# EASTMAN KODAK
# October 31, 2006
# 3rd Quarter Sales & Earnings

**Operator:** Good day everyone and welcome to the Eastman Kodak third quarter sales and earnings conference call. Today's conference is being recorded.

At this time for opening remarks and introductions, I'd like to turn the conference over to the Director and Vice President of Investor Relations, Mr. Don Flick. Please go ahead, sir.

**Don Flick:** Good morning and welcome to our discussion of third quarter earnings. I'm here this morning with Antonio Perez, Kodak's Chairman and CEO, Bob Brust, our Chief Financial Officer, and Frank Sklarsky, who has just joined our senior management team as Bob's successor.

Antonio will begin this morning with his observations on the quarter and then Bob will provide a review of the quarterly financial performance. As usual, before we get started, I have some housekeeping activities to complete.

First, certain statements during this conference call be forward-looking in nature or forward-looking statements as defined in the United States Private Securities Litigation Reform Act of 1995. For example, references to expectations for the company's earnings, revenue, and cash would be such forward-looking statements. These forward-looking statements are subject to a number of important risk factors and uncertainties, which are fully enumerated in our press release this morning.

Listeners are advised to read these important cautionary statements in their entirety. Lastly, although Kodak has significantly reduced its references to non-GAAP measures, in those instances where they are used, they are fully reconciled to the nearest GAAP equivalent in the documentation released this morning, which can also be found on our website.

Now, I'd like to turn the conference call over to Antonio Perez.

**Antonio Perez:** Thanks Don. Good morning to all and thanks for joining us for our discussion of third quarter earnings. This morning, I have the pleasant job of introducing Frank Sklarsky who is marking his second day at Kodak and will assume the CFO title on November 13th.

Frank, if you want to say a few words before we start.

**Frank Sklarsky:** Thanks Antonio. Obviously with something on the order of about ten hours on the job, I've got a lot of work to do to come up to speed so I can continue and extend the progress that Bob has made before me.

I am excited to join this management team. I'm very enthusiastic about the opportunities ahead for Kodak and I look forward to working with the investment community as we go forward.

**Antonio Perez:** Thank you, Frank and once again, welcome to the Kodak family. I would also like to recognize that this is Bob Brust's last quarterly conference call with investors bringing to an end seven years of invaluable contributions to Eastman Kodak.

Bob arrived when Kodak was truly a traditional imaging products company and played a key role in moving us to the positions we are in today; ready to complete the final phases of our transition.

Bob has been a key strategic partner for me and I thank him for both his tangible contributions and his counsel during these very challenging times. We wish Bob and his wife, Judy, well in their future activities.

Now let's move to discuss our third quarter performance. I am pleased with the quarterly results we posted this morning as they show the continued momentum we need to achieve our goals for the year. Some of the highlights for the quarter include the following. We achieved year-over-year earnings improvement of $85 million in our consumer digital group resulting from our progress and implement in the digital operation model as well as continued contributions from our IP portfolio which are part of our full-year plan for 2006 and in years to come.

On the operating side, we saw year-over-year earnings improvement in essentially every element of our consumer products portfolio; digital capture, image sensors, home printing and kiosks. Going forward, we will see an increasing flow of benefits from that improved operating model. Media burn rates will continue to build in our kiosks and dock printers.

New products such as CMOS sensors, new generation of cell cams and ink jet as they enter our portfolio. As part of this CDG story we will continue to create value through a variety of intellectual property agreements that will accelerate the creation of new businesses, provide access to markets previously unavailable to us, create advantageous business arrangement and important partnerships with key industry leaders, as well as, you know, providing returns on our R and D investments

Intellectual properties are on-going, multi-faceted elements of our business model and we will continue to manage it that way. Depending upon the timing of the deals and the accounting treatment, which is very much deal dependant, there might be a noticeable impact in any given quarter. However, our annual plans incorporate monetization of IP in a variety of forms and this is part of how we run the business.

Again, our strategy is to create long-term value through IP while managing IP contributions on a full-year basis. I remain confident we should get through essentially full-year, break-even performance for consumer digital as we work to continuously improve the earnings performance of our key consumer digital businesses.

We maintained double-digit operating margins of 11 percent in our health group. Despite the burden of additional costs associated with our strategic alternatives earnings initiative and significantly higher year-over-year silver prices. We see a satisfying order book growth for both our digital radiology product and in healthcare information systems. Our new product offerings are well received by the market.

It remains my objective to announce the completion of the strategic alternative study by the end of this year and we continue to post earning improvements in regard to the communications group and achieved a six percent digital operating margin in the quarter enabled by continuing integration savings and strong growth in digital plates, NEXPRESS color products, commercial ink-jet print solutions and document scanners. As a result, the total GCG earnings increased by $24 million dollars from last year third-quarter despite higher raw material costs from silver and aluminum.

