

**Dear Fellow Shareholders:**

2004 likely will be remembered as a year of booming economic growth, record oil prices, global struggles for democracy and a devastating tsunami in Asia. For Union Pacific, we will remember 2004 as a time of unprecedented demand for rail transportation. Unfortunately, we did not fully meet this demand as we experienced considerable operating difficulties. Our commitment to the future is that we are learning from these challenges and will emerge a stronger and better Railroad.

**Financial Recap**

As a result of record demand in our business, commodity revenue was the bright spot in the year, hitting a record \$11.7 billion and topping last year's record by more than \$650 million. Commodity volume growth was one driver of the revenue gain as we set monthly records for 7-day carloadings every month in 2004, peaking in November with an all-time weekly record of more than 194,000 carloads.

Union Pacific faced two significant financial challenges in 2004—the increased costs associated with our operational inefficiencies and record high fuel prices. Service issues, coupled with our increased hiring and training efforts, added roughly \$300 million in operating expenses to the year. Our average fuel price rose from \$1.02 per gallon in the first quarter of the year to \$1.46 per gallon in the fourth quarter, resulting in an additional \$200 million year-over-year expense increase net of our fuel surcharge recovery.

**Changing Business Environment**

Unprecedented levels of demand have created a very strong pricing environment that we are working diligently to convert into higher returns on investment. Across all business groups, we are obtaining solid price increases in the marketplace. At the same time, we are working to reduce the complexity and inflexibility of long-term contracts so that we can respond more quickly to changing market conditions.

One clear example is in our coal business where we have instituted new coal pricing mechanisms for all shipments from the Southern Powder River Basin (SPRB) in Wyoming, as well as spot movements out of Colorado and Utah. We have simplified the way

we do business with our customers by clearly communicating the revenue we need in order to reinvest in our coal business, while sharply reducing the administrative burden of dozens of separate contracts. In total, 322 million tons of coal moved out of the SPRB in 2004, and that is expected to grow to over 500 million tons by 2013. Our goal is to participate in meeting that growing demand, but only if the financial returns are sufficient to justify the necessary investment.

**Operating Recap**

Surging freight demand in the latter part of 2003 strained our network resources and slowed our system velocity, leaving us short of train crew personnel and locomotive power. Tactical plans were initiated to add resources. We graduated nearly 5,000 new conductors into service and acquired almost 400 new locomotives during 2004, but record volumes continued to overwhelm our system even as we added these resources.

In some of the most constrained parts of our network, we took additional steps during the year to manage network flows and volumes. For example, on our Sunset Corridor between Los Angeles and El Paso, where demand was particularly strong, we reduced the number of trains to improve fluidity. Another example is in our South Texas rock network where velocity improved 16 percent after we reduced the number of rail cars assigned to rock service to ease congestion. The 20 percent reduction in cars, combined with the velocity gain, allowed us to increase rock loadings by 26 percent during the peak construction months of August, September and October. We appreciate the tremendous level of support and cooperation that our customers provided in helping alleviate some of the congestion, and we look forward to continuing these efforts in the future.

We're also approaching our operational issues strategically through several network management initiatives. One of these is our Unified Plan, which takes a "clean sheet" approach to redesigning our transportation plan. Using quality tools, including an industrial engineering process known as Lean management to aid us in this process, we will work to simplify operations and balance the demands on our network, enabling Union Pacific to operate more

efficiently. When combined with efforts to manage the flow of business onto our Railroad, we believe these initiatives can improve the reliability and consistency of our service offerings.

As we entered 2005, we were looking forward to gaining momentum with our network efforts and increasing velocity. Instead, Mother Nature delivered a major storm to the Los Angeles Basin, Nevada and Utah, severely limiting our operations in that region for several weeks. Thanks to the heroic efforts of the men and women of Union Pacific, we were able to quickly restore vital rail service in the affected areas. We also saw our 7-day average train speed increase by 2.3 miles per hour from the last week in December to the last week in January. Continued improvement in network fluidity is our focus and is vital to achieving our 2005 goals.

