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Zacks Small-Cap Research

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M. Marin
312-265-9211
mmarin@zacks.com

scr.zacks.com
10 S. Riverside Plaza, Chicago, IL 60606

Tejon Ranch (TRC-NYSE)

TRC: Development & Leasing Activities Illustrate Progress of Growth Strategy

Real estate-development company TRC (Tejon Ranch Company) targets monetizing its land-based assets near Los Angeles and Bakersfield, CA. Housing demand and need for increased warehouse and distribution infrastructure in this region is high, while the availability of Class A properties is limited. Design & engineering work is proceeding on multiple projects, and the company is seeing strong interest and demand in advance of construction.

Current Price (2/21/23)	$18.92
Valuation	**$25.75**

OUTLOOK

Along with JV partner Majestic Realty, TRC recently fully pre-leased a Class A industrial building the JV is building. New tenant Sunrise Brands will occupy the full building once it is constructed. The company believes this lease before construction of the building has started reflects the strength of market demand and the strategic location and building amenities at the TRCC. The JV also recently leased a 629,274-square foot distribution center at the TRCC. We believe these lease transactions and ongoing development activities reflect the progress the company is making as it executes its growth strategy.

SUMMARY DATA

52-Week High	**$20.65**
52-Week Low	**$14.31**
One-Year Return (%)	**12.4**
Beta	**0.68**
Average Daily Volume (sh)	**37,065**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$501**
Short Interest Ratio (days)	**4.5**
Institutional Ownership (%)	**61**
Insider Ownership (%)	**22**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.7**
Earnings Per Share (%)	**31.1**
Dividend (%)	**N/A**
P/E using TTM EPS	**29.6**
P/S using 2022 Estimate	**35.0**
P/S using 2023 Estimate	**34.4**

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)
2020	**$10.3A**	**$4.8A**	**$13.5A**	**$9.2A**	**$37.8A**
2021	**$11.1A**	**$16.6A**	**$15.0A**	**$13.0A**	**$55.6A**
2022	**$21.0A**	**$9.3A**	**$31.5A**	**$12.0E**	**$73.8E**
2023					**$75.5E**

EPS / Loss Per share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2020	**-$0.03A**	**-$0.01A**	**$0.02A**	**-$0.00A**	**-$0.03A**
2021	**-$0.04A**	**$0.11A**	**$0.01A**	**$0.13A**	**$0.20A**
2022	**$0.16A**	**-$0.03A**	**$0.38A**	**$0.01E**	**$0.54E**
2023					**$0.55E**

Quarters might not add to annual reflecting rounding

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TRC CONTINUES TO ADVANCE GROWTH STRATEGY

Recent leasing transactions highlight attractive location, properties of TRCC

Tejon Ranch Company's (NYSE:TRC) recently announced milestones illustrate that the company is advancing its growth strategy, we believe. For example, TRC, along with JV partner Majestic Realty, recently secured a lease of the full facility that the JV is building while the site is still in pre-construction stages. The industrial building is planned to be a 446,000-square-foot industrial distribution facility. The facility is planned as a Class A, single load industrial building featuring a 36-foot clear height, seven-inch floor slab and an ESFR sprinkler system.

The company believes securing the lease this early in the process underscores the attractive location of the TRCC (Tejon Ranch Commerce Center) and the dearth of industrial / warehouse space located proximate to nearby cities. Leasing the building before construction has started also reflects the strength of market demand and the strategic location and building amenities at the TRCC, including access to a solid labor pool, according to management. For example, a multi-family residential complex under development (see below) is expected to providing housing for people living nearby the TRCC, including many employed at the TRCC.

Proximity Makes TRCC Attractive & Convenient

Management believes that its proximity to nearby cities makes the TRCC an attractive location for the construction of industrial infrastructure and housing. The TRCC is 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: Company presentation

ost 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. Given the location and proximity to nearby cities, the company believes it is well-positioned to be an important distribution point for commercial traffic for both south bound and north bound traffic.