Our film and photofinishing groups performed better than expected posting a 13 percent upgrade in margin as we continue to benefit from the effective cost reduction actions that we have been undertaking for the last three years.

As you have heard me say before, our objective is to take cost out faster than revenues decline and the results show that we are getting that done. Within the balance of the FPG portfolio, our entertainment film business grew three percent during this quarter, with no significant changes occurring in the industry.

We achieved another milestone in this year's third quarter as it marks the first time that digital earnings growth exceeded the traditional earnings decline with digital earnings increasing $98 million from last year and a traditional earnings declining $48 million.

This follows another milestone we achieved in the third quarter 2005 when digital revenues exceeded traditional revenues for the first time in our company. These accomplishments are key indicators for me of the success of our strategy in key milestones on our path to complete the transformations of this business.

We achieved our cash goals ending the quarter with more than $1.1 billion of cash on hand, which is almost double last year's result while reducing debt by $129 [sic] million in the third quarter, and $100 million in October. [Note: Kodak reduced debt by $192 million in the third quarter of 2006]. During the quarter, revenue was a bit softer than planned, although I am comfortable where we came out. We are making choices and the time will come with our improving cost structure and introduction of new product categories when our focus will be realigned.

As we indicated earlier this year, the consumer digital group began to realize the benefit of trading unprofitable revenue growth for market expansion especially in the area of digital cameras and in printer docks. However, consistent with our long-term objectives, we were able to maintain the number three market share position both in the U.S. and worldwide for consumer digital cameras on a year-to-date basis through August.

On the same basis, we continue to be the market share leader for our printer dock products in the U.S. I do know this is a year of significant position for GCG. Last year we completed our major acquisition program in this space, aiming at a revenue growth in 2006 including acquisitions in the high 20s. We will, in fact, achieve that.

This year, though, we are concentrating on effectively integrating the acquired businesses into a single entity so we can focus on growth next year. The principle drivers of growth include digital plates, workflow software, commercial ink jet solutions, NEXPRESS color products, and document scanning which are all posting strong growth.

Offsetting this growth this year are expected revenue declines primarily from analog plates and graphic films. Beginning in 2007, we expect the growth engines to more than offset the declines from the other elements of the portfolio and move us toward our expected top-line growth rate in this business.

As one more point along this path, we were very pleased with our success at the recent Graph Expo Trade Show in Chicago where we booked strong sales particularly in the areas of digital prepress and digital printing reflecting customer interest in expanding their digital print services.

Now, as you know, our portfolio of digital business is very seasonal, more than 50 percent of consumer digital sales and greater than 40 percent of total corporate digital sales occur in the last four months of the year. So, obviously we will need to work effectively to bring the year to a successful conclusion.

The key piece of our strategy this year will remain our focus on market expansion. Effective in January, we have achieved scale, now we must achieve the earnings and cash needed to complete our transformation and invest aggressively on expanding our product portfolio so we can achieve sustainable growth going forward. It's the logical next step in this position plan and the plan is working for us.

As I think about digital revenues for the fourth quarter, we will continue to focus on cash and digital earnings at the expense of revenue growth. Enroute to our year-over-year earnings turnaround in CDG,

As I conform to this strategy and look ahead from market forecasts and last year comparisons with the fourth quarter, while I'm not ruling out the possibility of ten percent revenue growth, we could come up somewhat short of that goal as we will continue to produce earnings performance over revenue growth.

In line with that, I continue to remain confident in our ability to achieve our digital earnings target for the year in the $350 million to $450 million range and our investable cash target of $400 to $600 million.

Now, I'd like to turn the call over to Bob who will review the financial results.

**Bob Brust:** Thanks Antonio. I would also like to extend my welcome to Frank who, as Antonio mentioned, will assume the role of CFO shortly after we sign off on the third quarter 10-Q. As Antonio indicated, the third quarter represented continued progress on the path to achieving our full-year transformational goals.

The third quarter gross profit margin was 27.3 percent versus 25.9 percent last year, an improvement of 1.4 percentage points and clear progress toward our target of approximately 30 percent gross profit as a percent of sales.

A number of items impacted the gross profit. On the positive side, these were manufacturing cost reductions, non-recurring licensing agreement, and foreign exchange, which together improved margin by approximately four percentage points.

These were partially offset by lower volumes, $40 million of adverse silver price impact on a year-over-year basis, which together reduced gross margin by about 2.6 percentage points. In the quarter SG&A decreased $105 million or 16 percent and declined as a percent of sales to 17.6 percent from 18.9 percent in the year ago quarter. SG&A represents the critical last part of our business transformation, as we need to reduce SG&A as a percent of sales by approximately three percentage points to achieve our target SG&A level of 14 to 15 percent of sales.

