Zacks Small-Cap Research

November 6, 2014

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Grupo Tmm Sab (GTMAY-OTC)

GTMAY: *Third Quarter 2014 Review and Looking Ahead to Mexico's Energy Reforms*

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	04/07/2013
Current Price (11/4/14)	$1.92
Target Price	**$2.50**

OUTLOOK

Grupo TMM, one of Mexico's largest maritime transportation companies, is positioning itself to benefit from anticipated growth from energy reform legislation that Mexico's president signed on August 11, 2014. 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	**$2.91**
52-Week Low	**$0.73**
One-Year Return (%)	**134**
Beta	**NA**
Average Daily Volume (sh)	**6,540**
ADRs at 5:1 ord. shares (mil)	**20**
Market Capitalization ($mil)	**$39**
Short Interest Ratio (days)	**5.7**
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	49 A	54 A	57 E	213 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	-$0.12 A	$0.06 A	-$0.07 E	-$0.56 E
2015					-$0.15 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 8

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KEY POINTS

- Last week, **Grupo TMM reported results for the third quarter of 2014**, with revenue virtually flat year-over-year, as TMM was able to offset a 23.6% decline in Ports & Terminals revenue with higher Maritime and other revenue.

- TMM improved its fleet capacity utilization to 91.0% and management has indicated that it is optimistic about a gradual industry outlook improvement over the remainder of 2014 and into 2015. **We are raising our price target to $2.50 from $1.50.**

- Mexico's President Peña Nieto signed energy reform legislation on August 11, 2014 that is intended to open Mexico's oil and natural gas markets to foreign direct investment. In turn, demand for exploration and distribution services within Mexico is expected to grow and TMM believes that it is well-positioned to benefit.

- The company has also initiated measures to strengthen its balance sheet. TMM repaid approximately $150 million pesos of principle of its Trust Certificate debt in the first nine months of 2014.

THIRD QUARTER 2014 HIGHLIGHTS

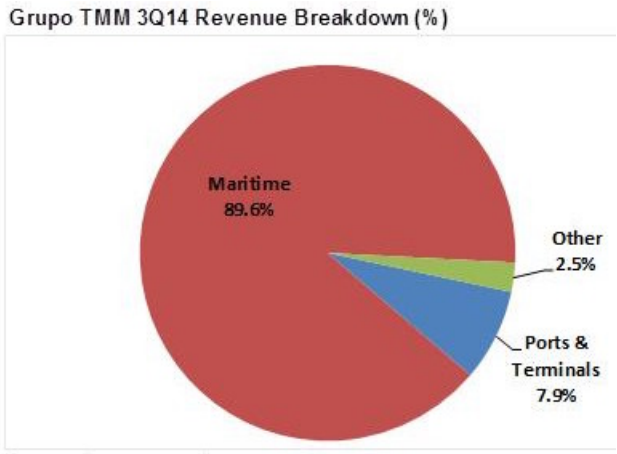
Last week, **Grupo TMM reported results for the third quarter of 2014**. TMM has been working to grow its revenue by expanding some of its higher revenue generating businesses and divesting lower revenue, lower margin units. In July 2013, for example, TMM divested its truck transportation and haul-away trailers business. Third quarter 2014 revenue was virtually flat year-over-year, at P$737.4 million compared to P$738.5 million registered in the third quarter of 2013. A 1.7% increase in Maritime revenue combined with a 45.7% improvement in Corporate and other revenue largely offset a 23.6% decline in Ports & Terminals revenue. This latter segment has been sluggish thus far in 2014, reflecting lower revenues in the Automotive segment. Exports to South America are down compared to 2013, despite increased car shipments to the U.S. One likely factor is a 2012 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 Assoc.), and continues to constrain shipments. Total automobile exports to Latin America were down 18.4% in the first nine months of 2014, according to AMIA. The agreement with Brazil ends in March 2015, as noted, although according to trade publications, Brazil may request an extension.

Mexican Auto Exports by Market

	Jan-Sep			% of Total Exports	
Market	2013	2014	% Chg	2013	2014
U.S.	1,199,962	1,384,590	15.4%	66.8%	70.9%
Canada	143,103	194,386	35.8%	8.0%	10.0%
Latin America	237,231	193,463	-18.4%	13.2%	9.9%
Asia	64,418	92,045	42.9%	3.6%	4.7%
Europe	123,177	77,729	-36.9%	6.9%	4.0%
África	7,245	1,432	-80.2%	0.4%	0.1%
Other	21,550	8,856	-58.9%	1.2%	0.5%
Total Exports	1,796,686	1,952,501	8.7%	100.0%	100.0%

Source: AMIA

Reflecting this recent slowdown, Ports & Terminals revenue contributed 7.9% of total revenue, down from a 10.4% contribution in last year's third quarter. TMM operates three Mexican port facilities, with one located in Tuxpan, the nearest port to Mexico City, and others in Tampico and Acapulco.



