Zacks Equity Research

December 13, 2010
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Grupo TMM (TMM-NYSE)

TMM: Solid Quarter. Reiterate Outperform

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/16/2010
Current Price (12/10/10)	$2.46
Six- Month 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 5-year growth strategy, 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. We feel the firm should outperform the industry and set a price target of $4.50

SUMMARY DATA

52-Week High	**$4.00**
52-Week Low	**$1.97**
One-Year Return (%)	**-32.97**
Beta	**0.33**
Average Daily Volume (sh)	**7,963**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$50**
Short Interest Ratio (days)	**0.97**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2010 Estimate	**NA**
P/E using 2011 Estimate	**2.6**
Zacks Rank	**5**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Value**
Industry	**Trans-Services**
Zacks Rank in Industry	**4 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	75 A	78 E	309 E
2011	85 E	88 E	92 E	95 E	360 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	-$0.27 A	-$0.16 E	-$0.70 E
2011	$0.21 E	$0.23 E	$0.25 E	$0.27 E	$0.96 E

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

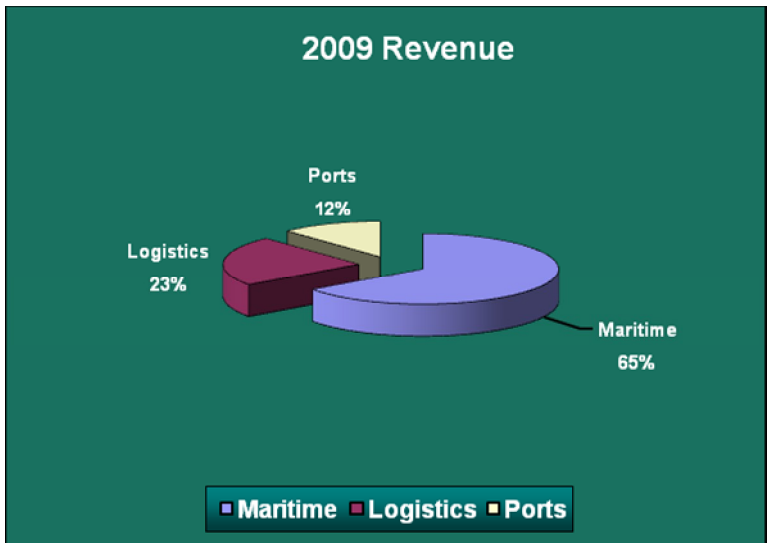
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KEY POINTS

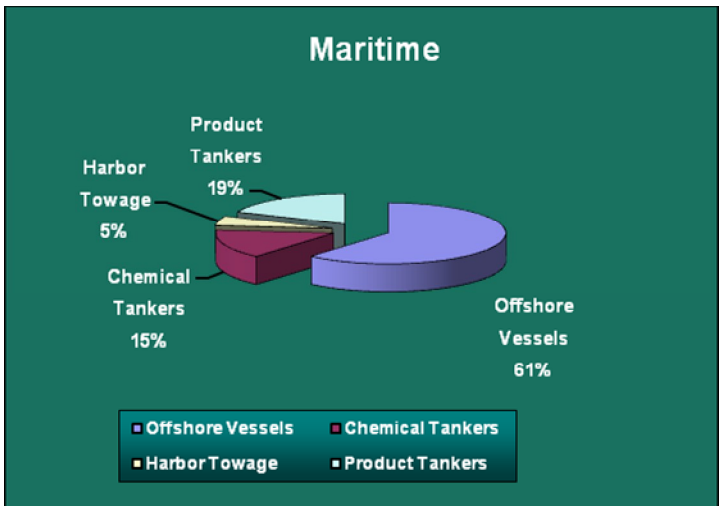
- The firm's Maritime division is the dominant business at TMM. The fleet has been updated. In 2008 and 2009 alone the firm added 10 offshore vessels and 3 tankers. The division enjoys higher than average utilization.
- TMM prefers to compete for margin rich niche business and employs long to medium -term contracts.
- TMM is committed to selling non-strategic assets. This should make the firm more efficient and more profitable.
- Approximately 90% of the Company total debt is peso denominated, non recourse to the Company and for a 20-year term.

