Zacks Small-Cap Research

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Grupo Tmm Sab (GTMAY-OTC)

GTMAY: *Positioned to Benefit From Mexico's Expected Energy Sector Boost*

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	04/07/2013
Current Price (6/13/14)	$0.87
Target Price	**$1.50**

OUTLOOK

Grupo TMM, one of Mexico's largest maritime transportation companies, is positioning itself to benefit from anticipated growth from Mexico's energy reforms, which are expected to boost oil production to as much as 3.0 million barrels per day by 2018 and 3.5 million - 4.0 million by 2025. In turn, this is expected to stimulate demand for maritime oil transportation. To prepare for these changes, TMM intends to upgrade its fleet, including augmenting its deep water capabilities. The company also aims to expand its facilities at the important Port of Tuxpan, which is located near Mexico City.

SUMMARY DATA

52-Week High	**$1.09**
52-Week Low	**$0.71**
One-Year Return (%)	**2.40**
Beta	**NA**
Average Daily Volume (sh)	**2,038**
ADRs at 5:1 ord. shares (mil)	**20**
Market Capitalization ($mil)	**$17**
Short Interest Ratio (days)	**4.9**
Institutional Ownership (%)	**2**
Insider Ownership (%)	**36**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-6.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**N/A**
P/E using 2015 Estimate	**N/A**
Zacks Rank	**3**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Maritime**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $US)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	63 A	49 A	54 A	50 A	215 A
2013	51 A	55 A	57 A	57 A	219 A
2014	53 A	56 E	59 E	57 E	225 E
2015					235 E

Earnings per ADR
($US EPS is operating earnings before non recurring items)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	-$0.53 A	$0.82 A	-$0.38 A	-$1.25 A	-$2.97 A
2013	-$0.64 A	-$0.89 A	-$0.28 A	-$0.34 A	-$2.15 A
2014	-$0.43 A	-$0.38 E	-$0.34 E	-$0.35 E	-$1.50 E
2015					-$1.35 E

Metrics Pro Forma; Quarters might not sum reflecting exchange rates

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Disclosures begins on page 11

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KEY POINTS

- **Grupo TMM is positioning itself to benefit from the anticipated growth of maritime transportation that Mexico's energy reforms are expected to fuel.** The company's five-year growth plan encompasses two major projects: development of a container and liquids terminal at the Port of Tuxpan in Veracruz and the addition of specialized offshore vessels to meet increased demand for deep water transportation.

- In December 2013, Mexico passed measures to allow international companies to explore energy opportunities. These reforms are expected to boost oil production to as much as 3.0 million barrels per day by 2018 and 3.5 million to 4.0 million barrels per day by 2025, up from 2.9 million in 2013. **In turn, this is also expected to fuel demand for maritime oil transportation.** TMM intends to upgrade its fleet with higher-rated vessels and deeper-water capabilities. The company believes it has a competitive advantage compared to international carriers, as Mexican law favors domestic carriers and reflecting its 22 years of experience transporting for Pemex.

- **The port of Tuxpan where TMM operates and plans to expand is strategically located close to Mexico City.** Foreign trade through the Gulf of Mexico has grown at a 7% average over the past few years. Moreover, a significant 41% of Mexico's gasoline and diesel energy is imported through the Gulf of Mexico.

- TMM's strategy is to divest under-performing operations and **focus on higher margin businesses.** The benefit of this strategy was evident, we believe, in 2014 first quarter results. Revenues grew 3.8%, primarily reflecting an 8.8% advance at the Maritime operation. Operating profit improved 69.9% year-over-year and EBITDA of $269.7 million pesos advanced 22.6%.

