Zacks Equity Research

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Grupo TMM (TMM-NYSE)

TMM: Solid Quarter, EBITDA Grows, Free Cash Flow Positive Again

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/16/2010
Current Price (08/02/10)	$2.25
Six- Month Target Price	**$4.50**

OUTLOOK

On July 28th TMM presented results for the June quarter. EBITDA increased 39.6% year over year and free cash flow was positive for the third straight quarter. Through participation in profitable niche markets complimented by predictable revenues and cash flows through medium and long-term contracts at its Maritime division TMM appears poised for long –term growth. We reiterate our outperform recommendation.

SUMMARY DATA

52-Week High	**$5.75**
52-Week Low	**$1.87**
One-Year Return (%)	**-35.47**
Beta	**0.12**
Average Daily Volume (sh)	**16,004**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$42**
Short Interest Ratio (days)	**0.60**
Institutional Ownership (%)	**17**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**22.7**
Earnings Per Share (%)	**N/A**
P/E using 2010 Estimate	**6.2x**
P/E using 2011 Estimate	**2.1x**
Zacks Rank	**3**

Risk Level	**Average,**
Type of Stock	**Small-Value**
Industry	**Shipping**
Zacks Rank in Industry	**5 of 9**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	86 A	93 A	95 A	89 A	363 A
2009	80 A	75 A	75 A	79 A	308 A
2010	81 A	75 A	78 E	85 E	319 E
2011	91 E	92 E	95 E	97 E	375 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	-$0.18 A	-$0.26 A	$0.25 A	$1.66 A	$1.47 A
2009	$0.09 A	-$1.20 A	$0.00 A	-$0.32 A	-$1.43 A
2010	-$0.41 A	$0.14 A	$0.15 E	$0.45 E	$0.33 E
2011	$0.21 E	$0.23 E	$0.25 E	$0.27 E	$0.96 E

1 ADR=5 common shares

Zacks Projected EPS Growth Rate – Next 5 Years % **15**

Year end numbers may not sum due to changes in share count

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WHATS NEW

On July 28th 2010 TMM announced results for the second quarter of fiscal year 2010 ending June 2010. Revenue for the period was $75.42 million falling 7.1% sequentially from $81.15 million and up 1.2% year over year.

Starting in the fourth quarter of 2009, TMM reclassified its segments. Ports and Terminals division's segments now include Acapulco, Tuxpan, shipping agencies, maintenance and repair, and automotive. TMM's Logistics division's segments include trucking, warehousing, auto hauling and inbound logistics.

Broken down by segment, Maritime, second-quarter 2010 revenues grew 8.4% year over year, mainly due to increased revenues at offshore vessels attributable to higher average tariffs per day and more vessels in operation. Operating profit in the Maritime division grew 14.3% in the 2010 second quarter compared to the previous year's second quarter, mainly as a result of a significant profit increase at product tankers due primarily to higher average daily rates and to having all seven vessels working with time-charter contracts.

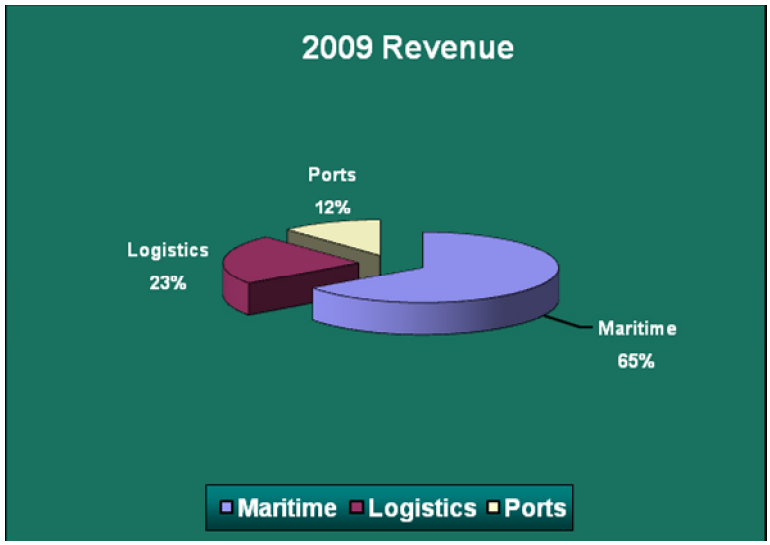
The Ports and Terminals division's revenue increased 46.1% year over year and operating profit for this division increased from $9,000 in the 2009 second quarter to $1.4 million in the 2010 second quarter. Improved results at the Ports and Terminals division was attributable mainly to increased cruise ship calls and automobiles handled at Acapulco, as well as increased revenue and higher container volumes at the maintenance and repair segment.

