



Horwath HTL™

Hotel, Tourism and Leisure

Hotel Market Structure and International Hotel Chains in the Eastern Adriatic Region

2015

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Foreword

This Report provides an overview of the hotel market structure in the Eastern Adriatic region, as well as a review of international hotel chains and their penetration into the regional market.

Eastern Adriatic region, as defined in this Report, encompasses the countries that are geographically located on the eastern coast of the Adriatic Sea: Slovenia, Croatia, Bosnia & Herzegovina, Montenegro and Albania.

Eastern Adriatic is one of the last regions in Europe that can be considered as an emerging tourist market, which has yet to develop in the years to come. This refers not only to international hotel brands and their presence in the market, but to the overall development of hotel supply and demand. With this in mind, it is not surprising that this region is one of the least branded regions on the European hotel market. On average, share of internationally branded hotels in total hotel rooms stock in the Eastern Adriatic region falls below 13%, which is 3 times less when compared with European average. When comparing the countries within the region based on the share of branded hotel rooms the results vary significantly, ranging from 1% in Bosnia and Herzegovina to 16% in Croatia.

This Report is based on the market research performed in January/February 2015.

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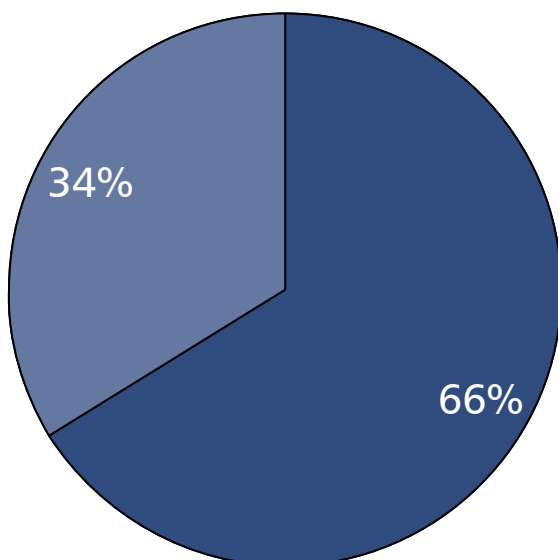
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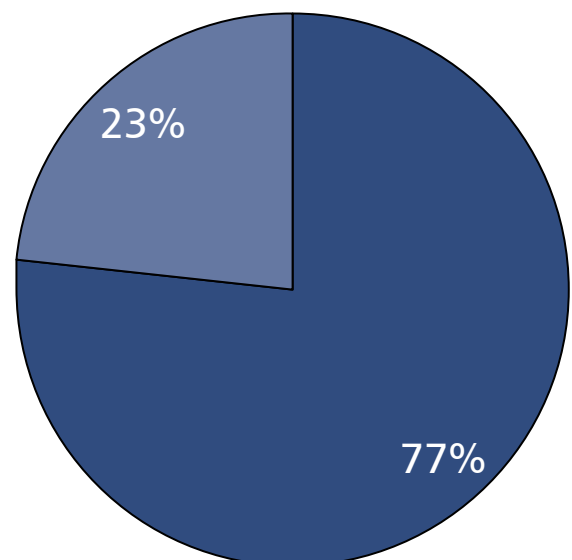
Key highlights

- The Eastern Adriatic region is one of the least branded regions on the European hotel market (3 times less branded than Europe in average).
- Largest number of international hotel brands entered the region during the last 10 years, focusing on the upscale segment and resort-type hotels.
- Dominant business model for international hotel chains in the Region is a management agreement, with just a few franchise agreements signed.
- Three quarters of internationally branded hotels belong to globally recognized brands, while one quarter belongs to regional hotel brands.
- The interest of international hotel brands for the region has increased over the last couple of years. A number of properties are currently in the pipeline or under negotiation, with management agreements still being the most common business model.
- Due to the dominant tourism product being "sun & beach", market entry barriers for international hotel operators are still present in the region, although the level of demand is constantly increasing.
- Due to its natural attractiveness, the region represents a market potential for international brands on a long run.

Branded hotels in the region



Branded rooms in the region



■ Global brands ■ Regional brands

Hotel market structure in the Eastern Adriatic region

Overall hotel supply structure in the Eastern Adriatic region has been formed in the 1960's and 70's, when most hotels that operate today were built. Today's asset structure per companies, especially in Croatia, relates to the former socialist enterprises that have been established parallel with the construction of the hotels. Former socialist enterprises in Croatia have been privatized on a company basis, thus preserving large companies with a number of hotels and other accommodation properties in their portfolio under one ownership.