We will be working hard on this task going forward, as we plan to essentially complete all of our restructuring efforts during 2007. R&D declined $42 million or 20 percent, led by reductions in the traditional product area. With R&D running at about 5.3 percent of sales level, we have essentially achieved our spending targets in this area.

Our restructuring efforts continued throughout the quarter, with the third quarter pre-tax charges totally $212 million. And, on an after-tax basis, $202 million dollars, or 70 cents per share, versus $363 million, or $1.26 per share in the year ago quarter.

These charges included severance, accelerated depreciation, exit costs, and asset and inventory write-downs.  Year-to-date through the third quarter, total after-tax restructuring charges total $613 million, compared with $752 million from the first three quarters of last year.

As we approach the end of the year, we can now better estimate our total restructuring charges for this year.  Our previous estimate had been between $1.2 and $1.4 billion pre-tax, and our current estimate for the full year restructuring charges is approximately a billion dollars, pre-tax as we find some actions less costly than anticipated, and some planned actions moving into next year.

We now expect full year cash restructuring payments will be approximately $600 million.

Approximately 1,650 positions were eliminated during the third quarter, bringing the program total to date to more than 22,200 positions.  Consolidated third quarter digital earnings from Operations were $105 million.  An improvement of $98 million from last year's third quarter's nearly break-even performance.

As Antonio has indicated, we are very focused this year on driving digital market expansion, and the quarter shows we are making some good progress.  The consumer digital group crossed over into profitability during the quarter with earnings of $24 million, versus a loss of $61 million in last year's third quarter.

Consumer digital gross profit improved across virtually all of the major product lines as a result of a lower-cost "go to market" model, improved portfolio participation strategy, and proceeds from the non-recurring licensing arrangement.

Digital earnings in the health group decreased from $50 million last year to $35 million this year, primarily as a result of costs associated with exploration of strategic alternatives, and a lower contribution from the digital output product portfolio, which continues to be impacted by increased silver pricing, and the growing industry shift to soft-copy diagnosis.

This decline was partially offset by increasing earnings contribution from digital capture, healthcare information systems, and digital dental products.  Digital earnings in the Graphics Communications Group increased $27 million, driven by strong demand for digital plates, excellent acceptance of a new low-end document scanner product, and strong performance in commercial inkjet printing systems and servers.

As a result, GCG's quarterly operating margin improved from less than one percent to 3.5 percent on a year-over-year basis, with digital operating margin running at six percent.  On a total company basis, traditional earnings were $157 million for the third quarter versus $205 million in last year's third quarter.

The FPG segment, which is the largest contributor to traditional earnings, achieved an operating margin of 13 percent for the third quarter, which is unchanged from the year ago quarter.  As a result of a strong focus on cost reduction, FPG was able to maintain flat year-over-year operating margins, while revenues declined 21 percent.

The other income and charges category had a positive year-over-year swing of $63 million.  The largest single item was the gain on the sale of property made surplus by our restructuring actions.  As you know, our restructuring programs have created excess property, which we will continue to monetize.

We achieved our cash goals in the quarter through a number of factors. These included holding inventory flat, on a quarter sequential basis, as opposed to the historical tendency to rise sharply from the second quarter level, as well as tightly managing receivables and capital expenditures.

This improved inventory discipline should position us well for meeting our full year inventory goals as we move into the important fourth quarter. As expected, cash received from IP and asset sales totaled more than $100 million. Through three quarters, our year-to-date investable cash performance is slightly ahead of last year's pace, and we ended the quarter with $1.1 billion of cash on the balance sheet, nearly double the $610 million in cash we had a year ago.

Year-to-date we have paid out $408 million in restructuring cash, compared with $417 million for the first three quarters of last year. We paid a $200 million debt obligation in September, and subsequently in October we retired an additional $100 million of debt. We remain confident that we will be able to achieve our goal of reducing debt by approximately $800 million this year.

Interest expense was $74 million in the current quarter, an increase of $17 million from the third quarter of last year, largely as a result of a non-recurring charge relating to a non-U.S. tax claim, as well as higher interest rates associated with the company's secured debt facility.

The company reported a gap loss of $37 million or 13 cents per share, on a continuing operations basis in the third quarter. Compared with a loss in the year ago quarter of $915 million, or $3.19 per share, when we recorded the large valuation allowance or $2.71 per share.

It is important to note that the current quarter results include 70 cents per share of restructuring costs. Lastly, we have received some questions regarding recently enacted pension legislation. As we review these laws we see no impact on the required or the expected funding levels for our US pension plan.

In summary, we are very confident that the company will achieve its cash flow, debt reduction, and digital earning goals for the year.

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

**Operator:** Thank you. Today's question and answer session will be conducted electronically. If you would like to ask a question, please press the star key followed by the digit one on your touch-tone telephone. Once again if you would like to ask a question, please press star one at this time.

