

Union Pacific

Trust the Vena process; Revamping ops constrained by macro; PO to \$274

Reiterate Rating: BUY | PO: 274.00 USD | Price: 241.57 USD

Cautious vol/price outlook balanced by operational strides

Union Pacific posted 4Q23 EPS of \$2.71, up 1% year-year, above our \$2.53 target and consensus' \$2.56 estimate. The results were great, as the company made significant gains in its service improvement (car miles/day (velocity) +14% y-y, locomotive productivity up 14% y-y, Intermodal trip plan compliance at 85%, up 22 pts y-y). However, the company lost an Intermodal contract to BNSF (Bloomberg noted it was APL, a division of CMA-CGM), and stressed coal comps will remain tough, as we expect volumes to be down year-year (we were down 2.4%, now -4%). Additionally, UNP noted that with inflation at 5%, it would offset the cost with pricing, but not enough pricing to offset operating margin dilution. Given the challenging weather to start the year, Union Pacific was fairly conservative (it did not set a volume, revenue, margin, or EPS outlook for 2024), signaling an uncertain top line path, while indicating continued improvement in operations (led by CEO Vena's culture of accountability, faster decisions, safety, and service), which creates operating leverage potential. UNP is facing additional labor cost inflation from work rest requirements, which can require additional employees near term, yet will be mitigated by improved productivity (longer trains, fewer starts). Given that backdrop, we expect a softer 1Q24 operating ratio (as it compares vs. a 62.1% print last year, yet a normalized 64% excluding fuel surcharge lag gains, vs. our 1Q24 target of 62.5%). We expect continued improvement in 2024 OR to 60.3% from 62.1%, yet now target flattish volumes, or +0.4% (from +3.4% prior and -0.7% last year).

Solid core beat; operational momentum is evident

Revenues were \$6.2 billion, flat year-year, \$260 million above our target. Operating income was \$2.4 billion, flat year-year, and \$142 million above our target (\$0.17/sh above). Operating ratio was 60.9%, a 10 bps improvement year-year and 240 bps improvement sequentially, 70 bps better than our target. It also benefited from \$108 mil in Other Income, \$26 million, or \$0.03/sh above our target.

Reit Buy; UNP remains top rail pick; PO to \$274

We increase our PO to \$274 from \$271, on 24.5x our 2024 EPS target (from 23.5x). We increase our target multiple one-turn on rapidly improving service levels as UP moves away from its trough earnings. Yet, we lower our 2024/2025 EPS 3%/4%, to \$11.15/\$12.85, from \$11.50/\$13.35, respectively, on near-term volume uncertainty.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	11.23	10.29	11.15	12.85	14.85
GAAP EPS	11.22	10.45	11.15	12.85	14.85
EPS Change (YoY)	12.9%	-8.4%	8.4%	15.2%	15.6%
Consensus EPS (Bloomberg)			11.38	12.69	14.48
DPS	5.08	5.20	5.35	5.55	5.75
Valuation (Dec)					
P/E	21.5x	23.5x	21.7x	18.8x	16.3x
GAAP P/E	21.5x	23.1x	21.7x	18.8x	16.3x
Dividend Yield	2.1%	2.2%	2.2%	2.3%	2.4%
EV / EBITDA*	13.5x	14.4x	13.5x	12.3x	11.2x
Free Cash Flow Yield*	3.9%	3.2%	4.0%	4.4%	5.0%

* For full definitions of *IQmethod*SM measures, see page 6.

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12650955

Timestamp: 25 January 2024 04:24PM EST

25 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	271.00	274.00
2024E Rev (m)	24,694.2	24,747.8
2025E Rev (m)	25,939.2	26,070.0
2026E Rev (m)	NA	27,430.8
2024E EPS	11.50	11.15
2025E EPS	13.35	12.85
2026E EPS	NA	14.85

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Stock Data

Price	241.57 USD
Price Objective	274.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-1-7
52-Week Range	183.69 USD - 246.99 USD
Mrkt Val (mn) / Shares Out (mn)	147,334 USD / 609.9
Free Float	98.3%
Average Daily Value (mn)	596.61 USD
BofA Ticker / Exchange	UNP / NYS
Bloomberg / Reuters	UNP US / UNP.N
ROE (2024E)	44.9%
Net Dbt to Eqty (Dec-2023A)	213.1%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Union Pacific

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	12.7%	11.2%	11.7%	12.7%	13.8%
Return on Equity	53.2%	46.6%	44.9%	49.9%	55.1%
Operating Margin	40.2%	37.9%	39.7%	42.2%	44.5%
Free Cash Flow	5,742	4,773	5,836	6,551	7,388