In such market structure, the split between ownership and management functions does not exist. The companies both own and operate their hotels, most of them located in a single destination, thus forming the quasi-monopolistic structure (monopolistic competition), since one or two hotel companies control most of the hotel supply in the area. This kind of market structure limits the competitive rivalry among the hotels within the destination, since most of the hotels are sold by the same sales department.

On the other hand, the privatization process in Montenegro has been done not only on a company basis, but on an asset basis as well, resulting with the more fragmented ownership structure and a greater number of stakeholders within the destination.

Tourism products, location and seasonality issue

Since the dominant product in Eastern Adriatic tourism market is "sun & beach", hotels are concentrated along the Adriatic coast, where some 90% of overall hotel supply is located. In the hinterland, the largest concentration of hotels can be found around capital cities. Branded properties follow such geographic dispersion as well.

Due to "sun & beach" being the main tourism product, high seasonality remains an important issue for the hotel industry in the Eastern Adriatic region. Seasonal concentration of demand in four summer months affects business and profitability. As a consequence, the hotels are mainly oriented to low cost strategy as a dominant tool to manage profitability.

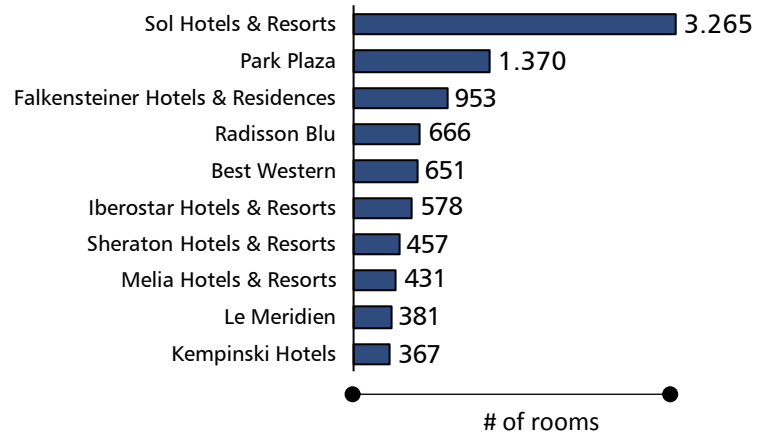


*Hilton Imperial Dubrovnik Hotel
Courtesy of Hilton Hotels & Resorts and Maistra d.d.*

International hotel brands and their presence in the region

21 different international hotel brands operate 59 hotels in the Eastern Adriatic region (without soft brands), most of them on the basis of management agreement, while franchise and service agreements are rare in the region. This is due to the necessity of international brands to limit the risk of lacking local management skills according to international standards that would potentially threaten the perception of the brand and its values. Most of the branded hotels are located along the Adriatic coast (42 branded hotels) and in capital cities of the region.

