Zacks Small-Cap Research

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GRUPO TMM (TMM-NYSE)

TMM: Maritime Shines - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/16/2010
Current Price (05/04/12)	$2.00
Target Price	**$4.50**

OUTLOOK

Grupo TMM is one of the largest integrated logistics and transportation companies in Mexico. The firm, through its subsidiaries provides maritime services, land transportation services, integrated logistics services, and ports and terminals management to international and domestic clients throughout Mexico. As part of its five-year growth strategy, the firm is committed to modernizing its fleet and increasing its penetration in Mexican Ports, which will in turn maximize margins. TMM's offshore and product tanker fleet generally work with long and medium-term contracts which has the effect of predictable cash flows.

SUMMARY DATA

52-Week High	**$2.96**
52-Week Low	**$1.32**
One-Year Return (%)	**-35.27**
Beta	**0.07**
Average Daily Volume (sh)	**5,631**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$36**
Short Interest Ratio (days)	**8.85**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**36**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-11.2**
EBITDA (%)	**57.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2011 Estimate	**N/A**
Zacks Rank	**3**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Maritime**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	81 A	75 A	75 A	74 A	305 A
2011	66 A	70 A	69 A	65 A	269 A
2012	63 A	64 E	66 E	68 E	261 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	-$0.41 A	$0.14 A	-$0.27 A	-$0.26 A	-$0.79 A
2011	-$0.42 A	-$0.30 A	$0.90 A	-$0.04 A	$0.15 A
2012	-$0.79 A	-$0.66 E	$0.05 E	$0.16 E	-$1.24 E

*EPS is impacted by currency exchange rate changes between USD/ MXN

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Maritime Shines at Grupo TMM

On May 2, Grupo TMM released results for the first quarter of 2012 ended March 31, 2012.

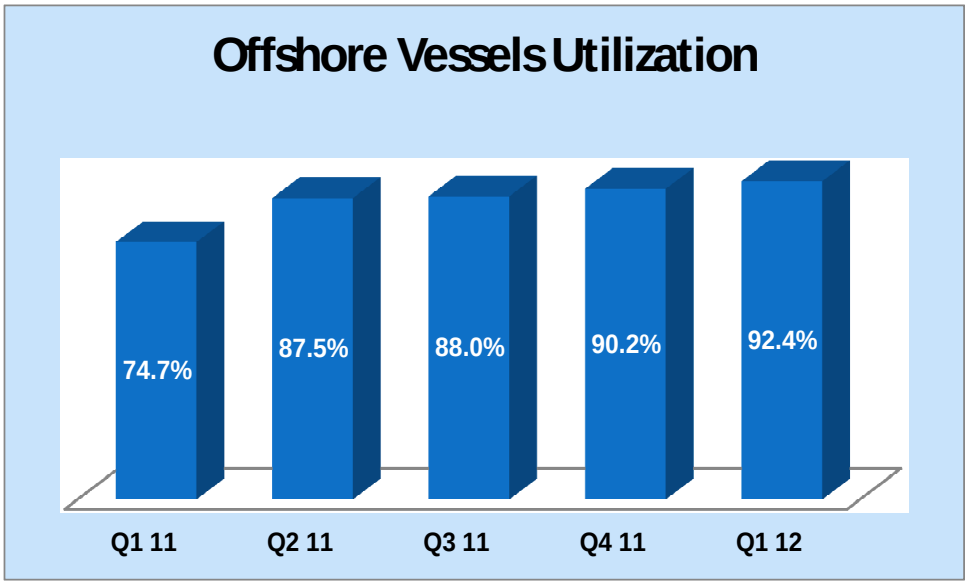
The Company reported mixed results for the quarter due to continued challenging global economic conditions as well as appreciation of the peso against the dollar which resulted in a net exchange loss, negatively impacting net income.

The Company's first quarter performance resulted in a 4.2 percent year over year decrease in revenue, with revenue dropping $2.8 million to $63.1 million from $65.9 million for the three months ended March 31, 2011.

