Zacks Small-Cap Research

August 2, 2011
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GRUPO TMM (TMM-NYSE)

TMM: Sequential Improvement on the Top-Line- OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/16/2010
Current Price (08/01/11)	$1.75
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	**$3.25**
52-Week Low	**$1.51**
One-Year Return (%)	**-22.81**
Beta	**0.30**
Average Daily Volume (sh)	**7,753**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$37**
Short Interest Ratio (days)	**7.91**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**23**
EBITDA (%)	**182**
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)
2009	80 A	75 A	75 A	79 A	308 A
2010	81 A	75 A	75 A	74 A	305 A
2011	66 A	70 A	70 E	71 E	277 E

Earnings per Share
(EPS excludes currency G/L)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	-$0.30 A	-$0.01 A	-$0.32 A	-$0.15 A	-$0.78 A
2010	-$0.07 A	-$0.09 A	-$0.14 A	-$0.12 A	-$0.42 A
2011	-$0.11 A	-$0.20 A	-$0.09 E	-$0.01 E	-$0.41 E

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

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WHATS NEW

On July 27, 2011 Grupo TMM reported stronger sequential results. Despite a challenging shipping marketplace, including the global reduction of tariffs for offshore vessels and product tankers, Maritime's operational results and fleet utilization improved from the first quarter of this year. Maritime's revenue and operating profit in the second quarter of 2011 improved from the first quarter of this year. Offshore fleet utilization improved to 87.5% in the second quarter of 2011 over the second quarter of 2010, and also improved from 74.7% in the first quarter of 2011. Product tanker fleet utilization decreased to 95.2% over the second quarter of 2010, due to one vessel in dry dock. However, utilization improved from 91.7% in the first quarter of 2011.

Ports and Terminals remains a bright spot for the company largely the result of Automotive and Auto handling. In the first half of 2011 Ports and Terminals revenue came in at $14.078 million compared to $11.885 million in the first half of 2010. This represents 18.5% growth rate. Looking deeper at the segment, revenue at the automotive segment increased 66.7% to $4 million, compared to the first half of last year, mainly attributable to higher volumes at the Volkswagen yard at Puebla. At Acapulco, auto handling revenue increased 52.8% to $1.9 million in the first half of 2011 compared to the same period of last year, due to increased exports to South America and Asia. Rounding out the segment, the maintenance and repair segment revenue increased 14.3% to $4 million in the first half comparison due mainly to higher volumes at the Manzanillo depot and to the addition of a new client at Altamira in the second quarter.

Turning to Logistics which excludes $6.7 million of revenue from the sale of assets in April 2010, revenue increased 7.6% in the first half of 2011 over the same period of last year, mainly due to a 46.6% revenue increase at auto hauling.

Strength in Utilization and New Opportunities
Several Factors point to a stronger second half. In the Maritime segment, TMM added one additional leased product tanker in the second quarter. This brings the number to seven vessels working with contracts through year end, solidifying utilization through 2011. At the offshore segment, one vessel previously working in the spot market began a 3-year contract in the second quarter, which will contribute to results going forward. The company anticipates the car handling segment at Acapulco will continue to grow, as exports from this Port continue to be in high demand. Also, two additional cruise lines began operation at this Port in July. Further, at the firm's automotive business in Puebla and Saltillo, volumes for value-added logistics services are expected to continue to grow.

Debt Pay Down
TMM's total debt was $892 million. Trust Certificates debt was impacted by $43.3 million from the appreciation of the peso versus the dollar in the first half of 2011. In the first half of 2011, the Company made two important payments. In February TMM made a payment of $44.5 million of Trust Certificates debt, including a capital prepayment of $8.4 million. In May, TMM paid the remaining balance of the securitization facility with Deutsche Bank for approximately $9.1 million. Both transactions show the firm's ability to use its free cash flow to make prepayments.

