



Targa Resources Corp. (TRGP)

Updated February 25th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$38	5 Year CAGR Estimate:	9.6%	Market Cap:	\$8.8 B
Fair Value Price:	\$36	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	4/28/2020 ¹
% Fair Value:	106%	5 Year Valuation Multiple Estimate:	-1.1%	Dividend Payment Date:	5/13/2020
Dividend Yield:	9.6%	5 Year Price Target	\$42	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

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 \$8.8 billion.

Targa was adversely affected by the downturn of the energy market that began in 2014 and has hardly recovered since then. 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 about -70% lower than it was before the downturn.

In mid-February, Targa reported (2/20/20) financial results for the fourth quarter of fiscal 2019. In the quarter, adjusted EBITDA grew 33% over prior year's quarter, as the gathering & processing and downstream segments were assisted by the first full quarter of operations of Grand Prix NGL project. In the year, adjusted EBITDA grew 11%, to a record \$1.44 billion, while distributable cash flow rose 0.5% and resulted in a marginal dividend coverage ratio of 1.0. General & administrative expenses and operating costs rose 9% and 10%, respectively. Management expects approximately 18% adjusted EBITDA growth and about 80% of its operating income to be fee-based in 2020.

Targa completed about \$4.0 billion of growth projects last year. These projects are likely to improve the results of the company in the upcoming quarters. However, we are worried about the high operating costs and the high interest expense of Targa. Moreover, the focus of management on EBITDA instead of cash flows and earnings is a red flag.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
CFPS	\$3.93	\$5.08	\$5.67	\$8.31	\$10.76	\$13.40	\$2.68	\$3.08	\$4.06	\$4.07	\$4.00	\$4.64
DPS	\$0.06	\$1.21	\$1.64	\$2.21	\$2.85	\$3.53	\$3.64	\$3.64	\$3.64	\$3.64	\$3.64	\$3.70
Shares²	42.3	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	233.0	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 may prove a pivotal year for Targa, as many growth projects came online last year. 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 \$8.9 billion or about 6 *times EBITDA* and its interest expense consuming two-thirds of its operating income in the last four quarters. In 2019, Targa issued 10-year bonds at a 6.875% rate, which shows the desperation of Targa for funds. Due to the high leverage of Targa, we expect its cash flow per share to grow by 3% per year over the next five years.

¹ Estimated date.

² In millions.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/CF	6.7	6.5	8.1	8.3	10.8	5.7	14.7	16.1	12.1	9.7	9.5	9.0
Avg. Yld.	0.2%	3.7%	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	9.6%	8.9%

Targa is currently trading at a price-to-cash flow ratio of 9.5, which is very close 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 -1.1% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	1.5%	23.8%	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	91.0	79.8%

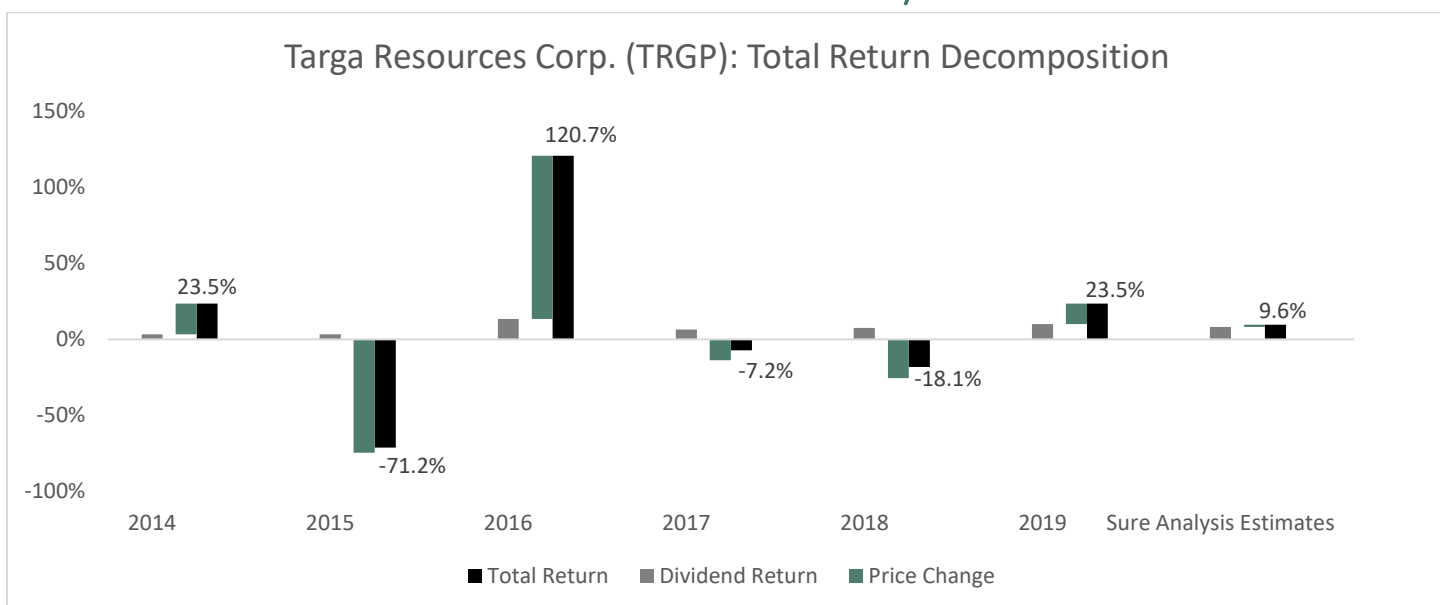
Thanks to its industry position, Targa benefits from the integration of its assets and some economies of scale. While this is a competitive advantage, the volatile performance record reveals the vulnerability of the company to the gyrations of commodity prices, which are beyond its control. Targa is a risky security with an excessive debt pile. The excessive leverage and the increasing operating and interest expenses of the company raise a red flag.

