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Zacks Small-Cap Research

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Tejon Ranch (TRC-NYSE)

TRC: California's Legislative Initiatives Might Provide Positive Tailwind

Tejon Ranch Co. is a real estate-development company that targets monetizing its land-based assets located 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. The company has multiple projects at various stages of development and is seeing strong interest and demand from prospective tenants.

OUTLOOK

California legislative initiatives to facilitate the state's goal of adding affordable housing – including AB 1449 and the establishment of the Housing Accountability Unit – might provide a positive tailwind for Tejon Ranch Co., in our view, as it advances its growth strategy and development plans. The company's multi-family residential complex under development is expected to provide much-needed housing for people working near the TRCC, including many employed at the TRCC itself.

Current Price (9/27/23)	$15.87
Valuation	**$25.75**

SUMMARY DATA

52-Week High	**$20.65**
52-Week Low	**$14.31**
One-Year Return (%)	**4.9**
Beta	**0.72**
Average Daily Volume (sh)	**37,080**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$425**
Short Interest Ratio (days)	**4.3**
Institutional Ownership (%)	**61**
Insider Ownership (%)	**22**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**33.4**
P/S using 2022 Estimate	**N/A**
P/S using 2023 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)
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	**$12.3A**	**$6.1A**	**$17.6E**	**$14.3E**	**$50.2E**

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	**$0.07A**	**$0.01A**	**-$0.03E**	**-$0.01E**	**$0.04E**

Quarters might not add to annual reflecting rounding

Disclosures on page 10.

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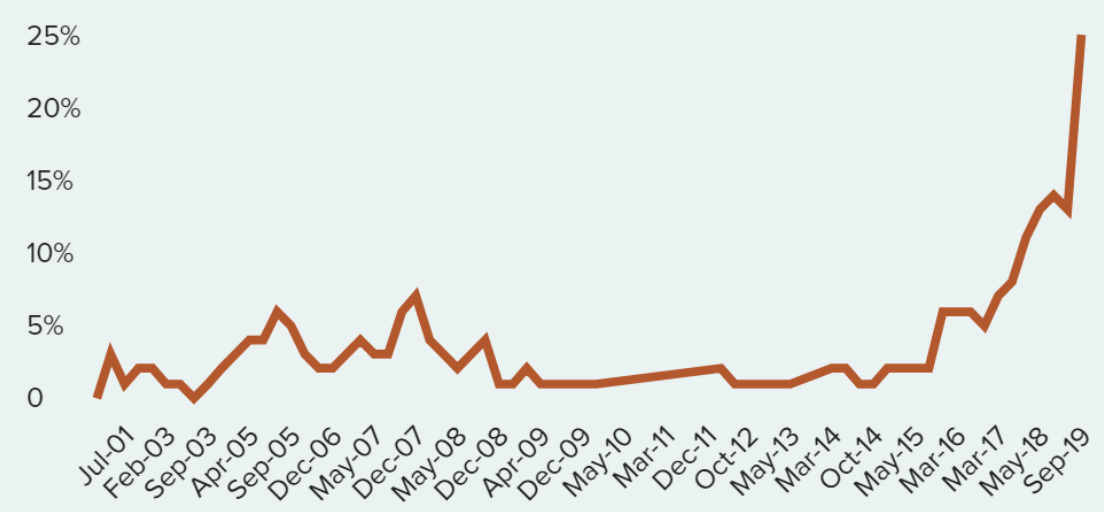
CALIFORNIA INITIATIVES TO BOOST AVAILABILITY OF AFFORDABLE HOUSING

State legislative initiatives might provide a positive tailwind for TRC strategy

As Tejon Ranch Company (NYSE:TRC) advances its growth strategy, California legislative initiatives might provide a positive tailwind, in our view. California Assembly Bill (AB) 1449 aims to exempt certain affordable apartment developments from review by the California Environmental Quality Act (CEQA). Specifically, the bill is expected to "exempt from CEQA certain actions taken by a public agency related to affordable housing projects, as defined, if certain requirements are met" until January 1, 2033. To qualify for exemption, projects need to be located in densely populated urban areas and include a number of units for residents who earn less than 80% of the median income in the local market, among other requirements. In addition, California governor Gavin Newsom has established the Housing Accountability Unit to facilitate the state's goal of adding affordable housing.