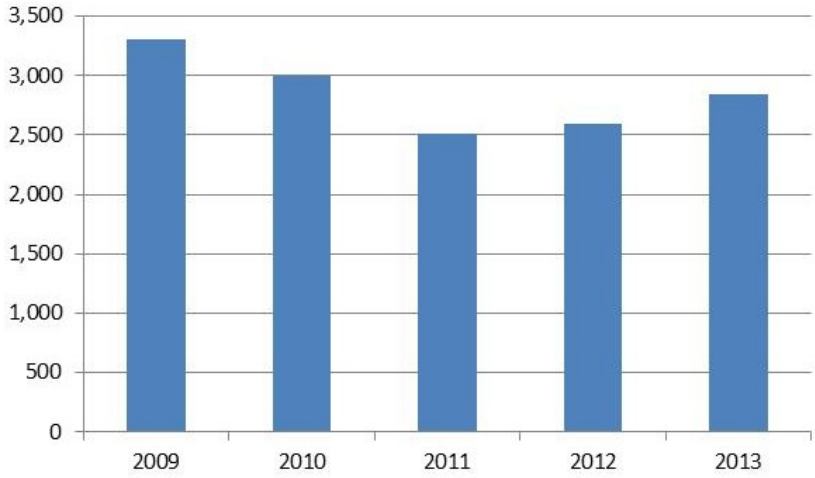
- The company also **strengthened its balance sheet** in the first quarter of 2014. TMM repaid approximately $369.2 million pesos of debt. As of March 31, 2014, total debt was $10,684.8 million pesos, down from $10,890.6 million at the end of 2013.

OVERVIEW

Founded in 1987, Grupo TMM (GTMAY-OTC) is one of the leading maritime transportation companies in Mexico. It provides maritime and ports services to international and domestic clients throughout Mexico. Since January 1997, the company has also been the exclusive provider of harbor towing services at the Port of Manzanillo, where it services roughly 1,700 ships annually from some of the largest fleet operators in the world including Hapag-Lloyd, NYK and MSC, as well as Mexico's own oil giant, Petroleos Mexicanos or Pemex.

Similar to many other companies in the maritime shipping sector, TMM was hurt by the recent economic recession. In 2010, for example, the company's total revenue of $2,992 million pesos declined 9% compared to the prior year. We believe 2010 represented a recent trough, as TMM has been working to grow its revenue by expanding some of its higher revenue generating businesses and divesting lower revenue, lower margin units. For example, TMM divested its truck transportation and haul-away trailers business in July 2013.

TMM Revenue, 2009-13 (Mexican Pesos Millions)



Source: Company reports.

STRATEGY

TMM is positioning itself to benefit from the anticipated growth in need for maritime transportation fueled by Mexico's energy reforms. The company's five-year growth plan contemplates two major projects: development of a container and liquids terminal at the Port of Tuxpan in Veracruz and the addition of specialized offshore vessels to meet increased demand for deep water transportation.

The company's strategy is to grow revenue and improve profitability by focusing on operations that offer strong growth potential and high margins, while divesting non-core, lower margin businesses. In September 2013, the Company completed the sale of its trucking and auto hauling operations, as noted. Operating losses related to these businesses were $275.6 million pesos in 2011 and $161.6 million pesos in 2012.

In addition to divesting non-core assets, TMM also intends to develop operations to:

- Exploit Mexico's energy reform initiatives;
- Increase cabotage services by extending existing routes and opening new ones. For example, TMM began a new container shipping cabotage trade in Mexico's Pacific coast in March 2014;
- Upgrade its fleet with higher-rated vessels and deeper-water capabilities;
- Expand the capacity of its shipyard repair services to more than 30 vessels per year including roughly 20 externally owned ships. Consistent with this goal, TMM acquired IDN (Inmobiliaria Dos Naciones) in 2012. IDN operates a shipyard in the port of Tampico that is strategically located near offshore oil and gas facilities, as well as key commercial routes between the southeastern U.S. and Mexico.

Port of Tuxpan – Key Trade Route: Container and Liquids Terminal Projects

TMM operates three Mexican port facilities, with one located in Tuxpan, the nearest port to Mexico City, and others in Tampico and Acapulco. As noted, one of the major projects in the company's five-year plan is the development of a container and liquids terminal at the Port of Tuxpan. Mexico has 16 commercial ports, with one – the port of Puerto Vallarta – designated primarily for cruise liners and the others for maritime commerce. To improve efficiency, as well as to increase capacity prompted by higher international trade, the Mexican government has encouraged development projects at these ports. Foreign trade through the Gulf of Mexico has grown at an average of 7% over the past few years, despite a 2009 drop in traffic related, we believe, to the general economic contraction. A significant 41% of Mexico's gasoline and diesel energy is imported through the Gulf of Mexico. Tuxpan, which is in Veracruz, is strategically located close to Mexico City.

