Zacks Small-Cap Research

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Grupo Tmm Sab (GTMAY-OTC)

GTMAY: *Believe Pemex Results Underscore Need for Opening of Energy Sector*

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	04/07/2013
Current Price (5/22/15)	$1.22
Target Price	**$2.50**

OUTLOOK

We remain positive on TMM's ability to benefit from the liberalization of Mexico's energy sector. Pemex's need to modernize is reflected in its financial and operating performance**,** we believe. Last month, Pemex announced results for the first quarter of 2015, with total crude oil production down 7.7% y/y. TMM is one of Mexico's largest maritime transportation companies and has a long history of working with Pemex. We believe TMM is well positioned to benefit from the opening of Mexico's energy sector, although in the near-term, the steep decline in oil prices could delay some of the expected growth, in our view.

SUMMARY DATA

52-Week High	**$2.91**
52-Week Low	**$0.85**
One-Year Return (%)	**44**
Beta	**NA**
Average Daily Volume (sh)	**2,600**
ADRs at 5:1 ord. shares (mil)	**20**
Market Capitalization ($mil)	**$25**
Short Interest Ratio (days)	**10.3**
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	**-3.5**
P/E using 2015 Estimate	**-4.0**
P/E using 2016 Estimate	**N/A**

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

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	49 A	54 A	51 A	187 A
2015	47 A	44 E	49 E	51 E	190 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	-$0.07 A	-$0.11 A	$0.05 A	-$0.22 A	-$0.35 A
2015	-$0.07 A	-$0.09 E	-$0.05 E	-$0.10 E	-$0.31 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 9

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KEY POINTS

- The need for Pemex (Petróleos Mexicanos) to modernize continues to be reflected in its financial and operating results, we believe. Last month, Pemex announced results for the first quarter of 2015, with revenues of P$279.5 billion down 31% from P$407.0 billion in the year ago quarter.

- Despite potential delays, we remain optimistic about TMM's long-term opportunity to benefit from Mexico's energy reforms. According to Pemex, energy reforms will alter how international companies participate in Mexico's energy sector and, in turn, boost oil production, which has been in decline for the past decade.

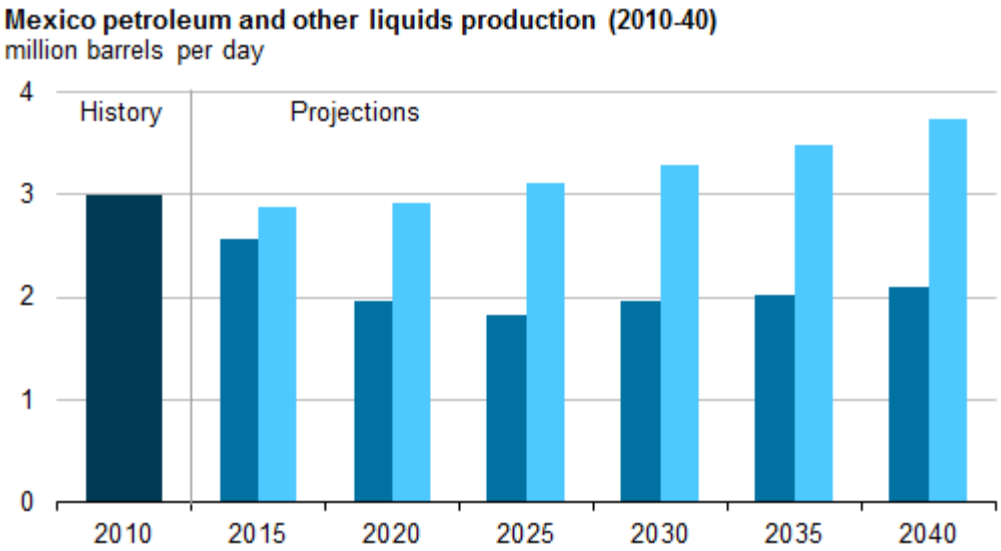
- Separately, TMM recently reported results for the first quarter of 2015. Driven primarily by a P$28.4 million or 4.7% year-over-year advance in Maritime revenue, TMM registered an 3.9% improvement in total revenue to P$713.6 million. In recent periods, Maritime revenue has been trending up versus prior year quarters, while Ports and Terminals revenue has been constrained by lower shipments of Mexican automobiles to Latin American markets.

