



# Union Pacific Corporation (UNP)

Updated October 30<sup>th</sup>, 2018 by Nate Parsh

## Key Metrics

<b>Current Price:</b>	\$141	<b>5 Year CAGR Estimate:</b>	3.3%	<b>Volatility Percentile:</b>	37.7%
<b>Fair Value Price:</b>	\$121	<b>5 Year Growth Estimate:</b>	4.0%	<b>Momentum Percentile:</b>	88.0%
<b>% Fair Value:</b>	117%	<b>5 Year Valuation Multiple Estimate:</b>	-3.0%	<b>Growth Percentile:</b>	20.0%
<b>Dividend Yield:</b>	2.3%	<b>5 Year Price Target</b>	\$148	<b>Valuation Percentile:</b>	20.6%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	8.2%

## 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 \$104 billion. Union Pacific generated almost \$20 billion in revenues in 2017.

Union Pacific released 3<sup>rd</sup> quarter earnings on October 25<sup>th</sup>. Union Pacific earned a company record \$2.15 per share, \$0.06 above estimates and a 43% increase from last year. Revenue grew 9.6% to \$5.93 billion.

Union Pacific's operating ratio was flat year-over-year at 61.7%, but an improvement sequentially from the 2<sup>nd</sup> quarter's 63% operating ratio. Freight revenue growth was from a combination of an increase of volume and pricing gains. All shipment types saw positive volume growth in the 3<sup>rd</sup> quarter, except for Energy, which had a 2% decline in volumes. Coal shipments fell 3% while frac sand suffered a 23% decline in volumes, but revenues did increase 1%. Industrial shipments grew 9% and had a 13% climb in revenues. Construction markets and industrial product end markets drove these increases. Premium volumes increased 9% and sales grew 18% due in part to stronger truck and SUV sales. Agriculture products showed a 2% gain in volumes and a 6% rise in revenues as strength in feed grains and biofuels were partially offset by lower wheat exports.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.27	\$1.81	\$2.77	\$3.36	\$4.14	\$4.71	\$5.75	\$5.41	\$5.07	\$5.79	<b>\$7.59</b>	<b>\$9.23</b>
<b>DPS</b>	\$0.47	\$0.54	\$0.66	\$0.97	\$1.25	\$1.48	\$1.91	\$2.20	\$2.26	\$2.48	<b>\$3.20</b>	<b>\$3.89</b>
<b>Shares</b>	1006.5	1010.1	983.13	959.86	938.93	912	883.37	849.21	815.8	780.9	<b>755</b>	<b>650</b>

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 has increased its dividend for the past 12 years. The company has raised its dividend at a rate of 18% per year. Union Pacific has raised its dividend three times in the last five quarters. The most recent increase occurred for the payment made at the end of September. Over the past five quarters, the dividend has grown by almost 33%. Union Pacific offers an annualized dividend of \$3.20.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	14.6	14.7	13.8	14.5	14.1	16.0	17.6	18.3	17.4	19.1	<b>18.6</b>	<b>16.0</b>
<b>Avg. Yld.</b>	1.4%	2.0%	1.7%	2.0%	2.1%	2.0%	1.9%	2.2%	2.6%	2.2%	<b>2.3%</b>	<b>2.6%</b>

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Shares of Union Pacific have increased \$1 since our July 19<sup>th</sup> update. Shares trade with a P/E of 18.6. Union Pacific shares have an average price to earnings multiple of 16 over the past decade. If the stock reverts to its decade long average P/E, then the stock's multiple could contract 3.0% per year through 2023.

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

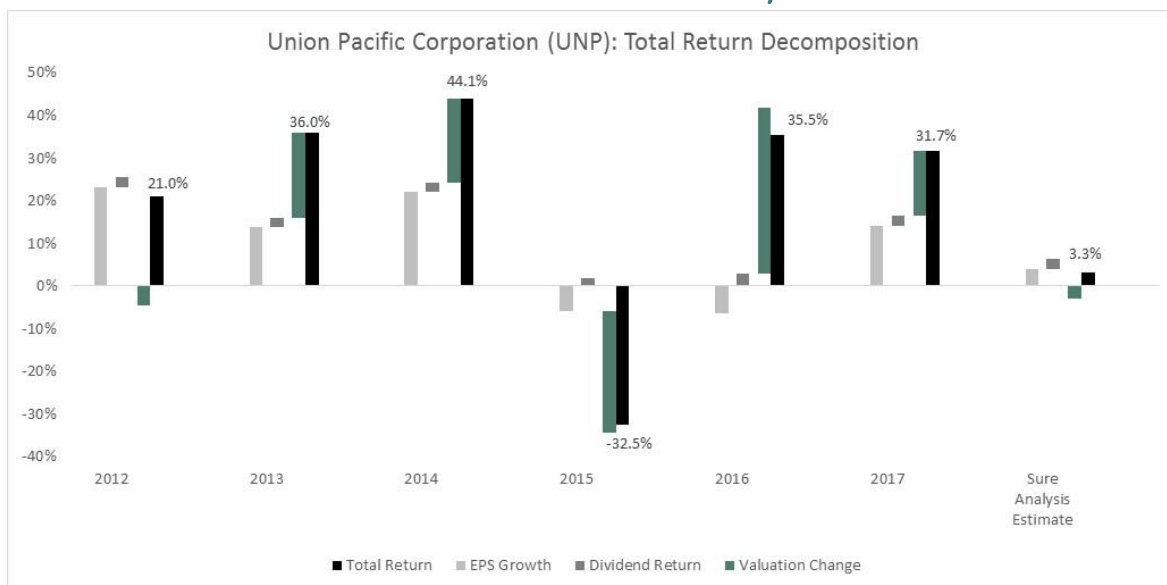
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	78.3%	85.3%	95.2%	97.9%	105%	105%	99.7%	85.4%	107%	104%	<b>110%</b>	<b>115%</b>
<b>Debt/A</b>	407%	391%	363%	352%	379%	346%	304%	325%	363%	427%	<b>447%</b>	<b>440%</b>
<b>Int. Cov.</b>	1.8	2.2	2.4	2.8	2.8	3.5	4.0	4.1	4.2	4.3	<b>4.4</b>	<b>5.0</b>
<b>Payout</b>	----	----	----	----	----	32.3%	35.0%	35.7%	35.3%	31.1%	<b>42.3%</b>	<b>42.3%</b>
<b>Std. Dev.</b>	75.4%	54.6%	43.0%	31.0%	31.0%	16.5%	20.9%	15.1%	25.8%	27.9%	<b>26.2%</b>	<b>20.0%</b>

