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	**16-0417150**
(State of incorporation)	**(IRS Employer Identification No.)**
343 STATE STREET, ROCHESTER, NEW YORK	**14650**
(Address of principal executive offices)	**(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 issuer's 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 Companys 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 Companys 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 Companys 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.

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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 December 31, 2005, respectively)	$ 2,541	$ 2,760

Of the total trade receivable amounts of $2,228 million and $2,447 million as of September 30, 2006 and December 31, 2005, respectively, approximately $306 million and $374 million are expected to be settled through customer deductions in lieu of cash payments. Such deductions represent rebates owed to the customer and are included in accounts payable and other current liabilities in the accompanying Consolidated Statement of Financial Position at each respective balance sheet date.

NOTE 3: INVENTORIES, NET

(in millions)	September 30, 2006	December 31, 2005
Finished goods	$ 964	$ 893
Work in process	230	243
Raw materials	284	319
Total	$ 1,478	$ 1,455

On January 1, 2006, the Company elected to change its method of costing its U.S. inventories to the average cost method, which approximates FIFO, whereas in all prior years most of the Company's inventory in the U.S. was costed using the LIFO method. As a result of this change, the cost of all of the Company's inventories in and outside the U.S. is determined by the FIFO or average cost method. The new method of accounting for inventory in the U.S. is deemed preferable as the average cost method provides better matching of revenue and expenses given the rapid technological change in the Company's products. The average cost method also better reflects more current costs of inventory on the Company's Statement of Financial Position. As prescribed in SFAS No. 154, "Accounting Changes and Error Corrections", retrospective application of the change in accounting method is disclosed below.

The effects of the change in methodology of costing U.S. inventories from LIFO to average cost on inventory and cost of goods sold for prior periods presented are as follows (in millions):

	As of and for the Three Months Ended September 30, 2005		As of and for the Nine Months Ended September 30, 2005		As of and for the Year Ended December 31, 2005	
	LIFO Method (1)	Average Cost Method	LIFO Method (1)	Average Cost Method	LIFO Method	Average Cost Method
Inventory	$ 1,657	$ 1,976	$ 1,657	$ 1,976	$ 1,140	$ 1,455
Cost of goods sold	$ 2,628	$ 2,631	$ 7,391	$ 7,420	$ 10,617	$ 10,650

(1) During the fourth quarter of 2005, the Company changed its methodology for allocating post employment benefit costs for retirees to the segments to which these costs are primarily attributable. The reallocation

had insignificant impacts on the line items comprising the consolidated and segment earnings (losses) from continuing operations before interest, other income (charges), net and income taxes, as amounts were reclassified between the (1) costs of goods sold, (2) selling, general and administrative expense, and (3) research and development costs expense lines. Prior period results have been adjusted to reflect this change in methodology.

Components of the Company's Consolidated Statement of Operations affected by the change in costing methodology as originally reported under the LIFO method and as adjusted for the change in inventory costing methodology from the LIFO method to the average cost method are as follows (in millions, except per share data):

	Three Months Ended September 30, 2005		
	As Previously Reported (1)	**LIFO to Average Cost Change in Costing Methodology Adjustments (2)**	**As Adjusted**
Cost of goods sold	$ 2,628	$ 3	$ 2,631
Gross profit	925	(3)	922
Loss from continuing operations before interest, other income (charges), net and income taxes	(120)	(3)	(123)
Loss from continuing operations before income taxes	(186)	(3)	(189)
Provision (benefit) for income taxes	853	(127)	726
Loss from continuing operations	(1,039)	124	(915)
Earnings from discontinued operations	1	—	1
Net loss	$ (1,038)	$ 124	$ (914)
Basic and diluted net loss per share:	$ (3.61)	$ .43	$ (3.18)
Continuing operations	$ (3.62)	$ .43	$ (3.19)
Discontinued operations	$ .01	—	$ .01

	Nine Months Ended September 30, 2005		
	As Previously Reported (1)	**LIFO to Average Cost Change in Costing Methodology Adjustments (2)**	**As Adjusted**
Cost of goods sold	$ 7,391	$ 29	$ 7,420
Gross profit	2,680	(29)	2,651

Loss from continuing operations before interest, other income (charges), net and income taxes	(432)	(29)	(461)
Loss from continuing operations before income taxes	(587)	(29)	(616)
Provision (benefit) for income taxes	734	(133)	601
Loss from continuing operations	(1,321)	104	(1,217)
Earnings from discontinued operations	2		2
Net loss	(1,319)	104	(1,215)
Basic and diluted net loss per share:	$ (4.58)	$ .36	$ (4.22)
Continuing operations	$ (4.59)	$ .36	$ (4.23)
Discontinued operations	$ .01		$ .01

(1) Refer to footnote (1) on Page 10.

(2) The impact on the provision (benefit) for income taxes for the three and nine months ended September 30, 2005 is primarily the result of the reduction in the net U.S. deferred tax assets for which a valuation allowance was previously recognized in the third quarter of 2005, as disclosed in Note 6.

