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Zacks Small-Cap Research

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Tejon Ranch (TRC-NYSE)

TRC: Share Price Represents Substantial Discount To Value of the Company's Real Estate Assets

Tejon Ranch Company is a real estate-development company that targets maximizing shareholder value by monetizing its land-based assets located near Los Angeles and Bakersfield, CA, where housing demand is high.

OUTLOOK

California faces a housing shortage, as highlighted in recent proposed legislation noting that the "lack of housing… threatens the economic, environmental, and social quality of life in California." TRC shares trade at a substantial discount to the valuations implied by nearby and state average real estate asset values. We would expect multiple expansion on TRC shares, as the company continues to advance its development plans and as TRC hits certain development milestones.

Current Price (11/23/20)	$14.65
Valuation	**$18.00**

SUMMARY DATA

52-Week High	**$16.74**
52-Week Low	**$12.51**
One-Year Return (%)	**-13.7**
Beta	**0.70**
Average Daily Volume (sh)	**112,078**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$372**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**69**
Insider Ownership (%)	**21**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-0.7**
Earnings Per Share (%)	**23.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**43.2**
P/S using 2020 Estimate	**83.9**
P/S using 2021 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Low,**
Type of Stock	**Small-Value**
Industry	**Real Estate Ops**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	**$13.5A**	**$5.1A**	**$15.4A**	**$11.6A**	**$45.6A**
2019	**$10.7A**	**$8.9A**	**$9.7A**	**$20.3A**	**$49.5A**
2020	**$10.3A**	**$4.8A**	**$13.5A**	**$17.4E**	**$46.0E**
2021					**$46.6E**

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	**$0.06A**	**-$0.04A**	**$0.13A**	**$0.01A**	**$0.16A**
2019	**$0.00A**	**$0.03A**	**$0.00A**	**$0.37A**	**$0.40A**
2020	**-$0.03A**	**-$0.01A**	**$0.02A**	**$0.05E**	**$0.02E**
2021					**$0.13E**

Quarters might not add to annual reflecting rounding

Disclosures on page 11.

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KEY POINTS

- Tejon Ranch Company (NYSE:TRC) is a real estate-development company that targets maximizing shareholder value through the monetization of its land-based assets. TRC's principal asset is its extensive land holding located approximately 60 miles north of Los Angeles and 25 miles south of Bakersfield, California. It is roughly an hour by car from Santa Clarita.
- Reflecting proximity to these major cities and to nearby highways – Interstate 5, for instance – it takes about 75 minutes to travel from the Tejon Ranch Commerce Centre (TRCC) to Los Angeles' Union Station.
- There is a shortage of housing in the greater Los Angeles metropolitan region. By historical measures, new and used house inventory is virtually non-existent. Housing prices continue to increase. TRC is the only major area close to Los Angeles where infrastructure is possible and one of the few real estate development companies with scale.
- Moreover, other nearby areas such as the Bakersfield metropolitan region and Antelope Valley (which extends from northern Los Angeles County to the southeast portion of Kern County, California,) also lack available and affordable houses.
- Tejon Ranch has received approvals from both the Los Angeles Board of Supervisors and Kern County Board of Supervisors to proceed with development plans.
- At the end of 3Q 2020, TRC had cash and securities aggregating about $50.4 million, with an additional $35.0 million available on its line of credit. TRC has also implemented cost containment efforts to offset the impact of COVID-19 on its revenue.

COMPANY BACKGROUND

Tejon Ranch Company (NYSE:TRC) is a real estate-development company that targets maximizing shareholder value through monetization of its land-based assets. TRC's principal asset is its extensive land holding located approximately 60 miles north of Los Angeles, 25 miles south of Bakersfield and about an hour by car from Santa Clarita, California. With 425 square miles of contiguous property north of the Los Angeles basin, it is the largest contiguous property in California and was formed from the consolidation of four Mexican land grants acquired in the 1850s and 1860s. TRC's agribusiness unit is operational and generates recurring revenue that can help fund development efforts.

