Targa Resources Corp. (TRGP)

Updated August 26th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$72	**5 Year CAGR Estimate:**	0.9%	**Market Cap:**	$16.1 B
Fair Value Price:	$58	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/27/2022[1]
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.2%	**Dividend Payment Date:**	11/14/2022
Dividend Yield:	1.9%	**5 Year Price Target**	$67	**Years Of Dividend Growth:**	1
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Sell

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 $16.1 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 much lower than it was in 2015. Moreover, its stock price plunged -90% from mid-2014 to early 2016 and is still -55% lower than it was before the downturn.

On June 16th, 2022, Targa announced that it agreed to acquire Lucid Energy for $3.55 billion in cash. Lucid provides natural gas gathering, treating and processing services in the Delaware Basin, with more than 1,000 miles of natural gas pipelines. Targa expects the deal to be immediately accretive to its cash flows.

In early August, Targa reported (8/4/22) financial results for the second quarter of fiscal 2022. Adjusted EBITDA and distributable cash flow grew 45% and 57%, respectively, over the prior year's quarter thanks to much higher realized commodity prices and record gathered and processed volumes in the Permian Basin. Thanks to sustained business momentum, management raised its guidance for adjusted annual EBITDA from at least $2.5 billion to $2.85-$2.95 billion, implying 37% growth at the mid-point.

Due to the pandemic, Targa cut its quarterly dividend by -89% in 2020, from $0.91 to $0.10. Targa has net debt of $9.1 billion but it can more readily service its debt now that some growth projects have begun to generate cash flows.

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	***$8.30***	***$9.62***
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[2]	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	***240.0***	***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 markedly volatile performance record throughout 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 $9.1 billion or about 4.4 *times last year's elevated EBITDA* and its interest expense consuming 25% 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] Estimated date.

[2] In millions.

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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	***8.7***	***7.0***
Avg. Yld.	3.6%	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	5.8%	1.0%	***1.9%***	***2.7%***

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 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 -4.2% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

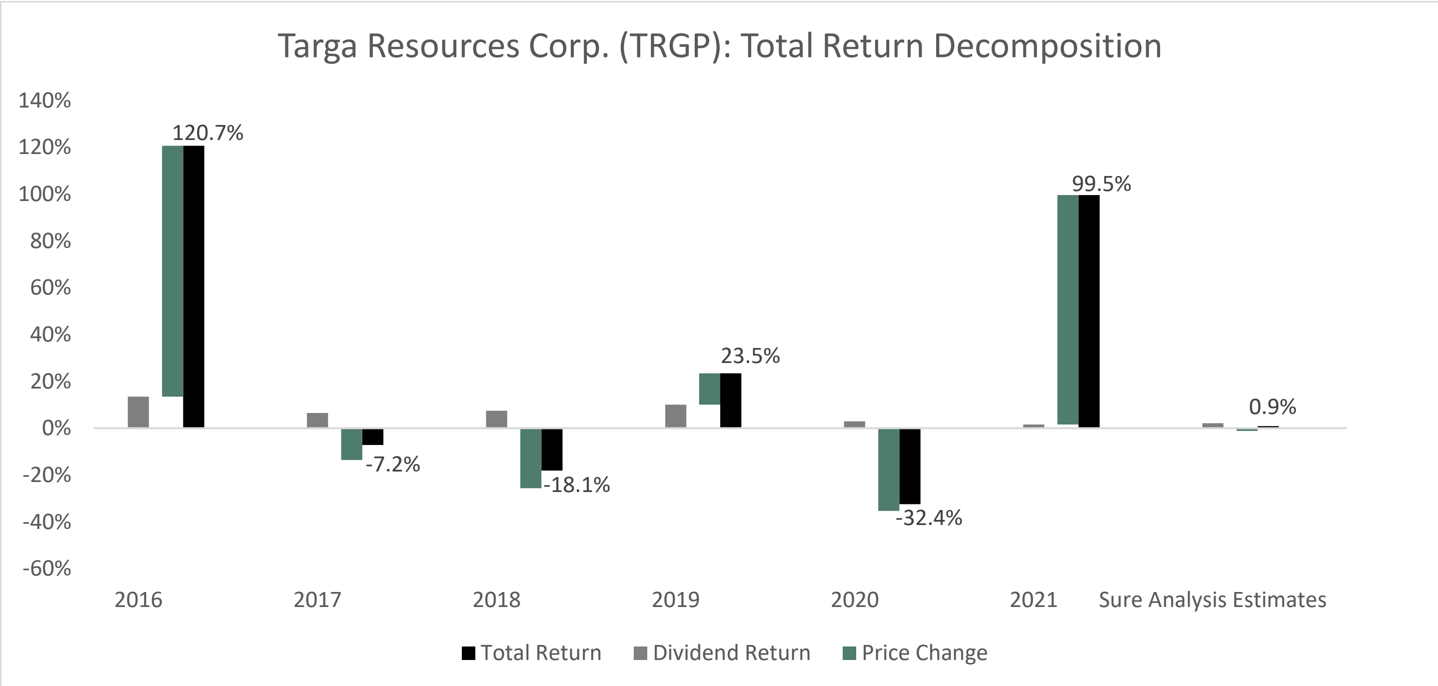
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	28.9%	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	24.0%	5.9%	***16.9%***	***18.6%***

