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Jun 11, 2020

Union Pacific(UNP)

$175.43 (As of 06/10/20)

Price Target (6-12 Months): **$186.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 03/26/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:C
	Value: C | Growth: C | Momentum: B	

Summary

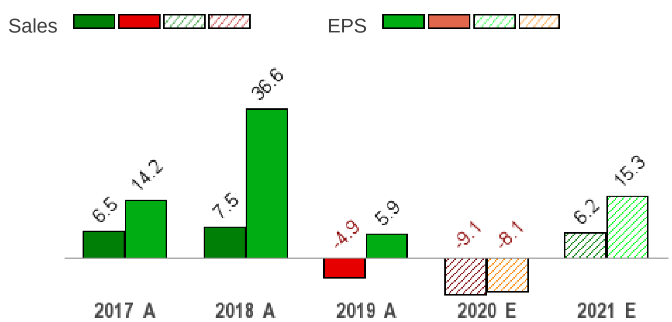
Union Pacific's cost-cutting measures are aiding its bottom line. Its ability to generate free cash flow is also a positive and supports its shareholder-friendly activities as well. In this respect, Union Pacific's decision to continue paying out dividends despite the current turbulence is reflective of its strong cash flow generating ability. Efforts to promote safety and enhance productivity are also noteworthy. However, coronavirus-induced disruptions are weighing on the company's operations. The impact is likely to be greater in the second quarter with volumes expected to plunge close to 20%. Moreover, operating ratio will not improve in the June quarter despite the cost cutting measures. The company withdrew its 2020 view with respect to operating ratio, headcount, volumes and buybacks due to the coronavirus-related woes.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$188.96 - $105.08**
20 Day Average Volume (sh)	**3,486,419**
Market Cap	**$119.0 B**
YTD Price Change	**-3.0%**
Beta	**1.08**
Dividend / Div Yld	**$3.88 / 2.2%**
Industry	**Transportation - Rail**
Zacks Industry Rank	**Bottom 18% (206 out of 252)**
Last EPS Surprise	**15.6%**
Last Sales Surprise	**2.4%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**07/16/2020**
Earnings ESP	**0.0%**
P/E TTM	**20.4**
P/E F1	**22.8**
PEG F1	**2.3**
P/S TTM	**5.5**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	5,332 E	5,071 E	5,548 E	5,442 E	20,961 E
2020	5,229 A	4,428 E	4,936 E	5,083 E	19,736 E
2019	5,384 A	5,596 A	5,516 A	5,212 A	21,708 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$2.20 E	$2.19 E	$2.42 E	$2.34 E	$8.88 E
2020	$2.15 A	$1.57 E	$1.94 E	$2.05 E	$7.70 E
2019	$1.93 A	$2.22 A	$2.22 A	$2.02 A	$8.38 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/10/2020. The reports text is as of 06/11/2020.

Overview

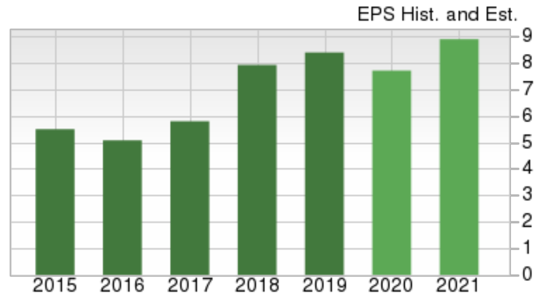
Union Pacific Corporation provides rail transportation services across 23 states in the United States through its principal operating company, Union Pacific Railroad Company. As the largest railroad in North America, Union Pacific connects the Pacific and Gulf Coast ports with the Midwest and gateways in eastern United States.

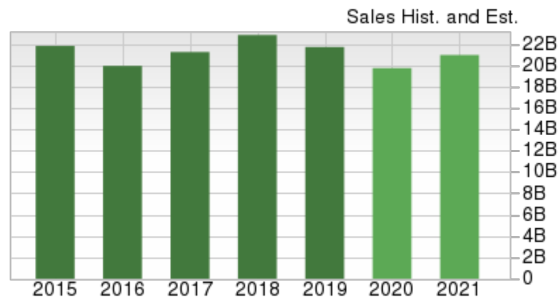
The company also connects with Canada's rail systems and is the only railroad, serving all the six major gateways to Mexico. Union Pacific offers transportation services for agricultural products, automotive, lumber, steel, paper, food, chemicals, coal, and industrial products, as well as for finished vehicles and intermodal containers.

