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Zacks Small-Cap Research

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Tejon Ranch (TRC-NYSE)

TRC: Obstacle to Development Plans Eliminated as Court Upholds Earlier Ruling

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. Housing demand in this region is high and availability of Class A properties is limited. TRC continues to move forward with its development plans.

Current Price (10/11/21)	$18.19
Valuation	**$25.00**

OUTLOOK

A lawsuit challenging TRC's development plans was permanently dismissed earlier this month and cannot be filed again, thereby eliminating an obstacle to TRC pursuing its development plans, we believe.
TRC recently launched construction of an industrial building at the TRCC with joint venture partner Los Angeles-headquartered Majestic Realty. The project, which represents an expansion of an existing relationship between TRC and Majestic, contributed to operating income of $2.5M in 2Q21 and, in our view, underscores the development prospects of the TRCC and TRC's overall land holdings.

SUMMARY DATA

52-Week High	**$19.59**
52-Week Low	**$13.44**
One-Year Return (%)	**17.35**
Beta	**0.59**
Average Daily Volume (sh)	**86,740**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$480**
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 (%)	**2.1**
Earnings Per Share (%)	**55.4**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/S using 2021 Estimate	**N/A**
P/S using 2022 Estimate	**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	$9.2A	$37.8A
2021	$11.1A	$17.6A	$13.7E	$9.4E	$50.8E

EPS / Loss Per share

	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	-$0.00A	-$0.03A
2021	-$0.04A	$0.11A	$0.02E	-$0.01E	$0.08E

Quarters might not add to annual reflecting rounding

Disclosures on page 11.

WHAT'S NEW? KEY POINTS

- A lawsuit challenging TRC's development plans was permanently dismissed earlier this month and cannot be filed again, thereby eliminating another obstacle to TRC pursuing its goals to deliver shareholder value by monetizing the value of its land holdings, we believe.

- Separately, TRC has started construction of an industrial building at the TRCC that is planned to be roughly 630,000-square-feet. The company is developing this building with a joint venture partner, Los Angeles-headquartered Majestic Realty, which is one of the country's largest privately-held industrial developers, according to *National Real Estate Investor* magazine.

- We view it as a positive that this project represents an expansion of an existing relationship between TRC and Majestic, which would seem to underscore Majestic's positive view of the TRCC's development prospects. The project represents the third new building and fourth JV partnership agreement TRC has entered into with Majestic over the past five years.

- Moreover, the project led to improved real estate results in 2Q21 that contributed to 2Q21 operating income of $2.5 million compared to an operating loss of $2.8 million in 2Q20. We believe it also highlights the underlying value of the company's real estate holdings.

- Proximity to nearby cities makes the TRCC an attractive location. The site of the planned new building is roughly 39-acres fronting the I-5 (interstate 5) highway, one of the busiest land-based transportation routes for passengers and cargo.

- TRC had cash and equivalents and marketable securities of $49.6 million at the end of 2Q21 to continue advancing its development plans. The company also intends to leverage funding from partners and debt financing and/or the sale of rights, among other financial resources. The company also reduced long-term debt to $50.4 million at the end of June 2021, from $57.5 million at year-end 2019.

EARLIER COURT RULING UPHELD – POSITIVE TAKEAWAYS

Tejon Ranch Company (NYSE:TRC) announced recently that a federal court has upheld an earlier ruling in TRC's favor regarding its development plans. 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 advance certain development plans at Tejon Ranch were rejected in December 2020. Earlier this month, a Court permanently dismissed an appeal in the case.

