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Zacks Small-Cap Research

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Tejon Ranch (TRC-NYSE)

TRC: Recent Updates Imply Strong Positives For Development Plans

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. Recent updates discussed in this report increase the value of TRC's land holdings, in our view.

Current Price (3/1/21)	$16.32
Valuation	**$25.00**

OUTLOOK

TRC received approval to develop multi-family apartments within the Tejon Ranch Commerce Center (TRCC) earlier this quarter. The planned apartment development will help provide much-needed housing. Like much of the state, Kern County, California is experiencing a severe shortage of housing, including of apartment units. In the greater Los Angeles metropolitan region overall, there is a shortage of housing; 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.

SUMMARY DATA

52-Week High	**$17.90**
52-Week Low	**$12.12**
One-Year Return (%)	**8.22**
Beta	**0.64**
Average Daily Volume (sh)	**93,721**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$442**
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	**46.6**
P/S using 2020 Estimate	**N/A**
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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WHAT'S NEW? KEY POINTS

- Earlier this quarter, Tejon Ranch Company received approval to develop multi-family apartments within the Tejon Ranch Commerce Center (TRCC). The planned apartment development will help provide much-needed housing in the area. Like much of the state of California, Kern County has a severe shortage of housing, including of apartment units.

- In the greater Los Angeles metropolitan region overall, there is a shortage of housing. 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.

- Despite the area's need for new homes, the company has received opposition from several environmental groups over the years against its plans to develop a portion of its land holdings. The company entered into a conservation agreement with environmental groups and other opponents in 2008.

- A recent court ruling earlier this quarter in favor of TRC and Kern County mitigates a big stumbling block to moving forward on the company's Grapevine project, where at least 50% of the energy supply is expected to be produced on site by renewable sources.

- Recent updates discussed in this report increase the value of TRC's land holdings, in our view.

COMPANY UPDATE

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.

Earlier this quarter, TRC received approval to develop multi-family apartments within the Tejon Ranch Commerce Center (TRCC) as a positive that is not fully reflected in the share price. The Kern County Board of Supervisors approved two *conditional use permits* that will enable TRC to develop multi-family apartment uses within the TRCC.

The TRCC is a 20 million square foot development that is on both sides of Interstate 5. TRC has already developed almost six million square feet of industrial, commercial and retail space in the TRCC, and holds the leases for a number of distribution facilities for companies such as IKEA, Caterpillar Inc., Dollar General and others. The TRCC has 14 million square feet of available space and "a proven ability to deliver" speedy turnaround on construction.

Conditional use permits allow development provided that certain conditions are met. Zoning authorities use conditional use permits when development would be beneficial for the community but they want to place certain restrictions on the development, including potentially prohibiting the operation of certain types of businesses. In California, conditional use permits are subject to the California Environmental Quality Act (CEQA). With Kern County apparently determining that the planned development project would not have a significant adverse effect on the local environment, the project is likely to advance without significant pushback from potential opponents, including from environmental groups.

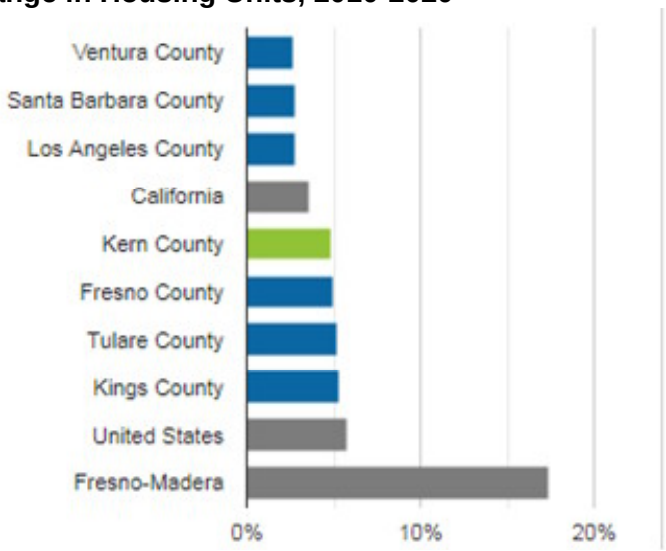
For instance, when one environment group recently sued the company in an attempt to block development, the U.S. District Court, Central District of California granted summary judgment in TRC's

favor in December 2020 in a lawsuit that challenged the 2013 approval of a Multi-Species Habitat Conservation Plan covering the upland regions of Tejon Ranch. In granting summary judgment, the court rejected every argument and cited Tejon Ranch development, as a potential solution to California's housing crisis.

