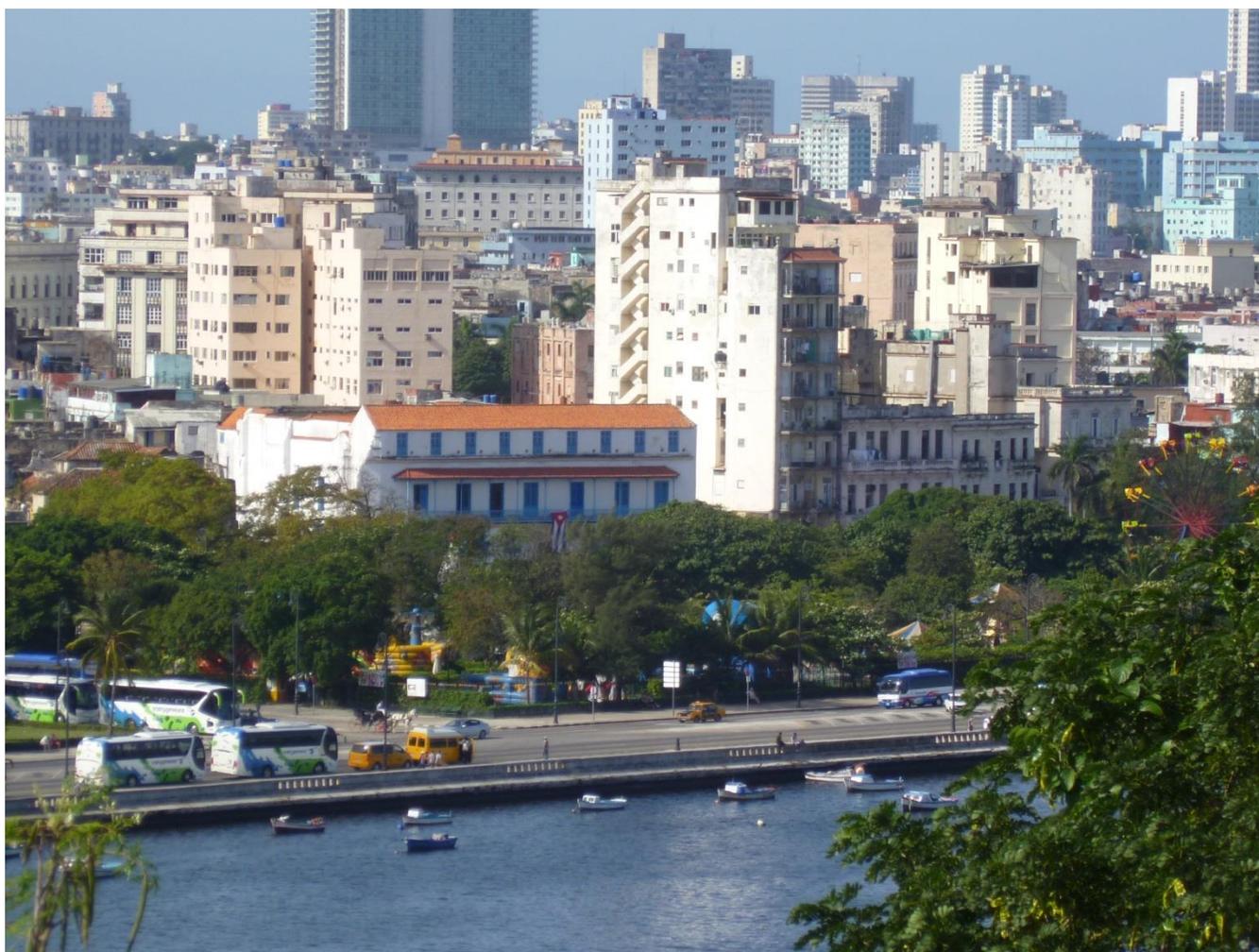


Cuba Market Report

One Year after the Announcement

January, 2016
BG Consultants, Inc.



La Habana, Cuba



One Year after the Announcement

2015 In Review

On December 17, 2014 president Obama said that the decision to renew relations would bring an end to the failed U.S. policy of isolating Cuba which is only located 90 miles south from Florida. Since his announcement, a series of talks between Cuban and American government officials have focused on improving greater commerce and trade, travel and free flow of information.

Since then, the State Department removed Cuba from its list of state sponsors of terrorism, President Obama held a face-to-face meeting with Raul Castro during the Summit of the Americas in Panama, the American flag was raised over a newly opened US embassy, and in Washington the Cuban embassy was also reopened, restrictions were eased on travel to Cuba by Americans, resulting in a 54 percent increase in trips this year, three Cabinet members — the secretaries of state, agriculture, and commerce — were dispatched on separate missions to Cuba, and plans have been announced to resume direct mail service and commercial air travel between the two countries, which will make it easier for approved travelers who have been relying on a complicated charter system to get to the island.

