Targa Resources Corp. (TRGP)

Updated November 3rd, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	$90	**5 Year CAGR Estimate:**	3.5%	**Market Cap:**	$20.0 B
Fair Value Price:	$82	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/30/2023
% Fair Value:	110%	**5 Year Valuation Multiple Estimate:**	-1.9%	**Dividend Payment Date:**	11/15/2023
Dividend Yield:	2.2%	**5 Year Price Target**	$95	**Years Of Dividend Growth:**	2
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Hold

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 $20.0 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 lower than it was in 2015. Moreover, its stock price plunged -90% from mid-2014 to early 2016 and is still -33% lower than it was before the downturn.

On July 29th, 2022, Targa acquired 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 has stated that the deal has already been accretive to its cash flows.

In early November, Targa reported (11/2/23) financial results for the third quarter of fiscal 2023. Adjusted EBITDA and distributable cash flow grew 6% and 1%, respectively, over the prior year's quarter thanks to record NGL transportation volumes but they marked a sharp deceleration vs. previous quarters, as the effect of the acquisition of the 25% stake in Grand Prix NGL Pipeline somewhat abated. Management reiterated its strong guidance for 2023, expecting adjusted EBITDA of $3.5-$3.7 billion, thus implying 24% growth at the mid-point. We expect 8-year high cash flow per share of $11.70 this year, primarily thanks to the contribution of recently completed growth projects.

Due to the pandemic, Targa cut its quarterly dividend by -89% in 2020 but it has raised its dividend twice since then. It has net debt of $13.8 billion but it can service its debt thanks to the cash flows from recently completed projects.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
CFPS	$8.31	$10.76	$13.40	$2.68	$3.08	$4.06	$4.07	$5.05	$6.74	$9.86	***$11.70***	***$13.56***
DPS	$2.21	$2.85	$3.53	$3.64	$3.64	$3.64	$3.64	$1.21	$0.40	$1.40	***$2.00***	***$2.60***
Shares[1]	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	229.9	***231.0***	***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 currently has decent growth prospects, 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 $13.8 billion or about 4.5 *times last year's EBITDA* and its interest expense consumes 25% of its operating income. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/CF	8.3	10.8	5.7	14.7	16.1	12.1	9.7	4.1	6.2	7.0	***7.7***	***7.0***
Avg. Yld.	3.2%	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	5.8%	1.0%	2.0%	***2.2%***	***2.7%***

Targa is currently trading at a price-to-cash flow ratio of 7.7, which is lower than its historical average of 9.5. Due to the high leverage and cyclicality of Targa, we assume a fair ratio of 7.0 for the stock. If Targa trades at our fair valuation level in five years, it will incur a -1.9% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

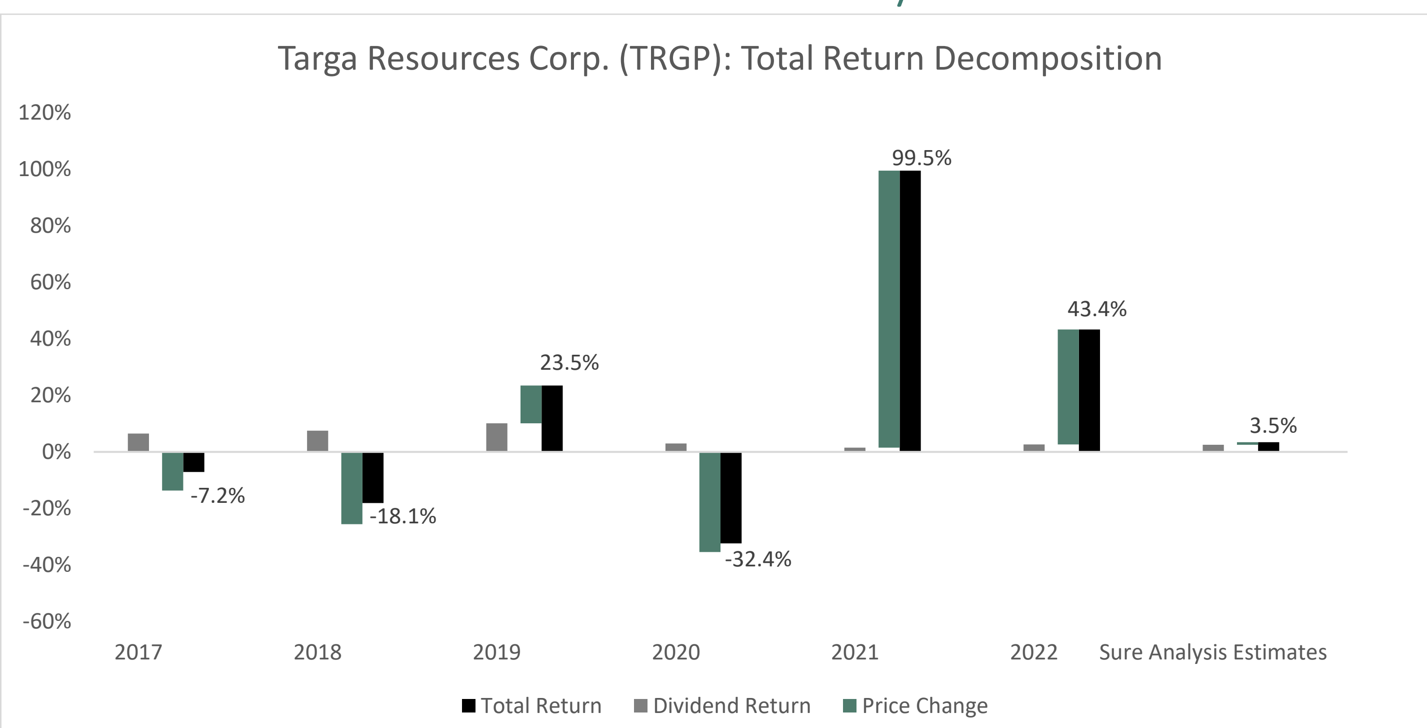
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	26.6%	26.5%	33.9%	136%	118%	89.7%	89.3%	24.0%	5.9%	14.2%	***17.1%***	***19.2%***