New tenant Sunrise Brands will occupy building once it is constructed...

The tenant for the new full building will be Sunrise Brands, which will occupy the entire building. Sunrise Brands is a California-based producer, distributor and retailer of branded (such as *Rebecca Minkoff*) and private-label apparel. Construction of the building that Sunrise Brands will occupy is expected to begin in 1Q23 and the building construction is expected to be completed in 1Q24. Sunrise will temporarily occupy space in another building the JV owns until the new building is completed.

The JV also recently leased a 629,274-square foot distribution center at the TRCC adjacent to the Sunrise Brands site to a major retailer. According to TRC, over the last 18 months, the JV has negotiated transactions at four TRCC building sites encompassing more than 2.5 million square feet of industrial space currently under construction or planned for construction beginning in 2023.

… Existing space at TRCC - fully leased & fully occupied

Existing space at TRCC continues to be fully leased and fully occupied, as the company continues to expand its portfolio of industrial properties. According to TRC, TRCC has nearly 12 million square feet of additional entitled space remaining that is available for lease, build-to-suit or sale. In 3Q22 TRC benefited from the sale of a 58-acre land parcel at the TRCC to a large multinational corporation for $22.0 million. This land sale represents the company's second largest industrial land sale to a third-party to-date in terms of size. Remaining available sites can accommodate buildings ranging from 20,000 to 2+ million square feet.

Development plans advancing …

TRC is advancing its real estate development plans. For example, design and engineering work progresses for a multi-family residential complex adjacent to the Outlets at Tejon. The planned complex consists of up to 495 apartments.

TRC has master planned mixed-use residential communities in various stages of development and other real estate projects in its pipeline. When its master planned developments are completed, Tejon Ranch will have more than 35k housing units available, 35+ million square feet of commercial / industrial space and 750 lodging units. TRC also is laying the foundation for expected growth with strategic relationships with development partners and customers. The company expects new JVs for the development, construction and management of a roughly 446,400 square foot industrial building in TRCC-East to be completed in 4Q23. The company intends to continue to pursue commercial/industrial development, multi-family development, leasing, sales, and investment within TRCC and its joint ventures and to continue to invest in its residential projects, including Mountain Village at Tejon Ranch, Centennial at Tejon Ranch and Grapevine at Tejon Ranch (see below).



Mountain Village



Centennial



Grapevine

Source: http://ir.tejonranch.com

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.

Moreover, the anticipated continued development of the California High-Speed Rail is also expected to facilitate commuting from TRC's land assets 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.

Recent court rulings have also been favorable for TRC's development plans. In 4Q22, the company announced that a legal dispute involving the Tejon Ranch Conservancy and a 2008 conservation and land use agreement had reached a resolution. Earlier in 2021, 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 permanently dismissed.

Liquidity & access to capital

At the end of 3Q22, TRC had cash & securities of about $61.5 million and $40.6 million available under its revolving credit line. The company had refinanced the term loan and revolver earlier in 2022, extending maturities and increasing its revolving credit facility ($45 million compared to $35 million under the prior revolver). Separately, TRC had roughly $1.2 million of restricted cash at the end of 3Q22 primarily related to funds held in escrow and, subsequent to the 4Q22 ruling noted above, released 50% of the advance payments it had withheld from escrow and intends to release the balance over a three-year period.

The company also intends to leverage funding from partners and debt financing and/or the sale of rights, among other financial resources. Moreover, TRC's agribusiness and commerce business units are operational and generate recurring revenue.

VALUATION

As Tejon Ranch remains in the early stages of its real estate development plans, the use of certain traditional valuation methods such as P/E, P/FCF or other methods do not reflect the value of the land once development plans are further along, in our view. We continue to value TRC shares on a price-to-acre basis.

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. We believe the Sunrise Brands lease and other recent developments are positives that likely increase the intrinsic value of TRC's land holdings over time.

Our $25.75 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. With the 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.

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.

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.

