Brand Cuba is an Emerging Powerhouse

As the United States reopens its embassy in Cuba and international relations are normalized between the countries, periods of rapid growth are expected for key sectors within the Cuban economy. The hospitality and tourism industry is among these projected growth areas, particularly as travel restrictions for Americans are reduced.

Ilan Marcoschamer, Senior Director with Alvarez & Marsal's (A&M) Hospitality & Leisure Group, was recently featured on GlobalHotelNetwork.com regarding his thoughts on "Brand Cuba," following an exploratory trip to Cuba and meetings with tourism industry and business leaders on the island. Global Marketing spoke with Mr. Marcoschamer about what he sees as the potential opportunities for A&M, both for our hospitality sector services group and across the firm.

Q. As the normalization of relations between the U.S. and Cuba continues, what can the hospitality industry expect for the remainder of the year and as we move into 2016?

Given the "lure factor" that Cuba has, particularly for hoteliers and other hospitality industry stakeholders, there is already a tremendous amount of intrigue about the destination. Most, if not all, of the major hotel companies have already sent fact-finding teams to the island. However, as long as the U.S. embargo remains in place, American companies cannot operate in Cuba. But what is already taking place is a considerable increase in non-U.S. actors moving in to secure deals and relationships prior to any U.S. companies, in anticipation of the eventual lifting of the embargo.

Q. How can American hotel entities and other businesses within the sector most successfully capitalize on "Brand Cuba's" new opportunities, now and in the near future?

Airlines and cruise ship companies have already been conceptually permitted to serve Cuba out of the U.S. as long as the purpose of travel of their passengers falls within the 12 categories currently permitted under the Department of the Treasury's Office of Foreign Assets Control (OFAC) rules. As far as the lodging sector is concerned, publicly traded, traditional hotel companies are still prohibited from doing business in Cuba as long as the embargo is in place. However, U.S. players that are determined to be early entrants and can employ boldness and legal ingenuity in their strategies may find opportunities through which they will be able to insert themselves into the Cuban market before the full lifting of the embargo. Afterwards, U.S.-based lodging brands and operators will likely be highly sought after due to their ability to channel lucrative American business to the island. The U.S. companies that invest time and effort in understanding the Cuban market and the mode of doing business there *prior to the full normalization* will be best suited to move quickly on the most attractive deals.

Q. Beyond hospitality, what do you think Brand Cuba may mean for A&M across the firm's various service sectors, such as banking and insurance?

There are enormous investment needs across every sector of the Cuban economy. While the Cuban workforce is among the most educated in the Americas, it lacks the sophistication and operational savvy required to support the amount of investment and development that is likely to occur in the next 10 to 15 years. A&M can assist multi-national companies that need to set up shop in Cuba, providing a full array of business services separated into two categories: "pre-deal" services including market familiarization, analytics and market intelligence, deal structuring and due diligence support; and "post-deal" services including project management, financial management, operational support, and technology infrastructure design and management. Separately, A&M can act as a local talent incubator, cultivating the next generation of Cuban business professionals which could feed the needs of clients and our own operations locally.

Q. How should U.S. companies appropriately time their investments to fully leverage the three-phase normalization process (post-announcement/pre-normalization, full normalization, rapid growth) that you outline in your article?

Cuba is a highly idiosyncratic place. While the country's needs are great, its pride is even greater. U.S. companies need to understand that and approach any investment opportunities with the right amount of comprehension, empathy and a long-term horizon. While the rapid growth phase may be at least two to three years away, the beneficiaries from that rapid growth phase will be those that are investing in building their knowledge and local relationships today.

Q. What obstacles do you predict these companies will continue to face in Cuba, even as opportunities within the hospitality industry and beyond continue to develop?

Understanding the cumbersome decision-making processes will be essential for any outside companies entering Cuba, as will be developing strategies to identify and communication with the appropriate individuals leading various facets of the market. In any type of commercial real estate, not just hospitality, there are unique challenges such as the lack of a proper mortgage financing market, unenforceable property rights and pre-revolution ownership claims. Lastly, business information that is widely available in the U.S. or other advanced economies is non-existent in Cuba, making it a destination for those on the more adventurous side.

Please continue reading below for Mr. Marcoschamer's full article from GlobalHotelNetwork.com.