TMM owns approximately 2,000 acres of land in Tuxpan, where management expects to focus much of its efforts to generate future revenue growth. TMM intends to develop a new container and liquids terminal at the port to meet the increasing demand for capacity in the Gulf of Mexico. Management believes that the liquids terminal will address the anticipated growth in demand for imported gasoline and diesel fuel through the construction of a pipeline and a berthing position.

Port of Tuxpan: Proximity to Mexico City



Source: Magellan Geographic

The Tuxpan container terminal would include:

- a modern container terminal
- a liquids terminal to service the energy and related sectors
- an edible and concentrated liquids terminal
- an export/import cargo-handling terminal.

In addition to its operations at Tuxpan, TMM's Ports and Terminals operations also include a port in Acapulco, loading and unloading operations at the port of Tampico, as well as shipping agencies at several other Mexican ports.

Specialized Vessels for Deep Water Transportation

TMM also intends to add specialized offshore vessels to its fleet to meet increased demand for deep water transportation. The company believes it has a competitive advantage compared to international carriers, reflecting its 22 years of experience transporting for Pemex and as Mexican law favors Mexican carriers. If no Mexican-flagged vessels are available, Mexico' will grant a temporary 3-month permit to foreign carriers. However, if an appropriate Mexican ship becomes available, it receives preferential treatment over renewing the permit for the foreign vessel.[1]

TMM operates 40 vessels, including product and chemical tankers, harbor tugs and 26 offshore supply vessels. The company continues to manage its fleet by adding certain vessels and divesting others. In 2006, for example, TMM acquired 11 offshore vessels from Seacor and took delivery on two new tugboats in 2008. In 2009, the company had two new FSIV vessels constructed and also exercised purchase options for the chemical tankers M/T Maya and the M/T Olmeca. The average age of TMM's fleet as of March 31, 2014 was approximately 11.9 years, down from 12.2 years at March 31, 2012.

Divestiture of Lower Margin Operations

The company's Automotive Logistics services business faced intense competition from both Mexican and international logistics companies. This is one reason why overall revenue at the Logistics division had been under pressure. Operating losses related to these businesses were $275.6 million pesos in 2011 and $161.6 million pesos in 2012. In the third quarter of 2013, TMM sold the lower performing trucking and auto-hauling land transportation businesses. **The company expects this divestiture to enable management to focus on the higher margin businesses and contribute to improved consolidated results.** Some of the more value added, higher margin services that TMM may focus on include "just-in-time" inventory planning, subassemblies and yards administration.

Energy Reform Opportunity

In 1938, Mexico was the first big oil producing country to nationalize its oil industry. President Lazaro Cardenas took control of the country's oil fields from U.S. and British companies and amended the nation's charter, an historical event that the country commemorates annually on March 18. Mexico assigned the state run oil monopoly Petroleos Mexicanos, Pemex, to be the country's sole producer of oil and gas. Pemex is Mexico's largest company and one of the largest oil producers in the world, according to the U.S. EIA (Energy Information Administration). Until the 1950s, crude oil was generally refined close to where it was drilled and then transported to markets in a number of small tankers, according to Global Forum on Transport and Environment in a Globalising World[2]. Methods of transportation evolved as oil companies began to locate refineries closer to end-users. In turn, this change drove the demand for larger tanker vessels (>200,000 deadweight tons), creating opportunities for maritime companies such as TMM. TMM has been transporting petroleum products, primarily for Pemex, since 1992.

Oil is a key component of Mexico's economy. Moreover, Mexico is an important player in the global oil sector, ranking among the 10 largest oil producing countries worldwide, according to the U.S. EIA. Oil accounted for 13% of the nation's export revenue in 2013, according to the Mexican central bank. However, Mexico's oil production has fallen significantly over the past ten years, reflecting lower production rates at large offshore fields such as Cantarell in the Yucatán. By 2009, Mexico's total oil production had declined 22% from its peak of 3.3 million barrels per day in 2004. Subsequent declines have been more moderate, but Pemex production continues to weaken. 2013 crude oil production was the lowest output since 1995, at an average of 2.9 million barrels per day. As a result, Mexico's net oil

[1] Mexico: The Legal Treatment Of Vessels And Offshore Installations Under The Mexican Foreign Investment And Navigation Frameworks, 3 June 2013

