A Joint Venture by
RBN Energy and **East Daley Capital**

Targa Resources

Integrated Infrastructure to Sustain Profits Despite E&P Meltdown

The recent crash in oil prices triggered by the Covid-19 pandemic and the Russia-Saudi oil price war has sent shockwaves through the U.S. midstream industry that has just emerged from a decade of massive infrastructure investment in response to unprecedented upstream production growth. With the lion's share of infrastructure needed to gather, transport, process, and store current and expected crude oil, natural gas, and NGLs output to market, the industry was looking forward to steady earnings growth. Suddenly, waves of huge capex cuts and well shut-ins by producers have shattered forecasts and shifted strategic instincts to survival instead of growth. All midstream revenues and cash flows will be impacted, but the prospects for each company will vary widely based on the infrastructure they have strategically decided to build, acquire, expand or divest. While the outlook for demand and pricing is still highly volatile, East Daley Capital's in-depth analysis and projections provide vital insights into the near and mid-term prospects for major midstream companies in this vastly changed operating environment.

This Spotlight Report focuses on one of the most interesting case studies: Targa Resources, which was founded in 2005 by management and Warburg Pincus as the general partner of MLP Targa Resource Partners. The MLP built a portfolio of natural gas processing and gathering assets in U.S. oil-weighted plays such as the Permian Basin, South Texas, North Texas, Oklahoma, North Dakota and the Louisiana Gulf Coast, as well as crude oil gathering and terminaling assets in North Dakota and West Texas. After becoming one of the first midstream entities to simplify its structure by absorbing its MLP and eliminating IDRs, Targa made the strategic decision in 2017 to invest $8 billion to become a major integrated natural gas and NGL midstream firm by building an NGL pipeline to connect its G&P systems in the Permian, North Texas and Oklahoma with expanding fractionation and export facilities in Texas and Louisiana. Although capex on the buildout significantly boosted debt, Targa expected its operating margin and EBITDA growth, driven by growing associated Permian gas output and rising export demand for NGLs, would allow it to deleverage as capex dropped off in 2020-2023. However, the current global crisis has reversed the outlook for Permian gas from growth to decline, and crippled — at least in the short term — global hydrocarbon demand. Analyzing Targa's performance under this new environment provides insights into the outlook for integrated natural gas and NGLs assets, especially in the Permian Basin.

East Daley's conclusions include:

- Despite the abrupt plunge in rig counts and well shut-ins, Targa's operating margin and Adjusted EBITDA are expected to increase 15% and 7%, respectively, between 2019 and 2022. But that is down from pre-pandemic forecasts of 42% and 40% growth in operating margin and Adjusted EBITDA over the same period.
- Targa's investment in becoming an integrated midstream company pays off as growth is driven by its pipeline, fractionation, and export assets, which boost the Logistics & Transportation segment's share of operating margins to 60% from 48% in 2019.

- Operating margin for the Gathering & Processing segment is expected to fall 18%, from $920 million in 2019 to $756 million in 2022, on significant declines outside of the Permian Basin, where margins will remain stable.
- The company has slashed 2020 growth capital investment by an additional 40% to $700-$800 million, enough to complete its major infrastructure expansion, then will drop investment to about $100 million in 2021 and beyond as it shelves significant additional growth projects.
- Targa's decision to slash its dividend 90% to save an estimated $755 million in distributable cash flow, along with recently announced capex and opex cost cuts, is forecast to lower its net debt by 29%, from $7.5 billion at year-end 2019 to $5.4 billion by year end 2023.
- Lower cash flow growth is likely to impact the timing and scope of Targa's repurchase of Stonepeak's stakes in three development joint ventures involving the Grand Prix and GCX pipelines and the Train 6 fractionator at Mont Belvieu.

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1.1 What is Spotlight?

Spotlight reports provide a deep dive into the fundamentals that shape the outlook for midstream energy companies. Our goal is to provide a comprehensive, fundamentals-based view of our Spotlight companies based on a bottoms-up analysis of their assets and operations. We tear apart their asset structure to reveal what volumes are flowing, what rates are (and can be) charged, how they are exposed to commodity price risk, how their assets fit together, and what aspects of their operations provide competitive advantages in today's extremely volatile energy marketplace.

Spotlight is a joint venture of RBN Energy, LLC and East Daley Capital Advisors, Inc. We have joined together with the support of Oil & Gas Financial Analytics, LLC to provide a comprehensive, detailed insight into the companies we select for our analysis. We use publicly available data, combined with the deep experience of our combined teams to get to the answers that can be overlooked in the more high-level assessments that are in the marketplace today. Instead of such a high-level approach, we get into the micro-level detail, integrating fundamentals data, market data and company data in a comprehensive model that provides a clear picture of the company and its prospects.

As with all energy fundamental analysis, Spotlight reports rely on estimates and approximations of volumes, throughputs and fees. No non-public data from the subject company or any other source has been used in the preparation of this report.

1.2 How can I get Spotlight?

Spotlight is available to RBN Backstage Pass subscribers. Non-subscribers may purchase individual company Spotlight reports separately. For more information about Spotlight, go to rbnenergy.com/spotlight.