting in 3Q20E, and the Zagreb hotel, which should open in late-2021/early-2022E, this means an increase in personnel costs in our model, to HRK 271m, or about 8% higher than the 2019 level. For 2022E-onwards, we assume flat staffing numbers and c.4% annual average wage growth. We expect other opex costs to increase by another c.8% vs. the 2019 levels, and we assume an average growth rate of 2.8% for 2022E-onwards.

Effective tax rate

From May 2019, Arena became eligible to claim incentive tax allowances for 2018-19 investments, including the Verudela Beach self-catering apartments, and the Arena One 99 Glamping and Kažela campsites. In total, these are worth c.HRK 61m, of which HRK 41.3m is available to be used until 2028 and is only for taxes paid from domestic operations (at a statutory rate of 18%). As a result, Arena recorded a tax benefit in the 2019 P&L of HRK 40.2m versus an average c.22% effective rate in the preceding two years. Moreover, the company expects similar tax allowances for the Hotel Brioni renovation, as well as another tax benefit, once that property reopens in 2021E. Going forward, we assume that foreign business will continue to pay tax at the respective rates (Germany 29.7% and Hungary 18%) and zero taxes on domestic earnings until the current incentives run out; in our model, this is through to 2025E. Inasmuch as we assume growing profitability in the Croatian businesses vs. the year-round hotels, starting from 2026E-onwards, we assume that Arena will be paying an effective rate of just over 20%.

Capex and cash flow

Arena is roughly in the middle of a four-year c.HRK 900m capex cycle, supported by the c.HRK 740m capital increase in 2017. In 2018-19, the company spent HRK 150m and HRK 233m, respectively, on: 1) the renovations of the Verudela apartments complex, and the Arena One 99 and Kazela campsites; plus 2) another estimated HRK 100m of maintenance capex. For 2020-21E, the key projects are the renovation of Brioni for c.HRK 240m, the acquisition of Hotel 88 in Belgrade (c.HRK 50m) and the renovation of a 115-room hotel in the centre of Zagreb (c.HRK 80m, assuming a cost of c.EUR 100k/room, similar to other city hotel projects in the region). Including maintenance, we expect Arena to invest HRK 287m and HRK 174m in 2020E and 2021E, respectively.

Assuming the tourism environment more or less normalises after 2021E, we pencil in additional growth capex in 2022-24E of HRK 100m/annually, e.g., renovations, the purchase of the stake in managed assets, in addition to maintenance capex of 4% of revenues. We note that the Croatian state recently made an offer to sell Guesthouse Riviera to Arena, a managed property in Pula, including a purchase price and settlement of rent for the past five years; Arena is in the process of evaluating the offer. For our fade period, from 2025E-onwards, we assume annual capex of c.HRK 115-120m/annually, in line with the expected level of depreciation.

Based on the capex plans outlined above, we expect the 2020E FCF to be deeply in the red, to the tune of c.HRK 360m (vs. last year's HRK 53m), but roughly breakeven by the end of 2021E. Current investment plans notwithstanding, we estimate that the business will still have HRK 230m in cash on hand as at end-2021E, without the need to draw down any further financing (it may do so, however, depending on its talks with the banks as its policy is to finance projects with a 60/40 debt/equity capital structure).

We note that, in view of the expected 2020E slowdown, **we assume that Arena suspends dividends for two years, i.e., from its 2019-20E earnings**. In our forecasts, it should be able to resume its progressive dividend payout policy starting from 2021E, with a DPS of HRK 5.5, increasing by HRK 0.5/share thereafter. Last year, the company did launch and complete a c.HRK 42m share buyback programme. No share buyback had been authorised for 2020E and, in view of COVID-19, we do not include another one in our modelling.

Bank loan covenants

Based on Arena's audited 2019 results, the company was comfortably within its bank loan covenants, with net debt/EBITDA of 2.1x (covenant ≤ 5.5x) and a debt service coverage ratio (DSCR) of 2.6x (covenant ≥ 1.2x). The company's net debt stood at HRK 481m, of which HRK 1,200m was gross debt and lease liabilities, and HRK 719m cash.

