Zacks Small-Cap Research

October 30, 2012
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GRUPO TMM (GTMAY-OTC)

TMM: Maritime strong despite weakness - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	07/02/2012
Current Price (10/26/12)	$0.70
Target Price	**$2.50**

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	**$2.38**
52-Week Low	**$0.83**
One-Year Return (%)	**-51.05**
Beta	**0.29**
Average Daily Volume (sh)	**34,935**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$14**
Short Interest Ratio (days)	**1.97**
Institutional Ownership (%)	**8**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-7.7**
EBITDA (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 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	61 A	67 A	66 E	257 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	$0.21 A	-$0.39 A	-$0.14 E	-$1.11 E

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

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WHATS NEW

On October 25, 2012 Grupo TMM released results for its third quarter and nine months ended September 30, 2012. The Company reported mixed results for the quarter due to lower tariffs and lower utilization at the product tanker segment and reduced operations at Acapulco.

Despite the global downturn in this industry, the Company secured three new vessel contracts during the quarter, totaling $30 million in revenue and demonstrating the irrepressible nature of the Company's Maritime division.

Likewise, the Maritime division's buoyancy was further verified by its strong and growing backlog of $175.6 million to date, which is up from a backlog of $167.6 million as of June 30, 2012.

The Company's third quarter performance resulted in a 3.1 percent year over year decrease in consolidated revenue, with revenue decreasing $2.2 million to $66.7 million from $68.8 million for the three months ended September 30, 2011.

Yet Maritime segment revenue improved $142,000 or 0.3 percent year over year to $44.6 million for the three months. The improvement was primarily a result of improvements at all divisions except for product tankers, which was negatively impacted by one unemployed vessel, by lower year over year average daily tariffs as well as by two less vessels in operation, that were lease in the third quarter of 2011.

For the first nine months of 2012, Maritime revenue fell 1.4 percent year over year to $125.9 million. The decrease in year to date Maritime revenue was mainly driven by revenue losses at product and chemical tankers.

Utilization at the offshore segment continued its upward trend at 89 percent, improving sequentially from 88.5 percent for the second quarter and jumping to 90.1 percent during the first nine months of 2012, up from 83.3 percent for the comparable period of 2011.



Third quarter 2012 consolidated EBITDA was $23.7 million, improving by 26.1 percent year over year from $18.8 million in the same period of last year.

Consolidated EBITDA for the first nine months of 2012 was $55.2 million, a decline of 10.2 percent compared to $61.5 million for the comparable period of 2011.

It should be noted that while the Company's Maritime segment's third quarter EBITDA was $21.1 million and unchanged from the 2011 third quarter, the division continues to generate competitive EBITDA margins.

As of September 30, 2012, Grupo TMM's total net debt was $760 million compared to $675.4 million as of December 31, 2011. The book value of the Company's Trust Certificates debt increased $62.9 million from December 31, 2011, as a result of a 7.7 percent appreciation of the peso against the dollar in the first nine months of 2012.

Furthermore, only $17.1 million or 2.1 percent of Grupo TMM's total debt of $832.7 million is short term.

Similarly, Grupo TMM's free cash flow for the three months ended September 30, 2012 was $8.0 million.

Management believes that the future holds profitable opportunities for Grupo TMM and expects to reach an agreement for the financing of the development of a container terminal at Tuxpan in the short-term.

The container terminal at the Port of Tuxpan, Veracruz will meet increasing demand for capacity in the Gulf of Mexico, taking advantage of organic growth in the Mexican market.

Additionally, the Company is currently working on a potential joint venture with an international shipyard, which would provide the necessary capabilities to build vessels at its own shipyard at the Port of Tampico, positioning TMM in a new niche market of building vessels, for the Company or for third parties, both of which would significantly grow revenue and profit base in the longer term.

