WOOD & COMPANY

Ilirija d.d.

Buy

Initiation of coverage

Price: HRK 130/share
Price target: HRK 178/share

Adriatic tourism, by land and by sea

We initiate coverage of Ilirija with a BUY recommendation and a price target (PT) of HRK 178/share, offering upside of 37%. Ilirija is a hospitality company, based in Biograd na moru, comprising five segments: 1) hotels; 2) nautical tourism – it operates the three largest marinas on the northern Adriatic coast; 3) camping; 4) real estate (a shopping centre in Zadar, with gross lettable area of 28,500m^2 sqm, acquired in 2016); and 5) a destination management company (DMC Ilirija Travel). The stable revenues from the marina business and the shopping centre in particular have insulated Ilirija's earnings from the worst of the COVID-19 pandemic, and its reasonable balance sheet management means that Ilirija should be able to resume growth investments once the pandemic has resolved itself, as well as dividends, in our view. The business has, historically, generated a ROCE of c.8% (vs. our WACC assumption of 7.5%) and we expect this to the remain the case from 2022E-onwards. On our numbers, the stock trades currently at 2021-22E EV/EBITDAs of 8.9x and 6.4x, respectively, or a 40% discount vs. its peers. However, its liquidity, we have to note, is extremely poor: over the past three years, it has traded, on average, just three days out of each month and its 6M ADTV is just EUR 809. For investors that can accept this limitation, however, the current entry point seems attractive, in our view.

Unlike most of its peers, we forecast Ilirija to break even for 2020E, thanks to its nautical and real estate businesses, which have proven quite COVID-19 resistant, posting net profit of HRK 1.4m, on revenues of HRK 103m (-37% yoy). Assuming: 1) a recovery to pre-COVID-19 tourist volumes by 2022E; and 2) c.4% trend growth in ADRs, we forecast 2021E net profit of HRK 20.1m, on revenues of HRK 135m (+32% yoy) and EBITDA of HRK 44.4m; for 2022E, we expect net profit of HRK 31.3m, on revenues of HRK 175m and EBITDA of HRK 57.7m, the latter two being 7% and 15% higher than the 2019 levels. We do not see any acute balance sheet issues, with management having secured a debt servicing moratorium on its long-term debt until April 2021.

Valuations: on our numbers, Ilirija trades at 2021-22E EV/EBITDAs of 8.9x and 6.4x, respectively, or a 40% discount vs. its peers; and at 2021-22E PERs of 15.5x and 10x, respectively, or discounts of 41% and 63%. Looking at the historic (2016-19) multiples as an indication of where the stock could trade, assuming a normalised environment, we note that Ilirija, its Croatian and global peers traded at median EV/EBITDAs and PERs of 10.9x and 21.1x, respectively, with Ilirija trading in line on EV/EBITDAs and at a c.34% discount on PERs. Applying these multiples trailing premia/discounts to our average 2021-22E earnings, we see a fair value for the stock of HRK 165/share, or a 7% discount to our DCF PT.

Risks: aside from the obvious COVID-19 related risks, we see two main risks for our investment thesis. Firstly: the competition from other marinas in the region, both domestic and foreign. Secondly: Ilirija may have to invest more than we have reflected in our model to modernise its hospitality and shopping centre assets.

Expected events

3Q20 results	End-October
4Q20 results	End-February
1Q21 results	End-April
2Q21 results	End-July

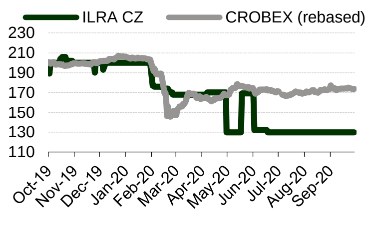
Key data

Market Cap	EUR 41m
Free float	47.1%
6M ADTV	EUR 809
Shares outstanding	2.4m
Major Shareholder	Arsenal (59.2%)
Reuters Code	ILRA.ZA
Bloomberg Code	ILRA CZ
CROBEX Index	1,601

Price performance

52-w range	HRK 206-130
52-w performance	-35.0%
Relative performance	-21.5%

Ilirija 12M share price performance



Year	Sales	EBITDA	Net profit	EPS	EPS	DPS	P/E	EV/EBITDA	P/CE	Div yield
	HRK m	HRK m	HRK m	HRK	% yoy	HRK	(x)	(x)	(x)	%
2017	146.6	48.6	27.2	13.24	-3%	3.00	12.3	9.2	9.7	1.8%
2018	156.4	52.5	36.9	15.33	16%	3.50	11.8	10.4	8.8	1.9%
2019	163.5	50.2	31.3	13.03	-15%	0.00	14.0	10.8	10.0	0.0%
2020E	102.9	22.9	1.4	0.59	-95%	0.00	218.7	17.9	19.5	0.0%
2021E	135.3	44.4	20.1	8.37	1309%	2.09	15.5	8.9	8.6	1.6%
2022E	174.8	57.7	31.3	13.03	56%	3.26	10.0	6.4	6.5	2.5%

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EQUITY RESEARCH

Contents

Closing Prices as of 23 October 2020

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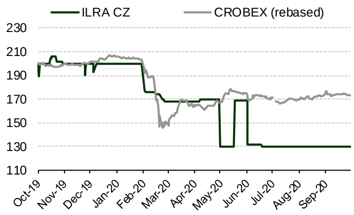
Company snapshot – BUY, HRK 178

BUY

Bloomberg ticker	ILRA CZ
Closing price (HRK)	130
Price target (HRK)	178
Upside to PT	36.9%
Shares outstanding (m)	2.4
MCAP (EUR m)	41
Free float	47.1%
ADTV (EUR '000)	0.8
52 Week Range (HRK)	206-103



COMPANY DESCRIPTION

Compared to the traditional Croatian resort operators, which rely primarily on streams of beachgoers during the summer season, Ilirija's business also adds its Marina Kornati, one of the largest marinas on the Croatian Adriatic coast, and nautical tourism. The marina's primary earnings driver provides year-round mooring for charter and private vessels; this is a stable business that generated HRK 30.1m for Ilirija alone last year, or 18% of its total revenues. In addition to moorings and other associated services, Ilirija also operates four mid-sized hotels, not only for visitors to the marina, a c.1,200 pitch campsite for more traditional holidaymakers, plus sports and dining facilities. The company also provides on-site event management at its own sites nearby, as well as hosting the annual Biograd Boat Show, one of the largest floating boat shows in the region. In 2016, the company acquired a shopping centre, City Galleria, in nearby Zadar, a six-floor c.28,500m2 shopping mall near the old city centre, which it financed with proceeds a small capital increase and debt; we view this an opportunistic purchase, having little synergy with the core tourism business; however, with >99% occupancy and a yield to its book value of c.12.2%, we estimate that it offers some EUR 3.7m (HRK 28m, or HRK 12 per Ilirija share) worth of "hidden" reserves, assuming a fair value yield for similar assets of 9%.

RATIOS

PER SHARE RATIOS	2017	2018	2019	2020E	2021E	2022E
EPS	13.2	15.3	13.0	0.6	8.4	13.0
CEPS	16.8	20.5	18.3	6.7	15.1	20.1
BVPS	143.0	134.7	144.2	144.7	153.1	164.0
DPS	3.0	3.5	0.0	0.0	2.1	3.3

FINANCIAL RATIOS	2017	2018	2019	2020E	2021E	2022E
EBITDA margin	33.2%	33.6%	30.7%	22.3%	32.8%	33.0%
EBIT margin	25.6%	25.4%	21.9%	7.0%	20.9%	23.5%
Net margin	18.6%	23.6%	19.2%	1.4%	14.9%	17.9%
ROE	9.6%	11.9%	9.3%	0.4%	5.6%	8.2%
ROCE	7.3%	9.0%	7.9%	1.4%	5.1%	7.4%
Net debt/EBITDA	2.3x	2.1x	2.0x	4.3x	1.8x	1.0x
Net debt/(cash) to equity	0.4x	0.3x	0.3x	0.3x	0.2x	0.1x

VALUATION RATIOS	2017	2018	2019	2020E	2021E	2022E
P/E	12.3x	11.8x	14.0x	218.7x	15.5x	10.0x
EV/EBITDA	9.2x	10.4x	10.8x	17.9x	8.9x	6.4x
P/CF	9.7x	8.8x	10.0x	19.5x	8.6x	6.5x
P/BV	1.1x	1.3x	1.3x	0.9x	0.8x	0.8x
EV/Capital Employed	1.1x	1.2x	1.2x	0.9x	0.9x	0.8x
EV/Sales	3.1x	3.5x	3.3x	4.0x	2.9x	2.1x
EV/EBIT	11.9x	13.8x	15.1x	57.1x	13.9x	9.0x
Cash flow from ops, HRK m	34.5	49.2	44.0	16.0	36.4	48.5
EV, HRK m	447	546	541	411	394	370
FCF, HRK m	8.4	8.5	17.8	3.2	17.4	28.9
FCF yield	2.5%	2.0%	4.0%	1.0%	5.6%	9.2%
Dividend yield	1.8%	1.9%	0.0%	0.0%	1.6%	2.5%

COMPANY FINANCIALS

INCOME STATEMENT, HRK m	2017	2018	2019	2020E	2021E	2022E
Total operating revenues	146.6	156.4	163.5	102.9	135.3	174.8
Materials and energy	-22.6	-23.3	-24.4	-11.5	-20.2	-25.9
Services	-18.9	-19.3	-21.7	-16.3	-18.0	-22.8
Staff cost	-38.9	-41.9	-47.4	-37.6	-36.1	-46.7
Other operating expenses	-17.6	-19.5	-19.9	-14.5	-16.7	-21.6
EBITDA	48.6	52.5	50.2	22.9	44.4	57.7
D&A	-11.1	-12.8	-14.4	-15.7	-16.1	-16.7
EBIT	37.5	39.7	35.8	7.2	28.2	41.0
Net financial expenses	-3.6	-2.8	-4.5	-5.6	-3.7	-2.8
Profit before taxation	33.9	36.9	31.3	1.6	24.6	38.2
Income tax	-6.6	0.0	0.0	-0.2	-4.4	-6.9
Net profit	27.2	36.9	31.3	1.4	20.1	31.3