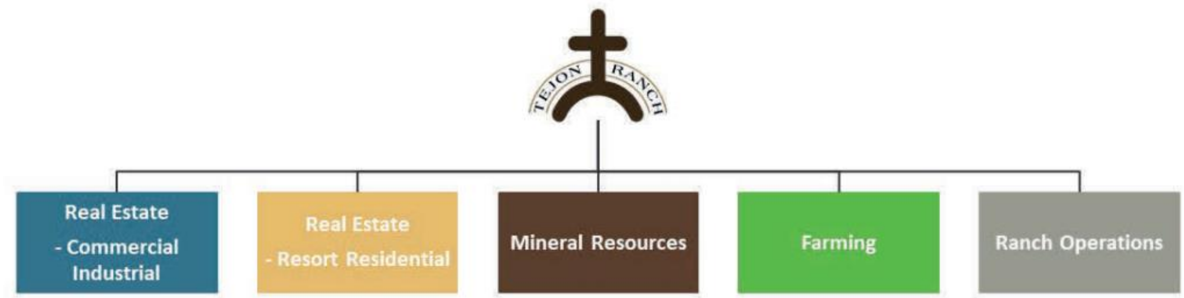
Mountain Village

Centennial

Grapevine

Source: http://ir.tejonranch.com

The company has master planned mixed-use residential communities in various stages of development and other real estate projects in its pipeline. Management believes that its development plans fulfill important needs, including addressing the need for more housing in California, job creation and responsible development that is coordinated with conservationist goals. Current revenue is derived from the Tejon Ranch Commercial Center (TRCC), farming and ranching, among other activities.



Source: Company reports

ONGOING DEVELOPMENT AT TRCC

TRC has commenced construction of an industrial building at the TRCC that is planned to be roughly 630,000-square-feet. The company is developing this building with a joint venture partner, Los Angeles-headquartered Majestic Realty. Majestic Realty is one of the country's largest privately-held industrial developers, according to *National Real Estate Investor* magazine. Originally established in 1948, Majestic has a long operating history. Moreover, as it is based in Los Angeles County, it seems likely that Majestic understands and has extensive relationships in TRCC's local real estate market.

We also view it as a positive that this project represents an expansion of an existing relationship between TRC and Majestic. Their initial partnership agreement was formed in 2016 to jointly purchase, own and manage an existing, fully leased, 651,909- square-foot building. The two JV partners then added two additional new build partnerships for speculative buildings that each generated strong pre-lease activity and which remain fully leased. This latest extension of their JV relationship would seem to underscore Majestic's positive view of TRCC's development prospects. The project represents the third new building and fourth JV partnership agreement TRC has entered into with Majestic over the past five years.

Moreover, the project and transaction with Majestic contributed to a $3.0 million increase in commercial / industrial real estate operating profits for 2Q21 compared to 2Q20. This, in turn, contributed to 2Q21 operating income of $2.5 million compared to an operating loss of $2.8 million in 2Q20. We believe it also highlights the underlying value of the company's real estate holdings.

TRCC - Conveniently Located

Proximity to nearby cities makes the TRCC an attractive location. 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.

Most of the Tejon 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.

Occupancy, Expected by Mid-2022, Likely Boosted by Relative Scarcity of Class A Properties

The approximately 630k-square-foot Class A industrial building is being designed for single- or multi-tenant use and will be constructed on a speculative basis. The JV partners believe the market for Class A space is highly competitive, reflecting limited inventory.

In general, prospective tenants have shown significant interest in the region's limited inventory and in the TRCC, reflecting the location, Class-A product and economic incentives offered by Kern County, according to TRC. In fact, the company believes the TRCC represents a substantially more cost economical option compared to other properties in the L.A. basin. Moreover, management also believes interest in TRCC has increased as a result of changing views of warehousing safety stock, as a result of disruptions to much of the general supply chain during the pandemic. The JV partners expect the building to be ready for occupancy by mid-2022. The TRCC has a track record of delivering speedy turnaround on construction.

CALIFORNIA'S HOUSING SHORTAGE

TRC Real Estate Well-Situated & Convenient For Residential Units

The location of the company's real estate also makes it attractive for development of residential properties. 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.

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.

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. Proximity to nearby cities also makes the TRCC an attractive location for the construction of apartment units. It takes about 75 minutes to travel from the TRCC to Los Angeles' Union Station and roughly an hour by car to Santa Clarita.