Union Pacific, based in Omaha, NE, also provides container and traffic services, primarily for shipper agents and consolidators, as well as for truckload carriers. The company was incorporated in Utah in 1969.

From first-quarter 2020, Union Pacific will report through three business groups: **Bulk** (formerly agricultural products), **Industrial** and **Premium**.

The bulk division (31.4% of freight revenues generated in 1Q20) is responsible for the transportation of grains, commodities produced from these grains, fertilizer apart from food and beverage products. The segment serves major grain markets, linking the Midwest and Western United States producing areas to export terminals in the Pacific Northwest and Gulf Coast ports and Mexico. The coal and petroleum coke products also come under the bulk group.





The Industrial unit (38.8%) includes multiple categories like construction, industrial chemicals and soda ash. The company's premium division includes three segments, namely international intermodal, domestic intermodal and finished vehicles. Meanwhile, LPG, petroleum and sand products also fall under its Industrial business.

The company's premium division (29.8%) includes three segments, namely international intermodal, domestic intermodal and automotive. Freight revenues account for bulk of the company's top line. In the first quarter of 2020, 93.3% of the company's total revenues of $5,229 million came from this source.

The company's fiscal year coincides with the calendar year.

Reasons To Buy:

We are pleased by the company's efforts toward promoting safety and enhancing productivity.

- We are encouraged by the company's efforts to check costs in a bid to drive the bottom line. In first-quarter 2020, the bottom line improved 11.4% on a year-over-year basis, primarily due to low costs. Operating expenses contracted 10% to $3,086 million. Additionally, operating income in the first quarter increased 9% year over year to $2,143 million.

- We are also pleased by the efforts of the company to promote safety and enhance productivity. To this end, the company completed the implementation of positive train control (PTC) on its network in December 2019. The technology is now implemented on Union Pacific's entire federally mandated rail lines, including required passenger train routes. Notably, the company generated productivity savings worth $590 million in 2019 through its G55 + 0 initiatives and Unified Plan 2020. The realized savings exceeded the company's expectations of productivity savings of at least $500 million through the same. In first-quarter 2020, employee safety results improved 11%.

- Even though the company withdrew its guidance for share buybacks due to the coronavirus-induced uncertainty, it continues to pay out dividends. This signifies its financial strength. Notably, the company hiked dividends five times since November 2017. It aims to keep its dividend payout ratio between 40% and 45% in the long term. Moreover, its ability to generate free cash flow ($688 million in the first quarter, up 25% year over year) is a positive and supports its dividend-paying capacity.

Reasons To Sell:

- The impact of coronavirus on Union Pacific's first quarter was limited with disruptions to China's supply chain starting only in mid-February followed by the closure of the U.S. automotive plants in March-end. Even then freight revenues and volumes declined 3% and 7%, respectively. The impact is likely to be deeper in the second quarter where volumes are anticipated to plunge close to 20%. Due to the bleak volume projection, operating ratio (operating expenses as a percentage of revenues) will not improve in the second quarter on a year-over-year basis.despite the cost-cutting measures. Notably, the company's chief financial officer Jennifer Hamann stated that overall volumes for the second quarter of 2020 decreased 22% on a year-over-year basis (through Jun 2, 2020). This unfavorable reading can be primarily attributed to double-digit declines in volumes at the Bulk (down 16%), Premium (down 29%) and Industrial divisions (down 17%). Also, due to the coronavirus-related uncertainty, Union Pacific withdrew its 2020 guidance with respect to operating ratio, headcount, volumes and buybacks.

The impact of coronavirus on volumes is likely to be deeper in the second quarter of 2020. Volumes are expected to decline nearly 20% in the June quarter.