In our base-case scenario, we believe that Arena's c.HRK 719m cash reserves should see it through the year comfortably – including all principle, interest and lease payments (c.HRK 93m), plus planned capex (c.HRK 287m) – although it is clear that the company will need to agree on waivers and/or reset covenants to manage the liabilities exposure, given the COVID-19 related drop in business. This year's DSCR and net debt/EBITDA covenants on Arena's largest loans (with UniCredit's Zagrebacka Banka) are ≥ 1.2x and ≤ 5.0x, respectively; while, at end-2020E, we see the DSCR at -0.6x and the gearing at -16x. In view of the tourism sector's importance for the Croatian economy, we expect both the government and local banks to show the maximum flexibility with borrowers like Arena. We fully expect the 2020 covenants to be waived and/or loosened, and that, by spring 2022E, the business should again be compliant on both the DSCR (we expect 1.9x for 2021E) and the net debt/EBITDA (4.5x vs. the covenant level of 4.5x).

Bank loan covenants (end-2019)

Lender	Amount	Covenant (1)	Covenant (2)
Zagrebačka Banka	EUR 32m and HRK 205m	DSCR ≥ 1.2x	Gearing ≤ 5x (2020); ≤ 4.5x (2021-on)
Zagrebačka Banka	EUR 10m and HRK 60m	DSCR ≥ 1.2x	Gearing ≤ 5x (2020); ≤ 4.5x (2021-on)
Erste Bank	EUR 5m and EUR 10.2m	ICR ≥ 2x EBITDA	n.m.
Deutsche Hypothekenbank		DSCR ≥ 1.8x	loan < 65% of property value
Deutsche Hypothekenbank		DSCR ≥= 1.1x	loan < 70% of property value

Source: Company data, WOOD Research

Debt service and covenant ratios

in HRK m	2019	2020E	2021E	2022E	2023E	2024E
Principle repayment	46.2	51.2	51.9	52.2	67.0	48.8
Interest payments	23.1	22.7	23.6	23.5	22.2	20.9
Lease payments	19.6	19.6	20.0	20.4	20.8	21.3
Debt service	**88.9**	**93.5**	**95.5**	**96.2**	**110.1**	**91.0**
EBITDA	229.5	-56.5	182.6	286.1	293.2	300.9
Net debt	481.5	822.5	826.4	727.5	623.7	514.2
Debt service coverage ratio (x)	**2.6**	**-0.6**	**1.9**	**3.0**	**2.7**	**3.3**
Net debt/EBITDA (x)	**2.1**	**-14.6**	**4.5**	**2.5**	**2.1**	**1.7**
Interest coverage (x)	**9.9**	**-2.5**	**7.7**	**12.2**	**13.2**	**14.4**

Source: Company data, WOOD Research

Recently, Arena refinanced the majority of its debt, as evidenced by the relatively modest principle repayment costs over the next five years. Its largest loan, a EUR 32m and HRK 205m (c.HRK 450m in total) facility from UniCredit's Zagrebačka Banka was refinanced at the end of 2017 at fixed rates of 1.95% (HRK) and 2.3% (EUR), which matures at end-2027. Moreover, last year, it raised another c.HRK 75m with Erste Bank at a fixed rate of 2.2%, again for 10 years. In our modelling, we assume an effective cost of interest of 2.25% for Arena from 2020E-onwards.

Valuation

DCF

We value Arena using a 10Y DCF model, with a peer multiples valuation as a sanity check. On this basis, we arrive at a DCF-based 12M PT of HRK 320/share, or upside of c.36% to the current level. The key assumptions in our DCF model are:

- ✓ A WACC of 6.1%, starting with a risk free rate of 5.0% for Croatia and an equity risk premium of 5.5%.
- ✓ We apply a levered beta of 0.85x, based on an unlevered beta of 0.63x from the Damodaran sector beta database for European hotel and gaming companies .
- ✓ The terminal value has been calculated as the average of the perpetuity, with a 0% terminal growth rate, and an exit EV/EBITDA of 8.0x.