Components of the Company's Consolidated Statement of Financial Position affected by the change in costing methodology for the year ended December 31, 2005 as originally reported under the LIFO method and as adjusted for the change in inventory costing methodology from the LIFO method to the average cost method are as follows (in millions):

	As Previously Reported	LIFO to Average Cost Change in Costing Methodology Adjustments	As Adjusted
ASSETS			
Current Assets			
Inventories, net	$ 1,140	$ 315	$ 1,455
Total Current Assets	5,781	315	6,096
TOTAL ASSETS	$ 14,921	$ 315	$ 15,236
SHAREHOLDERS' EQUITY			
Retained earnings	$ 6,402	$ 315	$ 6,717
Total Shareholders' Equity	1,967	315	2,282
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 14,921	$ 315	$ 15,236

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Components of the Company's Consolidated Statement of Cash Flows affected by the change in costing methodology for the nine months ended September 30, 2005 as originally reported under the LIFO method and as adjusted for the change in inventory valuation methodology from the LIFO method to the average cost method are as follows (in millions):

LIFO to Average

	As Previously Reported	Cost Change in Costing Methodology Adjustments (2)	As Adjusted
Cash flows relating to operating activities:			
Net loss	$ (1,319)	$ 104	$ (1,215)
Adjustments to reconcile to net cash used in operating activities:			
Provision for deferred taxes	925	(133)	792
Increase in inventories	(236)	29	(207)
Net cash used in operating activities	$ (60)	$	$ (60)

(2) Refer to footnote (2) on Page 11.

NOTE 4: PROPERTY, PLANT AND EQUIPMENT, NET

(in millions)	September 30, 2006	December 31, 2005
Land	$ 105	$ 127
Buildings and building improvements	2,401	2,552
Machinery and equipment	8,037	8,481
Construction in progress	104	219
	10,647	11,379
Accumulated depreciation	(7,629)	(7,601)
Net properties	$ 3,018	$ 3,778

Depreciation expense for the three months ended September 30, 2006 and 2005 was $264 million and $357 million, respectively, of which approximately $73 million and $105 million, respectively, represented accelerated depreciation in connection with restructuring actions. Depreciation expense for the nine months ended September 30, 2006 and 2005 was $906 million and $856 million, respectively, of which approximately $227 million and $261 million, respectively, represented accelerated depreciation in connection with restructuring actions.

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NOTE 5: GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $2,187 million and $2,141 million at September 30, 2006 and December 31, 2005, respectively. The changes in the carrying amount of goodwill by reportable segment for the nine months ended September 30, 2006 were as follows:

(in millions)	Consumer Digital Imaging Group	Film and Photofinishing Systems Group	Health Group	Graphic Communi-cations Group	Consolidated Total
Balance at December 31, 2005	$ 160	$ 571	$ 588	$ 822	$ 2,141
Purchase accounting adjustments				8	8

Currency translation adjustments	1	16	16	5	38
Balance at September 30, 2006	$ 161	$ 587	$ 604	$ 835	$ 2,187

The purchase accounting adjustments of $8 million for the nine months ended September 30, 2006 were attributable to the finalization of purchase accounting for the 2005 acquisition of KPG in the amount of $19 million, and finalization of purchase accounting for the 2005 acquisition of Creo in the amount of $(11) million.

Due to the realignment of the Company's operating model and change in reporting structure, as described in Note 15, Segment Information, effective January 1, 2006, the Company reassessed its goodwill for impairment during the first quarter of 2006, and determined that no reporting units carrying values exceeded their respective estimated fair values based on the realigned reporting structure and, therefore, there was no impairment.

The gross carrying amount and accumulated amortization by major intangible asset category as of September 30, 2006 and December 31, 2005 were as follows:

	As of September 30, 2006			
(in millions)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**	**Weighted-Average Amortization Period**
Technology-based	$ 486	$ 207	$ 279	7 years
Customer-related	401	109	292	13 years
Other	215	81	134	7 years
Total	$ 1,102	$ 397	$ 705	9 years

	As of December 31, 2005			
(in millions)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**	**Weighted-Average Amortization Period**
Technology-based	$ 482	$ 154	$ 328	7 years
Customer-related	400	81	319	13 years
Other	212	53	159	7 years
Total	$ 1,094	$ 288	$ 806	9 years

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The intangible assets acquired during the three months ended September 30, 2006 of $3 million were attributable to technology-based intangible assets for the purchase of software.

Amortization expense related to purchased intangible assets for the three months ended September 30, 2006 and 2005 was $36 million and $39 million, respectively. Amortization expense related to purchased intangible assets for the nine months ended September 30, 2006 and 2005 was $110 million and $81 million, respectively.

Estimated future amortization expense related to purchased intangible assets at September 30, 2006 is as follows (dollars in millions):

2006	$ 36
2007	135
2008	130
2009	118

2010		91
2011 and thereafter		195
Total	$	705

NOTE 6: INCOME TAXES

The Company's income tax provision and effective tax rate were as follows (dollars in millions):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2005		2006		2005	
Loss from continuing operations before income taxes	$	(18)	$	(189)	$	(544)	$	(616)
Provision for income taxes		19		726		73		601
Effective tax rate		(105.6)%		(384.1)%		(13.4)%		(97.6)%

The difference between the recorded provision for the three months ended September 30, 2006 and 2005, respectively, and that which would result from applying the U.S. statutory rate of 35.0% to the loss from continuing operations before income taxes is primarily attributable to the following (dollars in millions):