Maritime segment revenue increased $1.7 million or 4.3 percent year over year to $41.3 million for the three months compared to the comparable period of last year. The improved Maritime revenue was primarily a result of improvements at offshore and at harbor tugs, and to the revenue contribution of the Company's recently acquired shipyard.

Despite the Maritime segment being impacted by the difficult economic marketplace, the offshore business revenue improved 4.4 % and utilization continued its sequential improvement climbing from 74.7% in the first quarter of 2011 to 92.4% in the first quarter of 2012. Also, the Company reported that during the fiscal 2012 first quarter, it renewed three offshore contracts for a three-year period each.

The Maritime division currently has a backlog of $192.6 million.



Recall that TMM acquired a shipyard at the Port of Tampico, which is working at full capacity and contributing to Maritime's revenue and profit. Management expects to have the necessary capabilities to build vessels at this facility, which is in line with PEMEX's intention to add 32 offshore vessels to its fleet, of which 21 are required to be Mexican built vessels.

As of March 31, 2012, Grupo TMM's net debt was to $748.5 million compared to $675.4 million as of December 31, 2011. It should be noted that the book value of the Company's Trust Certificates debt increased $68.0 million from December 31, 2011, as a result of an 8.2 percent appreciation of the peso against the dollar in the first quarter of 2012. Still, only 1.7% or $14.0 million of the Company's current total debt is short term debt.

A Closer Look at the TMM's Growth Plan

The firm's five-year growth plan includes two projects. The first project consists of the development of a container and liquids terminal at the Port of Tuxpan, Veracruz. The container terminal will meet increasing demand for capacity in the Gulf of Mexico, taking advantage of organic growth in the Mexican market. The liquids terminal will address current and projected increased demand for imported gasoline and diesel fuel through the construction of a pipeline and a berthing position. Investors should be aware that the development of the facility could take up to two years. Along the same lines, the addition of specialized offshore vessels to TMM's fleet is anticipated to benefit the Company in meeting increased demand for deep water transportation.

New Opportunities

In January 2012, Grupo TMM acquired a shipyard at the Port of Tampico which is strategically positioned in the Gulf of Mexico, working at full capacity and contributing to Maritime's revenue and profit. This acquisition is in line with PEMEX's intention to add 32 offshore vessels to its fleet, of which 21 are required to be Mexican built vessels.