Targa offers a remarkable 9.6% dividend yield. However, its payout ratio exceeded 100% by a wide margin in 2016 and 2017 and currently stands at 89.3%. 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 could offer a 9.6% average annual return over the next five years, mostly thanks to its 9.6% dividend. However, investors should be aware of its volatile performance and its high sensitivity to commodity prices and underlying economic growth. In addition, the excessive leverage of the company renders the stock highly risky. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5476	6995	5679	6315	8617	6659	6691	8815	10484	8671
Gross Profit	781	956	1007	1178	1624	1821	1768	1909	2246	788
Gross Margin	14.3%	13.7%	17.7%	18.6%	18.8%	27.3%	26.4%	21.7%	21.4%	
SG&A Exp.	144	136	140	152	148	162	187	203	257	281
D&A Exp.	175	181	198	272	351	645	758	810	816	972
Operating Profit	195	351	352	372	636	474	269	272	447	436
Operating Margin	3.6%	5.0%	6.2%	5.9%	7.4%	7.1%	4.0%	3.1%	4.3%	
Net Profit	-15	31	38	65	102	58	-187	54	2	-209
Net Margin	-0.3%	0.4%	0.7%	1.0%	1.2%	0.9%	-2.8%	0.6%	0.0%	
Free Cash Flow	66	47	-155	-631	0	218	275	-358	-1971	-1488
Income Tax	23	27	37	48	68	40	-101	-397	6	-87.9

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3394	3831	5105	6049	6453	13211	12871	14389	16938	18815
Cash & Equivalents	188	146	76	67	81	140	74	137	232	331
Accounts Receivable	467	576	515	659	567	516	675	828	866	855
Inventories	50	92	99	151	169	141	138	205	165	162
Goodwill & Int. Ass.	N/A	1	681	653	592	2227	1864	2422	2030	1780
Total Liabilities	2358	2500	3352	3957	3914	6961	7147	7633	9467	10093
Accounts Payable	254	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	997
Long-Term Debt	1535	1567	2475	2989	3068	5938	4881	5053	6660	7784
Shareholder's Equity	144	158	144	149	170	1461	5249	6160	6079	4921
D/E Ratio	10.64	9.91	17.18	20.09	18.07	4.06	0.93	0.82	1.10	1.50

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	-0.4%	0.8%	0.9%	1.2%	1.6%	0.6%	-1.4%	0.4%	0.0%	-1.2%
Return on Equity	-12.9%	20.3%	25.2%	44.5%	64.2%	7.1%	-5.6%	0.9%	0.0%	-3.8%
ROIC	-0.6%	1.1%	1.1%	1.4%	1.9%	0.7%	-1.6%	0.5%	0.0%	-1.4%
Shares Out.	42.3	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	233.0
Revenue/Share	842.48	168.95	135.86	149.99	204.67	124.23	43.33	42.60	46.76	37.30
FCF/Share	10.14	1.14	-3.70	-14.99	-0.01	4.06	1.78	-1.73	-8.79	-6.4

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

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