(dollars in millions)		Three Months Ended September 30, 2006		Three Months Ended September 30, 2005	
	The ongoing impact of not providing any tax benefit on the losses incurred in the U.S., partially offset by the impact of the pre-tax earnings outside the U.S. being generated in jurisdictions with a net effective tax rate that is lower than the U.S. statutory rate. The Company recorded the write-down of its net deferred assets in the U.S. resulting from the Company's assessment of the realizability of the net deferred assets as of and for the three months ended September 30, 2005.	$	(14)	$	(88)
	The Company recorded discrete pre-tax charges for restructuring, asset sale gains, asset impairments, and a legal settlement charge totaling $168 million in the three months ended September 30, 2006, relating to which the Company recorded a tax benefit of $1 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $59 million due to the fact that the restructuring charges recorded in the U.S. have not been benefited, combined with the fact that the charges recorded outside the U.S. have been incurred in jurisdictions that have a net tax rate that is lower than the U.S. statutory rate.		58		

The Company recorded discrete pre-tax charges for restructuring, property sales due to focused cost reductions, asset impairments and in-process R&D charges totaling $258 million in the three months ended September 30, 2005, relating to which the Company recorded a tax provision of $88 million. This provision differs from the benefit that would have resulted using the U.S. statutory rate of $90 million due to the fact that the restructuring charges recorded in the U.S. have not been benefited, combined with the fact that the charges recorded outside the U.S. have been incurred in jurisdictions that have a net tax rate that is lower than the U.S. statutory rate.		178
The Company recorded discrete tax charges in the three months ended September 30, 2006 relating primarily to tax rate changes and impacts from the ongoing tax audits with respect to open tax years totaling $19 million.	(19)	
The Company recorded discrete tax charges in the three months ended September 30, 2005 relating primarily to the establishment of a valuation allowance against deferred tax assets in the U.S. and other foreign jurisdictions, the planned remittance of earnings from subsidiary companies outside the U.S. and other tax adjustments.		702
Total tax provision difference resulting from the Company s effective tax rate vs. the U.S. statutory rate	$ 25	$ 792

The difference between the recorded provision (benefit) for the nine months ended September 30, 2006 and 2005, respectively, and that which would result from applying the U.S. statutory rate of 35.0% to the loss from continuing operations before income taxes is primarily attributable to the following (dollars in millions):

(dollars in millions)	**Nine Months Ended September 30, 2006**	**Nine Months Ended September 30, 2005**
The ongoing impact of not providing any tax benefit on the losses incurred in the U.S., partially offset by the impact of the pre-tax earnings outside the U.S. being generated in jurisdictions with a net effective tax rate that is lower than the U.S. statutory rate. The Company recorded the write-down of its net deferred assets in the U.S. resulting from the Company's	$ 62	$ (126)

assessment of the realizability of the net deferred assets as of and for the nine months ended September 30, 2005.		
The Company recorded discrete pre-tax charges for restructuring, asset impairments, a legal settlement charge and asset sale gains/losses totaling $659 million in the nine months ended September 30, 2006, relating to which the Company recorded a tax benefit of $65 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $230 million due to the fact that the restructuring charges recorded in the U.S. have not been benefited, combined with the fact that the charges recorded outside the U.S. have been incurred in jurisdictions that have a net tax rate that is lower than the U.S. statutory rate.	165	
The Company recorded discrete pre-tax charges for restructuring, asset impairments, property sales due to focused cost reductions, a prior period land donation and in-process R&D charges totaling $873 million in the nine months ended September 30, 2005, relating to which the Company recorded a tax benefit of $91 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $305 million due to the fact that the restructuring charges recorded outside the U.S. have been incurred in jurisdictions that have a net tax rate that is lower than the U.S. statutory rate.		214
The Company recorded discrete tax charges in the nine months ended September 30, 2006 relating primarily to purchase accounting, tax rate changes and impacts from the ongoing tax audits with respect to open tax years. The tax charge of $36 million in the nine months ended September 30, 2006 includes a charge of $20 million relating to the finalization of the Creo purchase accounting and related changes to the allocation of the purchase price to the respective tax jurisdictions. Due to changes in the allocation of the purchase price between the U.S. and other countries, the finalization of the purchase accounting had a $20 million impact on the valuation allowance in the U.S.	36	
The Company recorded discrete tax charges in the nine months ended September 30, 2005 relating primarily to tax rate changes, the establishment of a valuation allowance against		729

	deferred tax assets in the U.S. and other foreign jurisdictions, and the planned remittance of earnings from subsidiary companies outside the U.S. and other tax adjustments.				
Total tax provision difference resulting from the Company's effective tax rate vs. the U.S. statutory rate		$	263	$	817

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The Company and its subsidiaries' income tax returns are routinely examined by various authorities. As a result, there are tax positions that are currently under review in various jurisdictions. Adequate provision has been made for all open years in accordance with SFAS No. 5, "Accounting for Contingencies." However, a degree of judgment is required when determining the Company's effective tax rate and in evaluating our tax provision. The Company establishes reserves when, despite significant support for the Company's filing position, a belief exists that these positions may be overruled by the respective tax jurisdictions. The reserves are adjusted upon the occurrence of external, identifiable events, including the settlement of the related tax audit year with various taxing authorities. A change in our tax reserves could have a significant impact on our effective tax rate and our operating results.

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NOTE 7: COMMITMENTS AND CONTINGENCIES

Environmental

At September 30, 2006, the Company's undiscounted accrued liabilities for environmental remediation costs amounted to $156 million and are reported in other long-term liabilities in the accompanying Consolidated Statement of Financial Position.