INVESTMENT THESIS

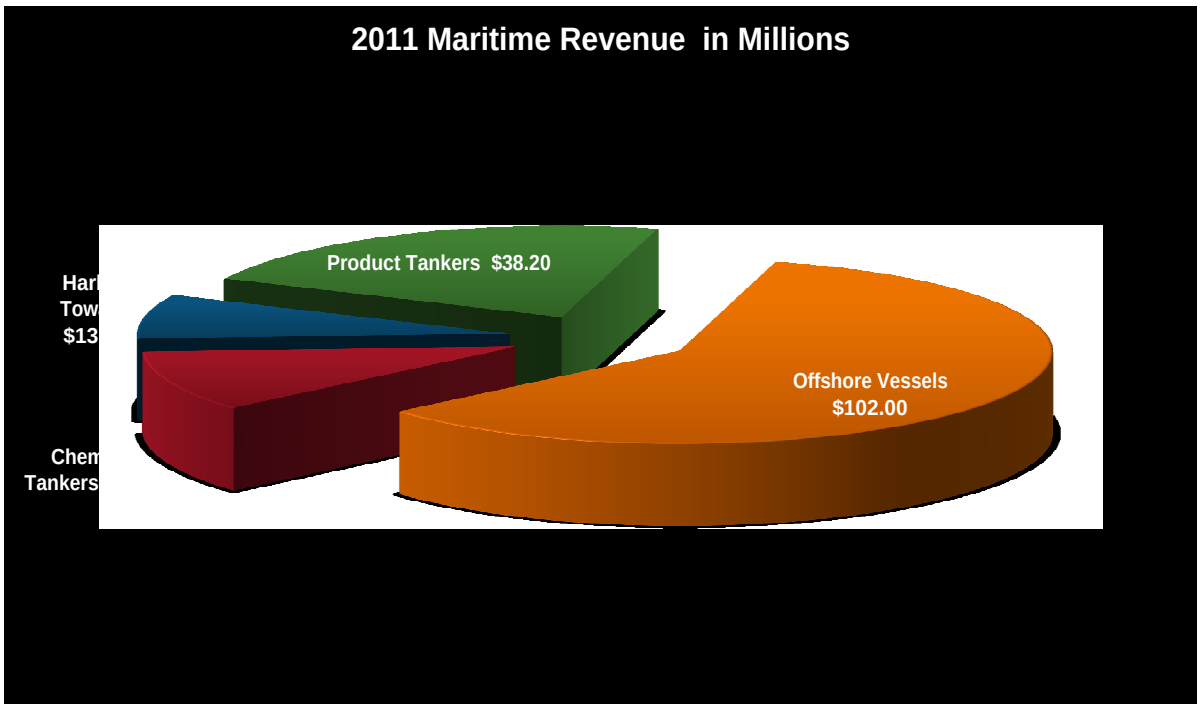
- The firm's Maritime division is the dominant business at TMM. The fleet was renewed throughout 2008 and 2009, adding 10 offshore vessels and 3 tankers to its fleet. TMM is committed to continue to modernize its fleet as part of its five-year growth plan, which will in turn maximize margins.

- TMM prefers to compete for margin rich niche business and employs long to medium-term contracts.

- TMM is committed to taking advantage of strategic opportunities to add new vessels to its fleet and increase its penetration in Mexican ports. This should make the firm more efficient and more profitable in the long run.

- The outlook for deep water drilling as well as the Mexican and American GDP looks promising.

Maritime Operations. (64% of Total Revenue)
The Maritime Operations division provides maritime transportation services, including offshore vessels that provide transportation and other services to the Mexican offshore oil industry, tankers that transport petroleum products within Mexican waters, parcel tankers that transport liquid chemical and vegetable oil cargos from and to the United States and Mexico, and tugboats that provide towing services at the port of Manzanillo, Mexico. The firm provides these services through its fleet of 39 vessels, which includes product tankers, a variety of offshore supply vessels, harbor tugs and chemical tankers.



Offshore Vessels
The offshore vessels unit has a fleet of 27 vessels mainly for transport of dry and liquid cargo, anchor handling tug vessels, crew boats, fire fighting vessels, four point mooring vessels and dynamic positioning vessels.



Product Tankers
This segment provides product tanker chartering services to PEMEX for the transportation of petroleum products, from refineries to various Mexican ports. The fleet is comprised of five product tankers, most of which are under medium-term contracts. The firm enjoys an advantage here as Mexican Maritime law establishes that cabotage services should be provided by Mexican flag vessels and Mexican companies are given priority.