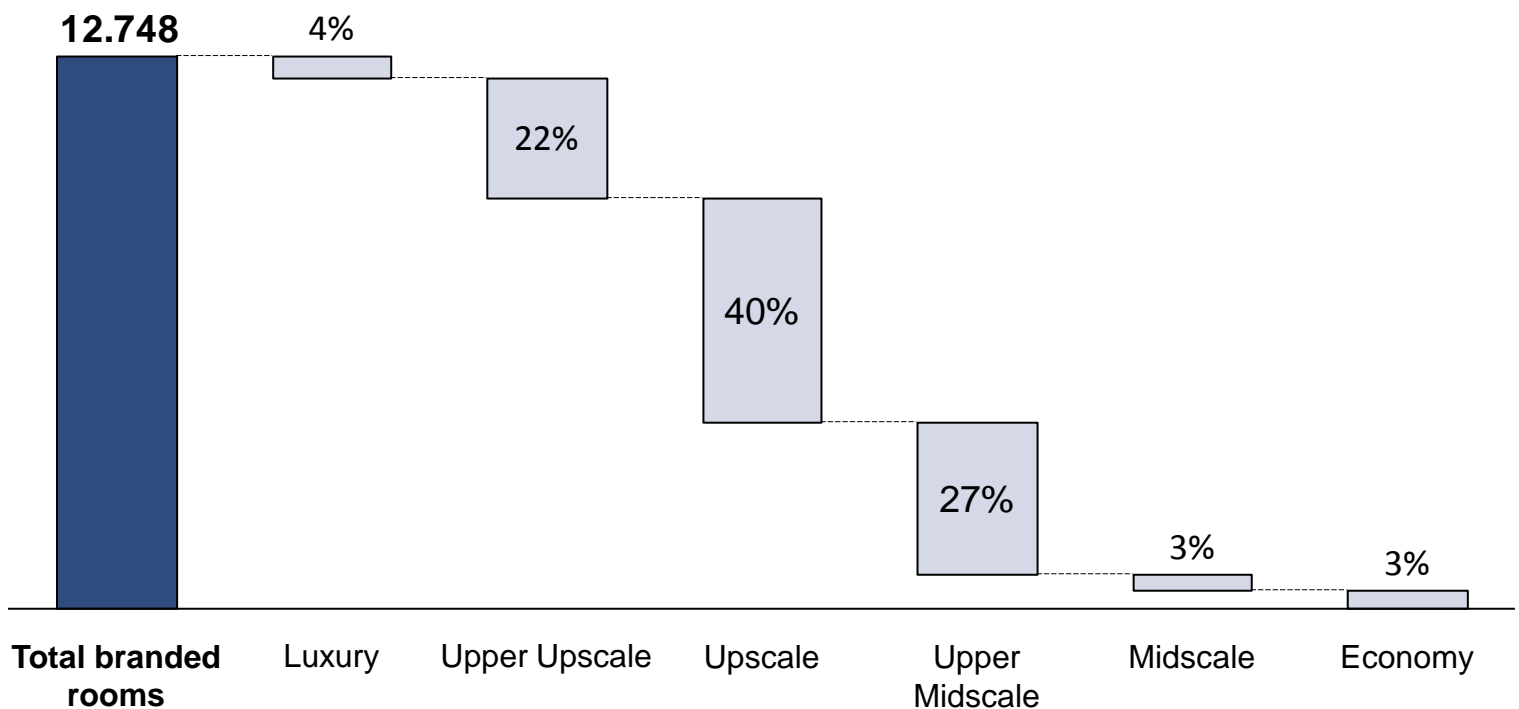
Top 10 international hotel brands in the Eastern Adriatic region
(based on management, franchise and service contracts)



Five of the top 10 largest global hotel companies (as per 325 Survey of Hotels Magazine, July 2014) are present in the Eastern Adriatic region with their brands. They currently operate 19 hotels in the region.



The biggest share (40%) of branded hotel rooms in the region falls within the upscale segment.



Some specifics per countries are as follows:

- With 16% branded hotel rooms out of total hotel supply, Croatia is the leader within the region., and represents the most developed hotel market in the Eastern Adriatic region.
- Bosnia and Herzegovina is at the very beginning with regards to international branding of the local hotel market, since only one hotel in Sarajevo has been recently branded by Marriott Residence Inn brand. This is the first hotel project opened in the region under Marriott's brand portfolio, and the other one is in pipeline for 2015.
- Albania has a very scarce presence of hotel brands, with only two hotels operating under international brands in Tirana (Sheraton and Best Western).
- Although only five hotels are internationally branded in Montenegro, in comparison with the region, Montenegro has the biggest share of higher-priced branded rooms, represented by Aman Resorts and The Regent brands. Pipeline of branded hotel projects that will enter the market in next couple of years is significant, and includes high-value global brands. Hotels in the pipeline are mostly located within high-end mixed-use resorts along Montenegro coast.
- Slovenia is moderately developed hotel market, with 8% of total hotel room supply being internationally branded and operated, with the equal share of city hotels and resort hotels being branded.

INTERNATIONAL BRANDS PRESENCE IN EASTERN ADRIATIC

	Nr. of hotels	Nr. of keys	Share in total
Global brands	47	9.792	8,9%
Regional brands	12	1.307	1,2%
Total	59	11.099	10,1%

Eastern Adriatic: Slovenia, Croatia, Bosnia and Herzegovina, Montenegro, Albania

* without soft brands

Source: Horwath HTL



*Hilton Imperial Dubrovnik Hotel
Courtesy of Hilton Hotels & Resorts and Maistra d.d.*

In the spotlight: Croatia

Croatia's hotel market structure

Being the most developed hotel market in the Eastern Adriatic region, Croatia shows the highest level of consolidation within its hotel industry. The consolidation process has been intensified over the last couple of years by several large mergers and acquisitions, after two decades of almost zero activity in the area of hotel transactions. Currently three large companies (or group of companies under a single ownership umbrella: Lukšić Group, Valamar Riviera and Maistra) operate half of the total commercial tourist accommodation in Croatia. Most of the stakeholders that took part in the consolidation processes were local and regional players, mostly due to their knowledge on how to overcome market entry barriers and overall business environment.