On the business column, the Obama administration has outlined an array of commercial activities that U.S. businesses may engage in legally, even though most trade is still prohibited by the embargo and U.S. investors can't invest in Cuba. Cuba has implemented a roaming agreement with U.S. carrier Verizon and signed a deal with a New York state-based drug company to market a Cuban cancer drug, the U.S. government has eased restrictions on sales of goods and services to private entrepreneurs and cooperatives, and more recently, Florida-based Stonegate Bank announced it would start issuing debit cards that American travelers can use in the island nation, a first for an American firm.

There have already been two environmental agreements — one that establishes sister relationships between marine sanctuaries in Cuban waters and the Florida Keys and a more far-reaching accord that will make it easier for U.S. and Cuban scientists to work together to protect the environmental resources of both nations.

But the most tangible change in Cuba since December, 2014 has been the parade of U.S. visitors, including four governors (New York, Arkansas, Texas & Virginia), and former hardline Cuban Americans, Obama Cabinet members and State Department delegations. American travelers have signed up for people-to-people tours in record numbers, helping Cuba set a new record for international visitors this year. There have been sports and cultural exchanges, U.S. governors have toured Havana, and countless U.S. business delegations have arrived in Cuba to test the waters.

Moving Slow

Because expectations were so high and many U.S. businesses were so eager to engage after a half-century drought, some say Cuba has been slow in taking up the United States on the new business opportunities the Obama administration began outlining in January 2015. Obama also has said he wants to work with Congress to lift the embargo. But such high hopes have been tamped down. It was apparent after the first round of normalization talks in Havana in January that rapprochement would be a slow process.

Even though U.S. companies are free to form partnerships with Cuban Government entities to improve the island's Internet and telecom infrastructure, the only deals announced so far have been a few roaming and direct-connect arrangements.



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This summer, Cuba began rolling out new public Wi-Fi hotspots that now number 50, but most Cubans don't have regular access to the Internet and desire for connectivity is huge.

Economic Impact

One year from the initiation of the normalization process, the actual effects between the two countries have been mostly indirect, starting from the anticipated impact that the lifting of the economic embargo will have on the Cuban market. This has resulted in a gradual but increased interest in business and investments by businesses from various countries, most notably Mexico, Spain and Russia.

Indeed, in the renegotiation and payment of foreign debt and payment, Cuba has shown significant progress: Russia's forgiveness of 90% of the debt owed to the former USSR was reduced to around \$3.5 billion, with payment terms stretching out over ten years at low interest rates, the cancellation of 70% of the debt owed to Mexico to about \$ 487 million, and –more recently- the reduction of 70% of the debt with the Paris Club, which had reached a value of about \$11.1 billion, and which now is only \$2.6 billion to be paid over a period of 18 years. Resulting from these renegotiations, progress has been seen in the procurement of new loans and foreign direct investment on the island, with an emerging capitalization of the island.

The availability of better financial conditions during 2015 has been officially recognized as one of the factors that led to a 4%

growth in GDP. This important process of debt renegotiation has led to the visit of many groups of important businessmen from many countries such as France, Spain, and Germany. A Mexican commercial group identified 50 possible investment projects, two of which have already been approved in the Mariel Special Development Zone and 19 other business transactions were reported in progress due to the many trade missions.

Another aspect of the indirect impact of the new relationship between Cuba and the U.S. is shown by the increase of 18% in tourism in general from 2014, which includes a growth of over 50% of Americans even as tourism remains prohibited. Cuba ended the year with about 3.5 million visitors, more than any Caribbean destination except the Dominican Republic.

Many Challenges Remain

A number of issues are holding back the progress toward full normalization. One well known problem relates to the more than 45,000 Cubans that arrived at US border checkpoints in the fiscal year that ended Sept. 30th; thousands more are trying to reach the United States by traveling through Central America or taking to the sea. It is the largest wave of Cuban migrants in decades. Unless the United States ends the wet foot/dry foot policy, Cubans will continue to find alternative routes to the U.S. through the Caribbean and Latin America.



Cubans in Central America



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One of the thorniest elements is the reparation for U.S. properties confiscated by Cuba from the Americans 55 years ago. The embargo came in response to Castro's seizure of refineries owned by U.S. companies that refused, under Kennedy's order, to process Soviet oil. More than 5,900 claims with an initial value of \$1.9 billion have been certified by the Justice Department's Foreign Settlement Claims Commission, and estimates put their current value, with interest, at more than \$7 billion. Notably, those claims do not include losses by Cubans who later fled to the U.S.