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.3x	1.3x	1.4x	1.3x	1.3x
Asset Replacement Ratio	1.6x	1.6x	1.4x	1.5x	1.5x
Tax Rate	22.9%	23.4%	24.0%	24.0%	23.4%
Net Debt-to-Equity Ratio	265.6%	213.1%	207.1%	215.4%	205.9%
Interest Cover	7.9x	6.8x	7.4x	7.9x	8.3x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	24,875	24,119	24,748	26,070	27,431
% Change	14.1%	-3.0%	2.6%	5.3%	5.2%
Gross Profit	18,096	17,665	18,470	19,847	21,333
% Change	7.2%	-2.4%	4.6%	7.5%	7.5%
EBITDA	12,255	11,467	12,231	13,430	14,690
% Change	6.1%	-6.4%	6.7%	9.8%	9.4%
Net Interest & Other Income	(925)	(956)	(966)	(1,033)	(1,099)
Net Income (Adjusted)	7,008	6,276	6,740	7,567	8,517
% Change	7.4%	-10.4%	7.4%	12.3%	12.6%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	7,008	6,276	6,740	7,567	8,517
Depreciation & Amortization	2,246	2,318	2,396	2,440	2,472
Change in Working Capital	(144)	(435)	(294)	(324)	(325)
Deferred Taxation Charge	262	117	394	442	481
Other Adjustments, Net	(10)	103	0	0	0
Capital Expenditure	(3,620)	(3,606)	(3,400)	(3,574)	(3,758)
Free Cash Flow	5,742	4,773	5,836	6,551	7,388
% Change	-5.8%	-16.9%	22.3%	12.3%	12.8%
Share / Issue Repurchase	(6,282)	(705)	(2,700)	(4,200)	(4,200)
Cost of Dividends Paid	(3,159)	(3,173)	(3,228)	(3,262)	(3,292)
Change in Debt	3,554	(747)	750	1,750	1,750

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	1,019	1,071	1,732	2,571	4,217
Trade Receivables	1,891	1,964	1,938	2,038	2,141
Other Current Assets	1,042	1,113	1,113	1,113	1,113
Property, Plant & Equipment	56,038	57,398	58,402	59,536	60,822
Other Non-Current Assets	5,459	5,586	5,028	4,432	3,447
Total Assets	65,449	67,132	68,213	69,690	71,739
Short-Term Debt	1,678	1,423	1,423	1,423	1,423
Other Current Liabilities	3,842	3,683	3,363	3,139	2,917
Long-Term Debt	31,648	31,156	31,906	33,656	35,406
Other Non-Current Liabilities	16,118	16,082	16,262	16,383	16,154
Total Liabilities	53,286	52,344	52,954	54,601	55,900
Total Equity	12,163	14,788	15,259	15,089	15,839
Total Equity & Liabilities	65,449	67,132	68,213	69,690	71,739

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Rail Transport/Railroads

Company Description

Union Pacific (UNP) is the largest railroad in North America, covering approximately 33,000 route miles in 23 states across two-thirds of US (27,500 owned miles and 6,000 leased or trackage right miles), linking Pacific Coast and Gulf Coast ports with the Midwest, eastern United States gateways, and various north/south corridors to Mexican gateways. UNP has approx. 7,500 locomotives and nearly 100,000 freight cars operating on its network.

Investment Rationale

UNP has improved its operating ratio from the mid-80s to low-60's over the past decade (though stalled for 4-6 years under prior CEO Lance Fritz. New CEO Vena, a PSR guru and protege of rail expert Hunter Harrison, reiterated his target to be industry margin leader, which should lead to sustained mid- to upper-teens earnings growth in the near term. Its addition of Mr. Vena, ongoing culture change, and expansion of Precision Scheduled Railroading should enhance its operational improvement.

Stock Data

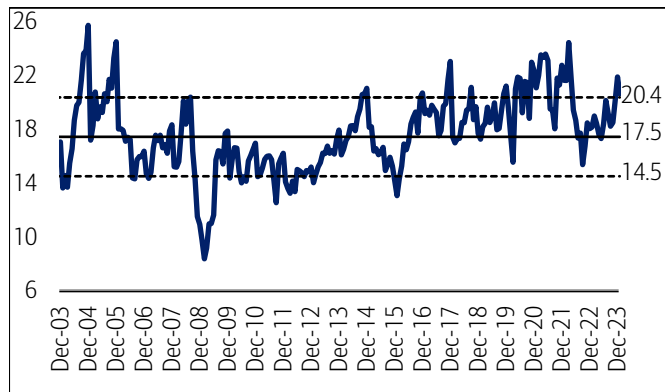
Average Daily Volume 2,469,725

Quarterly Earnings Estimates

	2023	2024
Q1	2.53A	2.45E
Q2	2.54A	2.75E
Q3	2.51A	2.89E
Q4	2.71A	3.07E

Exhibit 1: Union Pacific Forward P/E

Shares are trading at 21x, above its 15x-20x trading range.