RISKS

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

- There is the risk of further economic disruption and potentially recession, we believe.
- 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.
- TRC is subject to the need to obtain regulatory approvals and permits.
- 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.

PROJECTED INCOME STATEMENT

Tejon Ranch Income Statement & Projections ($000)

	2019	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22A	2Q22A	3Q22A	4Q22E	2022E	2023E
Real estate - commercial/industrial	$16,792	$9,536	$2,228	$8,126	$2,466	$6,656	$19,476	$7,349	$2,462	$22,352	$2,487	$34,650	$36,036
Mineral resources	9,791	10,736	7,176	7,404	4,774	1,633	20,987	11,968	4,131	3,139	3,934	23,172	23,380
Farming	19,331	13,866	607	279	6,726	3,427	11,039	655	1,921	4,776	4,570	11,922	12,029
Ranch operations	3,609	3,692	1,043	829	996	1,243	4,111	1,048	755	1,208	1,046	4,057	4,094
Total revenues	**49,523**	**37,830**	**11,054**	**16,638**	**14,962**	**12,959**	**55,613**	**21,020**	**9,269**	**31,475**	**12,037**	**73,801**	**75,539**
Real estate - commercial/industrial	12,961	7,122	1,552	4,712	2,331	3,358	11,953	2,736	1,822	6,845	2,072	13,475	14,553
Real estate - resort/residential	2,247	1,612	553	439	322	409	1,723	423	423	372	398	1,616	1,713
Mineral resources	5,818	6,414	5,047	4,253	3,025	1,234	13,559	7,157	2,445	1,745	2,875	14,222	14,364
Farming	15,251	15,103	1,478	1,203	7,296	4,139	14,116	1,762	3,462	8,752	4,180	18,156	18,338
Ranch operations	5,316	4,896	1,187	1,142	1,182	1,168	4,679	1,315	1,250	1,143	1,018	4,726	4,773
Corporate expenses	9,361	9,430	2,291	2,364	2,021	3,167	9,843	2,415	2,185	1,630	2,196	8,426	8,594
Total expenses	50,954	44,577	12,108	14,113	16,177	13,475	55,873	15,808	11,587	20,487	12,739	60,621	62,335
Operating income / (loss)	(1,431)	(6,747)	(1,054)	2,525	(1,215)	(516)	(260)	5,212	(2,318)	10,988	(702)	13,180	13,204
Investment income	1,239	884	7	9	5	36	57	17	79	204	102	402	410
Gain (loss) real estate sales		1,331	-	-			-	-	-		-	-	
Other (loss) income	(1,824)	110	64	43	24	33	164	918	(91)	211	20	1,058	423
Total other income	(585)	2,325	71	52	29	69	221	935	(12)	415	122	1,460	833
Operating income/(loss)	(2,016)	(4,422)	(983)	2,577	(1,186)	(447)	(39)	6,147	(2,330)	11,403	(580)	14,640	14,037
Equity pickup	16,575	4,504	(59)	1,365	1,510	6,386	9,202	1,213	1,663	1,991	1,092	5,959	6,172
Pretax income	14,559	82	(1,042)	3,942	324	5,939	9,163	7,360	(667)	13,394	512	20,599	20,209
Taxes	3,980	829	21	1,118	98	2,584	3,821	3,046	(5)	3,221	143	6,405	5,659
Net income (loss)	10,579	(747)	(1,063)	2,824	226	3,355	5,342	4,314	(662)	10,173	369	14,194	14,551
Minority interest	(1)	(7)	(8)	2	7	(7)	(6)	7	5	(11)	(6)	(5)	(10)
Net income	10,580	(740)	(1,055)	2,822	219	3,362	5,348	4,307	(667)	10,184	375	14,199	14,561
Loss/share - EPS (FD)	$0.40	($0.03)	($0.04)	$0.11	$0.01	$0.13	$0.20	$0.16	($0.03)	$0.38	$0.01	$0.54	$0.55
Average shares out (Mns)	26.1	26.3	26.4	26.4	26.5	26.5	26.4	26.5	26.5	26.5	26.6	26.5	26.6

