

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 8-K

Current Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): December 15,  
2003

Union Pacific Corporation

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(Exact Name of Registrant as Specified in its Charter)

Utah	1-6075	13-2626465
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

1416 Dodge Street, Omaha, Nebraska	68179
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (402) 271-  
5777

N/A

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(Former Name or Former Address, if Changed Since Last Report)

**Item 5. Other Events and Regulation FD Disclosure.**

Attached hereto and incorporated herein by reference are exhibits, which contain amendments to certain Items included in each of the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, Form 10-Q for the quarterly period ended March 31, 2003, and Form 10-Q for the quarterly period ended June 30, 2003, respectively. In anticipation of filing a Shelf Registration Statement on Form S-3, covering the registration of the sale of \$1 billion of securities, this Report and the Exhibits are being filed to reflect the recent disposition by the registrant of its trucking subsidiary, Overnite Corporation, a Virginia Corporation ("Overnite"), as a discontinued operation. As previously reported in the Report of the registrant on Form 8-K, dated November 5, 2003, the registrant sold all of the issued and outstanding common stock of Overnite in an underwritten initial public offering. **This Report does not update or otherwise modify the information in the Items contained in the Exhibits to this Report, except to reflect the matters discussed above, and the registrant is not under any obligation and does not hereby undertake to provide any such update or modification.**

**Item 7. Financial Statements and Exhibits.**

(c) Exhibits.

99.1 Amended Item 6. Selected Financial Data, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Item 8. Financial Statements and Supplementary Data, and Schedule II - Valuation and Qualifying Accounts as listed in Item 15. Exhibits, Financial Statement Schedules, and Reports from the 2002 Annual Report on Form 10-K amended for the effects of the matters discussed above.

Exhibits to Exhibit 99.1

12.1 Amended Ratio of Earnings to Fixed Charges for period ended December 31, 2002

23.1 Independent Auditors' Consent

(c) Exhibits. (cont.)

99.2 Amended Item 1. Consolidated Financial Statements, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations from the Quarterly Report on Form 10-Q for the period ended March 31, 2003, amended for the effects of the matters discussed above.

Exhibits to Exhibit 99.2

12.2 Amended Ratio of Earnings to Fixed Charges for period ended March 31, 2003

99.3 Amended Item 1. Consolidated Financial Statements, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations from the Quarterly Report on Form 10-Q for the period ended June 30, 2003, amended for the effects of the matters discussed above.

Exhibits to Exhibit 99.3

12.3(a) Amended Ratio of Earnings to Fixed Charges for three month period ended June 30, 2003

12.3(b) Amended Ratio of Earnings to Fixed Charges for six month period ended June 30, 2003

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned hereunto duly authorized.

Dated: December 15, 2003

UNION PACIFIC CORPORATION

By: /s/ James R. Young  
James R. Young  
Executive Vice President -  
Finance

## EXHIBIT INDEX

<u>Exhibit</u>	<u>Description</u>
99.1	Amended Item 6. Selected Financial Data, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Item 8. Financial Statements and Supplementary Data, and Schedule II - Valuation and Qualifying Accounts as listed in Item 15. Exhibits, Financial Statement Schedules, and Reports from the 2002 Annual Report on Form 10-K amended for the effects of the matters discussed above.
	<u>Exhibits to Exhibit 99.1</u>
12.1	Amended Ratio of Earnings to Fixed Charges for period ended December 31, 2002
23.1	Independent Auditors' Consent
99.2	Amended Item 1. Consolidated Financial Statements, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations from the Quarterly Report on Form 10-Q for the period ended March 31, 2003, amended for the effects of the matters discussed above.
12.2	Amended Ratio of Earnings to Fixed Charges for period ended March 31, 2003
99.3	Amended Item 1. Consolidated Financial Statements, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations from the Quarterly Report on Form 10-Q for the period ended June 30, 2003, amended for the effects of the matters discussed above.
	<u>Exhibits to Exhibit 99.3</u>
12.3(a)	Amended Ratio of Earnings to Fixed Charges for three month period ended June 30, 2003

12.3(b) Amended Ratio of Earnings to Fixed  
Charges for six month period ended June  
30, 2003

**10-K Amended Items for Period Ending December 31, 2002****Item 6. Selected Financial Data**

The following table presents, as of and for the years ended December 31, selected financial data for the Corporation for each of the last 10 years. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, Item 7, and with the Consolidated Financial Statements and notes thereto, Item 8. The information below is not necessarily indicative of the results of future operations.

<i>Millions of Dollars, Except Per Share Amounts, Ratios and Employee Statistics</i>										
	2002 <sup>[b]</sup>	2001	2000 <sup>[c]</sup>	1999	1998 <sup>[d]</sup>	1997	1996	1995	1994 <sup>[e]</sup>	1993 <sup>[f]</sup>
<b>For the Year Ended December 31<sup>[a]</sup></b>										
Operating revenue.....	11,159	10,830	10,765	10,175	9,480	10,133	7,825	6,510	5,455	5,063
Operating income (loss).....	2,253	2,018	1,850	1,784	337	1,134	1,499	1,291	1,078	946
Income (loss) <sup>[g]</sup> .....	1,265	934	810	765	(101)	435	782	655	533	380
Net income (loss).....	1,341	966	842	810	(633)	432	904	946	546	530
Per share – basic:										
Income (loss) <sup>[g]</sup> .....	5.02	3.77	3.29	3.10	(0.41)	1.77	3.61	3.20	2.60	1.86
Net income (loss).....	5.32	3.90	3.42	3.28	(2.57)	1.76	4.17	4.62	2.66	2.59
Per share – diluted:										
Income (loss) <sup>[g]</sup> .....	4.78	3.65	3.22	3.05	(0.41)	1.75	3.58	3.19	2.59	1.85
Net income (loss).....	5.05	3.77	3.34	3.22	(2.57)	1.74	4.14	4.60	2.66	2.58
Dividends per share.....	0.83	0.80	0.80	0.80	0.80	1.72	1.72	1.72	1.66	1.54
Operating cash flow.....	2,199	1,865	2,021	1,823	507	1,568	1,653	1,405	1,006	903
<b>At December 31<sup>[a]</sup></b>										
Total assets.....	32,764	31,551	30,917	30,192	29,590	28,860	27,990	19,500	14,543	13,797
Total debt.....	7,703	8,078	8,351	8,636	8,687	8,510	8,016	6,350	4,462	4,105
Common shareholders' equity.....	10,651	9,575	8,662	8,001	7,393	8,225	8,225	6,364	5,131	4,885
Equity per common share.....	41.99	38.26	35.09	32.29	29.88	33.30	33.35	30.96	24.92	23.81
<b>Additional Data<sup>[a]</sup></b>										
Rail commodity revenue.....	10,663	10,391	10,270	9,851	9,072	9,712	7,419	6,105	5,216	4,873
Rail carloads (000).....	9,131	8,916	8,901	8,556	7,998	8,453	6,632	5,568	4,991	4,619
Rail operating margin (%).....	21.0	19.3	17.7	18.0	4.6	12.6	20.9	21.9	22.1	20.9
Rail operating ratio (%).....	79.0	80.7	82.3	82.0	95.4	87.4	79.1	78.1	77.9	79.1
Average employees (000).....	47.3	48.7	50.5	52.5	53.6	54.0	41.4	35.2	30.8	30.1
Revenue per employee (000).....	235.9	222.4	213.2	193.8	176.9	187.6	189.0	184.9	177.1	168.2
<b>Financial Ratios (%) <sup>[a]</sup></b>										
Debt to capital employed <sup>[h]</sup> .....	38.8	42.2	45.1	47.6	49.4	50.9	49.4	49.9	46.5	45.7
Return on equity <sup>[i]</sup> .....	13.3	10.6	10.1	10.5	(8.1)	5.3	12.4	16.5	10.9	11.1

[a] Data included the effects of the acquisitions of Motor Cargo as of November 30, 2001, Southern Pacific Rail Corporation as of October 1, 1996, Chicago and North Western Transportation Company as of May 1, 1995, and Skyway Freight Systems, Inc. as of May 31, 1993, and reflects the disposition of the Corporation's trucking subsidiary in 2003, natural resources subsidiary in 1996, waste management subsidiary in 1995 and logistics subsidiary in 1998 which were properly reflected as discontinued operations.

[b] 2002 net income includes \$214 million pre-tax (\$133 million after-tax) gains on asset dispositions. In addition, net income included a reduction of income tax expense of \$67 million related to tax adjustments for prior years' income tax examinations.

[c] 2000 operating income and net income included \$115 million pre-tax (\$72 million after-tax) work force reduction charge (see note 12 to the Consolidated Financial Statements, Item 8).

[d] 1998 net loss included a \$547 million pre-and after-tax charge for the revaluation of OTC goodwill.

[e] 1994 net income included a net after-tax loss of \$404 million from the sale of the Corporation's waste management operations.

[f] 1993 net income included a net after-tax charge for the adoption of changes in accounting methods for income taxes, postretirement benefits other than pensions and revenue recognition, and a one-time charge for the deferred tax effect of the Omnibus Budget Reconciliation Act of 1993.

[g] Based on results from continuing operations.

[h] Debt to capital employed is as follows: total debt divided by debt plus equity plus convertible preferred securities.

[i] Based on average common shareholders' equity.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the Consolidated Financial Statements and applicable notes to the Consolidated Financial Statements, Item 8, and other information included in this Form 8-K.

Union Pacific Corporation (UPC or the Corporation) has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnite Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 14 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

### **CRITICAL ACCOUNTING POLICIES**

The Corporation's discussion and analysis of its financial condition and results of operations are based upon its Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires estimation and judgment that affect the reported amounts of revenues, expenses, assets, and liabilities. The Corporation bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The following are the Corporation's critical accounting policies that affect significant areas of the Corporation's operations and involve judgment and estimates. If these estimates differ materially from actual results, the impact on the Consolidated Financial Statements may be material.

**Depreciation** – Provisions for depreciation are computed principally on the straight-line method based on estimated service lives of depreciable property. The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation. Various methods are used to estimate useful lives for each group of depreciable property. Due to the capital intensive nature of the business and the large base of depreciable assets, variances to those estimates could have a material effect on the Corporation's Consolidated Financial Statements.

**Environmental** – The Corporation generates and transports hazardous and non-hazardous waste in its current and former operations, and is subject to federal, state and local environmental laws and regulations. The Corporation has identified approximately 433 sites at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 52 sites that are the subject of actions taken by the U.S. government, 27 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to activities of other parties, in addition to costs relating to its own activities at each site.

When an environmental issue has been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

The liability includes future costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties, and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved, site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites, and/or the speculative nature of remediation costs.

**Income Taxes** – The Corporation accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109). The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. These expected future tax consequences are measured based on provisions of tax law as currently enacted; the effects of future changes in tax laws are not anticipated. Future tax law changes, such as a change in the corporate tax rate, could have a material impact on the Corporation's financial position or its results of operations.

**Pension and Postretirement Benefits** – The Corporation incurs certain employment-related expenses associated with pensions and postretirement health benefits. In order to measure the expense associated with these benefits, management must make various estimates and assumptions, including discount rates used to value liabilities, assumed rates of return on plan assets, compensation increases, employee turnover rates, anticipated mortality rates and expected future healthcare costs. The estimates used by management are based on the Corporation's historical experience as well as current facts and circumstances. The Corporation uses third-party actuaries to assist management in properly measuring the expense and liability associated with these benefits. Actual future results that vary from the previously mentioned assumptions could have a material impact on the Consolidated Financial Statements.

Recent declines in the equity markets have caused the market value of the plan assets to decrease. As a result, a minimum pension liability adjustment of \$225 million, net of tax, (\$141 million related to continuing operations and \$84 million related to discontinued operations) was recorded in the fourth quarter of 2002 as a reduction to shareholders' equity (see note 6 to the Consolidated Financial Statements, Item 8). Also, during 2002, the Corporation decreased its assumed long-term rate of return on pension plan assets from 10% to 9%. This assumption change resulted in a \$16 million increase to 2002 pension expense. While the interest rate and asset return environment have significantly impacted the funded status of the Corporation's plans, the Corporation does not have any minimum pension funding requirements, as set forth in employee benefit and tax laws.

**Personal Injury and Occupational Illness** – The cost of injuries to employees and others related to Railroad activities or in accidents involving the trucking segment is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year. Compensation for Railroad work-related accidents is governed by the Federal Employers' Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. The Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work. Changes in estimates can vary due to evolving trends in litigation related to personal injury and occupational illness cases based on large jury awards and public pressures associated with certain occupational related injuries.

## **2002 COMPARED TO 2001 RESULTS OF OPERATIONS**

### **Operations**

**Net Income** – The Corporation reported net income of \$1.34 billion (\$5.32 per basic share and \$5.05 per diluted share) in 2002 compared to \$966 million (\$3.90 per basic share and \$3.77 per diluted share) in 2001. Income from continuing operations (see note 14 to the Consolidated Financial Statements) was \$1.27 billion (\$5.02 per basic share and \$4.78 per diluted share) in 2002 compared to \$934 million (\$3.77 per basic share and \$3.65 per diluted share) in 2001. The increase in income from continuing operations resulted from double digit operating income growth, lower interest costs, two large asset sale transactions (one with the Utah Transit Authority (UTA) for \$141 million pre-tax and one with the Santa Clara Valley Transportation Authority (VTA) for \$73 million pre-tax) and tax adjustments of \$33 million for prior years' income tax examinations. Operating income improved as revenue growth, lower fuel prices and productivity gains offset the effects of wage and benefit inflation and higher volume-related costs. Productivity is measured by both gross ton miles per inflation-adjusted expense dollar and gross ton miles per employee.

**Operating Revenues** – Operating revenue is comprised of rail commodity revenue and other revenues. Other revenues primarily include subsidiary revenue from various companies that are wholly owned or majority owned by the Railroad, revenue from the Chicago commuter rail operations and accessorial revenue earned due to customer detainment of Railroad owned or controlled equipment. The Corporation recognizes transportation revenues on a percentage-of-completion basis as freight moves from origin to destination. Other revenue is recognized as service is performed or contractual obligations

are met. Operating revenues increased \$329 million (3%) to a record \$11.2 billion in 2002. Commodity revenue increased \$272 million (3%) in 2002 driven by growth in the Automotive, Intermodal and Agricultural Products commodity groups. Other revenue increased \$57 million (13%) due to increased passenger, subsidiary, and accessorial revenues.

The following tables summarize the year-over-year changes in rail commodity revenue, revenue carloads and average revenue per car by commodity type:

<i>Commodity Revenue in Millions of Dollars</i>	<i>2002</i>	<i>2001</i>	<i>Change</i>
Agricultural.....	\$ 1,506	\$ 1,454	4%
Automotive.....	1,209	1,118	8
Chemicals .....	1,575	1,545	2
Energy .....	2,343	2,399	(2)
Industrial Products.....	2,035	1,970	3
Intermodal.....	1,995	1,905	5
Total.....	\$10,663	\$10,391	3%

<i>Revenue Carloads in Thousands</i>	<i>2002</i>	<i>2001</i>	<i>Change</i>
Agricultural.....	881	876	1%
Automotive.....	818	763	7
Chemicals .....	904	879	3
Energy .....	2,164	2,161	-
Industrial Products.....	1,413	1,405	1
Intermodal.....	2,951	2,832	4
Total.....	9,131	8,916	2%

<i>Average Revenue Per Car</i>	<i>2002</i>	<i>2001</i>	<i>Change</i>
Agricultural.....	\$1,709	\$1,660	3%
Automotive.....	1,477	1,465	1
Chemicals .....	1,742	1,756	(1)
Energy .....	1,083	1,111	(3)
Industrial Products.....	1,440	1,402	3
Intermodal.....	676	673	-
Total.....	\$1,168	\$ 1,165	-%

*Agricultural* – Revenue increased 4%, due to a 1% increase in carloads coupled with a 3% increase in average revenue per car. Meals and oils carloads increased due to strong export demand and more shipments to Mexico. Corn shipments to Mexico also increased. Revenue gains were also achieved through increased shipments of cottonseed, ethanol used as a fuel additive and frozen french fries. Average revenue per car increased due to a higher average length of haul, resulting from fewer short-haul empty storage moves and corn processor shipments combined with increased long-haul meals and oils and animal feed shipments.

*Automotive* – Revenue increased 8%, as a result of a 7% increase in carloads and a 1% increase in average revenue per car. Volume growth resulted from market share gains for finished vehicles, where carloads were up 11% despite a decline in U.S. light vehicle sales. Materials shipments declined 1%, due primarily to reduced production in Mexico. Market share gains partially offset the decline. Average revenue per car increased due to a shift in mix of carloads shipped, resulting from increased higher average revenue per car vehicles shipments and a decline in lower average revenue per car materials shipments. In addition, average length of haul for vehicle shipments increased.

*Chemicals* – Revenue increased 2%, as a result of a 3% increase in carloads and a 1% decrease in average revenue per car. Volume increased for liquid and dry chemicals due to relatively higher economic demand from industrial manufacturers. Plastics shipments rose as a result of increased demand for consumer durables. Revenue also increased due to higher domestic demand for fertilizer and demand for domestic and export soda ash shipments. Average revenue per car declined due to changes in customer contract terms.

*Energy* – Energy commodity revenue decreased 2% as average revenue per car declined 3%. Records were set for total carloads and coal trains loaded per day in the Southern Powder River Basin in Wyoming. Results were achieved through favorable weather conditions and improved cycle times. Offsetting the volume increase were reduced West Coast export shipments originating from the Colorado and Utah mining regions. Average revenue per car declined due to the impact of contract price negotiations on expiring long-term contracts with certain major customers.

*Industrial Products* – Revenue increased 3%, due to a slight increase in carloads coupled with a 3% increase in average revenue per car. Increased lumber shipments were the primary growth driver, due to strong housing construction and greater production in the Pacific Northwest region. Stone shipments increased due to strong building and road construction activity in the South. Revenue also increased for paper and newsprint commodities due to higher general demand. Reduced shipments of steel and metallic shipments in the first three quarters partially offset these increases. However, steel shipments rebounded in the fourth quarter as new U.S. tariffs made domestic producers more price-competitive with foreign producers. Average revenue per car increased due to price increases and a greater mix of longer average length of haul.

*Intermodal* – Revenue increased 5%, primarily due to a 4% increase in carloads. Volumes increased due to higher international shipments, resulting from strong import demand and market share gains in some segments. These gains were partially offset by the labor dispute between the International Longshoreman and Warehouse Union (ILWU) and the Pacific Maritime Association, which had a significant impact on intermodal volumes during the fourth quarter, primarily in October. Revenue declined for domestic shipments, due to soft market demand and the voluntary action of shedding low-margin trailer business in favor of higher-margin containers. The slight increase in average revenue per car was the result of price increases, offset by the mix impact of more lower revenue per car international shipments.

*Mexico Business* – In 2002 and 2001, respectively, UPRR generated \$873 million and \$860 million of revenues from rail traffic with businesses located in Mexico, which is included in the rail commodity revenue reported above. Shipments increased for agricultural products, chemicals, and industrial products commodity groups. Increased revenue for agricultural products resulted from higher corn and meal exports as well as increased beer imports. Increased chemicals business consisted of plastics exports, in addition to higher imports and exports of liquid and dry chemicals. The increase in industrial products resulted from higher imports and exports of steel and scrap and exports of pulp and paper products. Reduced automobile production partially offset these gains resulting in fewer shipments of parts and finished vehicles.

**Operating Expenses** – Operating expenses increased \$94 million (1%) to \$8.9 billion in 2002 from \$8.8 billion in 2001. The increase in expenses reflects wage and benefit inflation, higher equipment rents and depreciation expenses and increased casualty, purchased services and other costs. These increases were partially offset by a 3% reduction in employment levels at the Railroad, lower fuel prices and cost control efforts. Lower fuel prices for the Railroad of 73 cents per gallon in 2002 versus 88 cents per gallon in 2001, reduced fuel expense by \$198 million in 2002.

*Salaries, Wages and Employee Benefits* – Salaries, wages and employee benefits increased \$108 million (3%) in 2002 to \$3.7 billion. Increases were driven by inflation and volume-related costs related to a 4% increase in gross ton miles. A 3% reduction in employee force levels in conjunction with worker productivity improvements partially offset the inflation and higher volume-related costs.

*Equipment and Other Rents* – Equipment and other rents primarily includes rental expense the Railroad pays for freight cars owned by other railroads or private companies; freight car, intermodal and locomotive leases; other specialty equipped vehicle leases; and office and other rentals. Expenses increased \$26 million (2%) compared to 2001 due primarily to higher locomotive leases and volume-related costs, partially offset by savings from lower car cycle times (the average number of accumulated days per load or cycle that loaded and empty cars from other railroads spend on UPRR's system) and rental prices for private cars. The higher locomotive lease expense is due to the Railroad's increased leasing of new, more reliable and fuel efficient locomotives. These new locomotives replaced older, non-leased models in the fleet, which helped reduce expenses for depreciation, labor, materials and fuel during the year. The increase in volume costs is primarily due to

increased shipments of finished autos that almost exclusively utilize rented freight cars. The reduction in car cycle times is attributable to increased volume demand and better car utilization.

*Depreciation* – The majority of depreciation relates to track structure, including rail, ties and other track material. Depreciation expense increased \$21 million (2%) over 2001 as a result of higher capital spending in recent years. Capital spending totaled \$1.7 billion in 2002 and \$1.6 billion in 2001.

*Fuel and Utilities* – Fuel and utilities is comprised of locomotive fuel, utilities other than telephone, and gasoline and other fuels. Expenses declined \$184 million (15%) in 2002. The decrease was driven by lower fuel prices and a record low fuel consumption rate, as measured by gallons consumed per thousand gross ton miles. Fuel prices averaged 73 cents per gallon in 2002 compared to 88 cents per gallon in 2001 (including taxes, transportation costs and regional pricing spreads). The Railroad hedged approximately 42% of its fuel consumption for the year, which decreased fuel costs by \$55 million. As of December 31, 2002, expected fuel consumption for 2003 is 7% hedged at 58 cents per gallon excluding taxes, transportation costs and regional pricing spreads (see note 2 to the Consolidated Financial Statements, Item 8).

*Materials and Supplies* – Materials used for the maintenance of the Railroad's track, facilities and equipment is the principal component of materials and supplies expense. Office, small tools and other supplies and the costs of freight services purchased to ship company materials are also included. Expenses decreased \$11 million (2%), primarily reflecting a reduction in the number of locomotives overhauled. Materials expense for locomotive overhauls decreased due to the use of new, more-reliable locomotives during the past several years, the sale of older units, which required higher maintenance, and increased outsourcing of locomotive maintenance. Partially offsetting the reductions in locomotive overhauls was an increase in cost for freight car repairs.

*Casualty Costs* – The largest component of casualty costs is personal injury expense. Freight and property damage, insurance, environmental matters and occupational illness expense are also included in casualty costs. Costs increased \$30 million (9%) compared to 2001, as higher personal injury and insurance costs were partially offset by lower costs for freight damage.

*Purchased Services and Other Costs* – Purchased services and other costs include the costs of services purchased from outside contractors, state and local taxes, net costs of operating facilities jointly used by UPRR and other railroads, transportation and lodging for train crew employees, trucking and contracting costs for intermodal containers, leased automobile maintenance expenses, telephone and cellular expense, employee travel expense and computer and other general expenses. Expenses increased \$104 million (13%) compared to 2001 primarily due to increased spending for contract services, jointly operated facilities and state and local taxes.

**Operating Income** – Operating income increased \$235 million (12%) to a record \$2.3 billion in 2002, as revenue growth, productivity gains and lower fuel prices more than offset inflation, increased depreciation expense and higher rail costs due to increased rail volume.

**Non-Operating Items** – Interest expense decreased \$68 million (10%) compared to 2001 due to lower weighted-average debt levels and weighted-average interest rates in 2002. In 2002, the Corporation's weighted-average debt level (including the Convertible Preferred Securities) decreased from \$9,979 million in 2001 to \$9,523 million in 2002. The Corporation's weighted-average interest rate was 6.6% in 2002 as compared to 7.0% in 2001. Other income increased \$163 million in 2002 compared to 2001 due primarily to the asset sale transactions with the UTA and VTA. Income tax expense increased \$135 million (25%) in 2002 over 2001 as a result of higher pre-tax income levels in 2002 which was partially offset by a tax adjustment for prior years.

**Key Measures** – Income from continuing operations as a percentage of operating revenues increased to 11.3% in 2002 from 8.6% in 2001. Return on average common shareholders' equity was 13.3% in 2002, up from 10.6% in 2001. The Corporation's operating margin was 20.2% in 2002 compared to 18.6% in 2001.

## Discontinued Operations

In 2002, trucking revenues rose \$189 million (17%) to \$1.33 billion. The increase was primarily related to Motor Cargo (\$132 million). The additional revenue increase of \$57 million was due to an increase in volume of 5%, yield improvements, and higher revenue for special services, partially offset by lower fuel surcharge revenue as a result of lower fuel prices in 2002. Included in the volume improvement was additional business realized as a result of the forced closure of Consolidated Freightways in September 2002. Trucking operations generated operating income of \$71 million in 2002, an increase of \$17 million over 2001. Motor Cargo contributed \$9 million of the increase. The operating margin was 5.3% compared to 4.7% in 2001. Motor Cargo improved the operating margin by 0.2 percentage points in 2002. For the year, income from discontinued operations was \$76 million compared to \$32 million in 2001 which included a one-time benefit in 2002 of \$34 million as a result of the resolution of certain tax matters with the Internal Revenue Service, which was accounted for as a reduction of income tax expense during the period.

## 2001 COMPARED TO 2000 RESULTS OF OPERATIONS

### Operations

**Net Income** – The Corporation reported net income of \$966 million (\$3.90 per basic share and \$3.77 per diluted share) in 2001 compared to \$842 million (\$3.42 per basic share and \$3.34 per diluted share) in 2000. Income from continuing operations (see note 14 to the Consolidated Financial Statements) was \$934 million (\$3.77 per basic share and \$3.65 per diluted share) in 2001 compared to \$810 million (\$3.29 per basic share and \$3.22 per diluted share) in 2000. The increase in income from continuing operations was due primarily to the effect of a \$115 million pre-tax charge in 2000 combined with revenue growth, productivity gains and cost control, lower non-operating expense and lower fuel prices in 2001.

**Operating Revenues** – Operating revenue is comprised of rail commodity revenue and other revenues. Other revenues primarily include subsidiary revenue from various companies that are wholly owned or majority owned by the Railroad, revenue from the Chicago commuter rail operations and accessorial revenue earned due to customer detainment of Railroad owned or controlled equipment. Operating revenues increased \$65 million (1%) to \$10.8 billion in 2001. Commodity revenue increased \$121 million (1%) in 2001 to \$10.4 billion driven by growth in the Agricultural Products and Energy commodity groups. Other revenue decreased \$56 million (11%) due to lower switching, subsidiary and accessorial revenues.

The following tables summarize the year-over-year changes in rail commodity revenue, revenue carloads and average revenue per car by commodity type:

<i>Commodity Revenue in Millions of Dollars</i>	<i>2001</i>	<i>2000</i>	<i>Change</i>
Agricultural.....	\$ 1,454	\$ 1,400	4 %
Automotive.....	1,118	1,182	(5)
Chemicals .....	1,545	1,640	(6)
Energy .....	2,399	2,154	11
Industrial Products.....	1,970	1,985	(1)
Intermodal.....	1,905	1,909	-
Total.....	\$10,391	\$10,270	1 %

<i>Revenue Carloads in Thousands</i>	<i>2001</i>	<i>2000</i>	<i>Change</i>
Agricultural.....	876	873	- %
Automotive.....	763	815	(6)
Chemicals .....	879	936	(6)
Energy .....	2,161	1,930	12
Industrial Products.....	1,405	1,431	(2)
Intermodal.....	2,832	2,916	(3)
Total.....	8,916	8,901	- %

<i>Average Revenue Per Car</i>	<i>2001</i>	<i>2000</i>	<i>Change</i>
Agricultural.....	\$ 1,660	\$ 1,604	3 %
Automotive.....	1,465	1,450	1
Chemicals .....	1,756	1,752	-
Energy .....	1,111	1,116	-
Industrial Products.....	1,402	1,387	1
Intermodal.....	673	655	3
Total.....	\$ 1,165	\$ 1,154	1 %

*Agricultural* – Revenue increased 4%, due primarily to a 3% increase in average revenue per car. Carloads were flat, as higher corn shipments and meals and oils exports were offset by a decrease in demand for domestic and export wheat shipments and a poor sugar-beet harvest. Revenue gains were also achieved through increased beer imports from Mexico, wine shipments from California to eastern markets, express service of fresh and frozen products and increased demand for cottonseed. Average revenue per car increased due to a longer average length of haul, resulting from fewer short-haul wheat and sweetener shipments combined with increased long-haul domestic and Mexico corn shipments.

*Automotive* – Revenue declined 5% as a result of a 6% decrease in carloads and a 1% increase in average revenue per car. Materials volumes declined 16%, as the soft economy and a decline in vehicle sales led to high inventories, low industry production and auto plant shutdowns. Total finished vehicle shipments declined only 1%, as industry weakness was mitigated by market share gains. Consumer incentives in the fourth quarter stimulated vehicle sales and helped offset weakness early in the year. Average revenue per car increased due to a shift in mix of materials shipped, resulting from fewer shipments of materials with lower average revenue per car. Additionally, more materials were shipped in boxcars rather than containers, which yield higher average revenue per car than containers.

*Chemicals* – Revenue declined 6%, due to a 6% decrease in carloads. Volume declines were the result of the soft economy, as reduced demand for consumer durables led to high manufacturer inventories and weak demand for plastics. Reduced industrial manufacturing also depressed demand for liquid and dry chemicals. Fertilizer and phosphate rock revenues decreased as high energy costs early in the year reduced the market for these commodities. Average revenue per car was flat, as the positive impact of fewer low average revenue per car phosphate rock shipments was offset by a decrease in average revenue per car for soda ash shipments.

*Energy* – Energy commodity revenue increased 11% compared to 2000, due to a 12% increase in carloads. Records were set in 2001 for total carloads, revenue and coal trains loaded per day in the Southern Powder River Basin in Wyoming and in the coal mining regions of Colorado and Utah. These increases were driven by strong utility demand caused by severe winter weather in late 2000 and the first quarter of 2001. In the first half of the year, demand for coal also increased due to the high cost of alternative fuels, such as natural gas, fuel oil and higher-priced eastern-sourced coal. Carloads also increased due to gains in market share.

*Industrial Products* – Revenue decreased 1%, as a 2% decline in carloads was partially offset by a 1% increase in average revenue per car. The decline was mainly the result of the economic slowdown, which had a negative effect on many economically sensitive commodities including steel and paper markets. Steel producers were additionally impacted by high levels of low-cost imported steel, which forced plant shutdowns and bankruptcies. Newsprint and fiber revenue declined due to lack of demand for printed advertising. Partially offsetting these declines were increases in construction-related commodities, led by stone and cement, as strong building and road construction activity continued in the South and Southwestern regions of the country. Lumber volumes increased due to strong housing construction and uncertainty surrounding restrictions on Canadian lumber imports. Average revenue per car increased due to price increases and a greater mix of longer average length of haul business. These gains were partially offset by the impact of increased shipments of stone, which generates lower average revenue per car.

*Intermodal* – Revenue was flat, as a 3% decline in carloads was offset by a 3% increase in average revenue per car. The volume decrease was primarily the result of soft economic demand for domestic shipments. In addition, the voluntary action of shedding low-margin trailer business in favor of higher-margin containers contributed to the decline. Partially

offsetting the domestic declines were increases in international shipments, the result of higher import demand. The increase in average revenue per car was primarily the result of price increases.

**Operating Expenses** – Operating expenses decreased \$103 million (1%) to \$8.8 billion in 2001. Excluding the \$115 million work force reduction charge in 2000, operating expenses were essentially flat. Higher expenses as a result of inflation, higher equipment rents expense and depreciation were offset by savings from lower force levels, productivity gains and cost control efforts and lower fuel prices.

