Zacks Small-Cap Research

November 3, 2011
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GRUPO TMM (TMM-NYSE)

TMM: Utilization Well Above Average - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/16/2010
Current Price (11/2/11)	$1.90
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	**$2.96**
52-Week Low	**$1.32**
One-Year Return (%)	**-35.27**
Beta	**0.07**
Average Daily Volume (sh)	**5,631**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$36**
Short Interest Ratio (days)	**8.85**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**36**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**23.1**
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	69 A	71 E	275 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	$0.09 A	-$1.20 A	$0.00 A	-$0.35 A	-$1.71 A
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	$0.75 E	$0.93 E

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

2009 reflects a capital increase of 46.8 million shares

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WHATS NEW

On October 26, 2011, Grupo TMM, reported financial results for its fiscal 2011 third quarter, ended September 30, 2011. Investors should note a few significant items in the quarter.

- The firm was free cash flow positive on both a sequential basis as well as over a nine-month time period.
- Sequential improvement of revenue and utilization was seen at Maritime. Grupo TMM's offshore fleet utilization was at 88 percent and product tanker utilization was at 99 percent. This is well above average.
- TMM's net debt was reduced by $30.8 million during the first nine months of 2011. Only 1.4% or $11.0 million of the $761.5 million of the Company's current total outstanding debt is short term debt. Likewise, the book value of the Company's Trust Certificates debt was reduced by $66.8 million in the first nine months of 2011 as a result of the strengthening of the dollar versus the peso.
- Grupo TMM updated progress on its development of a container and liquids terminal at the Port of Tuxpan and the addition of specialized offshore vessels to its fleet. Both projects remain a potential source of growth going forward and are progressing well.

The third quarter performance resulted in an 8 percent year over year decrease in revenue, with revenue dropping $6.0 million to $68.8 million from $74.8 million for the three months ended September 30, 2010.The decrease in revenues was primarily due to a decrease in the Maritime segment which was partially offset by improved revenues in the Ports and Terminal segment revenue.

The Maritime segment revenue, which was negatively impacted by global reduction of tariffs for offshore vessels and product tankers, dropped 12.7 percent for the three months compared to the comparable period of last year.

Similarly, the Company's Logistics segment revenue during the quarter fell $0.8 or 4.4 percent year over year while Ports and Terminals revenue during the quarter improved $1.4 million or 25.4 percent.

While the Maritime segment was affected by a challenging economic marketplace, Maritime's revenue and fleet utilization sequentially improved from the first and second quarters of 2011. Furthermore, Grupo TMM's offshore fleet utilization was at 88 percent and product tanker utilization was at 99 percent. Both offshore fleet and product tanker utilization were well above the industry average.

Operating income for the third quarter decreased $2.4 million or 28 percent year over year, due in part to lower margins.

For the nine months ended September 30, 2011, year over year revenues fell by 11.7 percent or $27.0 to $204.4 million. Here again, the decrease in revenues for the nine months was primarily due to a decrease in the Maritime segment which was partially offset by improved revenues in the Ports and Terminal segment revenue.

Maritime revenue in the nine months of 2011 decreased $25.6 million or 16.7 percent to $127.8 million compared to the same periods of last year.

Excluding $6.7 million from the sale of Logistics in April 2010, Logistics revenue increased 3.5% in the nine months compared to the previous year, and revenue from the Ports and Terminals improved $3.5 million or 20.1% year over year for the nine months.

Free Cash Flow Positive

Despite head winds in the year over year comparison TMM was cash flow positive for the Quarter, $2.2 million and for the first nine months of 2011, $10.3 million.

Grupo TMM's cash and equivalents as of September 30, 2011 came to $57.0 million while working capital totaled $53.7 million. This compares to $142.3 million of cash and equivalents and working capital of $107.5 million for the period ended September 30, 2010. The cash reduction was primarily due to interest and principal payments on the Trust Certificates as well as the remaining balance of the Company's securitization facility.