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 margin growth, and provide above average return on assets. When looking at several metrics (EV/EBITDA, P/B, P/S) the firm looks undervalued. From an operational standpoint the firm has made impressive strides. 2010 EBITDA and EBITDA margin were the highest in the last five years, despite a global recessionary economic climate. Grupo exits 2010 having grown its EBITDA for the 5th consecutive year. EBITDA grew at a lofty 182% or a compounded yearly growth rate (CYGR) of 29.6%. The firm was also Free Cash Flow positive for the year 2010 and Net Cash from Operating Activities was $14.6 million in the second quarter of 2011.

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.

Container and Liquids Terminal at Port of Tuxpan

- Address increasing demand for capacity in Gulf of Mexico
- Alleviate existing congestion at Veracruz and Altamira container terminals taking advantage of organic growth
- Liquids terminal will replace existing buoy system through construction of pipeline and berthing position
- Concession to operate and environmental permits in place

The second project consists of adding specialized offshore vessels to the Company's fleet to meet the increasing demand for deep water exploration in Mexico.

Add specialized offshore vessels to TMM's fleet

- PEMEX business plan anticipates spending $29b annually over next several years to develop deepwater identified reserves
- Approximately 78% of these investments will be allocated to deep water exploration

INVESTMENT THESIS

- The firm's Maritime division is the dominant business at TMM. The fleet has been updated. In 2008 and 2009 alone the firm added 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.

- 2010 EBITDA and EBITDA margin was the highest in the last five years, despite global recessionary economic climate

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

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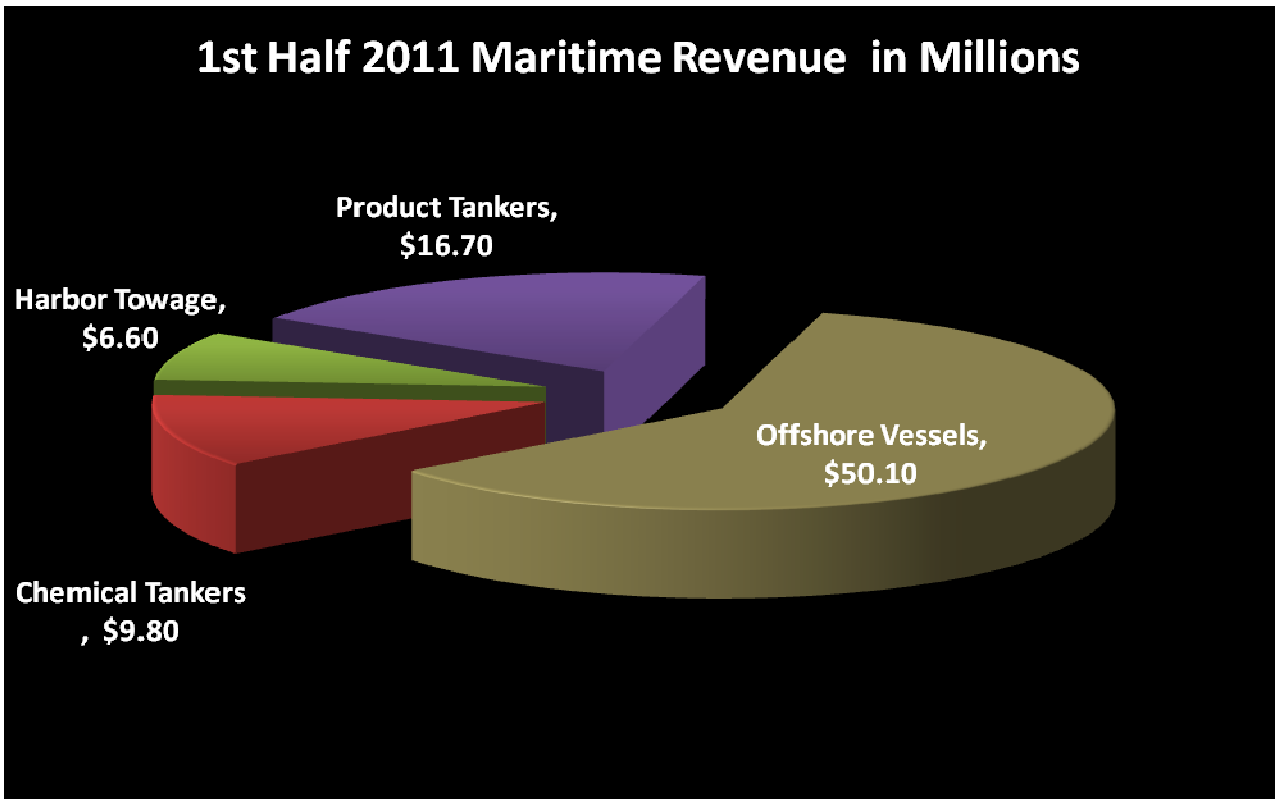
Maritime Operations. (62% of Total Revenue)