Source: Company reports, Zacks estimates

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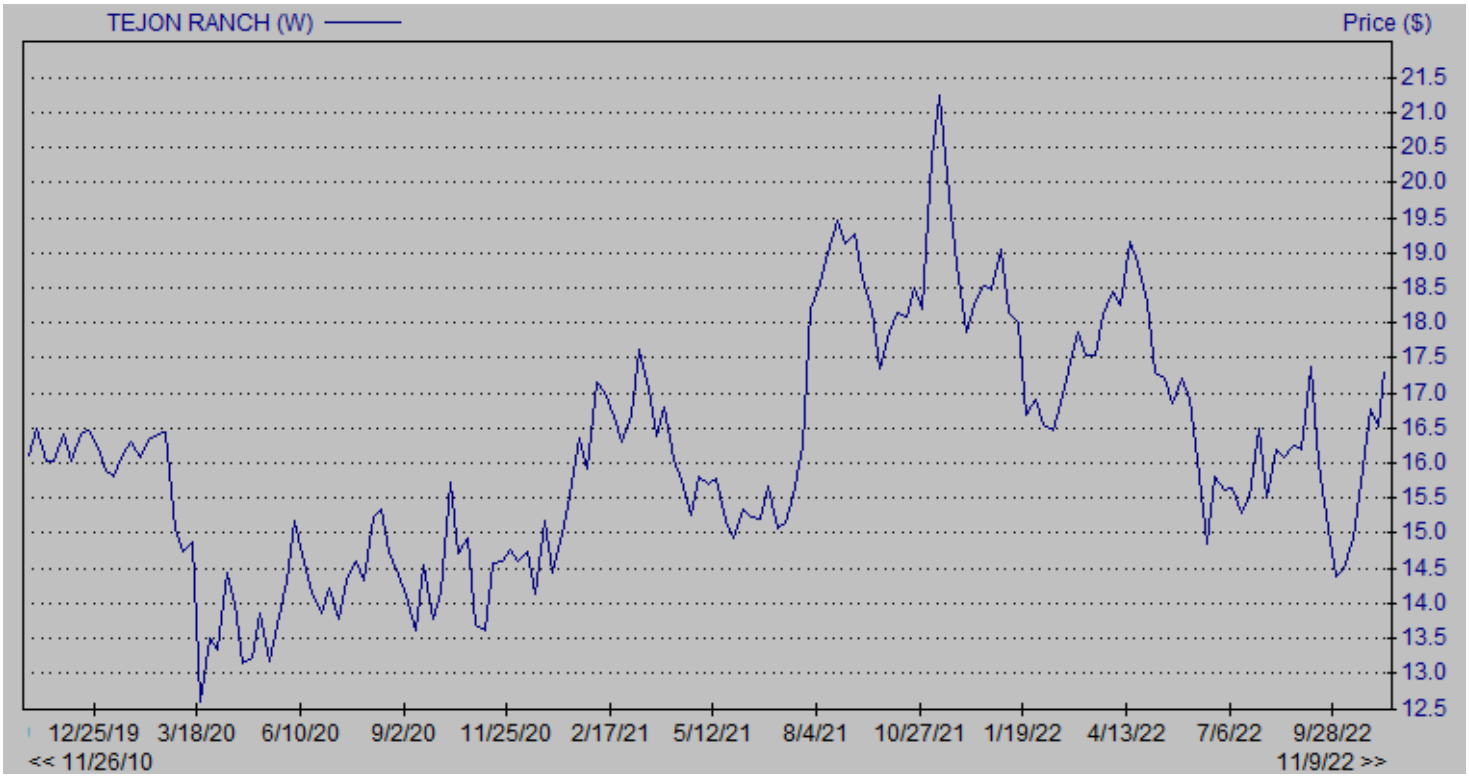

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