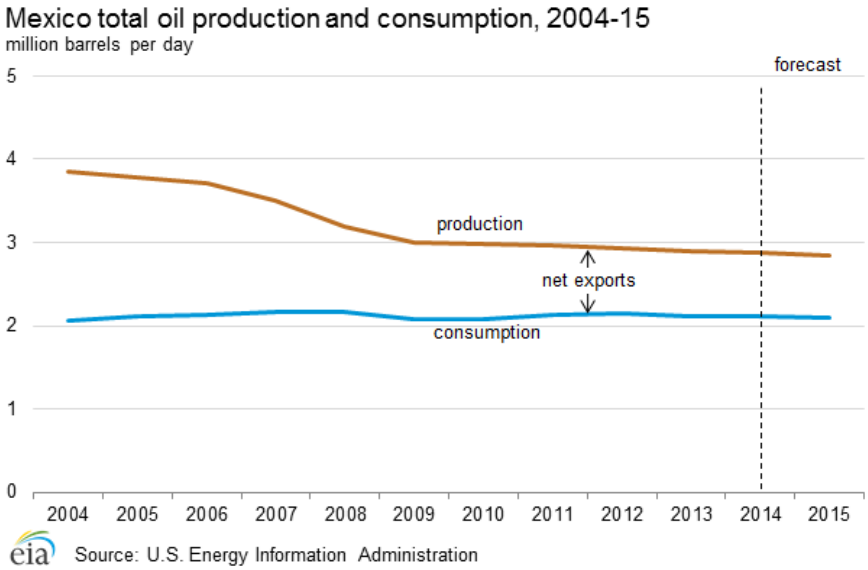
[2] *The Impacts of Globalisation on International Maritime Transport Activity; Past trends and future perspectives*, 10-12 November 2008

exports to the U.S., where Mexico exports the majority of its crude oil and imports most of its refined products, have also declined, as illustrated below.

In August 2013, Mexico initiated reforms to allow international companies to explore energy opportunities. The recent legislative reforms are intended to open the Mexican energy sector to national and international competition. According to Pemex, **energy reforms** will alter how international companies participate in Mexico's energy sector and, in turn, boost oil production. Industry insiders expect that the impact of these reforms could increase Mexico's oil production to as much as 3.0 million barrels per day by 2018 and 3.5 million to 4.0 million barrels per day by 2025. By increasing oil and natural gas production, the reforms are also expected to boost the availability of more affordable energy for the Mexican population.

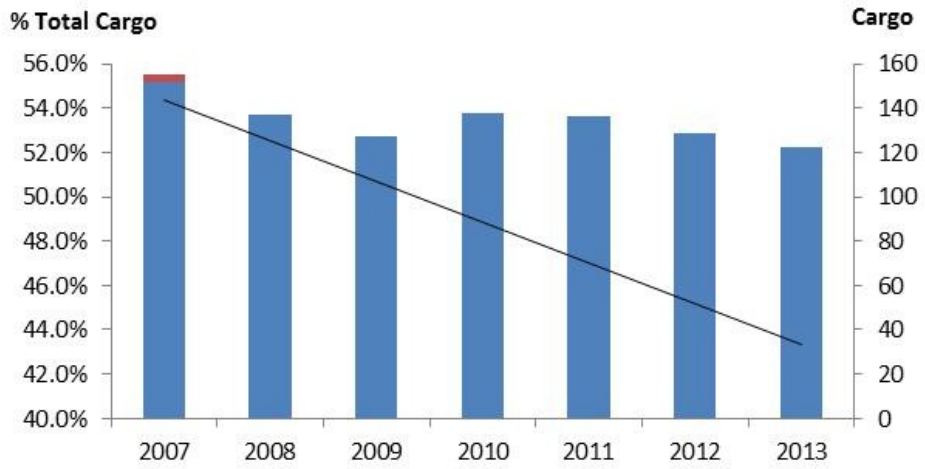
Pemex's goal is to attract international companies interested in Mexico's untapped reserves. Mexico has the biggest unexplored crude area after the Arctic Circle and many within the industry believe Mexico's reserves are more accessible than reserves in other parts of the world. Energy reform is expected to increase foreign direct investment in Mexico by as much as $15 billion to $20 billion annually.

