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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: Low LA Region Industrial Vacancies, Rising Lease Rates Expected Catalysts for Continued Strong Demand at TRCC

Recent activity underscore the value of TRC's land for a broad range of activities, in our view. TRCC continues to see strong lease activity on both existing & planned for development space, which TRC believes reflects its attractive location, given close proximity to nearby cities & roadways. TRCC is located ~60 miles north of LA & 25 miles south of Bakersfield. Demand for warehouse / distribution infrastructure & housing in this region is high & supply is extremely limited.

OUTLOOK

TRC has fully pre-leased industrial buildings even before construction has begun. That this reflects the strength of market demand and the strategic location and building amenities at the TRCC is consistent, we believe, with metrics from commercial real estate services firm CBRE citing industrial vacancies as low as 0.5% in the LA region & rising lease rates for warehouse / distribution space, while zoning regulations often lead to challenges to convert other use space to industrial / commercial use.

Current Price (11/14/23)	$16.50
Valuation	**$25.80**

SUMMARY DATA

52-Week High	**$20.65**
52-Week Low	**$15.25**
One-Year Return (%)	**-9**
Beta	**0.68**
Average Daily Volume (sh)	**37,143**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$441**
Short Interest Ratio (days)	**4.8**
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	**N/A**
P/S using 2023 Estimate	**N/A**
P/S using 2024 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)
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**	**$10.2A**	**$14.3E**	**$42.8E**
2024					**$44.1E**

EPS / Loss Per share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
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**	**-$0.01A**	**-$0.01E**	**$0.05E**
2024					**$0.10E**

Quarters might not add to annual reflecting rounding

Disclosures on page 11.

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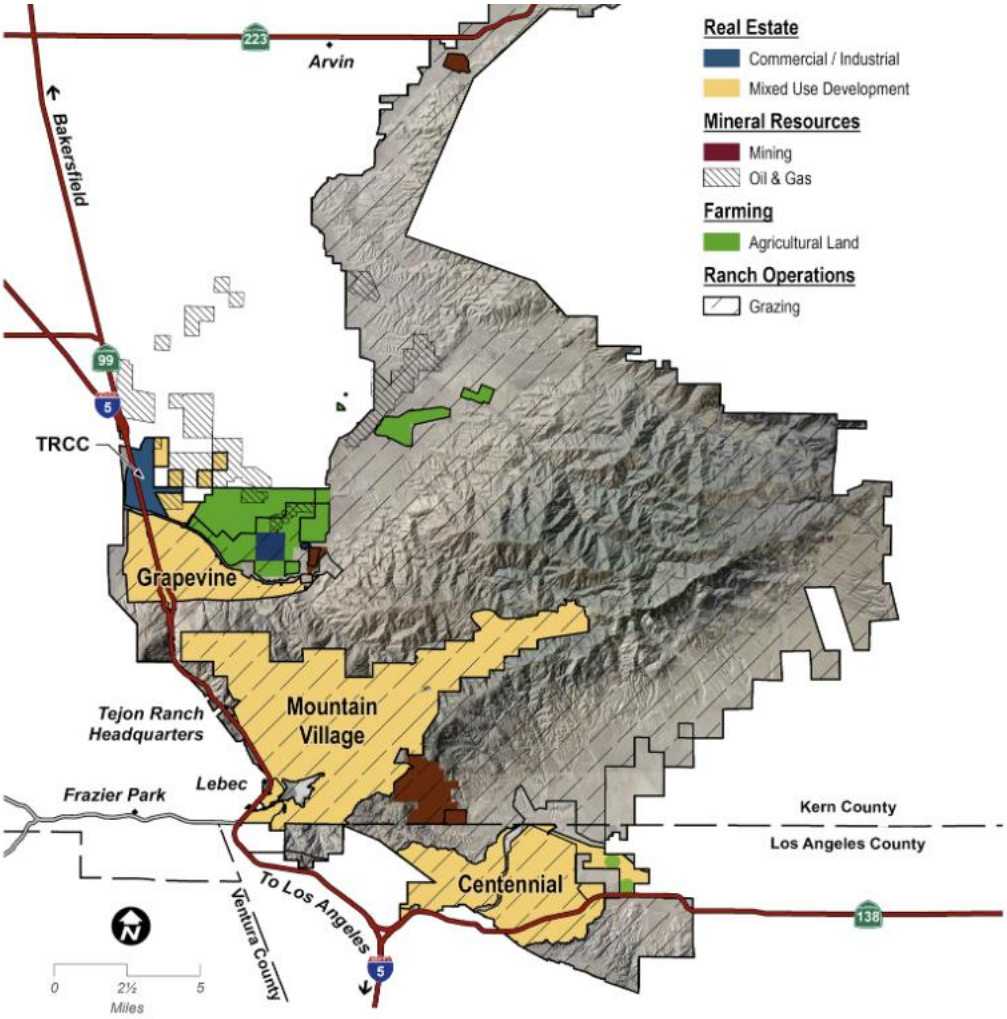
NEED FOR REGIONAL WAREHOUSE / INDUSTRIAL SPACE APPEARS TO BE GROWING

