Union Pacific Corp (UNP)

Earnings Update
Hold | Underperform
William Errett | January 25, 2024

Overview

Union Pacific is one of the largest railroad systems in the United States with over 32,000 miles of railways. Due to the nature of their business, they benefit from Cost Advantages and Switching Costs compared to alternative modes of transportation, as railroads are the most efficient way to move large and heavy items. They also benefit from Intangible Assets in the form of barriers to entry. Railroads are extremely expensive to make, and not only that, but you also must buy all the land to build the railroad, demolishing houses in the way.

Union Pacific printed results which were above investor expectations. They beat Revenue by about 2% and beat Earnings Per Share (EPS) by 5.4%. Operating Revenue came in at $6.2 Bn, flat from Q4 FY22. Union Pacific also kept operating expenses like last year during the at $3.7 Bn. This resulted in Operating Income being flat at $2.4 Bn. Due to increases in debt their interest expense remains elevated to $532 Mn. This all resulted in Net Income flat during the quarter ending at $1.6 Bn even though last Q4 already had mediocre results. Shares outstanding were roughly flat due to the pause of share repurchases. EPS finished the quarter at $2.71. Union Pacific puts heavy emphasis on Operating Ratio, which is just "1 – Operating Margin." Operating Ratio finished the quarter at 60.9%. In other words, Operating Margin was 39.1%. Union Pacific printed results for the full year like the quarter but slightly down from the year prior due to poor performance in Q1-Q3 where revenues and margins where down across the board.

Union Pacific has 3 different revenue cargo categories, Bulk, Industrial, and Premium. Bulk was flat on revenue of $1.9 Bn. This came off volume increasing by 3% to 522 thousand carloads and 2% lower revenue per carload to $3,712 per carload. Industrial was up 4% on revenue to $2.1 Bn. This came from a 3% increase in carloads to 555 thousand, and a 1% increase in revenue per carload, to $3,742 per carload. Finally Premium was down 3% on revenue to $1.8 Bn from volumes increasing 4% to 979 thousand carloads. Also, revenue per carload decreased 7% to $1,824.

In terms of more good news a few of the Key Performance indicators (KPIs) for Union Pacific increased this quarter. Daily Miles Per Car increased 14% to 217 miles. More of their shipments arrived on time during the quarter. Also, Train Length increased 2% to 9,413ft per train. This KPIs improved due to better resource utilization, higher levels of employment, and reducing overhead costs when it comes to decision making.

From a valuation perspective Union Pacific has an estimated fair value of about $200. This means there is a significant gap between the current price and what I believe the fair value is. However, this is and will continue to be a wide moat business. Because of this I recommend that we HOLD but keep updated as a possible sell in the future.

*CEO openly stated that they had 25% more sick leave on a week of a big playoff game. He also blamed collective bargaining agreements for issues regarding headcount.

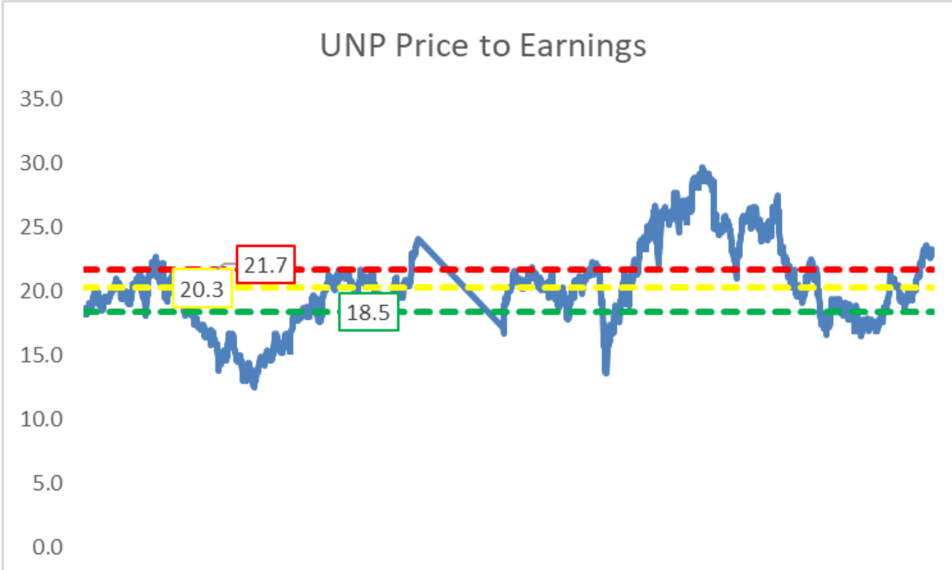
IOFS

Union Pacific is a great business when it comes to our Interpretation of Financial Statements (IOFS) Metrics. The only metrics that are difficult for them to maintain are the amount that they spend on capital expenditure each year. However, this is a very capital-intensive business, and in many ways, the capital that they own, and repair is a part of their long-term moat. They also fail when it comes to looking at their Return on Invested Capital, due to the large amount of debt that they have used to fund share repurchases. Also, due to the declining performance of net income their obligation ratio has expanded to 5.3x on the last 12 months of net income, so they now fail our obligation ratio for 2 years now.