ENERGY REFORM: LONG-TERM POSITIVE

We remain optimistic about the **long-term opportunity for Grupo TMM (GTMAY-OTC) to benefit from Mexico's energy reforms**. On August 11, 2014, Mexico's President Enrique Peña Nieto signed energy reform legislation that is intended to open Mexico's oil and natural gas markets to foreign direct investment. A year earlier, Mexico had initiated reforms to allow international companies to explore energy opportunities. The legislative reforms are intended to open the Mexican energy sector to national and international competition. According to Pemex (Petróleos Mexicanos), energy reforms will alter how international companies participate in Mexico's energy sector and, in turn, boost oil production, which has been in decline for the past decade. In 2014, Pemex produced 2.43 million barrels a day, down from 2.522 million barrels in 2013, with the metric declining to an average 2.35 million barrels/day by December 2014, according to Latin Post.

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. As a result of these legislative reforms, the U.S. Energy Information Administration (EIA) increased its preliminary projections for Mexico's oil production (see below). By increasing oil and natural gas production, the reforms are also expected to boost the availability of more affordable energy for the Mexican population.

The Mexican government has indicated plans to auction 169 oil and gas blocks for exploration and exploitation. Per the original schedule, the first contracts were slated to be awarded by July 2015. Mexico's Energy Secretariat expects to raise over $50 billion from the 169 blocks.

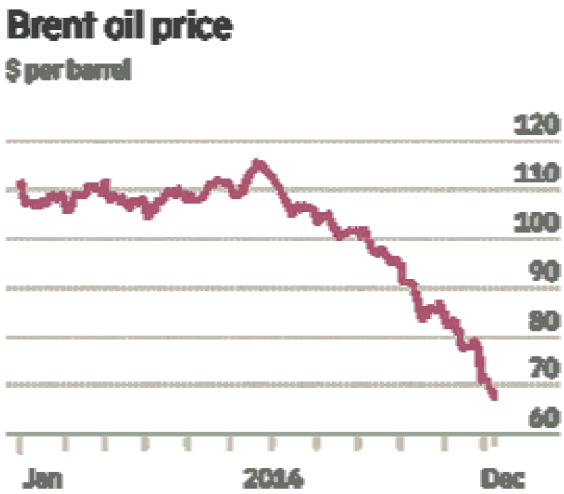


Source: EIA *International Energy Outlook 2014*

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. Major companies such as Noble Energy (NBL-not rated) and others have already indicated an increased interest in deep-water exploitation in the Gulf of Mexico. 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.

However, we believe the steep decline in global oil prices has created uncertainty about the schedule and about how much investment Mexico will attract near-term. After reaching $115 a barrel in 2014 (see figure below), oil prices dropped to roughly $44 / barrel, which represents the lowest level since April 2009. This has led the Mexican government to lower its 2015 budget by nearly 3%. Oil revenue contributes roughly 33% of the government's budget.



Source: Thomson Reuters

According to the National Hydrocarbons Commission, major energy companies such as Exxon Mobil (XOM-not rated), Chevron (CVX-not rated), BP (BP-not rated) and Shell (RDS-A-not rated) have indicated their interest in bidding on the Mexican blocks. However, industry insiders expect that the first bids for exploration contracts will be lower than originally expected and that some exploration projects are likely to be delayed. In fact, Mexico's Finance Secretary announced recently that Mexico would delay bidding for some fields that are expected to be particularly sensitive to oil price declines.

Moreover low oil prices led the government to reduce its 2015 spending forecast. Revenue from oil makes up roughly 33% of the government budget. The government reduced some $8.4 billion, or roughly 3%, from its 2015 budget. Moreover, largely mirroring the steep decline in oil prices and potential decline in oil production, Mexico has reduced its economic growth forecast for 2015. The Bank of Mexico's revised estimate is that GDP growth will be 2.5% to 3.5% in 2015, which is lower than its original 3%-4% forecast.