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. 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 product tankers. The utilization of the maritime fleet remains above the industry average. The firm currently has no stacked tankers. Backlog stands at $318 million.

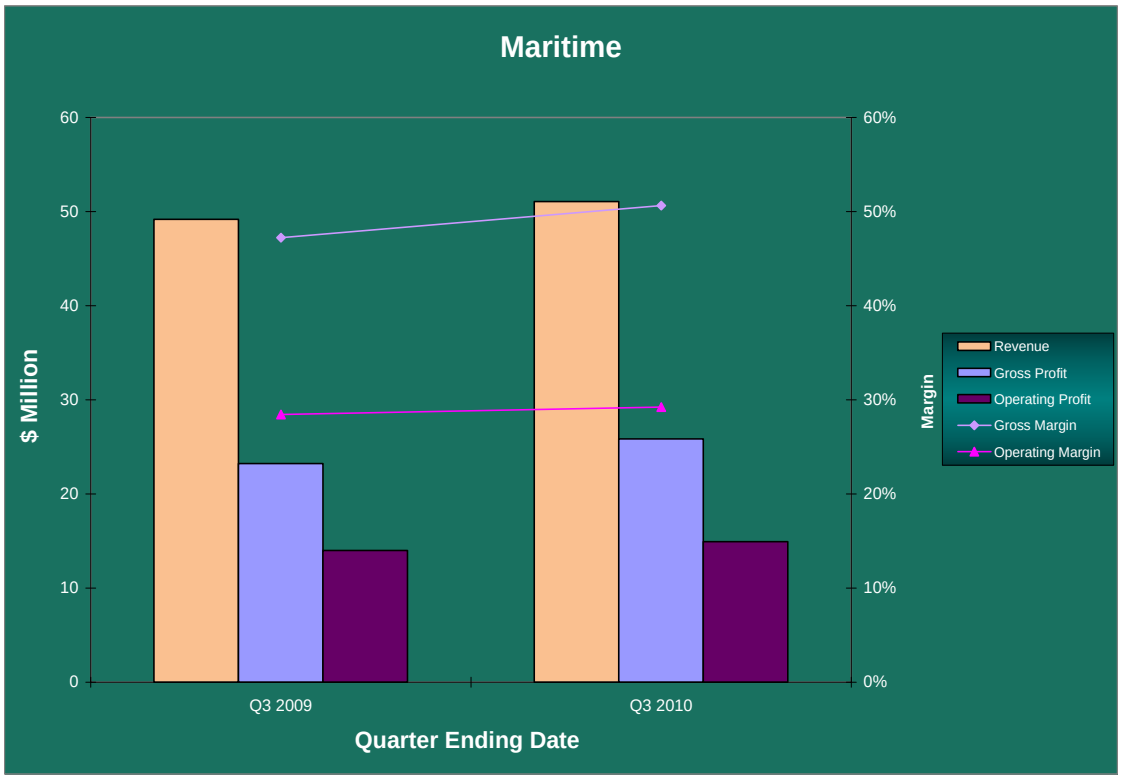
Offshore Vessels
The offshore vessels unit has a fleet of 31 vessels mainly for transport of dry and liquid cargo, anchor handling tug vessels, crew boats, fire fighting vessels, four point mooring vessels and dynamic positioning vessels.

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 medium and 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 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. The firm currently has five vessels that service over 1,700 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 2,000 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 intend to develop 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 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. (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.

This quarter marked the fourth consecutive quarter of positive free cash flow. Management anticipates reaching its annual EBITDA goal of $90 million in 2010. Contract backlog stands at $308.9 million.

Recall at the end of the 2nd quarter 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 allowed the firm to 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). In the 3rd quarter Peso Denominated debt was impacted by $14.8 million as the Peso appreciated versus the Dollar. Cash increased $22.3 million. Of the firm's entire debt position only 2.5% of net debt is short term.

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 throughout 2008 and 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.