- We are concerned about Union Pacific's high-debt levels. Debt/EBITDA ratio (adjusted) at Union Pacific deteriorated to 2.3 in 2018 from 1.9 in 2017. It increased to 2.5 at the end of 2019 and 2.7 at the end of first-quarter 2020. A high debt/EBITDA ratio often indicates that a firm may be unable to service its debt appropriately. Moreover, the company exited the first quarter of 2020 with cash and equivalents of $1,190 million, which lie below its current debt figure of $1,511 million.

- We are concerned about the year-over-year decrease in the top line in first-quarter 2020 due to weakness in freight revenues. Below-par top line performances in the coming quarters may hurt the stock significantly. Also, reduction in the capital spending forecast to $2.9 billion by $150-$200 million might hurt the stock's prospects.

Last Earnings Report

Earnings Beat at Union Pacific in Q1

Quarter Ending	03/2020
Report Date	**Apr 23, 2020**
Sales Surprise	**2.41%**
EPS Surprise	**15.59%**
Quarterly EPS	**2.15**
Annual EPS (TTM)	**8.61**

Union Pacific Corporation's earnings of $2.15 per share surpassed the Zacks Consensus Estimate of $1.86. Operating revenues of $5,229 million also beat the Zacks Consensus Estimate of $5,105.9 million.

While the bottom line improved 11.4% on a year-over-year basis, primarily due to low costs, the top line declined 3% year over year due to sluggish freight revenues (down 3%). Business volumes, measured by total revenue carloads, declined 7%.

Operating income in the first quarter increased 9% year over year to $2,143 million. Operating expenses contracted 10% to $3,086 million. As a result, operating ratio (operating expenses as a percentage of revenues) improved to 59% from 63.6% a year ago, driven by efforts to control costs to offset weak shipments.

Moreover, the company bought back 14.3 million sharesworth $2.6 billion in the first quarter. First-quarter effective tax rate came in at 23.1% compared with 22.3% a year ago. Total capital expenses were $807 million in the first quarter.

Segmental Performance

Bulk (Grain & grain products, Fertilizer, Food & refrigerated, Coal & renewables) freight revenues were $1,534 million, down 5% year over year. Revenue carloads too slid 7%. However, average revenue per car increased 2% year over year.

Industrial freight revenues totaled $1,894 million, up 3% year over year. While revenue carloads rose 3%, average revenue per car was flat year over year.

Freight revenues in the Premium division were $1,452 million, down 6% year over year. Moreover, revenue carloads dropped 12% year over year. However, average revenue per car increased 6%.

Meanwhile, other revenues slipped 7% to $349 million in the first quarter.

Q2 Outlook

Union Pacific expects carload volumes to plunge approximately 25% year over year in the second quarter due to freight softness as a result of coronavirus.

Recent News

Projection on Q2 Volumes and Operating Ratio — Jun 9, 2020

At the Deutsche Bank Annual Global Industrials and Materials Summit, Hamann stated that the overall volume decline at Union Pacific is estimated to be close to 20% in the June quarter. Also, operating ratio will not improve in the second quarter on a year-over-year basis.

Valuation

Union Pacific shares are down 3% year to date but up 2.5% over the past year. Stocks in the Zacks sub-industry and those in the Zacks Transportation sector are down 1.3% and 13.3% on a year-to-date basis, respectively. Over the past year, the Zacks sub-industry is up 0.4% and the sector is down 8.7%.

The S&P 500 index is down 1% year to date but up10.7% over the past year.

The stock is currently trading at 21.33X forward 12-month price-to-earnings, which compares to 19.58X for the Zacks sub-industry, 40.87X for the Zacks sector and 23.05X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.53X and as low as 11.77X, with a 5-year median of 17.53X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $186 price target reflects 22.61X forward 12-month earnings.