DCF model

HRK m	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
EBIT	-166.7	70.1	171.6	177.1	183.5	188.6	193.0	196.4	199.0	200.7
NOPLAT	-156.4	62.1	153.4	158.5	164.4	169.0	153.2	155.8	157.6	158.7
Depreciation	110.2	112.5	114.6	116.1	117.4	118.4	119.0	119.4	119.9	120.2
Change in NWC	-1.1	1.0	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Capex	-286.6	-173.9	-136.6	-137.4	-138.4	-114.2	-115.0	-117.1	-119.2	-121.2
FCF	**-333.8**	**1.8**	**131.7**	**137.2**	**143.5**	**173.2**	**157.2**	**158.1**	**158.3**	**157.7**
PV of FCF	**-333.8**	**1.7**	**117.1**	**115.0**	**113.4**	**129.0**	**110.4**	**104.7**	**98.8**	**92.9**

Sum of PV	549		549	Risk-Free Rate	5.0%
PV of Terminal value	1,532		1,511	Levered Beta	0.85
Total EV	**2,081**		**2,061**	Risk premium	5.5%
Net Debt (2019A)	-481		-481	**Cost of Equity**	**9.7%**
Provisions	-41		-41	Cost of Debt	2.6%
Equity value	1,558		1,538	Tax Rate	6.2%
Equity value/share	304		300	**Post-tax Cost of Debt**	**2.5%**
Average		**302**		Weight of Equity	49.6%
12M PT		**320**		Weight of Debt	50.4%
				WACC	**6.1%**

Source: WOOD Research

PT sensitivity to WACC and terminal growth rate

WACC/terminal growth	-2.0%	-1.5%	-1.0%	-0.5%	0.0%	0.5%	1.0%	1.5%	2.0%
4.1%	391	424	463	511	571	648	750	891	1,101
4.6%	345	372	404	442	488	546	619	717	854
5.1%	306	328	354	385	421	466	521	592	686
5.6%	272	290	312	337	366	401	444	498	566
6.1%	242	258	275	296	320	348	382	423	475
6.6%	215	229	244	261	281	304	331	364	404
7.1%	192	203	216	231	247	266	288	315	346
7.6%	171	180	191	204	218	234	252	273	299
8.1%	151	160	169	180	192	205	221	238	259

Source: WOOD Research

Peer multiples

Name	Country	Last price (LCU)	Mkt Cap (EUR)	P/E 20E	P/E 21E	P/E 22E	EV/EBITDA 20E	EV/EBITDA 21E	EV/EBITDA 22E	EBITDA margin 20E	EBITDA margin 21E	EBITDA margin 22E
ARENA HOSPITALITY GROUP	HR	236.0	160	n.m.	32.4	9.4	n.m.	11.1	6.8	-17%	24%	31%
VALAMAR RIVIERA DD	HR	23.3	388	n.m.	23.3	39.5	72.7	13.1	8.2	11%	30%	41%
PPHE HOTEL GROUP LTD	NE	10.2	482	n.m.	14.9	13.6	17.5	9.2	8.7	27%	34%	34%
MELIA HOTELS INTERNATIONAL	SP	3.41	783	n.m.	17.0	11.2	16.7	7.5	5.9	14%	24%	26%
DALATA HOTEL GROUP PLC	IR	2.52	468	n.m.	14.0	9.7	26.6	9.1	7.1	21%	33%	35%
NH HOTEL GROUP SA	SP	3.00	1,177	n.m.	18.8	13.2	9.4	5.5	6.2	25%	26%	27%
ACCOR SA	FR	20.9	5,659	n.m.	22.1	16.0	22.4	10.3	8.4	11%	19%	21%
LEMON TREE HOTELS LTD	IN	16.7	162	46.9	n/a	21.3	14.1	19.0	10.6	35%	31%	38%
INDIAN HOTELS CO LTD	IN	67.9	987	24.0	77.9	20.4	11.7	19.9	11.0	22%	16%	22%
HUAZHU GROUP LTD-ADR	CH	228.3	8,800	205.5	30.0	22.8	35.5	16.1	12.3	18%	28%	30%
SH JINJIANG INTL - B	CH	9.20	3,074	18.3	6.9	5.9	19.7	9.7	8.7	13%	20%	20%
MINOR INTERNATIONAL PCL	TH	18.1	2,408	n.m.	25.0	13.8	18.2	10.7	8.9	16%	19%	20%
Peer median				**35.4**	**22.1**	**13.7**	**18.2**	**10.5**	**8.5**	**17%**	**25%**	**28%**
Arena vs. peer median				*n.m.*	*46%*	*-32%*	*n.m.*	*6%*	*-21%*	*n.m.*	*-7%*	*10%*