*Salaries, Wages and Employee Benefits* – Salaries, wages and employee benefits decreased \$75 million (2%) in 2001 to \$3.6 billion. The decrease was due to the \$115 million work force reduction charge in 2000 combined with a 4% reduction in employee force levels as a result of the work force reduction plan. Partially offsetting these factors was wage and employee benefits inflation and added volume costs from a 3% gross ton mile increase.

*Equipment and Other Rents* – Expenses increased \$30 million (3%) compared to 2000 due primarily to higher locomotive lease expense and longer car cycle times. The higher locomotive lease expense is due to the Railroad's increased leasing of new, more reliable and fuel efficient locomotives. These new locomotives replaced older, non-leased models in the fleet, which helped reduce expenses for depreciation, labor, materials and fuel during the year. The increase in car cycle times is partially attributable to a decline in automotive shipments earlier in the year, which resulted in excess freight cars being stored at assembly plants and unloading facilities. Partially offsetting the increases in expenses were lower volume costs, lower car leases and lower prices for equipment. The decrease in volume costs was attributable to a decline in carloads in commodity groups such as Industrial Products and Intermodal that utilize a high percentage of rented freight cars.

*Depreciation* – Depreciation expense increased \$34 million (3%) over 2000, resulting from capital spending in recent years. Capital spending totaled \$1.6 billion in 2001, \$1.5 billion in 2000 and \$1.8 billion in 1999.

*Fuel and Utilities* – Expenses decreased \$29 million (2%). The decrease was driven by lower fuel prices and a record low fuel consumption rate, as measured by gallons consumed per thousand gross ton miles. Fuel prices averaged 88 cents per gallon in 2001 compared to 90 cents per gallon in 2000, including taxes, transportation costs and regional pricing spreads of 17 cents and 13 cents in 2001 and 2000, respectively. The Railroad hedged approximately 32% of its fuel consumption for the year, which increased fuel costs by \$20 million. As of December 31, 2001, expected fuel consumption for 2002 is 44% hedged at 56 cents per gallon excluding taxes, transportation costs and regional pricing spreads and for 2003 is 5% hedged at 56 cents per gallon excluding taxes, transportation costs and regional pricing spreads (see note 2 to the Consolidated Financial Statements, Item 8).

*Materials and Supplies* – Expenses decreased \$58 million (11%), reflecting locomotive overhaul reductions and productivity improvements and cost control measures. Locomotive overhauls decreased due to acquisition of new, more-reliable locomotives during the year and the sale of older units, which required higher maintenance. Materials and supplies expenses related to car maintenance also declined due to lower business levels in the industrial products and automotive commodity groups. The cars utilized in these commodity groups normally require more maintenance than the cars utilized within the other commodity groups.

*Casualty Costs* – Costs increased \$9 million (3%) compared to 2000, as higher insurance, bad debt and environmental expenses were partially offset by lower personal injury costs and lower costs for damaged freight cars.

*Other Costs* – Expenses decreased \$14 million (2%) compared to 2000 primarily due to decreased drayage costs and contract costs as well as other cost control measures partially offset by higher state and local taxes.

**Operating Income** – Operating income increased \$168 million (9%) to \$2.0 billion in 2001. This was due to the \$115 million work force reduction charge in 2000 and in 2001 by revenue growth, productivity gains and lower fuel prices.

**Non-Operating Items** – Interest expense decreased \$22 million (3%) compared to 2000 due to lower weighted-average debt levels and weighted-average interest rates in 2001. In 2001, the Corporation's weighted-average debt level decreased

from \$10,043 million in 2000 to \$9,979 million in 2001. The Corporation's weighted-average interest rate was 7.0% in 2001 as compared to 7.2% in 2000. Other income increased \$33 million (26%) in 2001 compared to 2000 due primarily to higher real estate sales. Income tax expense increased \$99 million (22%) in 2001 over 2000. The increase was a result of higher pre-tax income levels in 2001, partially due to the \$115 million work force reduction charge in 2000, and an increase in the effective tax rate from 35.5% in 2000 to 36.8% in 2001.

**Key Measures** – Income from continuing operations as a percentage of operating revenues increased to 8.6% in 2001 from 7.5% in 2000. Return on average common shareholders' equity was 10.6% in 2001, up from 10.1% in 2000. The Corporation's operating margin was 18.6% in 2001 compared to 17.2% in 2000.

## Discontinued Operations

In 2001, trucking revenues rose \$30 million (3%) to \$1,143 million. The growth resulted from rate increases, new services and \$10 million in incremental revenue due to the acquisition of Motor Cargo. Tonnage for the year was flat compared to 2000. Trucking operations generated operating income of \$54 million in 2001, compared to \$53 million for 2000. The operating ratio increased to 95.3%, compared to 95.2% in 2000. For the year, income from discontinued operations was \$32 million which was essentially flat from 2000.

## LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2002, the Corporation's principal sources of liquidity included cash, cash equivalents, the sale of receivables, and revolving credit facilities, as well as issuance of commercial paper and other sources of financing through the capital markets. The Corporation had \$1.875 billion of credit facilities available, of which there were no borrowings outstanding as of December 31, 2002. The sale of receivables program is subject to certain requirements including the maintenance of an investment grade bond rating. If the Corporation's bond rating were to deteriorate, it could have an adverse impact on the liquidity of the Corporation. Receivables sold as of December 31, 2002 were \$600 million. Access to commercial paper is dependent on market conditions. Deterioration of the Corporation's operating results or financial condition due to internal or external factors could negatively impact the Corporation's ability to utilize commercial paper as a source of liquidity. Liquidity through the capital markets is also dependent on the financial stability of the Corporation.

### Financial Condition

Cash from operations was \$2.2 billion, \$1.9 billion and \$2.0 billion in 2002, 2001 and 2000, respectively. The increase from 2001 to 2002 is the result of higher net income, partially offset by pension plan funding. The decrease from 2000 to 2001 was primarily due to the timing of large cash payments, including the payments for the work force reduction plan in 2001.

Cash used in investing activities was \$1.3 billion in 2002 and \$1.4 billion in 2001 and in 2000. The decrease from 2001 to 2002 was due to higher real estate sales, a warranty refund from a vendor and a dividend from an affiliate in 2002 being partially offset by higher capital spending. The amount remained essentially flat from 2000 to 2001 as reduced capital spending and higher asset sales in 2001 were offset by the receipt of cash dividends in 2000.

The following table details capital expenditures for the years ended December 31, 2002, 2001 and 2000 (includes capital leases of \$126 million, \$124 million and \$201 million, respectively):

<i>Capital Expenditures</i> <i>Millions</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Track.....	\$1,200	\$1,125	\$1,066
Locomotives.....	187	176	250
Freight cars.....	11	27	55
Facilities and other .....	422	368	379
<b>Total.....</b>	<b>\$1,820</b>	<b>\$1,696</b>	<b>\$1,750</b>

Cash used in financing activities was \$599 million, \$484 million and \$684 million in 2002, 2001 and 2000, respectively. The increase from 2001 to 2002 reflects lower financings (\$648 million in 2002 versus \$881 million in 2001), partly offset by an increase in the proceeds from the exercise of stock options (\$150 million in 2002 versus \$52 million in 2001). The decrease from 2000 to 2001 reflects higher financings in 2001 (\$881 million in 2001 versus \$305 million in 2000) and an increase in stock option proceeds (\$52 million in 2001 versus \$3 million in 2000), partially offset by higher debt repayments (\$1.2 billion in 2001 versus \$793 million in 2000).

Including the convertible preferred securities (see note 4 to the Consolidated Financial Statements, Item 8) as an equity instrument, the ratio of debt to total capital employed was 38.8%, 42.2% and 45.1% at December 31, 2002, 2001 and 2000, respectively.

For the years ended December 31, 2002, 2001, and 2000, the Corporation's ratio of earnings to fixed charges was 3.8, 2.9 and 2.4, respectively. The ratio of earnings to fixed charges has been computed on a consolidated basis. Earnings represent income from continuing operations less equity in undistributed earnings of unconsolidated affiliates, plus fixed charges and income taxes. Fixed charges represent interest charges, amortization of debt discount, and the estimated amount representing the interest portion of rental charges.

## Contractual Obligations and Commercial Commitments

As described in the notes to the Consolidated Financial Statements, Item 8, as referenced in the tables below, the Corporation has contractual obligations and commercial commitments that may affect the financial condition of the Corporation. However, based on management's assessment of the underlying provisions and circumstances of the material contractual obligations and commercial commitments of the Corporation, including material sources of off-balance sheet and structured finance arrangements, there is no known trend, demand, commitment, event or uncertainty that is reasonably likely to occur which would have a material adverse effect on the Corporation's consolidated results of operations, financial condition or liquidity. In addition, the commercial obligations, financings and commitments made by the Corporation are customary transactions which are similar to those of other comparable industrial corporations, particularly within the transportation industry.

The following tables identify material obligations and commitments as of December 31, 2002:

<i>Contractual Obligations</i>	<i>Millions of Dollars</i>	<i>Payments Due by Period</i>			
		<i>Total</i>	<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>
Debt (note 4) [a] .....	\$ 6,194	\$ 169	\$1,144	\$1,259	\$3,622
Operating leases (note 5) .....	3,237	426	737	563	1,511
Capital lease obligations (note 5) .....	2,446	210	407	360	1,469
Unconditional purchase obligations (note 9) [b] .....	404	224	180	-	-
<b>Total contractual obligations .....</b>	<b>\$12,281</b>	<b>\$1,029</b>	<b>\$2,468</b>	<b>\$2,182</b>	<b>\$6,602</b>

[a] Excludes capital lease obligations of \$1,457 million and market value adjustments for debt with qualifying hedges that are recorded as assets on the Consolidated Statements of Financial Position.

[b] Unconditional purchase obligations represent multi-year contractual commitments to purchase assets at fixed prices and fixed volumes. These commitments are made in order to take advantage of pricing opportunities and to insure availability of assets to meet quality and operational requirements. Excluded are annual contracts made in the normal course of business for performance of routine services, as well as commitments where contract provisions allow for cancellation.

<i>Other Commercial Commitments</i>	<i>Total Amounts Committed</i>	<i>Amount of Commitment Expiration Per Period</i>			
		<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
<i>Millions of Dollars</i>					
Credit facilities (note 4).....	\$1,875	\$875	\$1,000	\$ -	\$ -
Convertible preferred securities (note 4) ....	1,500	-	-	-	1,500
Sale of receivables (note 2).....	600	600	-	-	-
Guarantees (note 9)[a].....	368	14	22	13	319
Standby letters of credit (note 9) .....	52	45	7	-	-
Total commercial commitments .....	\$4,395	\$1,534	\$1,029	\$13	\$1,819

[a] Includes guaranteed obligations of affiliated operations.

## Financing Activities

**Credit Facilities** – The Corporation had no commercial paper borrowings outstanding as of December 31, 2002. Commercial paper is issued from time to time for working capital needs and is supported by \$1.875 billion in credit facilities, of which \$875 million expires in March 2003, with the remaining \$1.0 billion expiring in 2005. The credit facility for \$875 million includes \$825 million that was entered into during March 2002 and \$50 million entered into during June 2002. The \$1.0 billion credit facility was entered into during March 2000. The Corporation has the option to hold higher cash balances in addition to or in replacement of the credit facilities to support commercial paper. These credit facilities also allow for borrowings at floating (LIBOR-based) rates, plus a spread, depending upon the Corporation's senior unsecured debt ratings. The credit facilities are designated for general corporate purposes, and none of the credit facilities were used as of December 31, 2002. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers. The Corporation is reviewing rollover options for the credit facility that expires in March 2003.

**Shelf Registration Statement** – During January 2002, under an existing shelf registration statement, the Corporation issued \$300 million of 6-1/8% fixed rate debt with a maturity of January 15, 2012. The proceeds from the issuance were used for repayment of debt and other general corporate purposes. In April 2002, the Corporation called its \$150 million, 8-5/8% debentures due May 15, 2022 for redemption in May 2002. The Corporation issued \$350 million of 6-1/2% fixed rate debt with a maturity of April 15, 2012, in order to fund the redemption. The Corporation used the remaining proceeds to repay other debt and for other general corporate purposes. On May 17, 2002, the Corporation issued the remaining \$50 million of debt under the existing shelf registration statement. The debt carries a fixed rate of 5-3/4% with a maturity of October 15, 2007. The proceeds from the issuance were used for repayment of debt and other general corporate purposes.

The Corporation filed a \$1.0 billion shelf registration statement, which became effective in July 2002. Under the shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. At December 31, 2002, the Corporation had \$1.0 billion remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

**Other Significant Financings** – During June 2002, UPRR entered into a capital lease covering new locomotives. The related capital lease obligation totaled approximately \$126 million and is included in the Consolidated Statements of Financial Position as debt (see note 4 to the Consolidated Financial Statements, Item 8).

In December 2001, the Railroad entered into a synthetic operating lease arrangement to finance a new headquarters building, which will be constructed in Omaha, Nebraska. The expected completion date of the building is mid-2004. It will total approximately 1.1 million square feet with approximately 3,800 office workspaces. The cost to construct the new headquarters, including capitalized interest, is approximately \$260 million. The Corporation has guaranteed all of the Railroad's obligation under this lease.

UPRR is the construction agent for the lessor during the construction period. The Railroad has guaranteed, in the event of a loss caused by or resulting from its actions or failures to act as construction agent, 89.9% of the building related

construction costs incurred up to that point during the construction period. Total building related costs incurred and drawn from the lease funding commitments as of December 31, 2002, were approximately \$50 million. Accordingly, the Railroad's guarantee at December 31, 2002, was approximately \$45 million. As construction continues and additional costs are incurred, this guarantee will increase accordingly.

After construction is complete, UPRR will lease the building under an initial term of five years with provisions for renewal for an extended period subject to agreement between the Railroad and lessor. At any time during the lease, the Railroad may, at its option, purchase the building at approximately the amount expended by the lessor to construct the building. If the Railroad elects not to purchase the building or renew the lease, the building is returned to the lessor for remarketing, and the Railroad has guaranteed a residual value equal to 85% of the total construction related costs. The guarantee will be approximately \$220 million.

## **OTHER MATTERS**

**Personal Injury and Occupational Illness** – The cost of injuries to employees and others related to Railroad activities is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year. During 2002, the Railroad's reported number of work-related injuries that resulted in lost job time decreased 5% compared to the number of injuries reported during 2001, and accidents at grade crossings decreased 16% compared to 2001. Annual expenses for the Corporation's personal injury-related events were \$221 million in 2002, \$200 million in 2001 and \$204 million in 2000. As of December 31, 2002 and 2001, the Corporation had a liability of \$671 million and \$700 million, respectively, accrued for future personal injury costs, of which \$274 million and \$275 million were recorded in current liabilities as accrued casualty costs, respectively. The Railroad has additional amounts accrued for claims related to certain occupational illnesses. Compensation for Railroad work-related accidents is governed by the Federal Employers' Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. The Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work.

**Environmental Costs** – The Corporation generates and transports hazardous and non-hazardous waste in its current and former operations, and is subject to federal, state and local environmental laws and regulations. The Corporation has identified approximately 433 sites at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 52 sites that are the subject of actions taken by the U.S. government, 27 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to activities of other parties, in addition to costs relating to its own activities at each site.

When an environmental issue has been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

As of December 31, 2002 and 2001, the Corporation had a liability of \$188 million and \$171 million, respectively, accrued for future environmental costs, of which \$71 million and \$70 million were recorded in current liabilities as accrued casualty costs. The liability includes future costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties, and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved, site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites, and/or the speculative nature of remediation costs. The Corporation expects to pay out the majority of the December 31, 2002, environmental liability over the next five years, funded by cash generated from operations.

Remediation of identified sites previously used in operations, used by tenants or contaminated by former owners required cash spending of \$68 million in 2002, \$63 million in 2001, and \$62 million in 2000. The Corporation is also engaged in reducing emissions, spills and migration of hazardous materials, and spent cash of \$6 million, \$5 million and \$8 million in 2002, 2001, and 2000, respectively, for control and prevention. In 2003, the Corporation anticipates spending \$65 million for remediation and \$9 million for control and prevention. The impact of current obligations is not expected to have a material adverse effect on the liquidity of the Corporation.

## **Labor Matters**

*Continuing Operations* – Approximately 87% of the Railroad's nearly 47,000 employees are represented by 14 major rail unions. National negotiations under the Railway Labor Act to revise the national labor agreements for all crafts began in late 1999. In May 2001, the Brotherhood of Maintenance of Way Employees (BMW) ratified a five-year agreement, which included provisions for an annual wage increase (based on the consumer price index) and progressive health and welfare cost sharing. In August 2002, the carriers reached a five year agreement with the United Transportation Union (UTU) for annual wage increases as follows: 4.0% July 2002, 2.5% July 2003, and 3.0% July 2004. The agreement also established a process for resolving the health and welfare cost sharing issue through arbitration and also provided for the operation of remote control locomotives by trainmen. The Brotherhood of Locomotive Engineers (BLE) challenged the remote control feature of the UTU Agreement and a recent arbitration decision held that operation of remote control by UTU members in terminals does not violate the BLE agreement. In November 2002, the International Brotherhood of Boilermakers and Blacksmiths (IBB) reached a five year agreement following the UTU wage pattern. In January 2003, an arbitration award was rendered establishing wage increases and health and welfare employee cost sharing for the Transportation Communications International Union (TCU). Contract discussions with the remaining unions are either in negotiation or mediation. Also during 2002, the National Mediation Board ruled against the UTU on its petition for a single operating craft on the Kansas City Southern Railroad. The BLE is now working on a possible merger with the International Brotherhood of Teamsters (Teamsters).

*Discontinued Operations* – During 2002, OTC continued to oppose the efforts of the Teamsters to unionize OTC service centers. On February 11, 2002, the United States Court of Appeals for the Fourth Circuit, sitting as a full panel, refused to enforce four bargaining orders issued by the National Labor Relations Board (NLRB) that would have required OTC to bargain with the Teamsters, even though the Teamsters lost secret ballot elections. Subsequently, the NLRB moved for a judgment against itself to reverse the seven other bargaining orders it had issued, and the Fourth Circuit entered that judgment. On October 11, 2002, the NLRB's General Counsel dismissed a charge the Teamsters had filed in August 2001 alleging that OTC had been bargaining in bad faith. OTC has not reached any collective bargaining agreement with the Teamsters. On October 24, 2002, the Teamsters ended the national strike they had called against OTC three years earlier.

The Teamsters' eight-year campaign to organize OTC's service centers has become almost entirely dormant, and since October 2002, the Teamsters have lost rights to represent 41% of the approximately 2,100 employees they had organized. The Teamsters had become the bargaining representative of the employees at 26 of OTC's 170 service centers, but the employees at 17 of these locations recently have voted to decertify the Teamsters, and the NLRB has officially approved the votes in 14 of those locations. Decertification petitions are pending at four other service centers. Only a single representation petition currently is pending, but due to strike violence charges pending against the Teamsters, the NLRB has blocked the Teamsters' efforts to precipitate an election. In all, the Teamsters currently represent approximately 10% of OTC's 12,534 employees.

Employees at two Motor Cargo service centers located in North Salt Lake, Utah and Reno, Nevada, representing approximately 11% of Motor Cargo's total work force at 33 service centers, are covered by two separate collective bargaining agreements with unions affiliated with the Teamsters. Although the agreements cover most of the employees at these two facilities, less than half of these covered employees are actual members of unions.

**Inflation** – The cumulative effect of long periods of inflation has significantly increased asset replacement costs for capital-intensive companies such as the Railroad, OTC and Motor Cargo. As a result, depreciation charges on an inflation-adjusted basis, assuming that all operating assets are replaced at current price levels, would be substantially greater than historically reported amounts.

**Derivative Financial Instruments** – The Corporation and its subsidiaries use derivative financial instruments in limited instances for other than trading purposes to manage risk related to changes in fuel prices and to achieve the Corporation's

interest rate objectives. The Corporation uses swaps, futures and/or forward contracts to mitigate the downside risk of adverse price movements and hedge the exposure to variable cash flows. The use of these instruments also limits future gains from favorable movements. The Corporation uses interest rate swaps to manage its exposure to interest rate changes. The purpose of these programs is to protect the Corporation's operating margins and overall profitability from adverse fuel price changes or interest rate fluctuations.

The Corporation may also use swaptions to secure near-term swap prices. Swaptions are swaps that are extendable past their base period at the option of the counterparty. Swaptions do not qualify for hedge accounting treatment and are marked-to-market through the Consolidated Statements of Income.

*Market and Credit Risk* – The Corporation addresses market risk related to derivative financial instruments by selecting instruments with value fluctuations that highly correlate with the underlying item being hedged. Credit risk related to derivative financial instruments, which is minimal, is managed by requiring high credit standards for counterparties and periodic settlements. At December 31, 2002, the Corporation has not been required to provide collateral, nor has UPC received collateral relating to its hedging activities.

In addition, the Corporation enters into secured financings in which the debtor has pledged collateral. The collateral is based upon the nature of the financing and the credit risk of the debtor. The Corporation generally is not permitted to sell or repledge the collateral unless the debtor defaults.

*Determination of Fair Value* – The fair values of the Corporation's derivative financial instrument positions at December 31, 2002 and 2001, were determined based upon current fair values as quoted by recognized dealers or developed based upon the present value of expected future cash flows discounted at the applicable U.S. Treasury rate, London Interbank Offered Rates (LIBOR) or swap spread.

*Sensitivity Analyses* – The sensitivity analyses that follow illustrate the economic effect that hypothetical changes in interest rates or fuel prices could have on the Corporation's financial instruments. These hypothetical changes do not consider other factors that could impact actual results.

*Interest Rates* – The Corporation manages its overall exposure to fluctuations in interest rates by adjusting the proportion of fixed and floating rate debt instruments within its debt portfolio over a given period. The mix of fixed and floating rate debt is largely managed through the issuance of targeted amounts of each as debt matures or as incremental borrowings are required. Derivatives are used as one of the tools to obtain the targeted mix. In addition, the Corporation also obtains flexibility in managing interest costs and the interest rate mix within its debt portfolio by evaluating the issuance of and managing outstanding callable fixed-rate debt securities.

At December 31, 2002 and 2001, the Corporation had variable-rate debt representing approximately 12% of its total debt. If variable interest rates average 10% higher in 2003 than the Corporation's December 31, 2002 variable rate, which was approximately 3%, the Corporation's interest expense would increase by less than \$5 million after tax. If variable interest rates had averaged 10% higher in 2002 than the Corporation's December 31, 2001 variable rate, the Corporation's interest expense would have increased by less than \$5 million after tax. These amounts were determined by considering the impact of the hypothetical interest rates on the balances of the Corporation's variable-rate debt at December 31, 2002 and 2001, respectively.

Swaps allow the Corporation to convert debt from fixed rates to variable rates and thereby hedge the risk of changes in the debt's fair value attributable to the changes in the benchmark interest rate (LIBOR). The swaps have been accounted for using the short-cut method as allowed by Financial Accounting Standard (FAS) 133; therefore, no ineffectiveness has been recorded within the Corporation's Consolidated Financial Statements. In January 2002, the Corporation entered into an interest rate swap on \$250 million of debt with a maturity date of December 2006. In May 2002, the Corporation entered into an interest rate swap on \$150 million of debt with a maturity date of February 2023. This swap contained a call option that matches the call option of the underlying hedged debt, as allowed by FAS 133. In January 2003, the swap's counterparty exercised their option to cancel the swap, effective February 1, 2003. Similarly, the Corporation has exercised its option to redeem the underlying debt. As of December 31, 2002 and 2001, the Corporation had approximately \$898 million and \$598

million of interest rate swaps, respectively. The effect of a 10% interest rate increase or decrease in 2003 over the December 31, 2002 rates is included in the preceding and succeeding paragraph disclosure, respectively.

Market risk for fixed-rate debt is estimated as the potential increase in fair value resulting from a hypothetical 10% decrease in interest rates as of December 31, 2002, and amounts to approximately \$203 million at December 31, 2002. Market risk resulting from a hypothetical 10% decrease in interest rates as of December 31, 2001, amounted to approximately \$226 million at December 31, 2001. The fair values of the Corporation's fixed-rate debt were estimated by considering the impact of the hypothetical interest rates on quoted market prices and current borrowing rates.

*Fuel* – Fuel costs are a significant portion of the Corporation's total operating expenses. As a result of the significance of fuel costs and the historical volatility of fuel prices, the Corporation's transportation subsidiaries periodically use swaps, futures and/or forward contracts to mitigate the impact of adverse fuel price changes. The Corporation at times may use swaptions to secure more favorable swap prices.

As of December 31, 2002, expected rail fuel consumption for 2003 is 7% hedged at 58 cents per gallon, excluding taxes, transportation costs and regional pricing spreads. As of December 31, 2002, there were no outstanding hedges for 2004. Based on annualized fuel consumption during 2002, and excluding the impact of the hedging program, each one-cent increase in the price of fuel would have resulted in approximately \$8.2 million of additional fuel expense, after tax.

As of December 31, 2001, the Corporation had hedged approximately 44% of its forecasted 2002 rail fuel consumption and 5% of its forecasted 2003 fuel consumption at 56 cents per gallon, excluding taxes, transportation costs and regional pricing spreads.

As of December 31, 2002, expected trucking fuel consumption for 2003 is 5% hedged at 58 cents per gallon, excluding taxes, transportation costs and regional pricing spreads. As of December 31, 2002, there are no outstanding hedges for 2004. Based on annualized fuel consumption during 2002, and excluding the impact of the hedging program, each one-cent increase in the price of fuel would have resulted in approximately \$400,000 of additional fuel expense, after tax.

As of December 31, 2001, the Corporation had hedged approximately 16% of its forecasted 2002 trucking fuel consumption and 5% of its forecasted 2003 fuel consumption at 58 cents per gallon, excluding taxes, transportation costs and regional pricing spreads.

**Accounting Pronouncements** – In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 is effective for the Corporation beginning January 1, 2003. FAS 143 requires that the Corporation record a liability for the fair value of an asset retirement obligation when the Corporation has a legal obligation to remove the asset. The standard will affect the way the Corporation accounts for track structure removal costs, but will have no impact on liquidity. The Corporation is currently evaluating the impact of this statement on the Corporation's Consolidated Financial Statements. Any impact resulting from the adoption of this statement will be recorded as a cumulative effect of a change in accounting principle in the first quarter of 2003.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (FAS 146). FAS 146 requires that a liability for a cost associated with an exit or disposal activity is recognized at fair value when the liability is incurred and is effective for exit or disposal activities that are initiated after December 31, 2002. Management believes that FAS 146 will not have a material impact on the Corporation's Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others" (FIN 45). FIN 45 is effective for guarantees issued or modified after December 31, 2002. The disclosure requirements were effective for the year ending December 31, 2002, which expand the disclosures required by a guarantor about its obligations under a guarantee. FIN 45 also requires the Corporation to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in the issuance of the guarantee. Management does not believe that FIN 45 will have a material impact on the Corporation's Consolidated Financial Statements.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" (FAS 148). FAS 148 provides alternative methods of transition for voluntary changes to the fair value based method of accounting for stock-based employee compensation, and amends the disclosure requirements including a requirement for interim disclosures. The Corporation currently discloses the effects of stock-based employee compensation and does not intend to voluntarily change to the alternative accounting principle.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to existing entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. As described in note 9 to the Consolidated Financial Statements, Item 8, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In accordance with FIN 46, the Railroad will either consolidate, restructure or refinance the synthetic lease prior to July 1, 2003. The Corporation does not expect FIN 46 to have any impact on the treatment of the Sale of Receivables program as described in note 2 to the Consolidated Financial Statements, Item 8.

**Commitments and Contingencies** – There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries. The Corporation is also subject to various federal, state and local environmental laws and regulations, pursuant to which it is currently participating in the investigation and remediation of various sites. A discussion of certain claims, lawsuits, contingent liabilities and guarantees is set forth in note 9 to the Consolidated Financial Statements, Item 8.

**Pensions** – During the second quarter of 2002, the Corporation decreased its assumed rate of return on pension plan assets from 10% to 9%. This assumption change resulted in an increase to 2002 pension expense of \$16 million. In addition, due to declines on plan assets, a minimum pension liability adjustment was recorded during the fourth quarter of 2002. This adjustment resulted in a reduction of common shareholders' equity. The reduction in equity totaled \$225 million, after tax (approximately 2% of total equity).

OTC voluntarily contributed \$125 million to its pension plan during 2002. The Railroad voluntarily contributed \$100 million to its pension plan during the fourth quarter of 2002. The Corporation currently does not have any minimum funding requirements, as set forth in employee benefit and tax laws; however, UPC plans to voluntarily contribute approximately \$75 million during 2003. Required contributions subsequent to 2003 are dependent on asset returns, current discount rates and a number of other factors; however, the Corporation expects to continue discretionary funding to help manage any potential required funding in the future. Future contributions are expected to be funded primarily by cash generated from operating activities.

**Dividend Receivable** – The Railroad owns a 26% interest in Grupo Ferroviario Mexicano, S.A. de C.V. (GFM). GFM operates a major railway system in Mexico. During the third quarter of 2002, the Railroad recorded a dividend from GFM of approximately \$118 million. As of December 31, 2002, the dividend is reflected as a receivable in the Corporation's Consolidated Statements of Financial Position. The dividend is accounted for as a reduction to investments in and advances to affiliated companies in the Consolidated Statements of Financial Position as of December 31, 2002 and creates no effect on the Corporation's Consolidated Statements of Income. During the fourth quarter 2002, the Railroad received approximately \$20 million of the dividend receivable, and anticipates it will receive the remainder of the dividend during 2003.

**West Coast Port Disruption** – During September of 2002, the labor dispute between the International Longshoreman and Warehouse Union (ILWU) and the Pacific Maritime Association escalated and resulted in work slow-downs and a lockout of the ILWU dockworkers for four days at the end of the third quarter and continued for nine days into the fourth quarter of 2002. The estimated impact on fourth quarter earnings is approximately 10 cents per share, resulting mainly from international intermodal shipments diverted to trucks and suspended shipments due to vessel scheduling disruptions.

**Railroad Retirement Reform** – On December 21, 2001, The Railroad Retirement and Survivors' Improvement Act of 2001 (the Act) was signed into law. The Act was a result of historic cooperation between rail management and labor, and provides improved railroad retirement benefits for employees and reduced payroll taxes for employers. The estimated

savings to the Railroad during 2002 from passage of the Act was \$36 million, pre-tax, in reduced employer payroll taxes.

Incremental savings are expected in 2003 as the employer tax rate is further reduced by 1.4 percentage points from 15.6% to 14.2%.

**Work Force Reduction** – During 2003, the Corporation is planning to reduce approximately 1,000 administrative positions, through a combination of attrition and involuntary severance. The estimated 2003 severance cost is \$45 million, pre-tax, the majority of which should occur in the first quarter of 2003.

## **A LOOK FORWARD**

### **2003 Business Outlook**

**Continuing Operations** – The Railroad expects to build on the positive momentum generated in the past several years and continue to grow revenue, operating income and free cash flow. Free cash flow is defined as cash provided by operating activities less cash used in investing activities and dividends paid. Year-over-year revenue growth is projected in all commodity groups with the largest percentage increases projected in the intermodal, agricultural and industrial groups. Revenue derived from chemical and energy shipments is expected to increase steadily over 2003. Automotive revenue is also expected to increase slightly from last year's record setting pace, thereby continuing as a strong revenue provider. The Railroad will continue to focus on improving service performance while developing new, innovative rail service offerings to meet the changing needs of its customers. While operating expenses will likely increase for such items as insurance, pension, operating taxes and minimum guaranteed payments to union employees, cost controls and continuing improvements in productivity will remain a focus to drive the operating ratio lower. Fuel price will remain susceptible to near term volatile price swings. To help reduce the impact of fuel price volatility on earnings, the Railroad will continue to look for opportunities to use hedge contracts.