Most of the ranch is bordered by Highway 138 on the south, Interstate 5 and Highway 99 on the west, and Highway 223 on the north. I5 is the major (and in places the only) conduit from the Los Angeles basin north and onto the Central Valley. The ranch is bounded by the southern San Joaquin valley, the Tehachapi Mountains and Antelope valley. Given the location and proximity to nearby cities, it is well-positioned to be an important distribution point for commercial traffic for both south bound and north bound traffic.



Source: http://ir.tejonranch.com/

The only major highway from the Los Angeles basin north to San Francisco and Bakersfield is the I-5. There are other roads that are less direct, or are not capable of handling heavy trucks, and the I5 is the only reasonable route to Santa Clarita (50 miles away) and the Los Angeles basin. This major highway extends from inside Mexico to inside Canada.

The property is so large that it encompasses several ecosystems that overlap and the result is the development of certain unique species of plants and animals. The ranch is also a major feeding and breeding area for the California Condor. However, the company reached an agreement in 2008 with a coalition of several environmental groups to strike a balance between conservation and TRC's real estate development plans. TRC agreed to protect nearly 90% of the land area. Under this pact, key conditions include that:

- Tejon Ranch got the right to proceed with three large developments that must be approved by federal, state and county authorities.
- The company agreed to set aside 178,000 acres for conservation and will grant an option for purchase by the public of another 62,000 acres. Ongoing use of the land for grazing cattle is allowed.
- The major environmental groups agreed to drop their opposition to the three planned developments.
- Four of the five northward facing ridge lines in or abutting the Tejon Mountain Village would not be developed since they were prime feeding grounds for the California condor.

Moreover, at the company's Grapevine project, at least 50% of the energy supply will be produced on site by renewable sources. At MV, all homes are planned to feature roof-top photovoltaic solar arrays, while Centennial is intended for the whole community to be powered with clean, renewable energy sources.

Proximity to major cities and nearby highways – Interstate 5, for instance – make the company's property easily accessible. For instance, it takes about 75 minutes to travel the roughly 73 miles from the Tejon

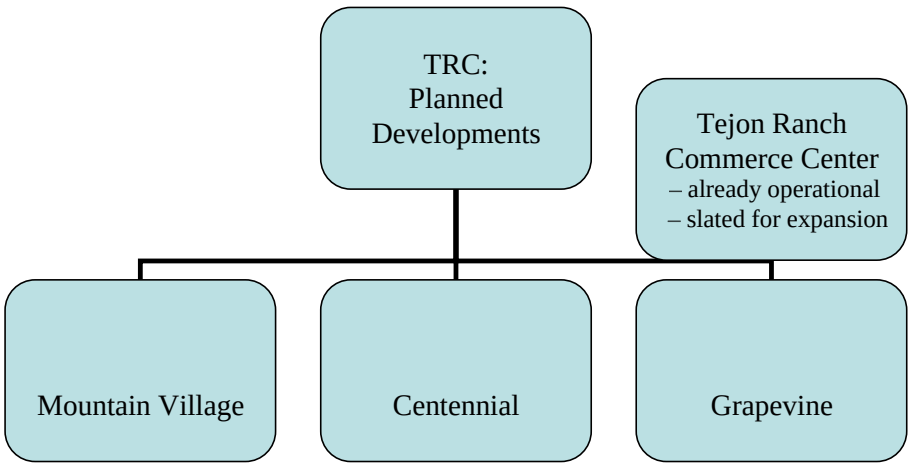
Ranch Commerce Centre (TRCC) to Los Angeles' Union Station and about 45 miles, on average, to travel between TRCC and Santa Clarita. TRCC is a 20 million square foot commercial / industrial development that is on both sides of Interstate 5.