Source: Bloomberg, WOOD Research

The consensus estimates for both Arena’s domestic and Croatian peers, as well as for the Greek or Turkish hotel operators, are limited, unfortunately. Compared to Valamar Riviara, which has a similar portfolio of properties and is Croatia’s largest listed resort company, we see Arena trading at significant discounts of 76% and 17% on PER and EV/EBITDA, respectively, on our 2022E earnings. This, in part, reflects the earnings growth at Arena, driven by new renovations and new properties, as well as our view that 2022E should be a normalised year, i.e., similar to 2018-19.

Compared to its European peer Melia, which is significantly larger and more geographically diversified, but again with a broadly similar operating profile, we see Arena trading roughly in line on our 2022E PER discount of 17%, but at a 15% premium on our 2022E EV/EBITDA. Other peers in our group – including Arena’s 52.9% owner PPHE – are arguably less directly comparable, operating mainly year-round hotels. This said, we see Arena trading roughly in line with this group on 2021E EV/EBITDA and at a 22% discount on 2022E EV/EBITDA. On our price target of HRK 320/share, Arena would trade at 2021-22E PERs of 44x and 12.7x, respectively, and on EV/EBITDAs of 13.5x and 8.3x. On this basis, the stock would still trade at significant premiums on our 2021E numbers, but in line with its peers (7% and 3% discounts on PER and EV/EBITDA, respectively) on our 2022E estimates.

Risks

- ✓ **While the COVID-19 crisis appears to have been contained in Central and Southeast Europe, the risk remains of governments imposing further travel restrictions, until a vaccine for the infection becomes widely available.**
- ✓ **Looking past the immediate impact of the social distancing measures, in a post-COVID world, travel and work habits as a whole may change in ways that, on the whole, could be negative for Arena's business.** Business travel – where Arena has exposure via its year-round hotels – in particular, may decline markedly, as companies rely more on safer – and cheaper – teleconferencing. Similarly, inbound leisure travel could be affected for many years, depending on COVID-related government policies. Arena's Croatian business faces the same challenges as other leisure travel; however, it may be less effected in the long run as a large majority of visitors are "domestic", i.e., from within the EU, and travel to the country by car, not by plane.
- ✓ **While the risks of defaulting on banks loans is minimal, based on our 2020E numbers, Arena would breach its current loan covenants when these are tested next February**. Management is already in talks with banks to modify or waive covenants and, in view of the tourism sector's importance for the Croatian economy, we expect local banks, with the support of the government and regulators, to show the maximum flexibility with borrowers like Arena. Over the mid-term, a lack of access to new debt financing could impair future growth potential (we note that we do not include new growth investments in our forecasts past 2021E).
- ✓ **ADRs could be depressed by small players choosing to compete on price for a more limited number of visitors.** While Croatia's larger tourism groups are expected to be disciplined with regards to pricing, smaller hoteliers and the owners of private accommodations (which, altogether, represent about half of the total rooms available) may not be, depressing prices for the industry as a whole.
- ✓ We expect Arena to resume dividends from its 2021E earnings but, depending on how the industry recovers, dividends could be further delayed and/or smaller than expected.
- ✓ Once tourism recovers to pre-COVID levels, then the competition for labour around Croatia's resorts could drive up personnel costs, and operators like Arena may have to resort to employing (and housing) foreign labour.
- ✓ Resort operators like Arena depend on the construction industry to build and renovate their properties, which could be a source of capex cost inflation.