Mexico's deep-water prospects in the Gulf of Mexico are expected to be attractive to major oil companies. Reserves are estimated to be 60 billion to 120 billion barrels in the deep-water of the Gulf of Mexico. However, Pemex lacks the technical expertise to drill in deep waters and seeks foreign partners to lend their technical expertise. As a result, TMM expects demand for exploration and distribution services within Mexico to grow and believes that it, as one of the leading companies in Mexico, is well-positioned to benefit from this anticipated growth. For this reason, TMM intends to upgrade its fleet with higher-rated vessels and deeper-water capabilities.



Petroleum is Mexico's single largest cargo item measured by weight, according to *Ports News and Industry Trends*. With the continued decline in output, over the past seven years it has declined in both total metric tons transported and as a percentage of the total cargo that passes through the country's ports. Specifically, Mexico transported 122.4 million metric tons of petroleum in 2013, which was down 19% from 151.5 million metric tons in 2009. Over the same period, petroleum has dropped from representing 55.5% of the total cargo transported through the country's ports to 42.5%. If the energy reforms increase oil production as the government expects, then the need for maritime transportation is also likely to rise, we believe.

Mexican Petroleum Transportation, 2007-2013



Cargo in millions of metric tons.
Source: SCT, Coordinación General de Puertos y Mercante, Estadísticas Mensuales

FINANCIAL HISTORY

First Quarter 2014 Highlights

In the 2014 first quarter 2014, TMM's consolidated revenues grew 3.8%, primarily reflecting an 8.8% revenue advance at the company's Maritime operation. In addition, TMM registered a 28.8% increase in tug revenues, mirroring increased LNG (Liquefied Natural Gas) services. Shipyard revenues more than doubled from a low base, reflecting higher average revenue contracts and 90.0% capacity utilization. These revenue gains were partially offset by a 16.2% reduction in revenues at the company's chemical tankers unit, primarily reflecting a decrease in volumes.

As a result, first-quarter 2014 consolidated operating profit reached $121.7 million pesos, which represented an impressive (in our view) 69.9% improvement compared to $71.6 million pesos registered in the prior year first quarter. The company recorded consolidated EBITDA of $269.7 million pesos, up significantly from $219.9 million pesos registered in the first quarter of 2013. We are revising our 2014 projections slightly, raising our total annual revenue forecast to $2,913 million pesos from $2,881 million earlier. On the higher expected revenue, our annual EBITDA forecast goes to $1,183 million pesos from $1,098 million before and our projected LPS (loss per share) is now (MP$3.88) compared to (MP$4.87) earlier.

Balance Sheet Improvements

TMM repaid approximately $369.2 million pesos of its debt in the first quarter 2014, the combination of principle and interest. As of March 31, 2014, TMM's total net debt was $9,907.9 million pesos, down from $10,254 million pesos at the end of 2013. Roughly 94% of TMM's debt is peso denominated. This means that the company has to supplement its peso generated revenue with revenues generated in dollars in order to repay and service its debt.

RISKS

- The company's initiatives could take longer than expected to produce operating efficiencies.
- Mexico's oil reforms might not have the impact that Pemex and the government expect.
- Despite medium and long-term contracts in place at the Maritime division, tariff volatility could impact operations.
- The global downturn in the product tanker business could impact Maritime's revenue and profit.
- The firm remains highly leveraged with MXP 9,781.3 million in net debt.
- TMM's new projects could take longer than expected to complete.
- Given that roughly 94% of TMM's debt is peso denominated and that the company must supplement its peso generated revenue with dollar revenues to service its debt, TMM faces currency exchange risk.