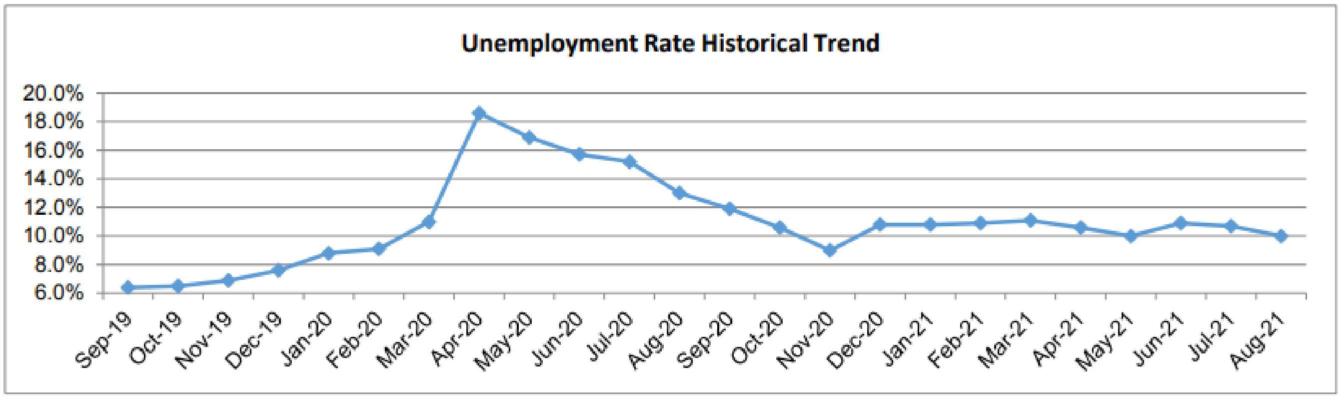
Moreover, the anticipated continued development of the California High-Speed Rail is also expected to facilitate commuting from TRCC to nearby cities. The California High-Speed Rail Authority has nearly 120 miles under construction, with more construction extensions anticipated. The Authority plans "a 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.

DEVELOPMENT EFFORTS CREATE MUCH NEEDED NEW JOBS

Permanent jobs and development-related employment

The company's development efforts will also create both permanent and development-related jobs. Centennial, for instance, is expected to create more than 23,000 permanent jobs on site and nearly 25,000 construction jobs.

The company's land assets are located in an area that is characterized by high unemployment, which appears to be supported by recent government employment data. At 10.0%, the Kern County unemployment rate during the month of August 2021 was higher than the 5.2% U.S. national unemployment rate during the same period, according to data from the Bureau of Labor Statistics (BLS) and State of California Employment Development Department.



Source: https://www.labormarketinfo.edd.ca.gov/file/lfmonth/bake$pds.pdf accessed October 2021

RESPONSIBLE CO-ORDINATED DEVELOPMENT

Responsible Coordinated Development

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.

TRC is committed to minimizing its carbon footprint and to proactively capture and store carbon. In terms of water conservation, the company has articulated a commitment to water conservation in its water asset and delivery plans. At TRCC-East, for instance, the company uses reclaimed water from the water treatment plant for irrigation purposes, while the landscaping at the Outlets at Tejon are comprised of drought-tolerant, native planting material, according to management.

The company further notes that each of its master planned mixed-use residential communities will feature state-of-the-art water conservation measures, reclaimed water for irrigation, storm water capture, and drought-tolerant landscaping, while TRC's agricultural operations use highly efficient drip irrigation to water its orchards and vineyards.

Grapevine Master Plan

Planned to include green energy supply

For instance, the Grapevine master planned mixed use residential community 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.

VALUATION

We view ongoing development as positives and potential catalysts that are not fully reflected in the TRC share price. 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.

TRC initiatives discussed in this report and other recent updates increase the value of TRC's land holdings, in our view. Our $25 per share valuation implies a valuation of just over $2,400 per acre, which represents a substantial discount to the valuations implied by other 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 also expect the value of land to increase significantly, and of TRC shares, 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.

Potential Funding Sources

As noted, the new project is being constructed on a speculative basis. As with the company's other planned projects, potential capital funding sources for development this industrial building and of the recently authorized 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.

TRC had cash and equivalents and marketable securities of $49.6 million at the end of 2Q21 to continue advancing its development plans. The company also intends to leverage funding from partners and debt financing and/or the sale of rights, among other financial resources. The company also reduced long-term debt to $50.4 million at the end of June 2021, from $57.5 million at year-end 2019.

RISKS

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

- With COVID-19 cases fluctuating in several places, we believe TRC and many companies face the risk of another economic disruption.
- 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.
- 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.
- TRC could be vulnerable to other 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.