Financials

P&L

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Revenues	**435.9**	**717.2**	**757.7**	**778.1**	**325.2**	**774.4**	**914.0**	**935.5**
Operating expenses	-295.1	-466.6	-507.8	-534.8	-369.0	-577.8	-613.8	-628.3
EBITDAR	140.8	250.5	250.0	243.3	-43.8	196.6	300.1	307.2
Rental expenses and concession fees land	-8.7	-37.7	-35.3	-13.8	-12.7	-14.0	-14.0	-14.0
EBITDA	**132.0**	**212.9**	**214.7**	**229.5**	**-56.5**	**182.6**	**286.1**	**293.2**
Depreciation, amortisation and impairment	-222.5	-62.5	-69.2	-99.5	-110.2	-112.5	-114.6	-116.1
EBIT	**-90.5**	**150.4**	**145.4**	**130.0**	**-166.7**	**70.1**	**171.6**	**177.1**
Financial revenues	0.1	6.1	0.8	0.8	0.6	0.5	0.4	0.3
Financial expenses	-41.0	-39.6	-31.6	-30.3	-27.1	-27.6	-27.0	-25.2
Other income and expenses	-6.6	-4.3	-2.0	6.7	-2.5	-2.5	-2.0	-2.0
Share in result of joint ventures	0.0	-1.0	1.2	1.5	1.5	1.5	1.5	1.5
Profit before tax	**-138.0**	**111.5**	**113.8**	**108.8**	**-194.2**	**42.0**	**144.4**	**151.7**
Income tax benefit/expense	23.7	-23.5	-25.2	40.2	12.0	-4.8	-15.3	-16.0
Profit/loss	**-114.3**	**88.1**	**88.7**	**149.0**	**-182.2**	**37.3**	**129.1**	**135.7**
EBITDA margin	**30.3%**	**29.7%**	**28.3%**	**29.5%**	**-17.4%**	**23.6%**	**31.3%**	**31.3%**
Tax rate	-17.2%	-21.0%	-22.1%	37.0%	-6.2%	-11.4%	-10.6%	-10.5%
Shares for EPS (m)	2.182	4.196	5.129	5.119	5.119	5.119	5.119	5.119
EPS	**-52.4**	**21.0**	**17.3**	**29.1**	**-35.6**	**7.3**	**25.2**	**26.5**
DPS	**0.0**	**0.0**	**5.0**	**0.0**	**0.0**	**5.5**	**6.0**	**6.5**