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

Targa has rallied 28% this year thanks to its positive business momentum. It could offer a 3.5% average annual return over the next five years thanks to 3.0% growth and its 2.2% dividend, partly offset by a -1.9% valuation headwind. It thus receives a hold rating but we note its volatile performance and its extreme sensitivity to downturns in the energy sector.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	6,315	8,617	6,659	6,691	8,815	10,484	8,671	8,260	16,950	20,930
Gross Profit	906	1,273	1,177	1,010	1,099	1,430	1,581	2,290	2,350	2,952
Gross Margin	14.3%	14.8%	17.7%	15.1%	12.5%	13.6%	18.2%	27.7%	13.9%	14.1%
SG&A Exp.	152	148	162	187	203	257	281	255	273	310
D&A Exp.	272	351	645	758	810	816	972	865	871	1,096
Operating Profit	372	636	474	269	256	447	507	1,253	1,329	1,729
Operating Margin	5.9%	7.4%	7.1%	4.0%	2.9%	4.3%	5.8%	15.2%	7.8%	8.3%
Net Profit	65	102	58	(187)	54	2	(209)	(1,554)	71	1,196
Net Margin	1.0%	1.2%	0.9%	-2.8%	0.6%	0.0%	-2.4%	-18.8%	0.4%	5.7%
Free Cash Flow	(631)	(0)	218	275	(358)	(1,971)	(1,488)	793	1,798	1,047
Income Tax	48	68	40	(101)	(397)	6	(88)	(248)	15	132

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	6,049	6,453	13,211	12,871	14,389	16,938	18,815	15,876	15,208	19,560
Cash & Equivalents	67	81	140	74	137	232	331	243	159	219
Accounts Receivable	659	567	516	675	828	866	855	863	1,332	1,408
Inventories	151	169	141	138	205	165	162	182	153	394
Goodwill & Int. Ass.	653	592	2,227	1,864	2,422	2,030	1,735	1,382	1,095	2,735
Total Liabilities	3,957	3,914	6,961	7,147	7,633	9,222	10,372	9,973	10,030	14,578
Accounts Payable	656	528	521	691	1,001	1,201	955	834	1,402	1,449
Long-Term Debt	2,989	3,068	5,938	4,881	5,053	6,660	7,784	7,725	6,571	11,309
Shareholder's Equity	149	170	1,461	5,249	6,160	6,079	4,921	2,654	2,012	2,666
D/E Ratio	20.09	18.07	4.06	0.93	0.82	1.05	1.58	2.91	3.27	4.24

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.2%	1.6%	0.6%	-1.4%	0.4%	0.0%	-1.2%	-9.0%	0.5%	6.9%
Return on Equity	44.5%	64.2%	7.1%	-5.6%	0.9%	0.0%	-3.8%	-41.0%	3.1%	51.1%
ROIC	1.4%	1.9%	0.7%	-1.6%	0.5%	0.0%	-1.4%	-10.4%	0.6%	8.3%
Shares Out.	42.2	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	231.1
Revenue/Share	149.99	204.67	124.23	43.33	42.60	46.76	37.30	35.57	74.15	90.57
FCF/Share	-14.99	-0.01	4.06	1.78	-1.73	-8.79	-6.40	3.41	7.86	4.53

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

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