However, it should be noted that the main reason for consolidation in the Croatian hotel industry is not the acquisition of established hotel properties and their brands, geographic diversification or strategic fit, but primarily the desire to build scale in order to achieve higher profitability leverage through restructuration over the extended portfolio. Low cost strategy for the time being remains the dominant business approach for large hotel companies. In the post-consolidation phase, large hotel companies will put focus on rapid integration which will create different types of challenges such as protecting their core corporate culture, consolidating different management styles, portfolio management, single properties market positioning, or building an ICT platform that

will allow them to capitalize on economies of scale.

The key success factor is the contextual intelligence related to the market, which will allow the key stakeholders to focus their resources on the branding of their portfolio, in order to provide product diversification.

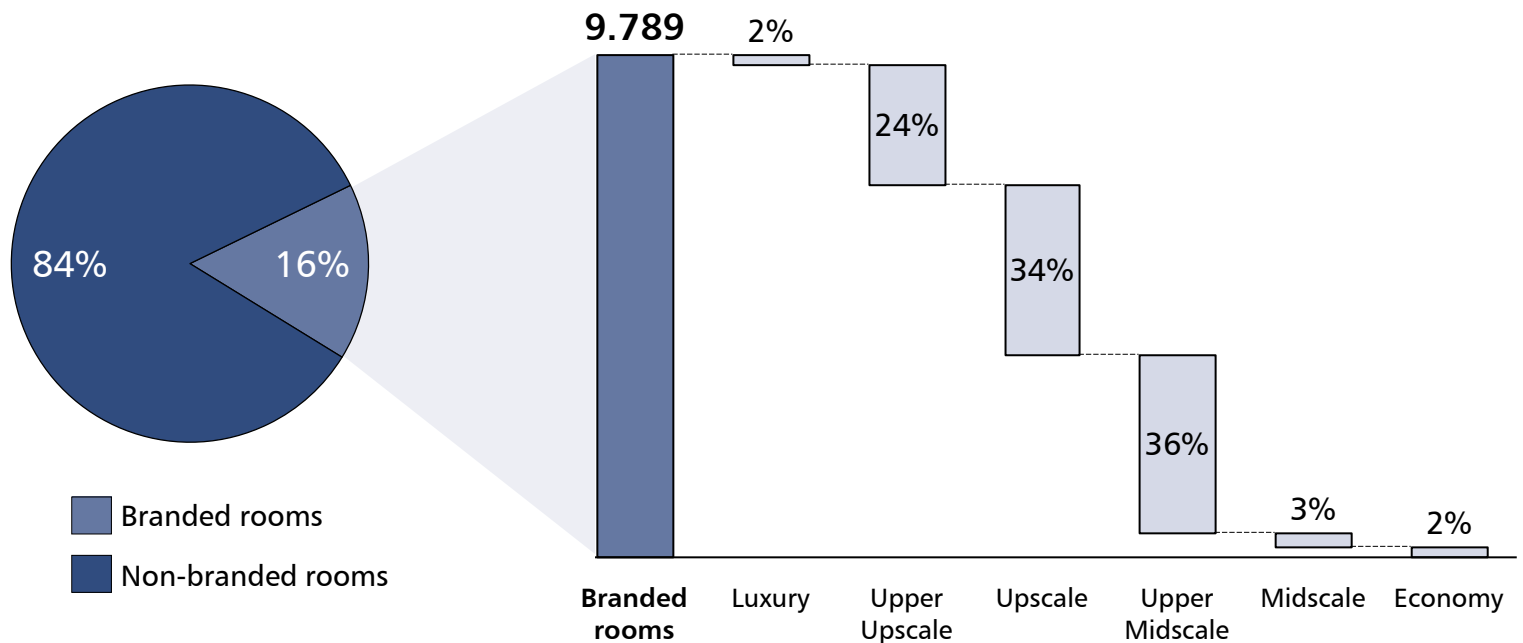
Penetration of international hotel brands in Croatia

Within the Eastern Adriatic region, Croatia is the most developed hotel market, mainly due to its supply of resort-type hotels, since more than 90% of Croatia's hotel capacities are concentrated along the Adriatic coast and on the islands. Most of these hotels operate in an extended season (6 to 8 months throughout the year). Due to the limited demand in low season (during the winter), very few high quality hotels operate year round due to the lack of demand.