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. Another issue that 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

After 3<sup>rd</sup> quarter earnings, we now estimate that Union Pacific can offer investors a total annual return of 3.3% over the next five years, up from 3.2% previously. This annual return is a combination of growth (4%), dividends (2.3%) and multiple reversion (-3%). Even with volume and sales increases across almost every product category and an impressive recent dividend growth, we don't anticipate much upside from Union Pacific at this time. Union Pacific is a borderline sell at current prices, and certainly not a buy. Investors looking for railroad sector exposure should consider Kansas City Southern (KSU) or Canadian Pacific (CP), as these railroads offer a higher potential total return by our analysis.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	17970	14143	16965	19557	20926	21963	23988	21813	19941	21240
<b>Gross Profit</b>	10733	9556	5700	6506	7533	8295	9677	8976	8269	9009
<b>Gross Margin</b>	59.7%	67.6%	33.6%	33.3%	36.0%	37.8%	40.3%	41.1%	41.5%	42.4%
<b>D&amp;A Exp.</b>	1366	1427	1487	1617	1760	1777	1904	2012	2038	2105
<b>Operating Profit</b>	4910	4066	4981	5724	6745	7446	8753	8052	7272	8061
<b>Op. Margin</b>	27.3%	28.7%	29.4%	29.3%	32.2%	33.9%	36.5%	36.9%	36.5%	38.0%
<b>Net Profit</b>	2335	1890	2780	3292	3943	4388	5180	4772	4233	10712
<b>Net Margin</b>	13.0%	13.4%	16.4%	16.8%	18.8%	20.0%	21.6%	21.9%	21.2%	50.4%
<b>Free Cash Flow</b>	902	750	1623	2697	2423	3327	3039	2694	4020	3992
<b>Income Tax</b>	1316	1084	1653	1972	2375	2660	3163	2884	2533	-3080

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	39722	42184	43088	45096	47153	49731	52372	54600	55718	57806
<b>Cash &amp; Equivalents</b>	1249	1850	1086	1217	1063	1432	1586	1391	1277	1275
<b>Acc. Receivable</b>	594	666	1184	1401	1331	1414	1611	1356	1258	1493
<b>Inventories</b>	450	475	534	614	660	653	712	736	717	749
<b>Total Liabilities</b>	24275	25383	25325	26518	27276	28506	31183	33898	35786	32950
<b>Accounts Payable</b>	629	612	677	819	825	803	877	743	955	1013
<b>Long-Term Debt</b>	8927	9848	9242	8906	8997	9577	11413	14201	15007	16944
<b>Total Equity</b>	15447	16801	17763	18578	19877	21225	21189	20702	19932	24856
<b>D/E Ratio</b>	0.58	0.59	0.52	0.48	0.45	0.45	0.54	0.69	0.75	0.68

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	6.0%	4.6%	6.5%	7.5%	8.5%	9.1%	10.1%	8.9%	7.7%	18.9%
<b>Return on Equity</b>	15.0%	11.7%	16.1%	18.1%	20.5%	21.4%	24.4%	22.8%	20.8%	47.8%
<b>ROIC</b>	9.8%	7.4%	10.4%	12.1%	14.0%	14.7%	16.3%	14.1%	12.1%	27.9%
<b>Shares Out.</b>	1007	1010.1	983.13	959.86	938.93	912	883.37	849.21	815.8	780.9
<b>Revenue/Share</b>	17.45	13.98	16.87	19.96	21.96	23.58	26.62	25.09	23.87	26.49
<b>FCF/Share</b>	0.88	0.74	1.61	2.75	2.54	3.57	3.37	3.10	4.81	4.98

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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