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 (11/01/10)	$2.73
Six- Month Target Price	**$4.50**

OUTLOOK

On October 28th Grupo TMM presented results for the September quarter. EBITDA increased 38.7% year over year and free cash flow was positive for the fourth 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	**$4.00**
52-Week Low	**$1.97**
One-Year Return (%)	**-21.55**
Beta	**0.25**
Average Daily Volume (sh)	**14,341**
Shares Outstanding (mil)	**20**
Market Capitalization ($mil)	**$56**
Short Interest Ratio (days)	**1.09**
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**
	N/A
P/E using TTM EPS	**N/A**
P/E using 2010 Estimate	**N/A**
P/E using 2011 Estimate	**2.8**
Zacks Rank	**3**

Risk Level	**Average,**
Type of Stock	**Small-Value**
Industry	**Trans-Services**
Zacks Rank in Industry	**2 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	$0.45 E	-$0.09 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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WHATS NEW

On October 28t^{h} 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.

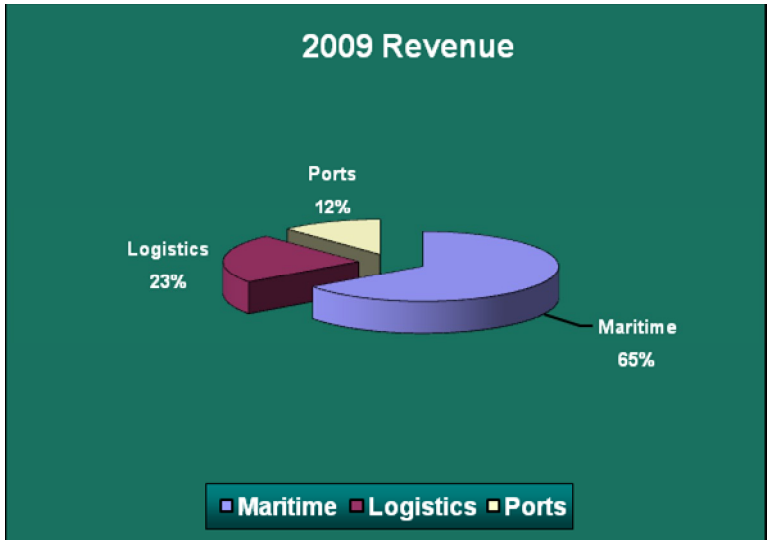
Improved results at the Ports and Terminals division in the 2010 periods compared to last year, were mainly attributable to increased revenue and profit at Acapulco as a result of higher cruise ship calls and auto handling volumes; at shipping agencies due to higher volumes, benefited by one new cruise 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.

This 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.

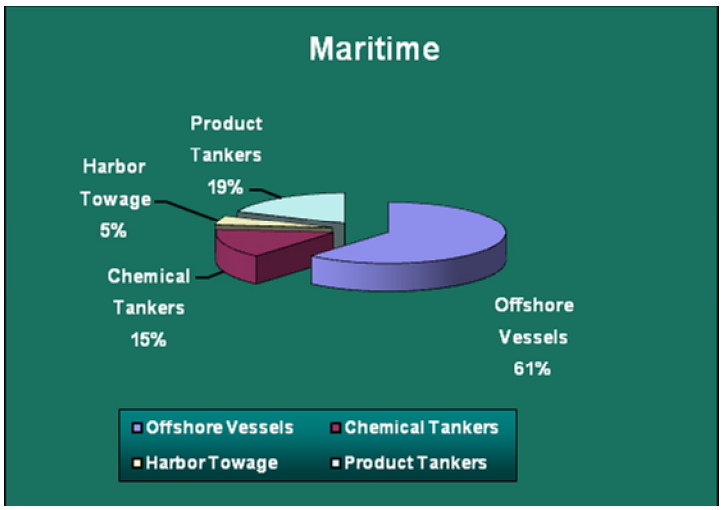
Recall at the end of the 2nd quarter the firm reopened its 20-year, non recourse, Mexican Trust Certificates Program to consolidate all tranches into one in an effort to improve the Program's credit rating. On July 13, HR Ratings de Mexico rated the new issuance of Trust Certificates AA in the domestic scale. The transaction closed on July 29th and 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). 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.

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.

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.

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