We'll take our first question from Jay Vleeschhouwer with Merrill Lynch.

**Jay Vleeschhouwer:** Yes, thanks, good morning. Antonio, I think it was two conference calls ago when you talked about some changes you were making in your global, logistics and management structure, and you've since announced the Flextronics arrangement, for instance.

Can you quantify the impact thus far, in terms of your operational or logistical systems, in terms of any financial or efficiency benefits that you've implemented, including Flex or other parts of the company?

Secondly, with respect to consumer digital, excluding IP sales, can you foresee that the operating gross margin of that business could sustainably get to the mid-twenties or better?

**Antonio Perez:** The Flextronic impact - I think it's too early to give you a number, but I think in February or January when we do the conference call, I think we will make an attempt to give you a number for the financial impact.

Obviously, the impact is a lot more than simply financial. There are a lot of other positive reasons why we did this, but we will make an attempt to give you the financial impact. It's too early; we are still working together with them. We haven't passed along all of the responsibilities the way it will be done in the next few months.

It will be a positive impact for sure, but it's too early to say. First of all, I don't know why you want to separate the impact of IP from the rest, because for me, it's an integral part of the business. Obviously, you can use your IP portfolio in many ways. You go to an extreme; you could ask people not to manufacture products, which will obviously help with the sale of your products.

That is not the path that we have taken, and not the path that we will ever take, but what we're trying to do is use that capital, and that know-how, and negotiate deals that will end up being revenue-generating deals, because we need those partnerships in the future. We are talking to all sorts of companies; many of them are key partners for us now and in the future.

Now, having said that about IP, we are managing the rest of the business to stand by itself. For the present consumer digital portfolio; our goal is to be in the single digits operating margins. With the new portfolio that would include CMOS and some of the other work we are doing, and inkjet in the future we will increase that number. Obviously we have to build scale in those businesses for them to be impactful.

**Jay Vleeschhouwer:** Two final questions, last year, and again year-to-date in '06, you had some good leverage in terms of improving your inventory turns as a source of cash. Looking into next year, do you think that you would have as much leverage or opportunity to improve turns as a component of improving cash flow again?

And finally, this year, as you say, you've been willing to forego some revenue in favor of cash and profitability. Do you think, as you now get closer to the end of the restructuring tunnel, that in '07 you could resume more of a focus on driving growth, having established a better base of profitability?

**Antonio Perez:** Yes, let me answer the last part of the question, and then I'll ask Bob to talk about cash. The answer is yes. Bob mentioned before that the most important part of the last leg of our restructuring is the reduction of our SG&A. And we have aggressive plans; we always did, for this part of the transition, to lower the SG&A.

That will improve our cost structure, and that, together with the Flextronics deal will help us to be more aggressive in that market. Remember that the deviation and the top line from the numbers that we had originally to the numbers that we have now, is by and large mostly due to our selective approach to the digital camera business.

And that was done, because with the structure we have we couldn't make money in those markets, and I didn't think it was appropriate to continue to grow that way. The first thing we have to do is to get the structure where it should be, get the supply chain where it should be and that will affect the cost of these products too, and then go back to revenue growth. Again, together with new product categories that the consumer digital group will start to have available starting sometime next year.

**Bob Brust:** Yes, Jay on the inventories, we have been able to work the inventories, and we have that opportunity next year as the traditional business still remains a multi-million dollar business, so the answer to your question is yes, there is a few hundred million dollars anyway available next year.

Also, going into next year, as we said, we should really start winding down this restructuring, both the charges, and we should see a lower cash requirement as we move through the quarters next year, so these things should phase in nicely for us to continue to have pretty good cash performance in the company.

**Jay Vleeschhouwer:** Thank you.
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**Matthew Troy:** Good afternoon, Guys. I just wanted to start off and say Bob, I know it's your last call, thank you very much for all your help, in always navigating the muddy waters with a smile, and a positive attitude, which I'm sure has been a difficult job, so I just wanted to thank you again.

**Bob Brust:** My pleasure.

**Matthew Troy:** I wanted to ask Antonio, on the Graphic Communications Group, revenues declined for the first time, a little bit, only about a percent year-over-year, and a little bit down sequentially.

I realize that a lot of things are going well at GCG, particularly on the cost side, which I'd be happy to hear about, but also I was wondering if you'd put some more detail around what may have come in light, relative to your expectations, and how would you think about top line growth going forward now that this is an organic franchise.

**Antonio Perez:** Well first off Matt, if you go back to the beginning of the year, if you remember what I've been saying is that the plans that we had for GCG top line were to grow, with acquisitions included, in the high twenties. And this is what we are doing. We are right in the high twenties. We have another quarter to go, of course, and our plans are to continue to do this. So, I feel that the top line is just what we thought it was going to be.