Timing of development in the coming years will be dependent on the strength of both the economy and the residential real estate market. TRC intends to focus on preparing engineering to support expected development and also identifying and securing capital funding sources that could potentially come from sources, such as joint ventures with financial partners, debt financing and/or the sale of rights, among other sources.

TRC Development Plans Address LA Area Housing Shortage

Moreover, there is a shortage of housing that makes the Los Angeles basin significantly constrained by the lack of reasonably priced housing. By historical measures, new and used house inventory is virtually non-existent. Prices continue to increase, with no apparent end in sight. Moreover, other nearby areas such as the Bakersfield metropolitan region and Antelope Valley (which extends from northern Los Angeles County to the southeast portion of Kern County, California,) also lack available and affordable houses.

The housing shortage is highlighted in recent proposed legislation in front of the California regulators. Senate Bill-50 notes that the "lack of housing, including emergency shelters, is a critical problem that threatens the economic, environmental, and social quality of life in California." TRC is the only major area close to Los Angeles where infrastructure is possible and one of the few real estate development companies with sufficient land and scale to help address the state's housing shortage in any meaningful way.



Source: Company reports

Positive Outlook on TRC Reflects Development Opportunity

Tejon Ranch has received approval from both the Los Angeles Board of Supervisors and Kern County Board of Supervisors to proceed with development plans. The three developments other than TRCC appear to be aimed at overlapping, but different, markets. Centennial is positioned towards Antelope Valley and east; Mountain Village towards the Los Angeles basin and the southeast and the Grapevine towards Bakersfield and points north. MV is fully entitled and all necessary permits have been issued to begin development once the mapping process is complete.

MV is designed to be a premier mountain resort community offering a variety of home site opportunities, a number of small resort hotels, and various outdoor recreational activities. It is entitled for 3,450 homes, 750 hotel keys and 160,000 sq. ft. of commercial space. TRC estimates that Centennial could create more than 23,000 permanent jobs once it is completed. It is contemplated to have 19,333 residential units and more than 10.1 mm sq. ft. of commercial space. Grapevine is contemplated to hold 12,000 residential units and 5.1 mm sq. ft. of commercial development; with an additional 7,000 acres available for entitlement

OPERATING SEGMENTS

Real Estate-Commercial/Industrial

The commercial segment includes TRCC, which as noted is a 20 million square foot development that is on both sides of Interstate 5 [I-5]. Included in the revenue in this segment are any land sales. TRCC holds the leases for a number of distribution facilities for companies such as IKEA, Caterpillar Inc., Dollar General and others. TRCC has substantial amounts of square feet. Leasing should grow once COVID-19 is under control. Our estimates do not include any land sales even though they are a prime requisite in the company's strategy and may be needed to finance development. Other areas within the commercial real estate are not very large and are generally not profitable.

This sector also includes lease revenue from the Pastoria Energy Facility, owned by Calpine. This is a highly efficient combined cycle gas fired generating station that produces enough electricity to power all of Bakersfield CA. TRC's revenue from the facility increased from $3.9 million in 2017 to $4.6 million in 2019, which equates to about a 9% CAGR.

Real estate-resort/residential

The above-noted 2008 environmental agreement gave TRC the rights to develop three properties and expand TRCC. The rest of the ranch is to remain undeveloped and allow grazing.

There are also a number of profit centers that are listed as ownership in unconsolidated equity, the largest of which is Petro Travel where Tejon has equal ownership but Petro is the operating entity.

Mineral Resources

With over 425 square miles of territory oil and gas (314 active well at year end 2019) limestone, rocks and stones, and water (TRC both buys and sells water), the mineral resources segment generated $5.8 million in revenue in 2019. In most cases TRC does not own the minerals but receives a royalty payment based on sales. Water use may be allocated by the State Dept. of Water Resources and changes depending on the winter snow pack. It is possible that the allocation is not enough to sustain operations at prior year's levels.