The Company is currently implementing a Corrective Action Program required by the Resource Conservation and Recovery Act (RCRA) at the Kodak Park site in Rochester, NY. As part of this program, the Company has completed the RCRA Facility Assessment (RFA), a broad-based environmental investigation of the site. The Company is currently in the process of completing, and in some cases has completed, RCRA Facility Investigations (RFI) and Corrective Measures Studies (CMS) for areas at the site. At September 30, 2006, estimated future investigation and remediation costs of $66 million are accrued for this site and are included in the $156 million reported in other long-term liabilities.

The Company has obligations relating to other operating sites and former operations with estimated future investigation, remediation and monitoring costs of $17 million. At September 30, 2006, these costs are accrued and included in the $156 million reported in other long-term liabilities.

The Company has obligations relating to plant closures and former operations. As a result of four plant closures, the Company has estimated future investigation, remediation and monitoring costs of $24 million. The Company has obligations with estimated future investigation, remediation and monitoring costs of $8 million at other former sites. At September 30, 2006, these costs are accrued and included in the $156 million reported in other long-term liabilities.

In 2005, the Company completed its acquisition of KPG through the redemption of Sun Chemical Corporation's 50 percent interest in the joint venture, and also completed its acquisition of Creo. As a result of the two acquisitions, the Company has obligations with estimated future investigation, remediation and monitoring costs of $20 million. At September 30, 2006, these costs are accrued and included in the $156 million reported in other long-term liabilities.

The Company has retained certain obligations for environmental remediation and Superfund matters related to certain sites associated with the non-imaging health businesses sold in 1994. At September 30, 2006, estimated future remediation costs of $21 million are accrued for these sites and are included in the $156 million reported in other long-term liabilities.

Cash expenditures for the aforementioned investigation, remediation and monitoring activities are expected to be incurred over the next thirty years for many of the sites. For these known environmental exposures, the accrual reflects the Company's best estimate of the amount it will incur under the agreed-upon or proposed work plans. The Company's cost estimates were determined using the ASTM Standard E 2137-01, "Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters," and have not been reduced by possible recoveries from third parties. The overall method includes the use of a probabilistic model which forecasts a range of cost estimates for the remediation required at individual sites. The projects are closely monitored and the models are reviewed as significant events occur or at least once per year. The Company's estimate includes equipment and operating costs for remediation and long-term monitoring of the sites. The Company does not believe it is reasonably possible that the losses for the known exposures could exceed the current accruals by material amounts.

A Consent Decree was signed in 1994 in settlement of a civil complaint brought by the U.S. Environmental Protection Agency and the U.S. Department of Justice. In connection with the Consent Decree, the Company is subject to a Compliance Schedule, under which the Company has improved its waste characterization procedures, upgraded one of its incinerators, and is evaluating and upgrading its industrial sewer system. The total expenditures required to complete this program are currently estimated to be approximately $1 million over the next two years. These expenditures are incurred as part of plant operations and, therefore, are not included in the environmental accrual at September 30, 2006.

The Company is presently designated as a potentially responsible party (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (the Superfund Law), or under similar state laws, for environmental assessment and cleanup costs as the result of the Company's alleged arrangements for disposal of hazardous substances at five Superfund sites. With respect to each of these sites, the Company's liability is minimal. In addition, the Company has been identified as a PRP in connection with the non-imaging health businesses in three active Superfund sites. Numerous other PRPs have also been designated at these sites. Although the law imposes joint and several liability on PRPs, the Company's historical experience demonstrates that these costs are shared with other PRPs. Settlements and costs paid by the Company in Superfund matters to date have not been material. Future costs are also not expected to be material to the Company's financial position, results of operations or cash flows.

The Clean Air Act Amendments were enacted in 1990. Expenditures to comply with the Clean Air Act implementing regulations issued to date have not been material and have been primarily capital in nature. In addition, future expenditures for existing regulations, which are primarily capital in nature, are not expected to be material. Many of the regulations to be promulgated pursuant to this Act have not been issued.

Uncertainties associated with environmental remediation contingencies are pervasive and often result in wide ranges of outcomes. Estimates developed in the early stages of remediation can vary significantly. A finite estimate of costs does not normally become fixed and determinable at a specific time. Rather, the costs associated with environmental remediation become estimable over a continuum of events and activities that help to frame and define a liability, and the Company continually updates its cost estimates. The Company has an ongoing monitoring and identification process to assess how the activities, with respect to the known exposures, are progressing against the accrued cost estimates, as well as to identify other potential remediation sites that are presently unknown.

Estimates of the amount and timing of future costs of environmental remediation requirements are by their nature imprecise because of the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of presently unknown remediation sites and the allocation of costs among the potentially responsible parties. Based upon information presently available, such future costs are not expected to have a material effect on the Company's competitive or financial position. However, such costs could be material to results of operations in a particular future quarter or year.

Asset Retirement Obligations

Additionally, as of September 30, 2006 and December 31, 2005, the Company has recorded approximately $85 million and $75 million, respectively, of asset retirement obligations within other long-term liabilities in the accompanying Consolidated Statement of Financial Position. The Companys asset retirement obligations primarily relate to asbestos contained in buildings that the Company owns. In many of the countries in which the Company operates, environmental regulations exist that require the Company to handle and dispose of asbestos in a special manner if a building undergoes major renovations or is demolished. Otherwise, the Company is not required to remove the asbestos from its buildings. The Company records a liability equal to the estimated fair value of its obligation to perform asset retirement activities related to the asbestos, computed using an expected present value technique, when sufficient information exists to calculate the fair value. The Company does not have a liability recorded related to each building that contains asbestos because the Company cannot estimate the fair value of its obligation for certain buildings due to a lack of sufficient information about the range of time over which the obligation may be settled through demolition, renovation or sale of the building.