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 44 vessels, which includes product and chemical tankers, harbor tugs and a variety of offshore supply vessels.

The Maritime division is further broken down into 4 segments; Offshore Vessels, Product Tankers, Chemical Tankers, and Harbor towing.

Offshore revenue decreased 21.1% negatively impacted by lower utilization, lower average daily tariffs and three less vessels in operation. Product tankers revenue decreased 17.7% due to lower average daily tariffs and lower utilization. At chemical tankers, revenue decreased 25.2% due to one less vessel in operation in the second quarter and lower freight volumes. Revenue at harbor towage improved 21.8% mainly due to increased ship calls at Manzanillo. Harbor towage operating margin remains above 50%.



Offshore Vessels

The offshore vessels unit has a fleet of 28 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 eight product tankers, most of which are under medium-term contracts.

The firm enjoys a bit of 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

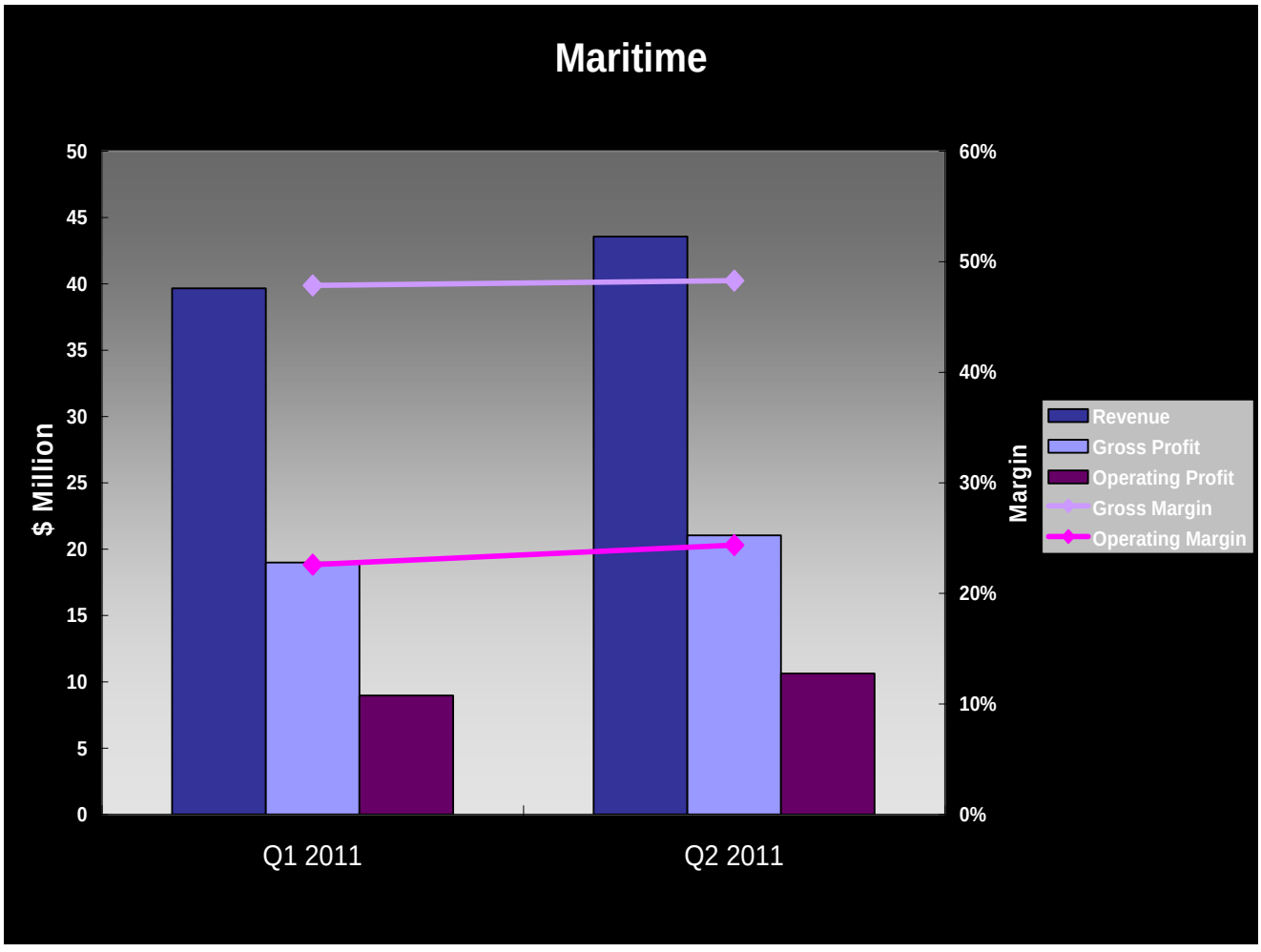
The firm currently operates two chemical vessels that transport chemicals, vegetable oils and molasses. Currently more than 90% of cargo is transported under a contract of Affreightment. This is a service contract under which a ship owner agrees to transport a specified quantity of fuel products or specialty 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. The firm currently has five vessels that service over 2,000 vessels per year. Major clients in Harbor Towing include Maersk, CSAV, NYK, MSC, and Hapag-Lloyd.