**Discontinued Operations** – Overnite expects financial performance to further improve upon its positive 2002 results. Solid revenue growth is projected, in part due to additional business resulting from the forced closure of Consolidated Freightways. Cost controls and productivity improvements are projected to positively impact operating expenses, which will mitigate the impact of inflationary pressures and volatile fuel prices. Overnite will continue to offer reliable on-time performance and quality service, which should enable Overnite to maintain profitable margins.

### **2003 Capital Investments**

The Corporation's 2003 capital expenditures and debt service requirements are expected to be funded through cash generated from operations, additional debt financings and the sale or lease of various operating and non-operating properties. The Corporation expects that these sources will continue to provide sufficient funds to meet cash requirements in the foreseeable future. In 2003, the Corporation expects to spend approximately \$1.8 to \$2.0 billion on capital expenditures. These capital expenditures will be used to maintain track and structures, continue capacity expansions on the Railroad's main lines, upgrade and augment equipment to better meet customer needs, build infrastructure and develop and implement new technologies. OTC and Motor Cargo will continue to maintain their truck fleet, expand service centers and enhance technology.

## CAUTIONARY INFORMATION

Certain statements in this report are, and statements in other material filed or to be filed with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Corporation) are, or will be, forward-looking statements as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. These forward-looking statements include, without limitation, statements regarding: expectations as to operational improvements; expectations as to cost savings, revenue growth and earnings; the time by which certain objectives will be achieved; estimates of costs relating to environmental remediation and restoration; proposed new products and services; expectations that claims, lawsuits, environmental costs, commitments, contingent liabilities, labor negotiations or agreements, or other matters will not have a material adverse effect on the Corporation's consolidated financial position, results of operations or liquidity; and statements concerning projections, predictions, expectations, estimates or forecasts as to the Corporation's and its subsidiaries' business, financial and operational results, and future economic performance, statements of management's goals and objectives and other similar expressions concerning matters that are not historical facts.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times that, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements.

Important factors that could affect the Corporation's and its subsidiaries' future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements include, but are not limited to:

- whether the Corporation and its subsidiaries are fully successful in implementing their financial and operational initiatives;
- industry competition, conditions, performance and consolidation;
- legislative and regulatory developments, including possible enactment of initiatives to re-regulate the rail industry;
- natural events such as severe weather, fire, floods and earthquakes;
- the effects of adverse general economic conditions, both within the United States and globally;
- any adverse economic or operational repercussions from terrorist activities and any governmental response thereto;
- war or risk of war;
- changes in fuel prices;
- changes in labor costs;
- labor stoppages; and
- the outcome of claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion and exposure to asbestos and diesel fumes.

Forward-looking statements speak only as of the date the statement was made. The Corporation assumes no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. If the Corporation does update one or more forward-looking statements, no inference should be drawn that the Corporation will make additional updates with respect thereto or with respect to other forward-looking statements.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

Information concerning market risk sensitive instruments is set forth under Management's Discussion and Analysis of Financial Condition and Results of Operations – Other Matters, Item 7.

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## Item 8. Financial Statements and Supplementary Data

### CONSOLIDATED STATEMENTS OF INCOME

Union Pacific Corporation and Subsidiary Companies

<i>Millions, Except Per Share Amounts, for the Years Ended December 31,</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Revenues .....	\$11,159	\$10,830	\$10,765
Operating Expenses:			
Salaries, wages and employee benefits .....	3,694	3,586	3,661
Equipment and other rents .....	1,240	1,214	1,184
Depreciation .....	1,147	1,126	1,092
Fuel and utilities .....	1,065	1,249	1,278
Materials and supplies .....	476	487	545
Casualty costs .....	359	329	320
Purchased services and other costs .....	925	821	835
Total .....	8,906	8,812	8,915
Operating income .....	2,253	2,018	1,850
Other income .....	324	161	128
Interest expense .....	(632)	(700)	(722)
Income before income taxes .....	1,945	1,479	1,256
Income taxes .....	(680)	(545)	(446)
Income from continuing operations .....	1,265	934	810
Income from discontinued operations, net of tax of \$(5), \$22, and \$21 .....	76	32	32
Net income .....	\$ 1,341	\$ 966	\$ 842
<b>Share and Per Share</b>			
Basic :			
Income from continuing operations .....	\$ 5.02	\$ 3.77	\$ 3.29
Income from discontinued operations .....	0.30	0.13	0.13
Net income .....	\$ 5.32	\$ 3.90	\$ 3.42
Diluted:			
Income from continuing operations .....	\$ 4.78	\$ 3.65	\$ 3.22
Income from discontinued operations .....	0.27	0.12	0.12
Net income .....	\$ 5.05	\$ 3.77	\$ 3.34
Weighted average number of shares (basic) .....	252.1	248.0	246.5
Weighted average number of shares (diluted) .....	276.8	271.9	269.5
Dividends .....	\$ 0.83	\$ 0.80	\$ 0.80

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

*Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars, as of December 31,</i>	<i>2002</i>	<i>2001</i>
<b>Assets</b>		
Current assets:		
Cash and temporary investments.....	\$ 367	\$ 103
Accounts receivable, net.....	557	472
Inventories .....	277	255
Current deferred income taxes .....	498	341
Other current assets.....	199	146
<b>Total current assets.....</b>	<b>1,898</b>	<b>1,317</b>
Investments:		
Investments in and advances to affiliated companies.....	649	725
Other investments.....	50	61
<b>Total investments.....</b>	<b>699</b>	<b>786</b>
Properties:		
Road and other .....	29,370	27,934
Equipment .....	7,451	7,507
Other .....	39	40
<b>Cost .....</b>	<b>36,860</b>	<b>35,481</b>
<b>Accumulated depreciation.....</b>	<b>(7,856)</b>	<b>(7,191)</b>
<b>Net properties.....</b>	<b>29,004</b>	<b>28,290</b>
Other assets .....	381	407
Assets of discontinued operations .....	782	751
<b>Total assets .....</b>	<b>\$32,764</b>	<b>\$31,551</b>
<b>Liabilities and Common Shareholders' Equity</b>		
Current liabilities:		
Accounts payable .....	\$ 430	\$ 522
Accrued wages and vacation .....	365	354
Accrued casualty costs.....	419	421
Income and other taxes .....	227	282
Dividends and interest.....	253	255
Debt due within one year .....	275	194
Other current liabilities.....	554	565
<b>Total.....</b>	<b>2,523</b>	<b>2,593</b>
Debt due after one year .....	7,428	7,884
Deferred income taxes .....	8,550	7,882
Accrued casualty costs.....	658	673
Retiree benefits obligation.....	762	659
Other long-term liabilities.....	385	463
Liabilities of discontinued operations.....	307	322
Company-obligated mandatorily redeemable convertible preferred securities .....	1,500	1,500
Commitments and contingencies		
Common shareholders' equity .....	10,651	9,575
<b>Total liabilities and common shareholders' equity.....</b>	<b>\$32,764</b>	<b>\$31,551</b>

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, for the Years Ended December 31,	2002	2001	2000
<b>Operating Activities:</b>			
Net income.....	\$ 1,341	\$ 966	\$ 842
Adjustments to reconcile net income to net cash provided by operating activities:			
Income from discontinued operations.....	(76)	(32)	(32)
Depreciation.....	1,147	1,126	1,092
Deferred income taxes.....	596	419	449
Cash paid to fund pension plan.....	(100)	-	-
Other, net.....	(398)	(430)	(354)
Changes in current assets and liabilities, net.....	(311)	(184)	24
Cash provided by operating activities .....	2,199	1,865	2,021
<b>Investing Activities:</b>			
Capital investments .....	(1,694)	(1,572)	(1,549)
Proceeds from asset sales .....	409	316	208
Other investing activities, net.....	(51)	(126)	(66)
Cash used in investing activities .....	(1,336)	(1,382)	(1,407)
<b>Financing Activities</b>			
Dividends paid.....	(201)	(198)	(199)
Debt repaid .....	(1,196)	(1,219)	(793)
Cash received from exercise of stock options.....	150	52	3
Financings, net.....	648	881	305
Cash used in financing activities.....	(599)	(484)	(684)
Net change in cash and temporary investments .....	264	(1)	(70)
Cash and temporary investments at beginning of year .....	103	104	174
Cash and temporary investments at end of year.....	\$ 367	\$ 103	\$ 104
<b>Changes in Current Assets and Liabilities, net</b>			
Accounts receivable, net.....	\$ (85)	\$ (24)	\$ (12)
Inventories .....	(22)	97	(22)
Other current assets.....	(53)	(28)	(27)
Accounts, wages and vacation payable.....	(81)	(115)	71
Other current liabilities.....	(70)	(114)	14
Total.....	\$ (311)	\$ (184)	\$ 24
<b>Supplemental cash flow information:</b>			
Cash paid during the year for:			
Interest.....	\$ 652	\$ 721	\$ 754
Income taxes, net.....	134	51	3
Non-cash transaction:			
Non-cash locomotive lease financings .....	126	124	201
Acquisition of Motor Cargo Industries, Inc. ....	-	80	-

The accompanying notes are an integral part of these Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY

*Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars</i>	<i>Accumulated Other Comprehensive Income (Loss)</i>							<i>Total</i>	<i>Total</i>
	[a] <i>Common Shares</i>	<i>Paid-in- Surplus</i>	<i>Retained Earnings</i>	[b] <i>Treasury Stock</i>	<i>Minimum Pension Liability Adjustments</i>	<i>Foreign Currency Translation Adjustments</i>	<i>Derivative Adjustments</i>		
Balance at January 1, 2000.....	\$691	\$4,019	\$5,053	\$(1,756)	\$ (2)	\$ (4)	\$ -	\$ (6)	\$8,001
Net income.....	-	-	842	-	-	-	-	-	842
Other comprehensive income									
From continuing operations,									
net of tax of \$3.....	-	-	-	-	-	6	-	6	6
Comprehensive income .....									848
Conversion, exercises of stock									
options, forfeitures and other -									
net (1,060,242) shares in 2000...	(3)	5	-	7	-	-	-	-	9
Dividends declared (\$0.80 per									
share).....	-	-	(196)	-	-	-	-	-	(196)
Balance at December 31, 2000 .....	688	4,024	5,699	(1,749)	(2)	2	-	-	8,662
Net income.....	-	-	966	-	-	-	-	-	966
Other comprehensive income (loss)									
From continuing operations,									
net of tax of \$(6).....	-	-	-	-	(5)	1	(7)	(11)	(11)
Comprehensive income .....									955
Conversion, exercises of stock									
options, forfeitures and other -									
net 265,112 shares in 2001[c] ....	1	(44)	-	200	-	-	-	-	157
Dividends declared (\$0.80 per									
share).....	-	-	(199)	-	-	-	-	-	(199)
Balance at December 31, 2001 .....	689	3,980	6,466	(1,549)	(7)	3	(7)	(11)	9,575
Net income.....	-	-	1,341	-	-	-	-	-	1,341
Other comprehensive income (loss)									
From continuing operations,									
net of tax of \$(85).....	-	-	-	-	(141)	(12)	14	(139)	(139)
From discontinued operations,									
net of tax of \$(48).....	-	-	-	-	(84)	-	-	(84)	(84)
Comprehensive income .....									1,118
Conversion, exercises of stock									
options, forfeitures and other -									
net 80,280 shares in 2002.....	-	(34)	-	202	-	-	-	-	168
Dividends declared (\$0.83 per									
share).....	-	-	(210)	-	-	-	-	-	(210)
Balance at December 31, 2002 .....	\$689	\$3,946	\$7,597	\$(1,347)	\$(232)	\$ (9)	\$7	\$(234)	\$10,651

[a] Common stock \$2.50 par value; 500,000,000 shares authorized; 275,579,367 shares issued at the end of 2002; 275,499,087 shares issued at the end of 2001; 275,233,975 shares issued at the end of 2000.

[b] Balance at end of year, shares at cost: 21,920,238 in 2002; 25,208,819 in 2001; 28,413,483 in 2000.

[c] The Corporation utilized approximately 1.7 million shares of treasury stock in the acquisition of Motor Cargo Industries, Inc.

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*Union Pacific Corporation and Subsidiary Companies*

### Significant Accounting Policies

**Principles of Consolidation** – The Consolidated Financial Statements include the accounts of Union Pacific Corporation (UPC or the Corporation) and all of its subsidiaries. Investments in affiliated companies (20% to 50% owned) are accounted for using the equity method of accounting. All significant intercompany transactions are eliminated.

**Cash and Temporary Investments** – Temporary investments are stated at cost which approximates fair value and consist of investments with original maturities of three months or less.

**Inventories** – Inventories consist of materials and supplies carried at the lower of average cost or market.

**Property and Depreciation** – Properties are carried at cost. Provisions for depreciation are computed principally on the straight-line method based on estimated service lives of depreciable property. The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation. A gain or loss is recognized in other income for all other property upon disposition. The cost of internally developed software is capitalized and amortized over a five-year period. An obsolescence review of capitalized software is performed on a periodic basis.

**Impairment of Long-lived Assets** – The Corporation reviews long-lived assets, including identifiable intangibles, for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the long-lived assets, the carrying value is reduced to the estimated fair value as measured by the discounted cash flows.

**Revenue Recognition** – The Corporation recognizes transportation revenues on a percentage-of-completion basis as freight moves from origin to destination. Other revenue is recognized as service is performed or contractual obligations are met.

**Translation of Foreign Currency** – The Corporation's portion of the assets and liabilities related to foreign investments are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average rates of exchange prevailing during the year. The resulting translation adjustments are reflected within shareholders' equity as accumulated other comprehensive income or loss. Transaction gains and losses related to intercompany accounts are not significant.

**Financial Instruments** – The carrying value of the Corporation's non-derivative financial instruments approximates fair value. The fair value of financial instruments is generally determined by reference to market values as quoted by recognized dealers or developed based upon the present value of expected future cash flows discounted at the applicable U.S. Treasury rate, London Interbank Offered Rates (LIBOR) or swap spread.

The Corporation periodically uses derivative financial instruments, for other than trading purposes, to manage risk related to changes in fuel prices and interest rates.

**Stock-Based Compensation** – At December 31, 2002, the Corporation has several stock-based employee compensation plans, which are described more fully in note 7. The Corporation accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. No stock-based employee compensation expense, related to stock option grants, is reflected in net income as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Stock-based employee compensation expense related to restricted stock and other incentive plans is reflected in net income. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation.

<i>Millions of Dollars, Except Per Share Amounts</i>	<i>Year Ended December 31,</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
Net income, as reported .....	\$1,341	\$ 966	\$ 842
Stock-based employee compensation expense included in reported net income, net of tax.....	31	11	11
Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax.....	(52)	(33)	(40)
Pro forma net income.....	\$1,320	\$ 944	\$ 813
EPS – basic, as reported .....	\$5.32	\$3.90	\$3.42
EPS – basic, pro forma.....	\$5.24	\$3.81	\$3.30
EPS – diluted, as reported .....	\$5.05	\$3.77	\$3.34
EPS – diluted, pro forma .....	\$4.98	\$3.69	\$3.23

**Earnings Per Share** – Basic earnings per share (EPS) is calculated on the weighted-average number of common shares outstanding during each period. Diluted earnings per share include shares issuable upon exercise of outstanding stock options, stock-based awards and the potential conversion of the preferred securities where the conversion of such instruments would be dilutive.

**Use of Estimates** – The Consolidated Financial Statements of the Corporation include estimates and assumptions regarding certain assets, liabilities, revenues and expenses and the disclosure of certain contingent assets and liabilities. Actual future results may differ from such estimates.

**Income Taxes** – The Corporation accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109). The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. These expected future tax consequences are measured based on provisions of tax law as currently enacted; the effects of future changes in tax laws are not anticipated. Future tax law changes, such as a change in the corporate tax rate, could have a material impact on the Corporation's financial position or its results of operations.

**Pension and Postretirement Benefits** – The Corporation incurs certain employment-related expenses associated with pensions and postretirement health benefits. In order to measure the expense associated with these benefits, management must make various estimates including discount rates used to value certain liabilities, assumed rates of return on plan assets used to fund these expenses, compensation increases, employee turnover rates, anticipated mortality rates and expected future healthcare costs. The estimates used by management are based on the Corporation's historical experience as well as current facts and circumstances. The Corporation uses third-party actuaries to assist management in properly measuring the expense associated with these benefits. Actual results that vary from the previously mentioned assumptions could have a material impact on the Corporation's results of operations, financial position or liquidity.

**Personal Injury** – The cost of injuries to employees and others on Union Pacific Railroad Company (UPRR) property or in accidents involving the trucking segment is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year.

**Environmental** – When environmental issues have been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

**Change in Presentation** – Certain prior year amounts have been reclassified to conform to the 2002 Consolidated Financial Statement presentation. These reclassifications had no effect on previously reported operating income or net income.

## 1. Operations and Segmentation

Union Pacific Corporation (UPC or the Corporation) has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnite Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 14 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

### Continuing Operations

**Rail Operations** – The Railroad is a Class I railroad that operates in the United States. As of October 1, 1996, the Railroad included Southern Pacific Rail Corporation (Southern Pacific or SP). In addition, during 1997, the Railroad and a consortium of partners were granted a 50-year concession to operate the Pacific-North and Chihuahua Pacific lines in Mexico. The Railroad made an additional investment in the consortium in 1999. During 2001, UPC completed its integration of Southern Pacific's rail operations.

The Railroad has over 33,000 route miles linking Pacific Coast and Gulf Coast ports to the Midwest and eastern United States gateways and providing several north/south corridors to key Mexican gateways. The Railroad serves the western two-thirds of the country and maintains coordinated schedules with other carriers for the handling of freight to and from the Atlantic Coast, the Pacific Coast, the Southeast, the Southwest, Canada and Mexico. Export and import traffic is moved through Gulf Coast and Pacific Coast ports and across the Mexican and Canadian borders. Railroad freight is comprised of six commodity lines: agricultural, automotive, chemicals, energy, industrial products and intermodal. The Railroad continues to focus on utilization of its capital asset base to meet current operating needs and to introduce innovative rail services across every commodity line.

The Railroad is subject to price and service competition from other railroads, motor carriers and barge operators. The Railroad's main competitor is Burlington Northern Santa Fe Corporation. Its rail subsidiary, The Burlington Northern and Santa Fe Railway Company, operates parallel routes in many of the Railroad's main traffic corridors. In addition, the Railroad's operations are conducted in corridors served by other competing railroads and by motor carriers. Motor carrier competition is particularly strong for intermodal traffic. Because of the proximity of the Railroad's routes to major inland and Gulf Coast waterways, barge competition can be particularly pronounced, especially for grain and bulk commodities.

The Railroad is dependent on two key suppliers of locomotives. Due to the capital intensive nature and sophistication of this equipment, there are strong barriers of entry to new suppliers. Therefore, if one of these suppliers would no longer produce locomotives, the Railroad could realize a significant increase in the cost and the potential for reduced availability of the locomotives that are necessary to its operations.

**Employees** – Approximately 87% of the Railroad's nearly 47,000 employees are represented by 14 major rail unions. National negotiations under the Railway Labor Act to revise the national labor agreements for all crafts began in late 1999. In May 2001, the Brotherhood of Maintenance of Way Employees (BMW) ratified a five-year agreement, which included provisions for an annual wage increase (based on the consumer price index) and progressive health and welfare cost sharing. In August 2002, the carriers reached a five year agreement with the United Transportation Union (UTU) for annual wage increases as follows: 4.0% July 2002, 2.5% July 2003, and 3.0% July 2004. The agreement also established a process for resolving the health and welfare cost sharing issue through arbitration and also provided for the operation of remote control locomotives by trainmen. The Brotherhood of Locomotive Engineers (BLE) challenged the remote control feature of the UTU Agreement and a recent arbitration decision held that operation of remote control by UTU members in terminals does not violate the BLE agreement. In November 2002, the International Brotherhood of Boilermakers and Blacksmiths (IBB) reached a five year agreement following the UTU wage pattern. In January 2003, an arbitration award was rendered establishing wage increases and health and welfare employee cost sharing for the Transportation Communications International Union (TCU). Contract discussions with the remaining unions are either in negotiation or mediation. Also during 2002, the National Mediation Board ruled against the UTU on its petition for a single operating craft on the Kansas

City Southern Railroad. The BLE is now working on a possible merger with the International Brotherhood of Teamsters (Teamsters).

## **Discontinued Operations**

**Trucking Operations** – The trucking segment includes the operations of OTC and Motor Cargo. OTC is a major interstate trucking company specializing in less-than-truckload (LTL) shipments. OTC serves all 50 states and portions of Canada and Mexico through 170 service centers located throughout the United States providing regional, inter-regional and long haul service. OTC transports a variety of products including machinery, tobacco, textiles, plastics, electronics and paper products. Motor Cargo is a western regional LTL carrier that provides comprehensive service throughout 10 western states. Motor Cargo transports general commodities, including consumer goods, packaged foodstuffs, industrial and electronic equipment and auto parts. OTC and Motor Cargo experience intense service and price competition from regional, inter-regional and national LTL carriers and, to a lesser extent, from truckload carriers, railroads and overnight delivery companies. Major competitors include US Freightways and CNF Inc. OTC and Motor Cargo believe they are able to compete effectively in their markets by providing high quality, customized service at competitive prices.

**Employees** – During 2002, OTC continued to oppose the efforts of the Teamsters to unionize OTC service centers. On February 11, 2002, the United States Court of Appeals for the Fourth Circuit, sitting as a full panel, refused to enforce four bargaining orders issued by the National Labor Relations Board (NLRB) that would have required OTC to bargain with the Teamsters, even though the Teamsters lost secret ballot elections. Subsequently, the NLRB moved for a judgment against itself to reverse the seven other bargaining orders it had issued, and the Fourth Circuit entered that judgment. On October 11, 2002, the NLRB's General Counsel dismissed a charge the Teamsters had filed in August 2001 alleging that OTC had been bargaining in bad faith. OTC has not reached any collective bargaining agreement with the Teamsters. On October 24, 2002, the Teamsters ended the national strike they had called against OTC three years earlier.

The Teamsters' eight-year campaign to organize OTC's service centers has become almost entirely dormant, and since October 2002, the Teamsters have lost rights to represent 41% of the approximately 2,100 employees they had organized. The Teamsters had become the bargaining representative of the employees at 26 of OTC's 170 service centers, but the employees at 17 of these locations recently have voted to decertify the Teamsters, and the NLRB has officially approved the votes in 14 of those locations. Decertification petitions are pending at four other service centers. Only a single representation petition currently is pending, but due to strike violence charges pending against the Teamsters, the NLRB has blocked the Teamsters' efforts to precipitate an election. In all, the Teamsters currently represent approximately 10% of OTC's 12,534 employees.

Employees at two Motor Cargo service centers located in North Salt Lake, Utah and Reno, Nevada, representing approximately 11% of Motor Cargo's total work force at 33 service centers, are covered by two separate collective bargaining agreements with unions affiliated with the Teamsters. Although the agreements cover most of the employees at these two facilities, less than half of these covered employees are actual members of unions.

## **2. Financial Instruments**

**Adoption of Standard** - Effective January 1, 2001, the Corporation adopted Financial Accounting Standards Board Statement (FASB) No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133) and FASB No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (FAS 138). FAS 133 and FAS 138 require that the changes in fair value of all derivative financial instruments the Corporation uses for fuel or interest rate hedging purposes be recorded in the Corporation's Consolidated Statements of Financial Position. In addition, to the extent fuel hedges are ineffective due to pricing differentials resulting from the geographic dispersion of the Corporation's operations, income statement recognition of the ineffective portion of the hedge position is required. Also, derivative instruments that do not qualify for hedge accounting treatment per FAS 133 and FAS 138 require income statement recognition. The adoption of FAS 133 and FAS 138 resulted in the recognition of a \$2 million asset on January 1, 2001.

**Strategy and Risk** – The Corporation and its subsidiaries use derivative financial instruments in limited instances for other than trading purposes to manage risk related to changes in fuel prices and to achieve the Corporation's interest rate objectives. The Corporation uses swaps, futures and/or forward contracts to mitigate the downside risk of adverse price

movements and hedge the exposure to variable cash flows. The use of these instruments also limits future gains from favorable movements. The Corporation uses interest rate swaps to manage its exposure to interest rate changes. The purpose of these programs is to protect the Corporation's operating margins and overall profitability from adverse fuel price changes or interest rate fluctuations.

The Corporation may also use swaptions to secure near-term swap prices. Swaptions are swaps that are extendable past their base period at the option of the counterparty. Swaptions do not qualify for hedge accounting treatment and are marked-to-market through the Consolidated Statements of Income.

**Market and Credit Risk** – The Corporation addresses market risk related to derivative financial instruments by selecting instruments with value fluctuations that highly correlate with the underlying item being hedged. Credit risk related to derivative financial instruments, which is minimal, is managed by requiring high credit standards for counterparties and periodic settlements. At December 31, 2002, the Corporation has not been required to provide collateral, nor has UPC received collateral relating to its hedging activities.

In addition, the Corporation enters into secured financings in which the debtor has pledged collateral. The collateral is based upon the nature of the financing and the credit risk of the debtor. The Corporation generally is not permitted to sell or repledge the collateral unless the debtor defaults.

**Determination of Fair Value** – The fair values of the Corporation's derivative financial instrument positions at December 31, 2002 and 2001, were determined based upon current fair values as quoted by recognized dealers or developed based upon the present value of expected future cash flows discounted at the applicable U.S. Treasury rate, London Interbank Offered Rates (LIBOR) or swap spread.

**Interest Rate Strategy** – The Corporation manages its overall exposure to fluctuations in interest rates by adjusting the proportion of fixed and floating rate debt instruments within its debt portfolio over a given period. The mix of fixed and floating rate debt is largely managed through the issuance of targeted amounts of each as debt matures or as incremental borrowings are required. Derivatives are used as one of the tools to obtain the targeted mix. In addition, the Corporation also obtains flexibility in managing interest costs and the interest rate mix within its debt portfolio by evaluating the issuance of and managing outstanding callable fixed-rate debt securities.

Swaps allow the Corporation to convert debt from fixed rates to variable rates and thereby hedge the risk of changes in the debt's fair value attributable to the changes in the benchmark interest rate (LIBOR). The swaps have been accounted for using the short-cut method as allowed by Financial Accounting Standard (FAS) 133; therefore, no ineffectiveness has been recorded within the Corporation's Consolidated Financial Statements. In January 2002, the Corporation entered into an interest rate swap on \$250 million of debt with a maturity date of December 2006. In May 2002, the Corporation entered into an interest rate swap on \$150 million of debt with a maturity date of February 2023. This swap contained a call option that matches the call option of the underlying hedged debt, as allowed by FAS 133. In January 2003, the swap's counterparty exercised their option to cancel the swap, effective February 1, 2003. Similarly, the Corporation has exercised its option to redeem the underlying debt. As of December 31, 2002 and 2001, the Corporation had approximately \$898 million and \$598 million of interest rate swaps, respectively.

**Fuel Strategy** – As a result of the significance of the Corporation's fuel costs and the historical volatility of fuel prices, the Corporation's transportation subsidiaries periodically use swaps, futures and/or forward contracts to mitigate adverse fuel price changes. In addition, the Corporation at times may use fuel swaptions to secure more favorable swap prices. The following is a summary of the Corporation's derivative financial instruments at December 31, 2002 and 2001:

<i>Millions, Except Percentages and Average Commodity Prices</i>	<i>2002</i>	<i>2001</i>
Interest rate hedging:		
Amount of debt hedged .....	\$ 898	\$ 598
Percentage of total debt portfolio .....	12%	7%
Fuel hedging/swaptions:		
Number of gallons hedged for 2002 <sup>[a]</sup> .....	552	567
Average price of 2002 hedges (per gallon) <sup>[b]</sup> .....	\$0.56	\$0.56
Number of gallons hedged for 2003 <sup>[c]</sup> .....	88	63
Average price of 2003 hedges outstanding (per gallon) <sup>[b]</sup> .....	\$0.58	\$0.56

[a] Fuel hedges which were in effect during 2002.

[b] Excluded taxes, transportation costs and regional pricing spreads.

[c] Fuel hedges which are in effect during 2003. These hedges expire December 31, 2003.

The fair value asset and liability positions of the Corporation's outstanding derivative financial instruments at December 31, 2002 and 2001 were as follows:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>
Interest rate hedging:		
Gross fair value asset position .....	\$ 52	\$13
Gross fair value (liability) position.....	-	-
Fuel hedging:		
Gross fair value asset position .....	12	-
Gross fair value (liability) position.....	-	(11)
Fuel swaptions:		
Gross fair value asset position .....	-	-
Gross fair value (liability) position.....	-	(24)
Total net fair value asset (liability) position, net.....	\$64	\$(22)

Fuel hedging positions will be reclassified from accumulated other comprehensive income (loss) to fuel expense over the life of the hedge as fuel is consumed. During 2003, the Corporation expects fuel expense to decrease \$12 million from this reclassification.

The Corporation's use of derivative financial instruments had the following impact on pre-tax income for the years ended December 31, 2002, 2001 and 2000:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Decrease in interest expense from interest rate hedging.....	\$ 29	\$ 4	\$ -
Decrease (increase) in fuel expense from fuel hedging .....	36	(14)	52
Decrease (increase) in fuel expense from fuel swaptions .....	19	(6)	-
Decrease (increase) in operating expenses .....	84	(16)	52
Increase (decrease) in other income, net from rail fuel swaptions .....	5	(18)	-
Increase (decrease) in pre-tax income.....	\$89	\$(34)	\$52

**Fair Value of Debt Instruments** – The fair value of the Corporation's long- and short-term debt has been estimated using quoted market prices or current borrowing rates. At December 31, 2002 and 2001, the fair value of total debt exceeded the carrying value by approximately \$991 million and \$254 million, respectively. At December 31, 2002 and December 31, 2001, approximately \$513 million and \$850 million, respectively, of fixed-rate debt securities contain call provisions that allow the Corporation to retire the debt instruments prior to final maturity subject, in certain cases, to the payment of premiums.

**Sale of Receivables** – The Railroad has sold, on a 364-day revolving basis, an undivided percentage ownership interest in a designated pool of accounts receivable to third parties through a bankruptcy-remote subsidiary. Receivables are sold at carrying value, which approximates fair value. The third parties have designated the Railroad to service the sold receivables. The amount of receivables sold fluctuates based upon the availability of the designated pool of receivables and is directly

affected by changing business volumes and credit risks. Payments collected from sold receivables can be reinvested in new receivables on behalf of the buyers. Should the Corporation's credit rating fall below investment grade, the amount of receivables sold would be reduced, and in certain cases, the buyers have the right to discontinue this reinvestment, thus requiring the Railroad to fund the receivables. At December 31, 2002 and 2001, accounts receivable are presented net of \$600 million of receivables sold.

### 3. Income Taxes

Components of income tax expense, excluding discontinued operations, were as follows for the years ended December 31, 2002, 2001 and 2000:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Current:			
Federal.....	\$76	\$120	\$ (2)
State .....	8	6	(1)
Total current.....	84	126	(3)
Deferred:			
Federal.....	532	370	424
State .....	64	49	25
Total deferred.....	596	419	449
Total.....	\$680	\$545	\$446

Deferred income tax liabilities (assets) were comprised of the following at December 31, 2002 and 2001:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>
Current liabilities .....	\$ (287)	\$ (282)
Alternative minimum tax credits .....	(211)	-
Net operating loss.....	-	(59)
Net current deferred income tax asset.....	(498)	(341)
Excess tax over book depreciation.....	8,170	7,803
State taxes, net.....	611	576
Retirement benefits.....	(267)	(232)
Alternative minimum tax credits .....	(140)	(315)
Net operating loss.....	-	(95)
Other .....	176	145
Net long-term deferred income tax liability .....	8,550	7,882
Net deferred income tax liability.....	\$8,052	\$7,541

For the years ending December 31, 2002, 2001 and 2000, a reconciliation between statutory and effective tax rates of continuing operations is as follows:

<i>Percentages</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Statutory tax rate.....	35.0%	35.0%	35.0%
State taxes-net .....	2.4	2.4	1.3
Dividend exclusion.....	(0.6)	(0.8)	(1.1)
Prior years' income tax examinations.....	(1.8)	(0.2)	-
Other .....	-	0.4	0.3
Effective tax rate.....	35.0%	36.8%	35.5%

During 2002, the Corporation made considerable progress on a number of significant income tax examination issues for prior tax years. Most of the Corporation's tax issues relating to 1986 through 1994, as well as some issues for 1995 through 1998, have now been substantially resolved. Based on these developments, the Corporation re-evaluated

its deferred tax assets and deferred tax liabilities in 2002, resulting in a decrease in income tax expense on continuing operations of \$33 million.