Other Commitments and Contingencies

At September 30, 2006, the Company had outstanding letters of credit totaling $144 million and surety bonds in the amount of $95 million primarily to ensure the payment of possible casualty and workers compensation claims, environmental liabilities, and to support various customs and trade activities.

On March 8, 2004, the Company filed a complaint against Sony Corporation in federal district court in Rochester, New York, for digital camera patent infringement. Several weeks later, on March 31, 2004, Sony sued the Company for digital camera patent infringement in federal district court in Newark, New Jersey. Sony subsequently filed a second lawsuit against the Company in Newark, New Jersey, alleging infringement of a variety of other Sony patents. The Company filed a counterclaim in the New Jersey action, asserting infringement by Sony of the Company's kiosk patents. The Company successfully moved to transfer Sony's New Jersey digital camera patent infringement case to Rochester, New York, and the two digital camera patent infringement cases are now consolidated for purposes of discovery. In June 2005, the federal district court in Rochester, New York appointed a special master to assist the court with discovery and the claims construction briefing process. Both the Company and Sony Corporation seek unspecified damages and other relief. A Markman hearing in the New York action was held on September 19-21, 2006. Although this lawsuit may result in the Company's recovery of damages, the amount of the damages, if any, cannot be quantified at this time. Accordingly, the Company has not recognized any gain in the financial statements as of September 30, 2006, in connection with this matter.

On June 13, 2005, a purported shareholder class action lawsuit was filed against the Company and two of its then current executives in the United States District Court for the Southern District of New York. On June 20, 2005 and August 10, 2005, similar lawsuits were filed against the same defendants in the United States District Court for the Western District of New York. The cases have been consolidated in the Western District of New York and the lead plaintiffs are John Dudek and the Alaska Electrical Pension Fund. The complaints filed in each of these actions (collectively, the Complaints) seek to allege claims under the Securities Exchange Act on behalf of a proposed class of persons who purchased securities of the Company between April 23, 2003 and September 25, 2003, inclusive. The substance of the Complaints is that various press releases and other public statements made by the Company during the proposed class period allegedly misrepresented the Companys financial condition and omitted material information regarding, among other things, the state of the Companys film and paper business. An amended complaint was filed on January 20, 2006, containing essentially the same allegations as the original complaint but adding an additional named defendant. Defendants motion to dismiss was argued on October 3, 2006 and granted on November 1, 2006.

On or about November 9, 2005, the Company was served with a purported derivative lawsuit that had been commenced against the Company, as a nominal defendant, and eleven current and former directors and officers of the Company, in the New York State Supreme Court, Monroe County. The Complaint seeks to allege claims on behalf of the Company that, between April 2003 and September 2003, the defendant officers and directors caused the Company to make allegedly improper statements, in press release and other public statements, which falsely represented or omitted material information about the Companys financial results and guidance. The plaintiff alleges that this conduct was a breach of the defendants common law fiduciary obligations to the

Company, and constituted an abuse of control, gross mismanagement, waste and unjust enrichment. Defendants initial responses to the Complaint are not yet due. The Company intends to defend this lawsuit vigorously but is unable currently to predict the outcome of the litigation or to estimate the range of possible loss, if any.

In addition to the matters described above, the Company and its subsidiary companies are involved in other lawsuits, claims, investigations and proceedings, including product liability, commercial, intellectual property, environmental, and health and safety matters, which are being handled and defended in the ordinary course of business. There are no such matters pending representing contingent losses that the Company and its General Counsel expect to be material in relation to the Companys business, financial position, results of operations or cash flows.

NOTE 8: GUARANTEES

The Company guarantees debt and other obligations under agreements with certain customers. At September 30, 2006, these guarantees totaled a maximum of $145 million, with outstanding guaranteed amounts of $112 million. The maximum guarantee amount includes guarantees of up to: $143 million of customer amounts due to banks and leasing companies in connection with financing of customers purchases of product and equipment from the Company ($112 million outstanding), and $2 million to other third parties (less than $1 million outstanding).

The guarantees for the third party debt mature between 2006 and 2011. The customer financing agreements and related guarantees typically have a term of 90 days for product and short-term equipment financing arrangements, and up to five years for long-term equipment financing arrangements. These guarantees would require payment from the Company only in the event of default on payment by the respective debtor. In some cases, particularly for guarantees related to equipment financing, the Company has collateral or recourse provisions to recover and sell the equipment to reduce any losses that might be incurred in connection with the guarantees.

Management believes the likelihood is remote that material payments will be required under any of the guarantees disclosed above. With respect to the guarantees that the Company issued in the quarter ended September 30, 2006, the Company assessed the fair value of its obligation to stand ready to perform under these guarantees by considering the likelihood of occurrence of the specified triggering events or conditions requiring performance as well as other assumptions and factors. The Company has determined that the fair value of the guarantees is not material to the Company's financial position, results of operations or cash flows.