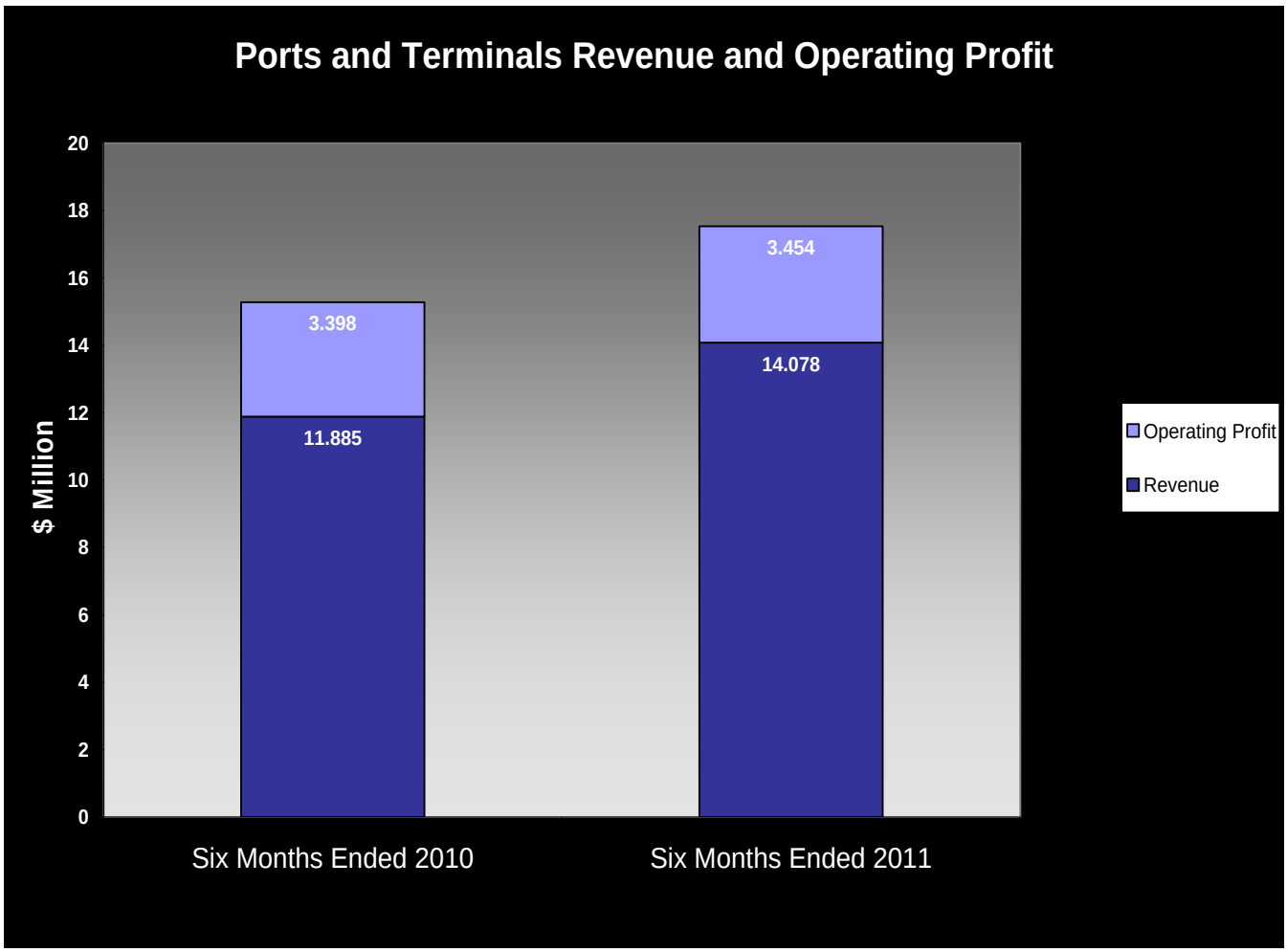






Ports and Terminals Operations. (10% of Total Revenue)
The firm presently operates two Mexican port facilities, Tuxpan and Acapulco, under concessions granted by the Mexican Government, which provide for certain renewal rights. This business unit also provides port agent services to vessel owners and operators in the main Mexican ports, value-added logistics services for the automotive industry and maintenance and repair services of containers. 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. While TMM currently handles only a small volume of cargo at the port, they are evaluating the development of a container terminal and a liquids terminal for oil products at this site, as part of their 5-year growth strategy.



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. (28% of Total Revenue)
TMM provides dedicated trucking services to major manufacturers, including automobile plantsand 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.