Similarly, as of September 30, 2011, TMM's net debt was reduced by $30.8 million during the first nine months of 2011. It should further be noted that only 1.4% or $11.0 million of the $761.5 million of the Company's current total outstanding debt is short term debt.

Likewise, the Company's Trust Certificates debt was reduced by $66.8 million in the first nine months of 2011 as a result of the strengthening of the dollar versus the peso.

Progress Continues
Finally, the Company updated progress on its development of a container and liquids terminal at the Port of Tuxpan and the addition of specialized offshore vessels to its fleet, both of which are expected to be funded with a combination of equity and debt.

TMM has satisfied all preliminary requirements and continues to work very closely with selected, interested parties for financial implementation. The Company expects these projects to significantly improve revenue base, profits and capital structure.

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. 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

Add specialized offshore vessels to TMM's fleet

- PEMEX business plan anticipates spending over $20b annually over next several years to develop deepwater identified reserves
- Increasing demand for deep water exploration in Mexico

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. 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.

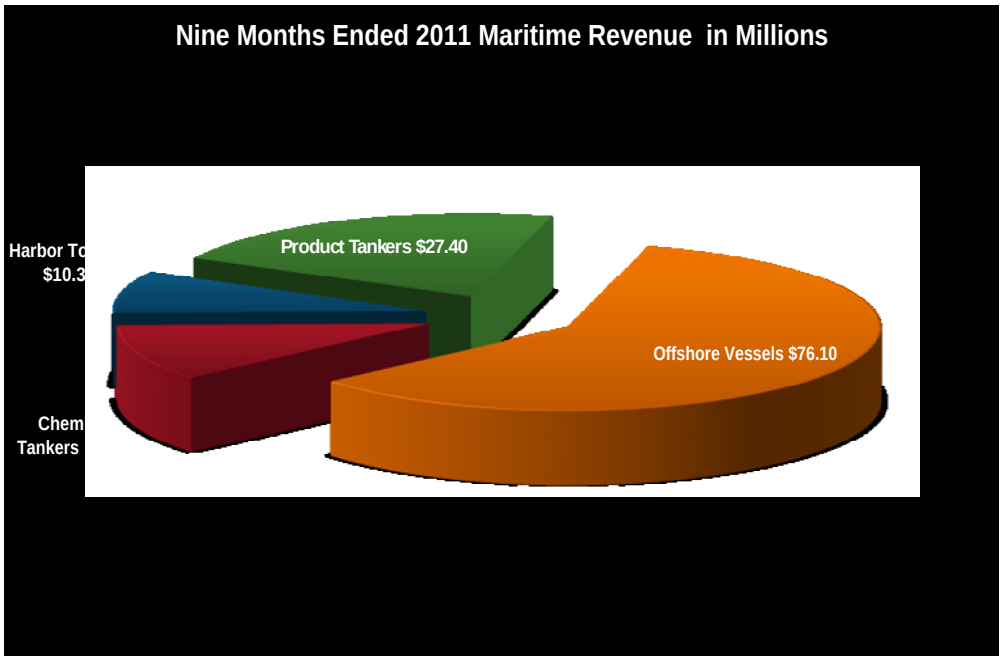
- 2010 EBITDA and EBITDA margin was the highest in the last five years, despite global recessionary economic climate. In 2011 the firm was Free Cash Flow positive in the third quarter and over the first nine months.