And having said that, we did say as well, that the most important objective that we have for this first year, was to take these six companies, four that we acquired from outside and two that we had inside – and make them one, which was not an issue and some of you, I think you too, remind me how difficult this is and I agree.

So, the focus is let's make sure that we have one company. Let's make sure that we, as soon as we can, go after the cost synergies, as you can see, they are coming out, and then get ready for growth next year which, for the second part of your question, we expect that will be within the high single digits for that group for next year.

**Matthew Troy:** OK, I think when we up there during the summer, I delineated the chapters of your legacy. You've certainly done an excellent job of being more of a pit bull, Antonio Perez, for Kodak on monetizing IP. Certainly seeing that this quarter. I think the second issue, which you've been able to pursue very well has been the ability to partner with external parties.

If I look at the GCG group, particularly on the revenue side, a question that I ask I think every call and I'll just re-ask it now - you've got some strong products at the high end, but potentially in some of those products you lack breath to compete with folks like Xerox and Canon, and others, with Canon being a partner at the same time.

Is there a thought process? Are we any closer to potentially seeing a partnership between a Kodak and perhaps a Japanese OEM? Just to scale the product line, whereby, you know, you'd share some of the technology to flush out that product line more definitively in '07? Thanks.

**Antonio Perez:** I draw the line in that the low end is weak and I fully agree and our team is working to solve that. And I think we have an opportunity for revenue growth. We feel that gap. We have a partnership with Canon and we're looking for other partnerships to do that.

We don't have any one that I can announce, but we couldn't agree more that there's an opportunity for us in the low end of the electrophotography base. We don't have a solution today and we want to have one. And we have done some internal work that's too early to show, but we've been involved with partnerships. We don't have anything yet, but we acknowledge this is an opportunity and an issue for us.

**Matthew Troy:** OK, I appreciate that. And, there's one last quick question. Is stream technology with the high industrial inkjet a very promising asset in the Kodak portfolio? Should we be thinking of that as the announcement at the next Drupa trade show in terms of time frame, I think we originally talked about '08-'09, 2010. Are we still on that track?

**Antonio Perez:** Yes, we're still on that track. You know, certainly, our vision will be to make an important statement at Drupa in 2008 and start to get revenue in 2009, and fully develop the technology into a larger portfolio in 2010.

But I still want to agree with what you said. That would be very significant, disrupting, and very valuable information for this company. At the same time, it's a pretty complex technology where we're still doing the right things in my view, and, you know, we'll have work to do. But, the plan is to be at Drupa, showing what we can do with stream in 2008.

**Matthew Troy:** Thanks Antonio and Bob. Thank you again for all the help.

**Antonio Perez:** You're welcome.

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**Carol Sabbagha:** Thank you very much. Just a couple questions, sticking with the Graphics business for a second. You talked in the MD&A about pricing, hurting in the quarter, which seemed that pricing might have gotten a little bit more aggressive, especially on the digital side. Can you talk a little bit more about that and give us color in what you're looking for, going forward?

**Antonio Perez:** Not much, Carol. I think the things that bother me the most were the price of silver and the price of aluminum, which hurt us the most. Especially silver, the aluminum kind of quieted down for a little bit and, you know, hopefully will go down. If it goes down we will have a great opportunity next year.

Pricing is always an issue, but I don't recall that it was a very significant amount.

**Carol Sabbagha:** OK, then moving on to Consumer Digital. Given that the fourth quarter, as you've pointed out many times in the past, is a huge quarter for that business, what would you like to see next quarter on the revenue side, or on the performance within the three main businesses in the fourth quarter? You don't have to give exact numbers, but some way to measure what would make you happy.

**Antonio Perez:** The biggest goal, you know, we've talked about this so many times - the biggest goal is that I want our consumer digital group to be breakeven by the end of the year. And this is very important strategically for us, because we're getting ready to introduce new products. And we don't want to carry P&Ls that are at a loss.

And we're going to have enough cash and stamina to put into the development of the new product lines. So, the most important goal for that group is to be at breakeven. Now we are growing in every single P&L that I remember, except for digital cameras and printer docks and if I missed any of the little ones let me know. But – I mean, I know the big ones, those are the two.

And fundamentally, it's digital cameras, and that was the decision that we made at about this time last year, when we saw that there was no way with the core structure that we had, that we could make that business an attractive business for us on the bottom line. We needed to do something different. And so we decided to do something different.

So, going back to your question, the objective for this quarter is to get to breakeven. If we have to sacrifice top line, we will. You know, I don't expect anything very different than what you have seen from the rest of the year so far, I expect, because we are focusing in that middle price range for digital cameras, where we're doing so well, and, they work well for us, and we've been very timid and very tentative in the low end because the reasons that I have mentioned. And I don't expect any change.

**Carol Sabbagha:** Antonio, is it still important, and I applaud you for focusing on the cost side, but is it still very important to be top three in consumer digital cameras or would you be willing to sacrifice that goal too?