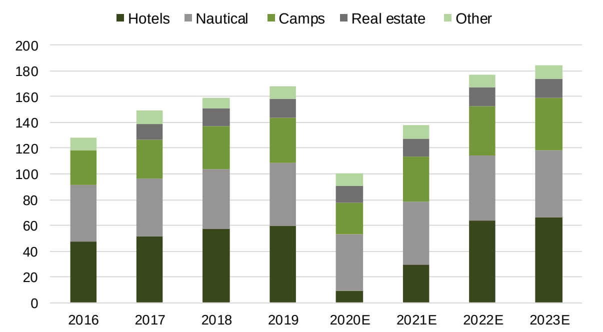
CASH FLOW, HRK m	2017	2018	2019	2020E	2021E	2022E
Net profit	27.2	36.9	31.3	1.4	20.1	31.3
Depreciation	11.1	12.8	14.4	15.7	16.1	16.7
Change in retained profit	-1.2	0.0	0.0	0.0	0.0	0.0
Sale of PP&E	0.3	0.1	0.0	0.0	0.0	0.0
Share bonuses	0.0	0.7	0.0	0.0	0.0	0.0
Change in working capital	-3.0	-1.3	-1.7	-1.2	0.1	0.4
CF from operating activities	34.5	49.2	44.0	16.0	36.4	48.5
CAPEX	-26.2	-40.7	-26.2	-12.8	-19.1	-19.6
Other	0.3	0.4	0.6	0.0	0.0	0.0
CF from Investments	-25.9	-40.3	-25.6	-12.8	-19.1	-19.6
Issuing of new shares	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of treasury shares	-0.7	-0.4	-0.4	0.0	0.0	0.0
Dividend paid	-6.0	-7.2	-8.4	0.0	0.0	-5.0
Increase/(decrease) in long-term borrov	-0.8	0.5	-5.0	17.9	-9.9	-10.5
Increase/(decrease) in short-term borro	-2.0	1.8	5.4	-6.4	-0.3	-0.6
Cash from financing activities	-9.5	-5.2	-8.4	11.4	-10.2	-16.2

BALANCE SHEET, HRK m	2017	2018	2019	2020E	2021E	2022E
Current Assets	14.2	22.8	34.0	41.7	53.3	70.4
Cash and equivalents	1.5	5.2	15.2	29.9	37.1	49.8
Trade receivables	8.4	13.4	15.8	9.5	13.2	17.1
Inventories	2.1	2.3	1.8	1.1	1.8	2.4
Other	2.2	1.8	1.2	1.2	1.2	1.2
Non-current assets	411.8	439.6	451.2	448.4	451.3	454.2
PP&E	332.7	361.5	374.0	372.3	376.4	380.6
Intangible assets	0.3	0.4	0.5	0.5	0.6	0.6
Investment property	78.8	77.7	76.7	75.5	74.2	73.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total Assets	426.1	462.4	485.3	490.1	504.6	524.6
Total Current Liabilities	29.0	34.8	40.1	25.5	29.8	34.0
Trade payables	16.1	20.1	20.1	11.9	16.5	21.3
ST loans	11.0	12.8	18.2	11.7	11.5	10.9
Other	1.9	1.9	1.9	1.9	1.9	1.9
Total Non-current Liabilities	102.8	103.4	98.4	116.3	106.4	95.8
Long-term debt	102.8	103.4	98.4	116.3	106.4	95.8
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total shareholders' equity	294.2	324.2	346.8	348.3	368.4	394.8
Total liab. & equity	426.1	462.4	485.3	490.1	504.6	524.6
Net Debt/(Cash)	112.3	111.0	101.3	98.1	80.7	56.9
Gearing	2.3	2.1	2.0	4.3	1.8	1.0
Capital Employed, HRK m	410.4	439.1	451.8	450.1	452.9	455.3

Operational highlights

Operational highlights	2017	2018	2019	2020E	2021E	2022E
Nautical						
Vessels on berth contract	712	741	740	720	740	740
Transit berths - inbound vessels	3,527	3,263	3,418	2,392	3,450	3,475
Transit berth overnight stays	12,144	10,639	11,227	14,610	13,110	11,468
Average contract rate (HRK)	38,611	38,903	40,686	39,984	42,111	43,584
Revenues per transit vessel	819.1	762.8	820.8	1,034.1	850.0	862.8
Transit berth ADR	237.9	234.0	249.9	169.3	223.7	261.4
Hotels						
Number of accomodation units	443	443	443	443	443	443
Open days	242	234	229	230	230	230
Rooms Available ('000)	107	104	102	102	102	102
Accommodation units sold ('000)	69.7	73.0	73.3	10.0	33.0	70.8
Occupancy on open day basis	65.0%	70.5%	72.1%	9.8%	32.4%	69.5%
Revenues per sold room	671.7	726.4	762.1	792.5	824.2	849.0
Camps						
Maximum pitch days ('000)	219.2	273.3	335.5	334.0	338.4	338.4
Camp units sold ('000)	126.0	152.7	182.7	157.1	178.3	184.0
Occupancy	57.5%	55.9%	54.4%	47.0%	52.7%	54.4%
Revenues per sold pitch	213.3	198.7	174.2	143.1	179.7	190.2

Gross revenues (HRKm) by segment



Investment case

We initiate coverage of Ilirija with a BUY recommendation and a price target (PT) of HRK 178/share, offering upside of 37%. In its business operations, as one of a rare number of listed tourism companies in Croatia, Ilirija covers all of the key segments of the Adriatic Mediterranean tourism offering, which is: the hotel sector (hotels: Ilirija**, Kornati****, Adriatic*** and Villa Donat****/***); the nautical sector (Marina Kornati****, and hotel port Ilirija-Kornati); camping (campsite "Park Soline"****); the real-estate segment (commercial shopping centre City Galleria in Zadar, with more than 28.500m^2 of gross area over six floors, and a total of 9.898m^2 net rented floor area); and destination management company/DMC Ilirija Travel (Arsenal in Zadar, Villa Primorje****, diffuse hotel Ražnjevića dvori AD 1307, and event boat "Nada"). Also, it has developed a hospitality services hospitality (restaurants "Marina Kornati" and "Park Soline", the "Donat" beach bar and and the "Lavender" lounge bar), a sports-recreational and entertainment centre (tennis center Ilirija, with 20 tennis courts, and an aquatic centre, with hospitality facilities), and it organises the largest floating boats fair in the region – the Biograd Boat Show. The stable revenues from the marina business and the shopping centre in particular have insulated Ilirija's earnings from the worst of the COVID-19 pandemic, and its reasonable balance sheet management means that Ilirija should be able to resume growth investments once the pandemic has resolved itself, as well as dividends, in our view. The business has, historically, generated a ROCE of c.8% (vs. our WACC assumption of 7.5%) and we expect this to the remain the case from 2022E-onwards. On our numbers, the stock trades currently at 2021-22E EV/EBITDAs of 8.9x and 6.4x, respectively, or a 40% discount vs. its peers. However, its liquidity, we have to note, is extremely poor: over the past three years, it has traded, on average, just three days out of each month and its 6M ADTV is just EUR 809. For investors that can accept this limitation, however, the current entry point seems attractive, in our view.**

Compared to the traditional Croatian resort operators, which rely primarily on streams of beachgoers during the summer season, Ilirija's business also has Marina Kornati, one of the largest marinas on the Croatian Adriatic coast, and nautical tourism. The marina's primary earnings driver is providing year-round mooring for charter and private vessels; this is a stable business that, last year alone, generated HRK 30.1m for Ilirija, or 18% of its total revenues. In short, if you have a boat or a yacht, you do not pack it up with you what it is time to head home – you have to park it somewhere. The coastline along Zadar county, where Biograd na Moru is located, with its intricate shoreline and numerous islands, is a popular area for sailors and holidaymakers chartering boats. In addition to moorings and other associated services, Ilirija also operates four mid-sized hotels, a c.1,200 pitch campsite for more traditional holidaymakers, plus sports and dining facilities. The company also provides on-site event management at its own sites nearby, as well as organising and hosting the annual Biograd Boat Show, one of the largest floating boat shows in the region. In 2016, Ilirija acquired a shopping centre, City Galleria, in nearby Zadar, a six-floor shopping mall with 28,500m^2 of gross lettable area near the old city centre, which it financed with proceeds from a small capital increase and debt; we view this as an opportunistic purchase, having little synergy with the core tourism business. However, with >99% occupancy and a yield to its book value of c.12.2%, we estimate that it offers some EUR 3.7m (HRK 28m, or HRK 12 per Ilirija share) worth of "hidden" reserves, assuming a fair value yield for similar assets of 9%.

Our base-case assumption for Croatian tourism generally, and Ilirija specifically, is that 2021E should see a partial recovery in tourist numbers and, by the 2022E summer holiday season, the financially stronger, established players – businesses with the resources to establish and maintain appropriately stricter hygiene standards – should manage to return to pre-COVID-19 occupancy levels. For this year, we expect Ilirija, unlike most of its peers, to remain in the black, thanks its nautical and real estate businesses, where earnings have proven to be quite COVID-19 resistant. We expect 2020 net profit of c.HRK 1.4m on revenues of HRK 103m (-37% yoy), with EBITDA of HRK 22.9m (-54% yoy). We assume a partial recovery in the hospitality business in 2021E and, by 2022E, assuming that: 1) occupancy rates return to 2018-19 levels; and 2) a c.4% trend growth in ADRs, we believe that the business can deliver revenues of c.HRK 175m and net profit of c.HRK 31.3m. We do not see any acute balance sheet issues – management has already secured a 12-month deferral of all three of its long-term loans and extended the maturity on one short-term line – although growth capex has been suspended for the time being; we are modelling the business on a steady-state basis, with only maintenance capex, but we would include new investment plans in our model once approved.