There are 42 hotels in Croatia operating under international brands, out of which 9 are regional brands and 33 globally recognized brands, most of them operating based on management agreements. The share of hotel rooms operated under international brands is 16% out of total hotel room supply.

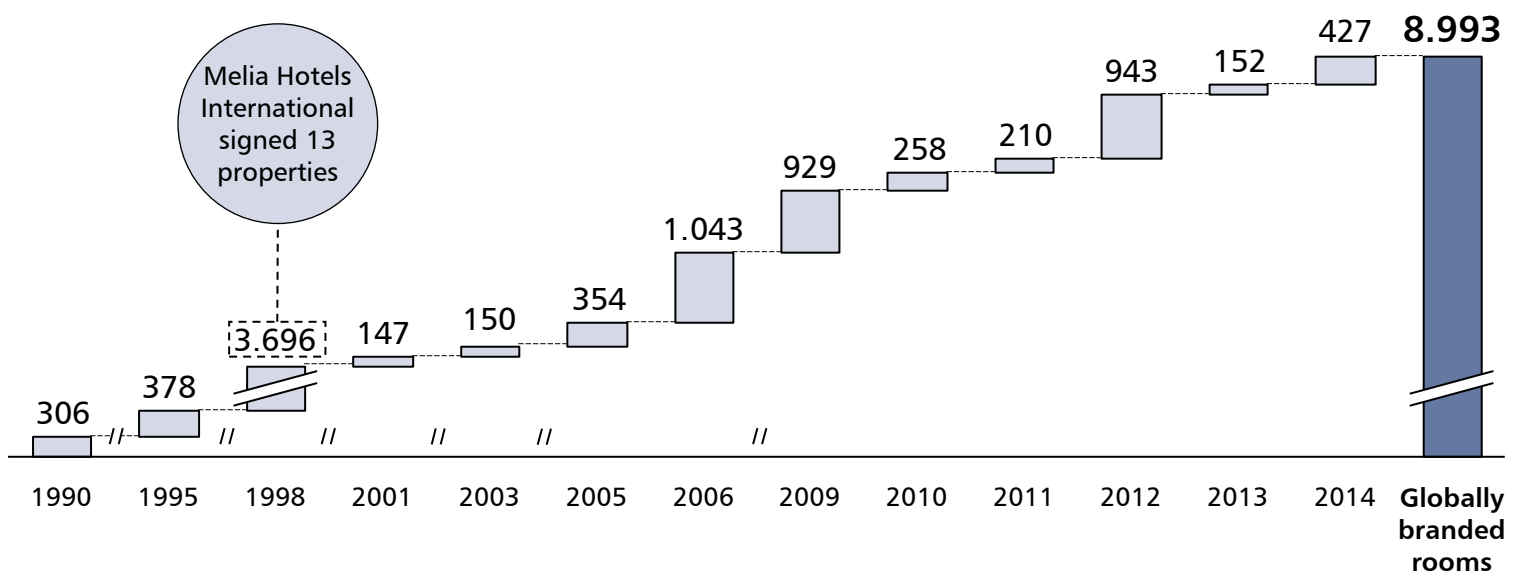
More than two thirds of internationally branded hotel rooms falls within the upper midscale and upscale segments. The smallest share of internationally branded rooms falls within the luxury segment, with Kempinski Hotels being the only luxury brand that entered the market.

Branded hotel rooms in Croatia



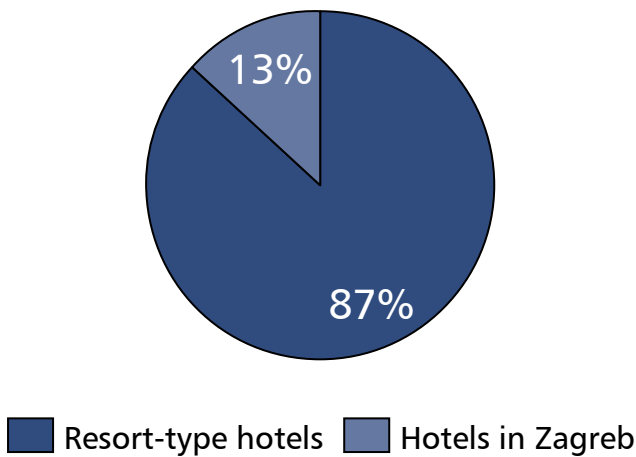
Global hotel brands first entered Croatia in the early 1990's, after which they have experienced stable growth. That growth intensified over the last 10 years, during which period almost 50% of globally branded hotel room stock. In the last couple of years, parallel with the market stabilization in the region, a number of international hotel companies have shown increasing interest in Croatia and the region, resulting with several projects currently under negotiation, waiting to be placed on the market and branded by global hotel brands over the next couple of years.