On the other hand, Cuba also has a number of issues related to substantial damages it claims were caused by the embargo and other U.S. extraterritorial actions, including ban on exports, trade sanctions which made banking nearly impossible, and other damages including what Cuba considers to be illegal distribution of its assets frozen in the U.S., and pending reparations for military aggressions, amongst others.

Trade between the U.S. and Cuba was actually less in 2015 than in 2014. When pressed, Cuban officials insist the limits to trade between the two countries are all on the U.S. side. The trade sanctions have a lot of teeth left, they say, continuing to ban most Cuban exports, block U.S. tourism and make banking nearly impossible.

Today, with U.S.-Cuban relations on the mend, the island has come to the edge of a new post-Castro era. The country's ideological foundations are cracking, and new uncertainties are coming — perhaps none larger than whether the egalitarian values of Castro's revolution will be swept away by rising inequalities and the breakdown of Cuba's socialist welfare state.

Communist Party elders want to keep a lid on market forces, but with every incremental opening, yawning income gaps emerge. Tour guides and hotel chambermaids make more than scientists and doctors.



Cuba also wants to engage on sensitive issues. Castro has said he wants the lifting of the embargo, the return of the U.S. Navy base at Guantanamo Bay, and the end to Radio and TV Marti and other acts of hostility against Cuba by the United States.

But the biggest obstacle to moving forward, though, is Congress. Although the Cuban embargo began with executive orders, Congress later added its own stamp, most significantly with the Cuban Liberty and Democratic Solidarity Act of 1996, which effectively bars the president from lifting the embargo unilaterally. Better known as the Helms-Burton Act, it precludes U.S. assistance until there are democratic reforms that don't involve the Castro brothers, and it authorizes sanctions against corporations and countries that do business with Cuba.

Expectations For 2016

In Cuba

Various economic indicators published by the government and other factors lead us to the following expectations regarding Cuba's financial outlook for 2016:

- GNP: Will increase efficiency in the importation of goods - *more emphasis will be made on the efficient management of inventories at all levels; this will have a direct effect on the GNP.*
- Imports: 50% of imports will be completed through international credit, which will consist



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of future debt-*all new credit will be carefully guarded as part of the creation of a sustainable debt.*

- Food: There is a downward trend in prices, but food products with an anticipated value of around \$2 billion will be imported during the calendar year.
- Oil: Cuba will consume 8.4 million tons, almost half for electricity and of that amount 50% (or 25% of the total amount) will be consumed by the private sector--*the Cuban national production of crude oil (including the equivalent gas) is estimated to be between 3.65 – 3.91 million tons.*
- Investments: The government's expenditure plan/budget for the year is \$7.841 billion USD. 58% of this amount will be used in economic activities that provide the most liquid currency income- *such as in the tourism sector, food industry and food programs, and in the production of construction materials and other construction products.*
- Housing: Cuba will build 27,480 homes, 12,480 of which will be built by the State- *this will reduce a very large deficit in construction; 350,000 tons of cement will be sold to the population and the private sector.*
- Wages: Regarding wages, significant wage increases of government workers are not expected- *thus increasing the number of persons who want to work in the emerging private sector.*



In the Normalization Process

It is very difficult to predict the future of negotiations between Cuba and the U.S., however, some of the issues treated bilaterally and other unilateral actions by both countries can be forecasted:

- Restoration of direct commercial flights within both countries-*This alone will substantially increase the number of Cuban-Americans visiting the Island and it is*

anticipated that air travel costs will be reduced by more than 25% from present costs.

- The European Union (EU) will announce a new Cuba policy, terminating the former “Common Position” which was established by the European Council of Ministers in 1996-*This is a necessary step for many in U.S. Congress to justify the termination of the Helms-Burton Act.*
- U.S. will provide guidelines to U.S. companies on business opportunities for their consideration-*and will appoint a Commercial Attaché at the U.S. Embassy in Havana.*
- Direct mail and small packages directly to Cuba from the U.S. will increase-*expect that this activity will help prop-up the private sector, particularly those sectors which serve the tourist market.*
- Authorization for the use of US dollars in Cuban transactions.
- U.S. Congress will substantially tweak the Cuban Adjustment Act and reduce funding for Radio & T.V. Marti.-*in response, Cuba will reduce restrictions imposed on Cuban-Americans, such as the prohibition of traveling by sea to the island, invest in Cuba or acquiring properties-In general, expect better relations between Cuba and Cuban-Americans.*
- Authorization by Cuba of cargo, ferry, and cruise ships originating from the U.S.-*This will substantially increase the amount of family packages and cargo in support of the private sector.*
- Technical visit by President Barack Obama.

Chronology of Significant Events

Jan. 15, 2015 — U.S. Commerce Department and Treasury roll out new regulations that expand trade with and travel to Cuba.

Jan. 22, 2015 — First round of normalization negotiations takes place in Havana. Talks on migration issues also held.

