Targa Resources Corp. (TRGP)

Updated August 30st, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	0.0%	**Market Cap:**	$10.3 B
Fair Value Price:	$36	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/28/2021[1]
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.2%	**Dividend Payment Date:**	11/15/2021
Dividend Yield:	0.9%	**5 Year Price Target**	$42	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**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 $10.3 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 -53% 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 August, Targa reported (8/5/21) financial results for the second quarter of fiscal 2021. Adjusted EBITDA and distributable cash flow decreased -11% and -15%, respectively, over the previous quarter, as a non-recurring benefit from winter storm Uri in the first quarter more than offset the benefit from higher gathered and processed volumes as well as higher commodity prices. Nevertheless, thanks to the ongoing recovery from the pandemic, management raised its adjusted EBITDA guidance for the full year from $1.8-$1.9 billion to $1.9-$2.0 billion, thus implying 19% growth at the mid-point.

Due to the pandemic, Targa cut its quarterly dividend by -89% last year, from $0.91 to $0.10. Targa completed about $4.0 billion of growth projects in 2019. 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 $8.2 billion. This amount is nearly equal to the market cap of the stock and thus it renders the stock risky in the event of a prolonged pandemic or another downturn.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
CFPS	$5.08	$5.67	$8.31	$10.76	$13.40	$2.68	$3.08	$4.06	$4.07	$5.05	***$5.20***	***$6.03***
DPS	$1.21	$1.64	$2.21	$2.85	$3.53	$3.64	$3.64	$3.64	$3.64	$1.21	***$0.40***	***$0.72***
Shares[2]	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	***235.0***	***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 over the last decade. On the bright side, Targa will have growth potential after the ongoing pandemic, as many growth projects came online in 2019. 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. In addition, Targa has an excessive debt load, with its net debt standing at $8.2 billion or about 4.2 *times EBITDA* and its interest expense consuming 31% 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, we expect cash flow per share to grow by 3% per year.

[1] Estimated date.

[2] In millions.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/CF	6.5	8.1	8.3	10.8	5.7	14.7	16.1	12.1	9.7	4.1	***8.7***	***7.0***
Avg. Yld.	3.7%	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	5.8%	***0.9%***	***1.7%***

Targa is currently trading at a price-to-cash flow ratio of 8.7, which is lower than its historical average of 9.6. Due to the high leverage of Targa, we assume a fair ratio of 7.0 for this stock. If Targa approaches our fair valuation level over the next five years, it will incur a -4.2% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

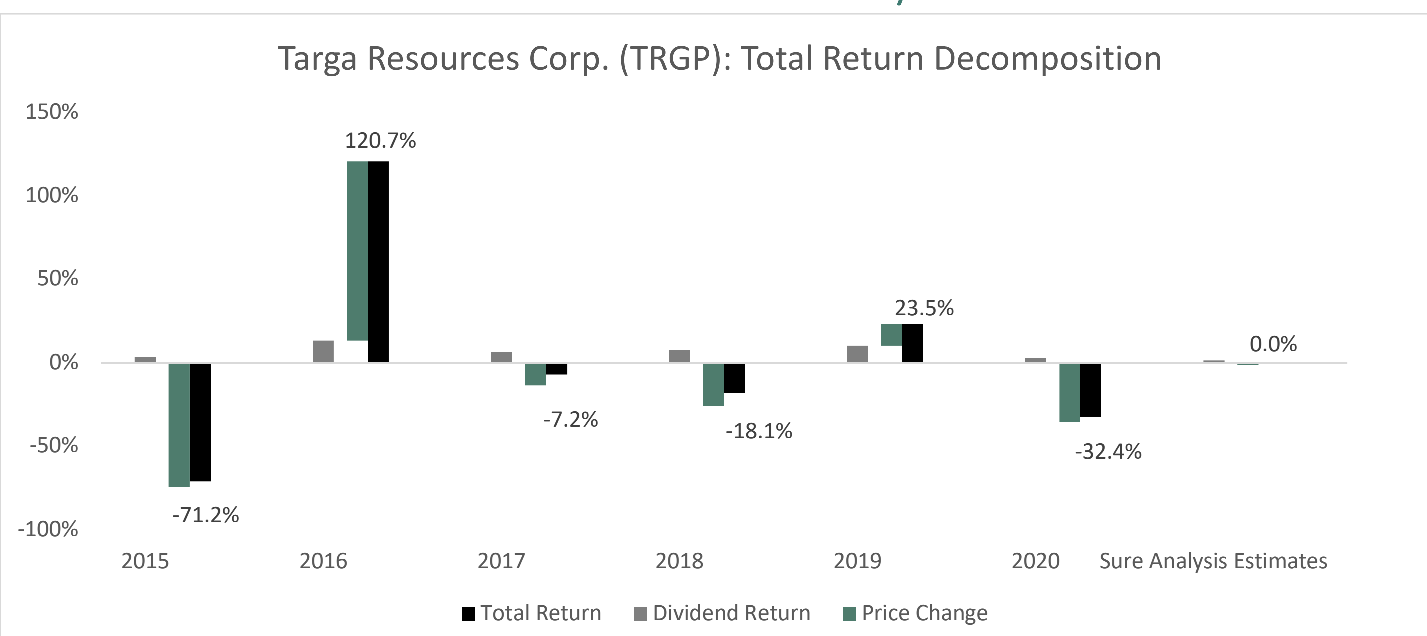
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	23.8%	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	24.0%	***7.7%***	***12.0%***

