Targa Resources Corp. (TRGP)

Updated February 25th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	0.9%	**Market Cap:**	$14.0 B
Fair Value Price:	$49	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	4/28/2022
% Fair Value:	127%	**5 Year Valuation Multiple Estimate:**	-4.6%	**Dividend Payment Date:**	5/13/2022
Dividend Yield:	2.3%	**5 Year Price Target**	$57	**Years Of Dividend Growth:**	1
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	250%

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 $14.0 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 (DCF) per share is still -50% lower than it was in 2015. Moreover, its stock price plunged -90% from mid-2014 to early 2016 and is still -60% lower than it was before the downturn.

In late February, Targa reported (2/24/22) financial results for the fourth quarter of fiscal 2021. Adjusted EBITDA and distributable cash flow grew 30% and 43%, respectively, over the prior year's quarter thanks to higher realized commodity prices and higher gathered and processed volumes in the Permian Basin. Thanks to sustained business momentum, management issued strong guidance for 2022. It expects adjusted EBITDA of $2.3-$2.5 billion, implying 17% growth at the mid-point of the guidance. It also expects to invest $700-$800 million on new growth projects this year in order to keep fueling future growth.

Due to the pandemic, Targa cut its quarterly dividend by -89% in 2020, 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 net debt of $8.5 billion. The company is recovering strongly from the pandemic this year thanks to multi-year high commodity prices and contribution from new growth projects but it will be vulnerable whenever the next downturn shows up.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
CFPS	$5.67	$8.31	$10.76	$13.40	$2.68	$3.08	$4.06	$4.07	$5.05	$6.74	***$7.00***	***$8.11***
DPS	$1.64	$2.21	$2.85	$3.53	$3.64	$3.64	$3.64	$3.64	$1.21	$0.40	***$1.40***	***$1.79***
Shares[1]	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	***228.0***	***400.0***

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 hardly grown its cash flow per share over the last decade. On the bright side, Targa will have growth potential after the pandemic, as many growth projects have come online in the last three years. These projects will contribute significant, mostly fee-based cash flows to the company.

On the other hand, Targa has greatly diluted its unitholders in the last decade. It also has a material debt load, with its net debt standing at $8.5 billion or about 4.2 *times last year's elevated EBITDA* and its interest expense consuming 30% of its operating income in the last 12 months. 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] 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/CF	8.1	8.3	10.8	5.7	14.7	16.1	12.1	9.7	4.1	6.2	***8.9***	***7.0***
Avg. Yld.	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	5.8%	1.0%	***2.3%***	***3.1%***

Targa is currently trading at a price-to-cash flow ratio of 8.9, which is lower than its historical average of 9.6. Due to the high leverage and cyclicality of Targa, we assume a fair ratio of 7.0 for the stock. If Targa reaches our fair valuation level over the next five years, it will incur a -4.6% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

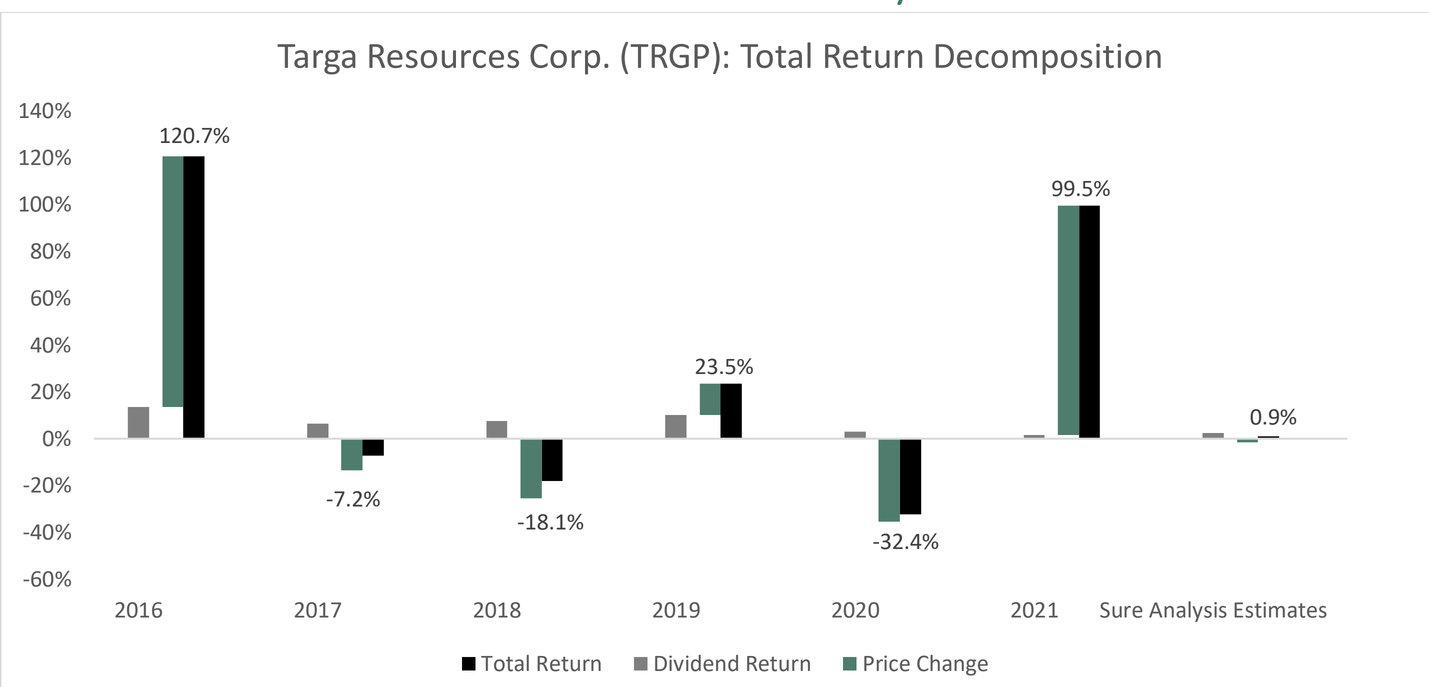
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	24.0%	5.9%	***20.0%***	***22.0%***

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 material debt load. The high 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. Whenever the next downturn in the energy sector shows up, Targa will come under pressure.

Final Thoughts & Recommendation

Thanks to the enthusiasm of the market over the strong recovery from the pandemic, Targa has nearly doubled in the last 12 months. The short-term momentum is positive for Targa. However, we expect the stock to offer a poor average annual return over the next five years due to its volatile performance and its extreme sensitivity to downturns in the energy sector. We rate the stock as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

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

Profitability & Per Share Metrics

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