REPORT ON THE AUDIT OF THE COMPANY MERGER AGREEMENT BETWEEN

HOTEL BONAVIA d.d. Rijeka and

PLAVA LAGUNA d.d. Poreč

R E P O R T

ON THE AUDIT OF THE COMPANY MERGER

HOTEL BONAVIA d.d., with its registered office in Rijeka, Dolac 4, Republic of Croatia, registered at the Commercial Court in Rijeka, Company ID 040000036, (hereinafter: HOTEL BONAVIA d.d.),

and

PLAVA LAGUNA d.d., with its registered office in Poreč, Rade Končara 12, Republic of Croatia, registered at the Commercial Court in Rijeka – Pazin office, Company ID 040020834, (hereinafter: PLAVA LAGUNA d.d.)

LEGAL BASIS

1. Based on the decision of the Commercial Court in Rijeka ref. no. 9-R1-106/12-2 from 2 July 2012, as proposed by the merging companies ("the merging companies"), the company PricewaterhouseCoopers d.o.o. was appointed as the auditor of the company merger.

2. In accordance with the provisions of Articles 512 and 513 of the Companies Act, the Management Boards of the merged companies have concluded a Merger Agreement, a draft of which we received on 24 September 2012.

   The Merger Agreement determines the share exchange ratio between the merging companies. The Management Boards established the share exchange ratio based on the standard valuation method, i.e. the discounted future cash flow method (the DCF method).

3. In accordance with the provisions of Art. 515 of the Companies Act, the responsibility of PricewaterhouseCoopers d.o.o., as the appointed auditor of the merger, is to review the Merger Agreement, and to express an opinion on whether the share exchange ratio is appropriate in respect of which the shareholders of the merged company will become shareholders of the acquiring company.

   Hence, our responsibility is to prepare a report which states:

   - the methods of establishing the share exchange ratio,
   - the reasons for which the selected share exchange ratio method is appropriate, and

- which share exchange ratio could be obtained from the application of different methods, if used, and the significance of individual methods for establishing the proposed exchange ratio and the value on which it rests, and the specific difficulties that have arisen in assessing the companies.

ESTABLISHING THE SHARE EXCHANGE RATIO METHOD

4. The merger involved the following companies: Hotel Bonavia d.d. (merged company) and Plava laguna d.d. (the acquiring company), pursuant to the Merger Agreement. The selection of the method for the share exchange ratio used by the Management Boards of the companies is examined, in addition for the companies in the contract, in the context of the activity these companies are engaged in as well as the market conditions that are manifested and recognised in the present moment.

   According to Article 14 (fourteen) of this Merger Agreement, the companies agreed that the share exchange ratio should be determined in accordance with the values from the valuation in accordance with the discounted cash flow method, in a way that treasury shares are excluded from the number of shares when determining the share exchange ratio.

5. In their own analysis and judgments, the companies used the basic valuation method in determining the capital value of each of the merging companies for the purpose of determining the share exchange ratio, as follows:

   - By using the <u>Discounted cash flow method</u> (DCF method), the future net cash inflows and outflows which are recorded in the present value by discounting (Article 14 of the Agreement).

   The merging companies also sought alternative valuation methods for the purpose of finding the most appropriate share exchange ratio. Hence, they analysed the accounting method, and they tried to use the method of multipliers. However, at the beginning of the valuation there were sufficient reasons for both of the companies to withdraw from the stated methods.

6. The auditor examined the applicability of other alternative methods and concluded the following:

   - With respect to the comparative method, there is no reliable comparable local data except for reporting, i.e. accounting data. However, it is immediately clear that companies in the same industry apply different valuation methods and different report accounting, since these are mostly subsidiaries of foreign investors from different parts of the world. Abroad it is also not possible to obtain valuation data, but only reporting data that are also characterised by large differences in the valuation of investments and results.