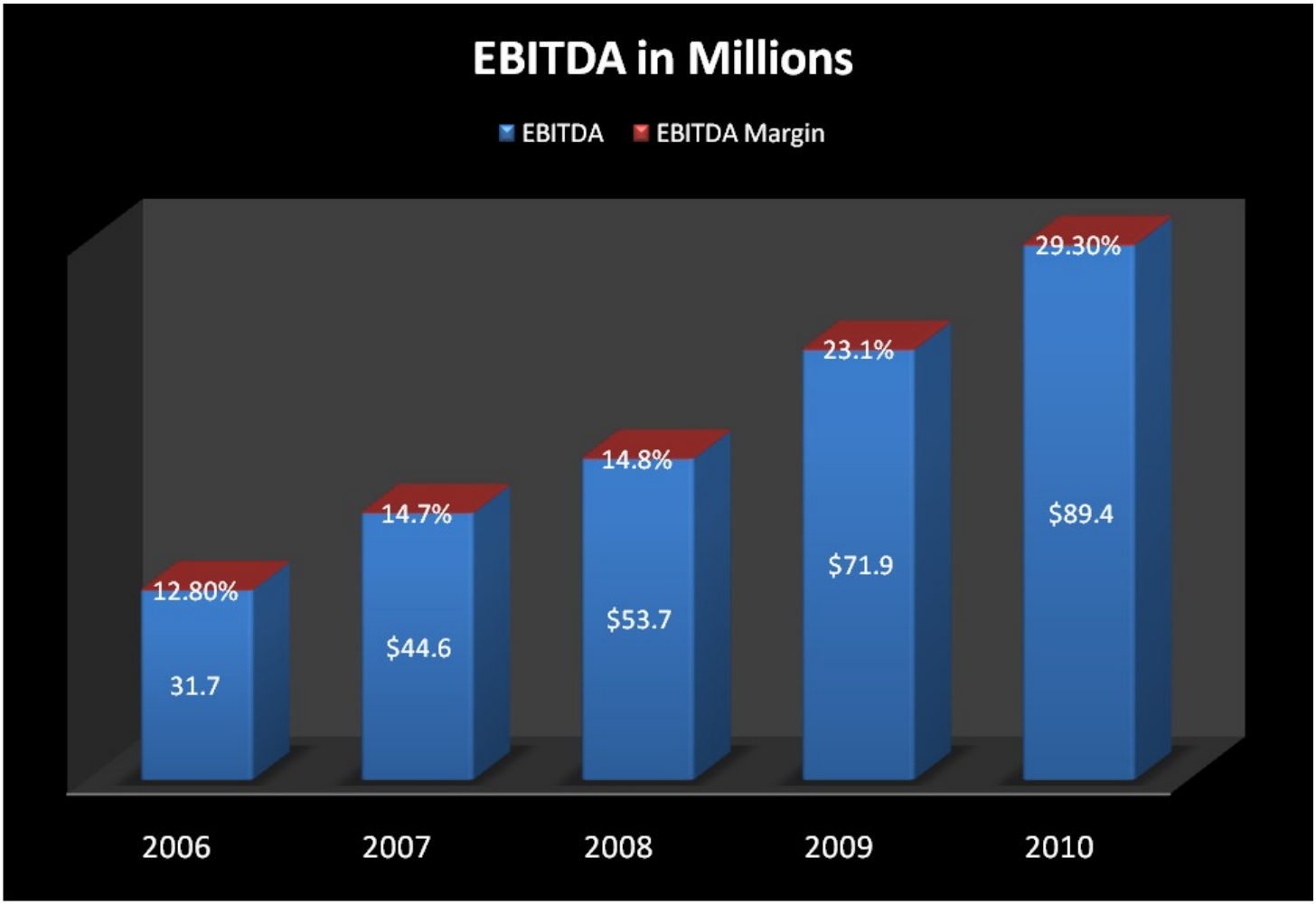


Growth Strategy

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

The company intends to increase its cabotage and 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. The Company believes its 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 2.5%, 2.2%, 2.7%, and 3.1% for the years 2011, 2012, 2013, and 2014.

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.

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 under valued when looking several ratios. We compared the firm against the transportation industry.

Price to book value a ratio 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	0.71	1.29

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. According to this

Metric	Grupo TMM	Industry Average
Price/Sales	0.13	1.21

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

The enterprise multiple looks at a firm as a potential acquirer would, because it takes debt into account - an item which other multiples like the P/E ratio do not include. Enterprise value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents. The Firm's Enterprise multiple is 8.85x compared to 10.21x for the industry. According to the enterprise multiple TMM appears undervalued compared to industry.