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 rallied 40% in the last 12 months. As such, we expect the stock to offer just a 0.9% average annual return over the next five years, as its 3.0% growth and its 1.9% dividend may be offset by a -4.2% valuation headwind. Given also 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	2021
Revenue	5,679	6,315	8,617	6,659	6,691	8,815	10,484	8,671	8,260	16,950
Gross Profit	809	906	1,273	1,177	1,010	1,099	1,430	1,581	2,290	2,350
Gross Margin	14.2%	14.3%	14.8%	17.7%	15.1%	12.5%	13.6%	18.2%	27.7%	13.9%
SG&A Exp.	140	152	148	162	187	203	257	281	255	273
D&A Exp.	198	272	351	645	758	810	816	972	865	871
Operating Profit	352	372	636	474	269	256	447	507	1,253	1,329
Operating Margin	6.2%	5.9%	7.4%	7.1%	4.0%	2.9%	4.3%	5.8%	15.2%	7.8%
Net Profit	38	65	102	58	(187)	54	2	(209)	(1,554)	71
Net Margin	0.7%	1.0%	1.2%	0.9%	-2.8%	0.6%	0.0%	-2.4%	-18.8%	0.4%
Free Cash Flow	(155)	(631)	(0)	218	275	(358)	(1,971)	(1,488)	793	1,798
Income Tax	37	48	68	40	(101)	(397)	6	(88)	(248)	15

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	5,105	6,049	6,453	13,211	12,871	14,389	16,938	18,815	15,876	15,208
Cash & Equivalents	76	67	81	140	74	137	232	331	243	159
Accounts Receivable	515	659	567	516	675	828	866	855	863	1,332
Inventories	99	151	169	141	138	205	165	162	182	153
Goodwill & Int. Ass.	681	653	592	2,227	1,864	2,422	2,030	1,735	1,382	1,095
Total Liabilities	3,352	3,957	3,914	6,961	7,147	7,633	9,222	10,372	9,973	10,030
Accounts Payable	571	656	528	521	691	1,001	1,201	955	834	1,402
Long-Term Debt	2,475	2,989	3,068	5,938	4,881	5,053	6,660	7,784	7,725	6,571
Shareholder's Equity	144	149	170	1,461	5,249	6,160	6,079	4,921	2,654	2,012
D/E Ratio	17.18	20.09	18.07	4.06	0.93	0.82	1.05	1.58	2.91	3.27

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.9%	1.2%	1.6%	0.6%	-1.4%	0.4%	0.0%	-1.2%	-9.0%	0.5%
Return on Equity	25.2%	44.5%	64.2%	7.1%	-5.6%	0.9%	0.0%	-3.8%	-41.0%	3.1%
ROIC	1.1%	1.4%	1.9%	0.7%	-1.6%	0.5%	0.0%	-1.4%	-10.4%	0.6%
Shares Out.	42.3	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6
Revenue/Share	135.86	149.99	204.67	124.23	43.33	42.60	46.76	37.30	35.57	74.15
FCF/Share	-3.70	-14.99	-0.01	4.06	1.78	-1.73	-8.79	-6.40	3.41	7.86

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