The need for Pemex to modernize continues to be reflected in its financial and operating results, we believe. Pemex has announced that it hopes to minimize the impact the budget cuts will have on oil production and "to establish alliances" that would enable it to maintain its original production goals for 2015. Last month, Pemex announced results for the first quarter of 2015, with Gross revenues of P$279.5 billion down from P$407.0 billion in the year ago quarter. Net losses reached (P$100.5) billion compared to (P$36.0) billion, reflecting lower oil output and prices. Pemex's total crude oil production averaged 2.30 million barrels/day during the quarter, which represents a 7.7% year-over-year decrease.

FIRST QUARTER 2015 HIGHLIGHTS

Separately, TMM recently reported results for the first quarter of 2015. Driven primarily by a P$28.4 million or 4.7% year-over-year advance in Maritime revenue, TMM registered an 3.9% improvement in total revenue to P$713.6 million compared to P$686.9 million recorded in the first quarter 2014. The latest quarter was consistent with recent periods, wherein Maritime revenue has been trending up versus prior year quarters, while Ports and Terminals revenue has been constrained by lower shipments of Mexican automobiles to Latin American markets. First quarter 2015 Ports & Terminals revenue of P$66.8 million was down 10.1% compared to the first quarter of 2014. This was offset by the above noted 4.7% increase in Maritime revenue combined with a 45.7% improvement in Corporate and other revenue.

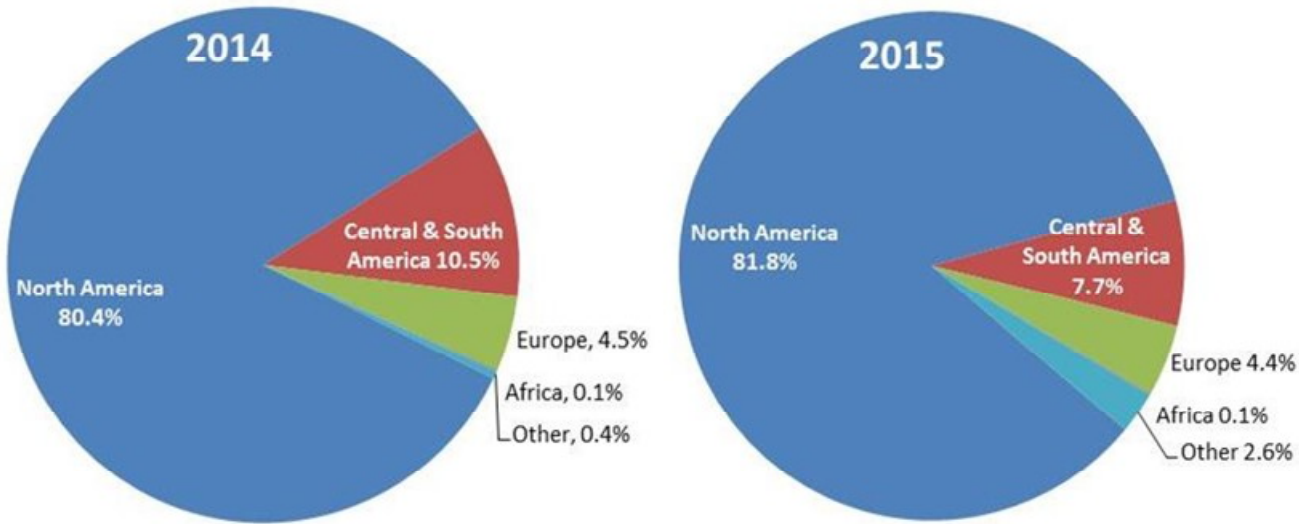
Automobile and Truck Exports, January-April 2015 vs 2014

			YTD 2015	*YTD 2014*	
	Autos	*Trucks*	*Total*	*Total*	% Chg
North America	418,174	336,095	754,269	650,402	16.0%
Central America	3,473	4,340	7,813	7,594	2.9%
South America	42,011	21,020	63,031	77,004	-18.1%
Europe	33,215	7,621	40,836	36,378	12.3%
Asia	5,279	26,420	31,699	33,040	-4.1%
Africa	0	643	643	634	1.4%
Other	23,156	582	23,738	3,480	582.1%
Total	525,308	396,721	922,029	808,532	14.0%
Source: AMIA					