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

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'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 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 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 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 seven 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

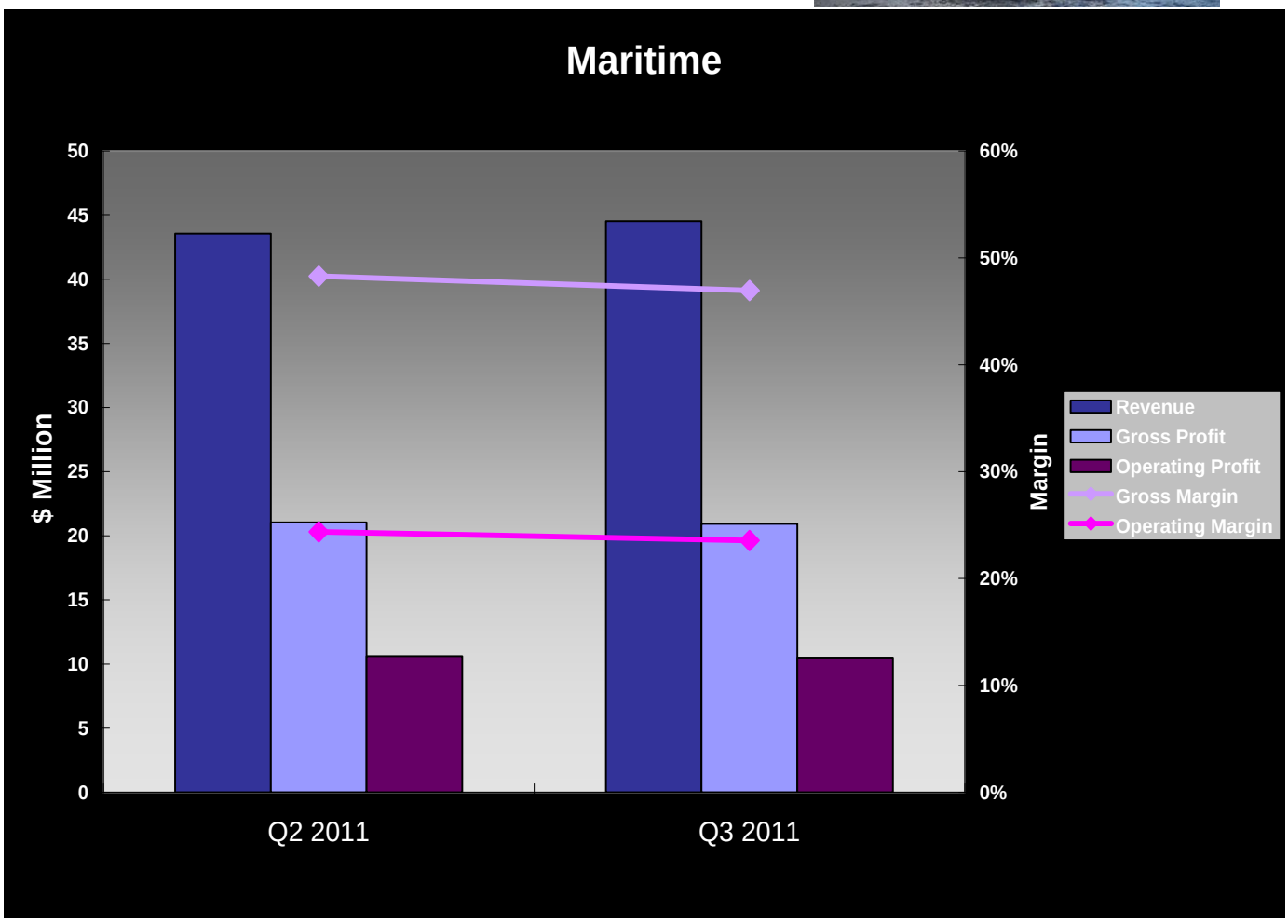
The firm currently operates two chemical vessels that transport chemicals, vegetable oils and molasses. Currently more than 90% of cargo is transported under a contract of Affreightment. This is a service contract under which a ship owner agrees to transport a specified quantity of fuel products or specialty 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.