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 decimation of the dividend in 2020. The -90% plunge of the stock in the first month of the pandemic in 2020 is a testament to the risk of the stock. If the ongoing downturn extends beyond this year, Targa will come under pressure.

Final Thoughts & Recommendation

Thanks to the enthusiasm of the market over the massive distribution of vaccines, Targa has more tripled off its bottom, eleven months ago. The pandemic has begun to subside, but we expect Targa to offer a poor average annual return over the next five years. We also note the volatile performance of Targa and its extreme sensitivity to any development related to the pandemic. If the pandemic subsides soon, the stock of Targa could maintain its momentum, but it will be highly vulnerable if the pandemic takes a turn for the worse. We rate the stock as a sell.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	6,995	5,679	6,315	8,617	6,659	6,691	8,815	10,484	8,671	8,260
Gross Profit	775	809	906	1,273	1,177	1,010	1,099	1,430	1,581	2,290
Gross Margin	11.1%	14.2%	14.3%	14.8%	17.7%	15.1%	12.5%	13.6%	18.2%	27.7%
SG&A Exp.	136	140	152	148	162	187	203	257	281	255
D&A Exp.	181	198	272	351	645	758	810	816	972	865
Operating Profit	351	352	372	636	474	269	256	447	507	1,253
Operating Margin	5.0%	6.2%	5.9%	7.4%	7.1%	4.0%	2.9%	4.3%	5.8%	15.2%
Net Profit	31	38	65	102	58	(187)	54	2	(209)	(1,554)
Net Margin	0.4%	0.7%	1.0%	1.2%	0.9%	-2.8%	0.6%	0.0%	-2.4%	-18.8%
Free Cash Flow	47	(155)	(631)	(0)	218	275	(358)	(1,971)	(1,488)	793
Income Tax	27	37	48	68	40	(101)	(397)	6	(88)	(248)

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	3,831	5,105	6,049	6,453	13,211	12,871	14,389	16,938	18,815	15,876
Cash & Equivalents	146	76	67	81	140	74	137	232	331	243
Accounts Receivable	576	515	659	567	516	675	828	866	855	863
Inventories	92	99	151	169	141	138	205	165	162	182
Goodwill & Int. Ass.	1	681	653	592	2,227	1,864	2,422	2,030	1,735	1,382
Total Liabilities	2,500	3,352	3,957	3,914	6,961	7,147	7,633	9,222	10,372	9,973
Accounts Payable	604	571	656	528	521	691	1,001	1,201	955	834
Long-Term Debt	1,567	2,475	2,989	3,068	5,938	4,881	5,053	6,660	7,784	7,725
Shareholder's Equity	158	144	149	170	1,461	5,249	6,160	6,079	4,921	2,654
D/E Ratio	9.91	17.18	20.09	18.07	4.06	0.93	0.82	1.05	1.58	2.91

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.8%	0.9%	1.2%	1.6%	0.6%	-1.4%	0.4%	0.0%	-1.2%	-9.0%
Return on Equity	20.3%	25.2%	44.5%	64.2%	7.1%	-5.6%	0.9%	0.0%	-3.8%	-41.0%
ROIC	1.1%	1.1%	1.4%	1.9%	0.7%	-1.6%	0.5%	0.0%	-1.4%	-10.4%
Shares Out.	42.4	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2
Revenue/Share	168.95	135.86	149.99	204.67	124.23	43.33	42.60	46.76	37.30	35.57
FCF/Share	1.14	-3.70	-14.99	-0.01	4.06	1.78	-1.73	-8.79	-6.40	3.41

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