29th December 2022

Dear Investors,

We wrote in September explaining why we were taking a large reserve against the carrying value of our portfolio. See here for that letter. In the past 2 months, we have had encouraging conversations with some debtors and have started to see some long-overdue payments being made to us. While much work remains to be done and there is much we don't know, we are nevertheless cautiously optimistic for our prospects in 2023.

News from Cuba

1. The emergence of offshore payments as substitute for illiquid local banks

Given the payments blockages at local banks that we and other creditors have experienced since November 2021, private businesses and some joint ventures with the state have started delivering imported goods to clients in Cuba in return for EUR paid to them in an offshore (e.g., Spanish) bank account. This was first tolerated and then permitted by the authorities, and we expect that it will become more extensive during 2023. The best-known online supermarket (a private company) has always only accepted payments made from abroad although goods are, of course, delivered in Cuba, much of it produced locally. Other suppliers have done the same. Although the goods are in warehouses in Cuba, they won't sell them for Cuban pesos, demanding instead EUR paid abroad. Wide access to the internet means that offshore payments can be made in real time for local deliveries by holders of international debit cards, both residents and their families offshore. Better organised private businesses and joint ventures have set up offshore merchant accounts to facilitate these real-time payments.

2. Payments through the offshore system

We have started to benefit from this. In the past 2 months, we have received more than EUR450,000 in long-overdue payments from debtors who now have liquidity outside Cuba. Although the amount is small, we had heavy reserves against those receivables and those reserves have been released. More importantly, it represents hope. Some of our delinquencies will be worked out this way. It will take time.

3. Some signs of life in the local banking system

It has become clear that the 'only' problem faced by any of our debtors in paying us, is a shortage of hard currency in the Cuban banking system. The central bank has clearly allowed more local "EUR equivalent" deposit balances to be created than are backed by real offshore EUR in the country's foreign correspondent banks. This has made it quite easy for businesses to pay us in local EUR… But much harder for them to instruct those EUR to be paid to us in Europe.

So the distinction between stronger and weaker debtors is no longer about whether they can pay us…They can all pay us. It's about *where* they can pay us. That's important because we are now seeing some promises of liquidity in the Cuban banking system. If general banking system liquidity was the only problem for all our debtors, the read-across is clearer and we become more hopeful.

So, what signs of liquidity are we seeing in the local banking system? One important debtor who owes us EUR23.5 million[1] has agreed to start paying maturing obligations to us in Europe. Only one such payment (EUR216K) for a long-overdue instrument has so far been received. However, they clearly believe that they will be allowed control of some large part of their FX revenues, which until now have been blocked in the banking system. They talk of getting current, at least with their current maturities, within H1 23.

4. Why the signs of improvement in the local banking system?
The Cuban economy is not transparent, and we cannot say whether, why and how much central bank reserves have improved. However, we believe that the following have improved the liquidity of the system.

- We are in the middle of the first tourist season since travel became normal post Covid. We anticipate 1.5 million visitors this year compared to 3.5 million in 2019 but only 500K in 2021. Again, it's a break in the downtrend that gets our attention. Our tourism-related debtors will not quickly become current. However, they are heavily reserved against so even a slow return to payments discipline will be good for the fund's returns.
- Outside tourism, the lifting of Covid restrictions has restored some activity.
- Adequate oil and refined products are now reaching Cuba. As most electricity is generated from petroleum, power supplies have improved. This is partly due to a thaw between the Biden administration and Venezuela, but mostly from increased shipments by Russia.
- We think that Cuban foreign trade banks held significant balances with Russian banks at the start of the war in Ukraine. Sanctions made those balances hard to use. We suspect that a recent trip to Turkey, Russia and China by the Cuban president and ministers may have released some liquidity from those countries.

The falling peso

In our September letter, we reported that the informal exchange rate with the USD had gone from 70:1 to 150:1 during the year until then. It is now 175 and stable since December 1st. The outlook for 2023 is for a reduced rate of devaluation. Although we have no assets in Cuban pesos, some of our debtors have sales in pesos. A falling peso makes it harder for them to earn the EUR to remain current with their foreign suppliers and with us.

What power do we have?

We have pointed out before that our debtors are natural monopolies in the Cuban economy. They are unlikely to cease to exist. So, when they are unable to make payments for past imports, they are unable to import anything new. That is an untenable situation if you are running a telephone network, oil refineries or hotels. Their essential suppliers are suffering as we are, and they are

[1] EUR16.6 million past due and EUR6.9 million still to mature

refusing to sell more goods, just as we are refusing to finance more shipments until an agreement is reached.