These initiatives are designed to address the state's severe shortage of housing, particularly affordable housing. According to the National Low Income Housing Coalition, there is a statewide shortage of affordable and available rental homes for people with incomes at or below the poverty guideline or 30% of the local area median income (AMI). More and more Californians believe that housing shortage is an issue, according to the Public Policy Institute of California (see chart below). 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.

Percent of Californians Believing Housing is State's Leading Issue



Source: the Public Policy Institute of California (PPIC)

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. The company is developing a multi-family residential complex, adjacent to the Outlets at Tejon. The company's planned multi-family residential development Phase 1 includes 228 of the planned 495 residential units.

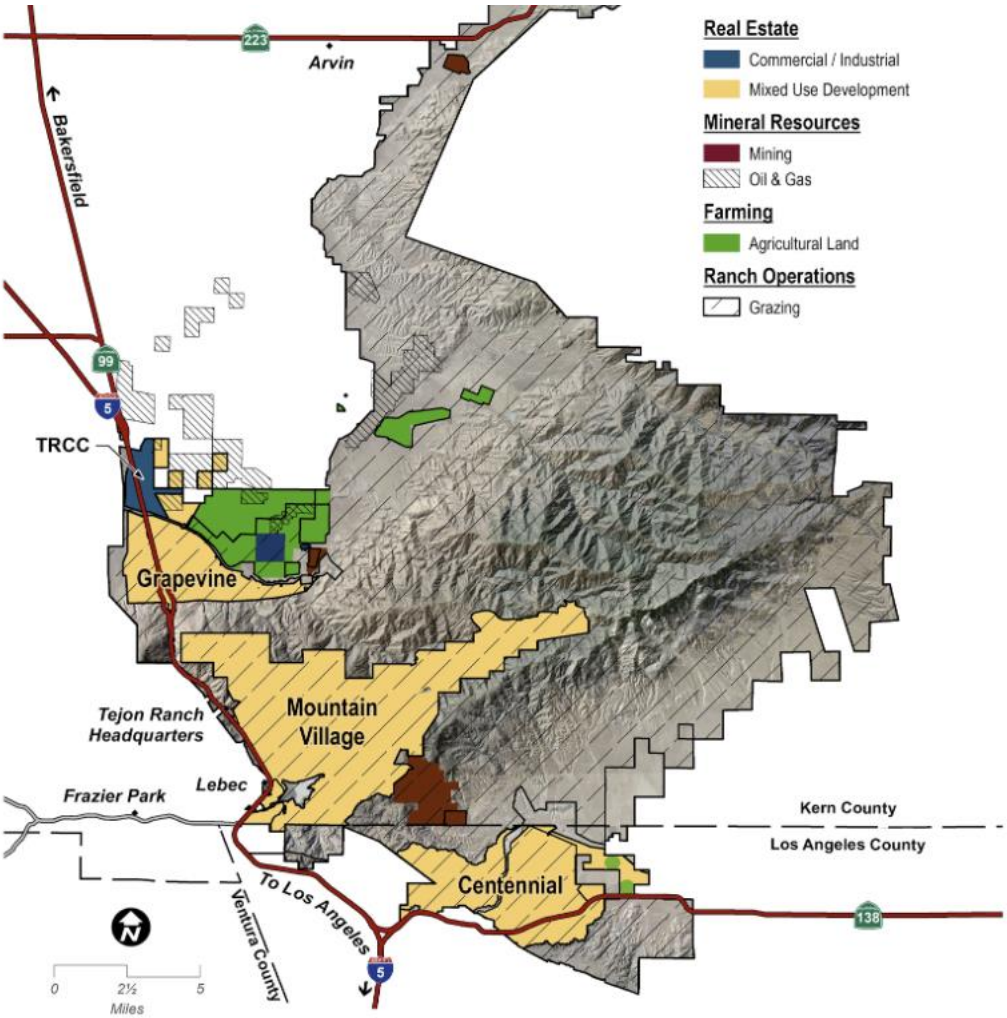
The multi-family residential complex under development is expected to provide housing for people working near the TRCC (Tejon Ranch Commerce Center) , including many employed at the TRCC itself. TRCC comprises 6.4 million square feet of GLA (gross leasable area. The planned apartment development will help provide much-needed housing.

TRCC is located in Kern County, which is experiencing a severe shortage of housing like much of the state, including of apartment units. 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. In fact, development has lagged compared to many other areas within the state, with the slow pace of development exacerbating the housing shortage problem.

Location is Convenient to Nearby Cities

Management believes that its proximity to nearby cities makes the TRCC an attractive location for the construction of housing, as well as industrial infrastructure. 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.