INDUSTRY OUTLOOK

The shipping industry includes dry bulk, wet bulk and container. TMM competes primarily in the wet bulk area.

The demand for shipping capacity rose for several years thanks to economic centers of development such as China and India. This pushed freight rates and operator profits up significantly. Luckily, supply of raw materials kept pace with demand, and thus did not constrain shipping activity. In addition, fuel costs are promoting a growing number of shippers to consider ocean versus other forms of transport.

Some drivers of the industry include.

- GDP outlook – the higher the level of a country's economic activity the greater the demand for raw materials to trade
- Oil demand and supply – the higher the demand for oil, the greater the need for tankers to transport
- Oil inventory levels – the amount of oil held in storage to meet future requirements has an impact on the demand for oil tankers in the future; seasonality often plays a critical role

Like all industries the economic crisis of 2009 hit the industry hard. Firms with newer fleets and higher margins outperformed.

INDUSTRY POSITION

TMM's ability to contract for the transportation of oil and oil derivatives by sea, as well as transport by truck, enables the firm to provide value-added "door-to-door" service to customers. The value of its transportation service is further enhanced by the firm's ability to provide warehousing and logistics services for some types of cargo.

Being a Mexican-owned and Mexican-operated company has inherent advantages. This allows TMM marketing and operational advantages and, in certain cases, preferential treatment in certain niche markets within Mexico. Mexican law provides that cabotage (intra-Mexican movement between ports) is reserved for ships flying the Mexican flag.

The Company's primary competitors in the Offshore Vessel business are Oceanografía, S.A. de C.V. (partner of Otto Candies LLC in Mexico) and Nautica Saltamar, S.A. de C.V. (a Mexican company with commercial agreements with Tidewater, Inc., the world's largest offshore vessel operator).

The Company's primary competitor in the **Parcel Tanker** business is Stolt-Nielsen Transportation Group Ltd. Some other competitors in this business include Clipper and Mapa Logistics S.A. de C.V.

The **tugboat business** does not have a direct competitor within the port of Manzanillo, however other important tugboat operations in Mexico are provided by Saam Remolques, S.A., Cía. Marítima del Pacífico, S.A de C.V and Cía Marítima S.A de C.V.

The Company's primary competitors in the **Product Tanker** business are, Arrendadora Ocean Mexicana, S.A. de C.V., Naviera Tulúm, S.A. de C.V., and Naviera del Sureste, S.A. de C.V.

The most important competitive factors concerning the **Maritime Operations** segment are pricing, the flying of the Mexican flag and the availability of equipment to fit customer requirements, including the ability to provide and maintain logistical support given the complexity of a project and the cost of transferring equipment from one market to another