… making TRCC likely an important distribution point for north / south bound commercial traffic…

As Tejon Ranch Company (NYSE:TRC) moves forward on its development plans, the company concurrently continues to generate revenue from the income producing units in its operations. Recent activity underscore the value of Tejon Ranch's underlying land assets for a broad range of activities, in our view.

For example, the Tejon Ranch Commerce Center (TRCC) continues to see strong lease activity on both existing area and space planned for development. The company believe this reflects the attractive location of the facility, given its close proximity to nearby urban centers and to roadways. 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



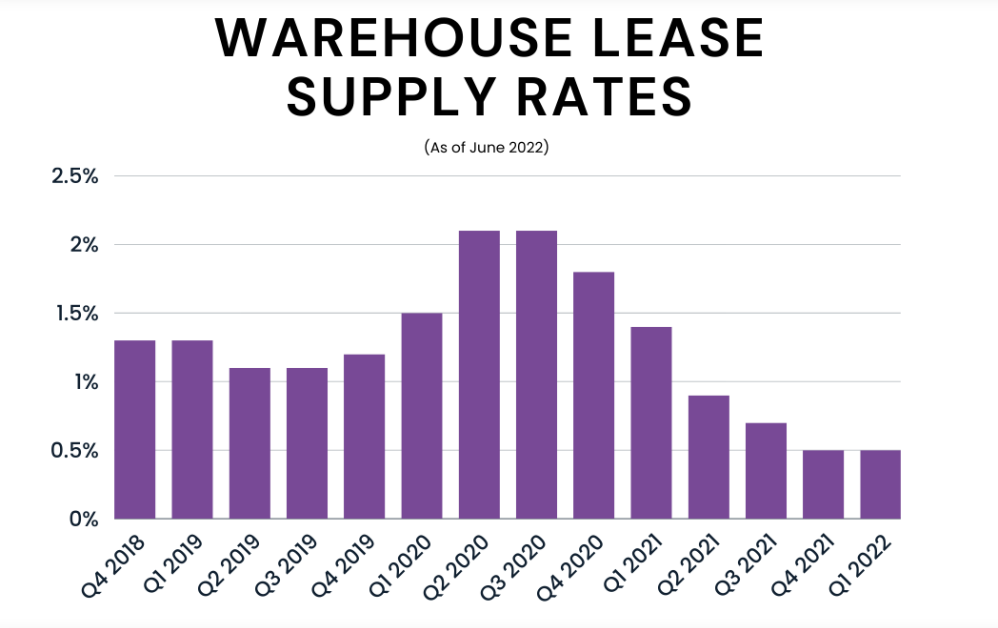
Source: Company 10K

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. Access to these roadways and location near major cities make TRCC well-positioned to be an important distribution point for commercial traffic for both south bound and north bound traffic, in our opinion.