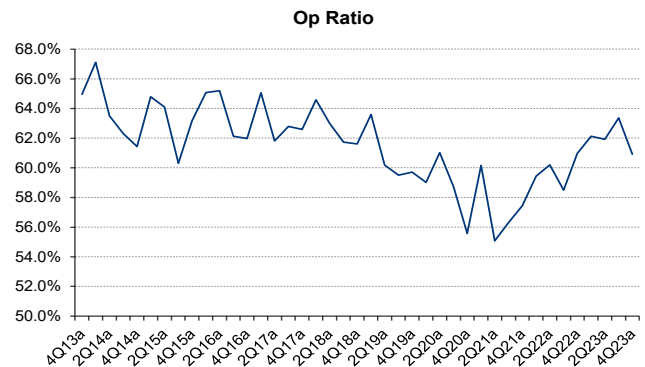


Source: BofA Global Research estimates and Bloomberg.

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Exhibit 2: Union Pacific Operating Ratio

Union Pacific operating ratio was 60.9% in 4Q, a 250 bps seq improvement from 3Q and 70 bps better than our target.



Source: BofA Global Research and company reports.

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Efficiency paves the path to industry best operating ratio

Union Pacific sees 2024 economic environment as muted as it expects a deceleration in Industrial Production and housing starts. It believes its volumes will be negatively affected by loss in International Intermodal business, lower coal demand, and the soft macro. It also targets pricing dollars to outpace inflation dollars (which it expects to increase approx. 5% ex-fuel) yet acknowledged pricing alone may not lead margin gains.

CEO Jim Vena sees increasing productivity and efficiency as the key lever in delivering industry-best margins, as he continues to see room to increase asset utilization and improve Union Pacific's service product. The company targets capex of \$3.4 billion in 2024 (from \$3.7 billion in 2023, or 17% of revenues, flat y-y), and expects no share repurchases in 1Q24 (we had expected \$900 million, now none) given the timing of the maturity of \$1.3 billion in debt.

Pricing and volumes offset lower fuel and negative mix

Volumes were up 3.4% year-year, ahead of our +1.8% target, aided by an acceleration in Intermodal carloads into yearend (Intermodal was up 5% year-year vs our +4% target). Grain volume growth (+4% vs our -2% target) was supported by new biofuel wins yet Autos (-0.5% vs our +5.0% target) was affected by the UAW labor strike, partly offset by dealer inventory replenishment. UNP views Coal growth in 2024 as challenged with muted natural gas pricing and elevated stockpile inventory (we target 2024 coal carloads to decline 4%) yet it expects Premium volumes to improve year-year despite its contract lost in International Intermodal negatively impacting its comps.

Yields (average revenue per carload) were down 2.8% year-year, better than our -6.0% target. Higher than expected core pricing gains were offset by lower fuel surcharge in Bulk and Industrial as well as negative mix (given the influx of lower-yielding Intermodal cars). Approximately half of UNP's book of business is up for repricing in 2024. We expect revenue/carload to increase 2.7% year-year in 2024, as its repricing moves are partly offset by the decline in Coal carloads.

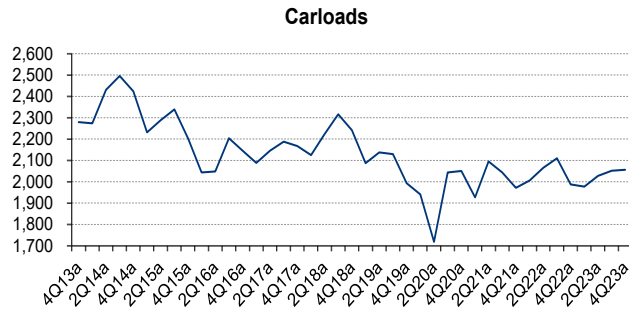
Service gains leading efficiency, driving margins

Service made significant strides in the quarter as freight car velocity averaged 217 car miles/day, up 14% year-year. The improved network performance was driven by higher train speeds and decreased terminal dwell. Intermodal Trip Plan and Manifest Trip Plan both increased 12 points year-year, to 85% and 70%, respectively. Efficiency also materially improved with locomotive productivity (GTM/horsepower) up 14% year-year, as it parked 500 power units in 4Q, and workforce productivity (car miles/full-time employee) up 4% year-year (it lowered headcount 560 in 4Q). Its productivity gain led it to lower OpEx slightly despite 3% higher volumes and increased cost inflation.