On our forecasts, Ilirija trades currently at 2021-22E EV/EBITDAs of 8.9x and 6.4x, respectively, or a 40% discount vs. its peers; and at 2021-22E PERs of 15.5x and 10x, respectively, or discounts of 41% and 63%, respectively. This said, the forward consensus estimates for both Ilirija's domestic Croatian peers, as well as its global peers, are limited and, where available, the multiples are significant skewed by the COVID-19 crisis. In this situation, we have chosen to look at the historic (2016-19) multiples as an indication of where the stock could be expected to trade, assuming the environment normalises, back to something like pre-COVID-19. With this proviso in mind, we note that, over the past four years, Ilirija and its Croatian and global peers traded at median EV/EBITDAs and PERs of 10.9x and 21.1x, respectively (for its Croatian peers alone, the multiples were 10.2x and 14x), with Ilirija trading in line with its peers on EV/EBITDAs and at a c.34% discount on PERs. Applying the peer multiples to our average 2021-22E earnings, with the appropriate training premia/discounts, we see a fair value for the stock of HRK 165/share, or a 7% discount to our DCF PT.

We see two main risks for our investment thesis. Firstly, the competition from other marinas in the region, both domestic and foreign. The second is that Ilirija may have to invest more than we have reflected in our model to modernise its hospitality and shopping centre assets. As for the first, we see no indication that the Croatian government wants to expand the number of concessions for new marinas massively; that said, we believe that the marina owners in the region are improving their services, with the aim of attracting new business. Also, boats are, by definition, not fixed to any one location. Our impressions is that Ilirija's clients are not the super-rich, who demand five-star amenities both onshore and offshore; these individual choose between Côte d'Azur, the UAE, Sydney and Florida. Ilirija's core clients are, rather, Croatian charter companies (whose customers pay for the experience of being at sea, not onshore), or the merely well-off (i.e., Germans, Austrians) who appreciate Biograd's accessibility by car and the bucolic surroundings. The likelihood that either group relocates for the livelier nightlife and wider range of amenities of a larger city like, say, Dubrovnik, is small, in our view. As for Ilirija's hospitality assets, they are historically competitive, but younger generations are rather drawn towards "experiences"; Ilirija may have to spend more, e.g., on "glamping" (glamorous camping), which is on the drawing board, but not yet reflected in our model. Regarding the shopping centre, it appears to have been maintained at a high level and the interior fully renovated 12 years ago. That said, it is approaching 20 years and is competing with a new asset on the edge of town; we cannot rule out that additional capex might be needed down the line.

Company description

Ilirija was founded in 1957 as a platform for organised tourism along the so-called Biograd Riviera, a stretch of coastline of over 20km located south of the city of Zadar, as well as the outlying islands (Kornati, Pasman). At the turn of the 1970s, Ilirija refurbished or built its current hotel assets, but really distinguished itself in 1976, when it purchased a fleet of 40 charter vessels (sailing yachts) and built Hotel Port Kornati, the country's first marina, with a total of 100 berths, becoming the pioneer of large-scale nautical tourism in the country.

In 1986, Ilirija expanded the marina significantly, to 405 berths (wet and dry slips); and, in 1998, it invested in sports facilities, i.e., a tennis centre and an aquatic centre, with the latter being a swimming, beach and sports, entertainment and hospitality facility, with bleachers with capacity of 4,000 seats. In 1991, Ilirija expanded its tourism offering, with the Park Soline campsite, and expanded the marina to its current capacity of 810 berths (740 wet slips and 70 dry slips).

The company's privatisation process started in 1993, when the Croatian Privatization Fund transformed Ilirija into a joint stock company. In 1999, the company was privatised as Arsenal Holdings d.o.o., owned by Davor Tudorović, and Australian businessman born in Croatia (in Pasman, very near Biograd na Moru). Arsenal Holdings is one of the business owned by the Tudorovic Group, a family-owned enterprise based in South Australia. In recent years, the responsibility for the oversight of Arsenal Holdings and Ilirija has been exercised by Mr. Tudorović's son, David. Ilirija was listed on the Zagreb Stock Exchange (ZSE) in 2003.

In recent years, the company has focused on improving the customer experience at its existing assets, including the modernisation of Marina Kornati in 2015-17, as well as event management (under Ilirija Travel). In late-2016, the business acquired a shopping centre, City Galleria (9,898m^2 of leasable area), near the historic centre of Zadar. The acquisition of the shopping centre, bought for HRK 78m (EUR 10.4m), was financed by a share capital increase of HRK 31m (24,700 new shares at HRK 1,255/share) – which diluted Arsenal's stake in Ilirija to 59.21%, from 65.13% – and a 15-year loan of EUR 6m (HRK 45.3m).

At the end of 2019, Ilirija's hospitality business consisted of the Kornati Marina, four hotels, one campsite and a destination management company (DMC Ilirija Travel**)**. The company's five operating segments are:

- ✓ **Hotels:** 36% of gross revenues. Ilirija owns and operates three hotels in Biograd na moru – Ilirija, Kornati and Adriatic, together with 371 rooms – and Villa Donat hotel in nearby Sv. Filip i Jakub (72 rooms). Ilirija and Kornati (4*) are located in the city center, near the marina, while Adriatic (3*) is located on the beach in the city centre, adjacent to the company's aquatic centre. Villa Donat has 16 4* rooms and an annex (56 rooms) classified as 3*. It has its own outdoor swimming pool, and is located near the main beach and the town center (4.4 km).
- ✓ **Nautical:** 29% of gross revenues and 42% of EBITDA. Marina Kornati is comprised of the original hotel marina (100 wet slips), directly adjacent to the historic city centre and the newer, larger marina (710 slips, including 70 dry slips) on the western side. Two-thirds of segment revenues are generated by the letting of permanent mooring for the vessels of charter companies and privately-owned vessels, c.6% is from transit (short term) mooring and one-quarter from other nautical services (port services, car parks, revenues from external service providers at the marina and events including the Biograd Boat Show, one of the oldest and largest such events in the region). Ilirija operates the marina on the basis of a government concession; the current one is valid until 2031 and can be extended for another 15 years. Ilirija has the legally acquired rights to protect the its investments and legitimate expectations, as the investments in Marina Kornati are assessed in the share capital of the company, which are a protected constitutional and legal category.
- ✓ **Camping:** 21% of gross revenues. Ilirija's Park Soline campsite consists of 1,208 pitches, from which the company generates several revenue streams. These include the rental of its own upscale mobile homes (225 units), which generated c.40% of segment revenues last year, but also short-term rentals for recreational vehicles or tents (20% of segment revenues). Another c.33% of revenues come from annual rental fees from travel agencies (which set up their own trailers or tents), or from individuals who pay a lump-sum fee for the use of a pitch for the full season.
- ✓ **Ilirija Travel:** the company's event management unit, which includes: 1) the Arsenal polyfunctional event centre in the nearby city of Zadar; 2) the event ship "Nada", a 36m multifunctional yacht; 3) diffuse Hotel Ražnjevića dvori AD 1307, a multi-functional facility, located in the settlement of Polača; and 4) Villa Primorje, a renovated traditional Dalmatian stone nobleman's house, with gardens and an outdoor swimming pool. Last year, Ilirija Travel organised over 600 events, attended by almost 55,000 people.

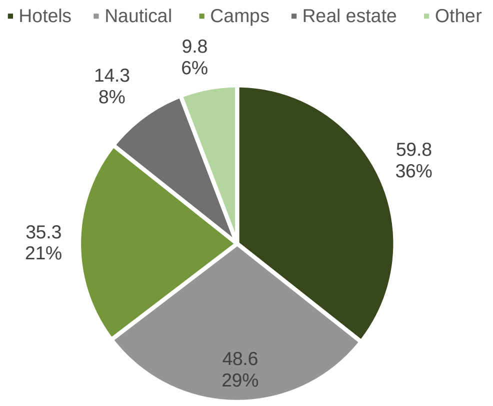
- ✓ **Real estate:** 8% of gross revenues and 14% of EBITDA. The segment is comprised of City Galleria in Zadar, with a total gross area of 28,500m^2 over six floors, including four floors with commercial space (net rentable area 9,898m^2) and two floors of underground garages (10,863m^2, 410 parking spaces). Additionally, the mall includes a six-screen multiplex theatre. The three largest tenants – Spar Hrvatska, Müller trgovina and Blitz – Cinestar – account for 49% of lettable area; the remainder is other food and service businesses, fashion, entertainment and office space; occupancy at end-2019 was at 99.8%.