**Antonio Perez:** No. Long term, it will be less important, Carol, because digital capture is where we're focused. This digital capture means many more instruments doing digital capture that are not pure digital cameras.

So, we have to be the leaders in digital capture, and that's the stated objective; that's what we're going after. Now digital cameras will still be an important part of our contribution because of our own cameras, and because of what they represent for the plan. So, we need to make digital cameras a good contributor to the company.

So, longer term I care less about the digital camera by itself, our market share over there will be similar to what it is now. The more important thing is to have enough size that you can buy from your suppliers at a price that is relatively competitive versus your competitors, that you have enough volume and you're not pressed.

Instead, the retailers will sit with you to talk about whatever they will do next year and give you shelf space. And as well, that you have enough of a portfolio that you can design platforms, and therefore you can have the same cost and, you know, important parts of the camera, you can buy them in a way that you can use for six or seven products.

Therefore, to justify the cost you lost, you can play with the cost and get a lot better. I don't know if it's number three, or if it's number four, or if it's number two but it's out there. And I think, yes, as long as we are within digital cameras, we will aspire to have those volumes.

One more thing. This is a decision of business. There are companies that come, like we used to do in the past and go after market share, and they go after market share. So you'll see one quarter that we might be number two or we might be number four, but we'll have to be out there if we're going to stay in the business and make money.

**Carol Sabbagha:** OK, very helpful. One last quick question. On inkjet, I think the last official word from the company, if I'm not wrong, is that you want to have an inkjet product out, I don't know what that means, but by year end. Where do we stand now on when we're going to see something, either in the market or a prototype, however you want to answer?

**Antonio Perez:** We have very good technology. We are obviously very late, like 20 years late into the market. I'm not going to bother about a month or two, as you can imagine. The plan was always to have an effect on our financials in 2007. And we are still debating when we're going to make an announcement.

My plan will be to do something – announce something – before the end of the year, and at this point I can't say anything more yet. But, you know, financially the effect was always going to have some significance in 2007, you know, we're still on that track.

**Carol Sabbagha:** OK, thank you very much.

**Operator:** We'll take our next question from you, Ulysses Yannas from Buckman & Reid.

**Ulysses Yannas:** Bob, we shall miss you.

**Bob Brust:** Thank you.

**Ulysses Yannas:** A question if I may. As I understand your pension plan is over-funded, right?

**Bob Brust:** Correct. The U.S. Pension plan, which is about 82 percent of the total obligation, is well over-funded.

**Ulysses Yannas:** I heard someplace that you might be using the over-funding to pay for severance costs. Is that true?

**Antonio Perez:** No. Let me go through this. I saw your name in an article, and thank you for your kind words, by the way. What we have announced is that for the restructuring actions announced after October 18 through most of 2007, termination benefits for the majority of U.S. employees will be provided in the form of special retirement benefits, payable from Kodak's over-funded U.S. pension plan. And, yes, one effect of this change will be to increase the amount of cash that is available to the company in 2007.

**Ulysses Yannas:** Is the number that I calculated over $700 million, correct, that is available?

**Bob Brust:** At the end of last year, we had approximately $6.5 billion in assets and it was over-funded by about 12 percent, so your calculation is about correct, yes, at that time. It's actually a little better now.

**Ulysses Yannas:** Thanks very much.

**Operator:** We'll go next to Shannon Cross, Cross Research.

**Shannon Cross:** Hi. Good afternoon. Question for you - could you provide more details - you said health imaging remains on track; you're going to close that out by the end of the year. Just in terms of the results that have been coming through in the business versus what the expectations are of the companies that you are talking to that might acquire. I'm curious as to how things are tracking.

**Antonio Perez:** I think they tracking fine, Shannon. There is a cost associated with announcing something like this, in two ways. One is, obviously, you're going to have consultants.

They tend to be very expensive. I hope they're not listening, but they are very expensive. And that is a cost you have to incur, and there's no way out, out of that.

The other thing is that you do affect, in some ways, sales. There are customers and we know them by name, and they have decided to delay some purchases so they're still waiting to see what we'll do. And that is a cost we evaluated when we made the announcement. Even knowing all of that, we thought it was fair to our customers and it was fair to our employees, and, I think that was the best thing for our shareholders anyway to be open about what we're doing.

So, those costs – we have to be dealing with those. And those plus the silver hit, those are two big differences that you see from the plans we have, and they are impacting our results.

You know, whoever is looking at this vision as to whether to form a partnership with us or to buy the business, they understand that and we obviously explained it in incredible detail to them. So, I think that progress is going fine, Shannon.