Source: Company reports

Against the relatively flat revenue, Cost of freight and services increased by 5.4% and depreciation & amortization advanced 6.1%. This was partially offset by a 9.3% decline in Corporate expenses. Including a P$237.0 million one-time contribution from the exchange of an asset that TMM contributed to a partnership with a strategic investor, operating income of P$321.7 million more than doubled compared to P$121.7 million registered in the third quarter of 2013.

TMM improved its fleet capacity utilization to 91.0%. Management has indicated that it is optimistic about a gradual industry outlook improvement over the remainder of 2014 and into 2015. To benefit TMM intends to make strategic investments in its maritime fleet. In fact, **TMM is positioning itself to benefit from the anticipated increase in maritime transportation that Mexico's energy reforms are expected to fuel.** As one of the leading maritime transportation companies in Mexico, with a roughly 30 year history, TMM is expected to be a beneficiary. We are raising our price target to $2.50 from $1.50.

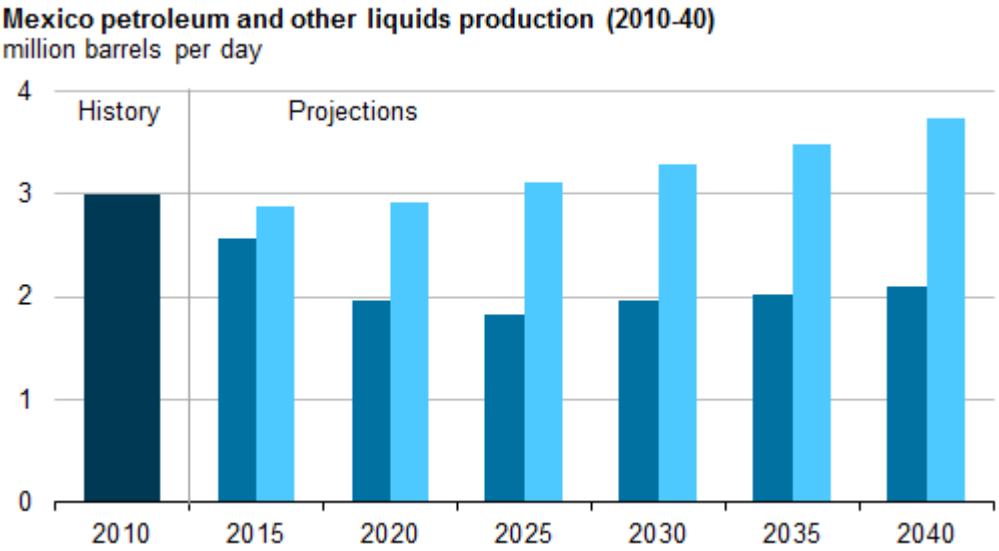
The company's five-year growth plan contemplates two major projects: development of a container and liquids terminal at the Port of Tuxpan in Veracruz and the addition of specialized offshore vessels to meet increased demand for deep water transportation. TMM intends to develop operations to:

- 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 which has contributed to total revenue in 2014, further helping to offset the slowdown on Ports & Terminals revenue.
- 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.

ENERGY REFORM

Mexico's President Enrique Peña Nieto signed energy reform legislation on August 11, 2014 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. In February 2015, Mexico will begin to auction off drilling rights to 169 offshore and onshore areas.

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) has 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.



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) 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.

BALANCE SHEET IMPROVEMENTS

The company has also initiated measures to strengthen its balance sheet. TMM repaid approximately $150 million pesos of principle of its Trust Certificate debt in the first nine months of 2014. As of September 30, 2014, TMM's total debt was P$10.7 billion, down from P$10.9 billion at December 2013. Less than 5% of that is short term. 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 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.