KERN COUNTY HOUSING SHORTAGE

The planned apartment development will help provide much-needed housing. Like much of the state of California, Kern County is experiencing a severe shortage of housing, including of apartment units. Construction of new units has lagged compared to many other areas within the state and the slow pace of development exacerbates the housing shortage problem. Moreover, a majority of California land is zoned for single-family or commercial use, while private home owners often oppose nearby construction of apartments. In 2019, a report from the California Housing Partnership estimated that Kern County needed an additional 26,200+ affordable rental units to meet its housing shortage.

Change in Housing Units, 2010-2020



2020 Census Bureau American Community Survey - Accessed on January 10, 2021

There is a shortage of housing in the greater Los Angeles metropolitan region overall, just as there is in the state generally. By historical measures, new and used house inventory is virtually non-existent. Reflecting the imbalance between supply (inventory) and demand, 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.

The state's 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 nearby land area with sufficient land and scale to help address the state's housing shortage in any meaningful way, as noted.

The recently granted Kern County approvals authorize TRC to develop up to a maximum of 495 multi-family residences in thirteen apartment buildings just north of the Outlets at Tejon. The development is also approved to include about 6,500 square feet of amenity space to serve the community and 8,000 square feet of revenue-generating retail space on the ground floor of some of the residential buildings.

Potential Funding Sources

In general, the 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.

As with the company's other planned projects, potential capital funding sources for development of the above-noted apartment units include possible joint ventures with financial partners, debt financing and/or the sale of rights, among other sources. Moreover, TRC's agribusiness and commerce business units are operational and generate recurring revenue. 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.

Proximity Makes TRCC Attractive & Convenient

Proximity to nearby cities makes the TRCC an attractive location for the construction of apartment units. TRC's extensive land holdings are located approximately 60 miles north of Los Angeles and 25 miles south of Bakersfield, California. Reflecting proximity to these major cities and to nearby highways – Interstate 5, for instance – it takes about 75 minutes to travel from the TRCC to Los Angeles' Union Station. It is roughly an hour by car from Santa Clarita.



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

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.

Moreover, the anticipated continued development of the California High-Speed Rail is also expected to facilitate commuting from TRCC to nearby cities. The California High-Speed Rail Authority has nearly 120 miles under construction, with more construction extensions anticipated. The Authority plans "a state-wide rail modernization" program that will help traverse one of the country's largest states, mitigating automobile congestion and pollution. The Authority recently completed five high-speed rail structures throughout Madera, Fresno, and Kern counties.

COURT RULING SUPPORTS DEVELOPMENT PLANS

TRC's 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.

TRC entered into an agreement with key environmental groups in 2008 to ensure that its development plans would be carried out in a way to mitigate the impact on the environment, creating the *Tejon Ranch Conservation and Land Use Agreement*. The agreement mandates that 90% of the ranch will be conserved as undeveloped land permanently. The 2008 agreement was designed to strike a balance between conservation, the area's severe housing shortage and consequent need for new housing, 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, Grapevine, Mountain View (MV) and Centennial, 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.

A recent court ruling earlier this quarter in favor of TRC and Kern County mitigates a big stumbling block to moving forward on the company's Grapevine development. Despite the area's need for new homes, the company has received opposition from several environmental groups over the years against its plans to develop a portion of its land holdings. Nevertheless, the reality is that the shortage of homes is growing and management has an environmentally responsible approach to development.

The company generally has been able to address issues raised by external conservation groups. For instance, objections raised in a lawsuit filed by the Tucson, Arizona-based Center for Biological Diversity (CBD) challenging Kern County's December 2019 re-approval for TRC to develop Grapevine at Tejon Ranch were rejected on January 22, 2021, with the court ruling in TRC and Kern County's favor.

Grapevine Master Plan

Planned to include green energy supply

Grapevine is a master planned mixed use residential community that 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. Importantly, at least 50% of Grapevine's energy supply is expected to be produced on site by renewable sources, as noted.



Source: Company reports

The Kern County Board of Supervisors unanimously approved Grapevine in 2016. CBD sued in 2017 to thwart the advancement of the project. Of the seven issues it raised regarding the sufficiency of the project's environmental impact report, only one issue led the court to request additional data. The court ordered Kern County to submit a revised environmental impact report incorporating additional work and information regarding the internal capture rate used in the traffic study. This type of study attempts to determine if and how much traffic to and from the vicinity will change and whether trips within the development, as commercial amenities expand, can offset some of the increased traffic to get to and leave the development. Such studies can provide important tools for developers such as Tejon Ranch, land use planners, and transportation agencies to improve decisions about how to minimize disruption to existing traffic patterns and provide transportation that is appropriate for the planned community.