All federal income tax years prior to 1986 are closed, and most issues for 1986 through 1994 have been resolved. Years 1995 through 1998 are currently under examination by the IRS.

The Corporation believes it has adequately provided for federal and state income taxes.

#### 4. Debt

Total debt as of December 31, 2002 and 2001, including interest rate swaps designated as hedges, is summarized below:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>
Notes and debentures, 2.0% to 8.4% due through 2054 [a].....	\$4,744	\$4,682
Capitalized leases, 5.4% to 12.8% due through 2024.....	1,457	1,439
Medium-term notes, 6.3% to 10.0% due through 2020 [a] .....	704	736
Equipment obligations, 6.3% to 10.3% due through 2019 .....	534	619
Term floating-rate debt .....	-	300
Mortgage bonds, 4.3% to 4.8% due through 2030.....	153	153
Tax-exempt financings, 3.3% to 5.7% due through 2026.....	168	168
Commercial paper and bid notes, average of 2.9% in 2002 and 5.1% in 2001.....	-	34
Unamortized discount .....	(57)	(53)
<b>Total debt .....</b>	<b>7,703</b>	<b>8,078</b>
<b>Less current portion.....</b>	<b>(275)</b>	<b>(194)</b>
<b>Total long-term debt.....</b>	<b>\$7,428</b>	<b>\$7,884</b>

[a] 2002 and 2001 includes a collective write-up of \$52 million and \$13 million, respectively, due to market value adjustments for debt with qualifying hedges that are recorded as assets on the Consolidated Statements of Financial Position.

**Debt Maturities** – Aggregate debt maturities as of December 31, 2002, excluding market value adjustments, are as follows:

<i>Millions of Dollars</i>	
2003 .....	\$ 275
2004 .....	673
2005 .....	677
2006 .....	658
2007 .....	788
Thereafter .....	4,580
<b>Total debt .....</b>	<b>\$7,651</b>

In January 2003, the Corporation called its \$150 million 7-7/8% debentures due February 1, 2023, for redemption in February 2003.

**Mortgaged Properties** – At December 31, 2002 and 2001, approximately \$9.5 billion and \$9.4 billion, respectively, of Railroad properties secure outstanding equipment obligations and mortgage bonds.

**Credit Facilities** – The Corporation had no commercial paper borrowings outstanding as of December 31, 2002. Commercial paper is issued from time to time for working capital needs and is supported by \$1.875 billion in revolving credit facilities, of which \$875 million expires in March 2003, with the remaining \$1.0 billion expiring in 2005. The credit facility for \$875 million includes \$825 million that was entered into during March 2002 and \$50 million entered into during June 2002. The \$1.0 billion credit facility was entered into during March 2000. The Corporation has the option to hold higher cash balances in addition to or in replacement of the credit facilities to support commercial paper. These credit facilities also allow for borrowings at floating (LIBOR-based) rates, plus a spread, depending upon the Corporation's senior unsecured debt ratings. The credit facilities are designated for general corporate purposes, and none of the credit facilities were used as

of December 31, 2002. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers. The Corporation is reviewing rollover options for the credit facility that expires in March 2003. To the extent the Corporation has long-term credit facilities available, commercial paper borrowings and other current maturities of long-term debt of \$188 million and \$674 million as of December 31, 2002 and 2001, respectively, have been reclassified as long-term debt maturing in the years 2004 and 2003, respectively. This reclassification reflects the Corporation's intent to refinance these short-term borrowings and current maturities of long-term debt on a long-term basis through the issuance of additional commercial paper or new long-term financings, or by using the currently available long-term credit facility if alternative financing is not available.

**Convertible Preferred Securities** – Union Pacific Capital Trust (the Trust), a statutory business trust sponsored and wholly owned by the Corporation, issued \$1.5 billion aggregate liquidation amount of 6.25% Convertible Preferred Securities (the CPS) in April 1998. Each of the CPS has a stated liquidation amount of \$50 and is convertible, at the option of the holder, into shares of UPC's common stock, par value \$2.50 per share (the Common Stock), at the rate of 0.7257 shares of Common Stock for each of the CPS, equivalent to a conversion price of \$68.90 per share of Common Stock, subject to adjustment under certain circumstances. The CPS accrues and pays cash distributions quarterly in arrears at the annual rate of 6.25% of the stated liquidation amount. The Corporation owns all of the common securities of the Trust. The proceeds from the sale of the CPS and the common securities of the Trust were invested by the Trust in \$1.5 billion aggregate principal amount of the Corporation's 6.25% Convertible Junior Subordinated Debentures due April 1, 2028 (the Debentures). The Debentures represent the sole assets of the Trust. The principal amount of the Debentures held by the Trust at December 31, 2002, was \$1.5 billion.

The Debentures accrue and pay interest quarterly in arrears at the annual rate of 6.25%. The Debentures mature on April 1, 2028, unless previously redeemed or repurchased in accordance with the terms of the indenture (the Indenture). The proceeds from the issuance of the Debentures were used by the Corporation for repayment of corporate borrowings.

The Corporation has guaranteed, on a subordinated basis, distributions and other payments due on the CPS (the Guarantee). Considered together, the Corporation's obligations under the Debentures, the Indenture, the Guarantee and the Amended and Restated Declaration of Trust governing the Trust provide a full and unconditional guarantee by the Corporation of the Trust's obligations under the CPS.

For financial reporting purposes, the Corporation has recorded distributions payable on the CPS as an interest charge to earnings in the Consolidated Statements of Income.

**Shelf Registration Statement and Other Significant Financings** – During January 2002, under an existing shelf registration statement, the Corporation issued \$300 million of 6-1/8% fixed rate debt with a maturity of January 15, 2012. The proceeds from the issuance were used for repayment of debt and other general corporate purposes. In April 2002, the Corporation called its \$150 million, 8-5/8% debentures due May 15, 2022 for redemption in May 2002. The Corporation issued \$350 million of 6-1/2% fixed rate debt with a maturity of April 15, 2012, in order to fund the redemption. The Corporation used the remaining proceeds to repay other debt and for other general corporate purposes. On May 17, 2002, the Corporation issued the remaining \$50 million of debt under the existing shelf registration statement. The debt carries a fixed rate of 5-3/4% with a maturity of October 15, 2007. The proceeds from the issuance were used for repayment of debt and other general corporate purposes.

The Corporation filed a \$1.0 billion shelf registration statement, which became effective in July 2002. Under the shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. At December 31, 2002, the Corporation had \$1.0 billion remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

During June 2002, UPRR entered into a capital lease covering new locomotives. The related capital lease obligation totaled approximately \$126 million and is included in the Consolidated Statements of Financial Position as debt.

**Dividend Restrictions** – The Corporation is subject to certain restrictions related to the payment of cash dividends. The amount of retained earnings available for dividends under the most restrictive test was \$5.2 billion and \$4.1 billion at

December 31, 2002 and 2001, respectively. In the fourth quarter of 2002, the Board of Directors voted to increase the quarterly dividend by 15% to 23 cents per share. The Corporation declared dividends of \$210 million in 2002 and \$199 million in 2001.

## 5. Leases

The Corporation leases certain locomotives, freight cars, trailers and other property. Future minimum lease payments for operating and capital leases with initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2002 were as follows:

<i>Millions of Dollars</i>	<i>Operating Leases</i>	<i>Capital Leases</i>
2003 .....	\$ 426	\$ 210
2004 .....	385	214
2005 .....	352	193
2006 .....	311	190
2007 .....	252	170
Later Years.....	1,511	1,469
Total minimum lease payments .....	\$3,237	2,446
Amount representing interest.....		(989)
Present value of minimum lease payments .....		\$ 1,457

Rent expense for operating leases with terms exceeding one month was \$585 million in 2002, \$575 million in 2001 and \$555 million in 2000. Contingent rentals and sub-rentals are not significant.

## 6. Retirement Plans

**Thrift Plan** – The Corporation provides a defined contribution plan (thrift plan) to eligible non-union employees. The Corporation’s contributions into the thrift plan are based on 50% of the participant’s contribution, limited to 3% of the participant’s base salary. Corporation thrift plan contributions were \$10 million for the year ended December 31, 2002 and \$11 million for the years ended December 31, 2001, and 2000.

**Railroad Retirement System** – All Railroad employees are covered by the Railroad Retirement System (the System). On December 21, 2001, The Railroad Retirement and Survivors' Improvement Act of 2001 (the Act) was signed into law. The Act was a result of historic cooperation between rail management and labor, and provides improved railroad retirement benefits for employees and reduced payroll taxes for employers. Contributions made to the System are expensed as incurred and amounted to approximately \$595 million in 2002, \$607 million in 2001 and \$611 million in 2000.

**Other Postretirement Benefits** – All non-union and certain of the Corporation’s union employees participate in defined contribution medical and life insurance programs for retirees. The Corporation also provides medical and life insurance benefits on a cost sharing basis for qualifying employees. These costs are funded as incurred.

**Pension Plans** – The Corporation provides defined benefit retirement income to eligible non-union employees through qualified and non-qualified (supplemental) pension plans. Qualified and non-qualified pension benefits are based on years of service and the highest compensation during the latest years of employment. The qualified plans are funded based on the Projected Unit Credit actuarial funding method and are funded at not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended and not more than the maximum amount deductible for tax purposes. The Corporation has settled a portion of the non-qualified unfunded supplemental plan’s accumulated benefit obligation by purchasing annuities.

Changes in the Corporation's projected benefit obligation are as follows, for the years ended December 31, 2002 and 2001:

<i>Millions of Dollars</i>	<i>Pension</i>		<i>Other Postretirement Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Net benefit obligation at beginning of year.....	\$1,654	\$1,534	\$497	\$391
Service cost.....	21	22	6	6
Interest cost.....	117	113	37	30
Plan amendments.....	(1)	(19)	(48)	2
Actuarial loss.....	34	55	105	101
Special termination benefits.....	-	59	-	1
Gross benefits paid.....	(122)	(110)	(46)	(34)
Net benefit obligation at end of year.....	\$1,703	\$1,654	\$551	\$497

As part of the work force reduction plan, discussed in note 12, the Corporation reclassified \$59 million and \$1 million in 2001 for pension and other postretirement benefits, respectively, from other current liabilities to retiree benefits obligation.

Changes in the Corporation's benefit plan assets are as follows for the years ended December 31, 2002 and 2001:

<i>Millions of Dollars</i>	<i>Pension</i>		<i>Other Postretirement Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Fair value of plan assets at beginning of year.....	\$1,404	\$1,644	\$ -	\$ -
Actual return on plan assets.....	(159)	(139)	-	-
Employer contributions.....	108	9	46	34
Gross benefits paid.....	(122)	(110)	(46)	(34)
Fair value of plan assets at end of year.....	\$1,231	\$1,404	\$ -	\$ -

As of December 31, 2002, the Corporation had pension plans with accumulated benefits that exceeded the fair value of plan assets. The accumulated benefit obligation for these plans was \$1.6 billion while the fair value of the assets was \$1.2 billion at the end of 2002.

The components of the funded status of the benefit plans for the years ended December 31, 2002 and 2001 were as follows:

<i>Millions of Dollars</i>	<i>Pension</i>		<i>Other Postretirement Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Funded status at end of year.....	\$(472)	\$(250)	\$(551)	\$(497)
Unrecognized net actuarial (gain) loss.....	290	(62)	171	71
Unrecognized prior service cost (credit).....	55	65	(56)	(11)
Unrecognized net transition obligation.....	(4)	(5)	-	-
Net liability recognized at end of year.....	\$(131)	\$(252)	\$(436)	\$(437)

At December 31, 2002 and 2001, \$43 million and \$29 million, respectively, of the total pension and other postretirement liability were classified as a current liability.

The Corporation decreased its assumed long-term rate of return on pension plan assets, during 2002, from 10% to 9%. This assumption change resulted in an increase to 2002 pension expense of \$16 million.

During 2002, actual asset returns for the Corporation's pension plans were adversely impacted by continued deterioration in the equity markets. Actual return on pension plan assets was approximately negative 10% in 2002. During the same time, corporate bond yields, which are used in determining the discount rate for future pension obligations,

continued to decline. As a result of negative asset returns and lower discount rates, the Corporation was required to recognize an additional minimum pension liability. The liability was recorded as a \$141 million after-tax reduction to common shareholders' equity as part of accumulated other comprehensive income (loss). The equity reduction would be restored to the balance sheet in future periods when the fair value of plan assets exceeds the accumulated benefit obligations. Recognition of this reduction to equity does not affect net income or cash flow in 2002 and has no impact on compliance with debt covenants.

While the interest rate and asset return environment has significantly impacted the funded status of the Corporation's plans, the Corporation does not currently have minimum funding requirements, as set forth in employee benefit and tax laws. Even though no minimum funding is required, the Corporation voluntarily contributed \$100 million to its pension plan during 2002.

Amounts recognized for the benefit plan liabilities in the Consolidated Statements of Financial Position for December 31, 2002 and 2001 consisted of:

<i>Millions of Dollars</i>	<i>Pension</i>		<i>Other Postretirement Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Prepaid benefit cost	\$ 7	\$ 5	\$ -	\$ -
Accrued benefit cost	(137)	(257)	(436)	(437)
Additional minimum liability	(294)	(33)	-	-
Intangible assets	55	22	-	-
Accumulated other comprehensive income	238	11	-	-
Net liability recognized at end of year	\$ (131)	\$ (252)	\$ (436)	\$ (437)

The components of the Corporation's net periodic pension and other postretirement costs (income) for the years ended December 31, 2002, 2001 and 2000 were as follows:

<i>Millions of Dollars</i>	<i>Pension</i>			<i>Other Postretirement Benefits</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Service cost	\$ 21	\$ 22	\$ 20	\$ 6	\$ 6	\$ 5
Interest cost	117	113	109	37	30	28
Expected return on assets	(144)	(157)	(145)	-	-	-
Amortization of:						
Transition obligation	(2)	(1)	(2)	-	-	-
Prior service cost (credit)	9	12	13	(3)	(2)	(3)
Actuarial gain.....	(15)	(23)	(26)	5	-	(2)
Total net periodic benefit cost (income)	\$ (14)	\$ (34)	\$ (31)	\$ 45	\$ 34	\$ 28

At December 31, 2002 and 2001, approximately 34% and 32%, respectively, of the funded plans' assets each year were held in fixed-income and short-term securities, with the remainder in equity securities.

The weighted-average actuarial assumptions for the years ended December 31, 2002, 2001 and 2000 were as follows:

<i>Percentages</i>	<i>Pension</i>			<i>Other Postretirement Benefits</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Discount rate	6.75%	7.25%	7.50%	6.75%	7.25%	7.50%
Expected return on plan assets	9.0	10.0	10.0	N/A	N/A	N/A
Rate of compensation increase	3.75	4.25	4.50	3.75	4.25	4.50
Health care cost trend:						
Current	N/A	N/A	N/A	10.00	7.70	7.70
Level in 2006	N/A	N/A	N/A	5.00	5.50	5.50

Assumed health care cost trend rates have a significant effect on the amount reported for health care plans. A one-percentage point change in the assumed health care cost trend rates would have the following effects on other postretirement benefits:

<i>Millions of Dollars</i>	<i>One % pt. Increase</i>	<i>One % pt. Decrease</i>
Effect on total service and interest cost components	\$ 5	\$ (4)
Effect on postretirement benefit obligation	50	(45)

## 7. Stock Options and Other Stock Plans

The Corporation has no options outstanding under the 1988 Stock Option and Restricted Stock Plan of Union Pacific Corporation (1988 Plan) and 11,146,185 options outstanding under the 1993 Stock Option and Retention Stock Plan of Union Pacific Corporation (1993 Plan). There are 1,585,709 retention shares and stock units (the right to receive shares of common stock) outstanding under the 1993 Plan. There are 10,710 restricted shares outstanding under the 1992 Restricted Stock Plan for Non-Employee Directors of Union Pacific Corporation (1992 Directors Plan). The Corporation no longer grants options or awards of restricted stock under the 1988 Plan, the 1993 Plan or the 1992 Directors Plan.

The UP Shares Stock Option Plan of Union Pacific Corporation (UP Shares Plan) was approved by UPC's Board of Directors on April 30, 1998. The UP Shares Plan reserved 12,000,000 shares of UPC common stock for issuance. The UP Shares Plan was a broad-based option program that granted eligible active employees on April 30, 1998 an option to purchase 200 shares of UPC common stock at \$55.00 per share. All options granted were non-qualified options that became exercisable on May 1, 2001 and remain exercisable until April 30, 2008. If an optionee's employment terminates for any reason, the option remains exercisable for a period of one year after the date of termination, but no option is exercisable after April 30, 2008. Pursuant to the terms of the UP Shares Plan, no options may be granted after April 30, 1998. As of December 31, 2002, there were 8,042,120 options outstanding under the UP Shares Plan.

The Corporation adopted the Executive Stock Purchase Incentive Plan (ESPIP) effective October 1, 1999, in order to encourage and facilitate ownership of UPC common stock by officers and other key executives of the Corporation and its subsidiaries. Under the ESPIP, participants purchased a total of 1,008,000 shares of UPC common stock with the proceeds of 6.02% interest-bearing, full recourse loans from the Corporation. Loans totaled \$47 million and have a final maturity date of January 31, 2006. Deferred cash payments were to be awarded to the participants to repay interest and the loan principal if certain performance and retention criteria were met within a 40-month period ending January 31, 2003. Dividends paid on the purchased shares were originally assigned to the Corporation to offset the accrued interest on the loan balance until March 2001 when the first performance criterion was satisfied and, accordingly thereafter, the dividends on the purchased shares were paid directly to the participants. Satisfaction of the first performance criterion also entitled participants to receive a cash payment equal to the net accrued interest on the outstanding principal balance of the loan. Satisfaction of the second performance criterion, in December 2002, entitled participants to receive a cash payment equal to one-third of the outstanding principal balance of their loan, and satisfaction of the retention criterion of continued employment with the Corporation until January 31, 2003, entitled participants to receive an additional cash payment equal to one-third of the outstanding principal balance of their loan. Such payments shall be applied against the participants' outstanding loan balance pursuant to the terms of the ESPIP. The remaining balance of the loan is payable in three equal installments on January 31, 2004, January 31, 2005 and January 31, 2006.

In April 2000, the shareholders approved the Union Pacific Corporation 2000 Directors Plan (Directors Plan) whereby 550,000 shares of UPC common stock were reserved for issuance to non-employee directors of the Corporation. Under the Directors Plan, each non-employee director, upon his or her initial election to the Board of Directors, receives a grant of 1,000 shares of restricted shares or restricted stock units. Additionally, each non-employee director receives annually an option to purchase a number of shares of UPC common stock, not to exceed 5,000 shares during any calendar year, determined by dividing 60,000 by 1/3 of the fair market value of one share of UPC common stock on the date of such Board of Directors meeting, with the resulting quotient rounded up or down to the nearest 50 shares. As of December 31, 2002, there were 3,000 restricted shares outstanding under the Directors Plan and there were 72,050 options outstanding under the Directors Plan.

In November 2000, the Corporation approved the 2001 Long Term Plan (LTP). Participants were awarded retention shares or stock units and cash awards subject to the attainment of certain performance targets and continued employment through January 31, 2004. The LTP performance criteria include three year (for fiscal years 2001, 2002 and 2003) cumulative earnings per share and stock price targets.

The Union Pacific Corporation 2001 Stock Incentive Plan (2001 Plan) was approved by the shareholders in April 2001. The 2001 Plan reserved 12,000,000 shares of UPC common stock for issuance to eligible employees of the Corporation in the form of non-qualified options, incentive stock options, retention shares, stock units and incentive bonus awards. Awards and options under the 2001 Plan may be granted to employees of the Corporation and its subsidiaries. Non-employee directors are not eligible. As of December 31, 2002, there were 854,931 retention shares and stock units outstanding under the 2001 Plan, and there were 2,074,950 options outstanding under the 2001 Plan.

Pursuant to the above plans, 9,544,569, 12,461,025, and 6,089,561 shares of UPC common stock were available for grant at December 31, 2002, 2001 and 2000, respectively.

**Options** – Stock options are granted with an exercise price equal to the fair market value of the Corporation’s common stock as of the date of the grant. Options are granted with a 10-year term and are generally exercisable one to two years after the date of the grant. A summary of the stock options issued under the 1988 Plan, the 1993 Plan, the UP Shares Plan, the Directors Plan and the 2001 Plan, and changes during the years ending December 31 are as follows:

	Year Ended December 31,					
	2002		2001		2000	
	Shares	Weighted -Average Exercise Price	Shares	Weighted -Average Exercise Price	Shares	Weighted -Average Exercise Price
Outstanding, beginning of year	23,189,323	\$51.12	25,342,300	\$50.48	25,391,470	\$50.41
Granted	2,107,500	61.14	1,798,150	49.91	253,250	41.96
Exercised	(3,814,625)	45.99	(2,044,997)	38.63	(175,900)	30.05
Forfeited	(130,093)	54.99	(1,906,130)	54.82	(126,520)	48.64
Outstanding, end of year	21,352,105	\$53.00	23,189,323	\$51.12	25,342,300	\$50.48
Options exercisable at year end	18,897,155	\$52.04	21,053,773	\$51.13	13,758,817	\$47.00
Weighted-average fair value of options granted during the year		\$17.78		\$13.09		\$11.84

The following table summarizes information about the Corporation’s outstanding stock options as of December 31, 2002:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price	
\$20.60 - \$41.91	1,224,249	2.82	\$33.12	1,224,249	\$33.12	
\$42.87 - \$52.53	5,133,671	6.02	47.78	5,130,671	47.78	
\$52.88 - \$62.40	14,994,185	5.34	56.42	12,542,235	55.62	
\$20.60 - \$62.40	21,352,105	5.36	\$53.00	18,897,155	\$52.04	

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions for options granted in 2002, 2001, and 2000, respectively: risk-free interest rates of 4.4%, 4.3% and 5.1%; dividend yield of 1.3%, 1.4% and 1.6%; expected lives of 5 years, 4 years and 4 years; and volatility of 28.8%, 29.5% and 31.4%.

**Restricted Stock and Other Incentive Plans** – The Corporation's plans provide for awarding retention shares of common stock or stock units to eligible employees. These awards are subject to forfeiture if employment terminates during the prescribed retention period, generally three or four years, or, in some cases, if a certain prescribed stock price or other financial criteria is not met. Restricted stock awards are issued to non-employee directors and are subject to forfeiture if certain service requirements are not met. During the year ended December 31, 2002, 804,956 retention shares, stock units, and restricted shares were issued at a weighted-average fair value of \$58.21. During 2001, 387,540 retention shares, stock units, and restricted shares were issued at a weighted-average fair value of \$49.95. During 2000, 283,059 retention shares, stock units, and restricted shares were issued at a weighted-average fair value of \$41.21. The cost of retention and restricted awards is amortized to expense over the retention period.

Under the LTP, 11,900 performance retention stock units and 1,019,500 performance retention shares and stock units were issued at a weighted-average fair value of \$60.97 and \$50.07 during 2002 and 2001, respectively. The cost of the LTP is expensed over the performance period which ends January 31, 2004.

The cost associated with the ESPIP retention criterion is amortized to expense over the 40-month period. The cost associated with the ESPIP first performance criterion is expensed over the life of the loan, and the cost associated with the second performance criterion was expensed in December 2002.

During the years ended December 31, 2002, 2001 and 2000, UPC expensed \$50 million, \$18 million and \$18 million, respectively, related to the other incentive plans described above.

## 8. Earnings Per Share

The following table provides a reconciliation between basic and diluted earnings per share for the years ended December 31, 2002, 2001 and 2000:

<i>Millions, Except Per Share Amounts</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
<b>Income statement data:</b>			
Income from continuing operations .....	\$1,265	\$ 934	\$ 810
Income from discontinued operations.....	76	32	32
Net income available to common shareholders - basic .....	\$1,341	\$966	\$ 842
Dilutive effect of interest associated with the CPS.....	58	58	58
Net income available to common shareholders - diluted .....	\$1,399	\$1,024	\$ 900
<b>Weighted-average number of shares outstanding:</b>			
Basic.....	252.1	248.0	246.5
Dilutive effect of stock options .....	1.8	1.3	0.6
Dilutive effect of retention shares, stock units and restricted shares.....	1.1	0.8	0.6
Dilutive effect of CPS .....	21.8	21.8	21.8
Diluted .....	276.8	271.9	269.5
<b>Earnings per share – basic:</b>			
Income from continuing operations .....	\$5.02	\$3.77	\$3.29
Income from discontinued operations.....	0.30	0.13	0.13
Net income.....	\$5.32	\$3.90	\$3.42
<b>Earnings per share – diluted:</b>			
Income from continuing operations .....	\$4.78	\$3.65	\$3.22
Income from discontinued operations.....	0.27	0.12	0.12
Net income.....	\$5.05	\$3.77	\$3.34

Common stock options totaling 2.3 million, 12.8 million and 21.5 million shares for 2002, 2001 and 2000, respectively were excluded from the computation of diluted EPS because the exercise prices of these options exceeded the average market price of the Corporation's common stock for the respective periods, and the effect of their inclusion would be anti-dilutive.

## 9. Commitments and Contingencies

**Unasserted Claims** – There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries. It is not possible at this time for the Corporation to determine fully the effect of all unasserted claims on its consolidated financial condition, results of operations or liquidity; however, to the extent possible, where unasserted claims can be estimated and where such claims are considered probable, the Corporation has recorded a liability. The Corporation does not expect that any known lawsuits, claims, environmental costs, commitments, contingent liabilities or guarantees will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

**Personal Injury and Occupational Illness** – The cost of injuries to employees and others related to Railroad activities or in accidents involving the trucking segment is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year. During 2002, the Railroad's reported number of work-related injuries that resulted in lost job time decreased 5% compared to the number of injuries reported during 2001, and accidents at grade crossings decreased 16% compared to 2001. Annual expenses for the Corporation's personal injury-related events were \$221 million in 2002, \$200 million in 2001 and \$204 million in 2000. As of December 31, 2002 and 2001, the Corporation had a liability of \$671 million and \$700 million, respectively, accrued for future personal injury costs, of which \$274 million and \$275 million were recorded in current liabilities as accrued casualty costs, respectively. The Railroad has additional amounts accrued for claims related to certain occupational illnesses. Compensation for Railroad work-related accidents is governed by the Federal Employers' Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. The Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work.

**Environmental** – The Corporation generates and transports hazardous and non-hazardous waste in its current and former operations, and is subject to federal, state and local environmental laws and regulations. The Corporation has identified approximately 433 sites at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 52 sites that are the subject of actions taken by the U.S. government, 27 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to activities of other parties, in addition to costs relating to its own activities at each site.

When an environmental issue has been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

As of December 31, 2002 and 2001, the Corporation had a liability of \$188 million and \$171 million, respectively, accrued for future environmental costs, of which \$71 million and \$70 million were recorded in current liabilities as accrued casualty costs. The liability includes future costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties, and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved, site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites, and/or the speculative nature of remediation costs. The Corporation expects to pay out the majority of the December 31, 2002, environmental liability over the next five years, funded by cash generated from operations. The impact of current obligations is not expected to have a material adverse effect on the results of operations or financial condition of the Corporation.

**Purchase Obligations and Guarantees** – The Corporation and its subsidiaries periodically enter into financial and other commitments in connection with their businesses. The Corporation does not expect that these commitments or guarantees will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

At December 31, 2002, the Corporation had unconditional purchase obligations of \$404 million for the purchase of locomotives as part of the Corporation's multi-year capital asset acquisition plan. In addition, the Corporation was contingently liable for \$368 million in guarantees and \$52 million in letters of credit at December 31, 2002. These contingent guarantees were entered into in the normal course of business and include guaranteed obligations of affiliated operations. None of the guarantees individually are significant, and no liability related to these guarantees exists as of December 31, 2002. The final guarantee expires in 2022. The Corporation is not aware of any existing event of default, which would require it to satisfy these guarantees.

**Other** – In December 2001, the Railroad entered into a synthetic operating lease arrangement to finance a new headquarters building which will be constructed in Omaha, Nebraska. The expected completion date of the building is mid-2004. It will total approximately 1.1 million square feet with approximately 3,800 office workspaces. The cost to construct the new headquarters, including capitalized interest, is approximately \$260 million. The Corporation has guaranteed all of the Railroad's obligation under this lease.

UPRR is the construction agent for the lessor during the construction period. The Railroad has guaranteed, in the event of a loss caused by or resulting from its actions or failures to act as construction agent, 89.9% of the building related construction costs incurred up to that point during the construction period. Total building related costs incurred and drawn from the lease funding commitments as of December 31, 2002, were approximately \$50 million. Accordingly, the Railroad's guarantee at December 31, 2002, was approximately \$45 million. As construction continues and additional costs are incurred, this guarantee will increase accordingly.

After construction is complete, UPRR will lease the building under an initial term of five years with provisions for renewal for an extended period subject to agreement between the Railroad and lessor. At any time during the lease, the Railroad may, at its option, purchase the building at approximately the amount expended by the lessor to construct the building. If the Railroad elects not to purchase the building or renew the lease, the building is returned to the lessor for remarketing, and the Railroad has guaranteed a residual value equal to 85% of the total construction related costs. The guarantee will be approximately \$220 million.

## 10. Other Income

Other income included the following:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Net gain on non-operating asset dispositions.....	\$287	\$133	\$ 88
Rental income.....	60	89	75
Interest income.....	14	12	11
Fuel swaptions.....	5	(18)	-
Other, net.....	(42)	(55)	(46)
<b>Total.....</b>	<b>\$324</b>	<b>\$161</b>	<b>\$128</b>

Included in the 2002 gain on non-operating asset dispositions is a pre-tax gain of \$141 million related to the sale of land, track, operating rights and facilities to the Utah Transit Authority (UTA) for \$185 million, which included approximately 175 miles of track that stretches from Brigham City, Utah, through Salt Lake City, Utah, south to Payson, Utah. The transaction contributed \$88 million to the Corporation's earnings on an after-tax basis. An additional \$16 million of the pre-tax gain has been deferred pending successful completion of arrangements for the relocation of various existing facilities.

Also included in the 2002 gain on non-operating asset dispositions is a pre-tax gain of \$73 million related to the sale of land and track to the Santa Clara Valley Transportation Authority (VTA) for \$80 million, which included approximately 15 miles of track that stretches from William Street in San Jose, California, north to Paseo Padre Parkway in Fremont, California. The transaction contributed \$45 million to the Corporation's earnings on an after-tax basis.