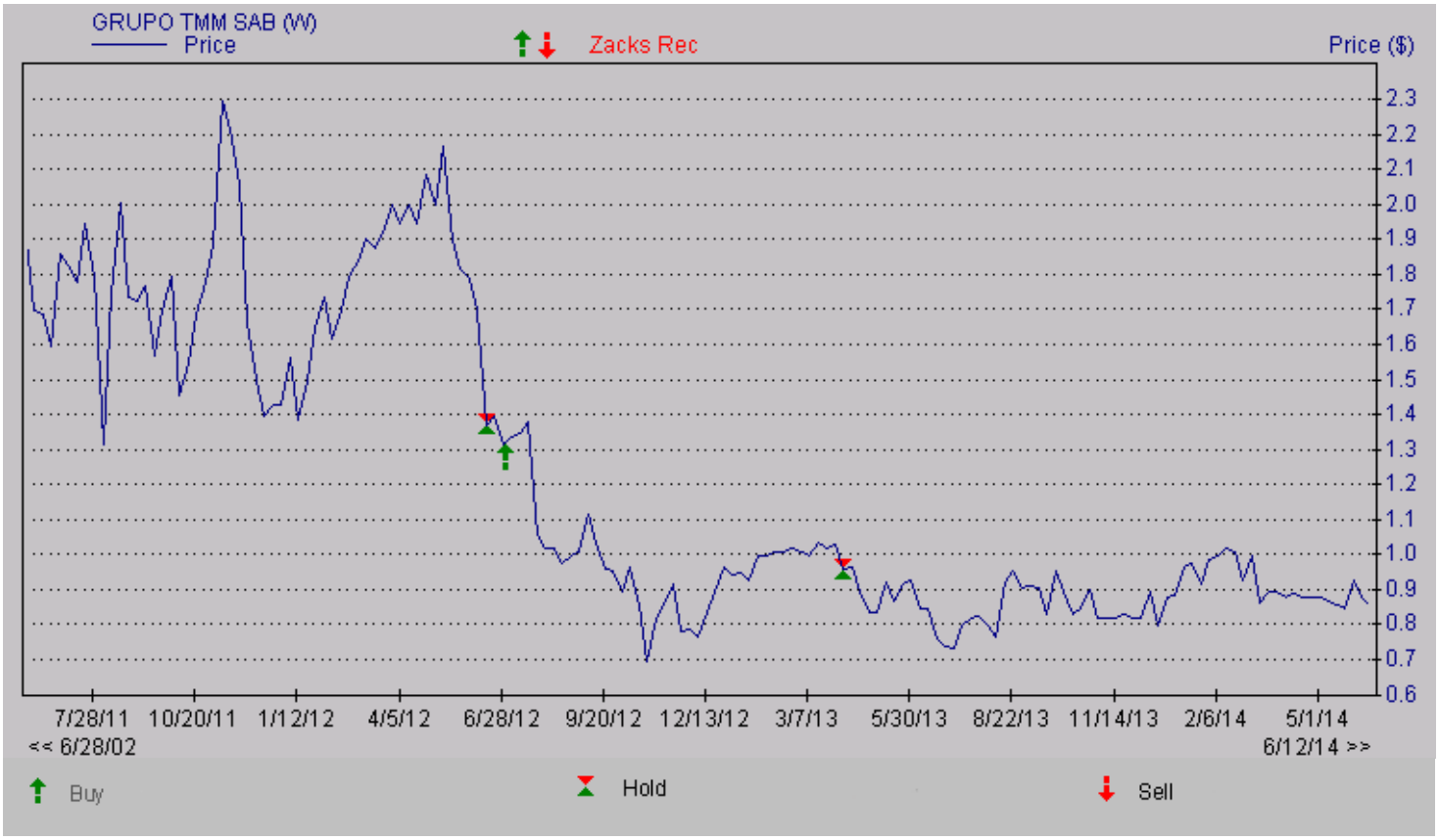
PROJECTED INCOME STATEMENT

Grupo TMM Quarterly Income Statements & Projections ($ Mexican Pesos millions)