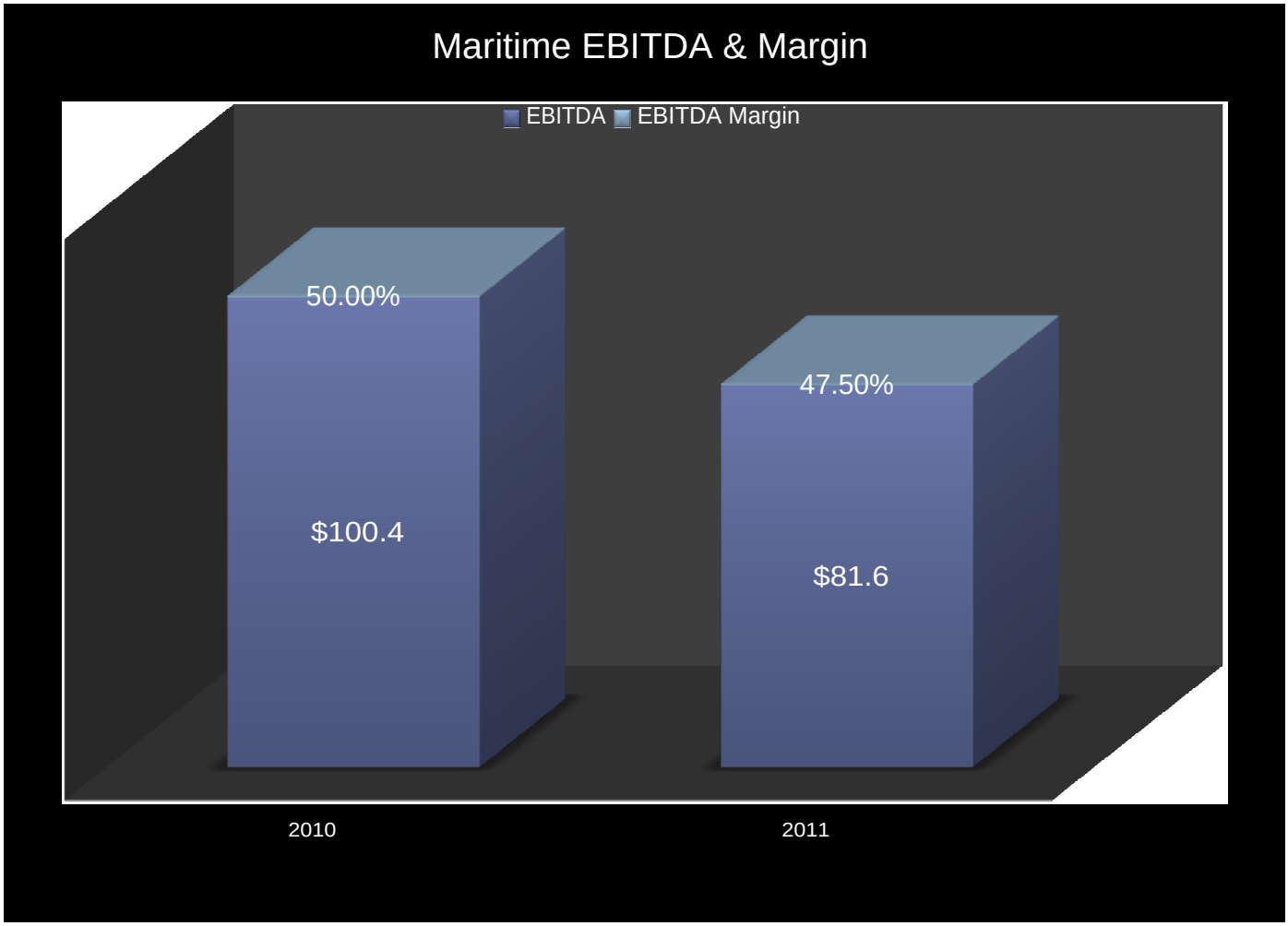


Chemical Tankers
The firm currently operates two chemical vessels that transport chemicals, vegetable oils and molasses. Currently more than 90% of cargo is transported under a contract of Affreightment. This is a service contract under which a ship owner agrees to transport a specified quantity of fuel products or specialty products, at a specified rate per ton, between designated loading and discharge ports. This type contract differs from a spot or consecutive voyage charter in that no particular vessel is specified.



Harbor Towing
TMM is the sole provider of towing services at the port of Manzanillo since January 1997 and has a concession through January 2015, which is anticipated to be renewed when expired.
The firm currently has five vessels that service over 2,000 vessels per year. Major clients include, NYK, MSC, PEMEX and Hapag-Lloyd.