Ilirija: tourism properties

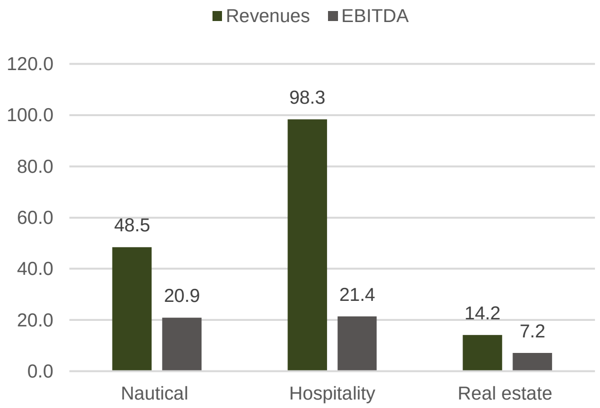
	Moorings / Rooms / Pitches	Stars	TripAdvisor rating	TripAdvisor local ranking	Location
Marina Kornati	810	4*	4.0	n.a.	Biograd na Moru
Ilirija	165	4*	4.0	1 of 13	Biograd na Moru
Kornati	106	4*	3.5	5 of 13	Biograd na Moru
Adriatic	100	3*	4.0	4 of 13	Biograd na Moru
Villa Donat	72	4* / 3*	3.5	1 of 6	Sveti Filip i Jakov
Campsite Park Soline	1,208	4*	3	38 of 256	Biograd na Moru

Source: TripAdvisor, WOOD Research

2019 revenues by segment (HRK m)



2019 EBITDA by segment (HRK m)

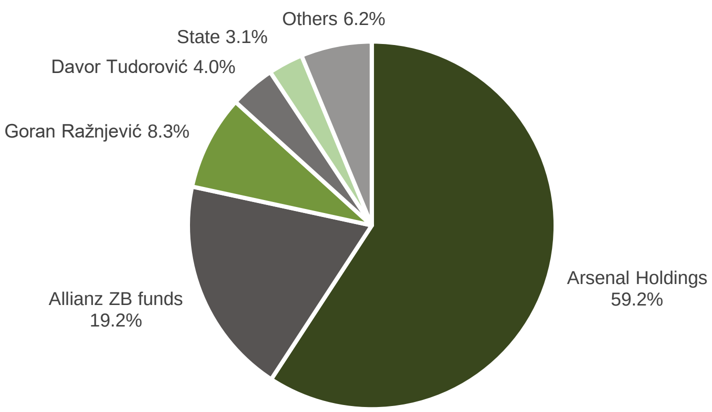


Source: Company data, WOOD Research

In addition to its operating assets, the company has a landbank of c.10 hectares, most of which (c.75%) is adjacent to existing facilities, e.g., Villa Donat in Sv. Filip i Jakov, the Villa Primorje Hotel, and the tennis centre at Park Soline. Additionally, it owns c.2.5 hectares of land in the settlement of Polača, situated along the state road that connects Biograd to the nearby highway. The land plot is equipped with basic utilities infrastructure, where Ilirija could build a dry marina, which would be functionally linked to the existing Marina Kornati.

Shareholder structure and corporate governance

Shareholders' structure



Source: Company data, WOOD Research

Ilirija's controlling shareholder is Davor Tudorović, an Australian businessman born in Croatia, who acquired the business during the period of state asset privatisation in the late-1990s. Mr. Tudorović owns 59.2% via his Croatian assets platform, Arsenal Holdings, and another 3.97% directly. Funds managed by the Croatia's AZ assets management hold 19.2% and Ilirija's CEO Goran Ražnjević owns 8.3% currently.

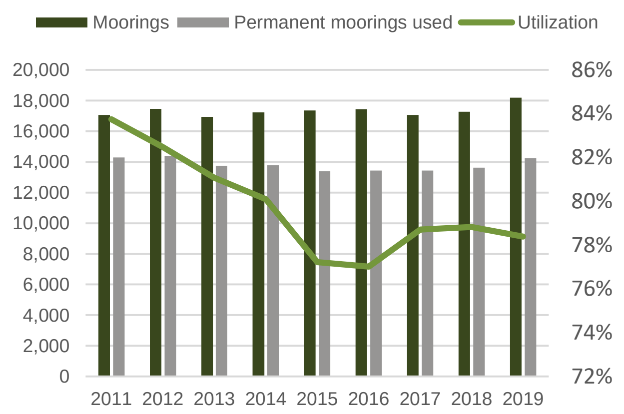
Mr. Ražnjević, who has managed the business since 2000, is the sole member of the Management Board and is appointed by the five-member Supervisory Board for a term of five years. Before his appointment as CEO, Mr. Ražnjević was director of Ilirija's financing and accounting section (1990-2000) and prior to that Director of Tax Administration for the city of Biograd. He is a member of the Association of Marinas of the Croatian Chamber of Commerce, one of the trade group representing the country's nautical tourism industry both at home and abroad, and was a court expert in finance and accounting.

Nautical tourism in Croatia

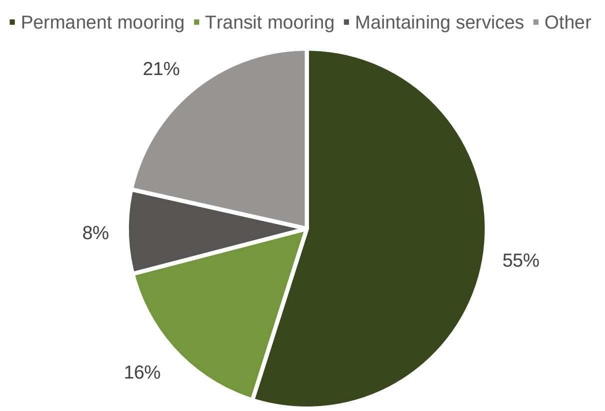
Nautical tourism in Croatia is a well-established industry, generating revenues of HRK 918m (c.EUR 124m) last year, according to the Croatian Bureau of Statistics data, and growing at c.5% p.a. (a 2015-19 CAGR). According to the most recent data, there are 61 wet slip and 17 dry marinas in the country – up from 50 and 10, respectively, in 2011 – with a surface area of 5,136,000m^2 and a total of 18,179 moorings (both wet and dry slips). Around 200,000 vessels moor at Croatian marinas on an annual basis, of which the largest number (c.47%) sail under a Croatian flag, followed by vessels from Italy (c.14%), Germany (c.12%), Austria (c.7%) and Slovenia (c.4%).

Mooring fees – the cost of "parking" a boat – account for c.70% of total revenues generated by the industry and the majority of these (more than three-quarters) come from permanent moorings of c.14,000 boats paid for by owners of charter or privately-owned vessels. On average, these vessels pay mooring fees for 26.7 days per month – a little more during the winter months, fewer during the summer season – so this represents a very stable income stream for marinas. The remaining 20-25% of revenues from mooring fees are generated by so-called transit vessels, i.e., boats just passing through; around 200,000 transit vessel moored at Croatian marinas last year, each for an average of 1.7 days. In terms of the total days of moorings, the figure was 4,030,000 days last year, with just over 90% on a permanent basis.

Moorings in Croatia

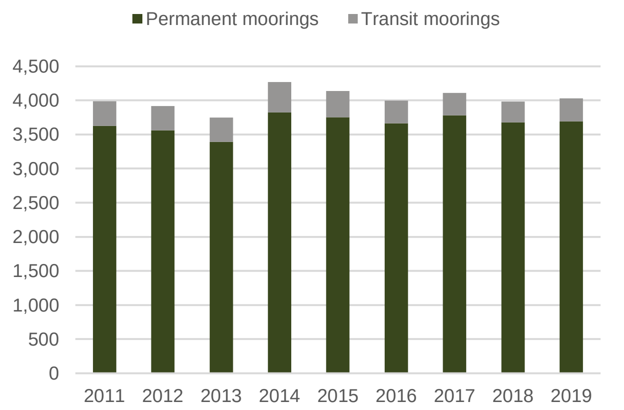


Nautical tourism revenues by activity (2019)

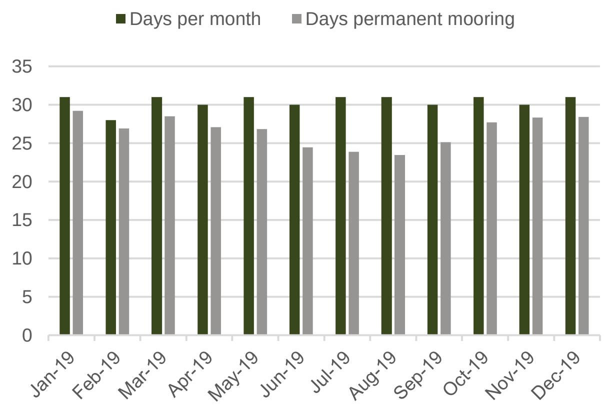


Source: Croatian Bureau of Statistics, WOOD Research

Usage of water moorings ('000 days)



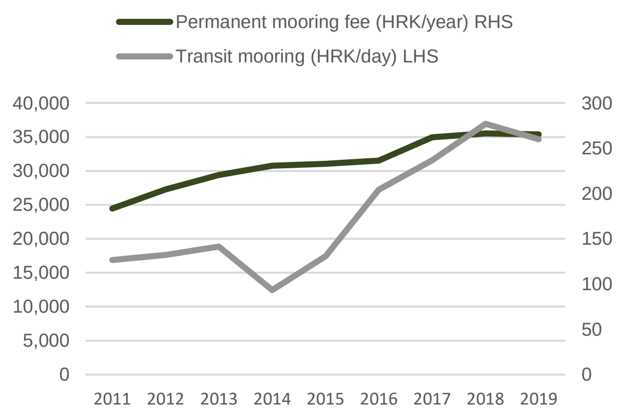
Days permanent mooring by month (2019)



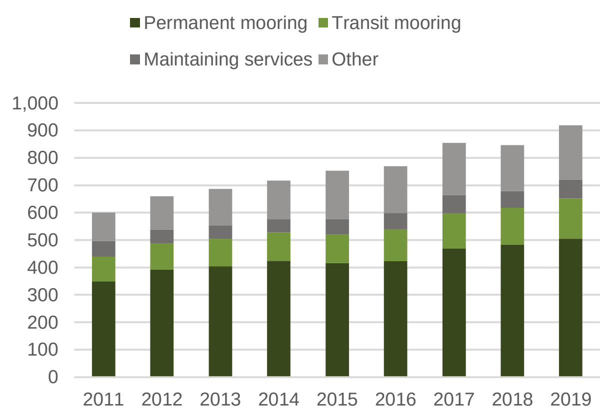
Source: Croatian Bureau of Statistics, WOOD Research

We note that in Croatia marinas are part of the public nautical domain, so the rights to operate a public marina, such as Ilirija's Marina Kornati, are awarded on the basis of a government concession, typically for 30 years. The effect is that the capacity in the sector has been allowed to grow, but at a slow pace, which has been supportive for pricing in the industry as a whole. We understand from Ilirija's management that the complicated system for awarding concessions for new marinas is a key reason for the slow growth of new capacities. In absolute terms, for most of the decade, the number of wet slips has been very stable, at c.17,250 (although they grew by c.900, to c.18,200, as have the number of days those moorings are used (between 3.9-4.1m days annually)). The growth in revenues, therefore, has been driven primarily by pricing. On our calculations, the annual cost of a permanent mooring has grown by just under 5% annually between 2011 and 2019. The average daily costs of transit mooring have grown even more quickly, by over 9% annually; although, here, we note that the average daily price is influenced by the length of stay. That said, the total price paid for mooring during a single visit to a Croatian marina has grown, on average, by c.7% over the past decade.