It's a very complex carve-out, even though we've cleaned up the company very significantly in my view and that has cost us a lot of money in the last three years in terms of restructuring. Even with all of that, the carve-out of health is very complicated, and all of that influences the valuation of the group – the way you do the carve-out. So, we're doing that very cautiously and we are on track.

We have options that we can choose and we'll still have a couple of meetings with the board to decide what path we're going to take. And my hope is that we will make that announcement by the end of the year.

**Shannon Cross:** OK, and can you talk a little about that from a manufacturing standpoint, on the analog side, I think you're at six sensitizing facilities, is that correct, or maybe five, and just where you're running in terms of usage rates on the facilities? Just trying to get an idea – as you step down and shut down facilities, where we stand in terms of manufacturing leverage.

**Antonio Perez:** We have less sensitizing sites and I think we have four if I count well. Four of great significance, not six. And we will have less next year, so obviously utilization for those facilities has gone up. That's why FPG is doing so well, apart from other things, is that the utilization of the factories is obviously better than it was before.

Because we are concentrating on certain product categories only in one place. So, we have some issues with inventory and supply chain because we're only producing in one place. But, the balance is positive for us. I don't have a number, specifically to give you.

We haven't disclosed by plan, but I could try to, when you call next, I could try to give you the magnitude of the improvement for the company. But – not per plan, I don't think I would like to go per plan through these things. But yes, there's an improvement in productivity and that was part of the restructuring plan.

**Shannon Cross:** OK, and then just one last question on your CMOS opportunity. I believe last time on the conference call you talked about, I'm not sure how the cell phone carriers refer to it; Beta testing or you had some sensors out for evaluation, can you give us an update on where you stand?

**Antonio Perez:** Yes. As you know, in a semi-conductor business what you do is you work with a possible customer for a design and you create something and then the customer evaluates that together with some other competitors and then they will choose you or they will not. This is what is called a design win. We have a portfolio of design wins that are in the well; I'm going to say it anyway, more than $100 million at this point.

So, this is the beginning. That doesn't mean that that is the number we are going to get. You can still lose orders if you don't produce well. But, I'm trying to give you a sense of where we are with the business. This is a new business for us.

So, we are building the expertise to gain those design wins and we've been involved with those in the last three or four months and more during the rest of the quarter. And we're building a portfolio of design wins, which I'm very happy with.

**Shannon Cross:** OK. Thank you.

**Operator:** We'll to go next to Eli Lapp, Dillon Read.

**Eli Lapp:** Yes, thank you. On the Health Imaging business, I was wondering if you could break down for us, because you attribute the lower earnings to higher silver prices and the strategic alternatives, I was wondering if you could break those two down for us, In terms of how much they've contributed to that decline?

**Bob Brust:** Hello, Eli. This is Bob. We don't disclose that amount of detail on how we do that. The silver for the company was about $40 million, and they are a very large user on x-ray film. So, that hurt. The biggest issue is the film decline and the silver on the film.

**Eli Lapp:** OK, all right, thank you.

**Bob Brust:** You're welcome.

**Operator:** We'll go next to Ajay Kejriwal, Goldman Sachs.

**Ajay Kejriwal:** Thank you. Just one follow-up question on IP. Antonio mentioned IP that it was an integral part of the operative performance, but could you quantify how much was income from IP in the first half? It looks like it was approximately $60 million in the quarter, and also if you could compare the first nine months this year with the full year last year.

And secondly, in terms of your digital earnings quote for this year, the $350 million to $450 million; how much of the IP income is baked into that number?

**Antonio Perez:** We can't do that. I don't even know how to calculate. I mean, this $57 or $60 million from this quarter, as you just calculated, is fine if you want to calculate it like that, but the truth is you make that calculation with no SG&A whatever associated with that number, right? This is just not real. It's not real for me. Those are the same engineers that are making the digital cameras and the CMOS sensors.

So, I don't know how to split it fairly, what is IP and what is pricing that you put into one product. Plus, the IP negotiations we have are actually a lot more than that - cash that in this case we have to disclose because of the nature of the deal. The IP deals are much more complicated than that. We get co-designs; we get component supplies; we can get sharing of the revenue of somebody else's product.

I can't possibly take all of that and create a new P&L in which I have to arbitrarily pull SG&A into it. I can't do that. That's why it's an integral part. And it's not because we don't want to give you a number. It's because it is an integral part of the business, and I don't know how to split it, unless we do something completely artificial.

**Ajay Kejriwal:** But just following up on that, so the break-even target for the consumer digital group for the end of the year, does that include IP, or is that more an operational …

**Antonio Perez**: Includes everything that has to do with that group. So, within the P&L that we call digital capture, that has the IP associated with digital capture. And then – yes, the answer to your question in a simple way is yes. It's actually part of the digital capture P&L.