…as illustrated by strong pre-lease activity

A Los Angeles-based company recently pre-leased space at TRCC, and MRC-5, the company's newest industrial building, is also pre-leased. Construction of MRC-5 is on-schedule for planned completion by 1Q24, according to the company. TRC, along with JV partner Majestic Realty, recently secured a lease of the full facility 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 as early in the process as it has underscores the attractive location of the TRCC and the dearth of industrial / warehouse space located proximate to nearby cities.

According to Courthouse News, reflecting the industrial vacancy rate as low as 0.5% in the LA region, rising lease rates for warehouse space puts warehouse lease rates in LA county among the highest among metropolitan areas in North America. Land that is already zoned for industrial use can be redeveloped into warehouses once existing leases expire more easily than trying to convert retail space to industrial warehouses because the latter is likely to face challenges from municipalities.



Based on information supplied by CBRE

Thus, leasing the building even before construction has begun 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. 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 be completed in 1Q24, as noted. In the meantime, Sunrise will temporarily occupy space in another building owned by a TRC JV until the new building is completed.

Once Sunrise Brands moves to its new site and vacates the temporary space, TRC has another tenant to occupy the space. TRC has signed a lease with a manufacturer and distributor of industrial components

for the 240,000 square feet of space that Sunrise Brands is occupying on a temporary basis until its building is constructed. According to TRC, over the last roughly two years, it has negotiated transactions at four TRCC building sites encompassing more than 2.5 million square feet of industrial space currently under or planned for construction.

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 to TRCC. 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.

In addition to strong demand for warehouse space, demand for retail footage at TRCC also remains solid and the company continues to add new stores to the Outlets at Tejon. Later this month, TRCC will add Under Armour, which is a well-known distributor of branded athletic performance apparel, footwear, and accessories.

Need for residential units also underscores attractiveness of TRC property…

The location of the company's land asset also makes it appealing as residential property. For example, a multi-family residential complex under development – the company is developing a multi-family residential complex, adjacent to the Outlets at Tejon – is expected to providing housing for people living nearby the TRCC, including many employed at the TRCC. Design and engineering for Phase 1 of the company's planned multi-family residential development at TRCC is underway. Phase 1 includes 228 of 495 residential units planned.

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 multi-family residential complex under development is expected to provide housing for people working near the TRCC, 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.

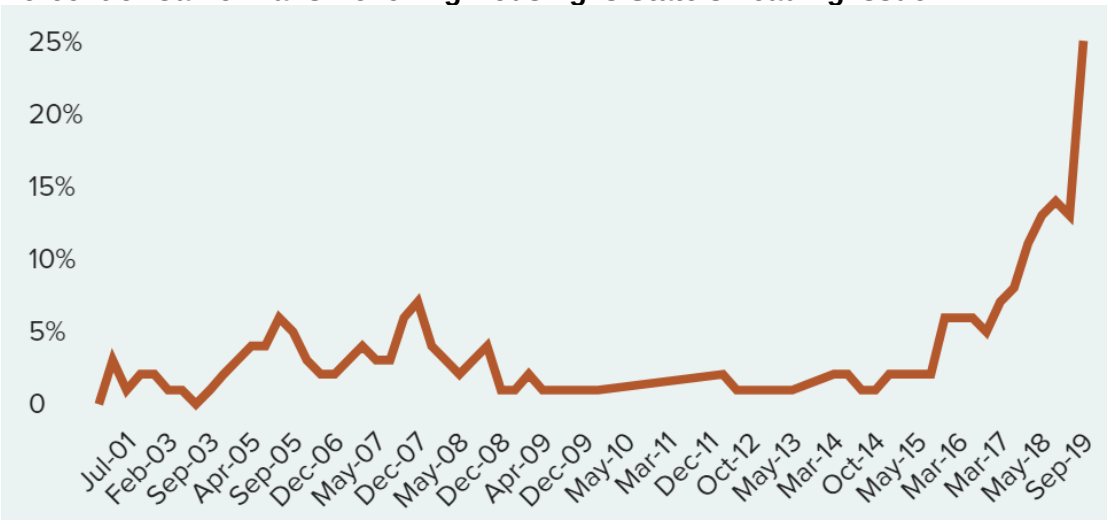
Moreover, the anticipated continued development of the California High-Speed Rail is also expected to facilitate commuting from TRC's land assets to nearby cities. The California High-Speed Rail Authority has nearly 120 miles under construction, with more construction extensions anticipated. The Authority 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.

