



## Eastman Kodak Could Turn Itself Around

By Scott Rothbort

RealMoney Contributor

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**Eastman Kodak** (EK) is down today, but it is hard to tell if it is earnings-related or market-related.

Perhaps Eastman Kodak was just due for some profit-taking after a nice run. The restructuring at the company continues, and management is making progress on the digital front as its mainstream business continues to evaporate. The company's balance sheet is improving quarter by quarter, with cash and equivalents on the rise and long-term debt on the decline.

Perhaps one day, Eastman Kodak is going to make a significant acquisition once the restructuring is complete. I suppose if you are a deep value investor that looks for turnarounds, then Eastman Kodak makes a good candidate. This is not the environment for deep value, however, as growth is now on investors' minds.

Eastman Kodak reported third-quarter 2007 EPS of 12 cents from continuing operations. Excluding after-tax restructuring costs of 33 cents per share, Eastman Kodak earned 45 cents per share. Revenue was \$2.581 billion.

Digital revenue now comprises over 60% of Eastman Kodak's total revenue, while digital earnings from operations (EFO) are 50% of the company's total EFO. Consolidated Eastman Kodak revenue declined 1% and included a benefit of 2% from favorable forex changes. Digital revenue grew by 16%, while mainstream revenue declined 16%.

Gross profit margins rose to 26.4% from 25.1% in the year-ago quarter. The improvement was attributed to reduction in manufacturing and supply costs as well as a 1% favorable forex change.

SG&A expenses were reduced by 8% year over year and now represent 17% of revenue vs. 18% a year ago. Year to date, SG&A costs were reduced by 15%. R&D costs were 5% of revenue and were in line with planned levels.

Pretax restructuring charges were \$127 million in third quarter 2007 vs. \$181 million in the third quarter of 2006. Year to date, pretax restructuring charges were \$594 million vs. \$621 million after nine months of 2006. Fiscal 2007 restructuring charges are still expected to be \$750 million to \$850 million vs. the prior estimate of \$900 million to \$1 billion due to manufacturing efficiencies and outsourcing. Cash expensed for restructuring may be lower than the previous \$600 million estimate.

For the Film Product Group, EFO grew 6%, revenue declined 18%, and entertainment film imaging revenue declined 5%. The company expects 2007 EFO to be 20% vs. the 13% to 16% previously forecasted. This segment introduced the finest-grain and sharpest 400-speed black-and-white film in October.

Continued momentum from second quarter was seen in third quarter and is expected to continue into the fourth quarter for the Graphic Communications Group. Digital revenue grew 9% year over year, and there was a double-digit increase in consumables as volume grew 38%. The company is targeting 6% to 9% digital revenue growth for 2007.

Consumer Digital Imaging Group revenue grew 16% year over year. Digital camera volume grew 35% year over year. Gross margins improved (no value provided) here, and the target is for a \$1 billion business in 2010.

Eastman Kodak ended the quarter with \$1.847 billion in cash and equivalents, with debt now at \$1.626 billion. The goal is to generate \$100 million in cash in 2007.

Management updated its 2007 guidance and now expects digital revenue growth to be at the upper end of the 3% to 5% prior outlook. Total company revenue will decline at the lower end of the 4% to 7% range, with digital earnings of \$150 million to \$250 million and EFO for the company of \$300 million to \$400 million.

### Eastman Kodak Preview: Pretty as a Picture?

**Eastman Kodak** (EK) is scheduled to release its third-quarter results and conduct its quarterly conference call on Thursday morning. The company is expected to earn 27 cents on revenue of \$2.49 billion. In the year-ago quarter, Eastman Kodak earned 44 or 45 cents (depending on your definition), excluding charges, on revenue of \$3.2 billion.

Eastman Kodak continues to suffer the consequences of its longtime domination of the film and development industry as digital imaging is now the global standard. In order to combat those changes, the company has been focusing (pun intended) on digital desktop printing, graphic communications and scientific imaging. From a presentation perspective, we should expect digital revenue and earnings to grow while the traditional businesses continue to contract. In the process, Eastman Kodak has cut back on costs, paid down debt, reduced dividend payouts and improved margins.

As you can see from the chart below Eastman Kodak stock has been a poor performer these last five years.



This was directly a result of the changing technological landscape in photography that I previously discussed. Since then, however, the company finally appeared to have turned the corner, found its footing and is now on the mend. This is apparent in the stock's performance this past 12 to 18 months. Eastman Kodak will never be the company it once was, but we have to accept it for the company it now is.

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*At the time of publication, Rothbort had no positions in the stocks mentioned, although positions can change at any time.*

*Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.*

*Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.*

*Rothbort holds an MBA in finance and international business from the Stern School of Business of New York University and a BS in economics and accounting from the Wharton School of Business of the University of Pennsylvania. He is a Professor of Finance and the Chief Market Strategist for the Stillman School of Business of Seton Hall University.*

*For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at [www.lakeviewasset.com](http://www.lakeviewasset.com). Scott appreciates your feedback; [click here](#) to send him an email.*

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