Ports and Terminals Operations. (10% of Total Revenue)
The firm presently operates two Mexican port facilities, Tuxpan and Acapulco, under concessions granted by the Mexican Government, which provide for certain renewal rights. This business unit also provides port agent services to vessel owners and operators in the main Mexican ports. At Acapulco, the Company operates and manages an automobile terminal, a cruise ship terminal and an automobile warehouse with a capacity to store up to 2,000 automobiles.

The company owns approximately 2,000 acres of land in Tuxpan, and a multipurpose cargo terminal, currently handling only small volume of cargo. As stated above in this report, Grupo TMM has made significant progress on a joint venture to develop a container and a liquids terminal for oil products at this Port.

The Company's shipping agencies offer services including multimodal supervision; ship port agent services, cargo and chandler services and bunkering services.



The automotive segment provides value-added logistics services including storage and distribution of finished vehicles from auto yards to final distribution companies. The Company also offers services of maintenance and repair of containers to major international shipping companies at Mexico's main ports including, Manzanillo, Veracruz,

Altamira, Ensenada and Mazatlán, as well as at intermodal and specialized terminals at Mexico City and Aguascalientes. In the second half of 2010, The Ports and Terminals division started offering stevedoring services for general cargo at Tampico.





Logistics Operations. (26% of Total Revenue)
TMM provides dedicated trucking services to major manufacturers, including automobile plants and retailers with facilities and operations throughout Mexico. The firm offers full-service logistical facilities in major industrial cities throughout Mexico, including Aguascalientes, Toluca, Puebla, Veracruz, Nuevo Laredo, Mexico City and Monterrey.

Services provided include consulting, analytical and logistics outsourcing, which encompass the management of inbound movement of parts to manufacturing plants consistent with just-in-time inventory planning practices; logistics network (order-cycle) analysis; logistics information process design; trucking, intermodal transport and auto haulage services; warehousing and bonded warehousing facility management; supply chain and logistics management; product handling and repackaging; local pre-assembly; and inbound and outbound distribution using truck transport.



Growth Strategy

Grupo TMM is committed to expanding its Maritime Operations through a number of methods.

The Company intends to increase its offshore services with medium and long-term contracts. Its intent is to escalate these services by taking advantage of the Mexican Navigation Law which grants priority to Mexican ship owners performing cabotage (intra-Mexican movement between Ports) in Mexican waters. Furthermore, as part of their 5-year growth plan, Grupo TMM expects to continue its commitment of increasing the number of new generation, cost efficient vessels to its fleet and therefore developing higher margin revenues.

Additionally, Grupo TMM's intention is to increase its penetration into Mexican Ports. The Company began a small operation of stevedoring services for general cargo during its 2010 Q4 at the Port of Tampico. Stevedoring services include the loading and unloading of ships. Furthermore, the Company owns 2,000 acres of land in Tuxpan and a multipurpose cargo terminal. This property in Tuxpan is uniquely positioned as a container and liquids terminal for oil products and already has a concession and the environmental permits to operate at this port. The Company is currently working on financing alternatives for the development of this site.



Deep Water Drilling Strength

Drilling rig contractors are bullish on the long-term outlook for the global ultra-deepwater drilling sector, with rig demand beginning to recover following the global financial crisis of 2008 and ultra-deepwater rig demand appearing outside the "Golden Triangle" markets of West Africa, Brazil and the U.S. Gulf of Mexico.

The number of deepwater discoveries has picked up again as the global financial recovery and sustainable oil prices have prompted national oil companies, majors and independents to begin spending again on exploration. Drilling companies are finding that operators are opting for high-specification rigs, including rigs with dynamic positioning (DP) capabilities to meet more challenging geological plays as well as increased safety and operational standards.

Noble Corporation also expects to see rig demand recovery over the next several years, with progressive growth toward the end of the decade. While deepwater and mid-water rig rates will remain under pressure in the near-term, the company noted that ultra-deepwater day rates are strong enough to encourage new build rig construction.

