EASTMAN KODAK CO
Form 10-Q
November 03, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2006

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ___ to ___

Commission File Number 1-87

EASTMAN KODAK COMPANY

(Exact name of registrant as specified in its charter)

NEW JERSEY **(State of incorporation)**	**16-0417150** **(IRS Employer Identification No.)**
343 STATE STREET, ROCHESTER, NEW YORK **(Address of principal executive offices)**	**14650** **(Zip Code)**

Registrant's telephone number, including area code: 585-724-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuers classes of common stock, as of the latest practicable date.

Class	Number of Shares Outstanding at October 31, 2006
Common Stock, $2.50 par value	**287,294,581**

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)

	Three Months Ended September 30	Nine Months Ended September 30

(in millions, except per share data)	**2006**	**2005**	**2006**	**2005**
Net sales	$ 3,204	$ 3,553	$ 9,453	$ 10,071
Cost of goods sold	2,330	2,631	7,092	7,420
Gross profit	874	922	2,361	2,651
Selling, general and administrative expenses	565	670	1,794	1,901
Research and development costs	170	212	540	680
Restructuring costs and other	137	163	451	531
Earnings (loss) from continuing operations before interest, other income (charges), net and income taxes	2	(123)	(424)	(461)
Interest expense	74	57	202	144
Other income (charges), net	54	(9)	82	(11)
Loss from continuing operations before income taxes	(18)	(189)	(544)	(616)
Provision for income taxes	19	726	73	601
Loss from continuing operations	$ (37)	$ (915)	$ (617)	$ (1,217)
Earnings from discontinued operations, net of income taxes	$ —	$ 1	$ —	$ 2
NET LOSS	$ (37)	$ (914)	$ (617)	$ (1,215)
Basic and diluted net loss per share:				
Continuing operations	$ (.13)	$ (3.19)	$ (2.15)	$ (4.23)
Discontinued operations	—	.01	—	.01
Total	$ (.13)	$ (3.18)	$ (2.15)	$ (4.22)
Number of common shares used in basic net loss per share	287.2	287.2	287.2	288.1
Incremental shares from assumed conversion of options	—	—	—	—
Number of common shares used in diluted net loss per share	287.2	287.2	287.2	288.1

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited) (Continued)

	Three Months Ended September 30		**Nine Months Ended September 30**	
(in millions)	**2006**	**2005**	**2006**	**2005**
CONSOLIDATED STATEMENT OF RETAINED EARNINGS				
Retained earnings at beginning of period, as previously reported	$ 6,062	$ 7,750	$ 6,402	$ 7,922
Effect of retroactive restatement for change in methodology of costing U.S. inventories from LIFO method to average cost method	—	—	315	215
Retained earnings at beginning of period, as restated	6,062	7,750	6,717	8,137
Net loss	(37)	(914)	(617)	(1,215)
Cash dividend	—	—	(72)	(72)
Loss from issuance of treasury stock	(3)	(1)	(6)	(15)
Retained earnings at end of quarter	$ 6,022	$ 6,835	$ 6,022	$ 6,835

The accompanying notes are an integral part of these consolidated financial statements.

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF FINANCIAL POSITION (Unaudited)

(in millions)		September 30, 2006		December 31, 2005
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$	1,102	$	1,665
Receivables, net		2,541		2,760
Inventories, net		1,478		1,455
Deferred income taxes		114		100
Other current assets		133		116
Total current assets		5,368		6,096
Property, plant and equipment, net		3,018		3,778
Goodwill		2,187		2,141
Other long-term assets		3,487		3,221
TOTAL ASSETS	$	14,060	$	15,236
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts payable and other current liabilities	$	3,740	$	4,187
Short-term borrowings		92		819
Accrued income taxes		669		483
Total current liabilities		4,501		5,489
OTHER LIABILITIES				
Long-term debt, net of current portion		3,247		2,764
Pension and other postretirement liabilities		3,291		3,476
Other long-term liabilities		1,207		1,225
Total liabilities		12,246		12,954
SHAREHOLDERS' EQUITY				
Common stock at par		978		978
Additional paid in capital		881		867
Retained earnings		6,022		6,717
Accumulated other comprehensive loss		(260)		(467)
		7,621		8,095
Less: Treasury stock at cost		5,807		5,813
Total shareholders' equity		1,814		2,282
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	14,060	$	15,236

The accompanying notes are an integral part of these consolidated financial statements.