Master Land Use Plan



Source: Company 10K

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. 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.

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.

To facilitate its development plans, Tejon Ranch recently reappointed Michael R.W. Houston as Senior Vice President, General Counsel and Corporate Secretary. He had held those positions at the company from 2016 to 2021, when he left to join the Southern California Association of Governments to serve as Chief Counsel and Director of Legal Services. He has extensive experience in real estate and economic development, land use and environmental issues, among other areas, according to the company.

Commercial & industrial leasing activity

In terms of retail and industrial interest in the TRCC, existing space continues to be fully leased and fully occupied. TRCC commercial portfolio, wholly owned and through joint venture partnerships, comprises 620,907 square feet of GLA and is 90% leased. Construction of a 446,400 square foot industrial building has commenced, with completion expected in early 2024; a lease for this building was secured in advance of construction with Sunrise Brands, a designer, producer, distributor, and retailer of branded and private-label apparel.

The company expects industrial vacancy rates to remain low, as industrial users requiring larger spaces generally have been moving further north from LA County into Kern County, including TRCC. In addition, TRCC has nearly 12 million square feet of additional entitled space remaining that is available for lease, build-to-suit or sale, according to TRC. Remaining available sites can accommodate buildings ranging from 20,000 to 2+ million square feet. Nevertheless, capital markets conditions and the interest rate environment could lead to a slowdown in new commercial real estate development in the near-term.

Expanding Development Plans …

Overall, TRC has master planned mixed-use residential communities in various stages of development and other real estate projects in its pipeline. 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). 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.



Mountain Village



Centennial



Grapevine

Source: http://ir.tejonranch.com

Centennial

TRC is analyzing the various paths to move forward on Centennial after a Los Angeles Superior Court judge recently flagged needed correction of certain environmental issues. Over the past several years, TRC has often worked in conjunction with the courts, county and with environmental groups to address various issues and we would expect the company to continue to do so to resolve these issues. Specifically, the company has noted that it will discuss with LA County the various options available to address the court's ruling.

TRC recently re-hired Nathan Keith as SVP of Real Estate. According to management, he was key in helping guide the Centennial project through the earlier entitlement process. Thus, he knows many of the parties who potentially will be involved in the discussions and understands the development plans for the Centennial project. He initially joined the company in 2007 and eventually attained the position of Vice President of Real Estate. In 2021, he left the company to join Williams Homes, a Santa Clarita, California-based real estate development and homebuilding company.

Liquidity & access to capital

At the end of 2Q23, TRC had cash & marketable securities of about $67 million and also $40.6 million available under its revolving credit line. In 2022 the company had refinanced the term loan and revolver, extending maturities and increasing its revolving credit facility ($45 million compared to $35 million under the prior revolver).

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. TRC recently named a new CFO, Brett A. Brown, who was EVP, CFO and Treasurer at Alexander & Baldwin in Hawaii before joining TRC. The company's former CFO is now focusing on his other responsibilities within the firm, including his role as Chief Operating Officer (COO).

VALUATION

TRC shares have come under pressure recently, partially reflecting the interest rate environment, we believe. While capital markets conditions and rising interest rates could slow new development in the near-term, Tejon Ranch remains committed to moving forward on development plans. We continue to believe the current share price does not reflect the value of the land once development plans are further along. We value TRC shares on a price-to-acre basis, as we believe the use of certain traditional valuation methods such as P/E, P/FCF or others is not appropriate at this early stage in the company's development.

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.

RECENT RESULTS

TRC's 2Q23 revenue and other income including equity pickup from JVs was $8.6 million, compared with $10.9 million for 2Q22. The year-over-year decline reflects several factors, including that Mineral resources segment revenue was lower ($1.6 million for 2Q23, compared to $4.1 million) due to reduced water sales in 2Q23 following heavy winter rainfalls. The State Water Project allocation was at 100%, , which limits water sales opportunities. By comparison, the State Water Project allocation was about 5% in 2Q22. In addition, Farming segment revenues was $1.0 million, compared to $1.9 million in 2Q22, reflecting lower almond and hay sales. Increased investment income ($540,000) partially offset these decreases. Net income was $267,000 in 2Q23, or $0.01 per share, compared to a net loss of ($667,000,) or ($0.03) per share. Adjusted EBITDA was $4.5 million, up from $2.9 million in 2Q22.