## **11. Accounting Pronouncements**

In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 is effective for the Corporation beginning January 1, 2003. FAS 143 requires that the Corporation record a liability for the fair value of an asset retirement obligation when the Corporation has a legal obligation to remove the asset. The standard will affect the way the Corporation accounts for track structure removal costs, but will have no impact on liquidity. The Corporation is currently evaluating the impact of this statement on the Corporation's Consolidated Financial Statements. Any impact resulting from the adoption of this statement will be recorded as a cumulative effect of a change in accounting principle in the first quarter of 2003.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (FAS 146). FAS 146 requires that a liability for a cost associated with an exit or disposal activity is recognized at fair value when the liability is incurred and is effective for exit or disposal activities that are initiated after December 31, 2002. Management believes that FAS 146 will not have a material impact on the Corporation's Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others" (FIN 45). FIN 45 is effective for guarantees issued or modified after December 31, 2002. The disclosure requirements were effective for the year ending December 31, 2002, which 45 expand the disclosures required by a guarantor about its obligations under a guarantee. FIN 45 also requires the Corporation to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in the issuance of the guarantee. Management does not believe that FIN 45 will have a material impact on the Corporation's Consolidated Financial Statements.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" (FAS 148). FAS 148 provides alternative methods of transition for voluntary changes to the fair value based method of accounting for stock-based employee compensation, and amends the disclosure requirements including a requirement for interim disclosures. The Corporation currently discloses the effects of stock-based employee compensation and does not intend to voluntarily change to the alternative accounting principle.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to existing entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. As described in note 9 to the Consolidated Financial Statements, Item 8, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In accordance with FIN 46, the Railroad will either consolidate, restructure or refinance the synthetic lease prior to July 1, 2003. The Corporation does not expect FIN 46 to have any impact on the treatment of the Sale of Receivables program as described in note 2 to the Consolidated Financial Statements.

## 12. 2000 Work Force Reduction Plan

The Corporation's Board of Directors approved a work force reduction plan (the Plan) in the fourth quarter of 2000. The Plan called for the elimination of approximately 2,000 Railroad positions during 2001. The Corporation accrued \$115 million pre-tax or \$72 million after-tax in the fourth quarter of 2000 for costs related to the Plan. The expense was charged to salaries, wages and employee benefits in the Corporation's 2000 Consolidated Statements of Income. Plan liability activity in 2001 included \$49 million paid in cash or reclassified to contractual liabilities for severance benefits to 571 employees; \$60 million of subsidized early retirement benefits covering 480 employees; with the remaining \$6 million charged back against salaries, wages and employee benefits in the Corporation's Consolidated Statements of Income. In December 2001, the Plan was completed with positions eliminated through a combination of subsidized early retirements, involuntary layoffs and attrition.

## 13. Selected Quarterly Data

Selected unaudited quarterly data are as follows:

<i>Millions of Dollars, Except Per Share Amounts</i>				
<i>2002</i>	<i>Mar. 31</i>	<i>June 30</i>	<i>Sep. 30</i>	<i>Dec. 31</i>
Operating revenues.....	\$2,662	\$2,822	\$2,850	\$2,825
Operating income	489	583	619	562
Net income.....	222	304	437	378
Net income per share				
Basic.....	0.89	1.21	1.73	1.49
Diluted.....	0.86	1.15	1.63	1.41
<i>2001</i>	<i>Mar. 31</i>	<i>June 30</i>	<i>Sep. 30</i>	<i>Dec. 31</i>
Operating revenues.....	\$2,663	\$2,708	\$2,734	\$2,725
Operating income	430	478	556	554
Net income.....	181	243	267	275
Net income per share				
Basic.....	0.73	0.98	1.08	1.10
Diluted.....	0.72	0.95	1.04	1.06

## 14. Discontinued Trucking Segment

On August 4, 2003, UPC announced its intention to effect a sale of its entire trucking interest. On November 5, 2003, UPC completed the sale of its entire trucking interest through an initial public offering. In order to facilitate this offering, immediately prior to the consummation of the offering, Overnite Corporation, a newly formed corporation, acquired from UPC all of the outstanding common stock of Overnite Holding, Inc., a wholly owned subsidiary of UPC and the ultimate parent holding company of OTC and Motor Cargo. In exchange, Overnite Corporation issued to UPC (1) all of its outstanding common stock and (2) a \$1.0 million promissory note payable by Overnite Corporation six months following the date of consummation of the acquisition. In addition, subsequent to this transaction but immediately prior to the consummation of the offering, Overnite Holding, Inc. paid to UPC a previously declared dividend consisting of \$128 million in cash and the forgiveness of net intercompany advances from Overnite to UPC as of the date of the transaction between Overnite Corporation and UPC. The cash portion of the dividend payable to UPC was made from the proceeds of an initial borrowing under a new Overnite credit facility. UPC, as the selling shareholder, sold all of the common stock of Overnite Corporation in an underwritten initial public offering and received all of the proceeds of the offering, less discounts and commissions paid to the underwriters and estimated expenses.

The entire trucking segment of UPC was reclassified as a discontinued operation during the period covered by this report, which includes the reclassification of the segment as a discontinued operation for all periods presented.

The following table presents a statement of financial position for the discontinued operations as of December 31, 2002 and 2001:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>
Current assets.....	\$254	\$225
Properties, net.....	501	502
Other assets .....	27	24
Total assets .....	782	751
Current liabilities.....	179	153
Noncurrent liabilities .....	128	169
Total liabilities .....	307	322
Net assets of discontinued operations.....	\$475	\$426
Accumulated other comprehensive income.....	\$ 84	\$ -

The December 31, 2002 and 2001 numbers vary from those recorded in the Overnite Corporation final Prospectus dated October 30, 2003, due primarily to the classification of deferred taxes, as well as the elimination of intercompany receivables for consolidated financial statement purposes.

The following table presents the revenues and income before income taxes for the discontinued operations for the years ended December 31, 2002, 2001 and 2000:

<i>Millions of Dollars</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Revenues.....	\$1,332	\$1,143	\$1,113
Income before income taxes .....	\$ 71	\$ 54	\$ 53

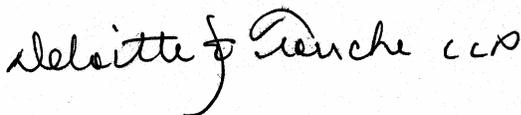
## INDEPENDENT AUDITORS' REPORT

Union Pacific Corporation, its Directors and Shareholders:

We have audited the accompanying consolidated statements of financial position of Union Pacific Corporation and Subsidiary Companies (the Corporation) as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in common shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the Corporation's consolidated financial statement schedule of valuation and qualifying accounts for each of the three years in the period ended December 31, 2002. These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Union Pacific Corporation and Subsidiary Companies at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

A handwritten signature in cursive script that reads "Deloitte & Touche LLP". The signature is written in dark ink and is positioned above the typed name of the firm.

Omaha, Nebraska

January 22, 2003

(December 12, 2003 as to Note 14)

**Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K****SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS***Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars, for the Years Ended December 31,</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Allowance for doubtful accounts:			
Balance, beginning of period .....	\$ 110	\$ 99	\$ 94
Charged to expense.....	16	17	12
Write-offs, net of recoveries .....	(18)	(6)	(7)
Balance, end of period.....	\$ 108	\$ 110	\$ 99
Accrued casualty costs:			
Balance, beginning of period .....	\$1,094	\$1,190	\$1,259
Charged to expense.....	359	329	320
Cash payments and other reductions .....	(376)	(425)	(389)
Balance, end of period.....	\$1,077	\$1,094	\$1,190
Accrued casualty costs are presented in the Consolidated Statements of Financial Position as follows:			
Current.....	\$ 419	\$ 421	\$ 412
Long-term.....	658	673	778
Balance, end of period.....	\$1,077	\$1,094	\$1,190

**RATIO OF EARNINGS TO FIXED CHARGES***Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars, Except for Ratio</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>1999</i>	<i>1998</i>
Earnings from continuing operations.....	\$1,265	\$ 934	\$ 810	\$ 765	\$(101)
Undistributed equity (earnings) loss.....	(34)	(48)	24	(45)	(44)
Total earnings.....	1,231	886	834	720	(145)
Income taxes .....	680	545	446	416	(82)
Fixed charges:					
Interest expense including					
amortization of debt discount.....	632	700	722	732	714
Portion of rentals representing an interest					
factor .....	43	42	171	183	178
Total fixed charges .....	675	742	893	915	892
Earnings available for fixed charges.....	\$2,586	\$2,173	\$2,173	\$2,051	\$ 665
Ratio of earnings to fixed charges.....	3.8	2.9	2.4	2.2	[a]

[a] 1998 earnings were inadequate to cover fixed charges by \$227 million.

**INDEPENDENT AUDITORS' CONSENT**

We consent to the incorporation by reference in Post-Effective Amendment No. 1 to Registration Statement No. 2-79663, Post-Effective Amendment No. 1 to Registration Statement No. 33-12513, Registration Statement No. 33-18877, Registration Statement No. 33-22106, Registration Statement No. 33-44236, Registration Statement No. 33-53968, Registration Statement No. 33-49785, Registration Statement No. 33-49849, Registration Statement No. 33-51071, Registration Statement No. 33-51735, Registration Statement No. 33-58563, Registration Statement No. 333-10797, Registration Statement No. 333-13115, Registration Statement No. 333-16563, Registration Statement No. 333-88225, Registration Statement No. 333-88709, Registration Statement No. 333-57958, Registration Statement No. 333-61856, Registration Statement No. 333-42768, Registration Statement No. 333-101430, Registration Statement No. 333-106707, Registration Statement No. 333-106708, Registration Statement No. 333-105714 and Registration Statement No. 333-105715 on Forms S-8 and Post-Effective Amendment No. 1 to Registration Statement No. 333-51617, Registration Statement No. 333-88666 and Amendment No. 1 to Registration Statement No. 333-88666 on Forms S-3 of our report dated January 22, 2003 (December 12, 2003 as to Note 14), appearing in this Current Report on Form 8-K of Union Pacific Corporation.

/s/ Deloitte & Touche LLP  
DELOITTE & TOUCHE LLP

Omaha, Nebraska  
December 15, 2003

**10-Q Amended Items for Period Ending March 31, 2002****Item 1. Consolidated Financial Statements****Consolidated Statements of Income (Unaudited)***Union Pacific Corporation and Subsidiary Companies*

<i>Millions, Except Per Share Amounts, For the Three Months Ended March 31,</i>	<i>2003</i>	<i>2002</i>
Revenues.....	\$2,736	\$ 2,662
Operating Expenses:		
Salaries, wages and employee benefits.....	964	913
Equipment and other rents .....	310	315
Depreciation .....	275	284
Fuel and utilities.....	352	225
Materials and supplies .....	103	121
Casualty costs .....	101	84
Purchased services and other costs .....	262	231
Total operating expenses .....	2,367	2,173
Operating income.....	369	489
Other income.....	13	21
Interest expense.....	(151)	(163)
Income before income taxes .....	231	347
Income taxes .....	(83)	(131)
Income from continuing operations before cumulative effect of accounting change.....	148	216
Income from discontinued operations, net of tax of \$5 and \$4.....	7	6
Cumulative effect of accounting change, net of tax of \$167 .....	274	-
Net income .....	\$ 429	\$ 222
<b>Share and Per Share</b>		
Basic:		
Income before cumulative effect of accounting change.....	\$ 0.58	\$ 0.86
Income from discontinued operations .....	0.03	0.03
Cumulative effect of accounting change.....	1.08	-
Net income .....	\$ 1.69	\$ 0.89
Diluted:		
Income before cumulative effect of accounting change.....	\$ 0.57	\$ 0.84
Income from discontinued operations .....	0.03	0.02
Cumulative effect of accounting change.....	1.07	-
Net income .....	\$ 1.67	\$ 0.86
Weighted average number of shares (Basic) .....	253.4	251.0
Weighted average number of shares (Diluted) .....	256.2	276.2
Dividends .....	\$ 0.23	\$ 0.20

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statements of Financial Position (Unaudited)***Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars</i>	<i>Mar. 31, 2003</i>	<i>Dec. 31, 2002</i>
<b>Assets</b>		
Current assets:		
Cash and temporary investments .....	\$ 305	\$ 367
Accounts receivable, net .....	479	557
Inventories .....	288	277
Current deferred income taxes .....	498	498
Other current assets.....	235	199
<b>Total current assets.....</b>	<b>1,805</b>	<b>1,898</b>
Investments:		
Investments in and advances to affiliated companies.....	645	649
Other investments .....	45	50
<b>Total investments.....</b>	<b>690</b>	<b>699</b>
Properties:		
Cost.....	37,190	36,860
Accumulated depreciation .....	(7,587)	(7,856)
<b>Net properties .....</b>	<b>29,603</b>	<b>29,004</b>
Other assets.....	602	381
Assets of discontinued operations.....	787	782
<b>Total assets.....</b>	<b>\$33,487</b>	<b>\$32,764</b>
<b>Liabilities and Common Shareholders' Equity</b>		
Current liabilities:		
Accounts payable .....	\$ 472	\$ 430
Accrued wages and vacation.....	366	365
Accrued casualty costs .....	421	419
Income and other taxes .....	255	227
Dividends and interest .....	231	253
Debt due within one year .....	267	275
Other current liabilities .....	498	554
<b>Total current liabilities .....</b>	<b>2,510</b>	<b>2,523</b>
Debt due after one year .....	7,555	7,428
Deferred income taxes .....	8,778	8,550
Accrued casualty costs.....	616	658
Retiree benefits obligation .....	811	762
Other long-term liabilities .....	374	385
Liabilities of discontinued operations .....	321	307
Company-obligated mandatorily redeemable convertible preferred securities .....	1,500	1,500
Commitments and contingencies		
Common shareholders' equity .....	11,022	10,651
<b>Total liabilities and common shareholders' equity .....</b>	<b>\$33,487</b>	<b>\$32,764</b>

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statements of Cash Flows (Unaudited)**

Union Pacific Corporation and Subsidiary Companies

<i>Millions of Dollars, For the Three Months Ended March 31,</i>	<i>2003</i>	<i>2002</i>
<b>Operating Activities</b>		
Net income .....	\$ 429	\$ 222
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations .....	(7)	(6)
Cumulative effect of accounting change.....	(274)	-
Depreciation .....	275	284
Deferred income taxes .....	67	92
Cash paid to fund pension plan .....	(50)	-
Other, net .....	(146)	6
Changes in current assets and liabilities, net.....	26	(256)
Cash provided by operating activities .....	320	342
<b>Investing Activities</b>		
Capital investments .....	(412)	(353)
Proceeds from asset sales .....	20	20
Other investing activities, net .....	(70)	(148)
Cash used in investing activities .....	(462)	(481)
<b>Financing Activities</b>		
Dividends paid .....	(58)	(50)
Debt repaid .....	(207)	(301)
Cash received from exercise of stock options .....	10	60
Financings, net .....	335	428
Cash provided by financing activities .....	80	137
Net change in cash and temporary investments .....	(62)	(2)
Cash and temporary investments at beginning of period .....	367	103
Cash and temporary investments at end of period .....	\$ 305	\$ 101
<b>Changes in Current Assets and Liabilities, Net</b>		
Accounts receivable, net .....	\$ 78	\$ (57)
Inventories .....	(11)	6
Other current assets.....	(36)	(41)
Accounts, wages and vacation payable .....	43	(22)
Other current liabilities.....	(48)	(142)
Total.....	\$ 26	\$(256)
<b>Supplemental Cash Flow Information:</b>		
Cash (paid) received during the period for:		
Interest.....	\$(175)	\$(188)
Income taxes, net .....	33	(48)

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

## Consolidated Statement of Changes in Common Shareholders' Equity (Unaudited)

Union Pacific Corporation and Subsidiary Companies

Millions of Dollars, For the Three Months Ended March 31, 2003	[a] Common Shares	Paid- in- Surplus	Retained Earnings	[b] Treasury Stock	Accumulated Other Comprehensive Income (Loss)			Total	Total
					Minimum Pension Liability Adjustments	Foreign Currency Translation Adjustments	Derivative Adjustments		
Balance at December 31, 2002...	\$689	\$3,946	\$7,597	\$(1,347)	\$(232)	\$(9)	\$7	\$(234)	\$10,651
Net income.....	-	-	429	-	-	-	-	-	429
Other comprehensive loss, From continuing operations, net of tax of \$7.....	-	-	-	-	-	(9)	(1)	(10)	(10)
Comprehensive income .....									419
Conversion, exercises of Stock options, forfeitures And other.....	-	2	-	8	-	-	-	-	10
Dividends declared \$0.23 per share).....	-	-	(58)	-	-	-	-	-	(58)
Balance at March 31, 2003 .....	\$689	\$3,948	\$7,968	\$(1,339)	\$(232)	\$(18)	\$6	\$(244)	\$11,022

[a] Common stock \$2.50 par value; 500,000,000 shares authorized; 275,579,367 shares issued at beginning of period; 275,668,417 shares issued at end of period.

[b] 21,920,238 treasury shares at beginning of period, at cost; 21,800,129 treasury shares at end of period, at cost.

The accompanying notes are an integral part of these Consolidated Financial Statements.

# UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**1. Responsibilities for Financial Statements** - The Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal and recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods presented. The Statement of Consolidated Financial Position at December 31, 2002 is derived from audited financial statements. The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto contained in the Annual Report on Form 10-K and contained in the current report on Form 8-K dated December 15, 2003 for Union Pacific Corporation (the Corporation or UPC) for the year ended December 31, 2002. The results of operations for the three months ended March 31, 2003 are not necessarily indicative of the results for the entire year ending December 31, 2003. Certain prior year amounts have been reclassified to conform to the 2003 financial statement presentation.

**Stock-Based Compensation** - At March 31, 2003, the Corporation had several stock-based employee compensation plans. The Corporation accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. No stock-based employee compensation expense, related to stock option grants, is reflected in net income as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Stock-based employee compensation expense related to restricted stock and other incentive plans is reflected in net income. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation. See note 5 to the Consolidated Financial Statements for reconciliation between basic earnings per share and diluted earnings per share.

<i>Millions of Dollars, Except Per Share Amounts</i>	<i>Three Months Ended March 31,</i>	
	<i>2003</i>	<i>2002</i>
Net income, as reported .....	\$ 429	\$ 222
Stock-based employee compensation expense included in reported net income, net of tax .....	9	5
Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax .....	(15)	(9)
Pro forma net income.....	\$ 423	\$ 218
EPS - basic, as reported.....	\$1.69	\$0.89
EPS - basic, pro forma.....	\$1.67	\$0.87
EPS - diluted, as reported .....	\$1.67	\$0.86
EPS - diluted, pro forma.....	\$1.65	\$0.84

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions for options granted during the three months ended March 31, 2003 and 2002, respectively: risk-free interest rates of 2.9% and 4.4%; dividend yield of 1.5% and 1.3%; expected lives of 5 years and 5 years; and volatility of 28.4% and 28.8%.

**2. Segmentation and Operations** - Union Pacific Corporation has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnite Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 10 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

### 3. Financial Instruments

**Strategy and Risk** - The Corporation and its subsidiaries use derivative financial instruments in limited instances for other than trading purposes to manage risk related to changes in fuel prices and to achieve the Corporation's interest rate objectives. The Corporation uses swaps, futures and/or forward contracts to mitigate the downside risk of adverse price movements and hedge the exposure to variable cash flows. The use of these instruments also limits future gains from favorable movements. The Corporation uses interest rate swaps to manage its exposure to interest rate changes. The purpose of these programs is to protect the Corporation's operating margins and overall profitability from adverse fuel price changes or interest rate fluctuations.

The Corporation may also use swaptions to secure near-term swap prices. Swaptions are swaps that are extendable past their base period at the option of the counterparty. Swaptions do not qualify for hedge accounting treatment.

**Market and Credit Risk** - The Corporation addresses market risk related to derivative financial instruments by selecting instruments with value fluctuations that highly correlate with the underlying item being hedged. Credit risk related to derivative financial instruments, which is minimal, is managed by requiring high credit standards for counterparties and periodic settlements. At March 31, 2003, the Corporation has not been required to provide collateral, nor has UPC received collateral relating to its hedging activities.

**Determination of Fair Value** - The fair values of the Corporation's derivative financial instrument positions at March 31, 2003 and December 31, 2002, detailed below, were determined based upon current fair values as quoted by recognized dealers or developed based upon the present value of expected future cash flows discounted at the applicable U.S. Treasury rate, London Interbank Offered Rates (LIBOR) or swap spread.

**Interest Rate Strategy** - The Corporation manages its overall exposure to fluctuations in interest rates by adjusting the proportion of fixed and floating rate debt instruments within its debt portfolio over a given period. The mix of fixed and floating rate debt is largely managed through the issuance of targeted amounts of each as debt matures or as incremental borrowings are required. Derivatives are used as one of the tools to obtain the targeted mix. In addition, the Corporation also obtains flexibility in managing interest costs and the interest rate mix within its debt portfolio by evaluating the issuance of and managing outstanding callable fixed-rate debt securities.

Swaps allow the Corporation to convert debt from fixed rates to variable rates and thereby hedge the risk of changes in the debt's fair value attributable to the changes in the benchmark interest rate (LIBOR). The swaps have been accounted for using the short-cut method as allowed by Financial Accounting Standard (FAS) 133; therefore, no ineffectiveness has been recorded within the Corporation's Consolidated Financial Statements. In February 2003, an interest rate swap for \$150 million that contained a call option was cancelled by the counterparty at a premium of \$5 million. Similarly, the Corporation exercised its option to redeem the underlying hedged debt. In March 2003, the Corporation entered into an interest rate swap on \$250 million of debt with a maturity of October 2007.

**Fuel Strategy** - Fuel costs are a significant portion of the Corporation's total operating expenses. As a result of the significance of fuel costs and the historical volatility of fuel prices, the Corporation's transportation subsidiaries use swaps, futures and/or forward contracts to mitigate the impact of adverse fuel price changes. In addition, the Corporation's transportation subsidiaries at times may use collars to manage risk related to changes in fuel prices.

The following is a summary of the Corporation's derivative financial instruments at March 31, 2003 and December 31, 2002:

<i>Millions, Except Percentages and Average Commodity Prices</i>	<i>Mar. 31, 2003</i>	<i>Dec. 31, 2002</i>
<b>Interest rate hedging:</b>		
Amount of debt hedged .....	\$ 998	\$ 898
Percentage of total debt portfolio .....	13%	12%
<b>Fuel hedging:</b>		
<b>Swaptions</b>		
Number of gallons hedged for 2002 [a] .....	-	552
Average price of 2002 hedges (per gallon) [b] .....	\$ -	\$ 0.56
Number of gallons hedged for the remainder of 2003 [c] .....	66	88
Average price of 2003 hedges outstanding (per gallon) [b] .....	\$ 0.58	\$ 0.58
<b>Collars:</b>		
Number of gallons hedged for 2003 [d] .....	57	-
Average cap price [b] .....	\$ 0.89	\$ -
Average floor price [b] .....	\$ 0.60	\$ -

[a] Fuel hedges expired December 31, 2002. Fuel hedges included the swap portion of a swaption with a base term expiring December 31, 2002

[b] Excluding taxes, transportation costs and regional pricing spreads.

[c] Fuel hedges which are in effect during 2003. These hedges expire December 31, 2003.

[d] Fuel collars expire June 30, 2003.

The fair value asset positions of the Corporation's outstanding derivative financial instruments at March 31, 2003 and December 31, 2002 were as follows:

<i>Millions of Dollars</i>	<i>Mar. 31, 2003</i>	<i>Dec. 31, 2002</i>
<b>Interest rate hedging:</b>		
Gross fair value asset position .....	\$46	\$52
Gross fair value (liability) position .....	-	-
<b>Fuel hedging:</b>		
Gross fair value asset position .....	10	12
Gross fair value (liability) position .....	-	-
<b>Total fair value asset position .....</b>	<b>\$56</b>	<b>\$64</b>

Fuel hedging positions will be reclassified from accumulated other comprehensive income to fuel expense over the life of the hedge as fuel is consumed.

The Corporation's use of derivative financial instruments had the following impact on pre-tax income for the three months ended March 31, 2003 and 2002:

<i>Millions of Dollars</i>	<i>Three Months Ended March 31,</i>	
	<i>2003</i>	<i>2002</i>
Decrease in interest expense from interest rate hedging.....	\$ 7	\$ 5
Decrease (increase) in fuel expense from fuel hedging.....	8	(6)
Decrease in fuel expense from fuel swaptions .....	-	10
Decrease in operating expenses .....	15	9
Increase in other income from interest rate swap cancellation .....	5	-
Increase in other income, net from fuel swaptions.....	-	3
Increase in pre-tax income.....	\$20	\$12

Through March 31, 2003, the Corporation had recorded less than \$1 million for fuel hedging ineffectiveness.

**Sale of Receivables** – The Railroad has sold, on a 364-day revolving basis, an undivided percentage ownership interest in a designated pool of accounts receivable to third parties through a bankruptcy-remote subsidiary. Receivables are sold at carrying value, which approximates fair value. The third parties have designated the Railroad to service the sold receivables. The amount of receivables sold fluctuates based upon the availability of the designated pool of receivables and is directly affected by changing business volumes and credit risks. Payments collected from sold receivables can be reinvested in new receivables on behalf of the buyers. Should the Corporation's credit rating fall below investment grade, the amount of receivables sold would be reduced, and in certain cases, the buyers have the right to discontinue this reinvestment, thus requiring the Railroad to fund the receivables. At March 31, 2003 and December 31, 2002, accounts receivable are presented net of \$590 million and \$600 million of receivables sold, respectively. In May 2003, the sale of receivables program was extended for 90 days without any significant term changes with the intent to renew the program for one year.

#### **4. Debt**

**Credit Facilities** - On March 31, 2003, the Corporation had \$1.925 billion in revolving credit facilities available, of which \$925 million expires in March 2004, with the remaining \$1.0 billion expiring in 2005. The facilities, which were entered into during March 2003 and March 2000, respectively, are designated for general corporate purposes and none of the credit facilities were used as of March 31, 2003. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers.

**Convertible Preferred Securities** - Union Pacific Capital Trust (the Trust), a statutory business trust sponsored and wholly owned by the Corporation, has issued 6-1/4% Convertible Preferred Securities (the CPS) with an aggregate liquidation amount of \$1.5 billion. Each of the CPS has a stated liquidation amount of \$50 and is convertible, at the option of the holder, into shares of UPC's common stock, par value \$2.50 per share (the Common Stock), at the rate of 0.7257 shares of Common Stock for each of the CPS, equivalent to a conversion price of \$68.90 per share of Common Stock, subject to adjustment under certain circumstances. The CPS accrue and pay cash distributions quarterly in arrears at the annual rate of 6-1/4% of the stated liquidation amount. The Corporation owns all of the common securities of the Trust. The proceeds from the sale of the CPS and the common securities of the Trust were invested by the Trust in \$1.5 billion aggregate principal amount of the Corporation's Convertible Junior Subordinated Debentures due 2028, which debentures represent the sole assets of the Trust. For financial reporting purposes, the Corporation has recorded distributions payable on the CPS as interest expense in the Consolidated Statements of Income.

**Partial Redemption of Convertible Preferred Securities** - On April 16, 2003, the Corporation announced that it would exercise its option to redeem \$500 million of the \$1.5 billion CPS. The redemption will take place on May 16, 2003 and will reduce the Corporation's annual interest expense related to the CPS by \$19.5 million in 2003 and by \$31.3 million in subsequent years, and will decrease the dilutive effect of the CPS on earnings per share by 7.3 million shares. The CPS were originally offered on April 1, 1998 at a price of \$50 each and will be redeemed at a price of

\$50.52, which includes a one percent redemption premium. The Corporation will incur a one-time pre-tax charge of \$15 million associated with the redemption in the second quarter of 2003.

**Shelf Registration Statement and Significant New Borrowings** - Under the current shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. During February 2003, under the shelf registration, the Corporation issued \$250 million of 3-7/8% fixed rate debt with a maturity of February 15, 2009. The proceeds of the issuance were used for repayment of debt and other general corporate purposes. At March 31, 2003, the Corporation had \$750 million remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

**5. Earnings Per Share** - The following table provides a reconciliation between basic and diluted earnings per share for the three months ended March 31, 2003 and 2002:

<i>Millions, Except Per Share Amounts</i>	<i>Three Months Ended March 31,</i>	
	<i>2003</i>	<i>2002</i>
<b>Income statement data:</b>		
Income from continuing operations before cumulative effect of accounting change.....	\$148	\$216
Income from discontinued operations .....	7	6
Cumulative effect of accounting change .....	274	-
Net income available to common shareholders – basic .....	\$429	\$222
Dilutive effect of interest associated with the CPS.....	-	15
Net income available to common shareholders – diluted .....	\$429	\$237
<b>Weighted average number of shares outstanding:</b>		
Basic .....	253.4	251.0
Dilutive effect of stock options .....	1.0	2.5
Dilutive effect of retention shares, stock units and restricted stock.....	1.8	0.9
Dilutive effect of CPS.....	-	21.8
Diluted .....	256.2	276.2
<b>Earnings per share – basic:</b>		
Income from continuing operations before cumulative effect of accounting change.....	\$0.58	\$0.86
Income from discontinued operations .....	0.03	0.03
Cumulative effect of accounting change .....	1.08	-
Net income.....	\$1.69	\$0.89
<b>Earnings per share – diluted:</b>		
Income from continuing operations before cumulative effect of accounting change.....	\$0.57	\$0.84
Income from discontinued operations .....	0.03	0.02
Cumulative effect of accounting change .....	1.07	-
Net income.....	\$1.67	\$0.86

Common stock options totaling 6.3 million and 2.1 million shares for the three months ended March 31, 2003 and 2002, respectively, were excluded from the computation of diluted EPS because the exercise prices of these options exceeded the average market price of the Corporation's common stock for the respective periods, and the effect of their inclusion would be anti-dilutive. Also excluded from the three months ended March 31, 2003, were 21.8 million shares related to the CPS, as the inclusion of these securities would result in an anti-dilutive effect on earnings per share before the cumulative effect of accounting change.

**6 Other Income** - Other income included the following for the three months ended March 31, 2003 and 2002:

<i>Millions of Dollars</i>	<i>Three Months Ended March 31,</i>	
	<i>2003</i>	<i>2002</i>
Net gain on non-operating asset dispositions .....	\$10	\$ 8
Rental income .....	12	12
Interest income.....	3	2
Other, net.....	(12)	(1)
Total.....	\$13	\$21

**7. Commitments and Contingencies**

**Unasserted Claims** - There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries, in addition to unasserted claims. It is not possible at this time for the Corporation to determine fully the effect of all such claims on its consolidated financial condition, results of operations or liquidity; however, to the extent possible, where unasserted claims can be estimated and where such claims are considered probable, the Corporation has recorded a liability. The Corporation does not expect that any known lawsuits or claims, including unasserted claims, will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

**Personal Injury and Occupational Illness** - The cost of injuries to employees and others related to Railroad activities or in accidents involving the trucking segment is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year. The three month expenses for the Corporation's personal injury-related events were \$59 million and \$56 million in 2003 and 2002, respectively. As of March 31, 2003, the Corporation had a liability of \$637 million accrued for personal injury costs, of which \$274 million was recorded as a current liability. The Railroad has additional amounts accrued for claims related to certain occupational illnesses. Compensation for Railroad work-related accidents is governed by the Federal Employers' Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. The Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work.

**Environmental** - The Corporation generates and transports hazardous and nonhazardous waste in its current operations and has done so in its former operations, and it is subject to federal, state and local environmental laws and regulations. The Corporation has identified approximately 415 active sites at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 52 sites that are the subject of actions taken by the U.S. government, 27 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to other parties, in addition to costs relating to its own activities at each site.

When an environmental issue has been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its external consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

As of March 31, 2003, the Corporation had a liability of \$192 million accrued for future environmental costs, of which \$71 million was recorded in current liabilities as accrued casualty costs. The liability includes future costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties, and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved,

site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites and/or the speculative nature of remediation costs. The Corporation expects to pay out the majority of the March 31, 2003 environmental liability over the next five years, funded by cash generated from operations. The impact of current obligations is not expected to have a material adverse effect on the results of operations, financial condition or liquidity of the Corporation.