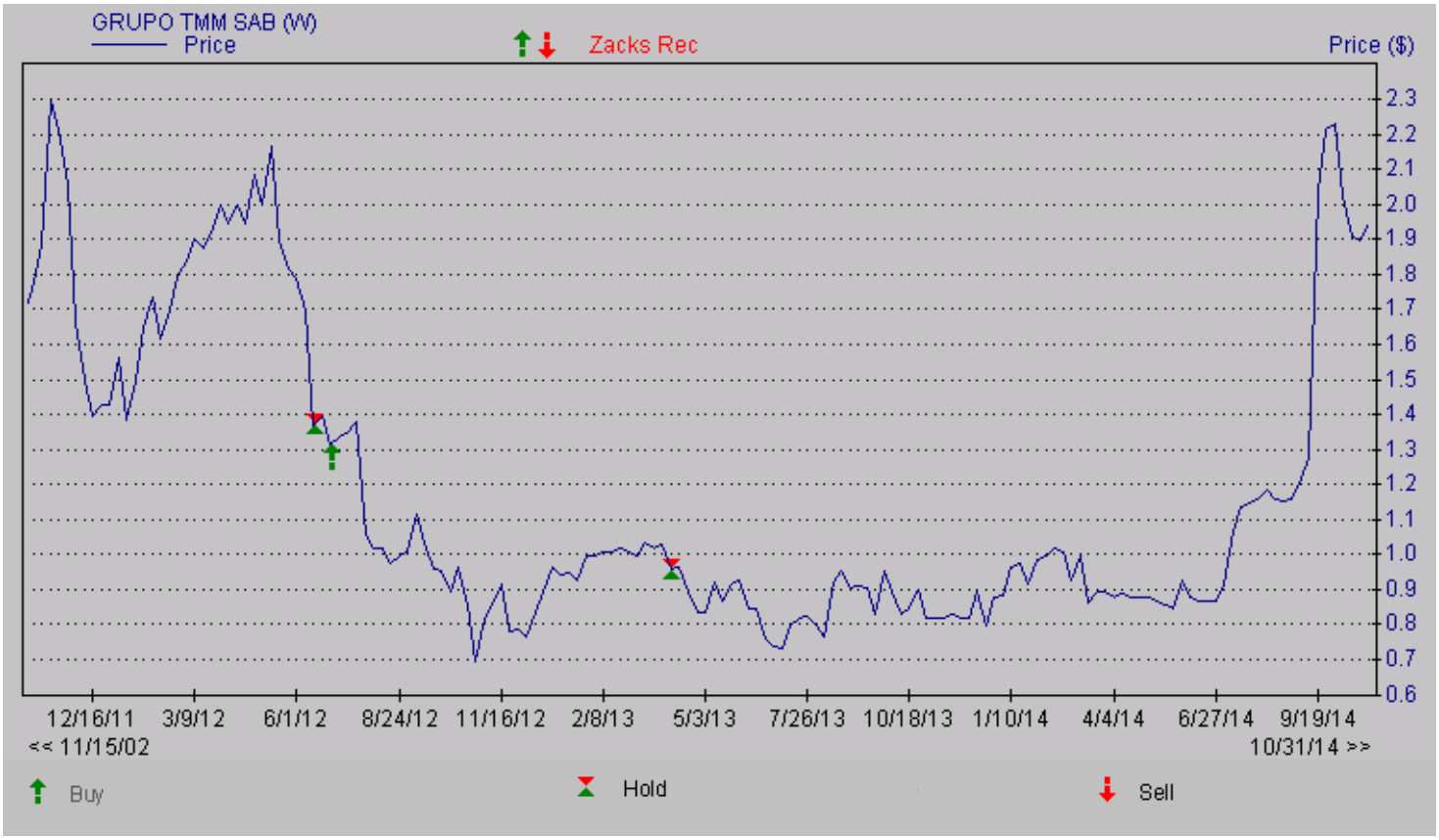
PROJECTED INCOME STATEMENT

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

	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14A	3Q14A	4Q14E	2014E	2015E
Ports & Terminals	97.7	92.2	76.6	66.2	332.7	74.3	77.7	58.5	49.7	260.2	262.8
Maritime	554.5	611.6	649.2	639.9	2,455.3	603.4	570.7	660.4	671.9	2,506.4	2,541.5
Corporate & others	12.6	12.6	12.7	12.7	50.6	12.7	17.3	18.5	12.8	61.3	61.9
Rev from freight & svcs	**P$664.8**	**P$716.4**	**P$738.5**	**P$718.8**	**P$2,838.6**	**P$690.4**	**P$665.7**	**P$737.4**	**P$734.3**	**P$2,827.8**	**P$2,866.1**
Ports & Terminals	(81.0)	(80.4)	(65.4)	(50.5)	(277.2)	(60.2)	(58.4)	(54.6)	(39.7)	(212.9)	(215.0)
Maritime	(297.2)	(334.8)	(360.1)	(381.7)	(1,373.8)	(321.3)	(315.1)	(389.3)	(356.1)	(1,381.8)	(1,395.6)
Corporate & others	(12.3)	(12.6)	(13.5)	(12.0)	(50.4)	(13.0)	(17.2)	(18.8)	(12.8)	(61.8)	(62.4)
Cost of freight & services	**(390.5)**	**(427.8)**	**(439.0)**	**(444.2)**	**(1,701.4)**	**(394.5)**	**(390.7)**	**(462.7)**	**(408.7)**	**(1,656.6)**	**(1,673.1)**
Ports & Terminals	(3.7)	(3.7)	(3.7)	(3.6)	(14.6)	(3.5)	(3.7)	(3.7)	(2.5)	(13.4)	(13.1)
Maritime	(142.2)	(139.8)	(140.6)	(139.7)	(562.3)	(142.6)	(144.5)	(149.8)	(161.3)	(598.2)	(610.0)
Corporate & others	(2.4)	(2.1)	(2.1)	(2.1)	(8.7)	(1.9)	(1.9)	(1.8)	(1.9)	(7.5)	(6.2)
Depreciation & amortization	(148.3)	(145.6)	(146.4)	(145.4)	(585.6)	(148.0)	(150.1)	(155.3)	(165.7)	(619.1)	(629.3)
Corporate expenses	(64.9)	(39.6)	(57.0)	(48.6)	(210.1)	(50.0)	(59.2)	(51.7)	(47.0)	(207.9)	(208.9)
EBIT											
Ports & Terminals	13.0	8.1	7.5	12.1	40.9	10.6	15.6	0.2	7.4	33.8	34.6
Maritime	115.1	137.0	148.5	118.5	519.2	139.5	111.1	121.3	154.5	526.4	535.9
Corporate & others	(2.1)	(2.1)	(2.9)	(1.4)	(8.5)	(2.2)	(1.8)	(2.1)	(2.0)	(8.1)	(6.8)
Other (expenses) income	10.5	(3.7)	25.6	31.6	64.0	23.9	(1.1)	254.0	26.9	303.7	300.0
