Opening Comments
Bob Brust
Q2'05 - July 20, 2005

Thank you, Antonio.

As you have seen in our press release this morning, we reported second quarter operational earnings of $.53 per share, which is well below our stated expectations of at least $.75 per share. While these results represent a substantial recovery from the first quarter, they are still clearly below where we wanted to be. There are four drivers of this quarter's results, which I'll discuss more fully in a few minutes. They include consumer film, Health digital revenue growth, unfavorable exchange impacts and unexpected tax movements.

First, there was a sharper than expected industry decline in consumer film sales, principally in Emerging Markets, where we are seeing an impact from digital substitution in the most developed sectors of these markets.
The decline in the US and European markets is about as we expected. The worldwide industry volume decline of consumer film in 2005 was previously forecast at approximately 20% and we now believe that number for the full year will be in the range of 23% to 27%.

As Antonio indicated, the increasing rate of consumer film decline represents one more reason for the accelerated program to reduce our traditional manufacturing infrastructure. Whether the decline rate is at the top or bottom of the forecast range is becoming increasingly irrelevant, as we are taking down the infrastructure at what we believe is the maximum rate possible. Therefore, we will be moving away from trying to make consumer film decline rate predictions in the future.

The second major component affecting second quarter results is in our Health Group. On the positive side, Health made significant progress improving its performance quarter sequentially, reporting higher operating margins of 16% versus the 11% reported in the first quarter, and improving sales for both Computed Radiography and Healthcare Information Systems products. However, overall digital revenue growth was less than anticipated, leading to the shortfall against expectation.

In addition, we found ourselves fighting a number of headwinds during the quarter, the most significant of which was the strengthening U.S. dollar. This had two areas of impact, which resulted in $.09 of unfavorable exchange versus our plan for the second quarter. $.06 was the result of unhedged U.S. dollar denominated Kodak Polychrome Graphics debt that was required to be marked to market. The second impact was a negative $.03 related to the impact of the strengthening dollar in the translation of non-U.S. dollar sales and costs.

Finally, unfavorable and unforecast tax charges/accruals negatively impacted the quarter by $.06 related to:

- A couple of state tax law changes
- Valuation allowances related to closure activities in Brazil that we thought would be part of restructuring but impacted instead operational results.
- And subsidiary remittances which required a small tax accrual

Consolidated revenue growth for the company was 6%, driven primarily by the recent KPG and Creo acquisitions, which together contributed $413 million of revenue in the quarter. The revenue growth was favorably impacted by foreign exchange of $54 million or 2% year over year. Digital products revenue grew 43% driven primarily by our portfolio of consumer digital products and services and the KPG and Creo acquisitions, which closed during the quarter.

Traditional products revenue declined 15%, which is a bit of an improvement versus our estimate of a 17% decline rate for the year, as accelerating consumer film declines were partially offset by strong motion picture film sales and better than expected x-ray film sales.
Emerging market sales increased 1%, although sales in China declined 6% as a result of consumer film declines in the more developed parts of this market, partially offset by strong sales of Health and Graphic Communications products.

Gross profit as a percent of sales was 29.0% on a GAAP basis, a decline of 2.8 percentage points from last year, primarily driven by an increase in year over year non-operational charges in Cost of Goods Sold of $52 million, and unfavorable price/mix.

SG&A increased $33 million or 5% in the quarter, but decreased as a percent of sales from 17.8% to 17.6%.
A combination of acquisition related costs of $77 million and unfavorable exchange of $8 million added $85 million to SG&A, which was partially offset by cost reduction activities during the quarter. Excluding acquisitions and exchange, SG&A declined by 8%.

As part of our current restructuring program, approximately 2,200 positions were eliminated during the quarter. In addition, cost reduction actions which included severance, accelerated depreciation, exit costs, and asset and inventory writedowns resulted in pre-tax charges totaling $353 million or $.88 per share. The use of restructuring cash was $75 million higher versus last year.

Second quarter operational EPS was $.53 per share, compared with last year's restated $.75. A number of non-operational items were recorded during the quarter which include the following:

- A pre-tax charge of $64 million, or $.13 per share relating to the writeoff of in-process R&D associated with the acquisitions of KPG and CREO.
- A charge of $6 million, or $.02 per share relating to a change in estimate of the tax benefit associated with a land donation from a prior period.

- A pre-tax charge of $19 million, or $.07 per share relating to the writedown of the Company's investment in Lucky Film, reflecting a decline in its stock share value.

These charges were partially offset by:

- A credit of $13 million, or $.03 per share relating to gains on the sale of real estate.

Including the impact of restructuring and other non-operational items, the GAAP loss per share for the second quarter was $.51 on a continuing operations basis.
The other income and charges category had a negative swing of $46 million year over year primarily driven by:

- The previously mentioned $23 million of unfavorable exchange impact from unhedged U.S. dollar denominated KPG debt.
- KPG equity income, which moved from "other income and charges" to the Graphic Communications segment as a result of the Company's acquisition of Sun Chemical's 50% interest in the KPG joint venture, which closed on April 1st.
- The Lucky Film valuation impairment of $19 million, which was somewhat offset by gains on sales of properties of $13 million.

