

Union Pacific(UNP)

\$178.47 (As of 01/27/20)

Price Target (6-12 Months): **\$189.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/26/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: F

Summary

We are impressed with Union Pacific's initiatives to reward its shareholders. Since November 2017, the company has raised its quarterly dividend payout five times. It is also active on the buyback front. Initiatives to control costs in order to drive the bottom line are also impressive. The company's operating ratio, which improved 210 basis points (bps) year over year to 60.6% in 2019, has been benefiting mainly owing to its cost-cutting initiatives. Operating ratio is anticipated to improve further in the days to come. However, sluggish overall volumes (down 11% in fourth-quarter 2019) due to freight-related weakness are a major headwind. Shares of Union Pacific have underperformed its industry in a year's time mainly due to sluggish volumes. Its escalated debt levels are concerning too. Also, the massive capex might be a spoilsport.

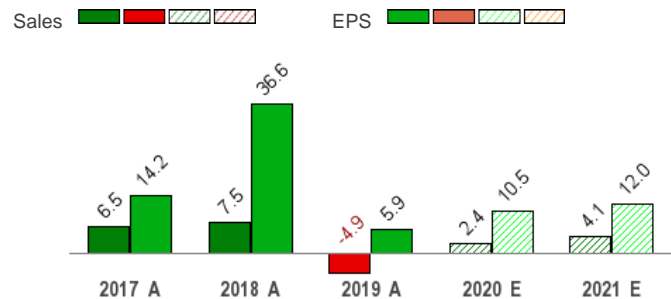
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$188.96 - \$149.09
20 Day Average Volume (sh)	2,820,037
Market Cap	\$123.9 B
YTD Price Change	-1.3%
Beta	1.08
Dividend / Div Yld	\$3.88 / 2.2%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 7% (238 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-0.5%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	-2.9%
Expected Report Date	04/16/2020
Earnings ESP	0.0%
P/E TTM	21.3
P/E F1	19.3
PEG F1	1.9
P/S TTM	5.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,611 E	6,011 E	6,265 E	5,972 E	23,142 E
2020	5,165 E	5,655 E	5,854 E	5,663 E	22,221 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	\$2.26 E	\$2.67 E	\$2.95 E	\$2.78 E	\$10.37 E
2020	\$1.94 E	\$2.37 E	\$2.46 E	\$2.39 E	\$9.26 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 01/27/2020. The reports text is as of 01/28/2020.

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.

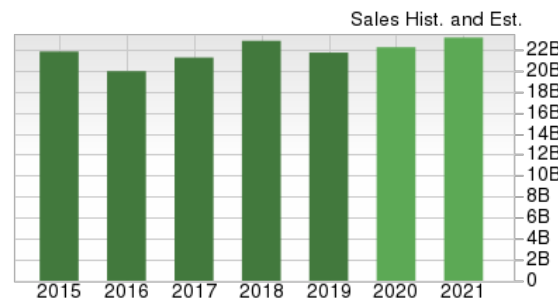
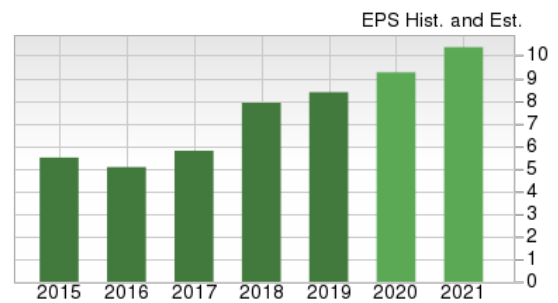
The agricultural products division is responsible for the transportation of grains, commodities produced from these grains, fertilizer apart from food and beverage products. The segment serves major grain markets, linking the Midwest and Western United States producing areas to export terminals in the Pacific Northwest and Gulf Coast ports and Mexico.

The energy division is sub-divided into three groups, namely coal, sand and petroleum, liquid petroleum gases (LPG) and renewables. The Industrial unit 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.

International business consists of import and export traffic moving in 20 or 40-foot shipping containers.

Freight revenues account for bulk of the company's top line. In 2019, 93.3% of the company's total revenues of \$21.71 billion came from this source. The balance came from other sources. The agricultural products, energy, industrial products and premium segments contributed 22%, 18.6%, 28.6% and 30.8% respectively to freight revenues in 2019.

From Jan 1, 2020, Union Pacific has three business groups : Bulk (formerly agricultural products), Industrial and Premium. The coal and petroleum coke products comes under the Bulk group. Meanwhile, LPG, petroleum and sand products shifted to its Industrial business from Energy.



