Targa Resources Corp. (TRGP)

Updated February 28th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$97	**5 Year CAGR Estimate:**	5.8%	**Market Cap:**	$21.8 B
Fair Value Price:	$87	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date[1]:**	4/25/2024
% Fair Value:	112%	**5 Year Valuation Multiple Estimate:**	-2.2%	**Dividend Payment Date:**	5/13/2024
Dividend Yield:	3.1%	**5 Year Price Target**	$111	**Years Of Dividend Growth:**	3
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. It has the largest gathering and processing position in the Permian Basin and a market capitalization of $21.8 billion.

Targa was adversely affected by the downturn of the energy market in 2014-2016 and has not fully 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 -28% 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 mid-February, Targa reported (2/15/24) financial results for the fourth quarter of fiscal 2023. Adjusted EBITDA and distributable cash flow grew 14% and 8%, respectively, over the prior year's quarter thanks to higher volumes in gathering and processing. Management provided strong guidance for 2024, expecting adjusted EBITDA of $3.7-$3.9 billion, thus implying 8% growth at the mid-point. We expect 9-year high cash flow per share of $12.40 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 three times since then. Management just raised the quarterly dividend from $0.50 to $0.75 and stated that it expects to keep raising the dividend for many more years. Targa has net debt of $14.5 billion but it can service its debt thanks to the cash flows from recently completed projects.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
CFPS	$10.76	$13.40	$2.68	$3.08	$4.06	$4.07	$5.05	$6.74	$9.86	$11.53	***$12.40***	***$15.83***
DPS	$2.85	$3.53	$3.64	$3.64	$3.64	$3.64	$1.21	$0.40	$1.40	$1.85	***$3.00***	***$3.90***
Shares[2]	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	229.9	224.5	***225.0***	***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 four years and the company has a long pipeline of growth projects. 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 $14.5 billion or about 4.1 *times last year's EBITDA* and its interest expense consumes 28% of its

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[1] Estimated date.

[2] 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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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 5% per year.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/CF	10.8	5.7	14.7	16.1	12.1	9.7	4.1	6.2	7.0	6.8	***7.8***	***7.0***
Avg. Yld.	2.5%	4.6%	9.2%	7.3%	7.4%	9.2%	5.8%	1.0%	2.0%	2.3%	***3.1%***	***3.5%***

Targa is currently trading at a price-to-cash flow ratio of 7.8, 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 -2.2% annualized drag due to the contraction of its cash flow multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

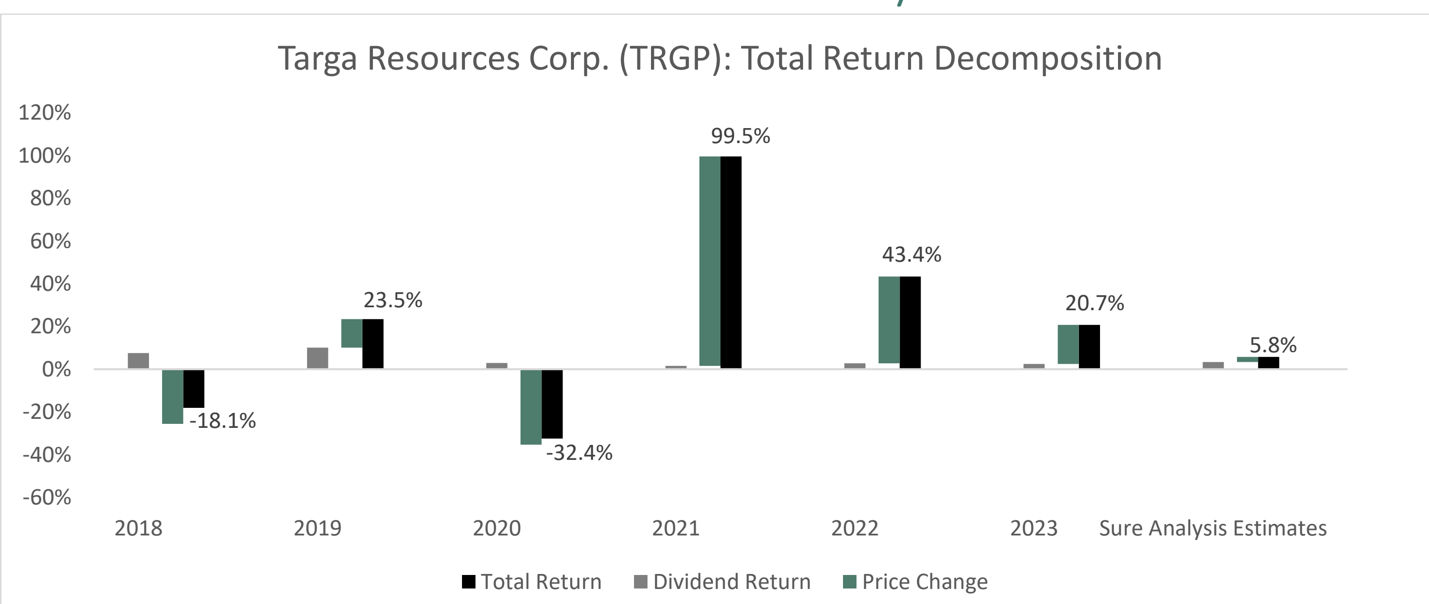
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	26.5%	33.9%	136%	118%	89.7%	89.3%	24.0%	5.9%	14.2%	16.0%	***24.2%***	***24.7%***