**Other Matters** - The Corporation and its subsidiaries periodically enter into financial and other commitments in connection with their businesses. It is not possible at this time for the Corporation to determine fully the effect of all unasserted claims on its consolidated financial condition, results of operations or liquidity; however, to the extent possible, where unasserted claims can be estimated and where such claims are considered probable, the Corporation has recorded a liability. The Corporation does not expect that any known lawsuits, claims, environmental costs, commitments, contingent liabilities or guarantees will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

At March 31, 2003, the Corporation had unconditional purchase obligations of \$236 million for the acquisition of locomotives as part of the Corporation's multi-year capital asset acquisition plan. In addition, the Corporation was contingently liable for \$382 million in guarantees and \$52 million in letters of credit at March 31, 2003. These contingent guarantees were entered into in the normal course of business and include guaranteed obligations of affiliated operations. The Corporation is not aware of any existing event of default, which would require it to satisfy these guarantees.

**8 Accounting Pronouncements** - In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to existing entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. As described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In accordance with FIN 46, the Railroad will either consolidate, restructure or refinance the synthetic lease prior to July 1, 2003. The Corporation does not expect FIN 46 to have any impact on the treatment of the Sale of Receivables program.

On April 30, 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (FAS 149). FAS 149 amends FAS 133 for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. FAS 149 also amends certain other existing pronouncements. It will require contracts with comparable characteristics to be accounted for similarly. In particular, FAS 149 clarifies when a contract with an initial net investment meets the characteristic of a derivative and clarifies when a derivative that contains a financing component will require special reporting in the statement of cash flows. FAS 149 is effective for the Corporation for contracts entered into or modified after June 30, 2003. The Corporation is evaluating the impact of adopting the requirements of FAS 149.

**9. Cumulative Effect of Accounting Change** - Surface Transportation Board (STB) accounting rules require that railroads accrue the cost of removing track structure over the expected useful life of these assets. Railroads historically used this prescribed accounting for reports filed with both the STB and SEC. In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). This statement was effective for the Corporation beginning January 1, 2003, and prohibits the accrual of removal costs unless there is a legal obligation to remove the track structure at the end of its life. The Corporation concluded that it did not have a legal obligation to remove the track structure, and therefore, under generally accepted accounting principles, the Corporation could not accrue the cost of removal in advance. Reports filed with the SEC will reflect the cost of removing these assets in the period in which they are removed. For STB reporting requirements only, the Corporation will continue to follow the historical method of accruing in advance, as prescribed by the STB. FAS 143

also requires the Corporation to record a liability for legally obligated asset retirement costs associated with tangible long-lived assets. At March 31, 2003, the Corporation's liability for legally obligated asset retirement costs was \$17 million. In the first quarter of 2003, the Corporation recorded income from a cumulative effect of accounting change, related to the adoption of FAS 143, of \$274 million, net of tax of \$167 million. The accounting change has no effect on the Corporation's liquidity. Had the change been retroactively applied, the change would have had an immaterial impact on net income and earnings per share and the following effect on operating expenses within the Corporation's Consolidated Statements of Income for the three months ended March 31, 2003 and 2002:

<i>Operating Expenses (In millions)</i>	<i>2003</i>	<i>2002 Actual</i>	<i>SFAS 143 Adjustments</i>	<i>2002 Pro Forma</i>
Salaries, wages and employee benefits.....	\$964	\$913	\$28	\$941
Equipment and other rents.....	310	315	-	315
Depreciation.....	275	284	(23)	261
Fuel and utilities.....	352	225	-	225
Materials and supplies.....	103	121	(5)	116
Casualty costs.....	101	84	-	84
Purchased services and other costs.....	262	231	3	234
<b>Total.....</b>	<b>\$2,367</b>	<b>\$2,173</b>	<b>\$ 3</b>	<b>\$2,176</b>

## **10. Discontinued Trucking Segment**

On August 4, 2003, UPC announced its intention to effect a sale of its entire trucking interest. On November 5, 2003, UPC completed the sale of its entire trucking interest through an initial public offering. In order to facilitate this offering, immediately prior to the consummation of the offering, Overnite Corporation, a newly formed corporation, acquired from UPC all of the outstanding common stock of Overnite Holding, Inc., a wholly owned subsidiary of UPC and the ultimate parent holding company of OTC and Motor Cargo. In exchange, Overnite Corporation issued to UPC (1) all of its outstanding common stock and (2) a \$1.0 million promissory note payable by Overnite Corporation six months following the date of consummation of the acquisition. In addition, subsequent to this transaction but immediately prior to the consummation of the offering, Overnite Holding, Inc. paid to UPC a previously declared dividend consisting of \$128 million in cash and the forgiveness of net intercompany advances from Overnite to UPC as of the date of the transaction between Overnite Corporation and UPC. The cash portion of the dividend payable to UPC was made from the proceeds of an initial borrowing under a new Overnite credit facility. UPC, as the selling shareholder, sold all of the common stock of Overnite Corporation in an underwritten initial public offering and received all of the proceeds of the offering, less discounts and commissions paid to the underwriters and estimated expenses.

The entire trucking segment of UPC was reclassified as a discontinued operation during the period covered by this report, which includes the reclassification of the segment as a discontinued operation for all periods presented.

The following table presents a statement of financial position for the discontinued operations as of March 31, 2003 and December 31, 2002:

<i>Millions of Dollars</i>	<i>March 31, 2003</i>	<i>December 31, 2002</i>
Current assets .....	\$240	\$254
Properties, net.....	496	501
Other assets .....	51	27
<b>Total assets .....</b>	<b>787</b>	<b>782</b>
Current liabilities .....	176	179
Noncurrent liabilities .....	145	128
<b>Total liabilities .....</b>	<b>321</b>	<b>307</b>
<b>Net assets of discontinued operations .....</b>	<b>\$466</b>	<b>\$475</b>
Accumulated other comprehensive income.....	\$ 84	\$ 84

The March 31, 2003 and December 31, 2002 numbers vary from those recorded in the Overnite Corporation final Prospectus dated October 30, 2003, due primarily to the classification of deferred taxes, as well as the elimination of intercompany receivables for consolidated financial statement purposes.

The following table presents the revenues and income before income taxes for the discontinued operations for the three months ended March 31, 2003 and 2002:

<i>Millions of Dollars</i>	<i>2003</i>	<i>2002</i>
Revenues .....	\$341	\$309
Income before income taxes.....	\$ 12	\$ 10

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES RESULTS OF OPERATIONS**

#### **Three Months Ended March 31, 2003 Compared to Three Months Ended March 31, 2002**

Union Pacific Corporation has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnite Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 10 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

A copy of this Current Report on Form 8-K, as well as the Corporation's 2002 Annual Report on Form 10-K, current reports on Form 8-K and any amendments to those reports are available free of charge on the Internet at the Corporation's website at [www.up.com/investors](http://www.up.com/investors). Additionally, the Corporation's corporate governance materials, including Board Committee charters, governance guidelines and policies and codes of conduct and ethics for directors, officers and employees may also be found on the Internet at the Corporation's website at [www.up.com/investors](http://www.up.com/investors).

#### **Critical Accounting Policies and Estimates**

The Corporation's discussion and analysis of its financial condition and results of operations are based upon its Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires estimation and judgment that affect the reported amounts of revenues, expenses, assets and liabilities. The Corporation bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. If these estimates differ materially from actual results, the impact on the Consolidated Financial Statements may be material. The Corporation's critical accounting policies are available in the Corporation's Annual Report on Form 10-K, Item 7.

#### **Operations**

**Net Income** – The Corporation reported net income of \$429 million (\$1.69 per basic share and \$1.67 per diluted share) in the first quarter of 2003, compared to \$222 million (\$0.89 per basic share and \$0.86 per diluted share) in the first quarter of 2002. Income from continuing operations before the cumulative effect of accounting change was \$148 million (\$0.58 per basic share and \$0.57 per diluted share) in the first quarter of 2003 compared to \$216 million (\$0.86 per basic share and \$0.84 per diluted share) in 2002. The decrease in income from continuing operations before the cumulative effect of accounting change resulted from lower operating income which was only partially offset by lower interest expense. Operating income declined as revenue growth and productivity gains were surpassed by fuel costs, wage and benefit inflation and higher volume-related costs. Productivity is calculated as both gross ton miles per inflation-adjusted expense dollar and gross ton miles per employee.

**Operating Revenues** – Operating revenue is comprised of commodity revenue and other revenues. Other revenues primarily include subsidiary revenue from various companies that are wholly owned or majority owned by the Railroad, revenue from the Chicago commuter rail operations and accessorial revenue earned due to customer detainment of Railroad owned or controlled equipment. Operating revenues increased \$74 million (3%) to \$2.7 billion. First quarter rail commodity revenues increased \$59 million (2%) to \$2.6 billion compared to 2002. First quarter revenue carloads increased 1% compared to a year ago, with the highest growth in the Automotive and

Industrial Products commodity groups. Average revenue per car increased 2% to \$1,188. Other revenues increased 13% to \$129 million in the first quarter compared to a year ago.

The following tables summarize the year-over-year changes in rail commodity revenue, revenue carloads and average revenue per car by commodity type:

<i>Commodity Revenue</i> <i>Millions of Dollars</i>	<i>Three Months Ended</i>		<i>%</i> <i>Change</i>
	<i>2003</i>	<i>Mar. 31,</i> <i>2002</i>	
Agricultural.....	\$ 373	\$ 369	1
Automotive.....	302	283	7
Chemicals.....	394	385	2
Energy.....	561	582	(4)
Industrial Products.....	510	474	8
Intermodal.....	467	455	2
<b>Total.....</b>	<b>\$2,607</b>	<b>\$2,548</b>	<b>2</b>

<i>Revenue Carloads</i> <i>Thousands</i>	<i>Three Months Ended</i>		<i>%</i> <i>Change</i>
	<i>2003</i>	<i>Mar. 31,</i> <i>2002</i>	
Agricultural.....	214	217	(1)
Automotive.....	207	193	7
Chemicals.....	219	218	1
Energy.....	521	545	(4)
Industrial Products.....	340	324	5
Intermodal.....	693	681	2
<b>Total.....</b>	<b>2,194</b>	<b>2,178</b>	<b>1</b>

<i>Average Revenue</i> <i>Per Car</i>	<i>Three Months Ended</i>		<i>%</i> <i>Change</i>
	<i>2003</i>	<i>Mar. 31,</i> <i>2002</i>	
Agricultural.....	\$1,741	\$1,701	2
Automotive.....	1,462	1,462	-
Chemicals.....	1,796	1,771	1
Energy.....	1,077	1,068	1
Industrial Products.....	1,498	1,461	3
Intermodal.....	674	668	1
<b>Total.....</b>	<b>\$1,188</b>	<b>\$1,170</b>	<b>2</b>

*Agricultural* - Revenue increased 1% in the first quarter of 2003. Sugar beet volume increased as unfavorable weather conditions in the fourth quarter 2002 caused shipments to be delayed until January. Ethanol shipments increased due to heightened demand for the fuel additive. Weak domestic and export demand for wheat, in addition to reduced corn exports to Mexico, offset these increases. Average revenue per car increased due to the positive mix impact of longer average length of haul shipments, as well as price increases that were partially related to fuel surcharges.

*Automotive* - Revenue increased 7% for the first quarter of 2003 driven by an increase in carloads. The volume growth was due to market share gains for materials shipments, in addition to higher production levels for domestic manufacturers. Average revenue per car was flat as price increases were offset by the mix impact of disproportionate growth in materials shipments, which move at a lower average revenue per car than finished vehicles.

*Chemicals* - Revenue increased 2% for the first quarter of 2003. Volume growth of 1% was driven by higher general demand for domestic fertilizer, soda ash and liquid and dry chemical shipments. A decline in plastics shipments, due to market uncertainty caused by the war and higher input costs which caused producers to lower inventories, partially offset the increases. Average revenue per car increased 1% due to a mix shift towards longer average length of haul business, in addition to price increases that were partially related to fuel surcharges.

*Energy* - Revenue decreased 4% for the first quarter of 2003 due to a 4% decline in carloads. The volume decline was led by the absence of export traffic from the Colorado and Utah mining regions, which Japan is now sourcing from other Far Eastern producers. In addition, a severe snowstorm in March caused an estimated loss of 71 trains out of the Southern Powder River Basin and Colorado and Utah mining regions. Average revenue per car increased 1%, primarily due to price increases that were partially related to fuel surcharges.

*Industrial Products* - Revenue increased 8% for the first quarter of 2003 driven by a 5% increase in carloads combined with a 3% increase in average revenue per carload. The volume increase was led by shipments of military equipment and ammunition in support of the war effort. Steel and scrap shipments increased as the weakening dollar created higher domestic and export demand for U.S. produced steel, augmented by market share gains. Demand for paperboard, partially due to lower inventories, also contributed to volume gains. Average revenue per car increased as a result of price increases and a greater mix of longer average length of haul business, notably government shipments.

*Intermodal* - Revenue increased 2% for the first quarter of 2003 as a result of a 2% increase in carloads. The additional volume was due to domestic market penetration gained through the Railroad's domestic strategy to penetrate the over-the-road markets. Strong market growth for international business was offset by penetration losses. Average revenue per car increased 1% due to price increases, primarily relating to fuel surcharges and contract index-based escalators.

*Mexico Business* - Included in the rail commodity revenue reported above, Mexican related revenue decreased 2% to \$206 million for the first quarter of 2003 over the comparable period in 2002. Reduced corn exports were the primary reason for the decline. The Mexican government delayed the issue of corn export permits for 2003 until late in the quarter. Partially offsetting the decline was increased steel business to and from Mexico.

**Operating Expenses** - First quarter operating expenses increased \$194 million (9%) to \$2.4 billion compared to 2002. In the first quarter, higher fuel prices, inflation and volume-related costs were partially offset by savings from lower employee force levels, productivity improvements and cost control.

*Salaries, Wages and Employee Benefits* - Salaries, wages and employee benefits increased \$51 million (6%) in the first quarter of 2003 compared to 2002. Increases were driven by inflation, the impact of FAS 143, protection costs and severance costs. Salaries, wages and benefits increased \$28 million due to the adoption of FAS 143 and were up \$23 million (3%) as inflation, higher protection cost expense and the 2003 severance program offset a 2% reduction in employee force levels. Protection cost represents the differential payment when the wage earned for active employment is lower than an employee's "protected" rate of pay (an historic average). An individual's protected rate is imposed by the STB for employees adversely affected by a merger and is established by collective bargaining agreement in other cases.

*Equipment and Other Rents* - Equipment and other rents primarily includes rental expense UPRR pays for freight cars owned by other railroads or private companies; freight car, intermodal and locomotive leases; other specialty equipped vehicle leases; and office and other rentals. Expenses decreased \$5 million (2%) in the first quarter compared to 2002. The decrease was due primarily to lower car cycle times (the average number of accumulated days that loaded and empty cars from other railroads spend on UPRR's system) coupled with lower expenses for car and other costs in the period. The decrease in car cycle times is partially attributable to increased volume demand and better car utilization. Partially offsetting the decrease was an increase in locomotive leases. The increase in volume costs is related to an increase in carloads in certain commodity types such as automotive, industrial products, intermodal and chemicals that utilize a high percentage of rented freight cars. The higher locomotive lease expense is due to UPRR's increased leasing of new, more reliable and fuel efficient locomotives. These new locomotives

replaced older, non-leased models in the fleet, which helped reduce expenses for depreciation, labor, materials and fuel during the period.

*Depreciation* - The majority of depreciation relates to track structure, including rail, ties and other track material. Depreciation expense decreased \$9 million (3%) in the first quarter of 2003 compared to 2002. The adoption of FAS 143 decreased depreciation by \$24 million, while capital spending in recent years increased depreciation by \$15 million. Full year capital spending totaled \$1.7 billion in 2002 and \$1.6 billion in 2001.

*Fuel and Utilities* - Fuel and utilities is comprised of locomotive fuel, utilities other than telephone, gasoline and other fuels. Expenses increased \$127 million (56%) in the first quarter of 2003 compared to a year ago. The increase was driven by higher fuel prices minimally offset by a lower fuel consumption rate, as measured by gallons consumed per thousand gross ton miles. Fuel prices averaged \$1.00 per gallon in the first quarter of 2003 compared to 61 cents per gallon in the first quarter of 2002 (price includes taxes and transportation costs). Higher fuel prices in 2003 resulted in a \$125 million increase in fuel expense in the first quarter compared to 2002. The lower consumption rate decreased fuel expense by \$3 million in the first quarter. A 1% increase in gross ton miles increased fuel expense by \$1 million in the first quarter. The Railroad hedged approximately 7% of its fuel consumption for the first quarter, which decreased fuel costs by \$8 million. As of March 31, 2003, expected fuel consumption for the remainder of 2003 is 7% hedged at 58 cents per gallon (excluding estimated taxes, transportation costs and regional pricing spreads). For the second quarter of 2003, UPRR has also entered into costless collar transactions with average floors and ceilings of 60 cents and 89 cents per gallon, respectively, excluding taxes, transportation costs and regional pricing spreads, for approximately 17% of expected second quarter volumes. Gasoline, utilities and propane expenses increased \$4 million in the first quarter primarily due to higher fuel prices.

*Materials and Supplies* - Material used for the maintenance of the Railroad's lines, structures and equipment is the principal component of materials and supplies expense. Office, small tools and other supplies and the costs of freight services purchased to ship company materials are also included. Expenses decreased \$18 million (15%) in the first quarter, primarily reflecting the impact of FAS 143 as well as lower engineering and freight car repairs and lower other costs.

*Casualty Costs* - The largest component of casualty costs is personal injury expense. Freight and property damage, insurance, environmental matters and occupational illness expense are also included in casualty costs. Costs increased \$17 million (20%) in the first quarter compared to 2002 due to higher insurance, freight damage and personal injury expenses.

*Purchased Services and Other Costs* - Purchased services and other costs include the costs of services purchased from outside contractors, state and local taxes, net costs of operating facilities jointly used by UPRR and other railroads, transportation and lodging for train crew employees, trucking and contracting costs for intermodal containers, leased automobile maintenance expenses, telephone and cellular expense, employee travel expense and computer and other general expenses. Expenses increased \$31 million (13%) in the first quarter compared to last year primarily due to increased purchases for locomotive, engineering and other contracts, coupled with higher state and local taxes and intermodal volume costs.

**Operating Income** - Operating income decreased \$120 million (25%) to \$369 million in the first quarter compared to \$489 million in 2002. The decrease in operating income in the period is attributable to higher fuel prices, wage and benefit inflation and volume-related costs that were partially offset by higher revenues and cost control efforts.

**Non-Operating Items** - Interest expense decreased \$12 million (7%) in the first quarter compared to 2002 due to lower interest rates and a lower average debt level in 2003. In the three months ended March 31, 2003, the Corporation's average debt level, including the CPS, decreased to \$9.2 billion from \$9.7 billion for the same period in 2002. The Corporation's effective interest rate was 6.5% during the first quarter of 2003 compared to 6.7% in 2002. Other income decreased \$8 million (38%) in the first quarter compared to 2002 due primarily to loss on foreign currency translation related to the dividend received from Grupo Ferroviario Mexicano, S.A. de C.V., early extinguishment of debt costs and the absence of favorable fuel swaptions in 2003. Income tax expense decreased \$48

million (37%) in the first quarter compared to 2002, due to lower pre-tax income in 2003 and foreign tax credits recorded on the Corporation's investment in Grupo Ferroviario Mexicano, S.A. de C.V.

**Other Key Measures** – Operating margin (operating income as a percentage of operating revenues) decreased to 13.5% in the first quarter of 2003 from 18.4% in the same period of 2002, primarily driven by higher fuel prices.

### **Discontinued Operations**

For the first quarter, trucking revenues increased \$32 million (10%) to \$341 million compared to the same period in 2002. The first quarter revenues were positively impacted by higher volumes (5%) due primarily to additional business realized as a result of the forced closure of Consolidated Freightways in September 2002, in addition to price increases, including fuel surcharges and rate increases. Operating income increased \$2 million (20%) to \$13 million in the first quarter. The operating margin for the first quarter was 3.7%, compared to 3.4% in 2002. For the first quarter, income from discontinued operations was \$7 million compared to \$6 million in 2002.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Financial Condition**

Cash provided by operations was \$320 million in the first three months of 2003 compared to \$342 million in 2002. The decrease is the result of lower income before the cumulative effect of accounting change and \$50 million of cash paid to fund the pension plan in 2003, partially offset by improved working capital.

Cash used in investing activities was \$462 million in the first three months of 2003 compared to \$481 million in 2002. The decreased use of cash is due to the receipt of \$96 million of dividends from Grupo Ferroviario Mexicano, S.A. de C.V. , partially offset by increased capital expenditures. The following table details capital expenditures for the three months ended March 31, 2003 and 2002:

<i>Capital Expenditures</i> <i>Millions</i>	<i>2003</i>	<i>2002</i>
Track.....	\$298	\$283
Locomotives .....	32	6
Freight cars .....	5	1
Facilities and other .....	77	63
<b>Total.....</b>	<b>\$412</b>	<b>\$353</b>

Cash provided by financing activities was \$80 million in the first three months of 2003 compared to \$137 million in the first three months of 2002. The decrease in cash provided is due to lower financings (\$335 million in 2003 compared to \$428 million in 2002) and less cash received from option exercises (\$10 million in 2003 compared to \$60 million in 2002), partially offset by lower debt repayments (\$207 million in 2003 compared to \$301 million in 2002).

For the three months ended March 31, 2003 and 2002, the Corporation's ratio of earnings to fixed charges was 2.8 and 2.9, respectively. The ratio of earnings to fixed charges has been computed on a consolidated basis. Earnings represent income from continuing operations less equity in undistributed earnings of unconsolidated affiliates, plus fixed charges and income taxes. Fixed charges represent interest charges, amortization of debt discount and the estimated amount representing the interest portion of rental charges.

### **Contractual Obligations and Commercial Commitments**

As described in the notes to the Consolidated Financial Statements and as referenced in the tables below, the Corporation has contractual obligations and commercial commitments that may affect the financial condition of the Corporation. However, based on management's assessment of the underlying provisions and circumstances of the

material contractual obligations and commercial commitments of the Corporation, including material sources of off-balance sheet and structured finance arrangements, there is no known trend, demand, commitment, event or uncertainty that is reasonably likely to occur which would have a material effect on the Corporation's financial condition, results of operations or liquidity. In addition, the commercial obligations, financings and commitments made by the Corporation are customary transactions, which are similar to those of other comparable industrial corporations, particularly within the transportation industry.

The following tables identify material obligations and commitments as of March 31, 2003:

<i>Contractual Obligations</i> <i>Millions of Dollars</i>	<i>Total</i>	<i>Payments Due by Period</i>			
		<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
Debt [a] .....	\$ 6,365	\$166	\$1,489	\$1,295	\$3,415
Operating leases .....	3,163	414	765	562	1,422
Capital lease obligations [b].....	2,364	203	414	357	1,390
Unconditional purchase obligations [c] .....	236	101	135	-	-
<b>Total contractual obligations .....</b>	<b>\$12,128</b>	<b>\$884</b>	<b>\$2,803</b>	<b>\$2,214</b>	<b>\$6,227</b>

[a] Excludes capital lease obligations of \$1,420 million, and market value adjustments for debt with qualifying hedges that are recorded as assets on the Consolidated Statements of Financial Position.

[b] Represents total obligations, including interest component.

[c] Unconditional purchase obligations represent multi-year contractual commitments to purchase or acquire assets at fixed prices and fixed volumes. These commitments are made in order to take advantage of pricing opportunities and to ensure availability of assets to meet quality and operational requirements. Excluded are contracts made in the normal course of business for performance of routine services, as well as commitments where contract provisions allow for cancellation.

<i>Other Commercial Commitments</i> <i>Millions of Dollars</i>	<i>Total Amounts Committed</i>	<i>Amount of Commitment Expiration Per Period</i>			
		<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
Credit facilities .....	\$1,925	\$ 925	\$1,000	\$ -	\$ -
Convertible preferred securities .....	1,500	-	-	-	1,500
Sale of receivables .....	600	600	-	-	-
Guarantees [a].....	382	17	19	13	333
Standby letters of credit .....	52	52	-	-	-
<b>Total commercial commitments .....</b>	<b>\$4,459</b>	<b>\$1,594</b>	<b>\$1,019</b>	<b>\$13</b>	<b>\$1,833</b>

[a] Includes guaranteed obligations of affiliated operations.

## Financing Activities

**Credit Facilities** - On March 31, 2003, the Corporation had \$1.925 billion in revolving credit facilities available, of which \$925 million expires in March 2004, with the remaining \$1.0 billion expiring in 2005. The facilities, which were entered into during March 2003 and March 2000, respectively, are designated for general corporate purposes and none of the credit facilities were used as of March 31, 2003. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers.

**Shelf Registration Statement and Significant New Borrowings** - Under the current shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. During February 2003, under the shelf registration, the Corporation issued \$250 million of 3-7/8% fixed rate debt with a maturity of February 15, 2009. The proceeds of the issuance were used for repayment of debt and other general corporate purposes. At March 31,

2003, the Corporation had \$750 million remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

**Partial Redemption of Convertible Preferred Securities** - On April 16, 2003, the Corporation announced that it would exercise its option to redeem \$500 million of the \$1.5 billion Convertible Preferred Securities (CPS). The redemption will take place on May 16, 2003 and will reduce the Corporation's annual interest expense related to the CPS by \$19.5 million in 2003 and by \$31.3 million in subsequent years, and will decrease the dilutive effect of the CPS on earnings per share by 7.3 million shares. The CPS were originally offered on April 1, 1998 at a price of \$50 each and will be redeemed at a price of \$50.52, which includes a one percent redemption premium. The Corporation will incur a one-time pre-tax charge of \$15 million associated with the redemption in the second quarter of 2003.

## **OTHER MATTERS**

**Commitments and Contingencies** - There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries. The Corporation is also subject to various federal, state and local environmental laws and regulations, pursuant to which it is currently participating in the investigation and remediation of various sites. A discussion of certain claims, lawsuits, contingent liabilities and guarantees is set forth in note 7 to the Consolidated Financial Statements, which discussion is incorporated herein by reference.

**Pensions** - During the first quarter of 2003, the Corporation decreased its assumed rate of return on pension plan assets from 9% to 8%. This assumption change will result in an increase to 2003 pension expense of \$14 million. During the first quarter of 2003 the Railroad voluntarily contributed \$50 million to its pension plan.

**Dividend Receivable** - The Corporation owns a 26% interest in Grupo Ferroviario Mexicano, S.A. de C.V. (GFM). GFM operates a major railway system in Mexico. During 2002, the Corporation recorded a dividend receivable from GFM of approximately \$118 million. As of December 31, 2002, the Corporation had received approximately \$20 million of the dividend. During the first quarter of 2003, the Corporation received the remaining dividend.

**Work Force Reduction** - During the first quarter of 2003, the Corporation incurred \$14 million, pre-tax, related to the reduction of approximately 295 administrative positions through involuntary severance.

**Accounting Pronouncements** - In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to existing entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. As described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In accordance with FIN 46, the Railroad will either consolidate, restructure or refinance the synthetic lease prior to July 1, 2003. The Corporation does not expect FIN 46 to have any impact on the treatment of the Sale of Receivables program.

On April 30, 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (FAS 149). FAS 149 amends FAS 133 for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. FAS 149 also amends certain other existing pronouncements. It will require contracts with comparable characteristics to be accounted for similarly. In particular, FAS 149 clarifies when a contract with an initial net investment meets the characteristic of a derivative and clarifies when a derivative that contains a financing component will require special reporting in the statement of cash flows. FAS 149 is effective for the Corporation for contracts entered into or modified after June 30, 2003. The Corporation is evaluating the impact of adopting the requirements of FAS 149.

## CAUTIONARY INFORMATION

Certain statements in this report are, and statements in other material filed or to be filed with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Corporation) are, or will be, forward-looking statements as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. These forward-looking statements include, without limitation, statements regarding: expectations as to operational improvements; expectations as to cost savings, revenue growth and earnings; the time by which certain objectives will be achieved; estimates of costs relating to environmental remediation and restoration; proposed new products and services; expectations that claims, lawsuits, environmental costs, commitments, contingent liabilities, labor negotiations or agreements, or other matters will not have a material adverse effect on the Corporation's consolidated financial position, results of operations or liquidity; and statements concerning projections, predictions, expectations, estimates or forecasts as to the Corporation's and its subsidiaries' business, financial and operational results, and future economic performance, statements of management's goals and objectives and other similar expressions concerning matters that are not historical facts.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times that, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements.

Important factors that could affect the Corporation's and its subsidiaries' future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements include, but are not limited to:

- whether the Corporation and its subsidiaries are fully successful in implementing their financial and operational initiatives;
- industry competition, conditions, performance and consolidation;
- legislative and regulatory developments, including possible enactment of new tax rates and possible enactment of initiatives to re-regulate the rail industry;
- natural events such as severe weather, fire, floods and earthquakes;
- the effects of adverse general economic conditions, both within the United States and globally;
- any adverse economic or operational repercussions from terrorist activities and any governmental response thereto;
- war or risk of war;
- changes in fuel prices;
- changes in labor costs;
- labor stoppages; and
- the outcome of claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion and exposure to asbestos and diesel fumes.

Forward-looking statements speak only as of the date the statement was made. The Corporation assumes no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. If the Corporation does update one or more forward-looking

statements, no inference should be drawn that the Corporation will make additional updates with respect thereto or with respect to other forward-looking statements.