Average permanent and transit mooring fees



Revenues from nautical tourism (HRK m)



Source: Croatian Bureau of Statistics, WOOD Research

Of the 61 wet-slip marina in Croatia, Ilirija's Marina Kornati ranks among the top-three in terms of size, capacity and available services, the other two being D-Marin Dalmacija near Zadar and Marina Punat on the island of Krk. Marina Kornati has 740 wet slips and can handle vessels up to 25m in length, with a maximum draft of six metres. D-Marin Dalmacija – which belongs to the D-Marin chain, operating 14 marinas in the Eastern Mediterranean and Gulf region – has 1,200 wet slips and accommodates vessels up to 60m and 8m in draft. Marina Punat has 800 wet slips and accommodates vessels up to 45m, but only 3m in draft. The largest marina operator in Croatia is ACI Club, which is 78%-owned by the state, with 22 marinas (18 year-round, four seasonal), with a total capacity of c.5,500 vessels. They are generally smaller operations, however; the median capacity of the 18 year-round marinas is 210 vessels. Due to their ability to accommodate larger vessels, the larger marinas, like Kornati, tend to serve as more active hubs for charter operators, as well as for maintenance and repair services.

Financial forecasts

Our base-case assumption for Croatian tourism generally, and Ilirija specifically, is that 2021E is likely to see a partial recovery in tourist numbers and, by the 2022E summer holiday season, the financially stronger, established players – businesses with the resources to establish and maintain appropriately stricter hygiene standards – should manage to return to pre-COVID-19 occupancy levels. For this year, we expect Ilirija, unlike most of its peers, to remain in the black, thanks to its nautical and real estate businesses, where earnings have proven to be quite COVID-19 resistant. We expect 2020 net profit of c.HRK 1.4m on revenues of HRK 103m (-37% yoy), with EBITDA of HRK 22.9m (-54% yoy). For next year, assuming occupancy level at the hotels at 45% of 2019, a more or less normal state at the camping site, and a low-single digit ADR and berthing fees growth, we assume net profit of HRK 20.1m on revenues of HRK 135m (c.83% of the pre-COVID-19 levels) and EBITDA of HRK 44.4m. Assuming that the 2022E hotel occupancy rates normalise, we then see net profit of HRK 31.3m, on revenues of HRK 175m. We do not see any acute balance sheet issues – management has already secured a 12-month deferral of all three of its long-term loans and extended the maturity of one short-term line – although growth capex has been suspended for the time being; we are modelling the business on a steady-state basis, with only maintenance capex, but would include new investment plans in the model once approved.

Key financial data

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Hotels	47.3	51.3	57.1	59.8	8.7	29.5	63.7	66.6
Nautical	44.1	45.1	46.2	48.6	44.3	48.7	50.6	52.0
Camps	27.3	29.8	33.5	35.3	24.6	35.2	38.3	40.9
Real estate	0.0	12.3	14.2	14.3	13.1	14.1	14.4	14.6
Other	9.0	11.1	8.5	9.8	10.0	10.0	10.0	10.0
Other operating revenues/discounts	-4.6	-3.0	-3.1	-4.2	2.2	-2.2	-2.1	-2.0
Total operating revenues	**123.2**	**146.6**	**156.4**	**163.5**	**102.9**	**135.3**	**174.8**	**182.2**
EBITDA	**42.8**	**48.6**	**52.5**	**50.2**	**22.9**	**44.4**	**57.7**	**60.4**
Profit from operations	33.8	37.5	39.7	35.8	7.2	28.2	41.0	43.1
Profit before taxation	30.5	33.9	36.9	31.3	1.6	24.6	38.2	40.5
Net profit	**29.9**	**27.2**	**36.9**	**31.3**	**1.4**	**20.1**	**31.3**	**33.2**
EPS (HRK)	13.5	13.2	15.3	13.0	0.6	8.4	13.0	13.8
DPS (HRK)	2.5	3.0	3.5	0.0	0.0	2.1	3.3	3.4
Dividend yield	2%	2%	2%	0%	0%	2%	3%	3%
Net debt/EBITDA	2.7	2.3	2.1	2.0	4.3	1.8	1.0	0.6
ROCE	8.4%	7.3%	9.0%	7.9%	1.4%	5.1%	7.4%	7.7%
FCF yield	-26.9%	2.5%	2.0%	3.9%	1.0%	5.6%	9.2%	9.7%

Source: Company data, WOOD Research

Revenues by segment

Nautical

Given the nature of the business, i.e., the majority of marina revenues are generated from fees for permanent moorings, Ilirija's nautical business should be largely unaffected by COVID-19, providing a solid base for the company's revenues and earnings. Contract berth revenues, i.e., permanent moorings, have, historically, generated right under 70% of the segment total (for the Croatian nautical tourism market as a whole, the figure is just under 80%), and we do not see that this should change materially in the coming years. Between 2016-19, Ilirija's average contract rates increased at a CAGR of 3.4% (vs. a CAGR of 4.0% for Croatian marinas as a whole, we calculate) and, in our model, we assume a 2019-23E CAGR of 2.6%. In view of the area's popularity as a base for both charter vessels and private individuals, which accounted for 43% and 57% of Ilirija's contracts last year, respectively, we assume that the number of vessels on berth contracts remains at the recent levels.

COVID-19 has had an interesting impact on transit berth revenues: in 1H20, the number of inbound vessels dropped by three-quarters to 268, although the number of transit overnight stays actually rose by 15%, i.e., fewer visits, but significantly longer stays in the marina (an average of 14.9 days in 1H20 vs. 3.3 days in 1H19). In our model, we assume somewhat longer stays in 2020-21E (6.1 days and 3.8 days, respectively), before normalising to the 2018-19 level of 3.3 days in 2022E. Similarly to contract rates, Ilirija's transit berth ADRs have increased at a 2016-19 CAGR of 3.6% (vs. 8.4% for the country as a whole, on our calculations) and we expect c.2% growth going forward.

The balance of the nautical segment's revenues are generated by Other nautical services and Other services, together around 35% of the total. The nautical services line is comprised of port services (c.25% of the 2017-19 total), vehicle parking (c.20%), revenues generated from cooperation with other service providers at the marina (c.20%), other sundry services, the Biograd Boat Show and other events (c.30%). The latter, in particular, has been a notable driver for the line, generating revenues of c.HRK 3.9m last year vs. HRK 2.3m in 2016 or a CAGR of 19%.

Nautical segment: key revenue and operating data

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Contract berth revenue	26.3	27.5	28.8	30.1	28.8	31.2	32.3	33.4
Transit berth revenue	2.8	2.9	2.5	2.8	2.5	2.9	3.0	3.1
Other nautical services	10.0	10.2	11.1	11.8	9.7	11.1	11.5	11.8
Other services	5.0	4.5	3.8	3.9	3.3	3.5	3.8	3.8
Total revenue	**44.1**	**45.1**	**46.2**	**48.6**	**41.0**	**45.2**	**46.8**	**48.2**
Vessels on berth contract	714	712	741	740	720	740	740	740
Transit berths - inbound vessels	3,544	3,527	3,263	3,418	2,392	3,450	3,475	3,500
Transit berth overnight stays	12,463	12,144	10,639	11,227	14,610	13,110	11,468	11,550
Average contract rate (HRK)	36,817	38,611	38,903	40,686	39,984	42,111	43,584	45,110
Revenues per transit vessel	791.2	819.1	762.8	820.8	1,034.1	850.0	862.8	875.7
Transit berth ADR	225.0	237.9	234.0	249.9	169.3	223.7	261.4	265.4

Source: Company data, WOOD Research

Hotels

Unsurprisingly, hotels have been affected the most of Ilirija's businesses by COVID-19, although currently, in our model, we assume a return to business as usual only from 2022E-onwards. Up until this year, hotel revenues were driven by a mix of ADR growth and improving occupancy rates. Ilirija's revenues per room sold – which includes the ADR and included meals, but not other hotel services – increased at a 2016-19 CAGR of 3.9% and we assume a similar pace for 2020E-onwards. Hotel capacity is almost wholly seasonal, with the company also managing the number of open days to maximise its occupancy rates and, by extension, ADRs (e.g., reducing open days during the off-peak parts of the season, visible between 2017 and 2018). Currently, we do not expect any new capacity in the segment; although plans exist to expand the Villa Donat hotel, management has put them on hold until the full extent of COVID-19's effects on the business become clear. In our model, growth in the segment is driven primarily by a recovery in occupancy rates and modest ADR inflation of c.4% p.a.