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 29% in the last 12 months thanks to its positive business momentum. It could offer a 5.8% average annual return over the next five years thanks to 5.0% growth and its 3.1% dividend, partly offset by a -2.2% valuation headwind. It thus receives a hold rating. Targa is likely to keep growing its cash flows significantly thanks to its pipeline of growth projects 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	8,617	6,659	6,691	8,815	10,484	8,671	8,260	16,950	20,930	16,060
Gross Profit	1,273	1,177	1,010	1,099	1,430	1,581	2,290	2,350	2,952	4,054
Gross Margin	14.8%	17.7%	15.1%	12.5%	13.6%	18.2%	27.7%	13.9%	14.1%	25.2%
SG&A Exp.	148	162	187	203	257	281	255	273	310	349
D&A Exp.	351	645	758	810	816	972	865	871	1,096	1,330
Operating Profit	636	474	269	256	447	507	1,253	1,329	1,729	2,626
Operating Margin	7.4%	7.1%	4.0%	2.9%	4.3%	5.8%	15.2%	7.8%	8.3%	16.4%
Net Profit	102	58	(187)	54	2	(209)	(1,554)	71	1,196	1,346
Net Margin	1.2%	0.9%	-2.8%	0.6%	0.0%	-2.4%	-18.8%	0.4%	5.7%	8.4%
Free Cash Flow	(0)	218	275	(358)	(1,971)	(1,488)	793	1,798	1,047	826
Income Tax	68	40	(101)	(397)	6	(88)	(248)	15	132	363

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	6,453	13,211	12,871	14,389	16,938	18,815	15,876	15,208	19,560	20,672
Cash & Equivalents	81	140	74	137	232	331	243	159	219	142
Accounts Receivable	567	516	675	828	866	855	863	1,332	1,408	1,471
Inventories	169	141	138	205	165	162	182	153	394	372
Goodwill & Int. Ass.	592	2,227	1,864	2,422	2,030	1,735	1,382	1,095	2,735	2,351
Total Liabilities	3,914	6,961	7,147	7,633	9,222	10,372	9,973	10,030	14,578	16,062
Accounts Payable	528	521	691	1,001	1,201	955	834	1,402	1,449	1,575
Long-Term Debt	3,068	5,938	4,881	5,053	6,660	7,784	7,725	6,571	11,309	12,664
Shareholder's Equity	170	1,461	5,249	6,160	6,079	4,921	2,654	2,012	2,666	2,740
D/E Ratio	18.07	4.06	0.93	0.82	1.05	1.58	2.91	3.27	4.24	4.62

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.6%	0.6%	-1.4%	0.4%	0.0%	-1.2%	-9.0%	0.5%	6.9%	6.7%
Return on Equity	64.2%	7.1%	-5.6%	0.9%	0.0%	-3.8%	-41.0%	3.1%	51.1%	28.1%
ROIC	1.9%	0.7%	-1.6%	0.5%	0.0%	-1.4%	-10.4%	0.6%	8.3%	8.0%
Shares Out.	42.1	56.0	184.7	217.6	232.1	232.5	229.2	228.6	231.1	226.0
Revenue/Share	204.67	124.23	43.33	42.60	46.76	37.30	35.57	74.15	90.57	71.06
FCF/Share	-0.01	4.06	1.78	-1.73	-8.79	-6.40	3.41	7.86	4.53	3.66

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