Operating Income	**P$71.6**	**P$99.7**	**P$121.7**	**P$112.2**	**P$405.5**	**P$121.8**	**P$64.6**	**P$321.7**	**P$139.9**	**P$648.0**	**P$654.8**
EBITDA	**P$219.9**	**P$245.3**	**P$268.1**	**P$257.6**	**P$991.1**	**P$269.8**	**P$214.7**	**P$240.0**	**P$305.6**	**P$1,267.1**	**P$1,284.1**
Financial (expenses) income	(230.2)	(230.6)	(227.5)	(216.6)	(904.9)	(216.4)	(213.3)	(204.1)	(216.4)	(850.2)	(810.0)
Exchange gain (loss)	25.2	(30.6)	6.9	2.8	4.4	(3.1)	0.6	(22.7)	(3.1)	(28.3)	(12.0)
Net financial cost	(205.0)	(261.2)	(220.6)	(213.8)	(900.5)	(219.5)	(212.7)	(226.8)	(219.5)	(878.5)	(822.0)
Loss before taxes	**(133.4)**	**(161.5)**	**(98.9)**	**(101.6)**	**(495.0)**	**(97.7)**	**(148.1)**	**94.9**	**(79.6)**	**(230.5)**	**(167.2)**
Provision for taxes	(7.1)	(29.2)	32.4	(0.8)	(4.7)	(2.2)	(3.8)	(2.7)	(0.2)	(8.9)	(5.0)
Net Loss before discontinuing	**(140.5)**	**(190.7)**	**(66.5)**	**(102.4)**	**(499.7)**	**(100.0)**	**(151.9)**	**92.2**	**(79.9)**	**(239.6)**	**(172.3)**
Loss from discontinuing operatic	(25.3)	(44.4)	(8.2)	14.3	(63.5)	(14.7)	(12.0)	(12.8)	(12.7)	(52.2)	(50.0)
Net Loss for the period	**(165.8)**	**(235.1)**	**(74.7)**	**(88.1)**	**(563.2)**	**(114.7)**	**(163.9)**	**79.4**	**(92.6)**	**(291.8)**	**(222.3)**
Attributable to:											
Minority interest	2.4	0.4	0.2	2.0	5.0	(1.5)	0.8	(1.0)	0.5	(1.2)	(4.0)
GTMM Equity holders	**(168.2)**	**(235.5)**	**(74.9)**	**(90.1)**	**(568.2)**	**(113.2)**	**(164.7)**	**80.4**	**(93.1)**	**(290.6)**	**(218.3)**
LPS	**(P$1.65)**	**(P$2.30)**	**(P$0.73)**	**(P$0.88)**	**(P$5.56)**	**(P$1.11)**	**(P$1.61)**	**P$0.79**	**(P$0.89)**	**(P$2.83)**	**(P$2.10)**
Avg shares out (millions)	102.2	102.2	102.2	102.2	102.2	102.2	102.2	102.2	104.2	102.7	104.2

Source: Company reports, Zacks estimates

HISTORICAL ZACKS RECOMMENDATIONS



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