Union Pacific Corporation (UNP)

Updated July 19th, 2018 by Nate Parsh

Key Metrics

Current Price:	$140	**5 Year CAGR Estimate:**	3.2%	**Volatility Percentile:**	47.7%
Fair Value Price:	$121	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	80.6%
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Valuation Percentile:**	36.9%
Dividend Yield:	2.1%	**5 Year Price Target**	$148	**Total Return Percentile:**	15.9%

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 2nd quarter earnings on July 19th. UNP earned a company record $1.98 per share, $0.03 above estimates and growing 36.6% year over year. Revenue grew 8% to $5.67 billion, beating estimates by $20 million.

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.

Union Pacific's operating ratio, the percentage of revenue that the railroad spent on operating costs, increased 1.1% to 63% last quarter. Union Pacific had carload growth of 4% while freight revenue increased 8%. Separately, the railway had 6% volume growth in intermodal during the quarter. As has been the case for some time, coal was weak, showing 10% declines in volumes. Other energy products, such as sand and petroleum, saw double digit growth. While agriculture volumes were down 1%, revenue for this product was up 5%. Fuel costs were a headwind, as they increased 48% from the 2nd quarter of 2017. Employee head count increased during the quarter as crews were dispatched to repair a collapsed tunnel near Oakridge, Oregon. This required trains to be rerouted, requiring more fuel and delays in arrival of shipments.

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 per share in dividend 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	***18.5***	***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. After a slight drop

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

in price since our May 14th update, Union Pacific's stock has a current multiple of 18.5. If the stock reverts to its decade long average P/E, then the stock's multiple could contract 2.9% per year through 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

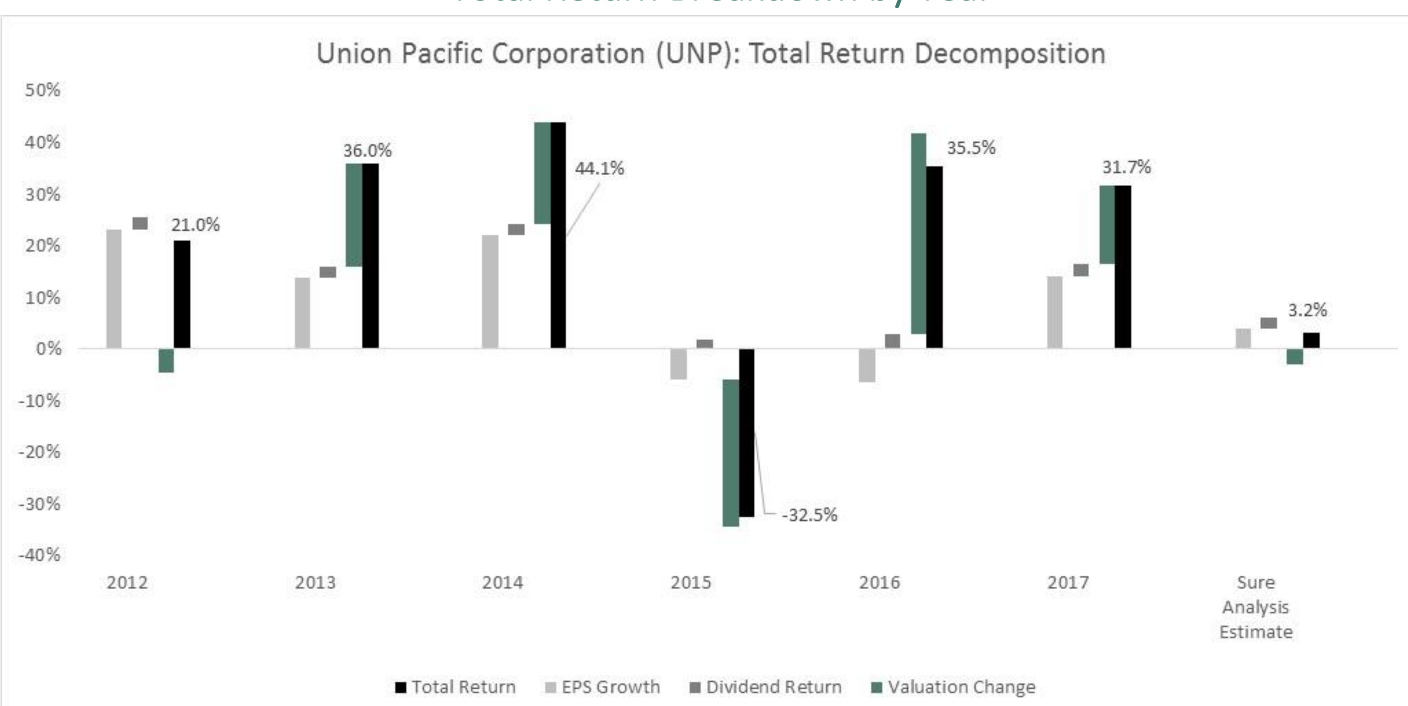
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	27%	22.7%	13.2%	14.4%	16%	16.7%	18.5%	16.4%	14.8%	15.6%	***16%***	***17.5%***
Debt/A	61.1%	60.2%	58.8%	58.8%	57.8%	57.3%	59.5%	62.1%	64.2%	57%	***59.7%***	***57.5%***
Int. Cov.	8.5	6	8.4	10.3	12.9	14.5	16	13.3	10.9	11.9	***11.8***	***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 3.2% per year through 2023, a slight increase from our previous update of 3.1%. This annual return is a combination of growth (4%), dividends (2.1%) and multiple reversion (2.9%). Both the company and the stock performed very well in the years following the last recession, but earnings growth has slowed in recent years. While competitor CSX Corporation (CSX) showed an improvement (decline) in operating ratio during its 2nd quarter, Union Pacific's went up. With the multiple already elevated and more likely to contract than expand, we do not see enough upside in Union Pacific to recommend purchasing at this point in time.

Total Return Breakdown by Year



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