Targa Resources Corp. (TRGP)

Updated November 16th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$21	**5 Year CAGR Estimate:**	11.6%	**Market Cap:**	$4.7 B
Fair Value Price:	$29	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/29/2020
% Fair Value:	73%	**5 Year Valuation Multiple Estimate:**	6.5%	**Dividend Payment Date:**	11/16/2020
Dividend Yield:	1.9%[1]	**5 Year Price Target**	$33	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**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 $4.7 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 -55% lower than it was in 2014. Moreover, its stock price plunged -90% from mid-2014 to early 2016 and is still -86% lower than it was before the downturn.

In early November, Targa reported (11/5/20) financial results for the third quarter of fiscal 2020. Adjusted EBITDA and distributable cash flow grew 20% and 28%, respectively, over last year's quarter, primarily thanks to contributions from new assets, which came online in the quarter. As the results of the company were affected by the pandemic less than we expected, we raised our forecast for annual distributable cash flow per share from $4.00 to $4.80. Moreover, management continues to expect adjusted EBITDA near the high end of its guidance of $1.5-$1.625 billion this year. Nevertheless, due to the pandemic, Targa has cut its quarterly dividend by -89% this year, from $0.91 to $0.10.

Targa completed about $4.0 billion of growth projects last year. We are worried about the high operating costs, the high interest expense of Targa and the unfortunate timing of these growth projects. Moreover, the focus of management on EBITDA instead of cash flows and earnings is a red flag. Furthermore, Targa has net debt of $8.5 billion. This amount is nearly double the market cap of the stock and thus it renders the stock risky in the event of a prolonged pandemic.

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	***$4.80***	***$5.56***
DPS	$0.06	$1.21	$1.64	$2.21	$2.85	$3.53	$3.64	$3.64	$3.64	$3.64	***$1.21***	***$0.72***
Shares[2]	42.3	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	***233.8***	***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 essentially failed to grow its cash flow per share in 2010-2019. On the bright side, Targa will have growth potential after the ongoing pandemic, 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 $8.5 billion or nearly 6 *times EBITDA* and its interest expense consuming 32% 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.

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[1] Forward dividend yield.

[2] In millions.

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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	***4.4***	***6.0***
Avg. Yld.	0.2%	3.7%	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	***1.9%***	***2.2%***

Targa is currently trading at a depressed price-to-cash flow ratio of 4.4, which is much lower than its historical average of 9.9. Due to the high leverage of Targa, we assume a fair ratio of 6.0 for this stock. If Targa approaches our fair valuation level over the next five years, it will enjoy a 6.5% annualized gain thanks to the expansion of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