The table below shows summary valuation data for UNP

Valuation Multiples - UNP

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	21.33	19.58	40.87	23.05
	5-Year High	22.53	19.58	40.87	23.05
	5-Year Low	11.77	13.46	10.48	15.23
	5-Year Median	17.53	16.74	13.29	17.49
EV/EBITDA TTM	Current	13.31	13.3	7.28	11.82
	5-Year High	32.29	31.25	11.14	12.85
	5-Year Low	7.11	7.86	5.44	8.25
	5-Year Median	11.22	12.08	7.33	10.81
P/S F 12M	Current	5.87	5.71	1.23	3.58
	5-Year High	6.19	5.71	1.42	3.58
	5-Year Low	2.7	3.04	0.84	2.53
	5-Year Median	4.24	4.52	1.2	3.02

As of 06/10/2020

Industry Analysis **Zacks Industry Rank:** Bottom 18% (206 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Canadian National Railway Company **(CNI)**	Neutral	3
Canadian Pacific Railway Limited **(CP)**	Neutral	4
CSX Corporation **(CSX)**	Neutral	3
FedEx Corporation **(FDX)**	Neutral	4
Kansas City Southern **(KSU)**	Neutral	4
Norfolk Southern Corporation **(NSC)**	Neutral	3
United Parcel Service, Inc. **(UPS)**	Neutral	4
Caterpillar Inc. **(CAT)**	Underperform	5

Industry Comparison Industry: Transportation - Rail

Industry Peers

	UNP	X Industry	S&P 500	CSX	KSU	NSC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	4	3
VGM Score	C	-	-	B	B	C
Market Cap	119.04 B	33.93 B	22.63 B	56.10 B	14.94 B	52.13 B
# of Analysts	10	7	14	10	8	10
Dividend Yield	2.21%	1.61%	1.87%	1.42%	1.02%	1.99%
Value Score	C	-	-	C	C	C
Cash/Price	0.01	0.04	0.06	0.04	0.01	0.01
EV/EBITDA	13.10	12.10	12.91	10.95	14.41	12.10
PEG Ratio	2.19	2.77	3.07	2.60	1.53	3.03
Price/Book (P/B)	7.44	3.32	3.09	4.72	3.14	3.50
Price/Cash Flow (P/CF)	14.97	12.63	12.15	12.25	14.54	12.63
P/E (F1)	21.87	22.08	22.10	20.27	23.02	21.11
Price/Sales (P/S)	5.52	4.73	2.40	4.76	5.11	4.70
Earnings Yield	4.39%	4.53%	4.30%	4.94%	4.34%	4.74%
Debt/Equity	1.65	0.69	0.76	1.39	0.68	0.79
Cash Flow ($/share)	11.72	6.11	7.01	5.98	10.81	14.93
Growth Score	C	-	-	C	A	C
Hist. EPS Growth (3-5 yrs)	12.65%	11.08%	10.87%	23.43%	11.08%	18.67%
Proj. EPS Growth (F1/F0)	-8.14%	-11.64%	-10.71%	-13.31%	-1.05%	-13.61%
Curr. Cash Flow Growth	-0.27%	2.96%	5.46%	0.86%	8.60%	3.26%
Hist. Cash Flow Growth (3-5 yrs)	2.78%	5.61%	8.55%	8.74%	5.61%	5.66%
Current Ratio	0.82	1.03	1.29	1.73	1.32	0.90
Debt/Capital	62.25%	44.24%	44.75%	58.09%	40.39%	44.24%
Net Margin	27.85%	22.73%	10.54%	27.74%	20.11%	21.89%
Return on Equity	34.15%	16.49%	16.08%	27.27%	14.63%	18.12%
Sales/Assets	0.35	0.34	0.55	0.31	0.30	0.30
Proj. Sales Growth (F1/F0)	-9.08%	-7.96%	-2.59%	-9.84%	-5.04%	-11.97%
Momentum Score	B	-	-	B	B	C
Daily Price Chg	-1.53%	-1.01%	-1.68%	-0.50%	-0.61%	-1.82%
1 Week Price Chg	8.81%	6.45%	7.51%	4.89%	8.00%	8.95%
4 Week Price Chg	14.85%	14.60%	16.99%	17.58%	16.49%	14.59%
12 Week Price Chg	52.44%	41.06%	37.11%	43.79%	43.80%	44.11%
52 Week Price Chg	2.45%	-5.36%	0.02%	-6.31%	32.69%	-5.36%
20 Day Average Volume	3,486,419	395,511	2,620,901	4,097,617	1,023,277	1,450,295
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.14%	0.00%	0.00%	-0.22%	0.00%	-1.81%
(F1) EPS Est 12 week change	-15.99%	-15.99%	-15.86%	-13.03%	-14.92%	-19.20%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-4.89%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	B
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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