Farming

There is plenty of land to farm. High profit crops include almonds and pistachios. The agribusiness operation also harvests fruit to grow, and sell in bulk such as grapes (with 835 acres), and useful crops like hay that can be used or sold. Variables that are difficult to forecast include weather, potential pest infestations, and prices that affect yields. Segment revenue grew from $16.4 million in 2017 to $19.3 million in 2019, which equates to about an 8.5% CARG. We note that the farming operation can be impacted by weather and harvest conditions.

Tejon Ranch

Within 425 square miles there is a lot of room to graze cattle and manage property as a working ranch. There is also enough space for trophy hunting and making films within the unused range. The ranch is also responsible for the maintenance, upkeep and security for all of the 270,000 acres of property. Cattle leases cover about 250,000 acres (1,012 km^2), and depending on the season, up to 12,000 head of cattle can be found grazing on the ranch. Revenue has held fairly steady at the $3.6 million - $3.8 million level over the past three years.

RECENT FINANCIAL RESULTS

Tejon Ranch reported 3Q 2020 results earlier this month. The company is developing four master planned developments, Mountain Village (MV), Centennial, and Grapevine and the expansion of the Tejon Ranch Commerce Center (TRCC), and currently is in the entitling and planning stage, as noted. MV, Centennial, and Grapevine are planned to be mixed-use residential communities. TRCC is a large commercial/industrial center currently in operation with nearly 6.0 million square feet completed and an additional 14.3 million square feet available for development. TRC expects to have 34,783 housing units, more than 35 million square feet of commercial/industrial space and 750 lodging units when these developments are completed.

Recurring Operating Revenue

Commercial/industrial sales and leasing operations in the developed Commerce Center provide cash flow to help TRC move forward towards continued expansion of the TRCC**,** which already holds the leases for a number of distribution facilities for companies such as IKEA, Caterpillar Inc., Dollar General and others.

TRC's operating units also include monetizing mineral resources (water, oil/gas, cement and rock aggregate, among others), farming and ranch operations, as well as the commerce center. TRC's mineral resources unit, in most cases, does not own the minerals but receives a royalty payment based on sales. The farming division produces and sells high-profit crops such as almonds and pistachios, as well as wine grapes and hay, while Tejon Ranch operations leverage the property to generate revenue from cattle grazing leases and location filming, among other revenue producing activities. The Pastoria Energy facility, owned by Calpine, is located on the Tejon Ranch. It is a highly efficient combined cycle gas fired generating station that produces enough electricity to power all of Bakersfield, California. The facility generates revenue that is reasonably constant each year and is another potential source of funding for development activities.

3Q 2020 Highlights

TRC's 2020 results at TRCC had been hurt by the economic downturn caused by the COVID-19 pandemic earlier in the year. After being closed as part of the shutdown measures, the outlets began reopening late in 2Q 2020 and experienced some rebound in 3Q 2020. Specifically, the shopping outlets at TRCC recorded record September monthly sales compared to prior Septembers since the outlets first opened. In addition, gas stations at TRCC also registered sales during August and September that nearly reached pre-COVID-19 levels. Moreover, while TRCC eateries were also negatively impacted by COVID-19, California restaurants were allowed to reopen for indoor seating late in the quarter and offer 25% capacity.

TRC's 3Q 2020 revenues reached $13.5 million. This represents a nearly 40% year-over-year improvement from $9.7 million registered in 3Q 2019. Revenues and other income including TRC's equity participation in the earnings of its unconsolidated JVs reached $15.1 million, up nearly 24% year-over-year compared to $12.2 million registered in 3Q 2019.

- **Farming segment** TRC's agribusiness operations are considered essential. Segment revenue reached $8.5 million, up 86% compared to $4.6 million recorded in the 2019 quarter. This included some $3.8 million from insurance claims to compensate for TRC's reduced pistachio crop, which was negatively impacted by the unseasonably warm weather. In fact, TRC sold 456k pounds of pistachios, down 45% compared to 831k pounds sold in 3Q 2019, largely resulting from poor weather conditions.