Hotel segment: key revenue and operating data

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Revenue from board services	43.5	46.8	53.0	55.8	7.9	27.2	60.1	62.9
Bars and sport centres	3.8	4.5	4.1	4.0	0.8	2.4	3.6	3.6
Total revenues	**47.3**	**51.3**	**57.1**	**59.8**	**8.7**	**29.5**	**63.7**	**66.6**
Number of accommodation units	443.0	443.0	443.0	443.0	443.0	443.0	443.0	443.0
Open days	226.2	241.9	233.7	229.4	230.0	230.0	230.0	230.0
Rooms Available ('000)	100.2	107.2	103.5	101.6	101.9	101.9	101.9	101.9
Accommodation units sold ('000)	64.0	69.7	73.0	73.3	10.0	33.0	70.8	72.0
Occupancy on open day basis	63.9%	65.0%	70.5%	72.1%	9.8%	32.4%	69.5%	70.6%
Revenues per sold room	680.3	671.7	726.4	762.1	792.5	824.2	849.0	874.4
Variance analysis								
Rooms Available		3.0	-1.9	-1.0	0.0	0.0	0.0	0.0
Occupancy		0.8	4.2	1.3	-50.2	19.0	32.1	1.0
Average daily rate		-0.5	3.8	2.6	2.2	0.3	0.8	1.8
Revenue from board services		**3.3**	**6.2**	**2.8**	**-47.9**	**19.3**	**33.0**	**2.8**

Source: Company data, WOOD Research

Campsite

As we have seen at other peer companies, the revenues at the campsite have not been nearly as badly affected by COVID-19 as the hotels – what with being outdoors, in the fresh air, camping is being viewed as the safer holiday option – and we understand that this has also been the case so far this year at Ilirija's Park Soline camp. The camp generates several distinct revenues streams, the largest and fastest-growing being rental revenue from the company's mobile homes, numbering 225 units currently (vs. 135 units in 2016). Mobile home rentals generate significantly higher revenues per sold pitch compared to letting an empty pitch, with average revenues of HRK 692/pitch last year vs. an average of HRK 175 for all of the company's 1,220 pitches. Similar to hotel rooms, the average 2016-19 revenues increased at a CAGR of c.3%, which we expect to continue going forward. The company has drawn up investment plans for 20-30 glamping units for the 2022E season, worth c.EUR 1m, which we assume could generate revenues similar to mobile homes, as well as for an outdoor pool for the camp (EUR 3.0m). The investment is conditional on the government extending the company's concession for the campsite – as with marinas, the right to operate camps is awarded by government concession – although, as with the Villa Donat expansion, the investments are on hold due to COVID-19 and not reflected in our modelling.

The other revenues streams at the camp are pitch rentals to travel agencies, individual campers and caravanners, or so-called lump sum rentals. Travel agencies rent pitches from Ilirija for an entire season (so generating an occupancy rate of 100% for Ilirija) to install their own caravans or permanent tents, which they then offer to holidaymakers in their catalogues. Last year, Ilirija rented 270 pitches to agencies at an average daily rate of HRK 67/pitch. Between 2016 and 2019, the average rates for agency rentals has declined by a CAGR of 11.5%, which reflects the general pressure on this segment of the market, as agencies generally target low-end price customers at a time when travellers are demanding better accommodation (e.g., Ilirija's own mobile homes). So-called lump sum rentals are, as we understand it, to private individuals who, like agencies, rent pitches for the whole season to use as their "summer home". Revenues growth has been driven by higher number of such rentals, while average prices have been on a slow decline (a 2016-19 CAGR of -3.3%, while we assume -4% going forward). Here, management's calculated trade-off between lower average rental rates vs. 100% occupancy seems a fair one in terms of overall revenues growth.

Pitches available to individual campers/caravanners last year totalled 508, or c.40% of the pitch capacity, and this figure has been declining as management shifts more of its inventory towards its own mobile homes or to lump-sum customers. Pricing here follows a similar trend to hotels and mobile homes, i.e., is of low-single digit CAGR growth (the average rate last year was HRK 278/pitch), although occupancy rates, even with a lower number of pitches available, have been falling: 16.5% in 2019 vs. 23% in 2016 – although we note that the weather on the continent last year was particularly unfavourable for this segment. Going forward, we conservatively estimate the occupancy here in the mid-high teens, although this could improve, in our view, assuming new investments into improving travellers' experiences (e.g., the new swimming pool).

Campsite segment: key revenue and operating data

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Mobile homes Ilirija	8.9	10.8	12.5	13.1	8.6	13.9	16.7	18.2
Agencies	4.0	4.4	4.7	5.0	3.5	4.1	4.3	4.4
Individuals	7.2	7.1	7.4	6.4	3.7	6.9	7.9	8.5
Lump sum	3.1	3.4	4.4	5.5	5.5	5.6	4.3	4.4
Other camp services	1.7	1.4	1.5	2.0	1.2	1.6	1.8	2.0
Other revenues	2.4	2.7	3.0	3.3	2.1	3.2	3.3	3.4
Total revenues	**27.3**	**29.8**	**33.5**	**35.3**	**24.6**	**35.2**	**38.3**	**40.9**
Maximum pitch days ('000)	218.1	219.2	273.3	335.5	334.0	338.4	338.4	338.4
Camp units sold ('000)	115.6	126.0	152.7	182.7	157.1	178.3	184.0	186.6
Occupancy	53.0%	57.5%	55.9%	54.4%	47.0%	52.7%	54.4%	55.1%
Revenues per sold pitch	207.9	213.3	198.7	174.2	143.1	179.7	190.2	201.2
Variance analysis								
Pitches available		0.1	6.0	5.9	-0.1	0.4	0.0	0.0
Occupancy		2.1	-0.7	-0.7	-3.6	3.4	1.1	0.5
Average daily rate		0.6	-1.8	-3.7	-5.7	5.7	1.9	2.0
Camp rental revenues		**2.3**	**3.4**	**1.5**	**-9.5**	**9.5**	**3.0**	**2.5**

Source: Company data, WOOD Research

Real estate

Despite the impact of COVID-19 on retailers, we understand that Ilirija's City Galleria shopping centre has, so far, managed to avoid the worst of the pain. During the spring lockdown (from 19 March to 11 May), lessees representing 57.4% of net rentable space were unable to operate, while others operated with reduced working hours. By end-June, however, regular operations were resumed, save for the Cinestar multiplex cinema (according to the mall's website, the cinema reopened, with social distancing, from 20 August). Reported occupancy remained at the 2019 level, i.e., at 99.8%.

In 2019, the shopping mall reported average monthly rental at EUR 10.7/sqm, c.16% higher than the first full year under Ilirija's ownership. The company does not disclose the turnover of the tenants. As such, we cannot calculate the occupancy cost ratio (rent as a percentage of renters' sales), so it is difficult to assess whether the level of rents is reasonable. That said, we note that EUR 10.7/sqm does not strike us as particularly demanding, looking at other smaller centres in regional cities in SEE. We also note that the shopping centre seems well-frequented, with over 3.5k reviews on Google, which are largely positive (4.1/5.0).

At end-2019, the building was valued at EUR 10.34m on the balance sheet, and does not seem to be carried at fair value. On the EUR 10.7/sqm rents, this would translate into a yield of 12.2%. Investor appetite for retail real estate assets has been subdued lately, so there is little transaction evidence to suggest the fair pricing for shopping centres in CEE – for such relatively niche assets in smaller towns, in particular. That said, we would rather expect the fair yield to be somewhere in the high single digits. Assuming that the building would be valued at 9%, the implied fair value would amount to c.EUR 14.0m, offering some EUR 3.7m (HRK 28m or HRK 12 per Ilirija share) worth of "hidden" reserves, relative to its current book value.

Based on the 1H20 data, we judge that Ilirija has seen a small negative impact on its rental income and, on our assumptions, we assume average rental income to fall by c.9% yoy, to EUR 9.7/sqm. For 2021E-onwards, we then assume 2% p.a. growth in rental income, i.e., in line with inflation. This said, we cannot rule out that further restrictions aimed at limiting the spread of the pandemic may be introduced, which could disrupt Christmas trading. If this were the case, we cannot rule out that Ilirija may need to offer some accommodative agreements to its tenants, to prevent tenant failures and ensure that vacancy does not increase excessively.

Real estate: revenues and lease rates

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Lease of Business units	n.a.	8.2	9.5	9.4	8.7	9.2	9.3	9.5
Common expenses	n.a.	2.9	3.1	3.2	3.0	3.2	3.3	3.4
Lease of common areas	n.a.	0.5	0.6	0.6	0.7	0.7	0.7	0.7
Advertising space	n.a.	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Garage parking	n.a.	0.7	0.8	0.9	0.5	0.9	0.9	0.9
Other business revenues	n.a.	0.0	0.2	0.1	0.1	0.1	0.1	0.1
Total revenues	n.a.	12.3	14.2	14.3	13.1	14.1	14.4	14.6
Lease price (EUR/sqm/year)	n.a.	110.7	131.2	128.0	116.6	122.5	125.8	129.2
Lease price (EUR/sqm/month)	n.a.	9.2	10.9	10.7	9.7	10.2	10.5	10.8

Source: Company data, WOOD Research

Operating costs

Typically, for the hospitality segment, Ilirija's single biggest cost line is labour costs, which represented c.29% of total revenues last year. This is up from 25% of revenues in 2016, and was driven by headcount, i.e., 283 full-time employees in 2019 vs. 210 in 2016. Materials and energy represent c.15% of the cost base, followed by services (repairs and maintenance, rental costs, municipal utility services and advertising) at c.14% and Other operating costs (contract workers, commissions and concession fees, etc.) around 12.5%. In total, operating expenses including depreciation represented c.79% of revenues last year and have increased at a 2016-19 CAGR of c.13% vs. a revenues CAGR of c.10%, primarily on the back of higher labour costs. Looking forward, the company has made it clear that it does not plan any permanent layoffs as a result of COVID-19; that said, we assume a stable level of headcount, in line with the company plans to suspend growth capex. We assume that the Other costs line will remain at the 2017-19 levels as a share of revenues, implying a return to an EBITDA margin of c.33% once, we assume, revenues normalise from 2022E-onwards.

Effective tax rate

The effective tax rate paid by the company over the past four years has varied significantly, due to the availability of the different tax breaks it has been able to utilise. In 2016, it was able to reduce its effective tax rate to just 2% by re-investing profits into an increase in the company's share capital. During 2019, the company was notified that it qualified for an investment tax break for prior years' investments, which allowed it to reduce its corporate tax obligation to zero for 2018 and 2019. Inasmuch as the company has suspended growth capex plans due to the COVID-19 crisis, we assume, in our model, that Ilirija's effective tax rate will revert to the standard rate of 18% from 2021E-onwards.

Balance sheet, capex and cash flows

Ilirija operates with prudent levels of debt, in our view, considering the industry and its shopping centre investment. The company's net debt to EBITDA stood at 2.0x at end-2019 and, while this grows to 3.8x at end-2020E, on our forecasts, the company has already reached an accommodation with its lender regarding covenants, so this should not be an acute issue for the coming quarters, in our view.