California legislative initiatives might also 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)

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.

Pursuing Centennial development



Source: http://ir.tejonranch.com

Tejon Ranch is also pursuing an appeal of the court ruling in the CEQA challenge on its Centennial planned development community. Centennial is one of three master planned mixed-use residential communities TRC has in various stages of development.

TRC is analyzing 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 also recently re-hired Nathan Keith as SVP of Real Estate to advance its Centennial project and facilitate TRC's development plans.

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.

To facilitate its overall development plans, Tejon Ranch also 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.

RECENT RESULTS

3Q23 Highlights

TRC reported total 3Q23 revenue of $10.2 million. While this represents a year-over-year decline of nearly 68%, comparisons are not apples-to-apples, we believe, as the company recorded a sizable $19.6 million non-recurring land sale in last year's comparable period. Excluding this, we estimate that total revenue would have been down about 15% on a pro forma basis, but that revenue for the company's important commercial/industrial segment would have been about 25% higher in 3Q23. We believe the estimated pro forma segment revenue growth reflects that robust demand for the company's facilities has resulted in strong leasing activity in recent quarters, as noted earlier.

The reported operating profit decline in the company's commercial/industrial segment was partially offset by a $4.5 million improvement in operating results of the farming unit. This segment improvement largely reflected lower cost of sales and lower fixed water charges. Conversely, farming segment operations continue to be impacted in 2023 by higher production expenses, such as fuel, fertilizer, pest control and labor costs. At the same time, the higher than usual almond inventory level from prior years is expected to adversely impact almond selling prices for the remainder of the year. The roughly 45% year-over-year decrease in farming segment revenues ($2.6 million in 3Q23 compared to $4.8 million in 3Q22) primarily reflects declines in sales of almond, as well as pistachios. The company delayed harvesting both crops, with adverse weather conditions delaying the harvest of the pistachio crop in 2023. As a result, the company generated no pistachio revenue in 3Q23. Overall, the farming segment recorded segment operating profit of $485k compared to a segment operating loss of about $4 million in 3Q22.

Notably, TRC's effective tax rate was above the statutory rate – 68% for the first three quarters of 2023, compared to 31% for the comparable period of 2022 – reflecting permanent differences related to compensation primarily for C suite executives. TRC reported a net loss of $341k, or ($0.01) per share compared to net income of $10.2 million, or $0.38 per share in 3Q22, the result of factors noted above.

Liquidity & access to capital

At the end of 3Q23, TRC had liquidity of about $113.2 million, with cash and securities of roughly $72.6 million and $40.6 million available on its line of credit. Nevertheless, the company noted that given the uncertain economic outlook and current interest environment, it's strategy is to maximize cash flow by limiting cash expenditures when it can. In addition, in 2022 the company refinanced the term loan and revolver, extending maturities and increasing its revolving credit facility ($45 million 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

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 designated for development, once development plans are further along, and the long-term value of the property for agricultural and other uses. 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-$26/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 believe the pressure on TRC shares in recent months reflecting, we believe, rising interest rates and legal challenges to development plans, among other factors, masks the longer-term potential as TRC seeks to monetize the value of the land. 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 NEWS

- On November 7, 2023, Tejon Ranch announced 3Q23 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)