- **Mineral Resource segment** TRC's mineral resource segment also was pressured by lower oil prices. Revenue came in at $1.3 million compared to $1.6 million in 3Q 2019.

- **Equity Pickup** Equity in earnings from unconsolidated joint ventures were $1.1 million in 3Q 2020 compared to $2.2 million in 3Q 2019.

    - Fuel margins in TRC's Petro Travel Plaza Holdings JV were lower year-over-year reflecting lower gasoline prices.

    - QSR and full service restaurant margins fell, reflecting closures due to COVID-19.

    - Results from the Five West Parcel JV were also lower following 4Q 2019 asset sales of building and land.

    At the end of 3Q 2020, TRC had cash and securities aggregating about $50.4 million, with an additional $35.0 million available on its line of credit. TRC has also implemented cost containment efforts to offset the impact of COVID-19 on its revenue.

VALUATION

Tejon Ranch is in the early stages of its real estate development plans, which makes the use of certain traditional valuation methods such as P/E, multiple of cash flow or a dividend discount model, among other methods, inappropriate. Book value, for example, does not reflect the value of the land once development plans are further along.

We believe TRC shares should be valued on a price-to-acre basis. With the aforementioned shortage of housing in the state, we do not believe the current share price at about the $14.65 level accurately reflects the potential value of the real estate once development plans are more advanced.

TRC owns 270,000 acres. At the current price of TRC shares, this equates to a valuation of about $1,400 per acre. This is down from a valuation range of about $2,200 to $3,800 for TRC in recent years and significantly below nearby relative land values.

For instance, according to the Federal Housing Finance Agency, the average land value per acre for *residential* land in the state of California exceeds $400,000. Given that TRC's asset is largely undeveloped except for TRCC and that the Federal Housing Finance Agency's metric includes expensive urban cities such as San Francisco and Los Angeles that drive the state average up, we would not expect TRC to command a similar valuation at this point. Nevertheless, we believe it points to just how under-valued TRC is, as reflected in the current share price. Measured on a price-to-acre basis, TRC even falls below California *farm* values, which command average valuations of about $10,000 per acre, according to the USDA.

Our $18 near-term valuation implies a valuation of just under $1,740 per acre, which is a substantial discount to the valuations implied by TRC's historical share price trading range and to the real estate valuations noted above. Even based on *only* the land that has been approved for development and/or is currently producing revenue from agribusiness and other operations (which we think understates TRC's potential), the $18/share expected near-term valuation implies a value of less than $6,000 per acre, a steep discount to the above-noted average $10,000 based on USDA data and only a fraction of the value accorded residential property within the state.

We expect the value of land to increase significantly as TRC continues to advance its development plans. We also expect multiple expansion on TRC shares as the company hits certain milestones in its development objectives.

RISKS

Risks to TRC achieving its objectives, and to our valuation, include the following.

- The real estate development industry is highly capital intensive. TRC might not find funding sources at the rates it expects or as soon as it expects.
- The company is subject to regulatory risk. Real estate development is subject to various land use regulations that require governmental approvals and permits and potential regulatory changes could impact TRC.
- The value of the land could fluctuate depending on several factors, including the regional economy and other competing development plans by other developers.
- The I-5 is a critical part of the TRC infrastructure and traffic / roadway congestion could impact the value of the company's land.
- The area outside of the Tejon Ranch lacks infrastructure to support homeowners.
- TRC could be vulnerable to litigation risk that could impede growth.
- Water rights are often an issue in California and can impact land values. TRC has complex water agreements and both buys and sells water.
- The company's agribusiness operation is cyclical and affected by commodity cycles, especially those involving almond, pistachio, walnut, and wine grape production. The business is also highly seasonal, with the second half of the calendar year usually generating more revenue than the first due to weather and harvest conditions.
- Timing of development in the coming years will be dependent on the strength of both the economy and the residential real estate market.