### **Safety—Always a Priority**

Regardless of the demands on our network or what Mother Nature has to offer, our first priority is to operate safely. We believe all accidents and injuries can be prevented, and it is the responsibility of everyone at Union Pacific to work toward that goal. During a year when we added thousands of new train crew personnel and moved record volumes, the number of claims for lost work day cases fell by 9 percent. Quality processes, designed to ensure we hire the right people and provide world-class training, and an overall culture of safety are essential to achieving continuous improvement in our safety record.

### **Corporate Changes**

Ike Evans, our Vice Chairman and a member of our Board, is retiring at the end of February 2005, after more than six years of dedicated service. Ike's leadership, determination and enthusiasm will certainly be missed. We wish him well and sincerely thank him for all he has contributed.

Another Board of Directors change occurred last June when we were pleased to welcome Erroll B. Davis, Jr., Chairman and CEO of Alliant Energy Corporation, to our Board. Erroll brings extensive management expertise and a customer perspective to our Board.

For the first time since 1910, Union Pacific Railroad changed its home address when we relocated our headquarters to the Union Pacific Center at 1400

Douglas Street. Working in partnership with the State of Nebraska, we consolidated personnel from 10 office buildings in Omaha and St. Louis into one new, bright, functional home. The new building greatly enhances work force efficiency, is a source of pride for Union Pacific employees and will serve as the central point of our operations for years to come.

### **Planning for the Future**

As 2004 demonstrated, a shift has occurred in the supply and demand fundamentals of rail transportation. For the first time in decades, demand exceeds supply and, given transportation infrastructure constraints and truck driver shortages, this situation is not likely to change in the near term. We must, therefore, work to find the point of equilibrium between supply and demand. As a Company, we must also embrace the changes that will be necessary to operate successfully in this new environment.

- *We will strive to eliminate unnecessary work events and reduce capacity constraints through process improvements.*
- *We will optimize network capacity to improve our yields.*
- *We will allocate capital resources based on the expected returns and the incremental capacity enhancement gained per dollar spent. For example, in 2004, a \$34 million investment increased our Denver coal train processing capacity by 25 percent and reduced our customers' inventory carrying costs. In addition, we'll save \$15 million annually in failure costs from this "Denver Beltline Connection."*

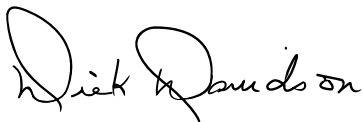
We also will continue to cultivate our vital employee assets. Over the next 10 years, we are projecting significant work force attrition and retirements, making it essential that we continue to work to attract high quality, energetic and diverse employees. We've been very pleased with the quality of people we've hired into train service over the last year, and we are equally excited about the new operating management associates who are just starting their careers. These men and women are the future of Union Pacific and, judging by what we are seeing so far, that future looks bright.

Our efforts to be an “employer of choice” have gained national recognition. *G.I. Jobs* magazine named Union Pacific as one of the Top 25 “military friendly” employers for our military recruiting efforts, percentage of new hires with military experience and policies toward National Guard and reserve service. We also were honored as a top employer for the third time by *Working Mother* magazine and for the second year in a row by *LATINA Style* magazine. In addition, the National Association of Secondary School Principals awarded Union Pacific its highest honor, the Distinguished Service Award, for creating The Principals’ Partnership program supporting public high school principals as they seek to educate America’s future work force.

### **2005 – Challenges and Opportunities**

Looking at 2005, our customers are indicating another year of strong demand. This environment should provide tremendous opportunities for our industry and our Company. Every year has its challenges, however, with external factors, such as the potential for rising interest rates or devaluation of the U.S. dollar, presenting a risk to economic growth. High fuel prices will likely remain an obstacle, but we will continue to push for greater fuel surcharge recoveries to offset this added cost. We’ll remain watchful of these external developments, working to minimize cost pressures on our business as we take advantage of the growing opportunities in the marketplace.

Union Pacific’s success in 2005 will be defined by how we operate our network. Through our various network management initiatives we must increase our velocity and, at the same time, work to restore efficiency using the Quality principles. By achieving these objectives, we will restore trust and confidence in Union Pacific as we increase the value of our Company for our customers, our employees and our shareholders.

A handwritten signature in black ink that reads "Dick Davidson". The signature is written in a cursive, flowing style.

Dick Davidson  
Chairman and Chief Executive Officer