The Company also guarantees debt owed to banks for some of its consolidated subsidiaries. The maximum amount guaranteed is $824 million, and the outstanding debt under those guarantees, which is recorded within the short-term borrowings and long-term debt, net of current portion components in the accompanying Consolidated Statement of Financial Position, is $253 million. These guarantees expire in 2006 through 2013. As of the closing of the $2.7 billion Senior Secured Credit Facilities on October 18, 2005, a $160 million KPG credit facility was closed. Debt outstanding under the KPG credit facility of $57 million was repaid and the guarantees of $160 million were terminated. Pursuant to the terms of the Company's $2.7 billion Senior Secured Credit Agreement dated October 18, 2005, obligations under the $2.7 billion Secured Credit Facilities and other obligations of the Company and its subsidiaries to the $2.7 billion Secured Credit Facilities lenders are guaranteed.

Indemnifications

The Company issues indemnifications in certain instances when it sells businesses and real estate, and in the ordinary course of business with its customers, suppliers, service providers and business partners. Further, the Company indemnifies its directors and officers who are, or were, serving at the Company's request in such capacities. Historically, costs incurred to settle claims related to these indemnifications have not been material to the Companys financial position, results of operations or cash flows. Additionally, the fair value of the indemnifications that the Company issued during the quarter ended September 30, 2006 was not material to the Companys financial position, results of operations or cash flows.

Warranty Costs

The Company has warranty obligations in connection with the sale of equipment. The original warranty period for equipment products is generally one year or less. The costs incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time of sale. The Company estimates its warranty cost at the point of sale for a given product based on historical failure rates and related costs to repair. The change in the Company's accrued warranty obligations balance from December 31, 2005 to September 30, 2006, which is reflected in accounts payable and other current liabilities in the accompanying Consolidated Statement of Financial Position, was as follows:

(in millions)		
Accrued warranty obligations at December 31, 2005	$	58
Actual warranty experience during 2006		(62)
2006 warranty provisions		55
Adjustments for changes in estimates		(1)
Accrued warranty obligations at September 30, 2006	$	50

The Company also offers its customers extended warranty arrangements that are generally one year, but may range from three months to three years after the original warranty period. The Company provides repair services and routine maintenance under these arrangements. The Company has not separated the extended warranty revenues and costs from the routine maintenance service revenues and costs, as it is not practicable to do so. Costs incurred under these arrangements for the nine months ended September 30, 2006 amounted to $208 million. The change in the Company's deferred revenue balance in relation to these extended warranty arrangements from December 31, 2005 to September 30, 2006, which is included in accounts payable and other current liabilities in the accompanying Consolidated Statement of Financial Position, was as follows:

(in millions)		
Deferred revenue at December 31, 2005	$	183
New extended warranty arrangements in 2006		417
Recognition of extended warranty arrangement revenue in 2006		(410)
Deferred revenue at September 30, 2006	$	190

NOTE 9: RESTRUCTURING COSTS AND OTHER

The Company is currently undergoing the transformation from a traditional products and services company to a digital products and services company. In connection with this transformation, the Company announced a cost reduction program in January 2004 that would extend through 2006 to achieve the appropriate business model and to significantly reduce its worldwide facilities footprint. In July 2005, the Company announced an extension to this program into 2007 to accelerate its digital transformation, which included further cost reductions that will result in a business model consistent with what is necessary to compete profitably in digital markets.

In connection with its announcement relating to the extended "2004-2007 Restructuring Program," the Company has provided estimates with respect to (1) the number of positions to be eliminated, (2) the facility square footage reduction, (3) the reduction in its traditional manufacturing infrastructure, (4) the total restructuring charges to be incurred, (5) incremental annual savings, and (6) incremental cash charges associated with these actions.

The actual charges for initiatives under this program are recorded in the period in which the Company commits to formalized restructuring plans or executes the specific actions contemplated by the program and all criteria for restructuring charge recognition under the applicable accounting guidance have been met.

Restructuring Programs Summary

The activity in the accrued restructuring balances and the non-cash charges incurred in relation to all of the restructuring programs described below were as follows for the third quarter of 2006:

(in millions)	Balance June 30, 2006	Costs Incurred	Reversals	Cash Payments	Non-cash Settlements	Other Adjustments and Reclasses (1)	Balance Sept. 30, 2006
2004-2007 Restructuring Program:							
Severance reserve	$ 280	$ 97	$	$ (90)	$ —	$ 13	$ 300
Exit costs reserve	29	14		(21)	—	2	24
Total reserve	$ 309	$ 111	$	$ (111)	$ —	$ 15	$ 324
Long-lived asset impairments and inventory write-downs	$	$ 28	$	$	$ (28)	$	$
Accelerated depreciation	$	$ 73	$	$ —	$ (73)	$ —	$ —
Pre-2004 Restructuring Programs:							
Severance reserve	$	$ —	$	$ —	$ —	$ —	$ —
Exit costs reserve	12	—		(1)	—	—	11
Total reserve	$ 12	$ —	$	$ (1)	$ —	$ —	$ 11
Total of all restructuring programs	$ 321	$ 212	$	$ (112)	$ (101)	$ 15	$ 335

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(1) The total restructuring charges of $212 million include: (1) pension and other postretirement charges and credits for curtailments, settlements and special termination benefits, and (2) environmental remediation charges that resulted from the Company’s ongoing restructuring actions. However, because the impact of these charges and credits relate to the accounting for pensions, other postretirement benefits, and environmental remediation costs, the related impacts on the Consolidated Statement of Financial Position are reflected in their respective components as opposed to within the accrued restructuring balances at September 30, 2006. Accordingly, the Other Adjustments and Reclasses column of the table above includes: (1) reclassifications to Other long-term assets and Pension and other postretirement liabilities for the position elimination-related impacts on the Company's pension and other postretirement employee benefit plan arrangements, including net curtailment gains, settlement losses, and special termination benefits of $11 million, and (2) reclassifications to Other long-term liabilities for the restructuring-related impacts on the Company's environmental remediation liabilities of $2 million. Additionally, the Other Adjustments and Reclasses column of the table above includes foreign currency translation adjustments of $2 million, which are reflected in Accumulated other comprehensive loss in the Consolidated Statement of Financial Position.