**EXHIBIT 12.2****Ratio of Earnings to Fixed Charges**

*Union Pacific Corporation and Subsidiary Companies  
(Unaudited)*

<i>Millions of Dollars, Except Ratios</i>	<i>Three Months Ended March 31,</i>	
	<i>2003</i>	<i>2002</i>
<b>Earnings:</b>		
Income from continuing operations.....	\$148	\$216
Undistributed equity earnings .....	54	(10)
<b>Total earnings .....</b>	<b>202</b>	<b>206</b>
<b>Income taxes .....</b>	<b>83</b>	<b>131</b>
<b>Fixed charges:</b>		
Interest expense including amortization of debt discount.....	151	163
Portion of rentals representing an interest factor .....	10	11
<b>Total fixed charges .....</b>	<b>161</b>	<b>174</b>
<b>Earnings available for fixed charges .....</b>	<b>\$446</b>	<b>\$511</b>
<b>Ratio of earnings to fixed charges.....</b>	<b>2.8</b>	<b>2.9</b>

**10-Q Amended Items for Period Ending June 30, 2002****Item 1. Consolidated Financial Statements****Consolidated Statements of Income (Unaudited)***Union Pacific Corporation and Subsidiary Companies*

<i>Millions, Except Per Share Amounts, For the Three Months Ended June 30,</i>	<i>2003</i>	<i>2002</i>
Revenues .....	\$2,894	\$2,822
Operating expenses:		
Salaries, wages and employee benefits .....	952	913
Equipment and other rents .....	298	308
Depreciation .....	253	286
Fuel and utilities .....	323	268
Materials and supplies .....	99	125
Casualty costs.....	105	97
Purchased services and other costs.....	281	242
Total operating expenses .....	2,311	2,239
Operating income .....	583	583
Other income.....	4	35
Interest expense.....	(149)	(158)
Income before income taxes.....	438	460
Income taxes .....	(163)	(167)
Income from continuing operations.....	275	293
Income from discontinued operations, net of tax of \$8 and \$8.....	13	11
Net income.....	\$ 288	\$ 304
<b>Share and Per Share</b>		
Basic:		
Income from continuing operations .....	\$ 1.08	\$ 1.16
Income from discontinued operations.....	0.05	0.05
Net income.....	\$ 1.13	\$ 1.21
Diluted:		
Income from continuing operations .....	\$ 1.05	\$ 1.11
Income from discontinued operations.....	0.05	0.04
Net income.....	\$ 1.10	\$ 1.15
Weighted average number of shares (Basic) .....	253.9	251.8
Weighted average number of shares (Diluted) .....	271.7	276.3
Dividends .....	\$ 0.23	\$ 0.20

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statements of Income (Unaudited)**  
*Union Pacific Corporation and Subsidiary Companies*

<i>Millions, Except Per Share Amounts, For the Six Months Ended June 30,</i>	<i>2003</i>	<i>2002</i>
Revenues .....	\$5,630	\$ 5,484
Operating expenses:		
Salaries, wages and employee benefits .....	1,916	1,826
Equipment and other rents .....	608	623
Depreciation .....	528	570
Fuel and utilities .....	675	493
Materials and supplies .....	202	246
Casualty costs.....	206	181
Purchased services and other costs.....	543	473
Total operating expenses .....	4,678	4,412
Operating income .....	952	1,072
Other income.....	17	56
Interest expense.....	(300)	(321)
Income before income taxes.....	669	807
Income taxes .....	(246)	(298)
Income from continuing operations before cumulative effect of accounting change.....	423	509
Income from discontinued operations, net of tax of \$13 and \$12.....	20	17
Cumulative effect of accounting change, net of tax of \$167 .....	274	-
Net income.....	\$ 717	\$ 526
<b>Share and Per Share</b>		
Basic:		
Income from continuing operations before cumulative effect of accounting change....	\$ 1.67	\$ 2.02
Income from discontinued operations.....	0.08	0.07
Cumulative effect of accounting change.....	1.08	-
Net income.....	\$ 2.83	\$ 2.09
Diluted:		
Income from continuing operations before cumulative effect of accounting change....	\$ 1.63	\$ 1.95
Income from discontinued operations.....	0.07	0.06
Cumulative effect of accounting change.....	1.01	-
Net income.....	\$ 2.71	\$ 2.01
Weighted average number of shares (Basic) .....	253.6	251.4
Weighted average number of shares (Diluted) .....	271.2	276.1
Dividends .....	\$ 0.46	\$ 0.40

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statements of Financial Position (Unaudited)***Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars</i>	<i>Jun. 30, 2003</i>	<i>Dec. 31, 2002</i>
<b>Assets</b>		
Current assets:		
Cash and temporary investments .....	\$ 495	\$ 367
Accounts receivable, net .....	514	557
Inventories .....	279	277
Current deferred income taxes .....	498	498
Other current assets .....	255	199
<b>Total current assets</b> .....	<b>2,041</b>	<b>1,898</b>
Investments:		
Investments in and advances to affiliated companies .....	674	649
Other investments .....	44	50
<b>Total investments</b> .....	<b>718</b>	<b>699</b>
Properties:		
Cost .....	37,716	36,860
Accumulated depreciation .....	(7,741)	(7,856)
<b>Net properties</b> .....	<b>29,975</b>	<b>29,004</b>
Other assets .....	419	381
Assets of discontinued operations .....	784	782
<b>Total assets</b> .....	<b>\$33,937</b>	<b>\$32,764</b>
<b>Liabilities and Common Shareholders' Equity</b>		
Current liabilities:		
Accounts payable .....	\$ 527	\$ 430
Accrued wages and vacation .....	385	365
Accrued casualty costs .....	404	419
Income and other taxes .....	271	227
Dividends and interest .....	242	253
Debt due within one year .....	170	275
Other current liabilities .....	501	554
<b>Total current liabilities</b> .....	<b>2,500</b>	<b>2,523</b>
Debt due after one year .....	8,101	7,428
Deferred income taxes .....	8,912	8,550
Accrued casualty costs .....	609	658
Retiree benefits obligation .....	794	762
Other long-term liabilities .....	395	385
Liabilities of discontinued operations .....	331	307
Company-obligated mandatorily redeemable convertible preferred securities .....	1,000	1,500
Commitments and contingencies		
Common shareholders' equity .....	11,295	10,651
<b>Total liabilities and common shareholders' equity</b> .....	<b>\$33,937</b>	<b>\$32,764</b>

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statements of Cash Flows (Unaudited)**  
Union Pacific Corporation and Subsidiary Companies

<i>Millions of Dollars, For the Six Months Ended June 30,</i>	<i>2003</i>	<i>2002</i>
<b>Operating Activities</b>		
Net income.....	\$ 717	\$ 526
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations .....	(20)	(17)
Cumulative effect of accounting change.....	(274)	-
Depreciation.....	528	570
Deferred income taxes .....	198	218
Cash paid to fund pension plan .....	(50)	-
Other, net.....	(109)	(89)
Changes in current assets and liabilities, net .....	67	(112)
Cash provided by operating activities .....	1,057	1,096
<b>Investing Activities</b>		
Capital investments.....	(863)	(822)
Proceeds from asset sales .....	42	75
Other investing activities, net .....	97	(26)
Cash used in investing activities .....	(724)	(773)
<b>Financing Activities</b>		
Dividends paid .....	(117)	(100)
Debt repaid .....	(857)	(697)
Cash received from exercise of stock options .....	39	102
Financings, net .....	730	649
Cash used in financing activities .....	(205)	(46)
Net change in cash and temporary investments.....	128	277
Cash and temporary investments at beginning of period.....	367	103
Cash and temporary investments at end of period .....	\$ 495	\$ 380
<b>Changes in Current Assets and Liabilities, Net</b>		
Accounts receivable, net .....	\$ 43	\$ (70)
Inventories .....	(2)	15
Other current assets .....	(56)	(44)
Accounts, wages and vacation payable.....	117	69
Other current liabilities .....	(35)	(82)
Total.....	\$ 67	\$(112)
Supplemental cash flow information:		
Non-cash locomotive lease financings.....	\$ 188	\$ 126
Cash (paid) received during the period for:		
Interest .....	(313)	(339)
Income taxes, net.....	23	(83)

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**Consolidated Statement of Changes in Common Shareholders' Equity (Unaudited)**  
*Union Pacific Corporation and Subsidiary Companies*

<i>Millions of Dollars, For the Six Months Ended June 30, 2003</i>	<i>[a]</i> <i>Common</i> <i>Shares</i>	<i>Paid-</i> <i>in-</i> <i>Surplus</i>	<i>Retained</i> <i>Earnings</i>	<i>[b]</i> <i>Treasury</i> <i>Stock</i>	<i>Accumulated Other Comprehensive Income (Loss)</i>			<i>Total</i>	<i>Total</i>
					<i>Minimum Pension Liability Adjustments</i>	<i>Foreign Currency Translation Adjustments</i>	<i>Derivative Adjustments</i>		
Balance at December 31, 2002...	\$689	\$3,946	\$7,597	\$(1,347)	\$(232)	\$ (9)	\$7	\$(234)	\$10,651
Net income.....	-	-	717	-	-	-	-	-	717
Other comprehensive loss From continuing operations, net of tax of \$3.....	-	-	-	-	-	(3)	(3)	(6)	(6)
Comprehensive income .....									711
Conversion, exercises of stock options, forfeitures and other .....	-	4	-	46	-	-	-	-	50
Dividends declared (\$0.46 per share).....	-	-	(117)	-	-	-	-	-	(117)
Balance at June 30, 2003.....	\$689	\$3,950	\$8,197	\$(1,301)	\$(232)	\$(12)	\$4	\$(240)	\$11,295

*[a] Common stock \$2.50 par value; 500,000,000 shares authorized; 275,579,367 shares issued at beginning of period; 275,668,152 shares issued at end of period.*

*[b] 21,920,238 treasury shares at beginning of period, at cost; 21,196,318 treasury shares at end of period, at cost.*

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

**UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Responsibilities for Financial Statements** - The Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal and recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods presented. The Consolidated Statement of Financial Position at December 31, 2002 is derived from audited financial statements. The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto contained in the Annual Report on Form 10-K and contained in the current report on Form 8-K dated December 15, 2003 for Union Pacific Corporation (the Corporation or UPC) for the year ended December 31, 2002. The results of operations for the three months and six months ended June 30, 2003 are not necessarily indicative of the results for the entire year ending December 31, 2003. Certain prior year amounts have been reclassified to conform to the 2003 financial statement presentation.

**2. Stock-Based Compensation** - At June 30, 2003, the Corporation had several stock-based employee compensation plans. The Corporation accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. No stock option expense is reflected in net income as all options granted under those plans had an exercise price equal to the market value of the Union Pacific Corporation common stock on the date of grant. Stock-based employee compensation expense related to restricted stock and other incentive plans is reflected in net income. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation. See note 6 to the Consolidated Financial Statements for reconciliation between basic earnings per share and diluted earnings per share.

<i>Millions of Dollars, Except Per Share Amounts</i>	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>2003</i>	<i>June 30, 2002</i>	<i>2003</i>	<i>June 30, 2002</i>
Net income, as reported .....	\$ 288	\$ 304	\$ 717	\$ 526
Stock-based employee compensation expense included in reported net income, net of tax.....	3	5	12	10
Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax .....	(9)	(11)	(23)	(20)
Pro forma net income.....	\$ 282	\$ 298	\$ 706	\$ 516
EPS - basic, as reported .....	\$1.13	\$1.21	\$2.83	\$2.09
EPS - basic, pro forma.....	\$1.11	\$1.18	\$2.78	\$2.05
EPS - diluted, as reported .....	\$1.10	\$1.15	\$2.71	\$2.01
EPS - diluted, pro forma.....	\$1.08	\$1.13	\$2.67	\$1.97

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model. The following were the weighted-average assumptions for options granted during both the three months and six months ended June 30, 2003: risk-free interest rates of 2.9%; dividend yield of 1.5%; expected lives of 5 years; and volatility of 28.4%. Assumptions for both the three months and six months ended June 30, 2002 were: risk-free interest rates of 4.4%; dividend yield of 1.3%; expected lives of 5 years; and volatility of 28.8%.

**3. Segmentation and Operation** - Union Pacific Corporation has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnight Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of

Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 11 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

#### **4. Financial Instruments**

**Strategy and Risk** - The Corporation and its subsidiaries use derivative financial instruments in limited instances for other than trading purposes to manage risk related to changes in fuel prices and to achieve the Corporation's interest rate objectives. The Corporation uses swaps, futures and/or forward contracts to mitigate the downside risk of adverse price movements and hedge the exposure to variable cash flows. The use of these instruments also limits future benefits from favorable movements. The Corporation uses interest rate swaps to manage its exposure to interest rate changes. The purpose of these programs is to protect the Corporation's operating margins and overall profitability from adverse fuel price changes or interest rate fluctuations.

The Corporation may also use swaptions to secure near-term swap prices. Swaptions are swaps that are extendable past their base period at the option of the counterparty. Swaptions do not qualify for hedge accounting treatment.

**Market and Credit Risk** - The Corporation addresses market risk related to derivative financial instruments by selecting instruments with value fluctuations that highly correlate with the underlying item being hedged. Credit risk related to derivative financial instruments, which is minimal, is managed by requiring high credit standards for counterparties and periodic settlements. At June 30, 2003, the Corporation has not been required to provide collateral, nor has UPC received collateral relating to its hedging activities.

**Determination of Fair Value** - The fair values of the Corporation's derivative financial instrument positions at June 30, 2003 and December 31, 2002, detailed below, were determined based upon current fair values as quoted by recognized dealers or developed based upon the present value of expected future cash flows discounted at the applicable U.S. Treasury rate, London Interbank Offered Rates (LIBOR) or swap spread.

**Interest Rate Strategy** - The Corporation manages its overall exposure to fluctuations in interest rates by adjusting the proportion of fixed and floating rate debt instruments within its debt portfolio over a given period. The mix of fixed and floating rate debt is largely managed through the issuance of targeted amounts of each as debt matures or as incremental borrowings are required. Derivatives are used as one of the tools to obtain the targeted mix. In addition, the Corporation also obtains flexibility in managing interest costs and the interest rate mix within its debt portfolio by evaluating the issuance of and managing outstanding callable fixed-rate debt securities.

Swaps allow the Corporation to convert debt from fixed rates to variable rates and thereby hedge the risk of changes in the debt's fair value attributable to the changes in the benchmark interest rate (LIBOR). The swaps have been accounted for using the short-cut method as allowed by Financial Accounting Standard (FAS) 133; therefore, no ineffectiveness has been recorded within the Corporation's Consolidated Financial Statements.

**Fuel Strategy** - Fuel costs are a significant portion of the Corporation's total operating expenses. As a result of the significance of fuel costs and the historical volatility of fuel prices, the Corporation's transportation subsidiaries use swaps, collars, futures and/or forward contracts to mitigate the impact of adverse fuel price changes.

The following is a summary of the Corporation's derivative financial instruments at June 30, 2003 and December 31, 2002:

<i>Millions, Except Percentages and Average Commodity Prices</i>	<i>June 30, 2003</i>	<i>Dec. 31, 2002</i>
<b>Interest rate hedging:</b>		
Amount of debt hedged .....	\$ 998	\$ 898
Percentage of total debt portfolio .....	12%	12%
<b>Fuel hedging/swaptions:</b>		
Number of gallons hedged for 2002 [a] .....	-	552
Average price of 2002 hedges (per gallon) [b] .....	\$ -	\$0.56
Number of gallons hedged for the remainder of 2003 [c] .....	44	88
Average price of 2003 hedges outstanding (per gallon) [b] .....	\$0.58	\$0.58

[a] Fuel hedges expired December 31, 2002. Fuel hedges included the swap portion of a swaption with a base term expiring December 31, 2002.

[b] Excluding taxes, transportation costs and regional pricing spreads.

[c] Fuel hedges which are in effect during 2003. These hedges expire December 31, 2003.

The fair value asset positions of the Corporation's outstanding derivative financial instruments at June 30, 2003 and December 31, 2002 were as follows:

<i>Millions of Dollars</i>	<i>June 30, 2003</i>	<i>Dec. 31, 2002</i>
<b>Interest rate hedging:</b>		
Gross fair value asset position .....	\$46	\$52
Gross fair value (liability) position .....	-	-
<b>Fuel hedging:</b>		
Gross fair value asset position .....	8	12
Gross fair value (liability) position .....	-	-
<b>Total fair value asset position .....</b>	<b>\$54</b>	<b>\$64</b>

Fuel hedging positions will be reclassified from accumulated other comprehensive income to fuel expense over the life of the hedge as fuel is consumed.

The Corporation's use of derivative financial instruments had the following impact on pre-tax income for the three months and six months ended June 30, 2003 and 2002:

<i>Millions of Dollars</i>	<i>Three Months Ended June 30,</i>		<i>Six Months Ended June 30,</i>	
	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>
Decrease in interest expense from interest rate hedging .....	\$ 8	\$ 7	\$15	\$12
Decrease in fuel expense from fuel hedging .....	3	6	11	-
Decrease in fuel expense from fuel swaptions .....	-	3	-	13
Decrease in operating expenses .....	11	16	26	25
Increase in other income from interest rate swap cancellation .....	-	-	5	-
Increase in other income from fuel swaptions .....	-	-	-	3
<b>Increase in pre-tax income .....</b>	<b>\$11</b>	<b>\$16</b>	<b>\$31</b>	<b>\$28</b>

Through June 30, 2003, the Corporation had recorded less than \$1 million for fuel hedging ineffectiveness.

**Sale of Receivables** – The Railroad has sold, on a 364-day revolving basis, an undivided percentage ownership interest in a designated pool of accounts receivable to third parties through a bankruptcy-remote subsidiary.

Receivables are sold at carrying value, which approximates fair value. The third parties have designated the Railroad to service the sold receivables. The amount of receivables sold fluctuates based upon the availability of the designated pool of receivables and is directly affected by changing business volumes and credit risks. Payments collected from sold receivables can be reinvested in new receivables on behalf of the buyers. Should the Corporation's credit rating fall below investment grade, the amount of receivables sold would be reduced, and in certain cases, the buyers have the right to discontinue this reinvestment, thus requiring the Railroad to fund the receivables. At June 30, 2003 and December 31, 2002, accounts receivable are presented net of \$590 million and \$600 million of receivables sold, respectively. On August 7, 2003, the sale of receivables program was renewed for one year without any significant term changes.

## 5. Debt

**Credit Facilities** - On June 30, 2003, the Corporation had \$1.925 billion in revolving credit facilities available, of which \$925 million expires in March 2004, with the remaining \$1.0 billion expiring in 2005. The facilities, which were entered into during March 2003 and March 2000, respectively, are designated for general corporate purposes and none of the credit facilities were used as of June 30, 2003. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers.

**Convertible Preferred Securities** - Union Pacific Capital Trust (the Trust), a statutory business trust sponsored and wholly owned by the Corporation, has issued 6-1/4% Convertible Preferred Securities (the CPS) with an aggregate liquidation amount of \$1.5 billion. Each of the CPS has a stated liquidation amount of \$50 and is convertible, at the option of the holder, into shares of UPC's common stock, par value \$2.50 per share (the Common Stock), at the rate of 0.7257 shares of Common Stock for each of the CPS, equivalent to a conversion price of \$68.90 per share of Common Stock, subject to adjustment under certain circumstances. The CPS accrue and pay cash distributions quarterly in arrears at the annual rate of 6-1/4% of the stated liquidation amount. The Corporation owns all of the common securities of the Trust. The proceeds from the sale of the CPS and the common securities of the Trust were invested by the Trust in \$1.5 billion aggregate principal amount of the Corporation's Convertible Junior Subordinated Debentures due 2028, which debentures represent the sole assets of the Trust. For financial reporting purposes, the Corporation has recorded distributions payable on the CPS as interest expense in the Consolidated Statements of Income.

**Partial Redemption of Convertible Preferred Securities** - On May 16, 2003, the Corporation exercised its option to redeem \$500 million of the \$1.5 billion CPS. The redemption took place during the second quarter. On June 2, 2003, the Corporation announced that it would exercise its option to redeem an additional \$500 million of the CPS. The second redemption took place on July 7, 2003. The CPS were originally offered on April 1, 1998 at a price of \$50 each and were redeemed at a price of \$50.52, which includes a one percent redemption premium. The Corporation recorded a pre-tax charge of approximately \$15 million associated with the redemption in the second quarter of 2003 and will record a similar charge in the third quarter related to the July 7, 2003 redemption.

**Shelf Registration Statement and Significant New Borrowings** - Under the current shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. During February 2003, under the shelf registration, the Corporation issued \$250 million of 3-7/8% fixed rate debt with a maturity of February 15, 2009. The proceeds of the issuance were used for repayment of debt and other general corporate purposes. On June 5, 2003, the Corporation issued \$300 million of 3-5/8% fixed rate debt with a maturity of June 1, 2010 and \$200 million of 5-3/8% fixed rate debt with a maturity of June 1, 2033. The proceeds of the issuance were used to redeem \$500 million of CPS on July 7, 2003. At June 30, 2003, the Corporation had \$250 million remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

**6 Earnings Per Share** - The following table provides a reconciliation between basic and diluted earnings per share for the three months and six months ended June 30, 2003 and 2002:

<i>Millions, Except Per Share Amounts</i>	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>2003</i>	<i>June 30, 2002</i>	<i>2003</i>	<i>June 30, 2002</i>
<b>Income statement data:</b>				
Income from continuing operations before cumulative effect of accounting change .....	\$275	\$293	\$423	\$509
Income from discontinued operations .....	13	11	20	17
Cumulative effect of accounting change.....	-	-	274	-
Net income available to common shareholders – basic .....	288	304	717	526
Dilutive effect of interest associated with the CPS.....	10	14	19	29
Net income available to common shareholders – diluted .....	\$298	\$318	\$736	\$555
<b>Weighted average number of shares outstanding:</b>				
Basic .....	253.9	251.8	253.6	251.4
Dilutive effect of stock options.....	1.5	1.9	1.3	2.0
Dilutive effect of retention shares, stock units and restricted stock..	1.8	0.8	1.8	0.9
Dilutive effect of CPS .....	14.5	21.8	14.5	21.8
Diluted .....	271.7	276.3	271.2	276.1
<b>Earnings per share – basic:</b>				
Income from continuing operations before cumulative effect of accounting change .....	\$1.08	\$1.16	\$1.67	\$2.02
Income from discontinued operations .....	0.05	0.05	0.08	0.07
Cumulative effect of accounting change.....	-	-	1.08	-
Net income.....	\$1.13	\$1.21	\$2.83	\$2.09
<b>Earnings per share – diluted:</b>				
Income from continuing operations before cumulative effect of accounting change .....	\$1.05	\$1.11	\$1.63	\$1.95
Income from discontinued operations .....	0.05	0.04	0.07	0.06
Cumulative effect of accounting change.....	-	-	1.01	-
Net income.....	\$1.10	\$1.15	\$2.71	\$2.01

Common stock options totaling 2.4 million and 4.0 million shares for the three months and six months ended June 30, 2003, respectively, and 2.1 million for both the three months and six months ended June 30, 2002, were excluded from the computation of diluted EPS because the exercise prices of these options exceeded the average market price of the Corporation's common stock for the respective periods, and the effect of their inclusion would be antidilutive. Also excluded from the three months and six months ended June 30, 2003, were 2.4 million and 4.8 million weighted average shares, respectively, related to the redeemed CPS, as the inclusion of these securities would result in an antidilutive effect on earnings per share before the cumulative effect of accounting change.

**7. Other Income** - Other income included the following for the three months and six months ended June 30, 2003 and 2002:

<i>Millions of Dollars</i>	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>2003</i>	<i>June 30, 2002</i>	<i>2003</i>	<i>June 30, 2002</i>
Net gain on non-operating asset dispositions .....	\$14	\$33	\$24	\$41
Rental income .....	13	14	25	26
Interest income.....	1	4	4	6
Early retirement of debt .....	(15)	(1)	(17)	(1)
Other, net.....	(9)	(15)	(19)	(16)
<b>Total.....</b>	<b>\$ 4</b>	<b>\$35</b>	<b>\$17</b>	<b>\$56</b>

## **8 Commitments and Contingencies**

**Unasserted Claims** - There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries, in addition to unasserted claims. It is not possible at this time for the Corporation to determine fully the effect of all such claims on its consolidated financial condition, results of operations or liquidity; however, to the extent possible, where unasserted claims can be estimated and where such claims are considered probable, the Corporation has recorded a liability. The Corporation does not expect that any known lawsuits or claims, including unasserted claims, will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

**Personal Injury and Occupational Illness** - The cost of injuries to employees and others related to Railroad activities or in accidents involving the trucking segment is charged to expense based on actuarial estimates of the ultimate cost and number of incidents each year. The Corporation's expenses for personal injury-related events were \$62 million and \$60 million for the three months ended June 30, 2003 and 2002, respectively. The Corporation's expenses for personal injury-related events for the six months ended June 30, 2003 and 2002 were \$121 million and \$116 million, respectively. As of June 30, 2003, the Corporation had a liability of \$620 million accrued for personal injury costs, of which \$274 million was recorded as a current liability. The Railroad has additional amounts accrued for claims related to certain occupational illnesses. Compensation for Railroad work-related accidents is governed by the Federal Employers' Liability Act (FELA). Under FELA, damages are assessed based on a finding of fault through litigation or out-of-court settlements. The Railroad offers a comprehensive variety of services and rehabilitation programs for employees who are injured at work.

**Environmental** - The Corporation generates and transports hazardous and nonhazardous waste in its current operations and has done so in its former operations, and it is subject to federal, state and local environmental laws and regulations. The Corporation has identified approximately 415 sites at which it is or may be liable for remediation costs associated with alleged contamination or for violations of environmental requirements. This includes 53 sites that are the subject of actions taken by the U.S. government, 28 of which are currently on the Superfund National Priorities List. Certain federal legislation imposes joint and several liability for the remediation of identified sites; consequently, the Corporation's ultimate environmental liability may include costs relating to other parties, in addition to costs relating to its own activities at each site.

When an environmental issue has been identified with respect to the property owned, leased or otherwise used in the conduct of the Corporation's business, the Corporation and its external consultants perform environmental assessments on such property. The Corporation expenses the cost of the assessments as incurred. The Corporation accrues the cost of remediation where its obligation is probable and such costs can be reasonably estimated.

As of June 30, 2003, the Corporation had a liability of \$197 million accrued for future environmental costs, of which \$60 million was recorded in current liabilities as accrued casualty costs. The liability includes future costs for remediation and restoration of sites, as well as for ongoing monitoring costs, but excludes any anticipated recoveries

from third parties. Cost estimates are based on information available for each site, financial viability of other potentially responsible parties and existing technology, laws and regulations. The Corporation believes that it has adequately accrued for its ultimate share of costs at sites subject to joint and several liability. However, the ultimate liability for remediation is difficult to determine because of the number of potentially responsible parties involved, site-specific cost sharing arrangements with other potentially responsible parties, the degree of contamination by various wastes, the scarcity and quality of volumetric data related to many of the sites and/or the speculative nature of remediation costs. The Corporation expects to pay out the majority of the June 30, 2003 environmental liability over the next five years, funded by cash generated from operations. The impact of current obligations is not expected to have a material adverse effect on the results of operations, financial condition or liquidity of the Corporation.

**Other Matters** - The Corporation and its subsidiaries periodically enter into financial and other commitments in connection with their businesses. It is not possible at this time for the Corporation to determine fully the effect of all unasserted claims on its consolidated financial condition, results of operations or liquidity; however, to the extent possible, where unasserted claims can be estimated and where such claims are considered probable, the Corporation has recorded a liability. The Corporation does not expect that any known lawsuits, claims, environmental costs, commitments, contingent liabilities or guarantees will have a material adverse effect on its consolidated financial condition, results of operations or liquidity.

At June 30, 2003, the Corporation had unconditional purchase obligations of \$180 million for the acquisition of locomotives as part of the Corporation's multi-year capital asset acquisition plan. In addition, the Corporation was contingently liable for \$395 million in guarantees and \$49 million in letters of credit at June 30, 2003. These contingent guarantees were entered into in the normal course of business and include guaranteed obligations of affiliated operations. The Corporation is not aware of any existing event of default, which would require it to satisfy these guarantees.

**9. Accounting Pronouncements** - In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to UPC for existing entities on July 1, 2003. As described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In June 2003, the Railroad restructured the synthetic lease resulting in no effect to the Consolidated Financial Statements due to the adoption of FIN 46.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 elaborates on the disclosure requirements to be made by a guarantor about its obligations under certain guarantees it has issued. It also clarifies that the guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 is effective for guarantees issued or modified after December 31, 2002, and the disclosure requirements are effective for financial statements for periods ending after December 15, 2002.

In conjunction with the restructuring of the synthetic lease of the new headquarters building as described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Corporation has guaranteed a residual value equal to 85% of the total construction related costs. At June 30, 2003, the Corporation's guarantee related to the building was \$79 million. The guarantee will be approximately \$220 million upon completion of the building. In accordance with FIN 45, the Corporation recorded a liability of approximately \$8 million in June 2003 related to the fair value of this guarantee.

On April 30, 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (FAS 149). FAS 149 amends FAS 133 for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. FAS 149 also amends certain other existing pronouncements. It will require contracts with comparable characteristics to be accounted for similarly. FAS 149 is effective for the Corporation for contracts entered into or modified after June 30, 2003. Management believes that FAS 149 will not have a material impact on the Corporation's Consolidated Financial Statements.

On May 15, 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (FAS 150). FAS 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. FAS 150 is effective for the Corporation's existing CPS on July 1, 2003. The Corporation is evaluating the impact of adopting the requirements of FAS 150.

**10. Cumulative Effect of Accounting Change** - Surface Transportation Board (STB) accounting rules require that railroads accrue the cost of removing track structure over the expected useful life of these assets. Railroads historically used this prescribed accounting for reports filed with both the STB and SEC. In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). This statement was effective for the Corporation beginning January 1, 2003, and prohibits the accrual of removal costs unless there is a legal obligation to remove the track structure at the end of its life. The Corporation concluded that it did not have a legal obligation to remove the track structure, and therefore, under generally accepted accounting principles, the Corporation could not accrue the cost of removal in advance. Reports filed with the SEC will reflect the expense of removing these assets in the period in which they are removed. For STB reporting requirements only, the Corporation will continue to follow the historical method of accruing in advance, as prescribed by the STB. FAS 143 also requires the Corporation to record a liability for legally obligated asset retirement costs associated with tangible long-lived assets. In the first quarter of 2003, the Corporation recorded income from a cumulative effect of accounting change, related to the adoption of FAS 143, of \$274 million, net of tax of \$167 million. The accounting change had no effect on the Corporation's liquidity. Had the change been retroactively applied, the change would have had an immaterial impact on net income and earnings per share.

**11. Discontinued Trucking Segment** - On August 4, 2003, UPC announced its intention to effect a sale of its entire trucking interest. On November 5, 2003, UPC completed the sale of its entire trucking interest through an initial public offering. In order to facilitate this offering, immediately prior to the consummation of the offering, Overnite Corporation, a newly formed corporation, acquired from UPC all of the outstanding common stock of Overnite Holding, Inc., a wholly owned subsidiary of UPC and the ultimate parent holding company of OTC and Motor Cargo. In exchange, Overnite Corporation issued to UPC (1) all of its outstanding common stock and (2) a \$1.0 million promissory note payable by Overnite Corporation six months following the date of consummation of the acquisition. In addition, subsequent to this transaction but immediately prior to the consummation of the offering, Overnite Holding, Inc. paid to UPC a previously declared dividend consisting of \$128 million in cash and the forgiveness of net intercompany advances from Overnite to UPC as of the date of the transaction between Overnite Corporation and UPC. The cash portion of the dividend payable to UPC was made from the proceeds of an initial borrowing under a new Overnite credit facility. UPC, as the selling shareholder, sold all of the common stock of Overnite Corporation in an underwritten initial public offering and received all of the proceeds of the offering, less discounts and commissions paid to the underwriters and estimated expenses.

The entire trucking segment of UPC was reclassified as a discontinued operation during the period covered by this report, which includes the reclassification of the segment as a discontinued operation for all periods presented.

The following table presents a statement of financial position for the discontinued operations as of June 30, 2003 and December 31, 2002:

<i>Millions of Dollars</i>	<i>June 30, 2003</i>	<i>December 31, 2002</i>
Current assets .....	\$235	\$254
Properties, net.....	498	501
Other assets .....	51	27
<b>Total assets .....</b>	<b>784</b>	<b>782</b>
Current liabilities .....	191	179
Noncurrent liabilities .....	140	128
<b>Total liabilities .....</b>	<b>331</b>	<b>307</b>
Net assets of discontinued operations .....	\$453	\$475
Accumulated other comprehensive income.....	\$ 84	\$ 84

The June 30, 2003 and December 31, 2002 numbers vary from those recorded in the Overnite Corporation final Prospectus dated October 30, 2003, due primarily to the classification of deferred taxes, as well as the elimination of intercompany receivables for consolidated financial statement purposes.

The following table presents the revenues and income before income taxes for the discontinued operations for the three months and six months ended June 30, 2003 and 2002:

<i>Millions of Dollars</i>	<i>Three months ended June 30,</i>		<i>Six months ended June 30,</i>	
	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>
Revenues .....	\$372	\$337	\$713	\$646
Income before income taxes.....	\$ 21	\$ 19	\$ 33	\$ 29

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **UNION PACIFIC CORPORATION AND SUBSIDIARY COMPANIES RESULTS OF OPERATIONS**

#### **Three Months and Six Months Ended June 30, 2003 Compared to Three Months and Six Months Ended June 30, 2002**

Union Pacific Corporation has one reportable business segment that operates primarily in the area of rail transportation, through its indirect wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (collectively, the Railroad). The Consolidated Financial Statements also include discontinued trucking operations, consisting of Overnite Transportation Company (OTC) and Motor Cargo Industries, Inc. (Motor Cargo), both operating as separate and distinct subsidiaries of Overnite, Inc. (Overnite), an indirect wholly owned subsidiary of UPC (see note 11 to the Consolidated Financial Statements regarding the reclassification of the Corporation's trucking segment as a discontinued operation).

A copy of this Current Report on Form 8-K, as well as the Corporation's 2002 Annual Report on Form 10-K, current reports on Form 8-K and any amendments to those reports are available free of charge on the Internet at the Corporation's website at [www.up.com/investors](http://www.up.com/investors). Additionally, the Corporation's corporate governance materials, including Board Committee charters, governance guidelines and policies and codes of conduct and ethics for directors, officers and employees may also be found on the Internet at the Corporation's website at [www.up.com/investors](http://www.up.com/investors).