First quarter 2015 Maritime revenues benefited from a P$40.9 million improvement in revenue the offshore segment due to an additional vessel in operation, as well as an P$11.2 million or 74.9% increase in shipyard revenue. This was offset, as noted, by lower Ports and Terminal segment revenue. In recent periods, TMM's Ports and Terminals segment has been hurt by lower revenues in the Automobile segment, despite record Mexican automobile production levels. This is because exports to South America have been down, despite increased shipments to the U.S. One likely factor is a 2011 agreement between Mexico and Brazil for Mexico to limit auto exports to Brazil until March 2015. This contributed to a 23% decline in exports of Mexican produced cars to Brazil in 2013, according to AMIA (Mexican Automobile Industry Association) and continues to constrain shipments.

This trend appears to have continued in 2015, based on AMIA data in the table above. Total automobile exports to South America were down 18.1% in the first four months of 2015, according to AMIA. During the period, they comprised 7.7% of total automotive exports from Mexico, down from 10.5% in the same time frame of 2014. While the pact with Brazil was originally set to expire in March 2015, Mexico recently agreed to renew vehicle quotas for another four years until March 2019. We have revised our projections.

Mexican Auto Exports by Market, Jan.-Apr. 2015 vs. 2014



Source: AMIA

TMM's total expenses in the first quarter of 2015, including direct costs, depreciation and amortization and Corporate expense, were up 6.3% compared to the same period of 2014. Among other factors, this increase reflected higher costs in the Maritime segment due to a change to low-sulfur fuels per new regulations, as well as higher depreciation costs due to the new accounting policy for valuation of vessels. As a result, operating income of P$99.9 million declined 18% year-over-year. Consolidated EBITDA was P$257.2 million, down 5% from P$271.6 million recorded in the same period of 2014.

Segment Operating Profits

Operating profit in the Maritime segment fell 9.5% year-over-year to P$127.8 million from P$141.2 million, mainly reflecting lower revenues in harbor tugs in the LNG terminal, as well as the above noted regulatory mandated transition to higher priced low-sulfur fuel. The segment operating profit was also hurt by higher expenses in chemical tankers because of poor weather conditions. Despite the lower revenue base, Ports and Terminals segment operating profit advanced 10.9% annually to P$11.8 million, primarily reflecting higher revenues in agencies and in the intermodal terminal combined with lower operating costs in the Tuxpan, Tampico and automotive segment operations. In addition, Ports and Terminals segment EBITDA grew 10.7% year-over-year to P$15.6 million, up from P$14.1 million registered in the first quarter 2014.

RISKS

- The recent trends in oil prices might delay investment in Mexico's energy sector.
- In addition, Mexico's oil reforms might not have the impact that Pemex and the government expect.
- The company's initiatives could take longer than expected to produce operating efficiencies.
- 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 balance sheet remains highly leveraged.
- 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.