RECENT NEWS

- On August 8, 2023, Tejon Ranch announced 2Q23 results.
- TRC named a new general counsel on July 10, 2023.
- On May 5, 2023, Tejon Ranch Co. named Brett Brown as its new Chief Financial Officer.
- Tejon Ranch Co. reported 1Q23 results on May 4, 2023.
- The company's former executive rejoined TRC to head the Centennial project on March 29, 2023.
- On March 27, 2023, Tejon Ranch Co. announced its intention to evaluate options to proceed with the planned development of Centennial following a court ruling.
- On January 5, 2023, the Tejon Ranch Co. and Majestic Realty Co. JV announced the pre-lease of the industrial building being built at the Tejon Ranch Commerce Center (TRCC).
- On November 30, 2022, Tejon Ranch Co. announced the settlement of litigation related to the Tejon Ranch Conservation and Land Use Agreement.

RISKS

Risks to TRC achieving its objective`s, and to our valuation, include the following.

- The company faces the risk that discussions to move Centennial forward take longer than expected and / or are not successful.
- There is the risk of further economic disruption and potentially recession, we believe.
- The real estate development industry is highly capital intensive and interest rates have increased. 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	2021A	1Q22A	2Q22A	3Q22A	4Q22A	2022A	1Q23A	2Q23A	3Q23E	4Q23E	2023E
Real estate - commercial/industrial	$16,792	$9,536	$19,476	$7,349	$2,462	$22,352	$8,352	$40,515	$2,676	$2,633	$5,270	$4,917	$15,496
Mineral resources	9,791	10,736	20,987	11,968	4,131	3,139	2,357	21,595	6,912	1,600	5,040	3,217	16,770
Farming	19,331	13,866	11,039	655	1,921	4,776	5,649	13,001	1,185	1,025	6,205	4,895	13,310
Ranch operations	3,609	3,692	4,111	1,048	755	1,208	1,095	4,106	1,492	840	1,052	1,238	4,622
Total revenues	**49,523**	**37,830**	**55,613**	**21,020**	**9,269**	**31,475**	**17,453**	**79,217**	**12,265**	**6,098**	**17,566**	**14,269**	**50,198**
Real estate - commercial/industrial	12,961	7,122	11,953	2,736	1,822	6,845	4,953	16,356	1,695	1,685	6,913	5,003	15,296
Real estate - resort/residential	2,247	1,612	1,723	423	423	372	411	1,629	388	324	376	415	1,503
Mineral resources	5,818	6,414	13,559	7,157	2,445	1,745	1,622	12,969	4,066	925	1,762	1,638	8,392
Farming	15,251	15,103	14,116	1,762	3,462	8,752	5,835	19,811	2,013	1,474	8,840	5,893	18,220
Ranch operations	5,316	4,896	4,679	1,315	1,250	1,143	1,316	5,024	1,330	1,338	1,154	1,329	5,152
Corporate expenses	9,361	9,430	9,843	2,415	2,185	1,630	3,469	9,699	2,287	2,222	1,646	3,504	9,659
Total expenses	50,954	44,577	55,873	15,808	11,587	20,487	17,606	65,488	11,779	7,968	20,692	17,782	58,221
Operating income / (loss)	(1,431)	(6,747)	(260)	5,212	(2,318)	10,988	(153)	13,729	486	(1,870)	(3,125)	(3,514)	(8,023)
Investment income	1,239	884	57	17	79	204	334	634	456	619	206	337	1,618
Gain (loss) real estate sales		1,331	-	-	-		-	-			-	-	-
Other (loss) income	(1,824)	110	164	918	(91)	211	50	1,088	334	(32)	213	51	566
Total other income	(585)	2,325	221	935	(12)	415	384	1,722	790	587	419	388	2,184
Operating income/(loss)	(2,016)	(4,422)	(39)	6,147	(2,330)	11,403	231	15,451	1,276	(1,283)	(2,706)	(3,126)	(5,839)
Equity pickup	16,575	4,504	9,202	1,213	1,663	1,991	2,885	7,752	1,517	1,938	2,011	2,914	8,380
Pretax income	14,559	82	9,163	7,360	(667)	13,394	3,116	23,203	2,793	655	(695)	(212)	2,541
Taxes	3,980	829	3,821	3,046	(5)	3,221	1,131	7,393	1,013	391	35	21	1,460
Net income (loss)	10,579	(747)	5,342	4,314	(662)	10,173	1,985	15,810	1,780	264	(730)	(233)	1,081
Minority interest	(1)	(7)	(6)	7	5	(11)	1	2	6	(3)	(11)	1	(7)
Net income	10,580	(740)	5,348	4,307	(667)	10,184	1,984	15,808	1,774	267	(719)	(234)	1,088
Loss/share - EPS (FD)	$0.40	($0.03)	$0.20	$0.16	($0.03)	$0.38	$0.07	$0.59	$0.07	$0.01	($0.03)	($0.01)	$0.04
Average shares out (Mns)	26.1	26.3	26.4	26.5	26.5	26.5	27.1	26.7	26.6	26.9	26.8	27.4	26.9