- By using the carrying value method, the companies' value was estimated on the basis of individualised carrying values of total capital that is presented in the audited financial statements as at 30 June 2012. The result of such analysis indicated a systematic generation of losses in the company Hotel Bonavia d.d. so that the carrying net assets did not have any returns, i.e. profit in a number of years. Based on such operations, the balanced equity of Hotel Bonavia d.d. has a negative trend, and it would therefore be necessary to record the liquidation value, not the value in such operations.

- Valuation methods that are based on the analysis of historical costs are not used (return on capital, return on assets). The auditor also considered them not to be appropriate, since in the tourism industry the market rewards intangible elements, for which there is no acquisition cost, such as: specialised tourist offer, general tourist attraction of the location, developed reputation and conveyed impressions that attract new visits, nearby arrangements, the proximity of transport, cultural, financial, religious or other facilities and other influences. The stated intangible elements were not found to be sufficient for the company to operate positively, and the historical result has already been explained in the above-described carrying value method.

- The current market (average) or the last spot value is not appropriate for the calculation of any share exchange ratio due to a very shallow market on the one hand, and the lack of a statistically reliable range of the market value of shares on the current financial market.

Given the capital intensive nature of tourism activities on the one hand and the high sensitivity (elasticity) of demand and revenues in this sector on the other hand, it emerged that the economic valuation of the current and future status is covered by two methods: the carrying value method, in which there are no predictions of future events, and the discounted cash flow method, which is based on the present value of future relatively safe events. In this sense, the DCF method remains as the only applicable one.

By accepting the discounted cash flow method and the share exchange criteria pursuant to the valuation based on this method, the contractual parties agreed to the merger while recognising the entrepreneurial value of companies and shares of the merging companies on this basis.

Values based on the carrying value method

Values using the carrying value method are not reliable because during 2012 Hotel Bonavia d.d. revalued fixed assets with the result of decreasing it, and is reducing its share capital. In the circumstances of continuous losses, this revaluation does not change the expected value for future periods. On the contrary, for the share exchange ratio it would be necessary to record liquidation values, and therefore the auditor withdrew from further processing and reporting of this data.

Values based on the discounted cash flow method

	Plava laguna d.d.	Hotel Bonavia d.d.
- in HRK		
Estimated value	2,140,923,727	1,307,705
Number of ordinary shares	536,848	1,491,763
Estimated value per share	3,987.95	0.88
Share exchange ratio at estimated value (DCF method)	1.00	0.00022066

REASON FOR APPLICATION OF DCF METHOD FOR SHARE EXCHANGE RATIO

7. When deciding on the share exchange ratio and the acceptance of the Merger Agreement, a calculation was carried out based on the discounted cash flow method, and the possibilities of applying other methods were also checked. The above methods were examined by the auditors in order to confirm the applicability of the selected method and to confirm the calculation of a fair share exchange ratio.

   By checking the calculation for each share exchange ratio method, we identified the following:

   Carrying value method

   In case where there is reasonable market information that can be used to determine the trend of earnings/losses, the experience of valuers does not rely on the carrying values that statically present the company value at a given time and is based on historical operations.

   The carrying value significantly differs from the market value, since it does not consider the future results of entrepreneurs, and because the carrying value of each company is necessarily different due to the application of different accounting policies (e.g., accounting valuation and capitalisation of assets, revaluation of assets). This method is not accepted as a reliable measure of the value of the merging companies.

Discounted cash flow method

8. Since the carrying value method has certain shortcomings, the more appropriate valuation method for determining the share exchange ratio in the merging companies is the discounted cash flow method (the DCF method).

The DCF methodology estimates the value of the company based on actual value sources, i.e. generated future cash flows. The main advantage of this method is that it can include all conceivable future changes in the companies and the prospects of the market, the economy as a whole, the industry or the business, as well as specific questions related to any company.