In 1996, at the height of the Special Period – the 10 years immediately following the collapse of the Soviet Union and with it the collapse of Cuba's export industries and a severe contraction in GDP – musicians Ry Cooder and Nick Gold conducted an experiment over a two-week period in Havana. They assembled several of the most legendary Cuban musicians – some like Ibrahim Ferrer and Compay Segundo who were well into their 80s at the time and recorded an album featuring some of the most beloved classical songs from the uniquely Cuban repertoire of Son, Cha-cha-cha, Marimba, and Danzón styles of music. The result was *Buena Vista Social Club* – a Grammy Award winning, multi-platinum album, followed by a world-wide tour and a documentary film. To-date, the original *Buena Vista Social Club* has sold over eight million copies world-wide, including nearly two million in the U.S. alone. Although several of the artists have since passed away, what started as a single album, has become an institution – a creative collective based on Cuban music, which has since then produced multiple albums, continued to perform live around the world, and has inspired what some entertainment industry observers called a "Cuba-mania" around the globe.

What made *Buena Vista Social Club* such a resounding success is its authenticity, soulfulness, non-pretentiousness, and, yes… funding from the U.S. Brand Cuba is extremely "sticky" (borrowing a term from brand strategy/ad agency lingo) and is beloved world-wide. Its stickiness comes from the elements that make up its essence – Latin sensuality, African spirituality, revolutionary zeal, passion for knowledge, perseverance in the face of adversity from non-other than the most powerful country in the world, all balanced against a healthy dose of Caribbean charm. *Buena Vista Social Club* delivered all of that, becoming the de-facto ambassadors of Cuban culture world-wide.

The result is a country brand deeply rooted in a rich cultural foundation, enhanced by a vast territory (as far as the Caribbean is concerned), plentiful biodiversity, extremely high literacy rates, and its people's natural wit and charm. From a tourism perspective, the combination of these destination and cultural attributes constitutes a formidably attractive offering in a marketplace crowded with commoditized, flavorless options.

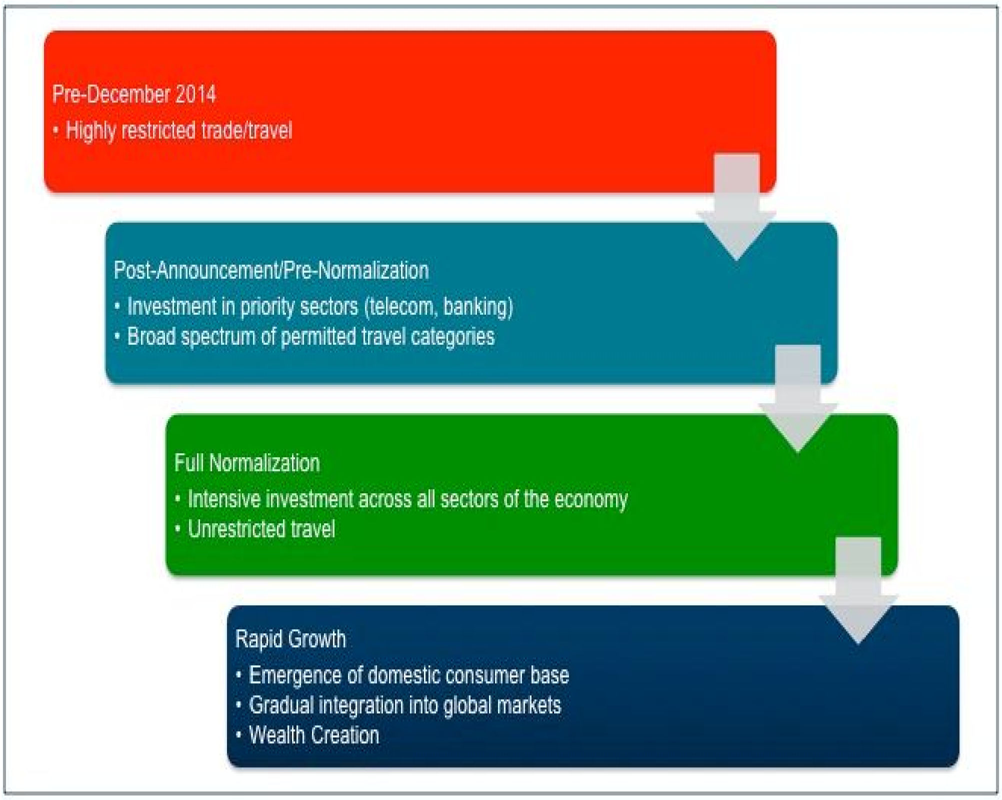
As the proverbial "diamond-in-the-raw," Cuba has to-date played a secondary role on the regional tourism stage, attracting mostly value-oriented tourism. Even though in 2014, Cuba's visitation exceeded that of most major Caribbean destinations such as Jamaica, the Bahamas and Puerto Rico, the economic impact of this volume of visitation is low relative to these destinations due to the value-oriented nature of Cuba's visitor base and the near complete absence of U.S. visitors. Nonetheless, this diamond-in-the-raw is about to get cut and polished by an inflow of U.S. dollars from unrestricted U.S. visitation and investment (on top of the impact of the lifting of U.S. sanctions on non-U.S. investment which will no longer be deterred by a possible U.S. ban because of dealings in Cuba).