Exhibit 3: Union Pacific Carloads

Volumes were up 3.4% year-year in 4Q23, ahead of our +1.8% target

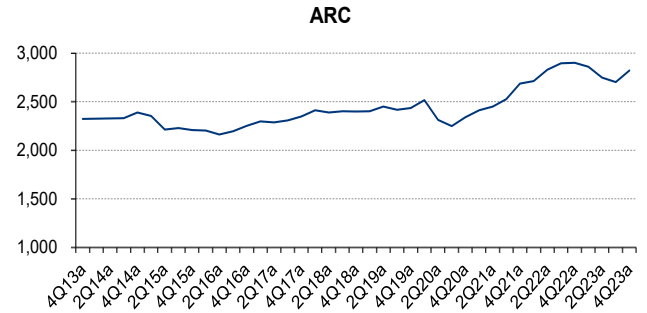


Source: BofA Global Research and company reports.

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Exhibit 4: Union Pacific Average Revenue per Carload

Yields (average revenue per carload) were down 2.8% year-year, better than our -6.0% target.

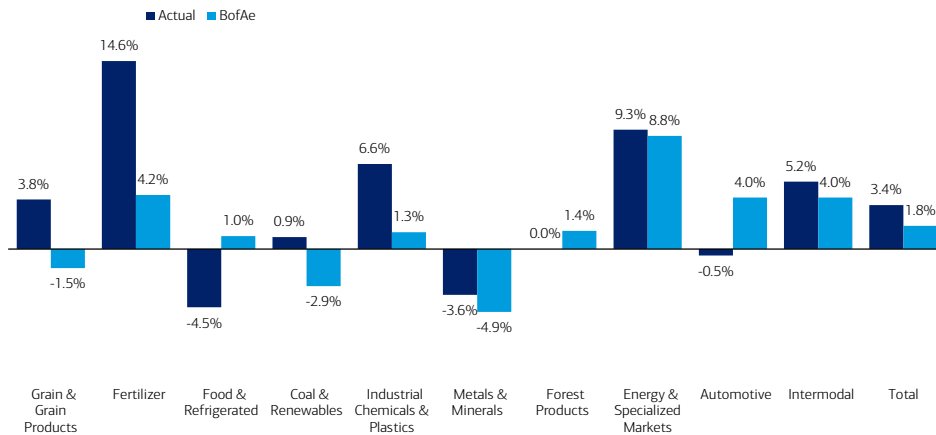


Source: BofA Global Research and company reports.

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Exhibit 5: Union Pacific 4Q23 Carload Growth Actual vs Estimate

Volumes were up 3.4% year-year in 4Q23, ahead of our +1.8% target

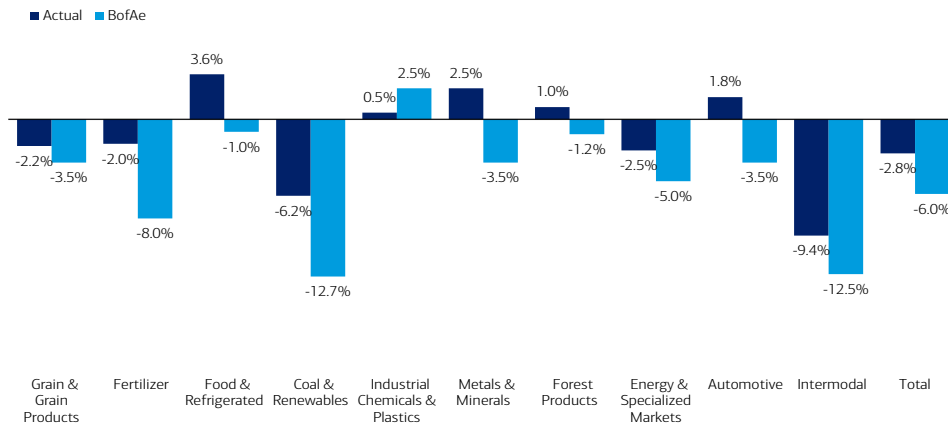


Source: BofA Global Research and company reports.

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Exhibit 6: Union Pacific 4Q23 Revenue/Carload Growth Actual vs Estimate

Yields (average revenue per carload) were down 2.8% year-year, better than our -6.0% target.