New Opportunities

Grupo TMM expects to reach an agreement for the financing of the development of a container terminal at Tuxpan in the short-term. Additionally, TMM continues to work to expand the Company's revenue and profit base through the addition of specialized offshore vessels to its fleet.

Similarly, in January 2012 TMM acquired a shipyard at the Port of Tampico, which has contributed to Maritime's revenue and profit.

Management is also working on a potential joint venture with an international shipyard, which would provide the necessary capabilities to build vessels at the Company's shipyard. These additional capabilities would position TMM in a new niche market of building vessels, for the Company or for third parties.

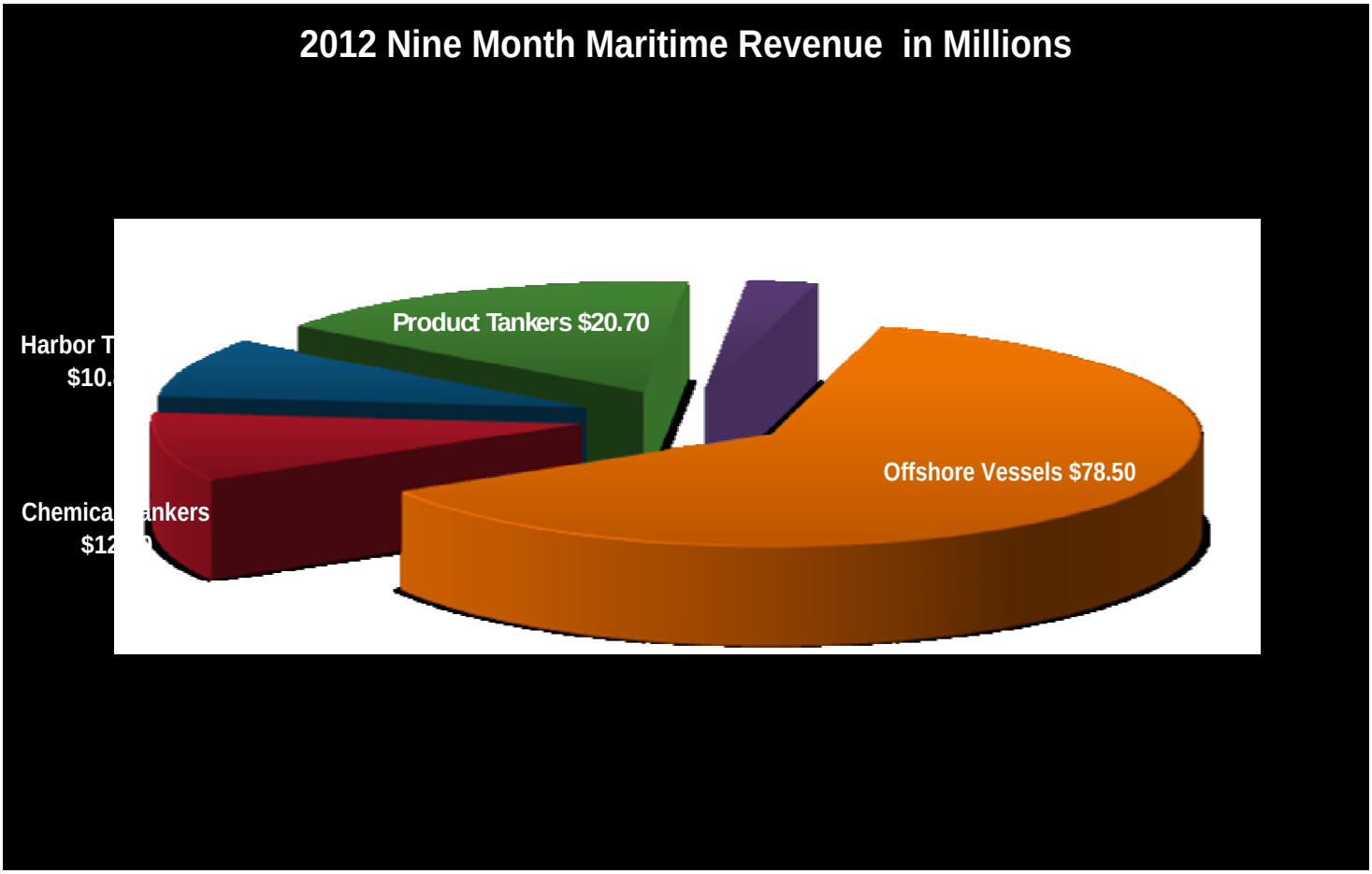
A Closer Look at the TMM's Growth Plan.
The firm's five-year growth plan includes two projects.