	2020A	2021A	1Q22A	2Q22A	3Q22A	4Q22A	2022A	1Q23A	2Q23A	3Q23A	4Q23E	2023E	2024E
Real estate - commercial/industrial	$9,536	$19,476	$7,349	$2,462	$22,352	$8,352	$40,515	$2,676	$2,633	$3,397	$4,917	$13,623	$14,100
Mineral resources	10,736	20,987	11,968	4,131	3,139	2,357	21,595	6,912	1,600	3,118	3,217	14,847	15,204
Farming	13,866	11,039	655	1,921	4,776	5,649	13,001	1,185	1,025	2,642	4,895	9,747	10,040
Ranch operations	3,692	4,111	1,048	755	1,208	1,095	4,106	1,492	840	1,052	1,238	4,622	4,733
Total revenues	**37,830**	**55,613**	**21,020**	**9,269**	**31,475**	**17,453**	**79,217**	**12,265**	**6,098**	**10,209**	**14,269**	**42,841**	**44,077**
Real estate - commercial/industrial	7,122	11,953	2,736	1,822	6,845	4,953	16,356	1,695	1,685	2,137	5,003	10,520	10,730
Real estate - resort/residential	1,612	1,723	423	423	372	411	1,629	388	324	367	415	1,494	1,524
Mineral resources	6,414	13,559	7,157	2,445	1,745	1,622	12,969	4,066	925	2,000	1,638	8,629	8,802
Farming	15,103	14,116	1,762	3,462	8,752	5,835	19,811	2,013	1,474	2,157	5,893	11,537	11,768
Ranch operations	4,896	4,679	1,315	1,250	1,143	1,316	5,024	1,330	1,338	1,196	1,329	5,193	5,297
Corporate expenses	9,430	9,843	2,415	2,185	1,630	3,469	9,699	2,287	2,222	2,315	3,504	10,328	10,534
Total expenses	44,577	55,873	15,808	11,587	20,487	17,606	65,488	11,779	7,968	10,172	17,782	47,701	48,655
Operating income / (loss)	(6,747)	(260)	5,212	(2,318)	10,988	(153)	13,729	486	(1,870)	37	(3,514)	(4,861)	(4,578)
Investment income	884	57	17	79	204	334	634	456	619	700	337	2,112	1,521
Gain (loss) real estate sales	1,331	-	-	-		-	-			-	-	-	-
Other (loss) income	110	164	918	(91)	211	50	1,088	334	(32)	(30)	51	323	(226)
Total other income	2,325	221	935	(12)	415	384	1,722	790	587	670	388	2,435	1,295
Operating income/(loss)	(4,422)	(39)	6,147	(2,330)	11,403	231	15,451	1,276	(1,283)	707	(3,126)	(2,426)	(3,283)
Equity pickup	4,504	9,202	1,213	1,663	1,991	2,885	7,752	1,517	1,938	1,161	2,914	7,530	7,680
Pretax income	82	9,163	7,360	(667)	13,394	3,116	23,203	2,793	655	1,868	(212)	5,104	4,398
Taxes	829	3,821	3,046	(5)	3,221	1,131	7,393	1,013	391	2,215	21	3,640	1,539
Net income (loss)	(747)	5,342	4,314	(662)	10,173	1,985	15,810	1,780	264	(347)	(233)	1,464	2,858
Minority interest	(7)	(6)	7	5	(11)	1	2	6	(3)	(6)	1	(2)	(2)
Net income	(740)	5,348	4,307	(667)	10,184	1,984	15,808	1,774	267	(341)	(234)	1,466	2,860
Loss/share - EPS (FD)	($0.03)	$0.20	$0.16	($0.03)	$0.38	$0.07	$0.59	$0.07	$0.01	($0.01)	($0.01)	$0.05	$0.10
Average shares out (Mns)	26.3	26.4	26.5	26.5	26.5	27.1	26.7	26.6	26.9	26.8	26.8	26.8	26.8