PROJECTED INCOME STATEMENT

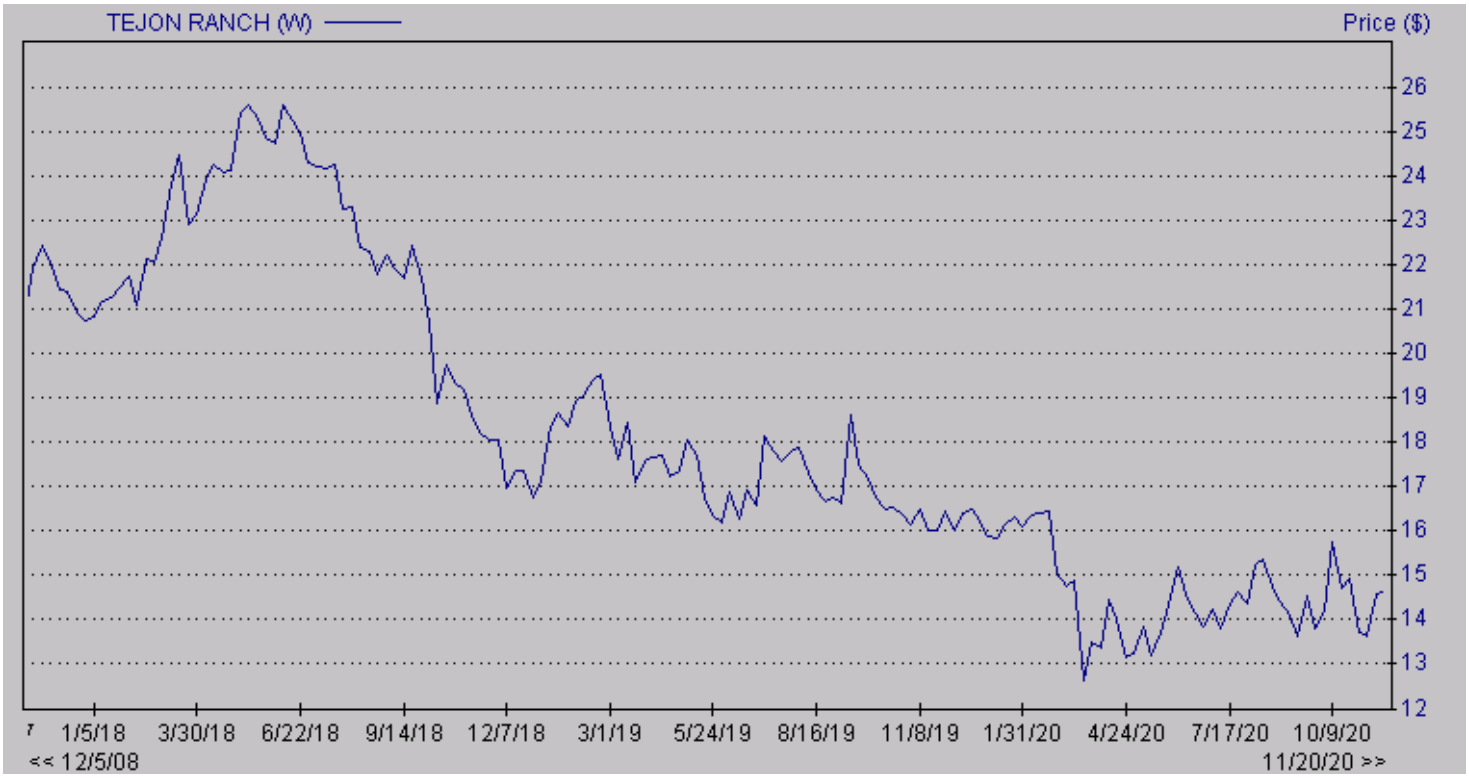
Tejon Ranch Income Statement & Projections ($000)