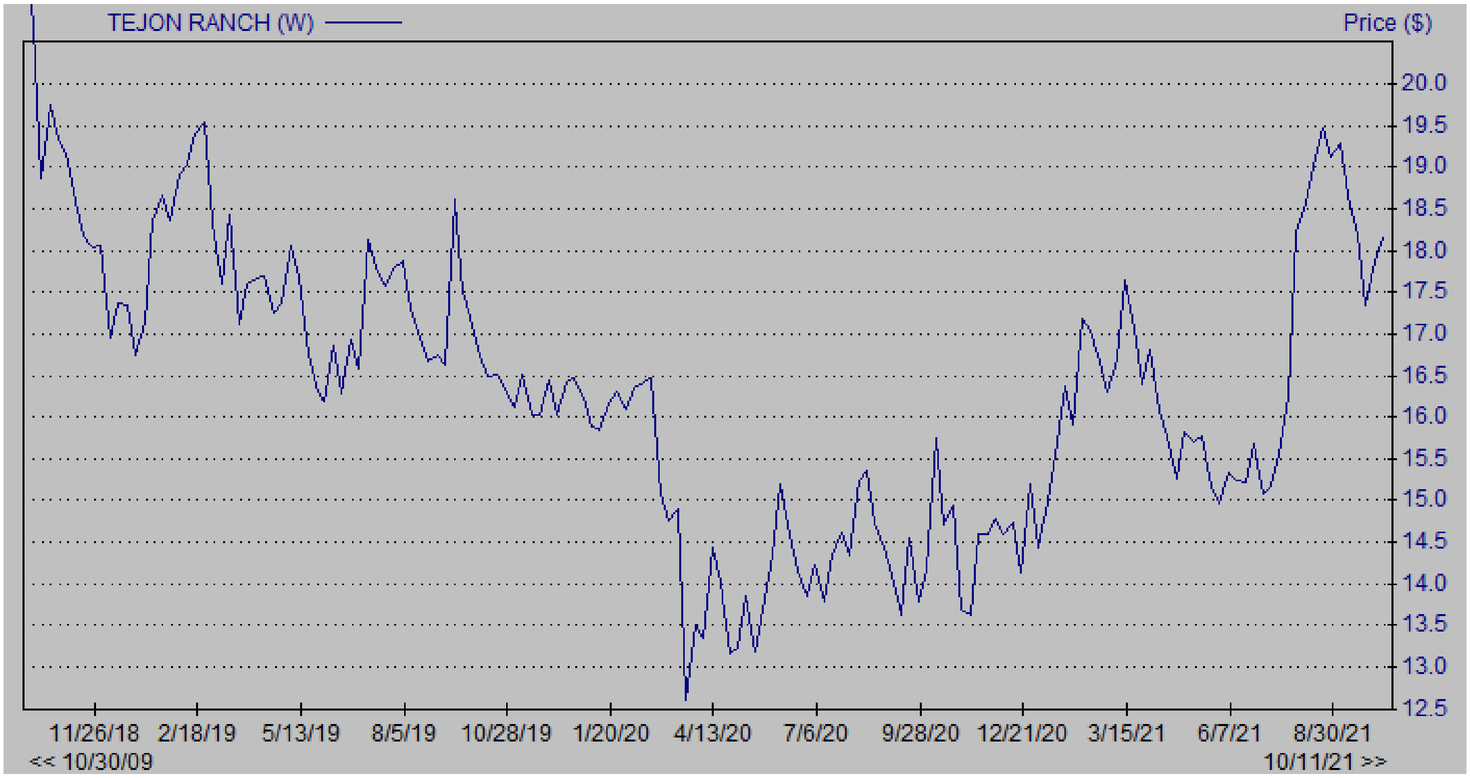
PROJECTED INCOME STATEMENT

Tejon Ranch Income Statement & Projections ($000)