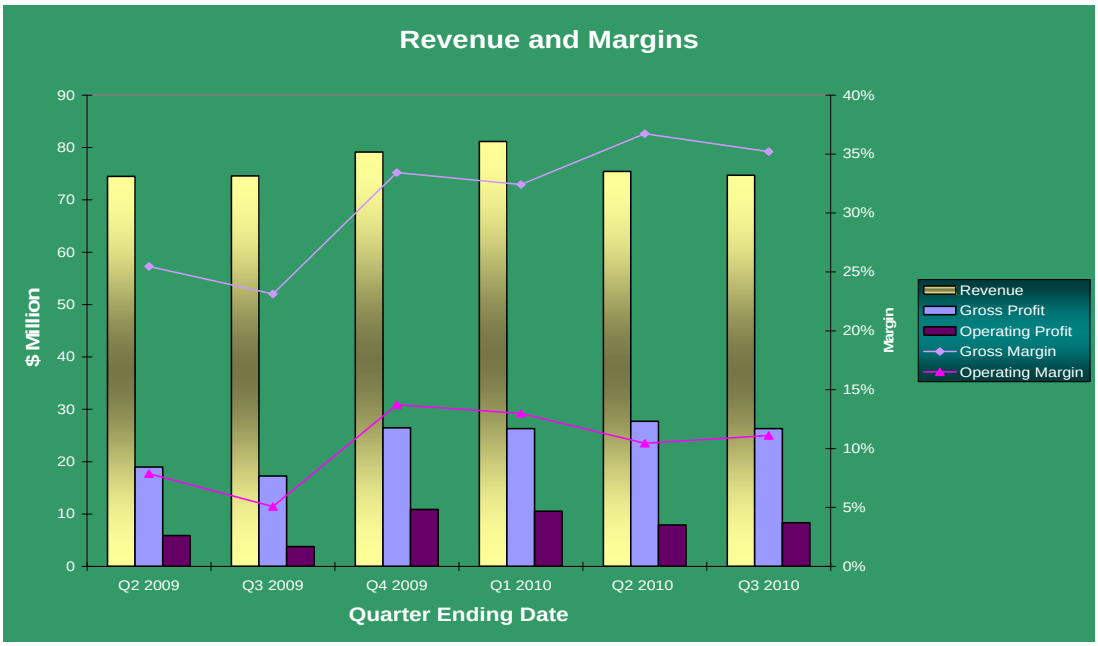
RECENT NEWS

On October 28, 2010 Grupo TMM announced results for the third quarter of fiscal year 2010 ending September 2010. Revenue for the period was $74.68 million down 0.9% sequentially from $75.42 million and up 0.3% year over year. Revenue in the 2010 periods was negatively impacted by reduced revenue at the Logistics division.

EBITDA increased 38.7 % to $22.2 million compared to $16.0 million in the same period of last year. In the first nine months of 2010, EBITDA increased 39.5% to $67.4 million compared to $48.3 million in the same period of 2009. However, first-nine months 2009 EBITDA included a $4.4 million profit from the sale of two offshore vessels in the second quarter of 2009. Without this one-time profit, EBITDA increased 53.5%, or $23.5 million, in the 2010 first nine months, compared to the same period last year.

At Maritime, third-quarter 2010 revenue grew 3.9 % compared to the 2009 third quarter, mainly due to increases at every segment except for chemical tankers, which had one less vessel in operation. Maritime's operating profit grew 6.4 percent in the 2010 third quarter compared to the same period of the previous year, mainly as a result of a 225.0 percent gross profit increase at product tankers due to higher average daily rates as well as a 66.7 percent gross profit increase at chemical tankers due to more efficient routes and reduced costs.

Improved results at the Ports and Terminals division in the 2010 periods compared to last year, were mainly attributable to increased revenue and profit at Acapulco as a result of higher cruise ship calls and auto handling volumes; at shipping agencies due to higher volumes, benefited by one new cruise line route among Mexican major ports in the third quarter; and at maintenance and repair due to continued improvement in the revenue mix and higher container volumes, specifically at Manzanillo.



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 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.

The company is trading at a reasonable 7.9x Enterprise value/EBITDA. Close competitors Tidewater and Seacor are trading at 9.3x and 4.5x.

We value the company based on the average of our EV/EBITDA multiple and our two stage intrinsic model.

The intrinsic value is essentially a sum of the company's future earnings, minus any long-term debt. Dividing the intrinsic value by the number of shares outstanding yields an intrinsic stock price. We used the following inputs:

- A 10-year period with an earnings growth rate of 12.0% (average forecast) and a discount rate of 10%.
- A continuing period assumed to go on forever, with earnings growing at 6% and a discount rate of 12%.

With these inputs we arrive at a target price of $4.50.

RISKS

- TMM is positioned to take advantage of deep water oil drilling. The recent situation in the South Eastern United States could make deep water drilling more difficult politically and more expensive.
- Despite medium and long-term contracts in place, the prospect of a double dip recession could impact the company.