B.F.I. Certificates of Deposit

Banco Financiero Internacional has offered 5-year certificates of deposit at 2% p.a. interest to those with money blocked in BFI bank accounts. This is not a solution to all the receivables we have from other debtors. It only addresses the EUR5.5 million we have in bank accounts at BFI. The average life of the proposed CD is 3.25 years. Receiving 2% p.a. for such a long period is clearly a rather poor instrument. But at least the bank is confronting the problem at last and offering some solution. This is similar to the way they paid out blocked balances after the Financial Crisis of 2008. Those CDs were honoured at that time.[2]

How we plan to use blocked funds

Although we may take a small amount of those CD's, we have another way of turning our blocked local EUR balances into EUR in Europe. We continue to invest by discounting performing instruments, buying them from exporters to Cuba. We have recently changed our terms so those exporters are forced to accept domestic EURs as part of each payment we make to them. The rest we pay in the normal way from EURs in Europe. The instruments mature by payment to us in Europe; thus, creating offshore liquidity from blocked local money. As most of our exporters have offices in Havana, they can use those locally blocked EURs. We believe that we can work down our locally blocked funds in this way within three years.

The reserve policy

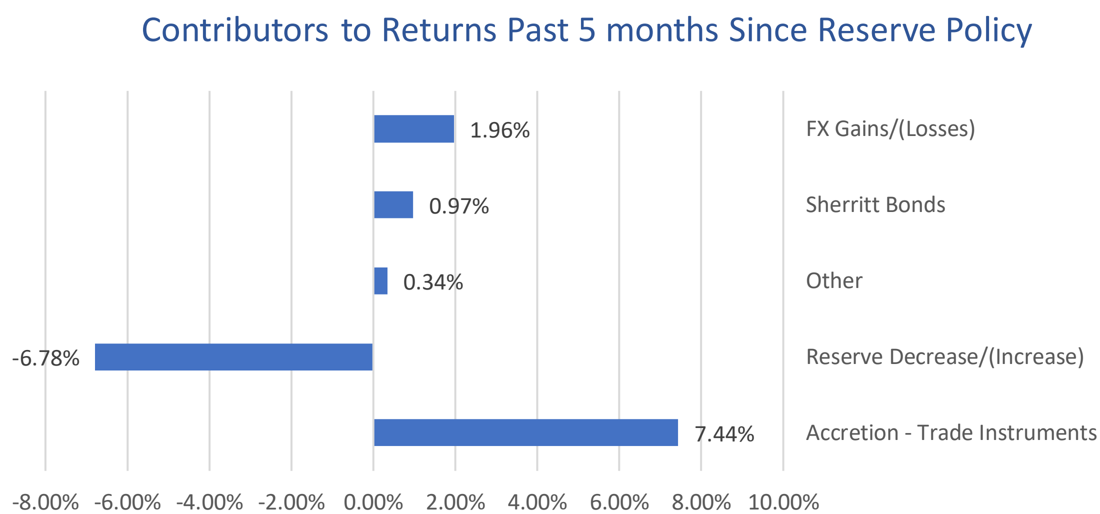
Readers will remember that the fund's auditors required us to use IFRS 9 reserve policy at our June 30 year end. That has resulted in a reserve which is 55.2% of assets under management. The reserve model is dynamic, releasing reserves when we collect a maturity and establishing a new reserve when a new asset is bought. The reserve percentages have not changed since our June 30 year end. They are:

Obligor	Reserve
BFI	12%
ETECSA	61%
Havana bank accounts	75%
Other obligors	90%

A pronounced move back towards payments discipline from a delinquent debtor would, no doubt, result in a conversation between the board and the auditors about whether the above reserve levels are appropriate. You will see from the small amounts so far received from late payors, that no fundamental change has been observed so far.

[2] This CD offer has nothing to do with BFI's letters of Credit which continue to perform on time. 67% of our assets under management is in these LC's

In the meantime, the reserve policy works quite well. We look at the chart below to see what is our *real* return from normal businesses and what is the short term effect of the reserve. We can expect short term volatility in the reserve. That doesn't worry us. As long as we see signs that, in time, we will be able to work out the delinquent assets, then we can see the reserve as a trader views his nightly mark-to-market… transient. We note from the bar chart that our *real* business; trade instruments and some bonds produced 8.41% (7.44% + 0.97%) during the 5 months since our audited results produced the large reserve. That is 21% annualised net of all fees.



In summary, there are some early signs of improvement. Cuban FX reserves remain stressed. However, our debtors are still the strongest Cuban companies. They are accessible to us, and they show a wish to restart servicing their debts. A small number of payments for long-overdue instruments have been received by the fund. Our largest holding in BFI letters of credit continues to perform well. In our opinion, we have adequate reserves. If the portfolio is well managed, we believe we can create good upside from today's valuations. However, we accept that this base-case has a much higher degree of uncertainty around it than in the early years of the fund. That uncertainty may result in unexpected downside or upside during any given period.

We remain committed to produce good returns for those who can tolerate Cuban risk.

Yours sincerely,

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