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OCTOBER 22, 2019

KIRBY CORPORATION (KEX)

KEX Q3 Earnings Preview

Stalled Q3 Inland Pricing May Muddle KEX's Quarter

- **Inland & Coastal Color:** Pages 1-2
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KEX: Q3 Industry Color & Inland Barge Data. Heading into **KEX's** Q3 earnings call (10/25), we expect a focus on **1)** Inland barge pricing, and whether momentum has stalled into Q3 (**which our data suggests**), **2)** any signs of additional weakness or stabilization within its OFS (D&S) segment, and **3)** the impact of a potential filing/restructuring of its largest competitor (**ACLI**) in H120.

Inland Spot Pricing A Bit Softer Than Expected In Q3: Inland barge pricing (spot 30k bbl) looks a bit softer than we'd have expected in Q3 (down ~6.2% since ~July) – which we'd *tentatively* attribute to capacity re-entering the market *en masse* following elongated H119 weather issues. Inland utilization (always a fuzzy number) seems relatively tight (~95%), so the move down in pricing *seems* anomalous (at least in part) but it's something we'll be looking for color on from **KEX**. To be clear, we think **KEX** likely frames Q3 pricing as flat(ish), and given the overall level of pricing noise, and how much acquired capacity **KEX** continues to reprice (below), it wouldn't seem like *that* big of a stretch, but it does seem like momentum has stalled, at least momentarily. We've lowered our Q3 EPS to $0.72, from $0.74.

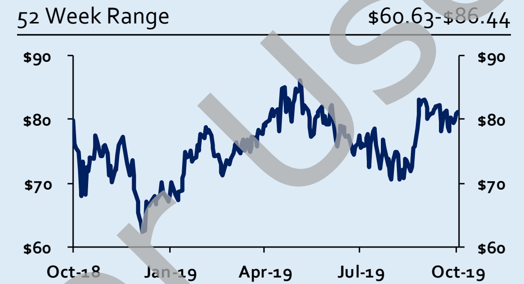
Additional Inland Dynamics: In addition to weather-related noise, we believe the effects of **KEX** repricing its recently acquired tonnage (Cenac, Targa, Higman, etc.) also continue to ripple through Q3 results. We also expect a growing focus on the impact that a *potential* **ACLI** filing/restructuring could have on the market. **ACLI** is **KEX's** largest Inland competitor, and could *feasibly* file and/or restructure in the next 2 quarters, which could either add or remove capacity from the market, depending on who we ask (we tend to think the latter).We believe **KEX** has kicked the tires on **ACLI's** ~400 tank barges, but seems to be standing pat, at least for now.

Are D&S Expectations Low Enough? After Q219 D&S revenue was down *14%* y/y ($367MM) with **KEX** guiding to another double-digit decline in Q3 while also cutting its FY guidance *14%* to $2.80-$3.20 (from $3.25-$3.75) – based largely on its D&S struggles. We're modeling in $35.2MM in 2020 D&S Operating Income (down 58% from our 2019 estimate of $84MM), and the question facing us and the market continues to be: *Is that low enough* – and how does the evolving macro backdrop (Saudi, IMO 2020, etc.) alter those expectations from here?

Price Target: $90 based on 24x our 2020e EPS of $3.68.

Stock Rating	**Outperform**
Price Target	**$90.00**
Current Price	**$81.46**
Upside/Downside	**10%**

52 Week Range $60.63-$86.44



Source: FactSet

Market Cap ($MM)	$4,873.6
Enterprise Value ($MM)	$6,603.0
Dividend Yield	N/A
CF Yield	1.0%
P/E (NTM)	22.2x
EV/EBITDA (NTM)	11.8x
Debt to Cap	31%

Corporate Governance Quartile	1st (Good)
Carbon Disclosure	No

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Coastal Keeps On Grinding. But H219 May Be A Bit Tricky: We expect **KEX's** Coastal segment to post flat-to-slightly positive operating margins amid its gradual recovery. While pricing seems roughly flat in Q3, with tonnage relatively well-balanced amid subdued volumes, our contacts indicate normal Sept/Oct seasonality may be pushed out to Nov after relatively disappointing late-Q3 volumes. That volume slippage into Q4 doesn't bode particularly well for **KEX** in Q4, as it's already guided to softer Q4 Coastal results amid increased maintenance activity on some of its larger barges. These dynamics probably don't move the needle for **KEX**, but bear watching, particularly within the context of muddled Q3/Q4 results within **KEX's** other segments.

While OFS and macro energy pressure has generally kept the stock in check over the long-term, we think **structural supply-side tailwinds** (*~0-1%* net Inland fleet growth and restricted production capacity) could help its core Inland business find a higher gear, and potentially drive upside over the long-term.

Raw Color From Industry Contacts

Inland

- Spot rates are flat to slightly softer since Q2.
  - 30kb spot $7,600/day ($8,100/day in July).
  - 30kb term $7,100/day ($7,400/day in July).
  - 30kb heated spot $8,700/day ($8,600/day in July).
  - 30kb heated term $8,200/day ($8,000/day in July).
- River conditions improved and unlocked trapped capacity.
- Demand remains strong.
  - Firmer momentum in 30k barges compared to 10k market (timing of petchem projects lagging 10ks).
- Supply is tight - Jeffboat shutdown and ongoing labor supply constraints greatly limiting capacity.
  - **Arcosa Madisonville facility targeting *12* deliveries in 2019 but will likely only complete *4*...**
    - Customers may seek liquidation damages.
    - Labor supply constraints severely limiting any efforts to ramp up production.
  - Yards mostly all booked through 2020/2021 and quoting peak-level prices for 30k barges ($3.2MM vs ~$2.6-2.7MM mid-cycle).
  - Rates have improved enough for operators to see positive cash flow - but nowhere near levels necessary to justify peak newbuild prices.
  - Net supply likely close to breaking even with scrapping.
  - Could see a shortage of barges in the next few years, potentially making the $3.2MM ask a new normal.
  - Risks to supply thesis are fairly muted. Labor supply constraints placing a tight cap on production - "there just aren't enough welders out there…it's not like you can just flex back to 2013 production levels."
    - e.g. Madisonville max capacity would be 18/year (2013 levels).
- Tug market also tight - Sub Chapter M regulation makes it more expensive to *maintain existing vessels* and EPA Tier 4 regulations makes it more expensive to *buy new vessels*.

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