PROJECTED INCOME STATEMENT & BALANCE SHEET

INCOME STATEMENT ($ Millions)	Sep-09 Q309	Dec-09 Q409	Mar-10 Q1 10	Jun-10 Q2 10	Sep-10 Q3 10	Dec-10 Q4 10 E	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 E	FY 2011 E
REVENUE												
Net Revenue	**74.6**	**79.1**	**81.2**	**75.4**	**74.7**	**78.0**	**248.1**	**303.3**	**363.0**	**308.2**	**309.0**	**375.0**
Sequential Growth	*#DIV/0!*	*6%*	*3%*	*-7%*	*-1%*	*4%*						
OPERATING EXPENSES												
Cost of Revenues	57.35	52.67	54.85	47.72	48.39	49.00	220.5	253.9	300.5	221.7	200.0	233.0
% of Revenue	*76.9%*	*66.6%*	*67.6%*	*63.3%*	*64.8%*	*62.8%*						
Gross Profit -	**17.2**	**26.5**	**26.3**	**27.7**	**26.3**	**29.0**	**27.7**	**49.4**	**62.4**	**86.5**	**109.0**	**142.0**
Proforma Gross Margin	*23.1%*	*33.4%*	*32.4%*	*36.7%*	*35.2%*	*37.2%*	*11.1%*	*16.3%*	*17.2%*	*28.1%*	*35.3%*	*37.9%*
Depreciation + Amort	8.82	10.84	12.50	14.25	13.81	15.00	16.5	25.7	33.8	44.6	55.6	50.0
% of Revenue	*11.8%*	*13.7%*	*15.4%*	*18.9%*	*18.5%*	*19.2%*	*6.7%*	*8.5%*	*9.3%*	*14.5%*	*18.0%*	*13.3%*
Corp Expenses	4.63	3.85	3.50	3.67	3.49	3.75	24.0	4.4	8.8	14.9	16	16
% of Revenue	*6.2%*	*4.9%*	*4.3%*	*4.9%*	*4.7%*	*4.8%*	*9.7%*	*1.4%*	*2.4%*	*4.8%*	*5.0%*	*4.3%*
GW Amort, Restructuring, other	-	-		*1.91*	*0.70*	*1.25*	-	-	-	0.5	*$ 2.00*	
% of Revenue												
Total Operating Expenses	13.45	14.69	16.00	19.82	18.00	18.75	40.5	30.0	42.5	59.9	73	66
% of Revenue	*18.0%*	*18.6%*	*19.7%*	*26.3%*	*24.1%*	*24.0%*	*16.3%*	*9.9%*	*11.7%*	*19.4%*	*24%*	*18%*
Operating Income -	**3.79**	**11.76**	**10.30**	**7.88**	**8.3**	**10.3**	**-12.9**	**19.3**	**19.9**	**26.6**	**36**	**76**
Operating Margin	*5.1%*	*14.9%*	*12.7%*	*10.5%*	*11.1%*	*13.1%*	*-5%*	*6%*	*5%*	*9%*	*12%*	*20%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-3.1	-43.0	-51.2	8.0	-34	-25	-55.8	-48.5	75.6	-118.3	-102	25
% of Revenue	*-4.10%*	*-54.38%*	*-63.04%*	*10.61%*	*-45.48%*	*-32.05%*	*-22.50%*	*-16.00%*	*20.84%*	*-38.39%*	*-33.01%*	*6.67%*
Tax Provision	0.2	1.03	0.5	1.0	1.6	2.2	-27.80	-0.84	20.09	1.7	5	2
Effective Tax Rate												
Net Income -	**0.49**	**-32.30**	**-41.37**	**14.87**	**-27.3**	**-16.95**	**-40.90**	**-28.35**	**75.44**	**-93.42**	**-71.3**	**98.8**
Net Income Margin	*0.7%*	*-40.8%*	*-51.0%*	*19.7%*	*-36.5%*	*-21.7%*	*-16.5%*	*-9.3%*	*20.8%*	*-30.3%*	*-23%*	*26%*
EARNINGS PER SHARE												
EPS - Basic	$0.00	$0.32	-$0.41	$0.14	-$0.27	-$0.16	$1.23	-$1.17	$1.47	-$1.43	-$0.70	$0.96
EPS - Diluted	$0.00	$0.32	-$0.41	$0.14	-$0.27	-$0.16	$1.23	-$1.17	$1.47	-$1.43	-$0.70	$0.96

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DISCLOSURES

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