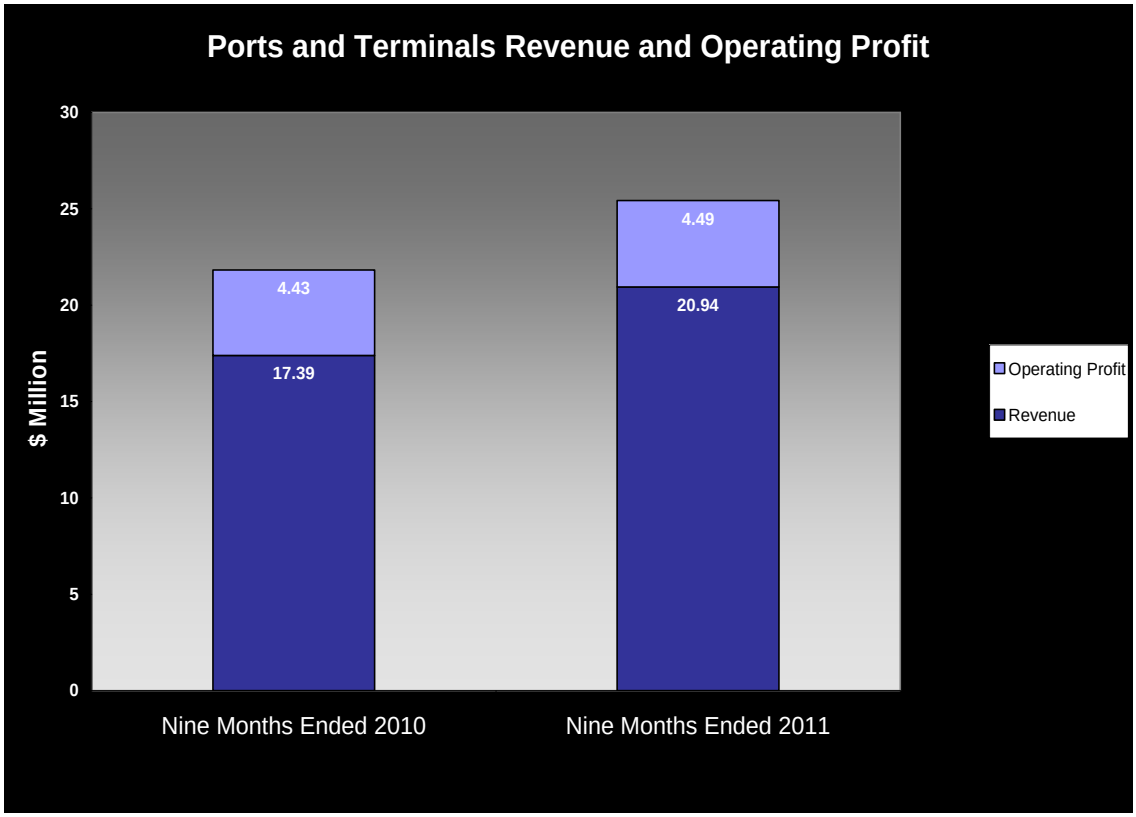




Ports and Terminals Operations. (10% of Total Revenue)

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. 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. (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.



