DEAR FELLOW SHAREHOLDERS:

The men and women of Union Pacific put forth an extraordinary effort in 2005, delivering solid results. Despite the unprecedented frequency and severity of major weather-related service disruptions, 2005 saw improved operating performance, record revenue, yield gains and improved financial results.

2005 RESULTS
Increasing operational efficiency was our key objective as we entered 2005. Progress toward that goal can be viewed in many ways, but by almost every measure, we did improve. Our network fluidity, in the form of lower terminal dwell times, improved 6 percent during 2005. The decline in average rail car inventories in 2005 and increased carloads also were indicators of greater operating efficiency.

We delivered improved financial performance this year against the backdrop of adverse weather and rising fuel prices. Demand for our services remained very strong and, as a result, we achieved several milestones:

• Commodity revenue grew 11 percent to a record $13 billion.
  • All six business groups attained “best ever” revenue levels.
  • Revenue for business moving into and out of Mexico totaled over $1.1 billion, a 15 percent increase versus 2004 and the first time Mexico revenue exceeded the $1 billion mark.
• Seven-day carloadings, a measure of our business strength, hit a record 198,416 carloads in the third week of November.
• Coal tonnage shipped out of the Southern Powder River Basin (SPRB) topped the 179 million ton mark. Despite setting a new record, SPRB Joint Line disruptions artificially constrained production.
• Operating income, excluding last year’s asbestos charge, grew 16 percent and our fuel-adjusted operating ratio decreased by 1.5 points, both signs of improved operating efficiency.
• Net income grew 20 percent excluding the effects of the asbestos charge in 2004 and the tax reduction in 2005.
• Free cash flow after dividends totaled $234 million.
• UP’s lease adjusted debt to capital measure improved 1.5 points to 43.6 percent, our strongest balance sheet since 1985.
• UP’s stock price rose 20 percent to close at $80.51 per share for the year.

CHALLENGING OPERATING ENVIRONMENT
Although we improved in 2005, the tremendous weather challenges we faced hindered our progress. A series of devastating events, starting in January with the West Coast storm and continuing through the year with Hurricanes Katrina and Rita and the Kansas washouts, severely damaged our Railroad. Our employees and the communities where we operate were impacted as well.

Weather issues and an expanded repair program caused operational problems on the SPRB Joint Line in Wyoming for much of the year. The additional resources and network initiatives we established to drive service improvement became the catalyst for our recovery efforts. This greater network resiliency and the tireless dedication of our employees allowed us to quickly restore service following each natural disaster.

These external challenges resulted in lost opportunities during the year. Our focus for the future is to continue the transition to operational excellence, and our momentum is building. There’s clearly a great deal of work ahead of us, but we believe we’re well positioned to make further progress.
SAFETY FIRST
Union Pacific’s approach to safety is one of zero tolerance. Although the rail industry is already one of the safest in America, we are working daily to improve. In 2005, our number of derailments improved 8 percent and the associated costs decreased 12 percent. We also enhanced grade crossing safety through the closure of 400 rail crossings and the installation of 750 locomotive video cameras. Cameras provide valuable evidence for accident investigations. In 2006, we will continue our focus on employee safety education and training, public awareness and derailment prevention.

OPERATING INITIATIVES
Strong business demand and significant attrition in our aging workforce required additional resources to meet the needs of our customers. Last year, we continued efforts begun in 2004 to bolster the Railroad’s critical assets - employees, locomotives and freight cars. We hired and trained nearly 2,100 conductors and 1,700 engineers and added 317 new fuel-efficient, emissions-compliant locomotives and 4,200 freight cars. We also increased our network capacity through targeted capital spending in some of our fastest growing corridors. Our Intermodal capacity increased with the opening of new facilities in Dallas and Salt Lake City, we installed 69 miles of double track on our Sunset Corridor and 14 miles of triple track to the SPRB Joint Line.

We began implementing our Unified Plan in April, instituting changes to our transportation plan. The Unified Plan is one of several network initiatives started in 2005 to redesign and simplify our operations. The goal is to increase velocity and improve customer service by reducing the workload on the network. Two areas targeted by the Unified Plan are main line train stops and terminal switching.

At the beginning of the year, only a third of UP’s regularly scheduled trains moved from origin to destination without stopping. The average manifest car was switched three times before arriving at its destination. Through the Unified Plan, our rate of train stops declined 16 percent and our car switching rate decreased 12 percent. This work links directly to improved terminal dwell time and reduced rail car inventory we experienced in 2005. We have more hard work ahead of us to increase efficiency, but customers are starting to recognize our efforts and are working with us to make operational changes.

We are also improving terminal efficiency through a newly developed technology tool called our Customer Inventory Management System (CIMS). We use CIMS to proactively manage terminal inventory and increase asset utilization as well as help customers improve processing efficiency.

The overall goal is to generate more terminal throughput with existing capacity. The initial CIMS pilot location was Phoenix. We subsequently rolled it out to major terminals in Las Vegas, Los Angeles, San Antonio and Houston, covering 40 percent of daily industry switching. In 2006, we plan to implement CIMS in additional terminals, including Salt Lake City, Roseville, Portland, Seattle, Fort Worth, Kansas City and Little Rock.

