Targa Resources Corp. (TRGP)

Updated May 21st, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$41	**5 Year CAGR Estimate:**	13.8%	**Volatility Percentile:**	80.9%
Fair Value Price:	$37	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	33.3%
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.1%	**Growth Percentile:**	66.4%
Dividend Yield:	8.9%	**5 Year Price Target**	$52	**Valuation Percentile:**	31.4%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	76.6%

Overview & Current Events

Targa Resources is a leading provider of midstream services and one of the largest independent midstream energy companies in North America. The company is primarily engaged in the business of gathering, processing, transporting and selling natural gas and natural gas liquids (NGLs). It also gathers and stores crude oil and refined products. Targa has a market capitalization of $9.8 billion.

Targa was adversely affected by the downturn of the energy market that began in 2014 and has hardly recovered, despite the rebound of the prices of natural gas and oil since early 2016. Its distributable cash flow per share is still 62% lower than it was in 2014. Moreover, its stock price plunged 90% from mid-2014 to early 2016 and is still 70% lower than it was before the downturn.

In early May, Targa reported (5/7/19) financial results for the first quarter of fiscal 2019. Revenue of $2.3 billion decreased 6% over last year's quarter and missed analysts' consensus by $170 million or 7%. As a result, the company switched from a profit of $22.9 million in last year's quarter to a loss of $38.9 million. Moreover, its distributable cash flow fell 9%, from $211.5 million to $196.7 million. The poor results resulted primarily from lower prices of natural gas and NGLs. Management reaffirmed previous guidance for approximately flat EBITDA this year and boasted of achieving record adjusted EBITDA of $313.9 million, which was 2% higher over last year's quarter. However, we are worried about the poor results and the high interest expense, which exceeded the operating income of Targa in the first quarter. We have thus revised our estimate for the distributable cash flow per share of this year from $4.20 to $4.10.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
CFPS	---	$3.93	$5.08	$5.67	$8.31	$10.76	$13.40	$2.68	$3.08	$4.06	***$4.10***	***$5.75***
DPS	---	$0.06	$1.21	$1.64	$2.21	$2.85	$3.53	$3.64	$3.64	$3.64	***$3.64***	***$4.00***
Shares	---	42.3	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	***250.0***	***300.0***

Midstream companies usually have more stable performance than upstream energy stocks. However, this has not been the case for Targa, which has a volatile performance record and has essentially failed to grow its cash flow per share since 2010. On the bright side, 2019 is a pivotal year for Targa, as many growth projects are coming online this year, such as additional gathering & processing facilities and another fractionator in Mont Belvieu. These projects will contribute significant, mostly fee-based cash flows to the company.

On the other hand, Targa has greatly diluted its unitholders in recent years and will continue to do so for the foreseeable future. In 2018, it diluted its stakeholders by 7%. In addition, it has an excessive debt load, with its net debt standing at $10.9 billion or 8*.0 times EBITDA* and its interest expense consuming all the operating income in the last four quarters. In January, Targa issued 10-year bonds at a 6.875% rate, which shows the desperation of the company for funds.

Nevertheless, in the absence of a recession or another downturn in the energy sector, we expect Targa to grow its cash flow per share by about 7% per year, from $4.10 this year to $5.75 in 2024, thanks to its growth projects.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/CF	---	6.7	6.5	8.1	8.3	10.8	5.7	14.7	16.1	12.1	***10.0***	***9.0***
Avg. Yld.	---	0.2%	3.7%	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	***8.9%***	***7.7%***

Targa is currently trading at a price-to-cash flow ratio of 10.0, which is almost equal to its historical average of 9.9. Due to the high leverage of Targa, we assume a fair ratio of 9.0 for this stock. If Targa approaches our fair valuation level over the next five years, it will incur a 2.1% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	1.5%	23.8%	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	***88.8%***	***69.6%***