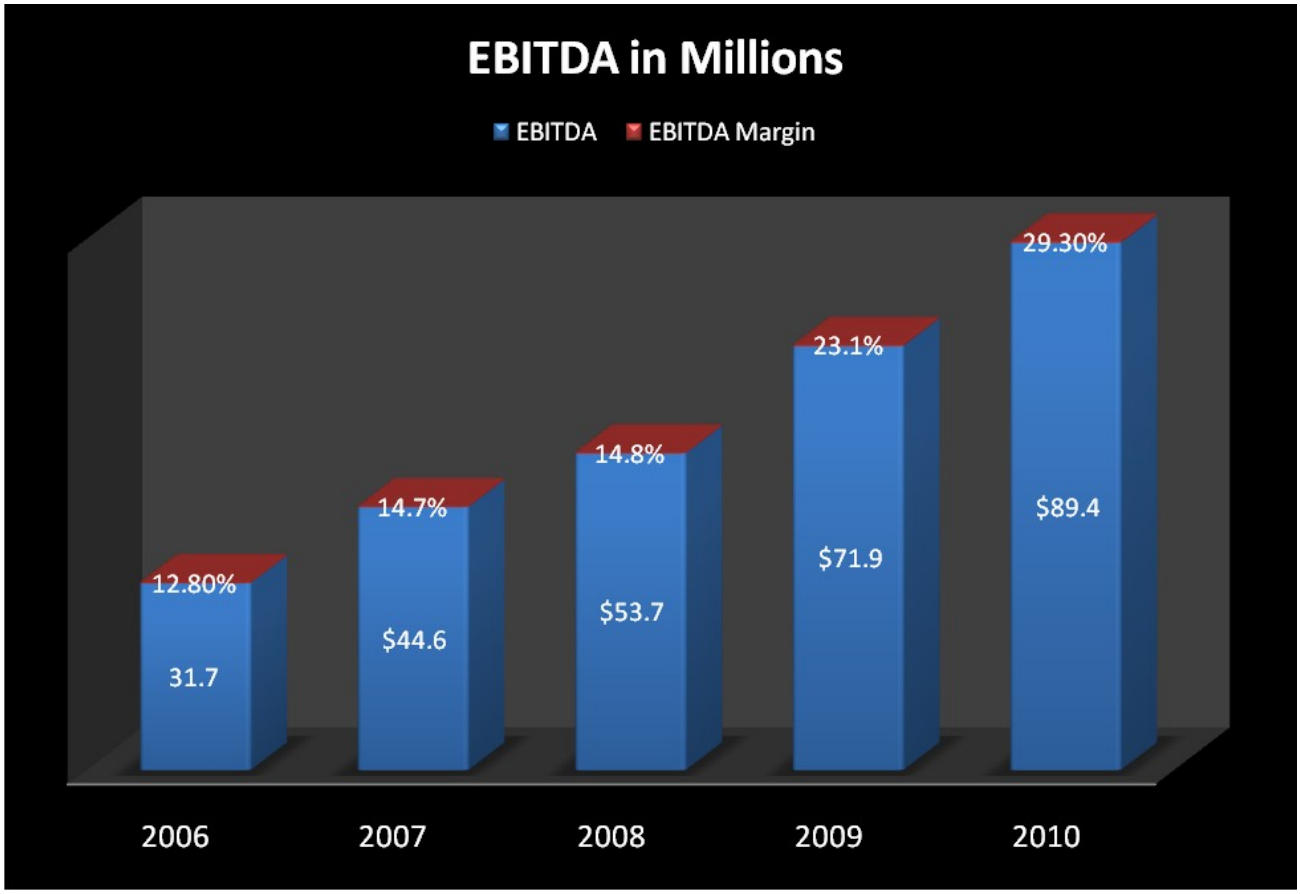
Growth Strategy

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. This 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.

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 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. 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 this trend has continued in 2011.

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.

Price to book value ratio is 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.

$$\text{P/B Ratio} = \frac{\text{Stock Price}}{\text{Total Assets - Intangible Assets and Liabilities}}$$