	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14E	3Q14E	4Q14E	2014E
Ports & Terminals	97.7	92.2	76.6	66.2	332.7	74.3	69.2	57.5	49.7	250.6
Maritime	554.5	611.6	649.2	639.9	2,455.3	603.4	648.3	688.2	671.9	2,611.7
Corporate & others	12.6	12.6	12.7	12.7	50.6	12.7	12.7	12.8	12.8	50.9
Rev from freight & svcs	**P$664.8**	**P$716.4**	**P$738.5**	**P$718.8**	**P$2,838.6**	**P$690.4**	**P$730.1**	**P$758.4**	**P$734.3**	**P$2,913.2**
Ports & Terminals	(81.0)	(80.4)	(65.4)	(50.5)	(277.2)	(60.2)	(55.3)	(46.0)	(39.7)	(201.2)
Maritime	(297.2)	(334.8)	(360.1)	(381.7)	(1,373.8)	(321.3)	(343.6)	(364.7)	(356.1)	(1,385.7)
Corporate & others	(12.3)	(12.6)	(13.5)	(12.0)	(50.4)	(13.0)	(12.7)	(12.8)	(12.8)	(51.4)
Cost of freight & services	**(390.5)**	**(427.8)**	**(439.0)**	**(444.2)**	**(1,701.4)**	**(394.5)**	**(411.6)**	**(423.5)**	**(408.7)**	**(1,638.3)**
Ports & Terminals	(3.7)	(3.7)	(3.7)	(3.6)	(14.6)	(3.5)	(3.5)	(2.9)	(2.5)	(12.3)
Maritime	(142.2)	(139.8)	(140.6)	(139.7)	(562.3)	(142.6)	(155.6)	(165.2)	(161.3)	(624.6)
Corporate & others	(2.4)	(2.1)	(2.1)	(2.1)	(8.7)	(1.9)	(1.9)	(1.9)	(1.9)	(7.6)
Depreciation & amortization	(148.3)	(145.6)	(146.4)	(145.4)	(585.6)	(148.0)	(160.9)	(169.9)	(165.7)	(644.5)
Corporate expenses	(64.9)	(39.6)	(57.0)	(48.6)	(210.1)	(50.0)	(49.0)	(48.0)	(47.0)	(194.0)
EBIT										
Ports & Terminals	13.0	8.1	7.5	12.1	40.9	10.6	10.4	8.6	7.4	37.0
Maritime	115.1	137.0	148.5	118.5	519.2	139.5	149.1	158.3	154.5	601.4
Corporate & others	(2.1)	(2.1)	(2.9)	(1.4)	(8.5)	(2.2)	(2.0)	(2.0)	(2.0)	(8.1)
Other (expenses) income	10.5	(3.7)	25.6	31.6	64.0	23.9	24.9	25.9	26.9	101.6
Operating Income	**P$71.6**	**P$99.7**	**P$121.7**	**P$112.2**	**P$405.5**	**P$121.8**	**P$133.4**	**P$142.8**	**P$139.9**	**P$537.9**
EBITDA	**P$219.9**	**P$245.3**	**P$268.1**	**P$257.6**	**P$991.1**	**P$269.8**	**P$294.4**	**P$312.8**	**P$305.6**	**P$1,182.5**
Financial (expenses) income	(230.2)	(230.6)	(227.5)	(216.6)	(904.9)	(216.4)	(216.4)	(216.4)	(216.4)	(865.6)
Exchange gain (loss)	25.2	(30.6)	6.9	2.8	4.4	(3.1)	(3.1)	(3.1)	(3.1)	(12.4)
Net financial cost	(205.0)	(261.2)	(220.6)	(213.8)	(900.5)	(219.5)	(219.5)	(219.5)	(219.5)	(878.0)
Loss before taxes	**(133.4)**	**(161.5)**	**(98.9)**	**(101.6)**	**(495.0)**	**(97.7)**	**(86.1)**	**(76.7)**	**(79.6)**	**(340.1)**
Provision for taxes	(7.1)	(29.2)	32.4	(0.8)	(4.7)	(2.2)	(2.2)	(1.2)	(0.2)	(5.8)
Net Loss before discontinuing	**(140.5)**	**(190.7)**	**(66.5)**	**(102.4)**	**(499.7)**	**(100.0)**	**(88.4)**	**(78.0)**	**(79.9)**	**(346.2)**
Loss from discontinuing operatic	(25.3)	(44.4)	(8.2)	14.3	(63.5)	(14.7)	(14.7)	(13.7)	(12.7)	(55.8)
Net Loss for the period	**(165.8)**	**(235.1)**	**(74.7)**	**(88.1)**	**(563.2)**	**(114.7)**	**(103.1)**	**(91.7)**	**(92.6)**	**(402.0)**
Attributable to:										
Minority interest	2.4	0.4	0.2	2.0	5.0	(1.5)	(1.5)	(0.5)	0.5	(3.0)
GTMM Equity holders	**(168.2)**	**(235.5)**	**(74.9)**	**(90.1)**	**(568.2)**	**(113.2)**	**(101.6)**	**(91.2)**	**(93.1)**	**(399.0)**
LPS	**(P$1.65)**	**(P$2.30)**	**(P$0.73)**	**(P$0.88)**	**(P$5.56)**	**(P$1.11)**	**(P$0.99)**	**(P$0.88)**	**(P$0.89)**	**(P$3.88)**
Avg shares out (millions)	102.2	102.2	102.2	102.2	102.2	102.2	102.2	103.2	104.2	102.9

Source: Company reports, Zacks estimates

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Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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