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EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)

(in millions)	Nine Months Ended September 30 2006	2005
Cash flows relating to operating activities:		
Net loss	$ (617)	$ (1,215)
Adjustments to reconcile to net cash used in operating activities:		
Earnings from discontinued operations	—	(2)
Equity in earnings from unconsolidated affiliates	—	(11)
Depreciation and amortization	1,016	937
Purchased research and development	—	54
Gain on sales of businesses/assets	(49)	(42)
Restructuring costs, asset impairments and other non-cash charges	118	170
(Benefit) provision for deferred taxes	(152)	792
Decrease in receivables	261	199
Increase in inventories	(16)	(207)
Decrease in liabilities excluding borrowings	(494)	(728)
Other items, net	(139)	(7)
Total adjustments	545	1,155
Net cash used in operating activities	(72)	(60)
Cash flows relating to investing activities:		
Additions to properties	(282)	(332)
Net proceeds from sales of assets	112	62
Acquisitions, net of cash acquired	(3)	(987)
(Investments in) distributions from unconsolidated affiliates	(10)	63
Marketable securities - purchases	(88)	(79)
Marketable securities - sales	89	70
Net cash used in investing activities	(182)	(1,203)
Cash flows relating to financing activities:		
Net decrease in borrowings with original maturity of 90 days or less	(8)	(65)
Proceeds from other borrowings	580	1,241
Repayment of other borrowings	(819)	(477)
Dividend payments	(72)	(72)
Exercise of employee stock options	—	12
Net cash (used in) provided by financing activities	(319)	639
Effect of exchange rate changes on cash	10	(21)
Net decrease in cash and cash equivalents	(563)	(645)
Cash and cash equivalents, beginning of year	1,665	1,255
Cash and cash equivalents, end of quarter	$ 1,102	$ 610

The accompanying notes are an integral part of these consolidated financial statements.

EASTMAN KODAK COMPANY
NOTES TO FINANCIAL STATEMENTS (Unaudited)

NOTE 1: BASIS OF PRESENTATION

BASIS OF PRESENTATION

The consolidated interim financial statements are unaudited, and certain information and footnote disclosure related thereto normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with Rule 10-01 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements were prepared following the same policies and procedures used in the preparation of the audited financial statements and reflect all adjustments (consisting of normal recurring adjustments) necessary to present fairly the results of operations, financial position and cash flows of Eastman Kodak Company and its subsidiaries (the Company). The results of operations for the interim periods are not necessarily indicative of the results for the entire fiscal year. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Certain amounts for prior periods have been reclassified to conform to the current period classification.

During the first quarter of 2005, the Company determined that property, plant and equipment was overstated by approximately $9 million ($5 million net of tax) as a result of the fact that interest, which had been capitalized during the construction period, had inadvertently not been written off at the time of the disposal of certain assets. The Company has assessed the impact of this item on each of the 2000-2004 annual periods and interim periods in 2004 and 2003 and determined that the impact of such errors is immaterial to each of these prior periods. The additional amount that should have been recorded as expense in each of the years 2000-2004 was less than $1.3 million per year on an after-tax basis. The Company has concluded that the $9 million adjustment ($5 million net of tax) is immaterial to the results of operations for the quarter ended March 31, 2005, the nine months ended September 30, 2005, and the results for the full year 2005. Accordingly, the Company recorded an adjustment of $9 million that is included in the nine months ended September 30, 2005 to write off these balances. Approximately $7 million of the adjustment relates to assets that were disposed of through restructuring actions and, therefore, is recorded in restructuring costs and other within the accompanying Consolidated Statement of Operations for the nine months ended September 30, 2005. Approximately $2 million relates to assets that were disposed of in the ordinary course of business and, therefore, is recorded in cost of goods sold within the accompanying Consolidated Statement of Operations for the nine months ended September 30, 2005.