	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	2020-12	2021-12	2022-12	2023-12
IOFS										
Revenue	$ 23,988	$ 21,813	$ 19,941	$ 21,240	$ 22,832	$ 21,708	$ 19,533	$ 21,804	$ 24,875	$ 24,119
Operating Income	$ 8,753	$ 8,052	$ 7,243	$ 8,106	$ 8,517	$ 8,554	$ 7,834	$ 9,338	$ 9,917	$ 9,100
Net Income	$ 5,180	$ 4,772	$ 4,233	$ 10,712	$ 5,966	$ 5,919	$ 5,349	$ 6,523	$ 6,998	$ 6,379
EBIT	$ 8,904	$ 8,278	$ 7,464	$ 8,351	$ 8,611	$ 8,797	$ 8,121	$ 9,635	$ 10,343	$ 9,573
EBITDA	$ 10,808	$ 10,290	$ 9,502	$ 10,456	$ 10,802	$ 11,013	$ 10,331	$ 11,843	$ 12,589	$ 11,891
Operating Margin	*36.5%*	*36.9%*	*36.3%*	*38.2%*	*37.3%*	*39.4%*	*40.1%*	*42.8%*	*39.9%*	*37.7%*
Net Margin	*21.6%*	*21.9%*	*21.2%*	*50.4%*	*26.1%*	*27.3%*	*27.4%*	*29.9%*	*28.1%*	*26.4%*
Capex/ Net Income	*83.9%*	*97.4%*	*82.8%*	*30.2%*	*57.6%*	*58.3%*	*54.7%*	*45.0%*	*51.7%*	*58.0%*
Dividend Payout ratio	*33.2%*	*40.1%*	*44.5%*	*18.6%*	*38.7%*	*44.2%*	*49.2%*	*43.1%*	*45.3%*	*49.8%*
Shares Outstanding	901.1	869.4	835.4	801.7	754.3	706.1	679.1	655.4	624.0	620.0
Returns %										
ROE	24.4	22.8	20.8	47.8	26.4	30.7	30.5	41.9	53.2	43.1
ROIC	11.3	10.0	8.6	20.9	11.7	11.1	10.0	11.6	11.9	13.8
Leverage & Liquidity										
LT Debt	10952	13607	14249	16144	20925	25414	26943	28992	32948	31156
ST Debt	461	594	758	800	1466	1257	960	2166	1678	1423
PF Stock	0	0	0	0	0	0	0	0	0	0
Leases*7	0	0	0	0	0	2534	3010	2310	2317	***2300***
Pension SF										
Cash	$ 1,586	$ 1,391	$ 1,277	$ 1,275	$ 1,273	$ 831	$ 1,799	$ 960	$ 973	$ 1,055
Obligation Ratio (1)	1.9x	2.7x	3.2x	1.5x	3.5x	4.8x	5.4x	5.0x	5.1x	5.3x
Per Share Data										
Earnings	$ 5.75	$ 5.49	$ 5.07	$ 13.36	$ 7.91	$ 8.38	$ 7.88	$ 9.95	$ 11.21	$ 10.45
Dividends	$ 1.91	$ 2.20	$ 2.26	$ 2.48	$ 3.06	$ 3.70	$ 3.88	$ 4.29	$ 5.08	$ 5.20

Union Pacific is concentrating on, and has room to improve, their operating margin. You might hear management call this their Operating Ratio (1-Operating Margin, so the lower the better). Union Pacific has been capable of maintaining an Operating Margin exceeding 40% in the last couple of years. It is also important that they improve this metric because a large percentage of growth on the bottom line has come from them becoming a more efficient business, rather than volumes (revenue) increasing over time.

Valuation



Union Pacific is currently trading above their 75th percentile for Price to Earnings, in other words it is most likely overvalued at this moment. Due to the operating headwinds that this business is currently facing, the change in leadership, the increased leverage, and the pause of share repurchases, I do not expect it to grow at rates that Union Pacific has been capable of in the past. This in combination with multiple expansion leads to an overvalued rating for the business.

Ticker: UNP

Price: $241.57

5 Year Discounted Cash Flow

								P/E	Total Return Price	PV	5 YR Return	Annual Return
Bear		**Current**	**2024**	**2025**	**2026**	**2027**	**2028**	18.0x	$ 265.23	$ 168.56	9.8%	**1.9%**
	EPS	$ 10.45	$ 10.76	$ 11.30	$ 11.87	$ 12.46	$ 13.08	20.0x	$ 291.40	$ 184.81	20.6%	**3.8%**
			3.0%	*5.0%*	*5.0%*	*5.0%*	*5.0%*	22.0x	$ 317.57	$ 201.06	31.5%	**5.6%**
Base		**Current**	**2024**	**2025**	**2026**	**2027**	**2028**	18.0x	$ 290.44	$ 184.36	20.2%	**3.8%**
	EPS	$ 10.45	$ 10.97	$ 11.74	$ 12.56	$ 13.44	$ 14.38	20.0x	$ 319.20	$ 202.22	32.1%	**5.7%**
			5.0%	*7.0%*	*7.0%*	*7.0%*	*7.0%*	22.0x	$ 347.97	$ 220.09	44.0%	**7.6%**
Bull		**Current**	**2024**	**2025**	**2026**	**2027**	**2028**	18.0x	$ 317.56	$ 201.36	31.5%	**5.6%**
	EPS	$ 10.45	$ 11.18	$ 12.19	$ 13.28	$ 14.48	$ 15.78	20.0x	$ 349.13	$ 220.96	44.5%	**7.6%**
			7.0%	*9.0%*	*9.0%*	*9.0%*	*9.0%*	22.0x	$ 380.70	$ 240.56	57.6%	**9.5%**