The December 17th 2014 announcement by the presidents of both countries about the imminent normalization of Cuba-U.S. relations has given rise to widespread speculation about the timing and pace of the process. As with any complex international political process, public fanfare and cordiality provide a smoke screen for more hard-nosed negotiating.

Despite the expected posturing by both sides, the normalization negotiations are nearly free of the highly toxic and virtually impossible to overcome themes such as religious fanaticism and competing claims over land (Cuba's demand that the U.S. return the Guantanamo Bay naval base being the one exception). Hence, the likelihood of a successful outcome out of these particular negotiations is relatively high, given that the cost of concessions by either side is relatively cheap in political currency and the benefits of an agreement to both sides are high in hard currency.

The timeline of the U.S. – Cuba relations normalization process is anybody's guess. There are many reasons to believe that it will be quick, namely the goodwill demonstrated (at least publically) by both sides to reach an agreement expeditiously; Cuba's dire need for investment across all sectors of the economy; an easily bridgeable cultural and language divide between the U.S. and Cuba (as compared with China, Vietnam or Russia); and the shear physical proximity of Cuba to the U.S. However, the obstacles to a speedy normalization of relations and establishment of unrestricted commercial ties are also many but most notably, the deeply entrenched interests of certain individuals and organizations within the communist regime who will undoubtedly fight to protect their turf from foreign intrusion and/or expect personal economic gains in exchange for facilitating the proper regulatory framework and normative protection for lucrative projects funded through foreign capital.

Based on precedents established in post-communist Eastern Europe and some Asian countries, we can expect the normalization process to happen over three phases, as illustrated in Exhibit 1.



Although each former communist country's experience has been different, the common denominator among all is a period of "growing pains" characterized by intensive structural reforms (typically involving social unrest and often violence) followed by a period of rapid economic growth. The period of rapid growth is characterized by real GDP growth in excess of 5 percent as illustrated in Exhibit 2.

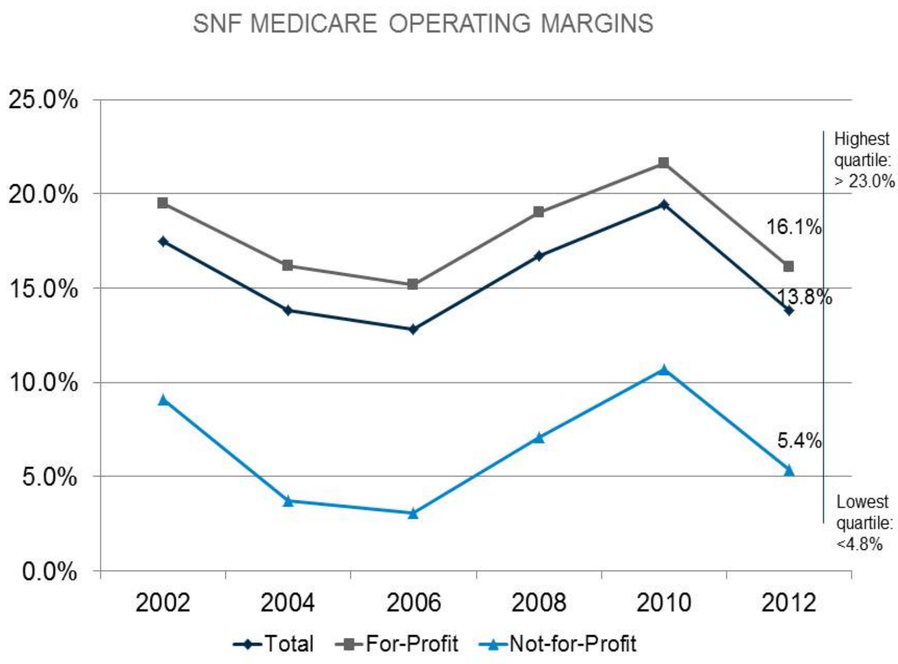
Annual GDP Growth; Constant Prices Local Currency