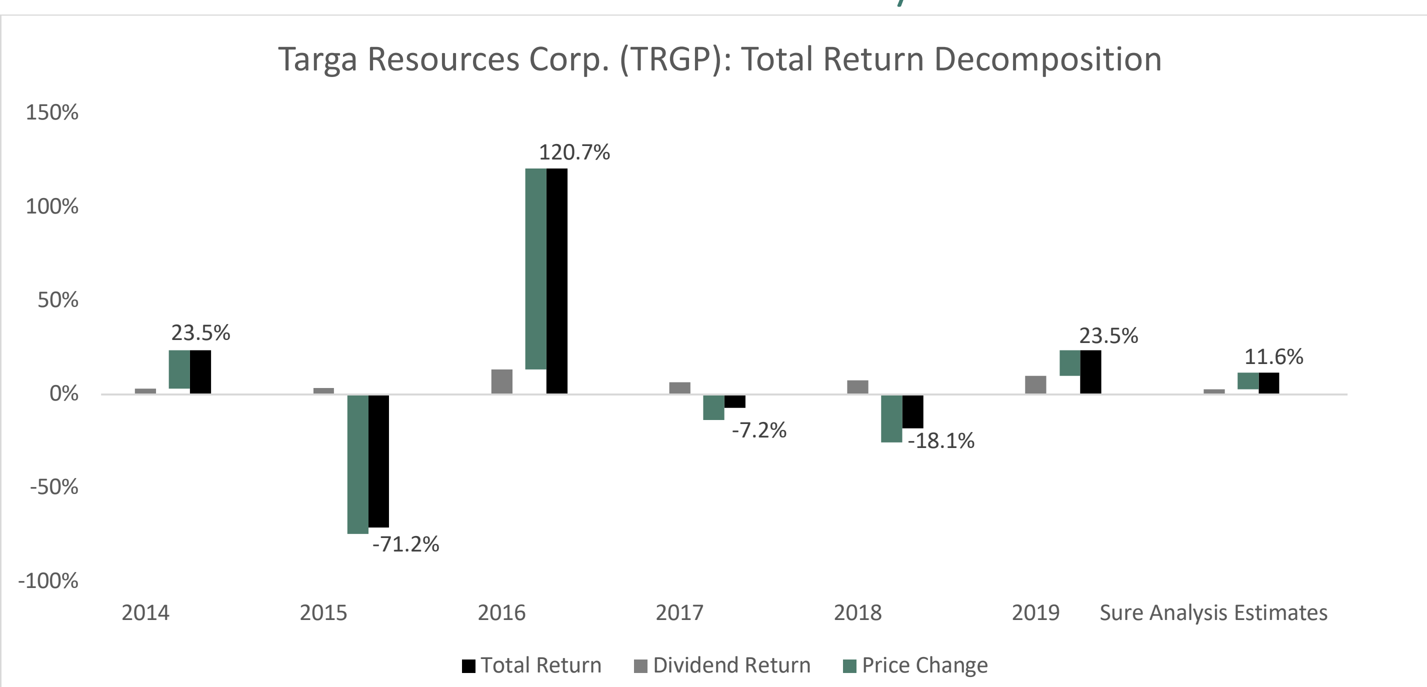
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	1.5%	23.8%	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	***8.3%***	***13.0%***

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 a high debt load. The excessive leverage and the high operating and interest expenses of the company raise a red flag and help explain the recent decimation of the dividend. If the ongoing recession lasts longer than expected, Targa will come under great pressure.

Final Thoughts & Recommendation

Due to the pandemic and its debt load, Targa is still -50% lower than it was in the beginning of the year. As a result, it could offer an 11.6% average annual return over the next five years. 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 risky. If the pandemic subsides next year, Targa could offer extraordinary returns, but the stock will be highly vulnerable if the pandemic lasts longer. We rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5,476	6,995	5,679	6,315	8,617	6,659	6,691	8,815	10,484	8,671
Gross Profit	336	487	496	529	786	637	457	476	708	788
Gross Margin	6.1%	7.0%	8.7%	8.4%	9.1%	9.6%	6.8%	5.4%	6.8%	9.1%
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	256	448	436
Operating Margin	3.6%	5.0%	6.2%	5.9%	7.4%	7.1%	4.0%	2.9%	4.3%	5.0%
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%	-2.4%
Free Cash Flow	66	47	(155)	(631)	(0)	218	275	(358)	(1,971)	(1,488)
Income Tax	23	27	37	48	68	40	(101)	(397)	6	(88)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3,394	3,831	5,105	6,049	6,453	13,211	12,871	14,389	16,938	18,815
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.	---	1	681	653	592	2,227	1,864	2,422	2,030	1,780
Total Liabilities	2,358	2,500	3,352	3,957	3,914	6,961	7,147	7,633	9,222	10,093
Accounts Payable	254	604	571	656	528	521	691	1,001	1,201	997
Long-Term Debt	1,535	1,567	2,475	2,989	3,068	5,938	4,881	5,053	6,660	7,784
Shareholder's Equity	144	158	144	149	170	1,461	5,249	6,160	6,079	4,921
D/E Ratio	10.64	9.91	17.18	20.09	18.07	4.06	0.93	0.82	1.05	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	-6.40

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