Source: Company reports, Zacks estimates

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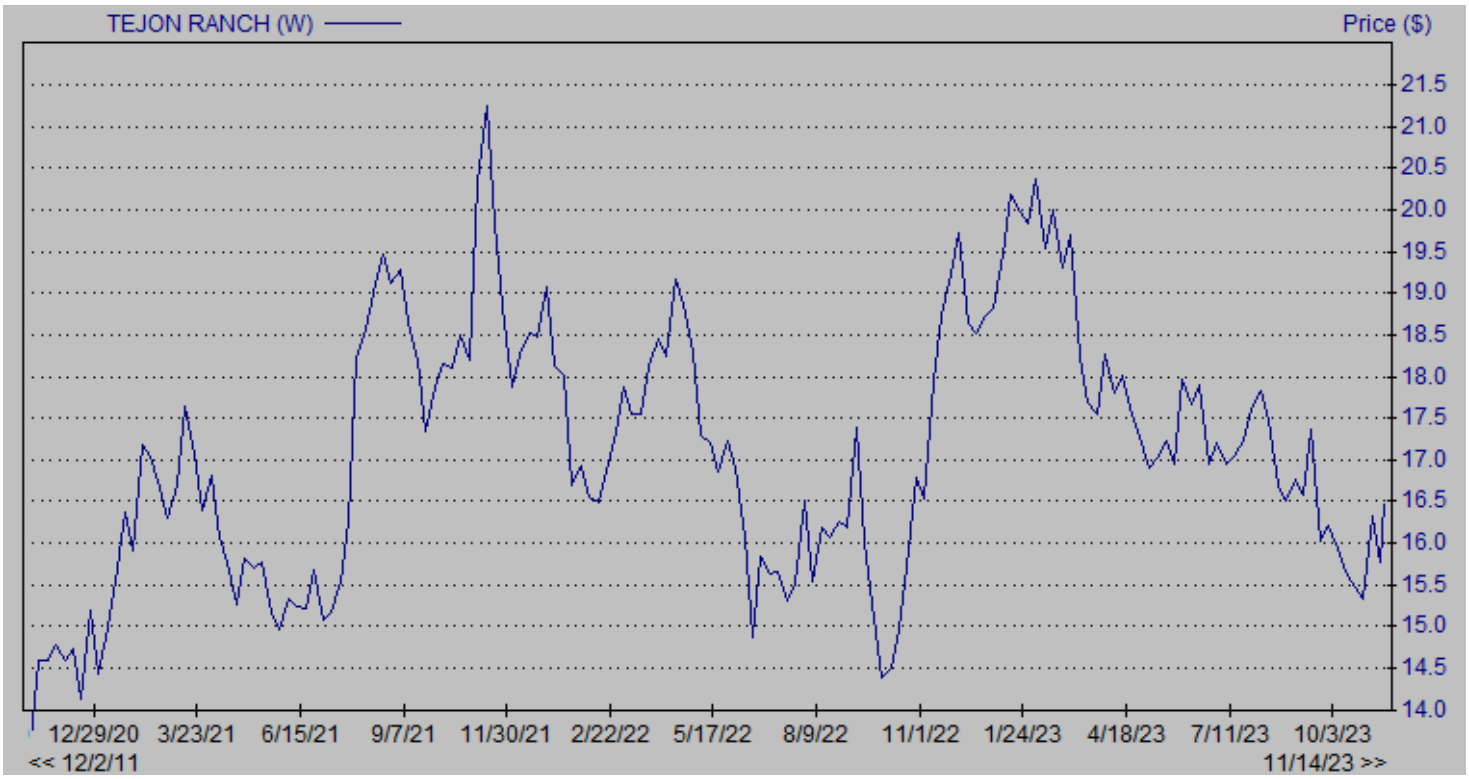
HISTORICAL STOCK PRICE



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