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.

While development of the facility could take up to two years, management believes it is close to reaching an agreement for the financial implementation of the development of a container terminal.

Still, when completed, the terminal will strategically position TMM in these lucrative markets.

The second project includes the addition of specialized offshore vessels to TMM's fleet to meet increased demand for deep water transportation. The Company's 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.



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. Likewise, in the 2012 third quarter the Company added two offshore vessels to its fleet. TMM is committed to continue to modernize its fleet with specialized offshore vessels as part of its five-year growth plan TMM prefers to compete for margin rich niche business and employs long to medium-term contracts.

- TMM is committed to increase its penetration in Mexican ports, particularly Tuxpan. This should make the firm more efficient and more profitable in the long run.

- The outlook for deep water drilling is promising.

Maritime Operations. (65% 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 42 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 29 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 three 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.



Shipyard
On January 2012, TMM announced today the acquisition of a shipyard at the Port of Tampico, Veracruz. The shipyard concentrates on ship repair and has in operation two, 3,000-ton lift capacity dry docks. In the medium term, the Company expects to have the necessary capabilities to build vessels at this facility.



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 is close to reaching an agreement to develop a container terminal at this Port. It is important to note that the Company has the required environmental permits to develop and operate at this port. The Company is also working on the financial implementation for a liquids terminal at Tuxpan.

The Company's shipping agencies offer services including port agent services, cargo and multimodal supervision; ship 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. (25% 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.



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.

This continued over the third quarter of 2012 as Noble Corp. and Diamond Offshore discussed the current strength in the offshore drilling market as a part of their respective Q3 earnings conference calls. Both companies see that the overall market is clearly in an upcycle and this has resulted in rising dayrates for rigs across the board. Rising dayrates are conducive to rising earnings in this industry. The two companies base their conclusions about the overall market strength on the contracts and contract extensions that each has seen recently.

VALUATION

Despite the different segments, the firm is primarily a shipping firm which is set to take advantage of deep water drilling opportunities and is uniquely positioned for higher margins than the competition due to the nature of its medium and long term contracts, having less exposure to tariff volatility.

For investors with a time frame of several quarters this may be a good entry point 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.

Metric	Grupo TMM	Industry Average
EV/EBITDA	10.35	7.59

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	0.06	3.95

According to the Price/Sales model the firm appears undervalued and fairly valued using the Enterprise model compared to the industry.

Using a blend of these valuation metrics we arrive at a price of $2.50.