Logistics revenues decreased 21.3%, year over year. The decrease were mainly attributable to lower trucking revenue and to reduced revenue of $3.8 million as a result of the sale of the minority stake in the company's automotive inbound logistics business in April. These decreases were partially offset by higher revenue at the warehousing and auto hauling segments.

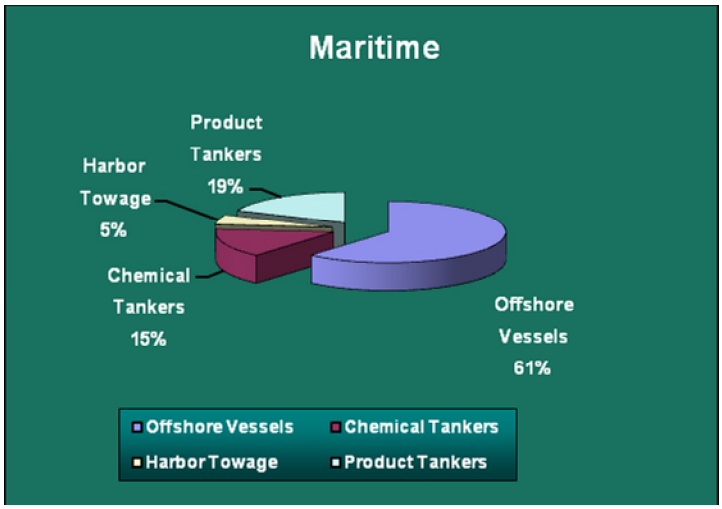
On the financial front the firm reopened its 20-year, non recourse, Mexican Trust Certificates Program to consolidate all tranches into one in an effort to improve the Program's credit rating. On July 13, HR Ratings de Mexico rated the new issuance of Trust Certificates AA in the domestic scale. The transaction closed on July 29th and should allow the firm to redeploy its fleet, prepay certain dollar-denominated debt and fund new projects. The new issuance rate is TIIE +245 basis points and was rated AA (domestic) by HR Ratings de México. The Company's shareholders approved this new issuance on April 30, 2010, at the Company's Annual Ordinary Shareholders Meeting. The TIIE is Mexico's Interbank Equilibrium Interest Rate. The firm consolidated the three tranches of its 20-year, non recourse Mexican Trust Certificates Program into one issuance, for $10.5 billion pesos (approximately $817 million dollars).

INVESTMENT THESIS

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. Despite the global recession in 2009, TMM continues to record solid EBITDA growth. The firm is committed to modernizing its fleet 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.



Maritime Operations. (65% of Total Revenue)
The Maritime division is further broken down into 4 segments; Offshore Vessels, Product Tankers, Chemical Tankers, and Harbor towing.



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 47 vessels (43 owned), which includes product and chemical tankers, harbor tugs and a variety of offshore supply vessels.

Renewing the Fleet
The firm's business strategy is to renew its maritime fleet with modern high quality vessels which will allow the TMM to take advantage of the increased demand for oil exploration in Mexico's deep waters.

Throughout 2008 and 2009 the firm added 10 offshore vessels and 3 tankers. The utilization of the maritime fleet remains above the industry average. The firm currently has no stacked tankers. Backlog stands at $318 million.

Offshore Vessels
The offshore vessels unit has a fleet of 32 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 six product tankers, all of which are under long-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 given priority.

Chemical Tankers
The firm currently operates four 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 1700 vessels per year. Major clients in Harbor Towing include Maersk, CSAV, NYK, MSC, and Hapag-Lloyd.

Ports and Terminals Operations. (12% 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 1,700 automobiles.

The Company owns approximately 2,000 acres of land in Tuxpan, and a terminal of multipurpose cargo. While TMM currently handles only a small volume of cargo at the port, they are in the process of developing the site.

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

Logistics Operations. (23% 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 and railroad hubs throughout Mexico, including Aguascalientes, Toluca, Puebla, Veracruz, Nuevo Laredo, Cuernavaca, Mexico City, Monterrey, Manzanillo, Ensenada, and Altamira.

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.

Currency Impact and Restructuring

At December 31, 2009, 65% of the company's revenues and 35% of its costs were dollar denominated. Currency fluctuations or the devaluation and depreciation of the Peso can impact revenues and costs as the company reports earnings in US dollars. Also, the majority of the firm's debt is denominated in Mexican Pesos. Therefore an appreciation of the Peso versus the dollar can cause exchange losses resulting in losses on the bottom-line. Investors should focus on top-line numbers as well as cash flow and EBITDA.

In December 2009 TMM restructured its receivables securitization facility. As part of the restructuring of the Facility, ("VEX") a related company of TMM, purchased Certificates with a face value of approximately USD $86.5 million from Deutsche Bank AG London. The amount of debt exchanged for equity was approximately USD $41.2 million.