Metric	Grupo TMM	Industry Average
Price/Book Value	0.31	2.03

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	1.79

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

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

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Sep-10 Q3 10	Dec-10 Q4 10	Mar-11 Q1 11	Jun-11 Q2 11	Sep-11 Q3 11	Dec-11 Q4 11 E	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 E
REVENUE												
Net Revenue	**74.7**	**74.0**	**65.9**	**69.6**	**68.8**	**71.0**	**248.1**	**303.3**	**363.0**	**308.2**	**305.4**	**275.4**
Sequential Growth		*-1%*	*-11%*	*6%*	*-1%*	*3%*						
OPERATING EXPENSES												
Cost of Revenues	48.39	47.84	44.17	47.31	47.15	48.25	220.5	253.9	300.5	221.7	198.8	186.9
% of Revenue	*64.8%*	*64.6%*	*67.0%*	*67.9%*	*68.5%*	*68.0%*						
Gross Profit -	**26.3**	**26.2**	**21.8**	**22.3**	**21.7**	**22.8**	**27.7**	**49.4**	**62.4**	**86.5**	**106.6**	**88.5**
Proforma Gross Margin	*35.2%*	*35.4%*	*33.0%*	*32.1%*	*31.5%*	*32.0%*	*11.1%*	*16.3%*	*17.2%*	*28.1%*	*34.9%*	*32.1%*
Depreciation + Amort	13.81	18.89	13.08	13.64	12.71	13.50	16.5	25.7	33.8	44.6	59.5	52.9
% of Revenue	*18.5%*	*25.5%*	*19.8%*	*19.6%*	*18.5%*	*19.0%*	*6.7%*	*8.5%*	*9.3%*	*14.5%*	*19.5%*	*19.2%*
Corp Expenses	3.49	3.38	4.13	4.35	4.40	4.40	24.0	4.4	8.8	14.9	14	17
% of Revenue	*4.7%*	*4.6%*	*6.3%*	*6.2%*	*6.4%*	*6.2%*	*9.7%*	*1.4%*	*2.4%*	*4.8%*	*4.6%*	*6.3%*
Other Income (Expenses)-Net	(0.69)	(0.74)	0.79	6.39	1.47	(1.00)	-	-	-	0.48	3.09	7.64
% of Revenue												
Total Operating Expenses	18.00	23.01	16.42	11.60	15.64	18.90	40.53	30.01	42.55	58.92	70.40	62.55
% of Revenue	*24.1%*	*31.1%*	*24.9%*	*16.7%*	*22.7%*	*26.6%*	*16.3%*	*9.9%*	*11.7%*	*19.1%*	*23%*	*23%*
Operating Income -	**8.3**	**3.2**	**5.3**	**10.7**	**6.1**	**3.9**	**-12.9**	**19.3**	**19.9**	**27.5**	**36**	**26**
Operating Margin	*11.1%*	*4.3%*	*8.1%*	*15.4%*	*8.8%*	*5.4%*	*-5%*	*6%*	*5%*	*9%*	*12%*	*9%*
NON-OPERATING ITEMS												
Non operating Income/Expense	-34	-31	-47	-38	89	75	-55.8	-48.5	75.6	-118.3	-108	79
% of Revenue	*-45.48%*	*-41.97%*	*-70.93%*	*-54.73%*	*128.89%*	*105.63%*	*-22.50%*	*-16.00%*	*20.84%*	*-38.39%*	*-35.43%*	*28.63%*
Tax Provision	1.6	-2.1	0.4	2.4	3.2	2.2	-27.80	-0.84	20.09	1.7	1	8
Effective Tax Rate												
Net Income -	**-27.3**	**-25.78**	**-41.87**	**-29.76**	**91.63**	**76.65**	**-40.90**	**-28.35**	**75.44**	**-92.46**	**-73.03**	**96.65**
Net Income Margin	*-36.5%*	*-34.8%*	*-63.5%*	*-42.7%*	*133.1%*	*108.0%*	*-16.5%*	*-9.3%*	*20.8%*	*-30.0%*	*-24%*	*35%*
EARNINGS PER SHARE												
EPS - Basic	-$0.27	-$0.26	-$0.42	-$0.30	$0.90	$0.75	$1.23	-$1.17	$1.47	-$1.43	-$0.79	$0.93
EBITDA (in Millions)	$22.12	$22.08	$18.41	$24.37	$18.76	$17.35	$3.66	$44.99	$53.68	$72.09	$95.65	$78.89