The costs incurred, which total $212 million for the three months ended September 30, 2006, include $73 million and $2 million of charges related to accelerated depreciation and inventory write-downs, respectively, that were reported in cost of goods sold in the accompanying Consolidated Statement of Operations for the three months ended September 30, 2006. The remaining costs incurred of $137 million were reported as restructuring costs and other in the accompanying Consolidated Statement of Operations for the three months ended September 30, 2006. The severance costs and exit costs require the outlay of cash, while long-lived asset impairments, accelerated depreciation and inventory write-downs represent non-cash items.

2004-2007 Restructuring Program

The Company announced on January 22, 2004 that it planned to develop and execute a comprehensive cost reduction program throughout the 2004 to 2006 timeframe. The objective of these actions is to achieve a business model appropriate for the Company's traditional businesses, and to sharpen the Company's competitiveness in digital markets.

The Program was expected to result in total charges of $1.3 billion to $1.7 billion over the three-year period, of which $700 million to $900 million are related to severance, with the remainder relating to the disposal of buildings and equipment. Overall, the Company's worldwide facility square footage was expected to be reduced by approximately one-third. Approximately 12,000 to 15,000 positions worldwide were expected to be eliminated through these actions primarily in global manufacturing, selected traditional businesses and corporate administration.

On July 20, 2005, the Company announced that it would extend the restructuring activity, originally announced in January 2004, as part of its efforts to accelerate its digital transformation and to respond to a faster-than-expected decline in consumer film sales. As a result of this announcement, the overall restructuring program was renamed the "2004-2007 Restructuring Program." Under the 2004-2007 Restructuring Program, the Company expected to increase the total employment reduction to a range of 22,500 to 25,000 positions, and to reduce its traditional manufacturing infrastructure to approximately $1 billion, compared with $2.9 billion as of December 31, 2004. These changes were expected to increase the total charges under the Program to a range of $2.7 billion to $3.0 billion. Based on the actual actions taken through the end of the third quarter of 2006 under this Program and an understanding of the estimated remaining actions to be taken, the Company expects that the employment reductions and total charges under this Program will be within the ranges of 25,000 to 27,000 positions and $3.0 billion to $3.4 billion, respectively, as indicated in the second quarter 2006 Form 10-Q. When essentially completed in 2007, the activities under this Program will result in a business model consistent with what is necessary to compete profitably in digital markets.

The Company implemented certain actions under the Program during the third quarter of 2006. As a result of these actions, the Company recorded charges of $139 million in the third quarter of 2006, which were composed of severance, long-lived asset impairments, exit costs and inventory write-downs of $97 million, $26 million, $14 million and $2 million, respectively. The severance costs related to the elimination of approximately 1,650 positions, including approximately 800 manufacturing, 600 administrative, and 250 research and development positions. The geographic composition of the positions to be eliminated includes approximately 1,050 in the United States and Canada and 600 throughout the rest of the world. The reduction of the 1,650 positions and the $111 million charges for severance and exit costs are reflected in the 2004-2007 Restructuring Program table below. The $26 million charge in the third quarter and the $72 million year-to-date charge for long-lived asset impairments were included in restructuring costs and other in the accompanying Consolidated Statement of Operations for the three and nine months ended September 30, 2006, respectively. The charges taken for inventory write-downs of $2 million and $8 million were reported in cost of goods sold in the accompanying Consolidated Statement of Operations for the three and nine months ended September 30, 2006, respectively.

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As a result of initiatives implemented under the 2004-2007 Restructuring Program, the Company recorded $73 million and $227 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Operations for the three and nine months ended September 30, 2006, respectively. The accelerated depreciation relates to long-lived assets accounted for under the held and used model of SFAS No. 144. The third quarter amount of $73 million relates to $70 million of manufacturing facilities and equipment, $2 million of photofinishing facilities and equipment, and $1 million of administrative facilities and equipment that will be used until their abandonment. The year-to-date amount of $227 million relates to $6 million of photofinishing facilities and equipment, $219 million of manufacturing facilities and equipment, and $2 million of administrative facilities and equipment that will be used until their abandonment. The Company will incur approximately $59 million of accelerated depreciation for the remainder of 2006 as a result of the initiatives already implemented under the 2004-2007 Restructuring Program.

Under this Program, on a life-to-date basis as of September 30, 2006, the Company has recorded charges of $2,647 million, which was composed of severance, long-lived asset impairments, exit costs, inventory write-downs, and accelerated depreciation of $1,243 million, $334 million, $236 million, $64 million, and $770 million, respectively. The severance costs related to the elimination of approximately 22,200 positions, including approximately 6,025 photofinishing, 10,300 manufacturing, 1,325 research and development and 4,550 administrative positions.