The court upheld the remainder of the environmental impact report and the county provided the information that the court had requested in a revised report that was then presented for a public review and comment process. The updated report received unanimous re-approval by the Kern County Planning Commission and Board of Supervisors in 2019. However, CBD challenged the county's approval again. In fact, since 2003 CBD has filed 12 legal actions against Tejon Ranch and its development plans. CBD has taken steps to delay other Tejon Ranch development plans, including the Centennial and Mountain Village (MV) master-planned communities. In December 2020, CBD lost another lawsuit challenging Tejon Ranch's MV development plans.

In the latest ruling, the court rejected CBD's attempt to re-litigate issues it had raised previously. The court also determined that Kern County's revised environmental impact report, which includes the supplemental analysis of the internal capture rate, was complete and in full compliance with the court's earlier ruling.

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 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.

Recent updates discussed in this report increase the value of TRC's land holdings, in our view. We are raising our near-term valuation to $25 from $18. The revised valuation implies a valuation of just over $2,400 per acre (versus the $1,740 implied value on the earlier $18 valuation). This is still a substantial discount to the valuations implied by the average TRC trading range and 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 $25/share expected near-term valuation implies a value of less than $8,400 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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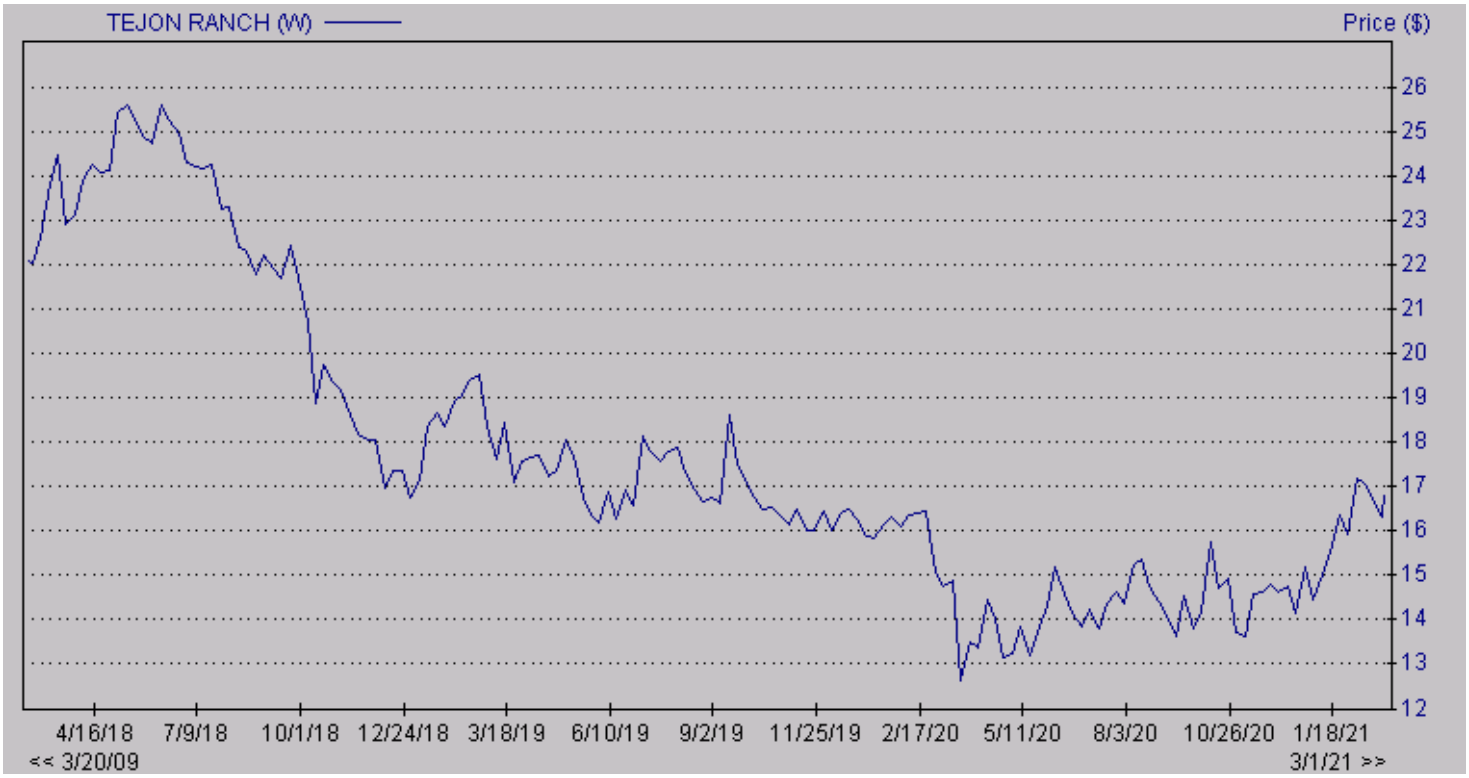
HISTORICAL STOCK PRICE



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