Dynamics of global hotel brands entering Croatian market



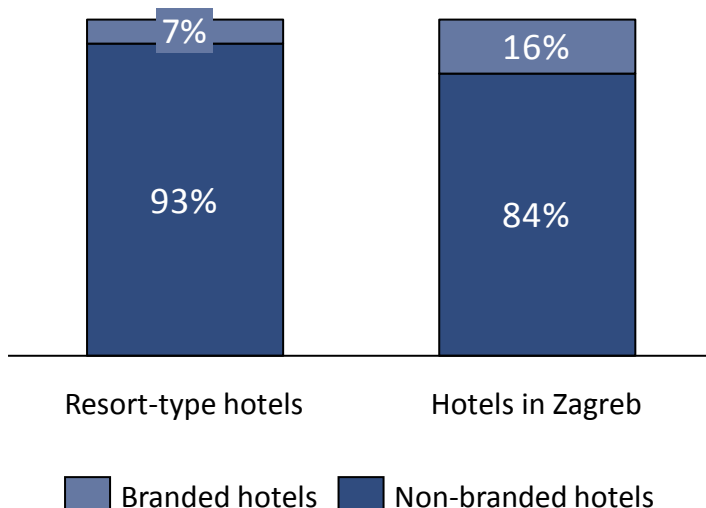
As expected, the biggest share of branded hotels in Croatia are resort-type hotels located along the Adriatic coast, while the rest are city hotels in Zagreb.

Branded hotels in Croatia



While branded hotels represent only 7% out of the total number of resort-type hotels in Croatia, internationally branded hotels in Zagreb represent 16% out of total hotels. Such concentration of international hotel brands in capital city is standard pattern.

Level of branding among hotel types in Croatia



Market outlook

While from the international investors perspective both Croatia and the Eastern Adriatic region are generally observed as a sort of „black box“ resulting in relatively low level of foreign direct investments in hotel industry, examples of some countries in the region (e.g. Montenegro) are showing that tourism investments are mostly real estate driven, with small share of commercial hotel facilities.

Generally, in Croatia and the whole Eastern Adriatic region there is a lack of tourism infrastructure such as large destination convention centres, golf courses, theme parks etc., that would generate additional market drivers to equilibrate the hotel demand year-round, and decrease the seasonality of demand concentrated in high summer season.

However, development projects of tourist infrastructure in the region are under preparation or underway, thus creating the prerequisites for lowering market entry barriers and operating risks for international hotel brands on medium and long term. Due to its natural attractiveness, the region represents a market potential for international hotel brands on a long run. This is proved by increasing interest of global brands looking for the opportunities along Adriatic coast and in the capital cities of the region.

About Horwath HTL

Horwath HTL is the world's leading hospitality consulting network. We are the industry's choice; a global network offering complete solutions across all markets.

At Horwath HTL, we focus on hotels, tourism and leisure. With over two hundred and fifty professionals worldwide, our network can draw on a tremendous amount of international experience and local knowledge that gives us, and our clients, a unique advantage. Horwath HTL has become synonymous with quality, service, impartial advice and expertise.

We offer a broad range of advisory solutions that covers the whole cycle of the hotel product, starting with planning and development, on to asset management and operational advice, to transactional and financial restructuring.

About the authors



Dr. Sanja Čizmar is a Senior Partner with Horwath HTL Croatia. Sanja earned her PhD degree in strategic management of hospitality industry at the University of Zagreb, Faculty of Economics and Business. She is a lecturer of hotel management at the Faculty for Economics and Business in Zagreb, and author of several text books about tourism and hospitality management, as well as numerous articles and columns in professional and scientific magazines. Sanja has built her hospitality industry management and consulting experience in South East Europe, working on consulting projects with the leading hospitality companies for more 20 years. She has been involved in over 400 projects including a wide range of project development assignments, coaching, asset management and hotel management contracting projects.



Mirko Jergović holds a masters degree in international tourism and hospitality management from EADA Business School in Barcelona, Spain. He started his career working as an Analyst for Horwath HTL Spain, where he worked on several high-profile projects, advising global hotel companies and investment funds. Since joining Horwath HTL Croatia as a Junior Consultant in 2014., Mirko has been working on various projects, advising both public and private sector in the region.



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