Source: BofA Global Research and company reports.

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Price objective basis & risk

Union Pacific (UNP)

Our \$274 price objective is based on a 24.5x multiple on our 2024 EPS estimate, as we are above the top of its 14x-20x historical range given the rapidly improving service gains under new CEO Jim Vena. We believe 2024 earnings will rebound from 2023's trough, particularly aided by the operational and cultural turnaround launched by Mr. Vena. The company should significantly improve its earnings outlook, drive improved cash flow, and return to buybacks in 2024. We target leverage to remain between 2.8x-3.0x, and look for it to re-engage in top-line growth, drive improved returns and cash flow.

Risks to our price objective are a more muted economic recovery, accelerating coal volume declines, muted winter weather leading utilities to build coal inventories, increased pricing competition neutralizing the benefits from the pricing currently enjoyed by the rail industry, higher than expected fuel prices, employee/union strikes, inability to exercise pricing power due to regulatory changes or legal challenges from customers, disruptive rail re-regulation that limits the company's ability to earn proper returns on its investments or mandates open access with unfavorable terms, risk from the Canadian Pacific (CP)-Kansas City Southern (KSU) merger absorbing Mexico vols, or harsh weather that disrupts operations beyond normal. Additionally, aggressive moves by in-region peer BNSF to take share, or if UNP's service metrics cannot improve, it could see sustained higher costs.

Analyst Certification

I, Ken Hoexter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Canadian Pacific Kansas City Ltd	CP	CP US	Ken Hoexter
	CSX Corporation	CSX	CSX US	Ken Hoexter
	FedEx Corp.	FDX	FDX US	Ken Hoexter
	J.B. Hunt Transport Services	JBHT	JBHT US	Ken Hoexter
	Kirby Corp	KEX	KEX US	Ken Hoexter
	Knight-Swift Transportation Holdings Inc	KNX	KNX US	Ken Hoexter
	Norfolk Southern	NSC	NSC US	Ken Hoexter
	Old Dominion Freight Line	ODFL	ODFL US	Ken Hoexter
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	Wabtec Corp.	WAB	WAB US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
NEUTRAL				
	Canadian National	CNI	CNI US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
UNDERPERFORM				
	ArcBest Corporation	ARCB	ARCB US	Ken Hoexter
	C.H. Robinson	CHRW	CHRW US	Ken Hoexter
	The Greenbrier Companies	GBX	GBX US	Ken Hoexter



US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

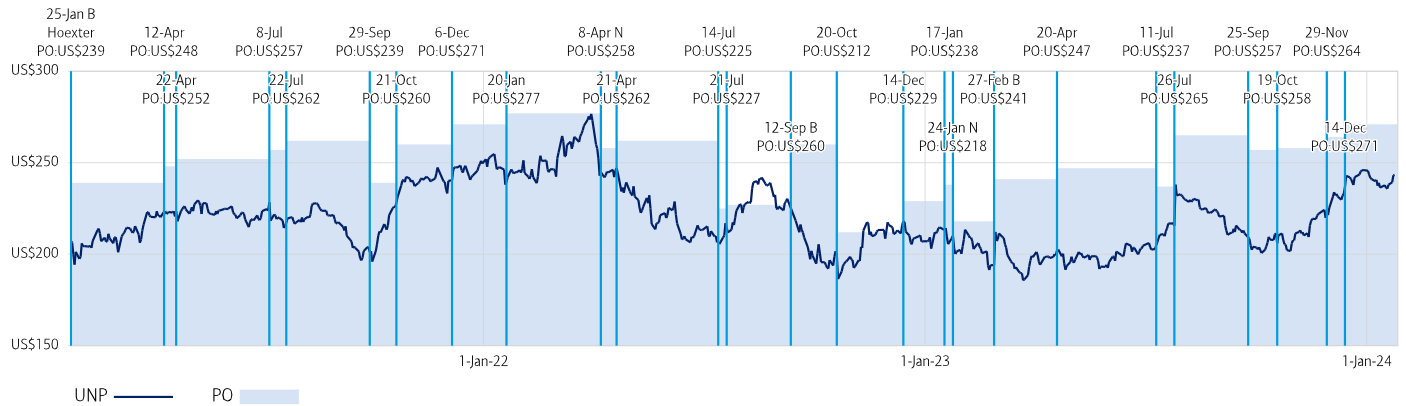
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Disclosures

Important Disclosures

Union Pacific (UNP) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	67	50.38%	Buy	44	65.67%
Hold	31	23.31%	Hold	13	41.94%
Sell	35	26.32%	Sell	17	48.57%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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