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
China	10.9%	10.0%	9.3%	7.8%	7.6%	8.4%	8.3%	9.1%	10.0%	10.1%	11.3%	12.7%	14.2%	9.6%	9.2%	10.4%	9.3%	7.7%	7.7%	7.4%	7.1%
Czech Republic	0.0%	4.5%	-0.9%	-0.2%	1.7%	4.2%	3.1%	2.1%	3.8%	4.7%	6.8%	7.0%	5.7%	3.1%	-4.5%	2.5%	1.8%	-1.0%	-0.9%	2.5%	2.5%
Estonia	2.2%	5.7%	11.7%	6.7%	-0.3%	10.0%	6.2%	6.1%	7.5%	6.5%	9.5%	10.4%	7.9%	-5.3%	-14.7%	2.5%	8.3%	4.7%	1.6%	1.2%	2.5%
Latvia	-2.1%	4.0%	9.6%	5.6%	2.9%	5.7%	7.3%	7.1%	7.7%	8.8%	10.1%	11.0%	10.0%	-2.8%	-17.7%	-1.3%	5.3%	5.2%	4.1%	2.7%	3.2%
Lithuania	0.0%	5.2%	8.1%	7.6%	-1.0%	3.6%	6.7%	6.8%	10.3%	7.4%	7.8%	7.8%	9.8%	2.9%	-14.8%	1.6%	6.0%	3.7%	3.3%	3.0%	3.3%
Poland	6.7%	6.2%	7.1%	5.0%	4.5%	4.3%	1.2%	1.4%	3.9%	5.3%	3.6%	6.2%	6.8%	5.1%	1.6%	3.9%	4.5%	2.0%	1.6%	3.2%	3.3%
Romania	7.1%	3.9%	-6.1%	-4.8%	-1.2%	2.9%	5.7%	5.1%	5.2%	8.5%	4.2%	7.9%	6.3%	7.3%	-6.6%	-1.1%	2.3%	0.6%	3.5%	2.4%	2.5%
Slovak Republic	7.9%	6.9%	4.4%	4.4%	0.0%	1.4%	3.5%	4.6%	4.8%	5.1%	6.7%	8.3%	10.5%	5.8%	-4.9%	4.4%	3.0%	1.8%	0.9%	2.4%	2.7%
Slovenia	4.1%	3.6%	5.1%	3.3%	5.3%	4.2%	2.9%	3.8%	2.8%	4.4%	4.0%	5.7%	6.9%	3.3%	-7.8%	1.2%	0.6%	-2.6%	-1.0%	1.4%	1.4%
Vietnam	9.5%	9.3%	8.2%	5.8%	4.8%	6.8%	6.9%	7.1%	7.3%	7.8%	7.5%	7.0%	7.1%	5.7%	5.4%	6.4%	6.2%	5.2%	5.4%	5.5%	5.6%

Annual Growth > 5%

Source: International Monetary Fund

Based on these historical precedents, over the next 12 years Cuba is likely to produce between US$61 billion and US$107 billion in incremental economic output, compared with baseline estimate of $26 billion assuming no normalization, as depicted in Exhibit 3.

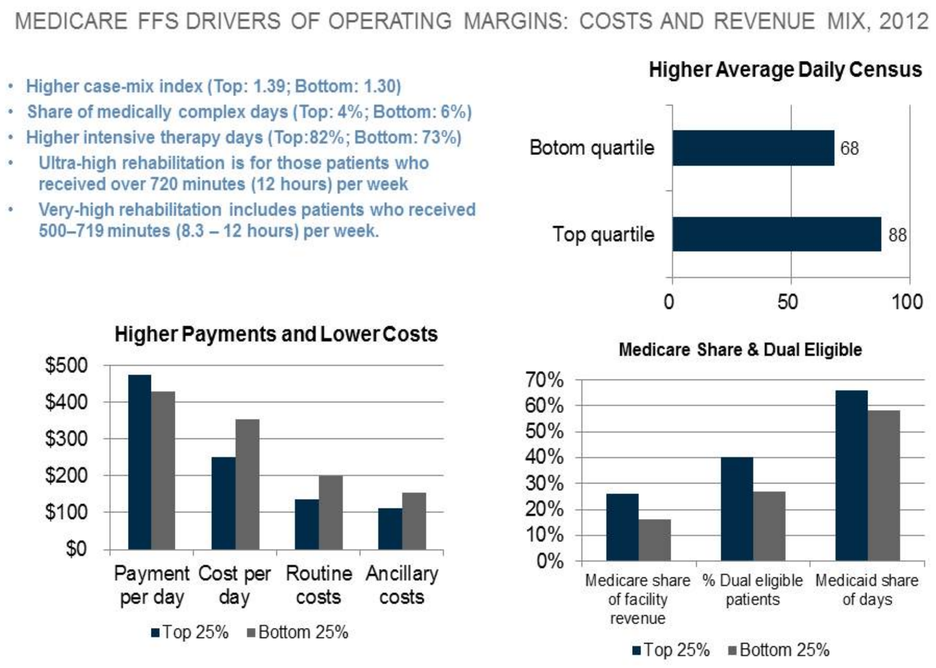


Source: MedPAC Data Book: Health care spending and the Medicare program, June 2014; Chart 8.5. 2013 Medicare margin" 13.1%
http://medpac.gov/documents/reports/chapter-8-skilled-nursing-facility-services-(march-2015-report).pdf