$$Enterprise\ Multiple = \frac{Enterprise\ Value}{EBITDA}$$

Metric	Grupo TMM	Industry Average
EV/EBITDA	8.85	10.21

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

RISKS

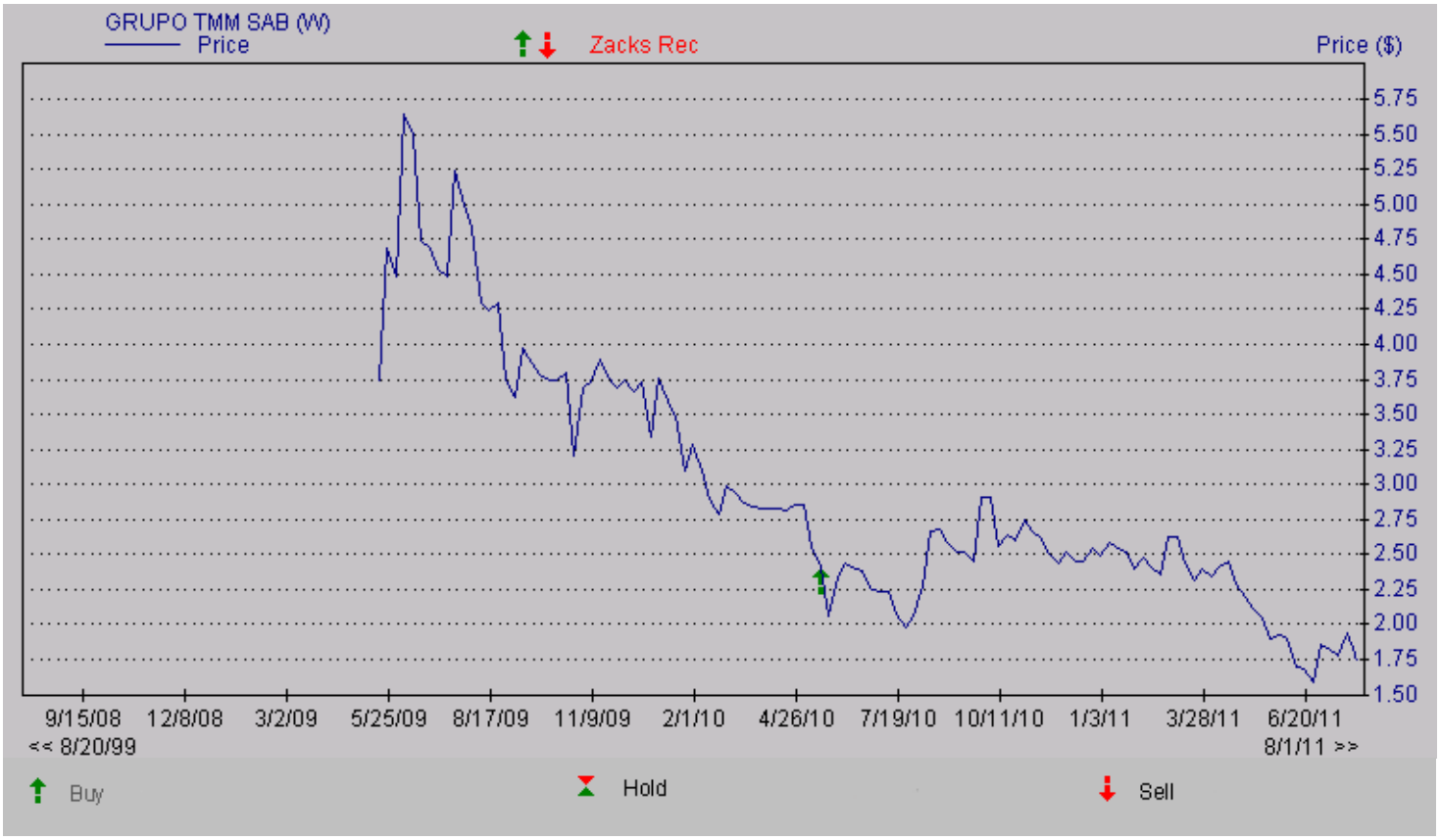
- Despite medium and long-term contracts in place at the Maritime division, tariff volatility could impact operations in the spot market
- The firm remains highly leveraged with $775.1 million in net debt.