Source: WOOD Research

Balance sheet

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Non-current assets	**1,468.8**	**1,852.1**	**1,934.0**	**2,349.5**	**2,501.9**	**2,521.3**	**2,522.7**	**2,521.6**
Inventories	3.8	4.4	3.2	3.1	1.3	3.0	3.6	3.7
Receivables	21.1	13.0	13.9	14.7	6.2	14.7	17.3	17.7
Other current assets	22.4	6.8	7.1	9.1	9.1	9.1	9.1	9.1
Current assets	**47.3**	**24.2**	**24.3**	**27.0**	**16.6**	**26.8**	**30.0**	**30.5**
Accounts payable	-43.0	-23.6	-19.9	-28.8	-12.0	-28.6	-33.8	-34.6
Other current liabilities	-78.5	-103.8	-76.9	-60.4	-60.4	-60.4	-60.4	-60.4
Net working capital	**-74.2**	**-103.3**	**-72.5**	**-62.2**	**-55.9**	**-62.2**	**-64.2**	**-64.5**
Net capital employed	**1,394.6**	**1,748.8**	**1,861.5**	**2,287.3**	**2,446.1**	**2,459.1**	**2,458.5**	**2,457.1**
Shareholders' equity	804.2	1,565.8	1,648.3	1,756.5	1,574.3	1,583.3	1,681.7	1,784.1
Long-term debt and lease liabilities	520.8	882.1	891.6	1,122.5	1,145.7	1,167.4	1,080.0	1,010.4
Short-term debt and lease liabilities	135.4	38.2	52.2	77.9	71.2	72.6	87.9	70.0
Total debt	**656.2**	**920.3**	**943.8**	**1,200.4**	**1,216.9**	**1,240.1**	**1,167.9**	**1,080.4**
Cash	-130.4	-800.1	-802.5	-718.9	-394.4	-413.7	-440.3	-456.7
Net debt/(cash)	**525.8**	**120.2**	**141.3**	**481.5**	**822.5**	**826.4**	**727.5**	**623.7**
Other long-term liabilities	56.9	62.8	71.9	49.3	49.3	49.3	49.3	49.3
Net capital employed	**1,387.0**	**1,748.8**	**1,861.5**	**2,287.3**	**2,446.1**	**2,459.1**	**2,458.5**	**2,457.1**
Total assets	**1,646.5**	**2,676.4**	**2,760.8**	**3,095.3**	**2,912.9**	**2,961.8**	**2,993.1**	**3,008.8**
ROCE	n.m.	5.5%	4.2%	6.1%	-5.2%	2.1%	5.2%	5.3%
NOPAT	n.m.	118.8	113.3	178.1	-156.4	62.1	153.4	158.5

Source: Company data, WOOD Research

Cash flow

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Profit/(loss) for the year	-114.3	88.1	88.7	149.0	-182.2	37.3	129.1	135.7
Income tax (benefit)/charge	-23.7	23.5	25.2	-40.2	-12.0	4.8	15.3	16.0
Financial expense (income)	41.4	34.7	21.4	28.7	26.5	27.1	26.6	24.9
Depreciation and amortisation	222.5	62.5	69.2	99.5	110.2	112.5	114.6	116.1
Other	5.5	7.1	5.6	-5.4	0.0	0.0	0.0	0.0
Cash flow from operating activities	**131.5**	**215.8**	**210.2**	**231.6**	**-57.5**	**181.6**	**285.6**	**292.7**
Change in working capital	21.9	16.2	-8.8	-8.2	-1.1	1.0	0.3	0.1
Taxes (paid)/received	-9.5	-1.3	-32.9	0.4	12.0	-4.8	-15.3	-16.0
Financial income (expense)	-25.7	-42.1	-25.4	-27.2	-27.1	-27.5	-27.0	-25.2
Settlement of legal cases	0.0	0.0	0.0	-23.5	0.0	0.0	0.0	0.0
Net cash from operating activities	**118.1**	**188.6**	**143.1**	**173.2**	**-73.6**	**150.3**	**243.7**	**251.6**
Capex	-146.6	-506.5	-150.4	-233.2	-286.6	-173.9	-136.6	-137.4
Other	-11.4	48.0	-10.5	6.9	0.0	0.0	0.0	0.0
Cash from investing activities	**-157.9**	**-458.4**	**-160.9**	**-226.3**	**-286.6**	**-173.9**	**-136.6**	**-137.4**
Change in borrowings	22.4	266.2	21.5	12.1	35.7	42.8	-52.2	-67.0
Dividends	0.0	0.0	0.0	-25.6	0.0	0.0	-28.2	-30.8
Purchase of shares in minorities	0.0	-68.3	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from share issuance	0.0	741.7	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of treasury shares	0.0	0.0	0.0	-16.3	0.0	0.0	0.0	0.0
Cash from financing activities	**22.4**	**939.5**	**21.5**	**-29.9**	**35.7**	**42.8**	**-80.4**	**-97.8**
Change in cash	**-17.4**	**669.7**	**3.7**	**-83.0**	**-324.5**	**19.3**	**26.7**	**16.4**
FCF	**-28.5**	**-317.9**	**-7.3**	**-60.0**	**-360.2**	**-23.6**	**107.1**	**114.2**

Source: Company data, WOOD Research

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