- The cash required for debt service in 2010 is expected to be reduced by approximately USD $37.9 million.
- Reducing the firm's contractual payments for the next three years by $85.9 million.
- Short-term debt is only 3.7% or $30.2 million of all outstanding debt.

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 certainly leads 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 in 2009 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.

PROJECTED INCOME STATEMENT & BALANCE SHEET

INCOME STATEMENT ($ Millions)	Jun-09 Q209	Sep-09 Q309	Dec-09 Q409	Mar-10 Q1 10	Jun-10 Q2 10	Sep-10 Q3 10 E	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 E	FY 2011 E
REVENUE												
Net Revenue	**74.5**	**74.6**	**79.1**	**81.2**	**75.4**	**78.0**	**248.1**	**303.3**	**363.0**	**308.2**	**319.0**	**375.0**
Sequential Growth		*0%*	*6%*	*3%*	*-7%*	*3%*						
OPERATING EXPENSES												
Cost of Revenues	55.58	57.35	52.67	54.85	47.72	49.00	220.5	253.9	300.5	221.7	229.0	233.0
% of Revenue	*74.6%*	*76.9%*	*66.6%*	*67.6%*	*63.3%*	*62.8%*						
Gross Profit -	**19.0**	**17.2**	**26.5**	**26.3**	**27.7**	**29.0**	**27.7**	**49.4**	**62.4**	**86.5**	**90.0**	**142.0**
Proforma Gross Margin	*25.4%*	*23.1%*	*33.4%*	*32.4%*	*36.7%*	*37.2%*	*11.1%*	*16.3%*	*17.2%*	*28.1%*	*28.2%*	*37.9%*
Depreciation + Amort	10.82	8.82	10.84	12.50	14.25	15.00	16.5	25.7	33.8	44.6	48.0	50.0
% of Revenue	*14.5%*	*11.8%*	*13.7%*	*15.4%*	*18.9%*	*19.2%*	*6.7%*	*8.5%*	*9.3%*	*14.5%*	*15.0%*	*13.3%*
Corp Expenses	2.29	4.63	3.85	3.50	3.67	3.75	24.0	4.4	8.8	14.9	16	16
% of Revenue	*3.1%*	*6.2%*	*4.9%*	*4.3%*	*4.9%*	*4.8%*	*9.7%*	*1.4%*	*2.4%*	*4.8%*	*4.9%*	*4.3%*
GW Amort, Restructuring, other	-	-	-		*1.91*	*1.25*	-	-	-	0.5		
% of Revenue												
Total Operating Expenses	13.11	13.45	14.69	16.00	19.82	18.75	40.5	30.0	42.5	59.9	64	66
% of Revenue	*17.6%*	*18.0%*	*18.6%*	*19.7%*	*26.3%*	*24.0%*	*16.3%*	*9.9%*	*11.7%*	*19.4%*	*20%*	*18%*
Operating Income -	**5.86**	**3.79**	**11.76**	**10.30**	**7.88**	**10.3**	**-12.9**	**19.3**	**19.9**	**26.6**	**27**	**76**
Operating Margin	*7.9%*	*5.1%*	*14.9%*	*12.7%*	*10.5%*	*13.1%*	*-5%*	*6%*	*5%*	*9%*	*8%*	*20%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-71.7	-3.1	-43.0	-51.2	8.0	7	-55.8	-48.5	75.6	-118.3	-20	25
% of Revenue	*-96.22%*	*-4.10%*	*-54.38%*	*-63.04%*	*10.61%*	*8.97%*	*-22.50%*	*-16.00%*	*20.84%*	*-38.39%*	*-6.27%*	*6.67%*
Tax Provision	0.6	0.2	1.03	0.5	1.0	2.2	-27.80	-0.84	20.09	1.7	2	2
Effective Tax Rate												
Net Income -	**-66.43**	**0.49**	**-32.30**	**-41.37**	**14.87**	**15.05**	**-40.90**	**-28.35**	**75.44**	**-93.42**	**4.8**	**98.8**
Net Income Margin	*-89.1%*	*0.7%*	*-40.8%*	*-51.0%*	*19.7%*	*19.3%*	*-16.5%*	*-9.3%*	*20.8%*	*-30.3%*	*1%*	*26%*
EARNINGS PER SHARE												
EPS - Basic	-$1.20	$0.00	$0.32	-$0.41	$0.14	$0.15	$1.23	-$1.17	$1.47	-$1.43	$0.33	$0.96
EPS - Diluted	-$1.20	$0.00	$0.32	-$0.41	$0.14	$0.15	$1.23	-$1.17	$1.47	-$1.43	$0.33	$0.96

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