Tourism and hospitality are likely early beneficiaries of the expected economic expansion that will result from normalization of diplomatic relations and commercial ties between the U.S. and Cuba. The allure of visiting the "forbidden island" is drawing an increasingly larger number of visitors from the U.S., traveling to Cuba under the broader definition of permitted travel to the island in the new regulation adopted by the U.S. in January 2015. Even in its current state, Cuba's tourism industry welcomed 1.1 million visitors as of March 2015 year-to-date, a 14% increase over the same period last year. Approximately 30% of the visitors were from the U.S., a 15.2% increase over the same period in 2014.

Brand Cuba is particularly appealing in the tourism sector. However, while the current volume of in-bound tourism to the island is impressive, especially considering that current U.S. visitors consist mostly of Cuban-Americans visiting friends and relatives (as opposed to high spending leisure travelers), Cuba is short-changing itself by catering largely to a value-oriented mass market. The breadth of Cuba's tourism attractions combined with its cultural context is unrivaled by any other destination in the Caribbean and unique around the world. These are the raw elements that create an irreplicable foundation on which investment (provided the right structures and securities are in place) can elevate the current tourism offerings to a highly competitive level. Hence, Brand Cuba's future success in the tourism market as a dynamic destination spanning the entire market spectrum and not merely its value segment, is contingent on an across-the-board upgrade to its physical product and support infrastructure.

Tourism and hospitality-related projects account for nearly 25% of the US$9.4 billion official investment portfolio, offered to foreign investors by the Ministry of Foreign Commerce and Investment in mid 2014, as illustrated in Exhibit 4.



Source: Table 8-7 http://medpac.gov/documents/reports/chapter-8-skilled-nursing-facility-services-(march-2015-report).pdf

These include joint-venture opportunities and/or hotel management contracts with a capital investment requirement. Under current regulation, foreign investors and resort companies have operated in Cuba for over two decades. With the vast majority of the foreign-brand operated lodging product being all-inclusive and sold through international tour operators, foreign capital vested in these assets has secured its interests through lockbox mechanisms abroad, giving them immediate access to cash to remedy any potential defaults by Cuban government partners. One such group currently active on the island which owns four of the largest internationally branded resorts, has deployed over US$100 in capital in lodging and other real estate in Cuba since 2002, has so far had no defaults, and has been able to secure attractive returns for its investors through long-term equity appreciation and an annual 6% cash dividend.

Despite the relative successes of early entrants, substantial deterrents remain in place for U.S. based capital providers and other potential actors in the post-normalization Cuban tourism sector, namely:

1. Lack of banking links that allow for credit card transactions and international transfers of funds;
2. Inadequate property ownership regulation and title protection;
3. Potential restitution claims against property seized by the Cuban government after the Revolution;
4. Instability of supply channels and inconsistency of supplies quality; and,
5. Poor telecommunications infrastructure.

Nonetheless, despite the challenges that lie ahead, there is no turning back on the imminent normalization of U.S. – Cuba relations, lest complete irrationality prevail among decision makers on both sides of the Florida Straits. The end of the economic embargo and political isolation imposed by the U.S. over the past five decades, will remove the biggest obstacle to the full realization of Brand Cuba's commercial potential, particularly in the tourism sector. As long as the Cuban authorities do not get in their own way…

Alvarez & Marsal Valuation Services, LLC, is a member of GlobalHotelNetwork.com and GHN's Investment Committee.

This article was first published at GlobalHotelNetwork.com, a thought leader coalition, providing expert market insights and thought leadership perspectives to C-level executives in the global travel and tourism industry.

About the Author

Ilan Marcoschamer is a Senior Director with Alvarez & Marsal Real Estate Advisory Services in Miami. With over 20 years of experience in operations, financial advisory and investment management, Mr. Marcoschamer advises clients on hospitality consumer trends, market fundamentals, industry best practices, development and financial management. He is responsible for the Miami practice of A&M's Hospitality & Leisure Group, servicing clients primarily in the Caribbean and Latin America.