CHANGE IN ACCOUNTING METHODOLOGY

On January 1, 2006, the Company elected to change its method of costing its U.S. inventories to the average cost method, whereas in all prior years most of the Company's inventory in the U.S. was costed using the LIFO method. The new method of accounting for inventory in the U.S. was adopted because the average cost method will provide for a better matching of revenue and expenses given the rapid technological change in the Company's products. The average cost method will also better reflect the cost of inventory on the Company's Consolidated Statement of Financial Position. Prior periods have been restated for comparative purposes in order to reflect the impact of this change in methodology from LIFO to average cost. See Note 3, "Inventories, Net" for further details.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs" that amends the guidance in Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing" (ARB No. 43) to clarify the accounting for abnormal idle facility expense, freight, handling costs, and wasted material (spoilage). In addition, this Statement requires that an allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred for fiscal years beginning after June 15, 2005 (year ending December 31, 2006 for the Company). The adoption of SFAS No. 151 did not have a material impact on the Consolidated Financial Statements of the Company.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments (an amendment of FASB Statements No. 133 and 140)." This Statement permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006 (year ending December

31, 2007 for the Company). Additionally, the fair value option may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under previous accounting guidance prior to the adoption of this Statement. The Company is currently evaluating the impact of SFAS No. 155.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting and reporting for income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken, or expected to be taken, in income tax returns. The Company is currently evaluating the impact of FIN 48. The Company will adopt this Interpretation in the first quarter of 2007.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which establishes a comprehensive framework for measuring fair value in GAAP and expands disclosures about fair value measurements. Specifically, this Statement sets forth a definition of fair value, and establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The provisions of SFAS No. 157 are generally required to be applied on a prospective basis, except to certain financial instruments accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," for which the provisions of SFAS No. 157 should be applied retrospectively. The Company will adopt SFAS No. 157 in the first quarter of 2008.

In September 2006, the FASB issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132(R))", which is effective in fiscal years ending after December 15, 2006. This Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position, and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 does not change the amount of actuarially determined expense that is recorded in the Consolidated Statement of Operations. SFAS No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, which is consistent with the Company's present measurement date. Utilizing current assumptions, which may change by the December 31, 2006 measurement date, the estimated impact of adopting the provisions of SFAS No. 158 is a pre-tax decrease to accumulated other comprehensive income, which would result in a decrease in shareholders' equity of approximately $550 million. The actual impact of adoption will depend on the funded status of the Company's plans at December 31, 2006, which will depend on several factors, principally 2006 returns on plan assets and discount rates at the end of the year. The estimated impact does not include any deferred tax impacts, as the Company has not yet completed its evaluation of the tax effect of adoption of SFAS No. 158. The adoption of SFAS No. 158 will have no impact on the Companys Statement of Cash Flows or compliance with its debt covenants.

In September 2006, the SEC staff issued Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. This SAB establishes a "dual approach" methodology that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the companys financial statements (both the statement of operations and statement of financial position). The SEC has stated that SAB No. 108 should be applied no later than the annual financial statements for the first fiscal year ending after November 15, 2006, with earlier application encouraged. SAB No. 108 permits a company to elect either retrospective or prospective application. Prospective application requires recording a cumulative effect adjustment in the period of adoption, as well as detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Companys application of SAB No. 108 in the fourth quarter of 2006 is not expected to have any impact on its consolidated financial statements.

NOTE 2: RECEIVABLES, NET

(in millions)		September 30, 2006		December 31, 2005
Trade receivables	$	2,228	$	2,447
Miscellaneous receivables		313		313
Total (net of allowances of $144 and $162 as of September 30, 2006 and				