



# Union Pacific Corporation (UNP)

Updated January 23<sup>rd</sup>, 2020 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$187	<b>5 Year CAGR Estimate:</b>	2.8%	<b>Market Cap:</b>	\$130 billion
<b>Fair Value Price:</b>	\$151	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	2/27/2020 <sup>1</sup>
<b>% Fair Value:</b>	124%	<b>5 Year Valuation Multiple Estimate:</b>	-4.2%	<b>Dividend Payment Date:</b>	3/30/2020 <sup>2</sup>
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$193	<b>Years Of Dividend Growth:</b>	13
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	10.2%

## 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. 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. Union Pacific transports industrial and agricultural products, as well as coal and chemicals. The company generates nearly \$22 billion in annual revenues.

Union Pacific reported earnings results for the fourth quarter and full year on 1/23/2020. The company earned \$2.02 per share for the quarter, \$0.05 below estimates. This was 4.7% lower than the previous year. Revenue was lower by 9.5% to \$5.2 billion. Union Pacific's operating ratio improved 190 bps to a fourth quarter record 59.7%. For the year, earnings-per-share decreased 1% to \$8.38 while revenue was down 4.8% to \$21.7 billion. The company's operating ratio for 2019 improved by 210 bps to 60.6%, also a record.

Freight revenue was down 10% in the quarter despite gains in pricing and business mix. Lower volumes and decreased fuel surcharge revenue offset these items. Agricultural Products saw a 2% drop in revenues and volumes. Strength in biofuel shipments was offset by lower domestic grain and potash volumes. Revenues for Energy decreased 25% on a steep decline in volumes. Sand volumes were down 53% on lower demand for frac sand. Coal volumes was lower by 25% due to weakening domestic demand. Sand and coal have been a headwind for the other railroad companies that have reported as well. Industrial revenue and volumes were flat year-over-year as growth in construction and plastics was offset by a drop in demand for forest products. Premium did see a 1% improvement in average revenue per car, but this was offset by a 15% decline in volumes. International intermodal was hit especially hard, suffering a 23% drop in volumes due to trade uncertainties and declining auto production. The company saw a 5% increase in car velocity, a 13% drop in terminal dwell and a 14% improvement in locomotive productivity during the quarter. Shares of Union Pacific touched a new high following the release of earnings before finishing up 3.5%. The company's average weighted share count was down 5% from the previous year. Union Pacific is expected to earn \$9.43 in 2020.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$2.77	\$3.36	\$4.14	\$4.71	\$5.75	\$5.41	\$5.07	\$5.79	\$7.91	\$8.38	<b>\$9.43</b>	<b>\$12.04</b>
<b>DPS</b>	\$0.66	\$0.97	\$1.25	\$1.48	\$1.91	\$2.20	\$2.26	\$2.48	\$3.06	\$3.88	<b>\$3.88</b>	<b>\$4.95</b>
<b>Shares<sup>3</sup></b>	983	960	939	912	883	849	816	781	755	695	<b>690</b>	<b>650</b>

Earnings-per-share have increased at a rate of almost 10% per year over the past decade, though much of this growth occurred in the years after the last recession. Earnings have increased at a rate of 5.3% over the past five years. We estimate that Union Pacific will grow earnings-per-share at a rate of 5% going forward due to revenue growth and continued business efficiency. Union Pacific has increased its dividend for each of the past 13 years. The company has been very aggressive in raising its dividend recently. The most recent increase raised the dividend 10.2% for the

<sup>1</sup> Estimated date

<sup>2</sup> Estimated dividend payment date

<sup>3</sup> In millions of shares

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payment made 9/30/2019. This marks the fifth ~10% increase in the last eight quarters. Dividends for 2019 were 24% higher than the total for 2018.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.5	14.1	16.0	17.6	18.3	17.4	19.1	18.1	18.1	21.6	19.8	16.0
Avg. Yld.	2.0%	2.1%	2.0%	1.9%	2.2%	2.6%	2.2%	2.1%	2.1%	2.1%	2.1%	2.6%

Shares of Union Pacific have increased \$25, or 15.4%, since our 10/19/2019 update. Shares trade with a price-to-earnings multiple of 19.8 based off of our expected earnings-per-share for the current year. Union Pacific shares have an average price-to-earnings multiple of 16 over the past decade. If the stock reverts to its average valuation by 2025, shareholders could see a 4.2% headwind to total returns over this time frame.

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

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	24%	29%	30%	31%	33%	41%	45%	43%	39%	46%	41%	41%