PROJECTED INCOME STATEMENT

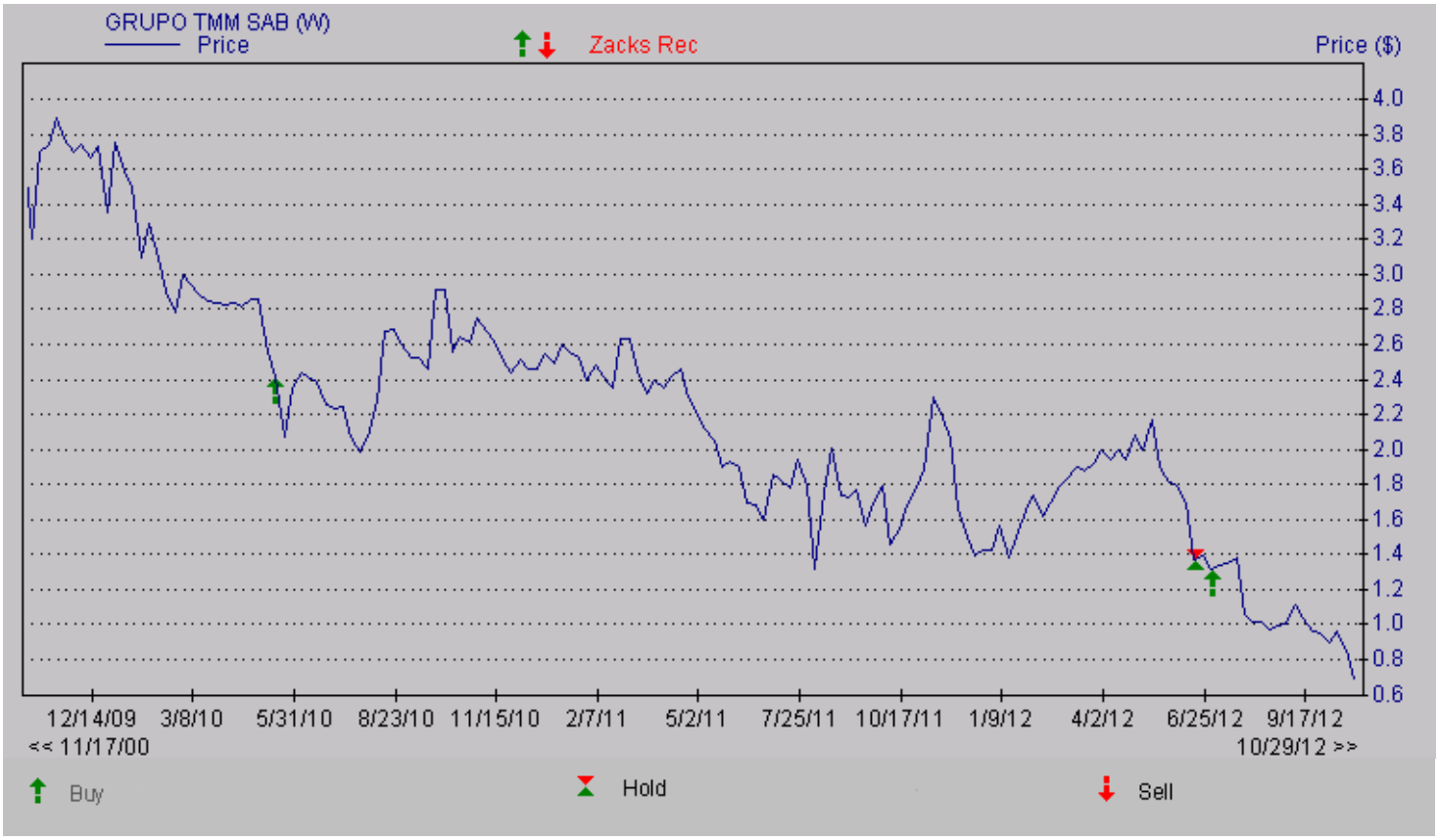
INCOME STATEMENT ($ Millions)	Sep-11 Q3 11	Dec-11 Q4 11	Mar-12 Q1 12	Jun-12 Q2 12	Sep-12 Q3 12	Dec-12 Q4 12 E	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012 E
REVENUE												
Net Revenue	**68.8**	**64.8**	**63.2**	**60.7**	**66.7**	**66.0**	**303.3**	**363.0**	**308.2**	**305.4**	**269.2**	**256.5**
Sequential Growth		*-6%*	*-2%*	*-4%*	*10%*	*-1%*						
OPERATING EXPENSES												
Cost of Revenues	47.15	43.76	43.72	42.83	44.19	44.00	253.9	300.5	221.7	198.8	182.4	174.7
% of Revenue	*68.5%*	*67.6%*	*69.2%*	*70.6%*	*66.3%*	*66.7%*						
Gross Profit -	**21.7**	**21.0**	**19.4**	**17.8**	**22.5**	**22.0**	**49.4**	**62.4**	**86.5**	**106.6**	**86.8**	**81.8**
Proforma Gross Margin	*31.5%*	*32.4%*	*30.8%*	*29.4%*	*33.7%*	*33.3%*	*16.3%*	*17.2%*	*28.1%*	*34.9%*	*32.2%*	*31.9%*
Depreciation + Amort	12.71	24.61	12.86	12.56	12.65	12.50	25.7	33.8	44.6	59.5	64.0	50.6
% of Revenue	*18.5%*	*38.0%*	*20.4%*	*20.7%*	*19.0%*	*18.9%*	*8.5%*	*9.3%*	*14.5%*	*19.5%*	*23.8%*	*19.7%*
Corp Expenses	4.40	2.22	3.87	3.63	4.25	4.00	4.4	8.8	14.9	14	15	16
% of Revenue	*6.4%*	*3.4%*	*6.1%*	*6.0%*	*6.4%*	*6.1%*	*1.4%*	*2.4%*	*4.8%*	*4.6%*	*5.6%*	*6.1%*
Other Income (Expenses)-Net	1.47	(10.26)	1.64	0.04	5.51	0.50	-	-	0.48	3.09	(1.62)	7.70
% of Revenue												
Total Operating Expenses	15.64	37.09	15.08	16.15	11.39	16.00	30.01	42.55	58.92	70.40	80.74	58.62