Mexican and US GDP Outlook

According to Capital Economics the increase in the Mexican IMEF manufacturing index last month suggests that the industrial sector has continued to benefit from stronger demand in the US. Data released on April 6, 2011 show that the IMEF manufacturing index rose to 54.1 last month, from 52.7 in February. That leaves the overall reading far above 50, which is the notional divide between expansion and contraction. Looking further ahead, demand from the US should remain strong in the near-term and Mexican industry, and therefore the economy, will perform correspondingly well. Capital Economics has projected an overall GDP growth of around 4.3% this year. The United States, with its debt issues faces a bit more of an unknown as most economic analysts look for growth in the range of 2.2%, 2.7%, and 3.1% for the years 2012, 2013, and 2014.

More recently Economists surveyed in October by the Bank of Mexico cut their estimates for economic growth for 2012, citing lower growth rates in the U.S. and persistent volatility in the international financial markets as the European debt crisis is still unresolved. For 2012, economists estimate GDP will grow by just 3.24%, compared with 3.50% previously. The survey of 26 banks and consultancy firms estimated U.S. growth of 2% in 2012, down from 2.1%.

VALUATION

The firm's industry position is quite unique in that it operates as a door to door provider of services, yet also at times enjoys niche markets and other times monopolistic markets. This has the potential to lead to higher margins than the competition. Despite the different segments, the firm is primarily a shipping firm which is set to take advantage of deep water drilling opportunities.

For investors with a time frame of several quarters this may be the best entry point in years as the firm is set to embark on a growth strategy that will improve the capital structure, (now highly leveraged) continue impressive utilization, and provide above average return on assets. When looking at several metrics (P/B, P/S) the firm looks undervalued. From an operational standpoint the firm has made impressive strides. (EBITDA margin and Utilization)

Management has effectively steered the company, for example it has kept its fleet of maritime assets modern with several purchases as well as selling off inefficient equipment. In our opinion investors should be more concerned with the top-line and EBITDA numbers given the large amount of debt denominated

in Mexican pesos. This adds the complexity of exchange gains and losses to the bottom line. The firm looks undervalued when looking several ratios. We compared the firm against the transportation industry.

Price to book value ratio is used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. The book value of equity is the difference between the book value of assets (original price – allowable depreciation) and the book value of liabilities. The market value of an asset in contrast to its book value reflects its earnings power and expected cash flows. The P/BV can very easily be compared across firms in the industry assuming accounting standards are consistent firm to firm.

$$P/B\,Ratio = \frac{Stock\ Price}{Total\ Assets - Intangible\ Assets\ and\ Liabilities}$$

Metric	Grupo TMM	Industry Average
Price/Book Value	0.33	2.85

While not as popular as Price/Earnings or Price/BV, Price/Sales is not influenced by accounting decisions in depreciation, inventory and extraordinary charges. P/S multiples are much less volatile than P/E multiples. However if the problem with the firm lies in cost control the P/S ratio will not reflect this flaw.

Metric	Grupo TMM	Industry Average
Price/Sales	0.15	1.76

According to the Price/Book Value and the Price/Sales models the firm appears undervalued compared to the industry.