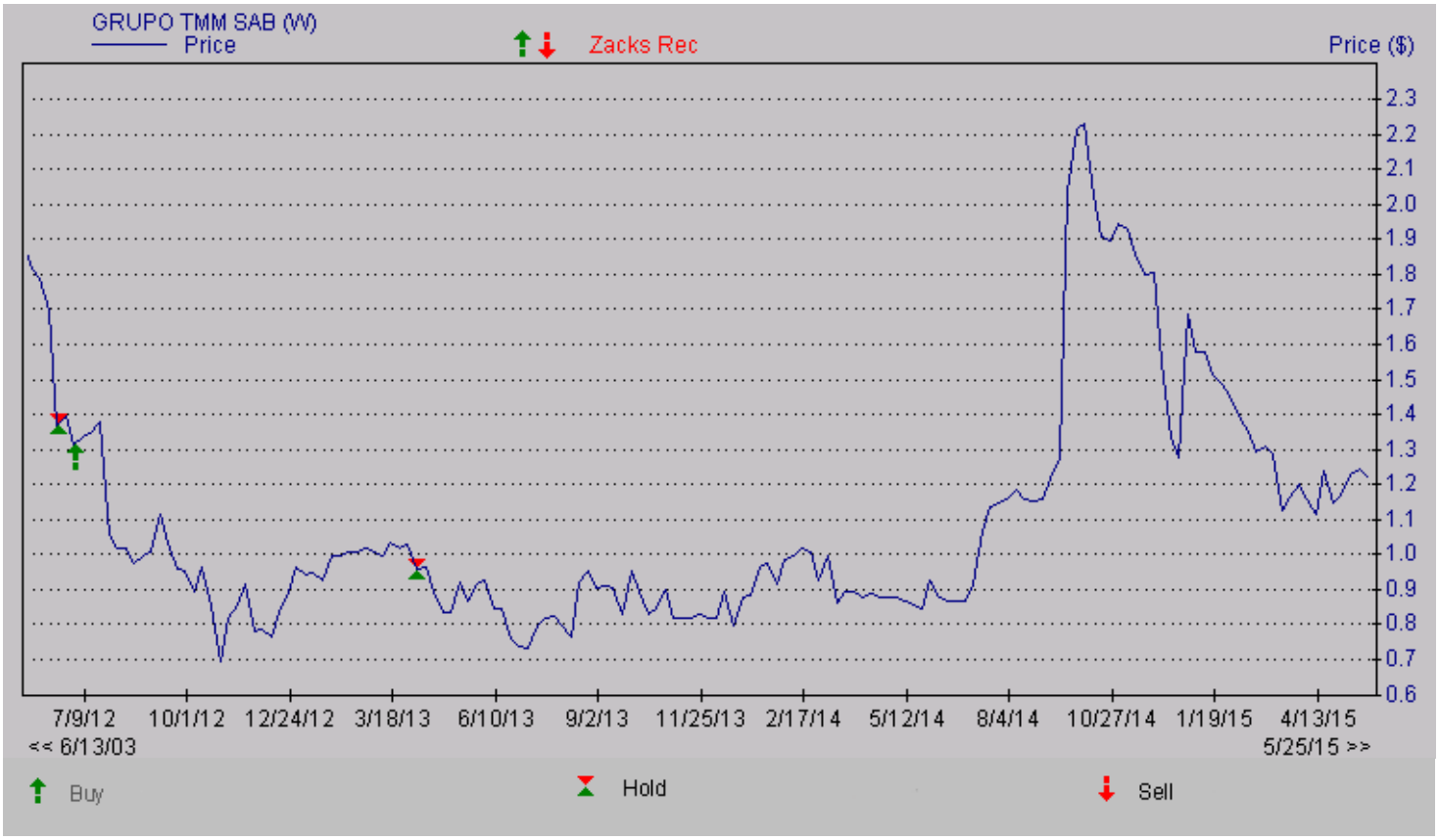
PROJECTED INCOME STATEMENT

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

	1Q14	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15E	3Q15E	4Q15E	2015E
Ports & Terminals	74.3	77.7	58.5	66.4	276.9	66.8	69.9	54.4	59.8	250.9
Maritime	599.9	570.7	660.4	692.2	2,523.2	628.3	580.5	672.9	699.1	2,580.8
Corporate & others	12.7	17.3	18.5	18.7	67.2	18.5	19.0	18.3	18.5	74.4
Rev from freight & svcs	**P$686.9**	**P$665.7**	**P$737.4**	**P$777.3**	**P$2,867.3**	**P$713.6**	**P$669.4**	**P$745.7**	**P$777.4**	**P$2,906.1**
Ports & Terminals	(60.2)	(58.4)	(54.6)	(57.1)	(230.3)	(51.2)	(57.8)	(48.6)	(51.4)	(209.0)
Maritime	(321.3)	(315.1)	(389.3)	(444.7)	(1,470.4)	(348.8)	(318.3)	(381.5)	(449.1)	(1,497.7)
Corporate & others	(13.0)	(17.2)	(18.8)	(15.9)	(64.9)	(18.2)	(17.4)	17.0	(16.1)	(34.6)
Cost of freight & services	**(394.5)**	**(390.7)**	**(462.7)**	**(517.7)**	**(1,765.6)**	**(418.2)**	**(393.4)**	**(413.1)**	**(516.6)**	**(1,741.3)**
Ports & Terminals	(3.5)	(3.7)	(3.7)	(4.3)	(15.2)	(3.8)	(3.7)	(3.6)	(4.3)	(15.5)
Maritime	(142.6)	(144.5)	(149.8)	(428.9)	(865.8)	(151.7)	(145.9)	(151.3)	(150.2)	(599.1)
Corporate & others	(1.9)	(1.9)	(1.8)	(1.9)	(7.5)	(1.9)	(1.9)	(1.8)	(1.9)	(7.6)
Depreciation & amortization	(148.0)	(150.1)	(155.3)	(435.1)	(888.5)	(157.4)	(151.6)	(156.7)	(156.4)	(622.2)
Corporate expenses	(50.0)	(59.2)	(51.7)	(14.3)	(175.2)	(54.4)	(59.8)	(52.2)	(52.9)	(219.3)
EBIT										
Ports & Terminals	10.6	15.6	0.2	5.0	31.4	11.8	8.4	2.2	4.0	26.4
Maritime	139.5	111.1	121.3	(181.4)	190.5	127.8	116.3	140.1	99.8	484.0
Corporate & others	(2.2)	(1.8)	(2.1)	0.9	(5.2)	(1.6)	(0.3)	33.5	0.5	32.2
Other (expenses) income	23.9	(1.1)	254.0	80.5	357.3	16.1	15.0	15.0	15.0	61.1