% of Revenue	*22.7%*	*57.3%*	*23.9%*	*26.6%*	*17.1%*	*24.2%*	*9.9%*	*11.7%*	*19.1%*	*23%*	*30%*	*23%*
Operating Income -	**6.1**	**-16.1**	**4.36**	**1.7**	**11.1**	**6.0**	**19.3**	**19.9**	**27.5**	**36**	**6**	**23**
Operating Margin	*8.8%*	*-24.8%*	*6.9%*	*2.8%*	*16.6%*	*9.1%*	*6%*	*5%*	*9%*	*12%*	*2%*	*9%*
NON-OPERATING ITEMS												
Non operating Income/Expense	89	10	-85	20	-50	-20	-48.5	75.6	-118.3	-108	14	-135
% of Revenue	*128.89%*	*14.89%*	*-134.35%*	*32.65%*	*-74.98%*	*-30.30%*	*-16.00%*	*20.84%*	*-38.39%*	*-35.43%*	*5.02%*	*-52.65%*
Tax Provision	3.2	-2.7	0.2	0.2	0.3	0.3	-0.84	20.09	1.7	1	3	1
Effective Tax Rate												
Net Income -	**91.63**	**-3.78**	**-80.65**	**21.25**	**-39.15**	**-14.25**	**-28.35**	**75.44**	**-92.46**	**-73.03**	**16.22**	**-112.81**
Net Income Margin	*133.1%*	*-5.8%*	*-127.7%*	*35.0%*	*-58.7%*	*-21.6%*	*-9.3%*	*20.8%*	*-30.0%*	*-24%*	*6%*	*-44%*
EARNINGS PER SHARE												
EPS - Basic	$0.90	-$0.04	-$0.79	$0.21	-$0.39	-$0.14	-$1.17	$1.47	-$1.43	-$0.79	$0.15	-$1.11
EBITDA (in Millions)	$18.76	$8.52	$17.22	$14.23	$23.75	$18.50	$44.99	$53.68	$72.09	$95.65	$70.05	$73.70

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RISKS

- Despite medium and long-term contracts in place at the Maritime division, tariff volatility could impact operations.
- The firm remains highly leveraged with $760 million in net debt.

HISTORICAL ZACKS RECOMMENDATIONS



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