Feb. 13, 2015 — U.S. releases rules on what types of goods and services may be imported from Cuba's self-employed sector.



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April 11, 2015 — President Barack Obama and Cuban leader Raúl Castro hold talks on the sidelines of the Summit of the Americas in Panama.

May 29, 2015 — State Department removes Cuba from the list of state sponsors of terrorism. It had been on the black list since 1982.

July 20, 2015 — The United States and Cuba renew diplomatic relations and open their embassies.

Aug. 14, 2015 — The United States holds a flag-raising ceremony to officially reopen its embassy in Havana and Secretary of State John Kerry travels to Cuba.



Sept. 18, 2015 — U.S. releases another set of Cuba regulations.

Sept. 28, 2015 — Raúl Castro delivers his first speech at the United Nations. He calls for the embargo to be lifted, return of the U.S. Navy base at Guantánamo Bay, reparations for damages caused by the embargo, and the end to Radio and TV Martí.

Sept. 29, 2015 — President Obama and Raúl Castro have bilateral meeting on sidelines of U.N. General Assembly.

Oct. 27, 2015 — United Nations approves a resolution condemning the embargo 191-2. The U.S. and Israel cast the only dissenting votes.

Dec. 8, 2015 — U.S. and Cuban delegations open dialogue on dealing with claims on property confiscated from U.S. citizens and corporations and Cuban counter-claims for damages caused by the embargo and U.S. hostility against the Cuban people.

Dec. 10, 2015 - The United States and Cuba reach agreement to start a pilot program that will take mail directly to Cuba from the United States, rather than through third countries.



A man leaves a postal office in Havana

Dec. 16, 2015 — U.S. announces that it is near a final agreement to restore direct commercial flights.

Dec. 17, 2015 — Cuba announces that it is near a final deal with the Paris Club to restructure \$16 billion in debt stemming from a 1986 default, with 14 creditors expected to forgive most of the amount owed.



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About us

BG Consultants' business advisory services exist to help clients with every aspect of their Cuba business needs. Our advisory group is comprised of individuals with years of experience in all facets of business, from engineering, mining, shipping, finance operations, and other. Our partners bring our clients the real-world wisdom of having sat on numerous boards of directors and advisory boards for public, private, and not-for-profit companies.

BGC can help clients identify investment opportunities, navigate through bureaucracies, key regulations and current restrictions, and provide creative solutions. We can help clients evaluate ways to enter the market, get ahead of the competition, and help not only reach goals, but perhaps develop new ones.

It's through personalized relationships with our clients that we are best able to understand and address the complex business challenges they may face. We provide recommendations and comprehensive answers to solve those needs, such as preparing business, and marketing strategies to help maximize profits.

Contributors

Dr. Teo Babun (CEO and Managing Director). Dr. Babun is the founder and CEO of BG Consultants, one of America's largest providers of strategic services related to Cuba. Dr. Babun is the author of more than 100 manuscripts and reports on Cuban business, political, and economic issues, including *The Business Guide to Cuba*. Dr. Babun was also the Director at Intercontinental Bank, where he served as Chair of the Investment Committee. He is a graduate of Michigan Technological University with a major in Electrical Engineering, and a Master's in



Business Administration. In 1981, he received the Outstanding Alumni Award from the University for his innovative business efforts. He earned a Doctor of Philosophy, Ph.D., from Vision International University, 2006, and a Doctor of Letters, D. Litt., from Miami International Seminary in 2002. In 2007 he was elected to the MTU Electrical and Computing Engineering Academy.



Dr. Jose Oro (President). Dr. Oro is President of OROMAX, Inc. Previously, Dr. Oro was a Director of Ministry of Basic Industries of Cuba from 1987 to 1991, leading the research and technical studies for ports, highways, railways, marine transportation, energy (including nuclear), construction materials and mining. After leaving Cuba, Dr. Oro has served as Chief Operating Officer and SVP at Gran Colombia Gold Corp, a gold mining Company operating in Colombia and VP and country manager of Galway Resources in Colombia, VP at Kirkland Lake Gold in Canada. Dr. Oro also spent time on the Latin American Corporate Finance team of Coopers & Lybrand in the Latin America Division. He is a geologist and an engineer by training, with doctoral studies in Geology from the Institute of Geology-Academy of Sciences of the Soviet Union, 1987, a Master in Science in Remote Sensing from the Institute of Sciences of the Earth and Space in the Netherlands in 1983 and a BS in Geological Engineering from the University of Pinar del Rio, Cuba in 1980.

CONTACT DETAILS FOR CUBAN-RELATED QUERIES

BG Consultants, Inc.
P.O. Box 546135
Miami, FL 33154
Office: 305.884.0441
Fax: 305.260.4214

Email: info@BGConsultants.net
Website: www.BGConsultants.net