When merging the equity with the equity as a capital and investment transaction, what becomes important for the investors is not only to the change in the capital structure but also the change in the ability of the ownership package. This is especially manifested to shareholders or investors in the ability to increase capital and in the decision-making options. The DCF method accepts the ability of capital in a way that unites all future expenditures with future revenues and sources of future cash flows in a way to select and award the results to equity. The consistent application of such valuation method includes all future cash flows, based on whose gross presentation by discounting these values up to the date determined in the Merger Agreement the present value is recorded.

Future operating activities of companies, such as redesigning the offer, renovation or improvement of accommodation facilities, retail outlets, cash generating units, or the effect of working capital management, have a material impact on the value that is required and defined at the exchange for other shares. It is impossible or very difficult to encompass all future factors and meet the requirement for an appropriate share exchange using other methods.

The DCF methodology also has its limitations. Since it is based on plans and forecasts of future results, there is an uncertainty whether the result will be in line with the forecast data. However, this uncertainty is not greater than the uncertainty associated with other methods. Uncertainty exists here due to a change in the outlook of similar companies, and as a result of this due to their valuation, but with similar or the same effects for both companies. Because of the similarity of the companies, the relative ratio in the valuation of companies will remain only at a higher or lower numerical level.

Based on the stated reasons, it is clear that the DCF method is more acceptable compared to other valuation methods, because it can unite all the relevant driving values that affect the value of the company.

Review of other methods and their applicability

In concrete circumstances, the comparative method has a significant disadvantage because there is no comparable valuation data. Only reporting data is available that does not provide insight into the estimated value of equity instruments. In addition, at the level of the published financial statements, for the comparable companies, there is a weakness due to the application of different policies and standards, and extraordinary items and unknown ways of valuation of accounting data in these reports. Other available information is mostly of promotional nature, and it is encumbered with the risk of inherent speculation.

With respect to other potential methods, no advantages greater than with respect to the above mentioned valuation methods have been found.

SHARE EXCHANGE RATIO

9. For the reasons described above, the discounted cash flow method was selected as appropriate for determining the share exchange ratio. Based on such structural and value criteria, the equities presented in the financial statements of the companies at the date of the Merger Agreement are merged (net assets of Hotel Bonavia d.d. is added to the net assets of Plava laguna d.d.) in the amounts presented in the financial statements at the date of the merger.

10. By using and complying with all the relevant data from the audited financial statements of the companies as at 30 June 2012, the Management Boards of the companies performed a detailed calculation of the share exchange as at 31 August 2012, based on the valuation of each company using the discounted cash flows as follows:

    The acquiring company will exchange shares without nominal value to shareholders of Hotel Bonavia d.d. with the shares of the acquiring company with a nominal value of HRK 1,800 using a ratio of 0.00022066:1.

    Following the merger, the share capital of the acquiring company, Plava laguna d.d., Poreč, remains unchanged. The number of ordinary shares before the merger was 546,318, and their number does not increase. The acquirers of shares (shareholders of Hotel Bonavia d.d.) will take over the treasury shares of Plava laguna d.d.

CONCLUSION

Based on the audit of the Merger Agreement between the companies Hotel Bonavia d.d. and Plava laguna d.d. we confirm the following:

1. We reviewed the Merger Agreement and the Management Reports on the merger.

2. We are satisfied that the most appropriate method for determining the share exchange ratio is the generally accepted method of the present value of future cash flows, the so-called discounted cash flow method.

3. Based on the applied discounted cash flow method the following share exchange ratio was correctly identified:

Plava laguna d.d.	1
Hotel Bonavia d.d.	0.00022066

4. Based on the Merger Agreement, the Management Boards established and accepted the share exchange ratio as described above. The auditor believes that in the Agreement both the appropriate valuation method and the appropriate share exchange ratio were selected.

PricewaterhouseCoopers d.o.o.

Zagreb, 26th September 2012

Signature

Dr.sc. Ivo Bijelić
Certified auditor