	2017	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20A	4Q20A	2020A	1Q21A	2Q21A	3Q21	4Q21	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	$2,392	$9,536	$2,228	$8,126	$2,737	$2,397	$15,488
Mineral resources	5,983	14,395	6,132	660	1,559	1,440	9,791	6,178	1,776	1,322	1,460	10,736	7,176	7,404	1,401	1,562	17,544
Farming	16,434	18,563	815	886	4,602	13,028	19,331	952	209	8,537	4,168	13,866	607	279	8,622	4,210	13,718
Ranch operations	3,837	3,691	889	805	876	1,039	3,609	863	676	944	1,209	3,692	1,043	829	953	1,221	4,047
Total revenues	**35,255**	**45,619**	**10,662**	**8,946**	**9,657**	**20,258**	**49,523**	**10,313**	**4,775**	**13,513**	**9,229**	**37,830**	**11,054**	**16,638**	**13,714**	**9,390**	**50,796**
							$3,831										
Real estate - commercial/industrial	6,529	6,246	1,792	4,593	1,968	4,608	12,961	1,931	1,747	2,026	1,418	7,122	1,552	4,712	2,046	1,432	9,742
Real estate - resort/residential	1,955	1,530	648	642	582	375	2,247	626	326	273	387	1,612	553	439	276	391	1,659
Mineral resources	2,964	6,223	3,832	598	576	812	5,818	3,878	714	648	1,174	6,414	5,047	4,253	654	1,186	11,140
Farming	16,201	16,028	1,598	825	5,979	6,849	15,251	1,702	1,099	8,108	4,194	15,103	1,478	1,203	8,189	4,236	15,106
Ranch operations	5,411	5,451	1,350	1,393	1,260	1,313	5,316	1,406	1,178	1,164	1,148	4,896	1,187	1,142	1,176	1,159	4,664
Corporate expenses	9,713	9,705	2,474	2,290	1,760	2,837	9,361	2,533	2,494	2,121	2,282	9,430	2,291	2,364	2,142	2,305	9,102
Total expenses	42,773	45,183	11,694	10,341	12,125	16,794	50,954	12,076	7,558	14,340	10,603	44,577	12,108	14,113	14,483	10,709	51,413
Operating loss	(7,518)	436	(1,032)	(1,395)	(2,468)	3,464	(1,431)	(1,763)	(2,783)	(827)	(1,374)	(6,747)	(1,054)	2,525	(769)	(1,320)	(618)
Investment income	462	1,344	349	329	294	267	1,239	228	151	455	50	884	7	9	460	51	526
Gain (loss) real estate sales				-	-				1,333	(2)	-	1,331	-	-	-	-	-
Other (loss) income	(275)	(59)	26	22	19	(1,891)	(1,824)	8	(12)	68	46	110	64	43	69	46	222
Total other income	187	1,285	375	351	313	(1,624)	(585)	236	1,472	521	96	2,325	71	52	528	97	748
Operating income/(loss)	(7,331)	1,721	(657)	(1,044)	(2,155)	1,840	(2,016)	(1,527)	(1,311)	(306)	(1,278)	(4,422)	(983)	2,577	(241)	(1,223)	131
Equity pickup	4,227	3,834	876	1,971	2,199	11,529	16,575	1,355	1,181	1,093	875	4,504	(59)	1,365	1,104	963	3,372
Pretax income	(3,104)	5,555	219	927	44	13,369	14,559	(172)	(130)	787	(403)	82	(1,042)	3,942	863	(260)	3,503
Taxes	(1,283)	1,320	95	218	7	3,660	3,980	512	196	403	(282)	829	21	1,118	233	(70)	1,302
Net income (loss)	(1,821)	4,235	124	709	37	9,709	10,579	(684)	(326)	384	(121)	(747)	(1,063)	2,824	630	(190)	2,201
Minority interest	(24)	(20)	5	2	(10)	2	(1)	(2)	7	(14)	2	(7)	(8)	2	(1)	(1)	(8)
Net income	(1,797)	4,255	119	707	47	9,707	10,580	(682)	(333)	398	(123)	(740)	(1,055)	2,822	631	(189)	2,209
Loss/share - EPS (FD)	($0.08)	$0.16	$0.00	$0.03	$0.00	$0.37	$0.40	($0.03)	($0.01)	$0.02	($0.00)	($0.03)	($0.04)	$0.11	$0.02	($0.01)	$0.08
Average shares out (Mns)	21.7	26.0	26.0	26.0	26.2	26.2	26.1	26.3	26.2	26.3	26.4	26.3	26.4	26.4	26.5	26.6	26.5

Source: Company reports, Zacks estimates

HISTORICAL STOCK PRICE



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