Operating Income	**P$121.8**	**P$64.6**	**P$321.7**	**(P$109.3)**	**P$398.8**	**P$99.7**	**P$79.6**	**P$138.6**	**P$66.4**	**P$384.3**
EBITDA	**P$269.8**	**P$214.7**	**P$240.0**	**P$325.8**	**P$1,287.3**	**P$257.1**	**P$231.2**	**P$295.3**	**P$222.9**	**P$1,006.5**
Financial (expenses) income	(216.4)	(213.3)	(204.1)	(197.6)	(831.4)	(193.4)	(193.6)	(193.8)	(194.0)	(774.8)
Exchange gain (loss)	(3.1)	0.6	(22.7)	(41.1)	(66.3)	3.1	3.1	3.1	3.1	12.4
Net financial cost	(219.5)	(212.7)	(226.8)	(238.7)	(897.7)	(190.3)	(190.5)	(190.7)	(190.9)	(762.3)
Loss before taxes	**(97.7)**	**(148.1)**	**94.9**	**(348.0)**	**(498.9)**	**(90.6)**	**(110.9)**	**(52.1)**	**(124.4)**	**(378.0)**
Provision for taxes	(2.2)	(3.8)	(2.7)	4.0	(4.7)	(0.5)	(3.8)	(5.0)	(13.9)	(23.2)
Net Loss before discontinuing	**(100.0)**	**(151.9)**	**92.2**	**(344.0)**	**(503.7)**	**(91.1)**	**(114.7)**	**(57.0)**	**(138.3)**	**(401.2)**
Loss from discontinuing operatic	(14.7)	(12.0)	(12.8)	(3.5)	(43.0)	(21.5)	(20.0)	(20.0)	(20.0)	(81.5)
Net Loss for the period	**(114.7)**	**(163.9)**	**79.4**	**(347.5)**	**(546.7)**	**(112.6)**	**(134.7)**	**(77.0)**	**(158.3)**	**(482.7)**
Attributable to:										
Minority interest	(1.5)	0.8	(1.0)	4.3	2.6	0.1	0.1	0.1	0.1	0.4
GTMM Equity holders	**(113.2)**	**(164.7)**	**80.4**	**(351.8)**	**(549.3)**	**(112.5)**	**(134.6)**	**(76.9)**	**(158.2)**	**(482.3)**
LPS	**(P$1.11)**	**(P$1.61)**	**P$0.79**	**(P$3.44)**	**(P$5.38)**	**(P$1.10)**	**(P$1.32)**	**(P$0.75)**	**(P$1.55)**	**(P$4.72)**
Avg shares out (millions)	102.2	102.2	102.2	102.2	102.2	102.2	102.2	102.2	102.2	102.2
	(0.07)	(0.11)	0.05	(0.22)	(0.35)	(0.07)	(0.09)	(0.05)	(0.10)	(0.31)

Source: Company reports, Zacks estimates

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