Using a blend of these valuation metrics we arrive at a price of $4.50

PROJECTED INCOME STATEMENT

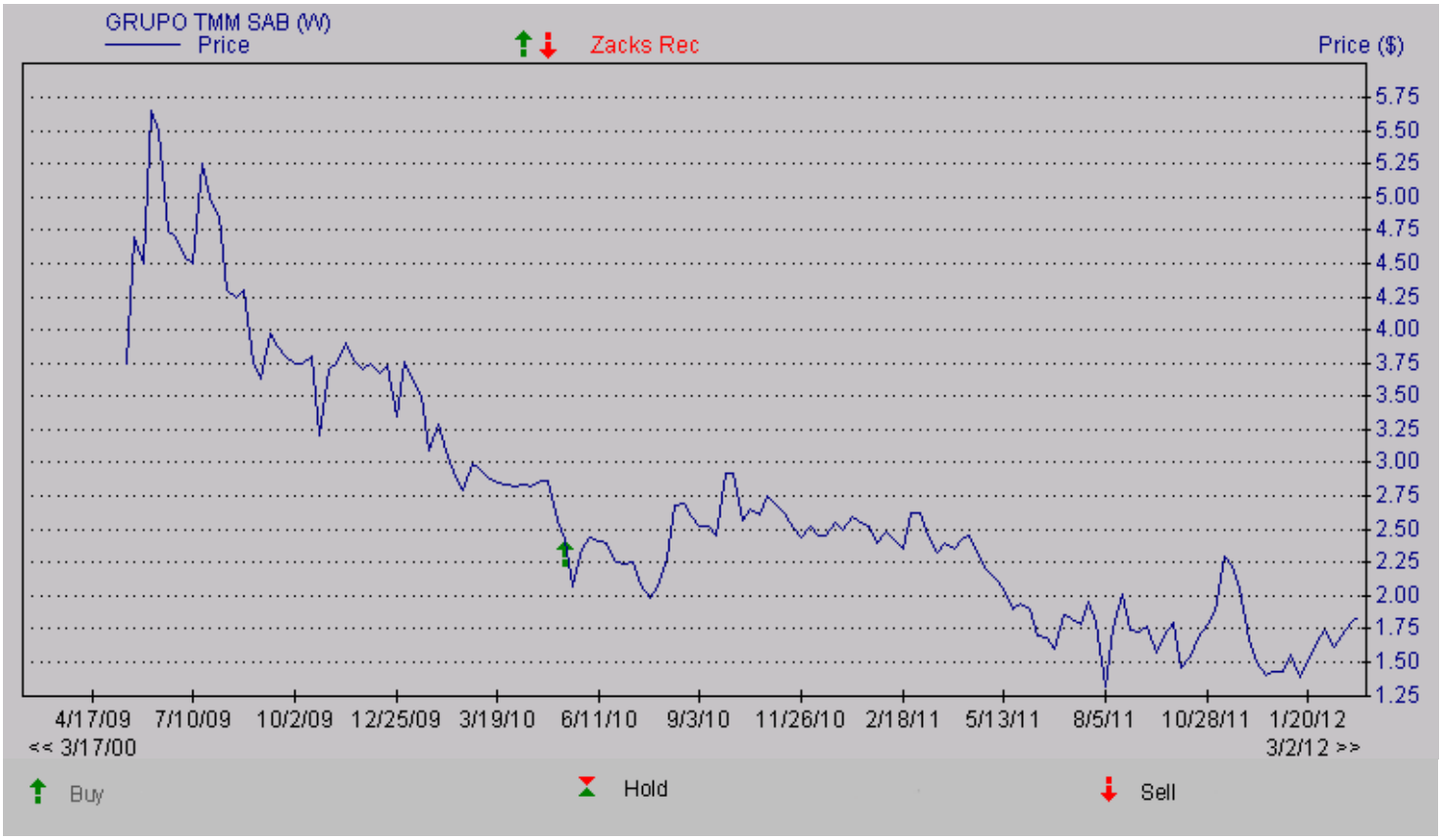
INCOME STATEMENT ($ Millions)	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11	Dec-11 Q4 11	Mar-12 Q1 12	Jun-12 Q2 12 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012 E
REVENUE												
Net Revenue	**65.9**	**69.6**	**68.8**	**64.8**	**63.2**	**64.0**	**303.3**	**363.0**	**308.2**	**305.4**	**269.2**	**261.0**
Sequential Growth		*6%*	*-1%*	*-6%*	*-2%*	*1%*						
OPERATING EXPENSES												
Cost of Revenues	44.17	47.31	47.15	43.76	43.72	43.00	253.9	300.5	221.7	198.8	182.4	173.6
% of Revenue	*67.0%*	*67.9%*	*68.5%*	*67.6%*	*69.2%*	*67.2%*						
Gross Profit -	**21.8**	**22.3**	**21.7**	**21.0**	**19.4**	**21.0**	**49.4**	**62.4**	**86.5**	**106.6**	**86.8**	**87.4**
Proforma Gross Margin	*33.0%*	*32.1%*	*31.5%*	*32.4%*	*30.8%*	*32.8%*	*16.3%*	*17.2%*	*28.1%*	*34.9%*	*32.2%*	*33.5%*
Depreciation + Amort	13.08	13.64	12.71	24.61	12.86	12.00	25.7	33.8	44.6	59.5	64.0	61.8
% of Revenue	*19.8%*	*19.6%*	*18.5%*	*38.0%*	*20.4%*	*18.8%*	*8.5%*	*9.3%*	*14.5%*	*19.5%*	*23.8%*	*23.7%*
Corp Expenses	4.13	4.35	4.40	2.22	3.87	3.50	4.4	8.8	14.9	14	15	15
% of Revenue	*6.3%*	*6.2%*	*6.4%*	*3.4%*	*6.1%*	*5.5%*	*1.4%*	*2.4%*	*4.8%*	*4.6%*	*5.6%*	*5.7%*
Other Income (Expenses)-Net	0.79	6.39	1.47	(10.26)	1.64	4.00	-	-	0.48	3.09	(1.62)	7.00
% of Revenue												
Total Operating Expenses	16.42	11.60	15.64	37.09	15.08	11.50	30.01	42.55	58.92	70.40	80.74	69.55
