



# Union Pacific Corporation (UNP)

Updated October 22<sup>nd</sup>, 2020 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$190	<b>5 Year CAGR Estimate:</b>	1.1%	<b>Market Cap:</b>	\$135 billion
<b>Fair Value Price:</b>	\$127	<b>5 Year Growth Estimate:</b>	7.0%	<b>Ex-Dividend Date:</b>	11/28/2020
<b>% Fair Value:</b>	149%	<b>5 Year Valuation Multiple Estimate:</b>	-7.7%	<b>Dividend Payment Date:</b>	12/30/2020 <sup>1</sup>
<b>Dividend Yield:</b>	2.0%	<b>5 Year Price Target</b>	\$178	<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 about \$19 billion in annual revenues.

On 10/22/2020, Union Pacific reported third quarter earnings results. The company reported GAAP EPS of \$2.01, 9.5% below last year's result and \$0.06 lower than expected. Revenue declined 10.9% to \$4.9 billion, \$50 million lower than expected. The railroad's operating ratio improved 80 basis points to an all-time quarterly low of 58.7%, but was slightly higher than consensus estimates of 58.4%. Revenue per carload decreased 4%, but was better than analysts' estimates of a decline of 5.5%. Volumes were down 4%. Declines on both metrics were a deceleration from the prior quarter where volumes were down 15% and revenue per carload declined 6%. Bulk volumes were down 9% while revenue fell 12%. Volumes declined 21% for coal and renewables on continued weaker demand. Grain and grain products volumes were higher by 3% due to strong demand for grain exports. Fertilizer volumes improved 4% while food and refrigeration was flat year-over-year, mostly due to COVID-19 related impacts. Industrial revenues decreased 18% and volumes fell 16%. Weaker demand led to a 20% decline in volumes for energy. COVID-19 lowered demand for forest products, where volumes were flat, and industrial chemicals and plastics, where volumes were down 9%. Fewer shipments drove a 22% decline in metals and mineral volumes. Premium rebounded significantly from the second quarter with revenue falling 1%, but volumes growing 5%. Automotive volumes were down 9%, but compare quite favorably to a decline of 64% in Q2. Intermodal volumes improved 9% due to better retail spending, inventory restocking and e-commerce growth. Union Pacific provided shipment volume updates so far in the fourth quarter. Premium volumes are higher by 11%, bulk is up 3% and industrial are down 9% so far. Lower fuel prices added 100 basis points to the improvement in operating ratio. Average car velocity improved 3% and train length was up 13%. Analysts expect the company to earn \$7.95 per share in 2020, up from \$7.62 previously.

## 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>\$7.95</b>	<b>\$11.15</b>
<b>DPS</b>	\$0.66	\$0.97	\$1.25	\$1.48	\$1.91	\$2.20	\$2.26	\$2.48	\$3.06	\$3.70	<b>\$3.88</b>	<b>\$4.95</b>
<b>Shares<sup>2</sup></b>	983	960	939	912	883	849	816	781	755	695	<b>686</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.

<sup>1</sup> Estimated dividend payment date

<sup>2</sup> In millions of shares

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The company has compounded assets per share by 7.3% over the last decade. Erring on the side of caution, we expect Union Pacific to grow earnings-per-share by 7% over the next five years as the company should see earnings move meaningfully higher after recovering from the COVID-19 pandemic.

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 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	23.9	16.0
Avg. Yld.	2.0%	2.1%	2.0%	1.9%	2.2%	2.6%	2.2%	2.1%	2.1%	2.1%	2.0%	2.8%

Shares of Union Pacific have increased \$16, or 9.2%, since our 7/23/2020 update. Shares trade with a price-to-earnings multiple of 23.9 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 multiple by 2025, then valuation would likely be a 7.7% headwind to total returns over this time frame.

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

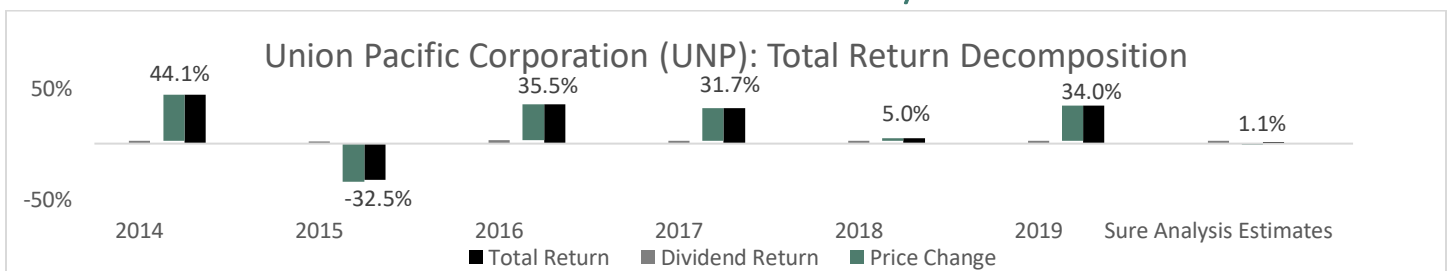
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	24%	29%	30%	31%	33%	41%	45%	43%	39%	46%	49%	44%

