# Union Pacific Corporation (UNP)

*Updated May 14th, 2018 by Nate Parsh*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $141 | **5 Year CAGR Estimate:** | 3.1% | **Quality Percentile:** | N/A |
| **Fair Value Price:** | $121 | **5 Year Growth Estimate:** | 4.0% | **Momentum Percentile:** | N/A |
| **% Fair Value:** | 117% | **5 Year Valuation Multiple Estimate:** | -3.0% | **Total Return Percentile:** | N/A |
| **Dividend Yield:** | 2.1% | **5 Year Price Target** | $148 | **Valuation Percentile:** | N/A |

## Overview & Current Events

President Lincoln signed the Pacific Railway Act of 1862 that authorized the Union Pacific Railroad Company to build a rail line west towards the coast from the Missouri River. The line would eventually meet another coming east from Sacramento. Today, Union Pacific is the largest railroad company in the country and operates more than 32,000 miles of rail throughout the western two-thirds of the country. The railroad has stops along both the Canadian and Mexican borders. Union Pacific transports industrial and agricultural products as well as coal and chemicals. The stock has a current market cap of $110 billion. Union Pacific generated almost $20 billion in revenues in 2017.

Union Pacific reported earnings for the first quarter of 2018 on 4/26/2018. The company earned $1.68 per share. This topped estimates by $0.02 and was an increase of 27% from Q1 2017. Union Pacific produced $5.5 billion in revenue, beating estimates by $100 million and growing 6.8% year over year. Union Pacific's operating ratio, the percentage of revenue that the railroad spent on operating costs, improved 0.6% to 64.6%. Total volumes were up 2%, led by a 6% increase in energy related products. Volume increases show that the economy is performing well because of higher demand for products. Only agricultural shipments declined, mostly due to lower grain exports.

## Growth on a Per-Share Basis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $2.27 | $1.81 | $2.77 | $3.36 | $4.14 | $4.71 | $5.75 | $5.41 | $5.07 | $5.79 | ***$7.59*** | ***$9.23*** |
| **DPS** | $0.47 | $0.54 | $0.66 | $0.97 | $1.25 | $1.48 | $1.91 | $2.20 | $2.26 | $2.48 | ***$2.92*** | ***$3.55*** |

Earnings per share for Union Pacific have increased at a rate of almost 10% per year over the past decade, though much of this growth occurred in the years directly after the last recession. Earnings have increased at a rate of 4% over the past five years. Projecting this growth rate to estimates for 2018, shares could earn produce $9.23 in earnings by 2023.

Besides volume growth, the other reason revenues were up almost 7% for the 1st quarter was because Union Pacific saw high levels of growth in its freight revenue. With WTI Crude oil prices rising above $70 a barrel, the demand for drilling related products has increased. This helps to explain the 15% year over year rise for Energy freight revenues. Industrial revenues were up 7% on the increase in military and waste volumes. Premium revenues improved 5%, due to domestic intermodal and auto parts growth which was offset by declines in exports and finished vehicles shipments. Coal shipments have declined due to demand for alternative energy sources, an issue most other railroads are dealing with.

While the company did see a decline in EPS during the last recession, Union Pacific's earnings more than recovered by 2010. EPS have improved almost every year since, aided by stock buybacks. The company bought back 9.3 million shares at an average price of $129 a share, which investors should consider a good use of capital given the share price.

Union Pacific has increased its dividend for the past 12 years. The company has raised its dividend at a rate of 18% per year. Much of this growth occurred at the beginning of the current decade. We expect dividends to rise at the same rate as earnings going forward. If this occurs, investors could receive $3.55 income by 2023.

## Valuation Analysis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Now | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 14.6 | 14.7 | 13.8 | 14.5 | 14.1 | 16.0 | 17.6 | 18.3 | 17.4 | 19.1 | ***18.6*** | ***16.0*** |
| **Avg. Yld.** | 1.4% | 2.0% | 1.7% | 2.0% | 2.1% | 2.0% | 1.9% | 2.2% | 2.6% | 2.2% | ***2.1%*** | ***2.4%*** |

Union Pacific shares have an average price to earnings multiple of 16 over the past decade. The last ten years have been a tail of two valuations. From 2008-2012, EPS grew steadily except for 2009. Dividend growth topped 21% per year in this span. Over the past five years, the P/E multiple has expanded greatly as share price has accelerated even as earnings have been less consistent. Dividend growth also slowed during this time to ~11% per year. If the stock reverts to its decade long average P/E, then the stock's multiple could contract 3% per year through 2023.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **GP/A** | 27% | 22.7% | 13.2% | 14.4% | 16% | 16.7% | 18.5% | 16.4% | 14.8% | 15.6% | ***16%*** | ***17.5%*** |
| **Debt/A** | 61.1% | 60.2% | 58.8% | 58.8% | 57.8% | 57.3% | 59.5% | 62.1% | 64.2% | 57% | ***59.7%*** | ***57.5%*** |
| **Int. Cov.** | 8.5 | 6 | 8.4 | 10.3 | 12.9 | 14.5 | 16 | 13.3 | 10.9 | 11.9 | ***11.8*** | ***11.3*** |
| **Payout** | 20.7% | 29.8% | 23.8% | 28.9% | 30.2% | 31.4% | 33.2% | 40.7% | 44.6% | 42.8% | ***38.5%*** | ***38.5%*** |
| **Std. Dev.** | 40% | 37% | 20.6% | 24.4% | 14% | 13.1% | 15.6% | 20.2% | 21.2% | 17.2% | ***18.2%*** | ***22.3%*** |

Union Pacific's earnings were impacted during the last recession. A decline in earnings would be likely to occur in the next recession as many of the products that the company transports, like automotive vehicles, are in high demand when the U.S. economy is on solid ground. Union Pacific's energy related shipments would likely drop as well if the price of oil were to suffer another significant decline. Another factor investors should keep in mind is that a trade war with China would most likely impact imports to the U.S. So far, actions between the world's two largest economies haven't led to a full-blown trade war. While Union Pacific's gross profit as a percentage of asset is higher than some of the railroads in our coverage universe, this metric has declined since 2008. The company's dividend payout ratio has risen steadily over the past few years as earnings growth has slowed. We feel that the company is unlikely to expand its dividend payout ratio much beyond current levels. Accelerated dividend growth will likely have to come from higher earnings growth.

## Final Thoughts & Recommendation

Shares of Union Pacific are expected to offer a total return of 3.1% per year over the next five years. This annual return is a combination of growth (4%), dividends (2.1%) and multiple reversion (-3%). Both the company and the stock performed very well in the years following the last recession, but earnings growth has slowed in recent years. We recommend that investors pass on Union Pacific for now. There are better railroad investments available elsewhere.

## Total Return Breakdown by Year