

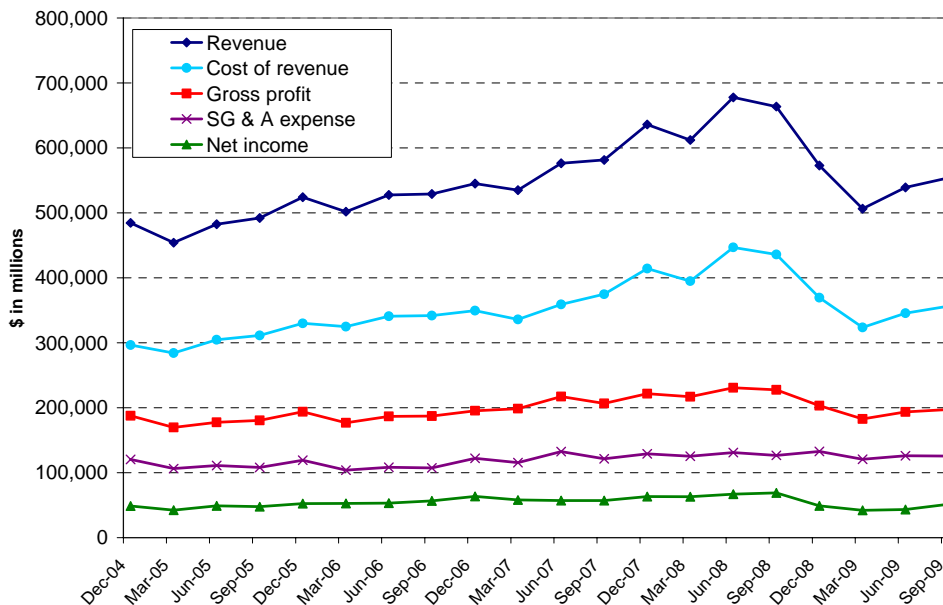
**Third Quarter Corporate Earnings: Losing Steam or Gaining Strength?
(Excerpt from a 5 page report)**

Our analysis of second quarter non-financial corporate earnings (see www.aametrics.com/feature_capital_markets.htm) led us to the conclusion that the Great Recession had come to an end in the first half of 2009. For the twenty-six non-financial companies in the Dow Jones Industrial Average (the Dow 26), sales revenues, expenses, and net income in aggregate all increased in the second quarter of 2009 from first quarter troughs. Although the second quarter sales and earnings recovery was not universal, it was broad-based with twenty-four of the twenty-six companies reporting increases in sales revenue.

We promised that we would take another look at the earnings story once third quarter results were in. The last of the Dow 26 reported earnings on Tuesday, November 24th, and with this report, we fulfill our promise.

As is evident from figure 1, the recovery in sales and net income continued into the third quarter. Aggregate sales revenue increased 2.7% to \$553.8 billion in the third quarter from \$539.4 billion in the second quarter (2Q 2009). The sales increase was not as strong as the 6.5% increase in the previous quarter and was not as broad-based with ten companies reporting a drop in sales from the previous quarter. The slower rate of sales growth and the mixed experience of the Dow 26 are a concern. Rather than supporting the case for a firm recovery, the 3Q 2009 sales results reflect a tentative recovery.

**Figure 1
Components of the Aggregate Earnings of the Dow 26**



Source: Bloomberg and Advisor calculations

Somewhat less evident from figure 1 is the robust 17.9% increase in aggregate net income for the Dow 26 to \$51.4 billion in 3Q 2009 from \$43.6 billion in 2Q 2009. This \$7.8 billion increase was a much stronger showing than the previous quarter's increase of only \$1.5 billion or 3.6%. The increase in net income, however, was not broad-based, with ten companies reporting declines in net income for the most recent quarter. Seven of the ten companies reporting declines in net income also had declines in sales revenue.

Figure 2 shows the aggregate results in tabular form and compares the current quarter with the past four quarters. Net income for the Dow 26 peaked in the third quarter of 2008.

Figure 2
Aggregated Comparative Income Statement for the Dow 26

	3Q 2009	2Q 2009	1Q 2009	4Q 2008	3Q 2008
Sales revenue	553,761	539,381	506,386	572,839	663,607
- Cost of revenue	356,497	345,742	323,535	369,600	436,126
Gross profit	197,264	193,639	182,851	230,239	227,481
- Selling, general & admin exp	125,614	126,251	120,781	132,933	126,892
Operating income	71,650	67,388	62,069	70,306	100,589
- Interest exp	4,635	5,734	5,273	4,890	4,734
+ Foreign exchange gains/(losses)	124	102	46	(165)	(55)
+ Net non-operating gains/(losses)	7,586	3,660	4,308	1,732	9,233
Pretax income	74,724	65,416	61,151	66,984	105,034
- Income tax exp	21,224	19,820	16,879	16,892	34,197
Income before extraordinary items	53,500	45,596	44,272	50,092	70,837
+Extraordinary gain/(loss) net	316	82	(22)	1,670	1,017
- Minority interests	2,449	2,101	2,176	2,702	2,812
Net income	51,365	43,577	42,074	49,060	69,042

Source: Bloomberg and Advisor calculations

Figure 2 shows that the robust increase in earnings from 2Q 2009 to 3Q 2009 was not due to a large increase in operating income. Operating income, in fact, increased more in the second quarter (\$5.3 billion or 8.6%) than in the third quarter (\$4.3 billion or 6.3%). The large increase in net income for the third quarter was primarily due to an increase in non-operating gains, which were concentrated in three companies, Chevron, ExxonMobil, and Merck.

On an equivalent per share basis (see Figure 3), quarterly earnings per share, fully diluted, increased by 17.0% from \$0.53 to \$0.62, in line with the increase in net income. Earnings per share, however, are still well below the peak of \$0.83 in 3Q 2008.

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