We recorded an estimated annual effective tax rate of 15.5% for the quarter, reflecting the expected sequential upward trend that was predicted earlier this year. This trend is being driven by a rebalance in the mix of where the company is earning income.

In addition, there was a $29 million year over year change recorded in "benefit for income taxes", which negatively impacted current quarter operational earnings relative to the same quarter last year. A tax benefit of $9 million was recorded in the year ago quarter relating to a tax reserve release resulting from an IRS settlement. In the current quarter, a tax charge of $20 million was recorded relating to changes in state tax laws, the recording of a valuation allowance, and the planned remittance of earnings from subsidiary companies outside the U.S.

Kodak's inventories of $1.523 billion increased $193 million quarter sequentially, primarily as a result of the Creo and KPG acquisitions, which added approximately $335 million of inventory.

Excluding acquisitions, inventories declined by more than $100 million. We made significant progress during the quarter in bringing down traditional inventories and will continue to aggressively address this issue in line with our goals and cash flow targets.

Net trade receivables increased $695 million quarter sequentially, primarily as a result of the Creo and KPG acquisitions. In addition, we traditionally experience seasonally higher sales in the second quarter.

Capital spending was $111 million in the second quarter, an increase of $20 million from last year's second quarter.

As expected, debt increased to $3.721 billion, from year-end 2004 levels of $2.321 billion as we closed the KPG and Creo acquisitions during the second quarter. The Creo acquisition has been funded under our $1.225 billion, 5-year revolver.

We plan on terming out a large portion of that debt soon, and are in the process of renegotiating that revolver which expires next year. Both of these events should be concluded this summer. We will now turn our attention to reducing debt for the next few years.

Second quarter investable cash flow was a negative $297 million compared to a negative $39 million in the year ago quarter. Net cash from operating activities as determined in accordance with GAAP was a negative $207 million versus $60 million in the year ago quarter driven primarily by lower earnings and an increase in cash payments associated with restructuring.

Cash on hand at the end of the quarter totaled $553 million, which compares to $519 million last year at the same time and $490 million on average for the past five years.

Despite our earnings shortfall to date, we look for investable cash performance to be on plan for the year in the $400 million to $600 million range, which equates to $1.0 billion to $1.2 billion in net cash provided by operating activities as determined in accordance with GAAP.

I'd like to take a minute to explain why I am so confident in our ability to achieve our targeted cash goals given the higher expected use of restructuring cash and lower year over year earnings:

- With a traditional inventory pool of approximately $800 million, we have aggressive plans in place to decrease these inventories faster than underlying industry decline rates.
- We are finding additional opportunities to constrain capital spending as we migrate to a less capital intensive digital infrastructure.
  As a result, our estimate for full year capital spending has been reduced from $600 million to less than $500 million.
- We continue to improve the quality of our receivables and have opportunities to improve past due performances in our acquired businesses.
- We will continue to seek returns from our portfolio of intellectual property, as we believe there is value to unlock here.
- Finally, we are creating surplus assets as a result of our restructuring actions, which we are working aggressively to monetize.

As Antonio mentioned, we will be implementing an accelerated cost restructuring program, which continues to demonstrate that we will deal effectively with the realities of the declining traditional portfolio, while continuing to improve the profitability of our expanding portfolio of digital products and services.

The additional initiatives are expected to eliminate approximately 9,300 positions, generate incremental annual savings of approximately $800 million and result in incremental cash charges of about $470 million over the life of the program. A significantly higher mix of writeoffs included in these additional initiatives will result in a lower cash impact relative to the program announced in January 2004.

In total, the combination of the existing program, the extension announced today, as well as a number of smaller initiatives will result in total employment reductions of 22,500 to 25,000 from January 2004 levels, with a total program cost of $2.7 billion to $3.0 billion when fully implemented. About half of the cost will be non-cash.

Because it has become increasingly difficult to predict short-term earnings due to the complex nature of our transformation, we will no longer be providing per share earnings forecasts.

As we dismantle almost $2 billion of assets and reform our infrastructure during the next two years, accurate forecasting becomes very challenging, if not virtually impossible.

As you have seen from our quarterly disclosure document distributed this morning, we will no longer include a discussion of "operational" earnings. Consistent with SEC recommended practices, we will report GAAP earnings only. However, we have and will continue to provide a description of non-operational items and where they are recorded within the P&L.

We will also report quarterly consolidated digital earnings from operations beginning in the third quarter and will further delineate digital earnings by segment beginning with the first quarter 2006 sales and earnings report.

Going forward, the Company will continue to focus on the most important metrics against which we should be measured - digital revenue growth, digital earnings growth and cash flow.

Antonio and I would now be happy to take your questions.