Reasons To Buy:

- ▲ We are encouraged by the company's efforts to check costs in a bid to drive the bottom line. In fact, operating ratio (operating expenses as a percentage of revenues) has been improving mainly due to its cost-cut efforts. Operating ratio, which expanded 210 bps, year over year, to 60.6% in 2019, is expected to improve further. The company expects the 2020 operating ratio to be approximately 59%. The metric is projected to be 55% over the long term. Notably, lower the value of operating ratio the better.
- ▲ 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.
- ▲ We are impressed with the company's efforts to reward investors through share buybacks and dividend payouts. The company returned \$8.4 billion to its stockholders in 2019. Of the \$8.4 billion, \$5.8 billion and \$2.6 billion were returned through buybacks and dividends respectively. Also, in July 2019, the company increased its quarterly dividend by 10.2% to 97 cents per share — marking the fifth dividend hike since November 2017. The company aims to keep its dividend payout ratio between 40% and 45%. Union Pacific aims to buy back shares worth \$20 billion during the 2018-2020 period. During the fourth-quarter conference call, it stated that 70% of the buyback target has been completed, with roughly \$6 billion to be repurchased in 2020.

We are impressed with the company's efforts to reward investors through share buybacks and dividend payouts. We are also pleased by efforts toward promoting safety and enhancing productivity.

Reasons To Sell:

- ▼ The lackluster freight scenario in the United States resulted in freight revenues declining 5% year over year in 2019 to \$20.2 billion. With bulk of the company's revenues coming from freight, decline in freight revenues resulted in the top line contracting 4.8%. Overall volumes (carloadings) declined 6% due to weakness in the agricultural products, premium and energy segments.
- ▼ 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 further to 2.5 at the end of 2019. A high Debt/EBITDA ratio often indicates that a firm may be unable to service its debt appropriately.
- ▼ The company's investment toward enhancement of its facilities is resulting in higher capital expenditures (\$3.2 in 2020, reflecting an increase of approximately 29% from the reported figure of 2018). This is also likely to limit bottom-line growth. Capital expenditures in 2020 are expected to be less than 15% of revenues.

Union Pacific is being hurt by sluggish freight revenues. High debt levels also represent a major concern.

Last Earnings Report

Earnings Miss at Union Pacific in Q4

Union Pacific's earnings of \$2.02 per share fell short of the Zacks Consensus Estimate by a penny. Moreover, the bottom line decreased 4.7% on a year-over-year basis.

Meanwhile, operating revenues of \$5,212 million beat the Zacks Consensus Estimate of \$5,165.1 million. However, the top line declined 9% year over year due to sluggish freight revenues (down 10%). The year-over-year contraction in the top line was due to an 11% reduction in business volumes, measured by total revenue carloads.

Operating income in the fourth quarter declined 5% year over year to \$2.1 billion. Operating expenses declined 12% to \$3.11 billion. As a result, operating ratio (operating expenses as a percentage of revenues) improved to 59.7% from 61.6% a year ago, driven by this railroad operator's efforts to control costs so as to offset weak shipments. Notably, lower the value of the metric, the better.

Moreover, the company bought back 35 million shares worth \$5.8 billion in 2019. Fourth-quarter effective tax rate came in at 25.3% compared with 22.9% a year ago. Total capital expenses were \$3.2 billion in 2019.

Segmental Performance

Freight revenues in the Agricultural Products were \$1.1 billion, down 2% year over year. Revenue carloads too slid 2% year over year. However, average revenue per car was flat year over year.

Freight revenues in the Energy division were \$838 million, down 25% year over year. Also, revenue carloads fell 20% year over year. Moreover, average revenue per car decreased 6%.

Industrial freight revenues totaled \$1.41 billion, flat year over year. Revenue carloads and average revenue per car were also unaltered year over year.

Freight revenues in the Premium division were \$1.51 billion, down 14% year over year. Moreover, revenue carloads dropped 15% year over year. However, average revenue per car inched up 1% year over year.

Meanwhile, other revenues slipped 2% to \$361 million in the fourth quarter of 2019.

Liquidity

The company exited the quarter with cash and cash equivalents of \$831 million compared with \$1,273 million at the end of 2018. Debt (due after a year) mounted to \$23.94 billion at the end of the quarter from \$20.93 billion at 2018 end. Debt-to-EBITDA ratio (on an adjusted basis) deteriorated to 2.5 from 2.3 at 2018 end.

Quarter Ending **12/2019**

Report Date	Jan 23, 2020
Sales Surprise	0.91%
EPS Surprise	-0.49%
Quarterly EPS	2.02
Annual EPS (TTM)	8.39

Recent News

Dividend Update — Nov 14, 2019

Union Pacific's board approved a quarterly cash dividend of 97 cents per share (annualized \$3.88), payable Dec 30 to its shareholders of record as of Nov 29, 2019. Union Pacific has paid dividends on its common stock for 120 years consecutively.

Valuation

Union Pacific shares are up 11.5% over the trailing 12-month period . Stocks in the Zacks sub-industry and the Zacks Transportation sector are up 15% and 5.7% in the past year, respectively. The S&P 500 index is up 22.2% in the past year.