Velocity was relatively unchanged versus 2004, largely due to the many weather issues we faced. Increasing network velocity is a key objective for 2006, and a continued emphasis on Unified Plan compliance is vital to achieving that goal.

In conjunction with the Unified Plan, we are increasing capacity by employing industrial engineering strategies that require little or no capital investment. For example, we initiated projects to:

• improve system velocity by reducing terminal dwell time,
• increase locomotive availability by decreasing locomotive service time,
• conserve fuel by reducing locomotive fuel consumption through technology and training, and
• facilitate volume growth by de-bottlenecking constrained terminals, intermodal yards and key rail corridors.

Additionally, teams in Phoenix, Houston, Kansas City and Los Angeles have studied traffic flows, operating practices and processes to increase throughput in these capacity-constrained areas.

ANOTHER YEAR OF RECORD FUEL PRICES
Following a more than 40 percent increase in diesel fuel prices in 2004, we experienced another huge increase in 2005. Our average diesel fuel price in the first quarter was $1.45 per gallon, but it increased to $2.08 per gallon by the fourth quarter. Two factors drove the increase: crude oil prices and refining spreads. After starting the year at about $40 per barrel, the price of crude oil topped out over $70 per barrel in September. In addition, refining spreads nearly tripled following the fall hurricanes.

Although somewhat mitigated by our fuel surcharge programs, rising fuel prices decreased our 2005 operating income. Our goal is 100 percent recovery of higher fuel costs to eliminate the earnings impact. Longer-term, high fuel prices create a competitive advantage for us, as rail transportation is three times more fuel efficient than trucking. We also increased our emphasis on fuel conservation through engineer training and improved locomotive technology. In 2005, our consumption rate improved by 2 percent, saving 35 million gallons of fuel.
**UP EMPLOYEES - A CRITICAL RESOURCE**

As we continue to hire for growth and to offset attrition, our goal is to be the "Employer of Choice" for our 49,750 current employees as well as the many prospective candidates we interview each year. Over the past two years, Union Pacific hired more than 13,000 employees into a rewarding, diverse and healthy work environment:

- UP was named the nation’s top Military Friendly Employer for 2005 by *GI Jobs* magazine.

- The Union Pacific Child Development Center opened in Omaha to provide care and an educational curriculum to young children of UP employees.

- *Working Mother* magazine honored us for the fourth year, and *LATINA Style* magazine for the third consecutive year, as a top employer.

- The Company also received numerous accolades for its employee health programs, including the prestigious C. Everett Koop National Health Award. Union Pacific is the only four-time recipient of this award and the only corporation honored in 2005.

The American Red Cross presented UP with its Circle of Humanitarians Award for donating so generously to its hurricane relief efforts. Employees contributed to the Red Cross, Salvation Army, America's Second Harvest and the Baton Rouge Area Foundation to aid hurricane victims. Employees also donated to UP's own Friend-to-Friend Network to help fellow employees who were affected by the hurricanes. In total, we donated more than $1 million to these worthwhile agencies.

UP has always maintained the highest standards of ethics, disclosure to investors and financial reporting. We have taken additional steps to comply with every aspect of the complex rules and regulations resulting from the Sarbanes-Oxley Act. Beyond that, we are implementing a risk-based compliance program to ensure a culture of compliance with laws and regulations in every aspect of our business.

**CORPORATE CHANGES**

As we enter 2006, we are moving ahead with the succession plan we began a few years ago. As of January 1, Jim Young took on the added responsibilities of president and chief executive officer of the Corporation while I remain chairman of the board. Jim was elected to the Union Pacific board in February 2005. These changes ensure an orderly management transition process for our Company.

Our Board will see additional changes in 2006 when Spencer Eccles steps down in compliance with the Board’s mandatory retirement age. Spence has been on the Board since 1976 and is currently serving on the Compensation and Benefits Committee and the Audit Committee. His great insight and wisdom over the years will certainly be missed. Dr. Ernesto Zedillo has decided not to stand for re-election due to his challenging workload as Director of the Yale Center for the Study of Globalization. Ernesto has been on the Board since 2001, serving on the Audit and Finance Committees. As the former President of Mexico, his assistance in understanding the NAFTA marketplace was invaluable.

I am pleased to welcome General Charles Krulak as our newest board member. General Krulak is a 35-year veteran of the U.S. Marine Corps, serving as their Commandant from 1995 to 1999. After retiring from the military, he joined MBNA, serving first as the chief executive officer of MBNA Europe and then as the executive vice chairman and chief administrative officer of MBNA Corporation.

**2006 - CONTINUOUS IMPROVEMENT**

Looking ahead, we believe that 2006 will be another year of record business levels as demand remains strong. In this business environment, we are focused on providing better service to our customers, improving the efficiency of our network and increasing the financial returns on our business. The process of improvement is "evergreen" as we continue to implement network and market strategies designed to increase profitability.

Beyond 2006, we will plan for the future of this great Railroad by making prudent capital investments. We will continue to devote resources for growth, supporting our long-term goal of earning a return that "meets and beats" our cost of capital.

The great value of the Union Pacific franchise is being recognized in today’s marketplace. It is our responsibility to translate that value into better service for our customers, rewarding jobs for our employees and higher returns for our shareholders.

Dick Davidson
Chairman of the Board

Jim Young
President and Chief Executive Officer