Source: Company reports, Zacks estimates

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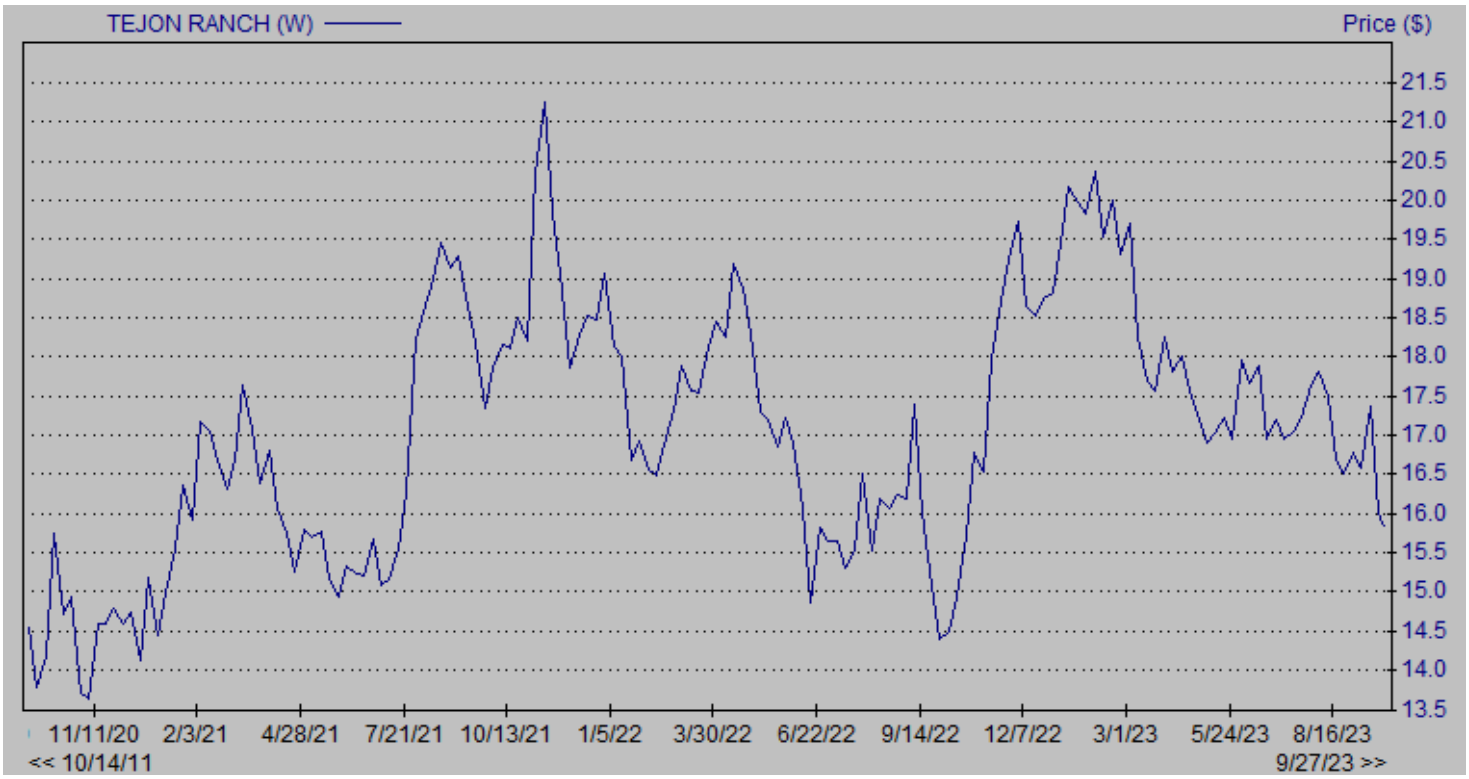

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