#### **Critical Accounting Policies and Estimates**

The Corporation's discussion and analysis of its financial condition and results of operations are based upon its Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires estimation and judgment that affect the reported amounts of revenues, expenses, assets and liabilities. The Corporation bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. If these estimates differ materially from actual results, the impact on the Consolidated Financial Statements may be material. The Corporation's critical accounting policies are available in the Corporation's 2002 Annual Report on Form 10-K, Item 7.

#### **Operations**

**Net Income** – The Corporation reported net income of \$288 million (\$1.13 per basic share and \$1.10 per diluted share) in the second quarter of 2003, compared to \$304 million (\$1.21 per basic share and \$1.15 per diluted share) in the second quarter of 2002. Year-to-date net income was \$717 million (\$2.83 per basic share and \$2.71 per diluted share) compared to \$526 million (\$2.09 per basic share and \$2.01 per diluted share) for the same period in 2002. Year-to-date income before the cumulative effect of accounting change (see note 10 to the Consolidated Financial Statements) was \$443 million (\$1.75 per basic share and \$1.70 per diluted share). Income from continuing operations (see Note 11 to the Consolidated Financial Statements) was \$275 million (\$1.08 per basic share and \$1.05 per diluted share) in the second quarter of 2003, compared to \$293 million (\$1.16 per basic share and \$1.11 per diluted share) in the second quarter of 2002. Year-to-date income from continuing operations was \$697 million (\$2.75 per basic share and \$2.64 per diluted share) compared to \$509 million (\$2.02 per basic share and \$1.95 per diluted share) for the same period in 2002. Year-to-date income from continuing operations before the cumulative effect of accounting change (see note 10 to the Consolidated Financial Statements) was \$423 million (\$1.67 per basic share and \$1.63 per diluted share). The decrease in income from continuing operations for the second quarter and the decrease in income from continuing operations before the cumulative effect of accounting change in the six month period was driven by higher fuel prices, inflation, volume-related expenses and lower gains from real estate sales which more than offset revenue gains, lower interest expense and productivity improvements. Productivity is calculated as both gross ton miles per inflation-adjusted expense dollar and gross ton miles per employee.

**Operating Revenues** – Operating revenue is comprised of commodity revenue and other revenues. Other revenues primarily include subsidiary revenue from various companies that are wholly owned or majority owned by the Railroad, revenue from the Chicago commuter rail operations and accessorial revenue earned due to customer detainment of Railroad owned or controlled equipment. Operating revenues increased \$72 million (3%) to \$2.9 billion for the second quarter of 2003. Year-to-date operating revenues increased \$146 million to \$5.6 billion compared to last year. Second quarter commodity revenues increased \$65 million (2%) to \$2.8 billion compared to 2002. Second quarter revenue carloads were flat compared to a year ago, with positive growth in the Energy and Industrial Products commodity groups. Average revenue per car for the period increased 3% to \$1,193 driven by pricing gains, fuel surcharges, index-based contract escalators and positive mix. Year-to-date commodity revenues grew 2% to \$5.4 billion compared to 2002. Revenue carloads were flat and average revenue per car showed a 2% increase to \$1,190 when compared to a year ago. Other revenues increased \$7 million (6%) to \$130 million in the second quarter compared to a year ago and increased \$21 million (9%) year-to-date when compared to 2002 as a result of higher subsidiary revenue and demurrage.

The following tables summarize the year-over-year changes in rail commodity revenue, revenue carloads and average revenue per car by commodity type:

<i>Three Months Ended</i>			<i>%</i>	<i>Commodity Revenue</i>	<i>Six Months Ended</i>		
<i>2003</i>	<i>June 30, 2002</i>	<i>Change</i>			<i>2003</i>	<i>June 30, 2002</i>	<i>%</i>
				<i>Millions of Dollars</i>			
\$ 374	\$ 354	6%	Agricultural.....	\$ 747	\$ 723	3%	
320	326	(2)	Automotive.....	622	608	2	
393	402	(2)	Chemicals .....	787	787	-	
602	570	6	Energy .....	1,163	1,152	1	
561	533	5	Industrial Products .....	1,071	1,007	6	
514	514	-	Intermodal.....	981	969	1	
\$2,764	\$2,699	2%	Total.....	\$5,371	\$5,246	2%	

<i>Three Months Ended</i>			<i>%</i>	<i>Revenue Carloads</i>	<i>Six Months Ended</i>		
<i>2003</i>	<i>June 30, 2002</i>	<i>Change</i>			<i>2003</i>	<i>June 30, 2002</i>	<i>%</i>
				<i>Thousands</i>			
206	210	(2%)	Agricultural.....	420	427	(2%)	
214	219	(2)	Automotive.....	421	412	2	
226	233	(3)	Chemicals .....	445	450	(1)	
537	520	3	Energy .....	1,058	1,065	(1)	
382	373	3	Industrial Products .....	722	698	4	
752	771	(2)	Intermodal.....	1,445	1,452	-	
2,317	2,326	-	Total.....	4,511	4,504	-	

<i>Three Months Ended</i>			<i>% Average Revenue Per Car</i>	<i>Six Months Ended</i>		
<i>2003</i>	<i>June 30, 2002</i>	<i>% Change</i>		<i>2003</i>	<i>June 30, 2002</i>	<i>% Change</i>
\$1,817	\$1,681	8%	Agricultural.....	\$1,778	\$1,691	5%
1,494	1,486	1	Automotive.....	1,478	1,475	-
1,743	1,728	1	Chemicals .....	1,769	1,749	1
1,120	1,095	2	Energy .....	1,099	1,081	2
1,466	1,429	3	Industrial Products .....	1,481	1,444	3
684	667	3	Intermodal.....	679	668	2
\$1,193	\$1,160	3%	Total.....	\$1,190	\$1,165	2%

*Agricultural* - Revenue increased 6% in the second quarter and 3% for the year-to-date period of 2003 over the comparable periods in 2002, as a 2% decline in carloads in both periods was more than offset by an increase in average revenue per car. Ethanol shipments increased due to heightened demand for the fuel additive. Market demand for feed grains to domestic and Pacific Northwest export locations also improved. Canned and packaged shipments increased due to greater demand and new business. Partially offsetting the revenue gains were volume and revenue declines for domestic and export wheat, meals and oils and feed grains exports to gulf ports. Average revenue per car increased due to the positive mix impact of longer average length of haul shipments, as well as price increases and fuel surcharges.

*Automotive* - Revenue declined 2% for the second quarter but increased 2% for the year-to-date period of 2003 over the comparable periods in 2002. The trend in year-over-year sales growth for domestic manufacturers experienced in the first quarter reversed in the second quarter, as the softening economy weakened demand for finished vehicles and forced production cuts. Market share gains for finished vehicle and materials shipments partially offset these declines. Average revenue per car increased 1% in the second quarter but was flat for the year-to-date period as price increases were offset by the mix impact of disproportionate growth in materials shipments, which move at a lower average revenue per car than finished vehicles.

*Chemicals* - Revenue decreased 2% for the second quarter and was flat for the year-to-date period of 2003 over the comparable periods of 2002, as declining carloads in both periods were partially offset by an increase in average revenue per car. Reduced plastics volume led the decline in carloads in both periods, as the soft economy combined with higher input costs caused producers to lower inventories and reduce shipments. Increased market demand for domestic and export soda ash partially offset the decline. Average revenue per car increased 1% for both the three months and six months ended June 30, 2003 compared to 2002, due to a mix shift towards longer average length of haul, in addition to price increases and fuel surcharges.

*Energy* - Revenue increased 6% for the second quarter and 1% for the year-to-date period of 2003 over the comparable periods of 2002. First quarter volume declined due to the absence of export traffic from the Colorado and Utah mining regions, which Japan is now sourcing from other Far Eastern producers. In addition, a severe snowstorm in March caused an estimated loss of 71 trains out of the Southern Powder River Basin and Colorado and Utah mining regions. In the second quarter, strong utility demand due to lower inventories resulted in a 3% increase in carloads. Average revenue per car increased 2% in both periods, primarily due to index-based contract escalators.

*Industrial Products* - Revenue increased 5% for the second quarter and 6% for the year-to-date period of 2003 over the comparable periods of 2002, due to increases in carloads and average revenue per carload. The volume increase was led by shipments of military equipment and ammunition in support of the war effort. Steel and scrap shipments increased as the weakening dollar created higher domestic and export demand for U.S. produced steel, augmented by market share gains. Demand for paperboard, partially due to lower inventories, also contributed to volume gains. Average revenue per car increased 3% in both periods, primarily due to price increases and fuel surcharges.

*Intermodal* - Revenue was flat for the second quarter and increased 1% for the year-to-date period of 2003 over the comparable periods of 2002, as a decline in carloads in the second quarter was more than offset by an increase in average revenue per car. Domestic revenue grew 6% in the second quarter and 7% in the first half of the year. International revenue decreased in the second quarter and first half of the year due to penetration losses, partially

offset by strong first quarter market growth. Average revenue per car for the three and six month periods increased due to fuel surcharges and price increases.

*Mexico Business* - Included in the rail commodity revenue reported above is Mexican related revenue, which increased 2% to \$225 million for the second quarter and was flat at \$431 million for the year-to-date period of 2003 over the comparable periods of 2002. Business gains were led by increased steel and scrap shipments to and from Mexico. Reduced corn exports partially offset the increase, as the Mexican government delayed the issue of corn export permits for 2003 until late in the first quarter.

**Operating Expenses** - Second quarter operating expenses increased \$72 million (3%) to \$2.3 billion compared to 2002. Year-to-date operating expenses increased \$266 million (6%). Expenses in both periods were negatively impacted by higher fuel prices, inflation, severance and volume-related costs, which were partially offset by lower depreciation expense, productivity improvements and cost control measures.

*Salaries, Wages and Employee Benefits* - Salaries, wages and employee benefits increased \$39 million (4%) in the second quarter of 2003 compared to 2002. Year-to-date, wage and benefit expenses rose \$90 million (5%). Increases were driven by inflation, the adoption of FAS 143 (see note 10 to the Consolidated Financial Statements), protection costs and severance costs. The adoption of FAS 143 accounted for \$29 million and \$57 million of the increases for the second quarter and year-to-date, respectively. A 2% reduction in employee force levels in both periods and improvements in productivity partially offset the effects of inflation and protection costs. Protection cost represents the differential payment when the wage earned for active employment is lower than an employee's "protected" rate of pay. An individual's protected rate is imposed by the Surface Transportation Board for employees adversely affected by a merger or is established by collective bargaining agreements in other cases.

*Equipment and Other Rents* - Equipment and other rents primarily includes rental expense UPRR pays for freight cars owned by other railroads or private companies; freight car, intermodal and locomotive leases; other specialty equipped vehicle leases; and office and other rentals. Expenses decreased \$10 million (3%) in the second quarter compared to 2002 and \$15 million (2%) year-to-date. The second quarter decrease was due primarily to lower car hire receipt levels in 2002 and reduced rental prices for private freight cars, partially offset by higher leased car expenses. Equipment and other rents decreased year-to-date due to lower rental prices for private cars and a reduction in lease expenses in the first quarter of 2003, partially offset by higher locomotive lease expenses. The higher locomotive lease expenses are due to UPRR's increased leasing of new, more reliable and fuel efficient locomotives. These new locomotives replaced older, non-leased models in the fleet, which helped reduce expenses for depreciation, labor, materials and fuel during the period.

*Depreciation* - The majority of depreciation expense relates to track structure, including rail, ties and other track material. Depreciation expense decreased \$33 million (12%) in the second quarter and \$42 million (7%) year-to-date over 2002. The adoption of FAS 143 (see note 10 to the Consolidated Financial Statements) decreased depreciation expense in the second quarter by \$25 million and \$49 million year-to-date. Additionally, implementation of the recent depreciation study required and approved by the Surface Transportation Board resulted in reduced depreciation rates for certain track assets, lowering depreciation expense by \$25 million for the first six months of 2003. Conversely, capital spending in recent years has increased depreciation expense. Full year capital spending totaled \$1.7 billion in 2002 and \$1.6 billion in 2001.

*Fuel and Utilities* - Fuel and utilities is comprised of locomotive fuel, utilities other than telephone, gasoline and other fuels. Expenses increased \$55 million (21%) in the second quarter and \$182 million (37%) year-to-date 2003 compared to a year ago. The increase was driven by higher fuel prices minimally offset by a lower fuel consumption rate, as measured by gallons consumed per thousand gross ton miles. Fuel prices averaged 88 cents per gallon in the second quarter of 2003 compared to 72 cents per gallon in the second quarter of 2002 (price includes taxes and transportation costs). Year-to-date, fuel prices averaged 94 cents per gallon compared to 67 cents per gallon in 2002. Higher fuel prices in 2003 resulted in a \$54 million increase in fuel expense in the second quarter and \$179 million increase year-to-date compared to 2002. The lower consumption rate decreased fuel expense by \$7 million in the second quarter and \$10 million year-to-date. A 2% increase in gross ton miles for the second quarter and a 1% increase year-to-date resulted in additional fuel expense of \$5 million and \$6 million, respectively. The Railroad hedged approximately 7% of its fuel consumption for the second quarter, which decreased fuel costs by \$3 million.

Gasoline, utilities and propane expenses increased \$3 million in the second quarter and \$7 million year-to-date primarily due to higher fuel prices.

*Materials and Supplies* - Materials used for the maintenance of the Railroad's lines, structures and equipment is the principal component of materials and supplies expense. Office, small tools and other supplies along with the costs of freight services purchased to ship company materials are also included. Expenses decreased \$26 million (21%) in the second quarter and \$44 million (18%) year-to-date, primarily due to the adoption of FAS 143 (see note 10 to the Consolidated Financial Statements), cost control measures, fewer locomotive repairs as well as a partial shift to more locomotive contracting.

*Casualty Costs* - The largest component of casualty costs is personal injury expense. Freight and property damage, insurance, environmental matters and occupational illness expense are also included in casualty costs. Costs increased \$8 million (8%) in the second quarter compared to 2002 and \$25 million (14%) year-to-date due to higher insurance costs, personal injury expense and expenses associated with destruction of foreign equipment.

*Purchased Services and Other Costs* - Purchased services and other costs include the costs of services purchased from outside contractors, state and local taxes, net costs of operating facilities jointly used by UPRR and other railroads, transportation and lodging for train crew employees, trucking and contracting costs for intermodal containers, leased automobile maintenance expenses, telephone and cellular expense, employee travel expense and computer and other general expenses. Expenses increased \$39 million (16%) in the second quarter and \$70 million (15%) year-to-date when compared to last year. In the second quarter of 2003, higher expenses were driven by increased spending for contract services, higher expenses for jointly operated facilities and increased state and local taxes. Expenses increased year-to-date primarily due to increased contract services, higher state and local taxes and increased intermodal volume costs in the first quarter.

**Operating Income** - Operating income was flat at \$583 million in the second quarter of 2003 compared to the same period in 2002, as higher fuel prices, wage and benefit inflation and volume-related costs offset higher revenues, lower depreciation expense and cost control efforts. Year-to-date operating income decreased \$120 million (11%) compared to 2002 primarily resulting from significantly higher fuel prices in the first six months of 2003.

**Non-Operating Items** - Interest expense decreased \$9 million (6%) in the second quarter and \$21 million (7%) year-to-date due to lower interest rates and a lower average debt level in 2003. In the three months ended June 30, 2003, the Corporation's average debt level, including the CPS, decreased to \$9.2 billion from \$9.6 billion for the same period in 2002. Year to date, the Corporation's average debt level, including the CPS, decreased to \$9.2 billion from \$9.7 billion for the same period in 2002. The Corporation's effective interest rate was 6.5% during the second quarter of 2003 compared to 6.6% in 2002. For the year-to-date period, the effective interest rate was 6.5% compared to 6.7% in 2002. Other income decreased \$31 million (89%) in the second quarter and \$39 million (70%) year-to-date compared to 2002 primarily due to reduced gains from real estate sales, the absence of fuel swaptions in 2003 and expense associated with the redemption by UPC of \$500 million of its Convertible Preferred Securities (CPS). Another contributing factor for the year-to-date decrease, was losses from foreign currency transactions related to the dividend received from Grupo Ferrovial Mexicano, S.A. de C.V. Income tax expense decreased \$4 million (2%) in the second quarter and \$52 million (17%) year-to-date compared to 2002 due to lower pre-tax income in 2003.

**Other Key Measures** - Operating margin (operating income as a percentage of operating revenues) decreased to 20.1% in the second quarter of 2003 from 20.7% in the same period of 2002. Year-to-date the operating margin was 16.9% in 2003, down from 19.5% in 2002.

### **Discontinued Operations**

In the second quarter, discontinued trucking revenues increased \$35 million (10%) to \$372 million compared to the same period in 2002. Year-to-date trucking revenues have improved \$67 million (10%) when compared to last year.

In both periods, the revenues were positively impacted by higher volumes primarily due to additional business realized as a result of the forced closure of Consolidated Freightways Corporation in September 2002 as well as fuel surcharges and rate increases. Discontinued operations generated operating income of \$21 million in the second quarter, and increase of \$3 million (15%) when compared to 2002. The operating margin for the second quarter was 5.6%, compared to 5.4% in 2002. Year-to-date operating income improved \$5 million (17%), and operating margin increased from 4.4% in 2002 to 4.7% in 2003. In the second quarter of 2003, income from discontinued operations was \$13 million compared to \$11 million for the same period a year ago. Year-to-date income from discontinued operations was \$20 million versus \$17 million in 2002.

## LIQUIDITY AND CAPITAL RESOURCES

### Financial Condition

Cash provided by operations was \$1.1 billion in the first six months of 2003 and 2002, remaining essentially flat as lower income before the cumulative effect of accounting change, lower depreciation expense and \$50 million of cash paid to fund the pension plan in 2003 were partially offset by improved working capital.

Cash used in investing activities was \$724 million in the first six months of 2003 compared to \$773 million in 2002. The decreased use of cash is due to the receipt of \$96 million of dividends from Grupo Ferroviario Mexicano, S.A. de C.V. in the first quarter of 2003, partially offset by increased capital expenditures and lower proceeds from asset sales. The following table details capital expenditures for the six months ended June 30, 2003 and 2002 (includes capital leases of \$188 million and \$126 million, respectively):

<i>Capital Expenditures</i> <i>Millions</i>	<i>2003</i>	<i>2002</i>
Track.....	\$ 639	\$641
Locomotives .....	250	143
Freight cars .....	10	4
Facilities and other .....	152	160
<b>Total.....</b>	<b>\$1,051</b>	<b>\$948</b>

Cash used by financing activities was \$205 million in the first six months of 2003 compared to \$46 million in the first six months of 2002. The increase in cash used is due to higher debt repayments (\$857 million in 2003 compared to \$697 million in 2002), including the redemption of \$500 million of CPS, and less cash received from option exercises (\$39 million in 2003 versus \$102 million in 2002). This increase was partially offset by higher financings (\$730 million in 2003 compared to \$649 million in 2002).

For the three months and six months ended June 30, 2003, the Corporation's ratio of earnings to fixed charges was 2.9 and 2.9, respectively, compared to 3.7 and 3.3 for the three months and six months ended June 30, 2002. The ratio of earnings to fixed charges has been computed on a consolidated basis. Earnings represent income before cumulative effect of accounting change, less equity in undistributed earnings of unconsolidated affiliates, plus fixed charges and income taxes. Fixed charges represent interest charges, amortization of debt discount and the estimated amount representing the interest portion of rental charges.

### Contractual Obligations and Commercial Commitments

As described in the notes to the Consolidated Financial Statements and as referenced in the tables below, the Corporation has contractual obligations and commercial commitments that may affect the financial condition of the Corporation. However, based on management's assessment of the underlying provisions and circumstances of the material contractual obligations and commercial commitments of the Corporation, including material sources of off-balance sheet and structured finance arrangements, there is no known trend, demand, commitment, event or uncertainty that is reasonably likely to occur which would have a material effect on the Corporation's financial

condition, results of operations or liquidity. In addition, the commercial obligations, financings and commitments made by the Corporation are customary transactions, which are similar to those of other comparable industrial corporations, particularly within the transportation industry.

The following tables identify material obligations and commitments as of June 30, 2003:

<i>Contractual Obligations</i> <i>Millions of Dollars</i>	<i>Total</i>	<i>Payments Due by Period</i>			
		<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
Debt [a] .....	\$ 6,643	\$ 62	\$1,390	\$1,290	\$3,901
Operating leases .....	3,073	427	743	544	1,359
Capital lease obligations [b].....	2,640	215	423	376	1,626
Unconditional purchase obligations [c] .....	180	90	90	-	-
<b>Total contractual obligations .....</b>	<b>\$12,536</b>	<b>\$794</b>	<b>\$2,646</b>	<b>\$2,210</b>	<b>\$6,886</b>

[a] Excludes capital lease obligations of \$1,586 million, and market value adjustments for debt with qualifying hedges that are recorded as assets on the Consolidated Statements of Financial Position.

[b] Represents total obligations, including interest component.

[c] Unconditional purchase obligations represent multi-year contractual commitments to purchase or acquire assets at fixed prices and fixed volumes. These commitments are made in order to take advantage of pricing opportunities and to ensure availability of assets to meet quality and operational requirements. Excluded are contracts that do not meet the disclosure requirements of Statement of Financial Accounting Standards No. 47 "Disclosure of Long-term Obligations."

<i>Other Commercial Commitments</i> <i>Millions of Dollars</i>	<i>Total Amounts Committed</i>	<i>Amount of Commitment Expiration Per Period</i>			
		<i>Less Than 1 Year</i>	<i>2-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
Credit facilities [a] .....	\$1,925	\$ 925	\$1,000	\$ -	\$ -
Convertible Preferred Securities [b].....	1,000	500	-	-	500
Sale of receivables [c] .....	600	600	-	-	-
Guarantees [d].....	395	19	17	13	346
Standby letters of credit [e].....	49	49	-	-	-
<b>Total commercial commitments .....</b>	<b>\$3,969</b>	<b>\$2,093</b>	<b>\$1,017</b>	<b>\$13</b>	<b>\$846</b>

[a] None of the credit facilities were used as of June 30, 2003.

[b] \$500 million of the Convertible Preferred Securities were redeemed in May 2003, and an additional \$500 million were redeemed in July 2003.

[c] \$590 million of the facility was utilized at June 30, 2003.

[d] Includes guaranteed obligations of affiliated operations.

[e] None of the letters of credit were drawn upon as of June 30, 2003.

## Financing Activities

**Credit Facilities** - On June 30, 2003, the Corporation had \$1.925 billion in revolving credit facilities available, of which \$925 million expires in March 2004, with the remaining \$1.0 billion expiring in 2005. The facilities, which were entered into during March 2003 and March 2000, respectively, are designated for general corporate purposes and none of the credit facilities were used as of June 30, 2003. Commitment fees and interest rates payable under the facilities are similar to fees and rates available to comparably rated investment-grade borrowers.

**Convertible Preferred Securities** - Union Pacific Capital Trust (the Trust), a statutory business trust sponsored and wholly owned by the Corporation, has issued 6 1/4% Convertible Preferred Securities (the CPS) with an aggregate liquidation amount of \$1.5 billion. Each of the CPS has a stated liquidation amount of \$50 and is convertible, at the option of the holder, into shares of UPC's common stock, par value \$2.50 per share (the Common

Stock), at the rate of 0.7257 shares of Common Stock for each of the CPS, equivalent to a conversion price of \$68.90 per share of Common Stock, subject to adjustment under certain circumstances. The CPS accrue and pay cash distributions quarterly in arrears at the annual rate of 6-1/4% of the stated liquidation amount. The Corporation owns all of the common securities of the Trust. The proceeds from the sale of the CPS and the common securities of the Trust were invested by the Trust in \$1.5 billion aggregate principal amount of the Corporation's Convertible Junior Subordinated Debentures due 2028, which debentures represent the sole assets of the Trust. For financial reporting purposes, the Corporation has recorded distributions payable on the CPS as interest expense in the Consolidated Statements of Income.

**Partial Redemption of Convertible Preferred Securities** - On May 16, 2003, the Corporation exercised its option to redeem \$500 million of the \$1.5 billion CPS. The redemption will reduce the Corporation's interest expense related to the CPS by \$19.5 million in 2003 and by \$31.3 million in subsequent years, and will decrease the dilutive effect of the CPS on earnings per share by 7.3 million shares. The redemption took place during the second quarter. On June 2, 2003, the Corporation announced that it would exercise its option to redeem an additional \$500 million of the CPS. The second redemption took place on July 7, 2003 and will reduce the Corporation's interest expense related to the CPS by an additional \$15.1 million in 2003 and by \$31.3 million in subsequent years, and will ultimately decrease the dilutive effect of the CPS on earnings per share by 7.3 million shares. The CPS were originally offered on April 1, 1998 at a price of \$50 each and were redeemed at a price of \$50.52, which includes a one percent redemption premium. The Corporation recorded a pre-tax charge of approximately \$15 million associated with the redemption in the second quarter of 2003 and will record a similar charge in the third quarter related to the July 7, 2003 redemption.

**Shelf Registration Statement and Significant New Borrowings** - Under the current shelf registration statement, the Corporation may issue, from time to time, any combination of debt securities, preferred stock, common stock or warrants for debt securities or preferred stock in one or more offerings. During February 2003, under the shelf registration, the Corporation issued \$250 million of 3-7/8% fixed rate debt with a maturity of February 15, 2009. The proceeds of the issuance were used for repayment of debt and other general corporate purposes. On June 5, 2003, the Corporation issued \$300 million of 3-5/8% fixed rate debt with a maturity of June 1, 2010 and \$200 million of 5-3/8% fixed rate debt with a maturity of June 1, 2033. The proceeds of the issuance were used to redeem \$500 million of CPS on July 7, 2003. At June 30, 2003, the Corporation had \$250 million remaining for issuance under the shelf registration. The Corporation has no immediate plans to issue equity securities.

## **OTHER MATTERS**

**Commitments and Contingencies** - There are various claims and lawsuits pending against the Corporation and certain of its subsidiaries. The Corporation is also subject to various federal, state and local environmental laws and regulations, pursuant to which it is currently participating in the investigation and remediation of various sites. A discussion of certain claims, lawsuits, contingent liabilities and guarantees is set forth in note 8 to the Consolidated Financial Statements, which discussion is incorporated herein by reference.

**Pensions** - During the first quarter of 2003, the Corporation decreased its assumed rate of return on pension plan assets from 9% to 8%. This assumption change will result in an increase to 2003 pension expense of \$14 million. During the first six months of 2003 the Railroad voluntarily contributed \$50 million to its pension plan.

**Accounting Pronouncements** - In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to UPC for existing entities on July 1, 2003. As described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Railroad has a synthetic operating lease arrangement to finance a new headquarters building, which falls within the guidance of FIN 46. In June 2003, the Railroad restructured the synthetic lease resulting in no effect to the Consolidated Financial Statements due to the adoption of FIN 46.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 elaborates on the disclosure requirements to be made by a guarantor about its obligations under certain guarantees it has issued. It also clarifies that the guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 is effective for guarantees issued or modified after December 31, 2002, and the disclosure requirements are effective for financial statements for periods ending after December 15, 2002.

In conjunction with the restructuring of the synthetic lease of the new headquarters building as described in note 10 to the Consolidated Financial Statements, Item 8, in the Annual Report on Form 10-K, the Corporation has guaranteed a residual value equal to 85% of the total construction related costs. At June 30, 2003, the Corporation's guarantee related to the building was \$79 million. The guarantee will be approximately \$220 million upon completion of the building. In accordance with FIN 45, the Corporation recorded a liability of approximately \$8 million in June 2003 related to the fair value of this guarantee.

On April 30, 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (FAS 149). FAS 149 amends FAS 133 for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. FAS 149 also amends certain other existing pronouncements. It will require contracts with comparable characteristics to be accounted for similarly. FAS 149 is effective for the Corporation for contracts entered into or modified after June 30, 2003. Management believes that FAS 149 will not have a material impact on the Corporation's Consolidated Financial Statements.

On May 15, 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (FAS 150). FAS 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. FAS 150 is effective for the Corporation's existing CPS on July 1, 2003. The Corporation is evaluating the impact of adopting the requirements of FAS 150.

## **CAUTIONARY INFORMATION**

Certain statements in this report are, and statements in other material filed or to be filed with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Corporation) are, or will be, forward-looking statements as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. These forward-looking statements include, without limitation, statements regarding: expectations as to operational improvements; expectations as to cost savings, revenue growth and earnings; the time by which certain objectives will be achieved; estimates of costs relating to environmental remediation and restoration; proposed new products and services; expectations that claims, lawsuits, environmental costs, commitments, contingent liabilities, labor negotiations or agreements, or other matters will not have a material adverse effect on the Corporation's consolidated financial position, results of operations or liquidity; and statements concerning projections, predictions, expectations, estimates or forecasts as to the Corporation's and its subsidiaries' business, financial and operational results, and future economic performance, statements of management's goals and objectives and other similar expressions concerning matters that are not historical facts.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times that, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements.

Important factors that could affect the Corporation's and its subsidiaries' future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements include, but are not limited to:

- whether the Corporation and its subsidiaries are fully successful in implementing their financial and operational initiatives;
- industry competition, conditions, performance and consolidation;
- legislative and regulatory developments, including possible enactment of new tax rates and possible enactment of initiatives to re-regulate the rail industry;
- natural events such as severe weather, fire, floods and earthquakes;
- the effects of adverse general economic conditions, both within the United States and globally;
- any adverse economic or operational repercussions from terrorist activities and any governmental response thereto;
- war or risk of war;
- changes in fuel prices;
- changes in labor costs;
- labor stoppages; and
- the outcome of claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion and exposure to asbestos and diesel fumes.

Forward-looking statements speak only as of the date the statement was made. The Corporation assumes no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. If the Corporation does update one or more forward-looking statements, no inference should be drawn that the Corporation will make additional updates with respect thereto or with respect to other forward-looking statements.

**EXHIBIT 12.3 (a)****Ratio of Earnings to Fixed Charges**

*Union Pacific Corporation and Subsidiary Companies  
(Unaudited)*

<i>Millions of Dollars, Except Ratios</i>	<i>Three Months Ended June 30,</i>	
	<i>2003</i>	<i>2002</i>
Earnings:		
Income from continuing operations.....	\$275	\$293
Undistributed equity earnings .....	(16)	(10)
Total earnings .....	259	283
Income taxes .....	163	167
Fixed charges:		
Interest expense including amortization of debt discount.....	149	158
Portion of rentals representing an interest factor .....	68	11
Total fixed charges .....	217	169
Earnings available for fixed charges .....	\$639	\$619
Ratio of earnings to fixed charges.....	2.9	3.7

**EXHIBIT 12.3 (b)****Ratio of Earnings to Fixed Charges**

*Union Pacific Corporation and Subsidiary Companies  
(Unaudited)*

<i>Millions of Dollars, Except Ratios</i>	<i>Six Months Ended June 30,</i>	
	<i>2003</i>	<i>2002</i>
<b>Earnings:</b>		
Income before cumulative effect of accounting change .....	\$ 423	\$ 509
Undistributed equity earnings .....	38	(21)
<b>Total earnings .....</b>	<b>461</b>	<b>488</b>
<b>Income taxes .....</b>	<b>246</b>	<b>298</b>
<b>Fixed charges:</b>		
Interest expense including amortization of debt discount.....	300	321
Portion of rentals representing an interest factor .....	78	22
<b>Total fixed charges .....</b>	<b>378</b>	<b>343</b>
<b>Earnings available for fixed charges .....</b>	<b>\$1,085</b>	<b>\$1,129</b>
<b>Ratio of earnings to fixed charges.....</b>	<b>2.9</b>	<b>3.3</b>