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. 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

Following third quarter results, Union Pacific Corporation is expected to offer a total annual return of 1.1% through 2025, down from our previous estimate of 2.1%. The COVID-19 pandemic continues to impact the railroad, but Union Pacific's results were improved compared to the second quarter. The railroad still has issues, such as coal and energy demand, but certain areas were quite strong, especially intermodal. That said, shares trade at 149% of our fair value. Union Pacific continues to earn a sell rating from Sure Dividend due to projected returns. We have raised our 2025 price target \$7 to \$178 due to revised estimates for 2020.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	16,965	19,557	20,926	21,963	23,988	21,813	19,941	21,240	22,832	21,708
<b>Gross Profit</b>	5,700	6,506	7,533	8,295	9,677	8,976	8,240	9,054	9,539	9,614
<b>Gross Margin</b>	33.6%	33.3%	36.0%	37.8%	40.3%	41.1%	41.3%	42.6%	41.8%	44.3%
<b>D&amp;A Exp.</b>	1,487	1,617	1,760	1,777	1,904	2,012	2,038	2,105	2,191	2,216
<b>Operating Profit</b>	4,981	5,724	6,745	7,446	8,753	8,052	7,243	8,106	8,517	8,554
<b>Op. Margin</b>	29.4%	29.3%	32.2%	33.9%	36.5%	36.9%	36.3%	38.2%	37.3%	39.4%
<b>Net Profit</b>	2,780	3,292	3,943	4,388	5,180	4,772	4,233	10,712	5,966	5,919
<b>Net Margin</b>	16.4%	16.8%	18.8%	20.0%	21.6%	21.9%	21.2%	50.4%	26.1%	27.3%
<b>Free Cash Flow</b>	1,623	2,697	2,423	3,327	3,039	2,694	4,020	3,992	5,249	5,156
<b>Income Tax</b>	1,653	1,972	2,375	2,660	3,163	2,884	2,533	(3,080)	1,775	1,828

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	43,088	45,096	47,153	49,731	52,372	54,600	55,718	57,806	59,147	61,673
<b>Cash &amp; Equivalents</b>	1,086	1,217	1,063	1,432	1,586	1,391	1,277	1,275	1,273	831
<b>Acc. Receivable</b>	1,184	1,401	1,331	1,414	1,611	1,356	1,258	1,493	1,755	1,595
<b>Inventories</b>	534	614	660	653	712	736	717	749	742	751
<b>Total Liabilities</b>	25,325	26,518	27,276	28,506	31,183	33,898	35,786	32,950	38,724	43,545
<b>Accounts Payable</b>	677	819	825	803	877	743	955	1,013	872	749
<b>Long-Term Debt</b>	9,242	8,906	8,997	9,577	11,413	14,201	15,007	16,944	22,391	25,200
<b>Total Equity</b>	17,763	18,578	19,877	21,225	21,189	20,702	19,932	24,856	20,423	18,128
<b>D/E Ratio</b>	0.52	0.48	0.45	0.45	0.54	0.69	0.75	0.68	1.10	1.39

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	6.5%	7.5%	8.5%	9.1%	10.1%	8.9%	7.7%	18.9%	10.2%	9.8%
<b>Return on Equity</b>	16.1%	18.1%	20.5%	21.4%	24.4%	22.8%	20.8%	47.8%	26.4%	30.7%
<b>ROIC</b>	10.4%	12.1%	14.0%	14.7%	16.3%	14.1%	12.1%	27.9%	14.1%	13.7%
<b>Shares Out.</b>	983	960	939	912	883	849	816	781	755	695
<b>Revenue/Share</b>	16.87	19.96	21.96	23.58	26.62	25.09	23.87	26.49	30.27	30.74
<b>FCF/Share</b>	1.61	2.75	2.54	3.57	3.37	3.10	4.81	4.98	6.96	7.30

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

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