% of Revenue	*24.9%*	*16.7%*	*22.7%*	*57.3%*	*23.9%*	*18.0%*	*9.9%*	*11.7%*	*19.1%*	*23%*	*30%*	*27%*
Operating Income -	**5.3**	**10.7**	**6.1**	**-16.1**	**4.36**	**9.5**	**19.3**	**19.9**	**27.5**	**36**	**6**	**18**
Operating Margin	*8.1%*	*15.4%*	*8.8%*	*-24.8%*	*6.9%*	*14.8%*	*6%*	*5%*	*9%*	*12%*	*2%*	*7%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-47	-38	89	10	-85	-75	-48.5	75.6	-118.3	-108	14	-150
% of Revenue	*-70.93%*	*-54.73%*	*128.89%*	*14.89%*	*-134.35%*	*-117.19%*	*-16.00%*	*20.84%*	*-38.39%*	*-35.43%*	*5.02%*	*-57.47%*
Tax Provision	0.4	2.4	3.2	-2.7	0.2	2.2	-0.84	20.09	1.7	1	3	-5
Effective Tax Rate												
Net Income -	**-41.87**	**-29.76**	**91.63**	**-3.78**	**-80.65**	**-67.70**	**-28.35**	**75.44**	**-92.46**	**-73.03**	**16.22**	**-127.15**
Net Income Margin	*-63.5%*	*-42.7%*	*133.1%*	*-5.8%*	*-127.7%*	*-105.8%*	*-9.3%*	*20.8%*	*-30.0%*	*-24%*	*6%*	*-49%*
EARNINGS PER SHARE												
EPS - Basic	-$0.42	-$0.30	$0.90	-$0.04	-$0.79	-$0.66	-$1.17	$1.47	-$1.43	-$0.79	$0.15	-$1.24
EBITDA (in Millions)	$18.41	$24.37	$18.76	$8.52	$17.22	$21.50	$44.99	$53.68	$72.09	$95.65	$70.05	$79.65

Ken Nagy, CFA Zacks Investment Research 5/4/2012

RISKS

- Despite medium and long-term contracts in place at the Maritime division, tariff volatility could impact operations
- The firm remains highly leveraged with $748 million in net debt.

HISTORICAL ZACKS RECOMMENDATIONS



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