The stock is currently trading at 18.98X forward 12-month price-to-earnings, which compares to 17.7X for the Zacks sub-industry, 12.95X for the Zacks sector and 18.62X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.59X and as low as 11.77X, with a 5-year median of 17.42X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$189 price target reflects 20.09X 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 F12M	Current	18.98	17.7	12.95	18.62
	5-Year High	23.59	19.35	17	19.34
	5-Year Low	11.77	13.46	10.48	15.18
	5-Year Median	17.42	16.68	13.16	17.45
EV/EBITDA TTM	Current	14.23	13.88	7.96	12.25
	5-Year High	32.29	31.25	11.08	12.86
	5-Year Low	7.21	7.98	6	8.48
	5-Year Median	10.93	11.91	7.43	10.68
P/S F12M	Current	5.54	5.37	1.14	3.46
	5-Year High	5.82	5.37	1.44	3.46
	5-Year Low	2.7	3.04	1.02	2.54
	5-Year Median	4.17	4.43	1.24	3

As of 01/27/2020

Industry Analysis Zacks Industry Rank: Bottom 7% (238 out of 255)



Top Peers

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

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	UNP Neutral	X Industry	S&P 500	CSX Underperform	KSU Neutral	NSC Neutral
VGM Score	D	-	-	D	C	D
Market Cap	123.89 B	25.74 B	23.86 B	58.81 B	15.78 B	52.84 B
# of Analysts	9	6.5	13	9	7	5
Dividend Yield	2.17%	1.69%	1.81%	1.28%	0.98%	1.86%
Value Score	D	-	-	F	D	D
Cash/Price	0.01	0.03	0.04	0.03	0.00	0.01
EV/EBITDA	13.34	11.88	13.94	11.38	13.48	12.37
PEG Ratio	1.93	1.93	2.00	1.39	1.36	1.93
Price/Book (P/B)	6.83	3.47	3.25	4.96	3.13	3.47
Price/Cash Flow (P/CF)	15.23	14.64	13.46	12.57	15.18	14.64
P/E (F1)	19.27	18.37	18.67	17.91	20.43	18.31
Price/Sales (P/S)	5.71	4.76	2.62	4.93	5.50	4.59
Earnings Yield	5.19%	5.44%	5.35%	5.59%	4.89%	5.46%
Debt/Equity	1.32	0.73	0.72	1.35	0.46	0.73
Cash Flow (\$/share)	11.72	5.98	6.92	5.98	10.81	13.84
Growth Score	C	-	-	B	B	C
Hist. EPS Growth (3-5 yrs)	11.06%	10.01%	10.68%	21.86%	9.46%	14.51%
Proj. EPS Growth (F1/F0)	10.49%	9.75%	7.51%	0.67%	16.40%	10.28%
Curr. Cash Flow Growth	-0.27%	2.96%	13.40%	0.86%	8.60%	26.47%
Hist. Cash Flow Growth (3-5 yrs)	2.78%	5.61%	8.78%	8.74%	5.61%	6.34%
Current Ratio	0.79	0.79	1.22	1.52	0.78	0.73
Debt/Capital	56.91%	42.11%	42.92%	57.41%	31.54%	42.11%
Net Margin	27.27%	23.78%	11.39%	27.91%	18.80%	23.98%
Return on Equity	32.86%	15.82%	17.19%	27.49%	13.41%	18.22%
Sales/Assets	0.35	0.35	0.54	0.31	0.30	0.31
Proj. Sales Growth (F1/F0)	2.36%	4.51%	4.09%	-0.91%	5.68%	1.33%
Momentum Score	F	-	-	C	D	F
Daily Price Chg	-3.88%	-1.48%	-1.40%	-1.99%	-1.50%	-2.50%
1 Week Price Chg	0.19%	0.02%	-1.09%	0.39%	0.04%	-0.70%
4 Week Price Chg	-0.93%	1.97%	-0.25%	3.91%	7.18%	4.67%
12 Week Price Chg	1.04%	1.66%	3.64%	2.29%	9.86%	5.20%
52 Week Price Chg	11.61%	16.50%	18.08%	14.57%	50.08%	22.24%
20 Day Average Volume	2,820,037	404,122	1,615,215	3,735,200	1,246,829	1,357,282
(F1) EPS Est 1 week change	-1.95%	0.00%	0.00%	0.00%	0.55%	0.00%
(F1) EPS Est 4 week change	-2.95%	-0.40%	0.00%	-3.57%	1.31%	-0.79%
(F1) EPS Est 12 week change	-4.57%	-3.06%	-0.17%	-5.79%	1.39%	-1.95%
(Q1) EPS Est Mthly Chg	-3.68%	-1.40%	0.00%	-6.50%	-0.34%	-2.45%

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	D
Growth Score	C
Momentum Score	F
VGM Score	D

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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