Ilirija has three main long-term loan facilities, all with Erste & Steiermarkische Bank and denominated in EUR, which totalled EUR 15.2m at the end of 2019 (including the current portion of long-term borrowing), and a long-term lease agreement of EUR 2.569m. As noted above, management has already secured a 12-month deferral of payments for all three of its long-term loans (until April 2021) and, in our view, should not have any issues with servicing its debts once the deferrals expire. A EUR 1.68m loan for the reconstruction of the marina and a EUR 7.491m loan to refinance older debt, both approved in 2016, are both for fifteen years, as is a EUR 6m loan to finance the acquisition of the City Galleria shopping centre; the most expensive are only 3.25%. As a result, the cost of servicing the debt, both principle and interest payments, should not exceed HRK 14m for the coming two years (2021-22E).

Thanks to the stabile nature of the nautical business in particular, in 1H20, the company still generated cash from operations of HRK 18.7m and we expect cash from operations at a similar level for FY20E, assuming 3Q20E at c.50% of the 2019 level, but losses in 4Q20E (a traditional feature of the business' seasonal nature and the company's revenue recognition policy, e.g., revenues from services are recorded at the date of invoicing), on a par with the levels observed in 2018-19. For 2021E, we assume cash from operations of HRK 38m, or >3x that year's debt servicing costs, and a similar level for 2022E.

In terms of capex, in our model, we assume this to remain at maintenance levels of EUR 2.5-3m for 2021E, throughout our forecast horizon. As noted above, management has drawn up plans for room expansion in the hotel segment (Villa Donat), and for glamping units and an outdoor pool for the Park Soline campsite. Due to the pandemic, however, these have all been put on hold and are not reflected in our modelling. In 2016-19, the company invested, on average, c.EUR 4m annually (excluding the acquisition of City Galleria), with the most important projects being an extensive renovation of Marina Kornati (for the 2018 season), but also a total of 75 mobile homes at Park Soline, an indoor pool for Hotel Ilirija, gasification of the boilers all three hotels in Biograd, replacing the exterior fences of the Ilirija and Kornati Hotels with glass ones, and the renovation of the outdoor surface areas of City Galleria.

Valuation

DCF valuation

We value Ilirja using a 10Y DCF model, with a multiples valuation as a sanity check. On this basis, we arrive at a DCF-based 12M PT of HRK 178/share, or upside of c.37% to the current level. The key assumptions in our DCF model include:

- ✓ A WACC of 7.5%, 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 0.79x, based on an unlevered beta of 0.63x from the Damodaran sector beta database for European hotel and gaming companies.
- ✓ A terminal value calculated as the average of the perpetuity, with a 0% terminal growth rate, and an exit EV/EBITDA of 8.0x.

DCF valuation

HRK m	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
EBIT	7.2	28.2	41.0	43.1	44.6	45.9	47.3	48.7	50.2	51.7
NOPLAT	6.3	23.2	33.6	35.3	36.6	37.7	38.8	39.9	41.2	42.4
Depreciation	15.7	16.1	16.7	17.3	17.9	18.5	19.2	19.8	20.5	21.2
Change in NWC	-1.2	0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capex	-12.8	-19.1	-19.6	-20.2	-20.8	-21.4	-22.0	-22.7	-23.4	-24.1
FCF	**8.1**	**20.4**	**31.2**	**32.5**	**33.8**	**34.9**	**36.0**	**37.2**	**38.4**	**39.6**
PV of FCF	**8.1**	**18.9**	**26.9**	**26.1**	**25.2**	**24.1**	**23.1**	**22.2**	**21.3**	**20.5**

	I. Perpetuity (g=0%)	II. Exit EV/EBITDA 8.0x
Sum of PV	216	216
PV of Terminal value	268	301
Total EV	**485**	**518**
Net Debt (2019A)	-101	-101
Equity value	**383**	**416**
Equity value (HRK/sh)	158.8	172.5
Average (HRK/sh)	166	
12M PT (HRK/sh)	**178**	

Risk-Free Rate	5.0%
Levered Beta	0.79
Risk premium	5.5%
Cost of Equity	**9.3%**
Cost of Debt	3.2%
Tax Rate	18.0%
Effective Cost of Debt	**2.6%**
Weight of Equity	72.9%
Weight of Debt	27.1%
WACC	**7.5%**

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%
5.5%	206	217	228	242	258	277	300	329	366
6.0%	190	199	209	220	233	248	267	289	317
6.5%	176	183	192	201	212	225	239	257	279
7.0%	163	170	177	185	194	204	216	231	248
7.5%	152	158	164	170	178	187	197	208	222
8.0%	142	147	152	158	164	172	180	190	201
8.5%	133	137	141	146	152	158	165	173	183
9.0%	124	128	132	136	141	146	152	159	167
9.5%	117	120	123	127	131	136	141	147	154

Source: WOOD Research

Peer multiples

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
ILIRIJA DD	**HR**	**130.0**	**41**	**218.7**	**15.5**	**10.0**	**17.9**	**8.9**	**6.4**	**22%**	**33%**	**33%**
ARENA HOSPITALITY GROUP DD	HR	270.0	183	n.m.	37.1	10.7	n.m.	11.8	7.2	-17%	24%	31%
PPHE HOTEL GROUP LTD	NE	10.8	504	n.m.	n/a	29.8	210.1	19.6	11.5	4%	25%	32%
MELIA HOTELS INTERNATIONAL	SP	3.27	720	n.m.	n/a	59.4	-43.0	13.9	8.9	-11%	18%	23%
DALATA HOTEL GROUP PLC	IR	2.55	568	n.m.	n/a	12.6	75.5	16.1	8.5	12%	27%	36%
NH HOTEL GROUP SA	SP	2.44	955	n.m.	n/a	1217.5	30.0	6.3	4.8	10%	30%	32%
ACCOR SA	FR	24.3	6,344	n.m.	n/a	28.5	-28.5	19.9	11.2	-14%	13%	19%
LEMON TREE HOTELS LTD	IN	28.1	255	78.9	n/a	330.6	19.0	35.2	15.6	35%	32%	41%
INDIAN HOTELS CO LTD	IN	100.6	1,372	35.5	n/a	54.3	15.5	75.1	16.3	22%	7%	22%
HUAZHU GROUP LTD-ADR	CH	291.3	78,735	n/a	39.3	24.8	135.9	19.3	14.4	7%	29%	32%
SH JINJIANG INTL HOTELS - B	CH	11.52	31,003	29.5	8.3	6.5	34.9	13.7	11.0	12%	21%	23%
MINOR INTERNATIONAL PCL	TH	18.1	2,545	n.m.	n.m.	22.6	69.8	11.2	8.3	5%	21%	23%
Peer median				**35.5**	**26.3**	**26.6**	**30.0**	**15.0**	**9.9**	**7%**	**24%**	**31%**
Ilirija vs. peer median				*n.m.*	*-41%*	*-63%*	*-40%*	*-41%*	*-33%*			

Source: Bloomberg, WOOD Research

As a sanity check for our DCF valuation, we look at Ilirija's 2021-22E forward earnings (which, in our model, represent a partial, respectively full return to business as usual) on the median peer multiples for hospitality businesses. However, the forward consensus estimates for both Ilirija's domestic Croatian peers, as well its global peers, are limited and, where available, multiples are skewed significantly by the COVID-19 crisis. In this case, we have chosen to look at the historic (2016-19) multiples as an indication of where the stock could be expected to trade, assuming the environment normalises, back to something like the pre-COVID-19 situation.

Historic Croatian tourism peer multiples

	EV/EBITDA 2016	EV/EBITDA 2017	EV/EBITDA 2018	EV/EBITDA 2019	PER 2016	PER 2017	PER 2018	PER 2019
Ilirija	10.4	10.4	10.4	10.8	11.1	14.4	11.8	14.1
Arena Hospitality Group	16.0	12.1	10.2	10.1	n.a.	28.1	23.0	12.3
Plava Laguna	8.0	9.4	8.9	8.6	11.7	15.4	11.2	17.3
Valamar Riviera	6.0	11.6	10.7	9.8	9.4	21.0	20.6	16.1
Maistra	9.2	10.9	10.7	10.0	17.9	20.3	11.2	20.8
Global peers	10.1	22.2	24.2	11.2	28.1	24.3	19.2	23.3
Median	**10.0**	**11.6**	**10.7**	**11.0**	**22.1**	**22.7**	**17.4**	**20.2**
Ilirija vs peer median	*5%*	*-11%*	*-3%*	*-2%*	*-50%*	*-37%*	*-32%*	*-30%*

Source: Bloomberg, WOOD Research

With this proviso in mind, we note that, over the past four years, Croatian tourism stocks have traded at median EV/EBITDAs and PERs of 10.2x and 14x, respectively. For the non-Croatian names in our peer comparison, the median EV/EBITDAs and PERs are at 16.7x and 23.8x, respectively, or 65-70% premiums to the Croatian companies. Taking both together, the historical median EV/EBITDA for the group works out at 10.9x and 21.1x on PER.

Using these multiples assumptions, and assuming Ilirija's historic premia/discount to the peer median, we see a fair value for the stock's average 2021-22E earnings at HRK 148/share, upside from the current level of 14%, but 17% below our DCF PT. On EV/EBITDA, we see a fair value of HRK 183/share, 40% upside from the current level and in line with our DCF valuation. The average of the two metrics is HRK 165/share, so 27% upside from current levels and c.7% below our PT.