**Ajay Kejriwal:** Great, thank you.

**Operator:** We'll go next to Sam Doctor, J.P. Morgan.

**Sam Doctor:** Thank you, a couple of questions, really, to follow up on some of them asked already. In terms of the $100 million in design wins that you have for CMOS sensors, can we expect that to transfer into revenue in 2007, or will it extend out beyond that?

**Antonio Perez:** No. I don't know. I won't even go, Sam, into that revenue for 2007. Design wins are – I was trying to give a sense for Shannon what kind of business we are building. Design wins - they are a different project.

Some of them are for three months; some of them will come out in a year and a half, others in nine months. We don't have a projection for next year. We will do more in February. When is this date in February?

**Bob Brust:** February 8th.

**Antonio Perez:** February 8th we will dig more into that. We will give you our best shot of what the influence of the new product portfolio could be, so you can work it with us. Right now I was just trying to show to Shannon that we are building a design business with that and …

**Sam Doctor:** OK.

**Antonio Perez:** But I don't have a number for 2007.

**Sam Doctor:** All right, and on SG&A you did a big job reducing numbers this quarter. How much of the reduction came from advertising and what would be the new target advertising expense within the 14 to 15 percent target model?

**Antonio Perez:** I don't know the answer to that. But for advertising, we've been running around what we wanted to do for the year. Our biggest concentration in SG&A is about, honestly, individuals and processes. That's what we're after. Advertising is going to be with us for the rest of our lives. So, we're not going to save anything out of that. It might be in different shapes and forms.

We're changing our advertising mix - we do less TV than we used to do in the past. We do a lot more at the store level, because most of the bottle for our products is at the store level rather than in the mass advertising that we used to do for film. But, we're still doing advertising.

**Sam Doctor:** OK, and finally, could you comment on shared manufacturing facilities that you may have between the x-ray and the photo film? And how would that impact the ability to spin off the health business to Equity or any other buyers?

**Antonio Perez:** Health is very concentrated in Colorado. But, you're assuming that we're going to sell it and we haven't said that we're going to sell it. But, Colorado is the key facility for that and it's – obviously, we use it for few other things, but it's mostly health.

**Sam Doctor:** OK, all right, thank you.

**Operator:** We'll take our final question from Adam Comora, EnTrust Capital.

**Adam Comora:** Yes, hi. Great. I just wanted to get your quick thoughts on what's happening out there in the motion picture industry, if you could give us a ballpark on how big that business is, it would be great. And just what your thoughts are.

**Antonio Perez:** It's a little more than $1 billion. The business is very stable. This quarter, we happened to grow three percent, but we expect the business to be flat for the year. There is a transition going on to digital. So far, it hasn't had any influence whatsoever on our numbers. But we are following that, we are part of that, as a matter of fact. We collaborate very intensely with the industry in that transition.

We have one part of our business, although small, that is dedicated to digital post-processing. We have two companies working on that, as well as special effects, which are all digital. So we are part of that transformation. But, it didn't affect our business. We have, obviously, a path to deal with this with time, but so far this is a flat business with good margins and about $1 billion in revenue.

**Adam Comora:** When do you see the impact starting to affect you guys? Or when do you see that digital transformation happening?

**Antonio Perez:** Well, the digital transformation, I guess started many years ago. It's just that this feeling, which is developing it's not steady for all sorts of reasons. There are business models. They have to be effective in the sight of print, which is the copies that have been sold to theaters, and then, as well in the originating film. The quality of film is still far superior to any of the digital cameras that exist in the market.

So, the two different parts of the market, one could argue the technology's existed for the transformation of the projection and distribution – the technology's been there for years. The business model doesn't fit well. And I think it's going to take some time.

In the case of origination, I think there's more technology involved and the methodology of dealing with all of the different elements of getting the look and feel of a movie is just so different that I think it would take longer for that digital transition to happen. We have been saying in the past that we don't expect significant changes in the next two years.

I said that two years ago, I'm saying it again, although it's one year later. I don't expect significant changes in the next two years for the overall business. I would expect to see print film to go down a little bit first and I said as well – that as long as this business lasts for another two years, we would be very happy.

The plan is that part of the business is crucial for the transformation because it generates a lot of cash and we've been in need of a lot of cash for the transformation. We have one more year, as Bob said, we're going to start seeing, after the second quarter of next year, that the cash that we need for the transformation is a lot less.

Therefore, I hope the business lasts for a long time and I think there are many signs that will indicate that. But they're not going to be crucial for us. They're not going to be an impediment for us to build a digital company.

**Adam Comora:** OK. Thanks.

**Operator:** And Mr. Perez, at this time I would like to turn the call back over to you for any additional or closing remarks.

**Antonio Perez:** Well, thank you very much for attending. We're very committed to the fourth quarter. We are fully aware of the challenges we have. But we have full confidence that we are going to have a good year and have a good trick or treating tonight.

**Operator:** And this does conclude today's conference. Thank you for your participation.

END