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Jun-10 Q2 10	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11 E	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E
REVENUE												
Net Revenue	**75.4**	**74.7**	**74.0**	**65.9**	**69.6**	**70.0**	**248.1**	**303.3**	**363.0**	**308.2**	**305.4**	**277.0**
Sequential Growth		*-1%*	*-1%*	*-11%*	*6%*	*1%*						
OPERATING EXPENSES												
Cost of Revenues	47.72	48.39	47.84	44.17	47.31	48.25	220.5	253.9	300.5	221.7	198.8	186.0
% of Revenue	*63.3%*	*64.8%*	*64.6%*	*67.0%*	*67.9%*	*68.9%*						
Gross Profit -	**27.7**	**26.3**	**26.2**	**21.8**	**22.3**	**21.8**	**27.7**	**49.4**	**62.4**	**86.5**	**106.6**	**91.0**
Proforma Gross Margin	*36.7%*	*35.2%*	*35.4%*	*33.0%*	*32.1%*	*31.1%*	*11.1%*	*16.3%*	*17.2%*	*28.1%*	*34.9%*	*32.9%*
Depreciation + Amort	14.25	13.81	18.89	13.08	13.64	14.50	16.5	25.7	33.8	44.6	59.5	55.8
% of Revenue	*18.9%*	*18.5%*	*25.5%*	*19.8%*	*19.6%*	*20.7%*	*6.7%*	*8.5%*	*9.3%*	*14.5%*	*19.5%*	*20.1%*
Corp Expenses	3.67	3.49	3.38	4.13	4.35	4.40	24.0	4.4	8.8	14.9	14	17
% of Revenue	*4.9%*	*4.7%*	*4.6%*	*6.3%*	*6.2%*	*6.3%*	*9.7%*	*1.4%*	*2.4%*	*4.8%*	*4.6%*	*6.3%*
GW Amort, Restructuring, other	*1.91*	*0.69*	*0.74*	*(0.79)*	*(6.39)*	-	-	-	-	0.5	*$ 3.09*	*$ (11.17)*
% of Revenue												
Total Operating Expenses	19.82	18.00	23.01	16.42	11.60	18.90	40.5	30.0	42.5	59.9	77	62
% of Revenue	*26.3%*	*24.1%*	*31.1%*	*24.9%*	*16.7%*	*27.0%*	*16.3%*	*9.9%*	*11.7%*	*19.4%*	*25%*	*22%*
Operating Income -	**7.88**	**8.3**	**3.2**	**5.3**	**10.7**	**2.9**	**-12.9**	**19.3**	**19.9**	**26.6**	**30**	**29**
Operating Margin	*10.5%*	*11.1%*	*4.3%*	*8.1%*	*15.4%*	*4.1%*	*-5%*	*6%*	*5%*	*9%*	*10%*	*10%*
NON-OPERATING ITEMS												
Non operating Income/Expense	8.0	-34	-31	-47	-38	-21	-55.8	-48.5	75.6	-118.3	-108	-121
% of Revenue	*10.61%*	*-45.48%*	*-41.97%*	*-70.93%*	*-54.73%*	*-30.00%*	*-22.50%*	*-16.00%*	*20.84%*	*-38.39%*	*-35.43%*	*-43.64%*
Tax Provision	1.0	1.6	-2.1	0.4	2.4	2.2	-27.80	-0.84	20.09	1.7	1	7
Effective Tax Rate												
Net Income -	**14.87**	**-27.3**	**-25.78**	**-41.87**	**-29.76**	**-20.35**	**-40.90**	**-28.35**	**75.44**	**-93.42**	**-79.20**	**-98.94**
Net Income Margin	*19.7%*	*-36.5%*	*-34.8%*	*-63.5%*	*-42.7%*	*-29.1%*	*-16.5%*	*-9.3%*	*20.8%*	*-30.3%*	*-26%*	*-36%*
EARNINGS PER SHARE												
EPS - Basic	$0.14	-$0.27	-$0.26	-$0.42	-$0.30	-$0.17	$1.23	-$1.17	$1.47	-$1.43	-$0.79	-$0.96
EPS - Diluted	$0.14	-$0.27	-$0.26	-$0.42	-$0.30	-$0.17	$1.23	-$1.17	$1.47	-$1.43	-$0.79	-$0.96
EPS- Basic Excluding Exchange G/L	-$0.09	-$0.14	-$0.12	-$0.11	-$0.20	-$0.09				-$0.78	-$0.42	-$0.41
EPS-Diluted Excluding Exchange G/L	-$0.09	-$0.14	-$0.12	-$0.11	-$0.20	-$0.09				-$0.78	-$0.42	-$0.41

Ken Nagy, CFA Zacks Investment Research 8/1/2011

HISTORICAL ZACKS RECOMMENDATIONS



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