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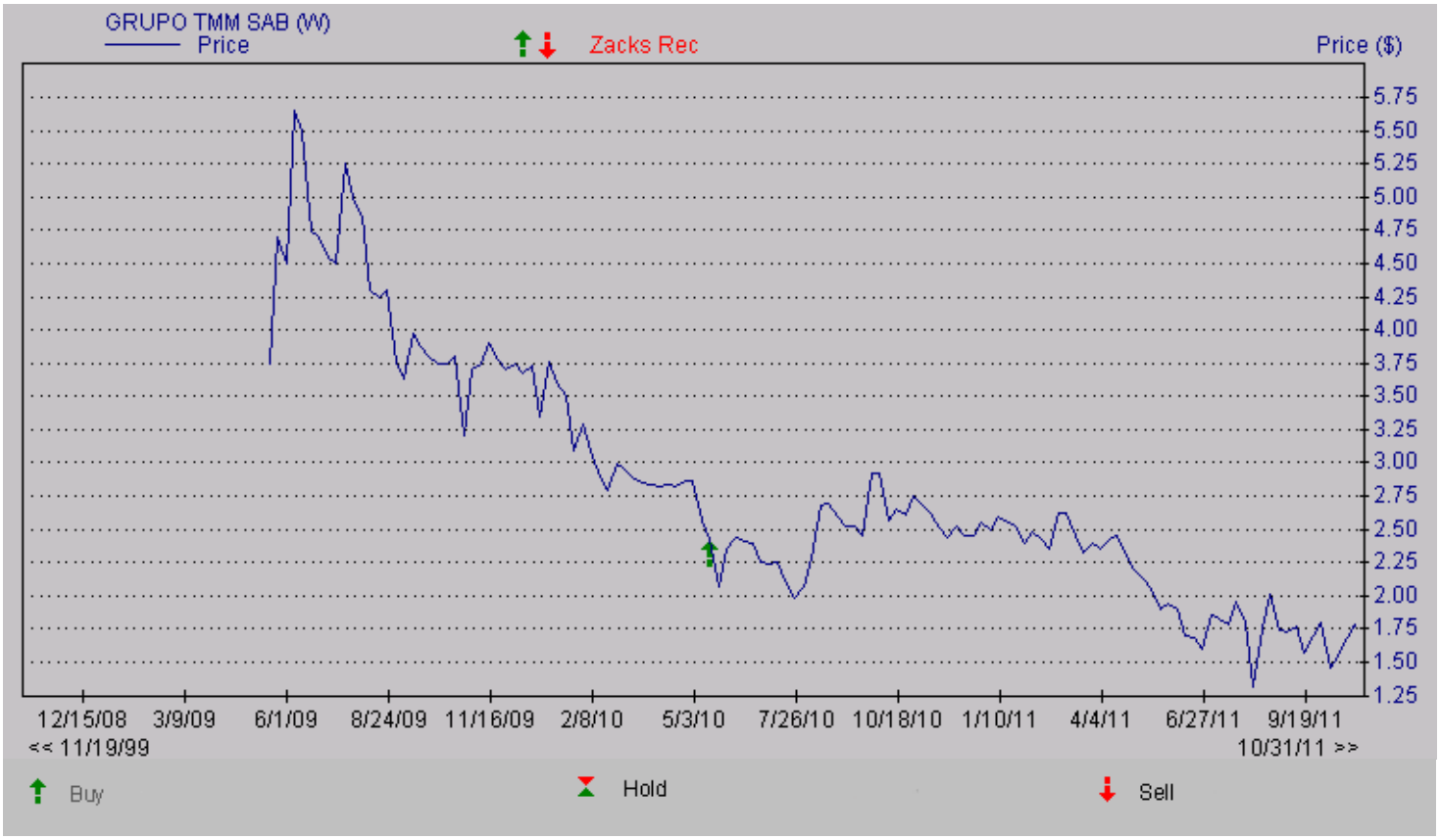
RISKS

- Despite medium and long-term contracts in place at the Maritime division, tariff volatility could impact operations
- The firm remains highly leveraged with $795 million in net debt.

HISTORICAL ZACKS RECOMMENDATIONS



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