	2017	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20A	4Q20E	2020E	2021E
Real estate - commercial/industrial	$9,001	$8,970	$2,826	$6,595	$2,620	$4,751	$16,792	$2,320	$2,114	$2,710	$2,170	$9,314	$9,547
Mineral resources	5,983	14,395	6,132	660	1,559	1,440	9,791	6,178	1,776	1,322	1,001	10,277	10,380
Farming	16,434	18,563	815	886	4,602	13,028	19,331	952	209	8,537	13,158	22,856	23,085
Ranch operations	3,837	3,691	889	805	876	1,039	3,609	863	676	944	1,049	3,532	3,568
Total revenues	**35,255**	**45,619**	**10,662**	**8,946**	**9,657**	**20,258**	**49,523**	**10,313**	**4,775**	**13,513**	**17,379**	**45,980**	**46,579**
Real estate - commercial/industrial	6,529	6,246	1,792	4,593	1,968	4,608	12,961	1,931	1,747	2,026	4,516	10,220	10,322
Real estate - resort/residential	1,955	1,530	648	642	582	375	2,247	626	326	273	379	1,604	1,620
Mineral resources	2,964	6,223	3,832	598	576	812	5,818	3,878	714	648	820	6,060	6,121
Farming	16,201	16,028	1,598	825	5,979	6,849	15,251	1,702	1,099	8,108	7,260	18,169	16,352
Ranch operations	5,411	5,451	1,350	1,393	1,260	1,313	5,316	1,406	1,178	1,164	1,326	5,074	5,125
Corporate expenses	9,713	9,705	2,474	2,290	1,760	2,837	9,361	2,533	2,494	2,121	2,865	10,013	9,312
Total expenses	42,773	45,183	11,694	10,341	12,125	16,794	50,954	12,076	7,558	14,340	17,166	51,140	48,852
Operating loss	(7,518)	436	(1,032)	(1,395)	(2,468)	3,464	(1,431)	(1,763)	(2,783)	(827)	213	(5,160)	(2,273)
Investment income	462	1,344	349	329	294	267	1,239	228	151	455	410	1,244	1,256
Gain (loss) real estate sales				-	-				1,333	(2)	(2)	1,329	1,000
Other (loss) income	(275)	(59)	26	22	19	(1,891)	(1,824)	8	(12)	68	61	125	126
Total other income	187	1,285	375	351	313	(1,624)	(585)	236	1,472	521	469	2,698	2,382
Operating income/(loss)	(7,331)	1,721	(657)	(1,044)	(2,155)	1,840	(2,016)	(1,527)	(1,311)	(306)	681	(2,463)	110
Equity pickup	4,227	3,834	876	1,971	2,199	11,529	16,575	1,355	1,181	1,093	984	4,613	4,463
Pretax income	(3,104)	5,555	219	927	44	13,369	14,559	(172)	(130)	787	1,665	2,150	4,572
Taxes	(1,283)	1,320	95	218	7	3,660	3,980	512	196	403	366	1,477	1,097
Net income (loss)	(1,821)	4,235	124	709	37	9,709	10,579	(684)	(326)	384	1,299	673	3,475
Minority interest	(24)	(20)	5	2	(10)	2	(1)	(2)	7	(14)	(13)	(22)	(23)
Net income	(1,797)	4,255	119	707	47	9,707	10,580	(682)	(333)	398	1,312	695	3,498
Loss/share - EPS (FD)	($0.08)	$0.16	$0.00	$0.03	$0.00	$0.37	$0.40	($0.03)	($0.01)	$0.02	$0.05	$0.02	$0.13
Average shares out (Mns)	21.7	26.0	26.0	26.0	26.2	26.2	26.1	26.3	26.2	26.3	27.3	26.5	27.3

Source: Company reports, Zacks estimates

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