Peer multiples valuation

HRK m	PER	EV/EBITDA
Peer group avg. multiples 2016-19	21.1	10.9
Trailing 4yr premium/(discount)	-34%	-2%
Average 2021-22E earnings forecast (HRK m)	25.7	51.1
EV		**542**
Net debt (2019)		-101
Equity value	**357**	**441**
Equity value (HRK/sh)	148	183
Weight	50%	50%
Fair value (HRK/sh)	**165**	

Source: Bloomberg, WOOD Research

Risks

- **While COVID-19 was largely contained during the 2020 summer season across most of Europe, the situation has deteriorated in recent months. It is impossible therefore to rule out the government imposing further travel restrictions until a vaccine for the infection becomes widely available.**
- **Ilirija has already secured a debt servicing moratorium on its long-term debt until April 2021, so should not find itself under acute stress over the coming quarters. That said, if the pandemic dictates further shutdowns and travel restrictions in 2021E, similar to this year, then Ilirija could be forced back into negotiations with the banks.** Given the stable revenues generated by the marina and the shopping centre, plus the relatively large size of the camping segment (which has been less affected by COVID-19) vs. the hotels, we see this as unlikely.
- **We assume that Ilirija will postpone its growth capex indefinitely, while it is still impossible to estimate the full impact of COVID-19 on the company's business. Nevertheless, our assumptions for maintenance capex may prove insufficient for ensuring that Ilirija's assets remain competitive.** Here, we would judge the potential risk mostly as being on the City Galleria shopping centre, which is facing competition from the newer Supernova Zadar located on the edge of the city, or on the hotel assets. Marina Kornati, we note, has already undergone a series of extensive renovations, for the 2018 and 2020 summer seasons.
- **ADRs could be depressed by small operators 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 accommodation (which, altogether, represent about half of the total rooms available) may not be, depressing prices for the industry as a whole.
- **Ilirija operates Marina Kornati and the Park Soline campsite on the basis of government concessions, and we cannot rule out that these will not be renewed/extended.**
- **We expect Ilirija to resume dividends from its 2021E earnings** but, depending on how the industry recovers, dividends could be delayed further and/or smaller than expected.
- Resort operators like Ilirija depend on the construction industry to build and renovate their properties, which could be a source of capex cost inflation.

Financials

Income statement

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Sales	121.8	143.4	154.9	160.9	96.7	133.6	172.9	180.2
Other operating revenues	1.4	3.2	1.5	2.6	6.2	1.8	1.9	2.0
Total operating revenues	**123.2**	**146.6**	**156.4**	**163.5**	**102.9**	**135.3**	**174.8**	**182.2**
Materials and energy	-18.3	-22.6	-23.3	-24.4	-11.5	-20.2	-25.9	-26.8
Services	-14.8	-18.9	-19.3	-21.7	-16.3	-18.0	-22.8	-23.8
Staff cost	-30.3	-38.9	-41.9	-47.4	-37.6	-36.1	-46.7	-48.6
Other operating expenses	-17.0	-17.6	-19.5	-19.9	-14.5	-16.7	-21.6	-22.5
Total operating expenses	-89.4	-109.1	-116.7	-127.7	-95.7	-107.1	-133.8	-139.1
EBITDA	**42.8**	**48.6**	**52.5**	**50.2**	**22.9**	**44.4**	**57.7**	**60.4**
D&A	-9.0	-11.1	-12.8	-14.4	-15.7	-16.1	-16.7	-17.3
Profit from operations	**33.8**	**37.5**	**39.7**	**35.8**	**7.2**	**28.2**	**41.0**	**43.1**
Net financial expenses	-3.3	-3.6	-2.8	-4.5	-5.6	-3.7	-2.8	-2.6
Profit before taxation	**30.5**	**33.9**	**36.9**	**31.3**	**1.6**	**24.6**	**38.2**	**40.5**
Income tax	-0.6	-6.6	0.0	0.0	-0.2	-4.4	-6.9	-7.3
Net profit	**29.9**	**27.2**	**36.9**	**31.3**	**1.4**	**20.1**	**31.3**	**33.2**
EPS (HRK)	13.5	13.2	15.3	13.0	0.6	8.4	13.0	13.8
DPS (HRK)	2.5	3.0	3.5	0.0	0.0	2.1	3.3	3.4
Dividend yield	1.8%	1.8%	1.9%	n.m.	n.m.	1.6%	2.5%	2.7%
EBITDA margin	34.8%	33.2%	33.6%	30.7%	22.3%	32.8%	33.0%	33.1%
Net margin	24.3%	18.6%	23.6%	19.2%	1.4%	14.9%	17.9%	18.2%

Source: Company data, WOOD Research

Balance sheet

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Intangible assets	0.4	0.3	0.4	0.5	0.5	0.6	0.6	0.5
PP&E	318.2	332.7	361.5	374.0	372.3	376.4	380.6	384.7
Investment property	78.5	78.8	77.7	76.7	75.5	74.2	73.0	71.8
Investment in subsidiaries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total long-term assets	**397.1**	**411.8**	**439.6**	**451.2**	**448.4**	**451.3**	**454.2**	**457.1**
Inventories	2.1	2.1	2.3	1.8	1.1	1.8	2.4	2.5
Receivables	8.3	8.4	13.4	15.8	9.5	13.2	17.1	17.8
Financial investments	2.5	2.2	1.8	1.2	1.2	1.2	1.2	1.2
Cash	2.3	1.5	5.2	15.2	29.9	37.1	49.8	63.9
Total current assets	**15.3**	**14.2**	**22.8**	**34.0**	**41.7**	**53.3**	**70.4**	**85.3**
Total assets	**412.4**	**426.1**	**462.4**	**485.3**	**490.1**	**504.6**	**524.6**	**542.4**
Share capital	175.0	229.1	229.1	229.1	229.1	229.1	229.1	229.1
Treasury shares	-0.5	-1.2	-1.1	-1.4	-1.4	-1.4	-1.4	-1.4
Capital reserves	26.7	2.7	2.9	2.9	2.9	2.9	2.9	2.9
Reserves	24.0	24.0	27.0	29.2	38.7	38.7	38.7	38.7
Retained earnings	19.9	12.3	29.4	55.6	77.6	79.0	94.1	117.6
Profit for the period	29.9	27.2	36.9	31.3	1.4	20.1	31.3	33.2
Total equity	**274.9**	**294.2**	**324.2**	**346.8**	**348.3**	**368.4**	**394.8**	**420.1**
Long-term loans	103.6	102.8	103.4	98.4	116.3	106.4	95.8	87.7
Total long term liabilities	**103.6**	**102.8**	**103.4**	**98.4**	**116.3**	**106.4**	**95.8**	**87.7**
Trade payables	19.0	16.1	20.1	20.1	11.9	16.5	21.3	22.2
Short-term loans	13.0	11.0	12.8	18.2	11.7	11.5	10.9	10.6
Deferred income	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Total current liabilities	33.9	29.0	34.8	40.1	25.5	29.8	34.0	34.7
Total liabilities	**137.5**	**131.8**	**138.2**	**138.5**	**141.8**	**136.2**	**129.9**	**122.3**
Total equity and liabilities	**412.4**	**426.1**	**462.4**	**485.3**	**490.1**	**504.6**	**524.6**	**542.4**
Gross debt	116.6	113.8	116.2	116.6	128.0	117.8	106.7	98.2
Net debt	114.3	112.3	111.0	101.3	98.1	80.7	56.9	34.3
Gearing	2.7	2.3	2.1	2.0	4.3	1.8	1.0	0.6
Capital employed	393.0	410.4	439.1	451.8	450.1	452.9	455.3	458.1
NOPAT	33.2	30.1	39.7	35.8	6.3	23.2	33.6	35.3
ROCE	8.4%	7.3%	9.0%	7.9%	1.4%	5.1%	7.4%	7.7%

Source: Company data, WOOD Research

Cash flow statement

HRK m	2016	2017	2018	2019	2020E	2021E	2022E	2023E
Net profit	29.9	27.2	36.9	31.3	1.4	20.1	31.3	33.2
Depreciation	9.0	11.1	12.8	14.4	15.7	16.1	16.7	17.3
Change in retained profit	0.0	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Sale of PP&E	0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Share bonuses	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Change in working capital	-14.8	-3.0	-1.3	-1.7	-1.2	0.1	0.4	0.1
Cash from operations	**24.2**	**34.5**	**49.2**	**44.0**	**16.0**	**36.4**	**48.5**	**50.6**
Purchase of intangible assets	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Purchase of tangible assets	-27.4	-24.7	-40.3	-25.7	-12.5	-18.8	-19.3	-19.9
Purchase of investment property	-78.5	-1.5	-0.1	-0.2	0.0	0.0	0.0	0.0
Decrease in investments in subsidiaries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Decrease in loans and deposits	3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Decrease/(increase) in short-term investments	-1.3	0.3	0.4	0.6	0.0	0.0	0.0	0.0
Net cash from investing activities	**-103.8**	**-25.9**	**-40.3**	**-25.6**	**-12.8**	**-19.1**	**-19.6**	**-20.2**
Issuing of new shares	33.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of treasury shares	-0.1	-0.7	-0.4	-0.4	0.0	0.0	0.0	0.0
Dividend paid	-4.9	-6.0	-7.2	-8.4	0.0	0.0	-5.0	-7.8
Increase/(decrease) in long-term borrowings	50.3	-0.8	0.5	-5.0	17.9	-9.9	-10.5	-8.2
Increase/(decrease) in short-term borrowings	2.7	-2.0	1.8	5.4	-6.4	-0.3	-0.6	-0.3
Net cash from financing activities	**81.6**	**-9.5**	**-5.2**	**-8.4**	**11.4**	**-10.2**	**-16.2**	**-16.3**
Change in cash	2.0	-0.8	3.7	10.0	14.7	7.2	12.7	14.1
Previous year	0.3	2.3	1.5	5.2	15.2	29.9	37.1	49.8
Current year	**2.3**	**1.5**	**5.2**	**15.2**	**29.9**	**37.1**	**49.8**	**63.9**
FCF	**-81.8**	**8.4**	**8.5**	**17.8**	**3.2**	**17.4**	**28.9**	**30.4**
FCF yield	-26.9%	2.5%	2.0%	3.9%	1.0%	5.6%	9.2%	9.7%

Source: Company data, WOOD Research

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