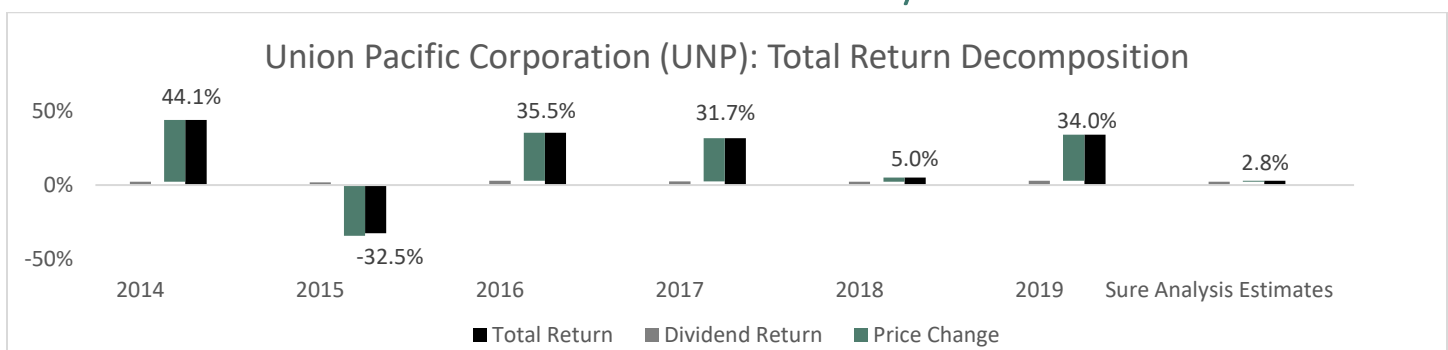
Union Pacific's earnings were impacted during the last recession. A decline in earnings would be likely to occur in the next recession as many of the products that the company transports, like automotive vehicles, are in high demand when the U.S. economy is strong. Union Pacific's dividend payout ratio has generally stayed below 40% over the last ten years. 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.

Union Pacific is the largest railroad in the U.S. and spans the western two-thirds of the country. This gives the company pricing power for its shipments, as was seen in the most recent quarter due to strong network effects that railroads enjoy. The railroad has stops along both the Canadian and Mexican borders, making Union Pacific an attractive option for businesses looking to ship goods to almost any place in North America.

## Final Thoughts & Recommendation

After reviewing fourth quarter results, Union Pacific Corporation is expected to offer a total annual return of 2.8% through 2025, down from our previous estimate of 4.9%. The railroad, like many within the sector, continue to experience headwinds in nearly every product category. On the other hand, Union Pacific has become more efficient in 2019 and the operating ratio posted all-time best figures in both the most recent quarter and for the full year. How many more costs the company can squeeze out remains to be seen. We have raised our 2025 price target \$10 to \$193, but move to the sidelines on the stock. We encourage investors to consider taking profits in Union Pacific due to low projected total returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	14,143	16,965	19,557	20,926	21,963	23,988	21,813	19,941	21,240	22,832
<b>Gross Profit</b>	9,556	5,700	6,506	7,533	8,295	9,677	8,976	8,240	9,054	9,539
<b>Gross Margin</b>	67.6%	33.6%	33.3%	36.0%	37.8%	40.3%	41.1%	41.3%	42.6%	41.8%
<b>SG&amp;A Exp.</b>	4,063									
<b>D&amp;A Exp.</b>	1,427	1,487	1,617	1,760	1,777	1,904	2,012	2,038	2,105	2,191
<b>Operating Profit</b>	4,066	4,981	5,724	6,745	7,446	8,753	8,052	7,243	8,106	8,517
<b>Op. Margin</b>	28.7%	29.4%	29.3%	32.2%	33.9%	36.5%	36.9%	36.3%	38.2%	37.3%
<b>Net Profit</b>	1,890	2,780	3,292	3,943	4,388	5,180	4,772	4,233	10,712	5,966
<b>Net Margin</b>	13.4%	16.4%	16.8%	18.8%	20.0%	21.6%	21.9%	21.2%	50.4%	26.1%
<b>Free Cash Flow</b>	750	1,623	2,697	2,423	3,327	3,039	2,694	4,020	3,992	5,249
<b>Income Tax</b>	1,084	1,653	1,972	2,375	2,660	3,163	2,884	2,533	(3,080)	1,775

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	42,184	43,088	45,096	47,153	49,731	52,372	54,600	55,718	57,806	59,147
<b>Cash &amp; Equivalents</b>	1,850	1,086	1,217	1,063	1,432	1,586	1,391	1,277	1,275	1,273
<b>Acc. Receivable</b>	666	1,184	1,401	1,331	1,414	1,611	1,356	1,258	1,493	1,755
<b>Inventories</b>	475	534	614	660	653	712	736	717	749	742
<b>Total Liabilities</b>	25,383	25,325	26,518	27,276	28,506	31,183	33,898	35,786	32,950	38,724
<b>Accounts Payable</b>	612	677	819	825	803	877	743	955	1,013	872
<b>Long-Term Debt</b>	9,848	9,242	8,906	8,997	9,577	11,413	14,201	15,007	16,944	22,391
<b>Total Equity</b>	16,801	17,763	18,578	19,877	21,225	21,189	20,702	19,932	24,856	20,423
<b>D/E Ratio</b>	0.59	0.52	0.48	0.45	0.45	0.54	0.69	0.75	0.68	1.10

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	4.6%	6.5%	7.5%	8.5%	9.1%	10.1%	8.9%	7.7%	18.9%	10.2%
<b>Return on Equity</b>	11.7%	16.1%	18.1%	20.5%	21.4%	24.4%	22.8%	20.8%	47.8%	26.4%
<b>ROIC</b>	7.4%	10.4%	12.1%	14.0%	14.7%	16.3%	14.1%	12.1%	27.9%	14.1%
<b>Shares Out.</b>	1012	983	960	939	912	883	849	816	781	755
<b>Revenue/Share</b>	13.98	16.87	19.96	21.96	23.58	26.62	25.09	23.87	26.49	30.27
<b>FCF/Share</b>	0.74	1.61	2.75	2.54	3.57	3.37	3.10	4.81	4.98	6.96

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

### Disclaimer

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