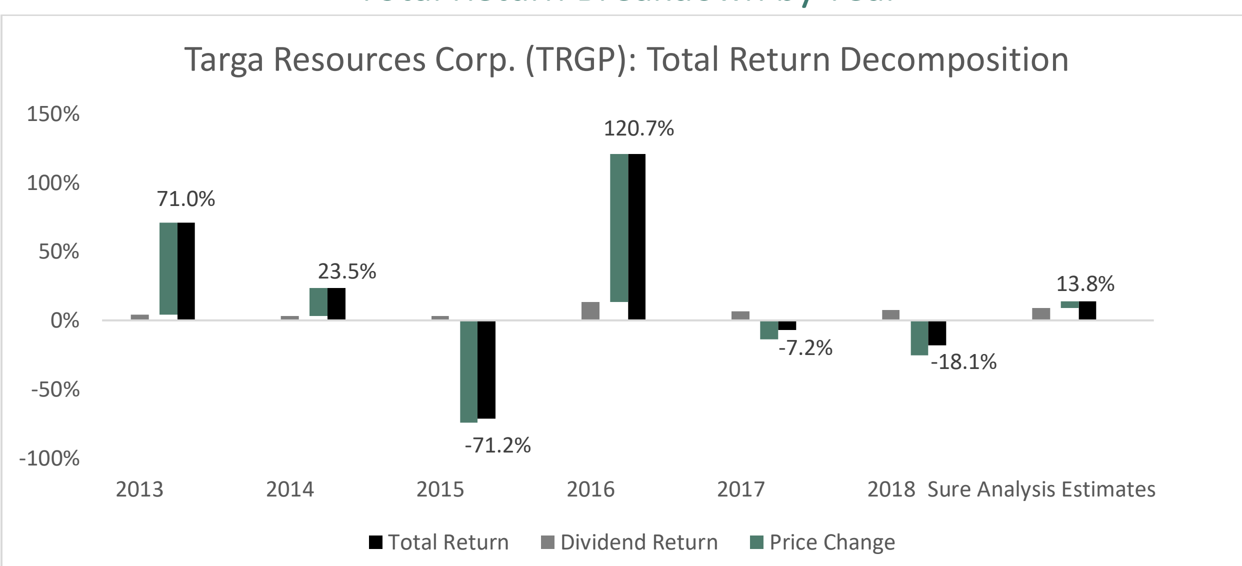
Thanks to its business-leading position, Targa benefits from the integration of its assets and some economies of scale. While this is a competitive advantage, the volatile performance record reveals the vulnerability of the company to the gyrations of commodity prices, which are beyond its control. Targa is a relatively risky security with an excessive debt pile. The company sold a 45% interest in Badlands for $1.6 billion in April so it will somewhat improve its financial metrics from next quarter but it still has a long way to go to achieve a strong balance sheet.

Targa offers a remarkable 8.9% dividend yield. However, its payout ratio exceeded 100% by a wide margin in 2016 and 2017 and currently stands at 89.7%. Additionally, given the high sensitivity of Targa to commodity prices, the dividend is likely to be cut in the event of a downturn, such as a recession or a strong decline in commodity prices.

Final Thoughts & Recommendation

In the absence of a recession and a downturn in the energy sector, Targa can offer a 13.8% average annual return over the next five years, mostly thanks to its 8.9% dividend. However, investors should be aware of its volatile performance and its high sensitivity to commodity prices and underlying economic growth. As a recession has not shown up for a whole decade, this is an important risk factor to consider, particularly given the high leverage of the company. We rate the stock as a hold but note this is a very high-risk security with an elevated chance of reducing its dividend in the future.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	4536	5476	6995	5679	6315	8617	6659	6691	8815	10484
Gross Profit	745	781	956	1007	1178	1624	1821	1768	1909	2246
Gross Margin	16.4%	14.3%	13.7%	17.7%	18.6%	18.8%	27.3%	26.4%	21.7%	21.4%
SG&A Exp.	120	144	136	140	152	148	162	187	203	257
D&A Exp.	169	175	181	198	272	351	645	758	810	816
Operating Profit	217	195	351	352	372	636	474	269	272	447
Operating Margin	4.8%	3.6%	5.0%	6.2%	5.9%	7.4%	7.1%	4.0%	3.1%	4.3%
Net Profit	29	-15	31	38	65	102	58	-187	54	2
Net Margin	0.6%	-0.3%	0.4%	0.7%	1.0%	1.2%	0.9%	-2.8%	0.6%	0.0%
Free Cash Flow	236	66	47	-155	-631	0	218	275	-358	-1971
Income Tax	21	23	27	37	48	68	40	-101	-397	6

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3368	3394	3831	5105	6049	6453	13211	12871	14389	16938
Cash & Equivalents	252	188	146	76	67	81	140	74	137	232
Accounts Receivable	404	467	576	515	659	567	516	675	828	866
Inventories	39	50	92	99	151	169	141	138	205	165
Goodwill & Int. Ass.	N/A	N/A	1	681	653	592	2227	1864	2422	2030
Total Liabilities	2613	2358	2500	3352	3957	3914	6961	7147	7633	9467
Accounts Payable	206	254	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Long-Term Debt	1606	1535	1567	2475	2989	3068	5938	4881	5053	6660
Shareholder's Equity	87	144	158	144	149	170	1461	5249	6160	6079
D/E Ratio	18.38	10.64	9.91	17.18	20.09	18.07	4.06	0.93	0.82	1.10

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.8%	-0.4%	0.8%	0.9%	1.2%	1.6%	0.6%	-1.4%	0.4%	0.0%
Return on Equity	26.4%	-12.9%	20.3%	25.2%	44.5%	64.2%	7.1%	-5.6%	0.9%	0.0%
ROIC	1.1%	-0.6%	1.1%	1.1%	1.4%	1.9%	0.7%	-1.6%	0.5%	0.0%
Shares Out.	---	42.3	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1
Revenue/Share	1193.7	842.48	168.95	135.86	149.99	204.67	124.23	43.33	42.60	46.76
FCF/Share	62.21	10.14	1.14	-3.70	-14.99	-0.01	4.06	1.78	-1.73	-8.79

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.