The following table summarizes the activity with respect to the charges recorded in connection with the focused cost reduction actions that the Company has committed to under the 2004-2007 Restructuring Program and the remaining balances in the related reserves at September 30, 2006:

(dollars in millions)	**Number of Employees**	**Severance Reserve**	**Exit Costs Reserve**	**Total**	**Long-lived Asset Impairments and Inventory Write-downs**	**Accelerated Depreciation**
2004 charges	9,625	$ 418	$ 99	$ 517	$ 157	$ 152
2004 reversals	—	(6)	(1)	(7)	—	—
2004 utilization	(5,175)	(169)	(47)	(216)	(157)	(152)
2004 other adj. & reclasses	—	24	(15)	9	—	—
Balance at 12/31/04	4,450	267	36	303	—	—
2005 charges	8,125	497	84	581	161	391
2005 reversals	—	(3)	(6)	(9)	—	—
2005 utilization	(10,225)	(377)	(95)	(472)	(161)	(391)
2005 other adj. & reclasses	—	(113)	4	(109)	—	—
Balance at 12/31/05	2,350	271	23	294	—	—
Q1, 2006 charges	1,175	90	19	109	38	82
Q1, 2006 reversals	—	(1)	—	(1)	—	—
Q1, 2006 utilization	(1,425)	(97)	(14)	(111)	(38)	(82)
Q1, 2006 other adj. & reclasses	—	6	1	7	—	—
Balance at 03/31/06	2,100	269	29	298	—	—
Q2, 2006 charges	1,625	141	20	161	14	72
Q2, 2006 reversals	—	—	(1)	(1)	—	—
Q2, 2006 utilization	(1,300)	(118)	(15)	(133)	(14)	(72)
Q2, 2006 other adj. & reclasses	—	(12)	(4)	(16)	—	—
Balance at 06/30/06	2,425	280	29	309	—	—
Q3, 2006 charges	1,650	97	14	111	28	73
Q3, 2006 utilization	(1,075)	(90)	(21)	(111)	(28)	(73)
Q3, 2006 other adj. & reclasses	—	13	2	15	—	—
Balance at 09/30/06	3,000	$ 300	$ 24	$ 324	$ —	$ —

As a result of the initiatives already implemented under the 2004-2007 Restructuring Program, severance payments will be paid during periods through 2008 since, in many instances, the employees whose positions were eliminated can elect or are required to receive their payments over an extended period of time. Most exit costs have been paid or will be paid during 2006. However, certain costs, such as long-term lease payments, will be paid over periods after 2006.

The charges of $212 million recorded in the third quarter of 2006 included $36 million applicable to the Film and Photofinishing Systems Group segment, $16 million applicable to the Consumer Digital Imaging Group segment, $6 million applicable to the Graphic Communications Group segment, and $3 million applicable to the Health Group segment. The balance of $151 million was applicable to manufacturing, research and development, and administrative functions, which are shared across all segments.

Pre-2004 Restructuring Programs

At September 30, 2006, the Company had remaining exit costs reserves of $11 million relating to restructuring plans committed to or executed prior to 2004. Most of these remaining exit costs reserves represent long-term lease payments, which will continue to be paid over periods throughout and after 2006.

NOTE 10: RETIREMENT PLANS AND OTHER POSTRETIREMENT BENEFITS

Components of the net periodic benefit cost for all major funded and unfunded U.S. and Non-U.S. defined benefit plans for the three and nine months ended September 30 are as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2005		2006		2005	
(in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S	Non-U.S.
Service cost	$ 22	$ 8	$ 30	$ 9	$ 68	$ 27	$ 90	$ 30
Interest cost	82	46	89	39	246	133	268	124
Expected return on plan assets	(131)	(57)	(130)	(50)	(391)	(166)	(390)	(154)
Amortization of:								
Prior service cost	—	2	—	5	—	11	—	20
Actuarial loss	2	17	9	17	8	63	28	48
Pension (income) expense before special termination benefits, curtailment losses and settlements	(25)	16	(2)	20	(69)	68	(4)	68
Special termination benefits	—	8	—	2	—	39	—	47
Curtailment (gain) loss	(13)	(6)	—	3	(20)	(1)	—	20
Settlement loss (gain)	5	—	—	—	13	(5)	—	—
Net pension (income) expense	(33)	18	(2)	25	(76)	101	(4)	135
Other plans including unfunded plans	—	5	—	2	—	15	—	6
Total net pension (income) expense	$ (33)	$ 23	$ (2)	$ 27	$ (76)	$ 116	$ (4)	$ 141

For the quarters ended September 30, 2006 and 2005, $8 million and $2 million, respectively, of special termination benefits charges were incurred as a result of the Company's restructuring actions and, therefore, has been included in restructuring costs and other in the Consolidated Statement of Operations. Additionally, as a result of the Company's restructuring actions, the Company recognized a net curtailment credit of $20 million and a net settlement loss of $5 million that have been included in restructuring costs and other in the Consolidated Statement of Operations for the quarter ended September 30, 2006.

As a result of the cumulative impact of the ongoing position eliminations under its 2004-2007 Restructuring Program, as disclosed in Note 9, the Company incurred curtailment gains and losses with respect to certain of its retirement plans in the third quarter of 2006. These curtailment events resulted in the remeasurement of the plans’ obligations during the quarter, which impacted the accounting for the additional minimum pension liabilities. These remeasurements resulted in an increase in the additional minimum pension liabilities of $82 million during the third quarter of 2006. This increase is reflected in the pension and other postretirement liabilities component within the accompanying Consolidated Statement of Financial Position as of September 30, 2006. The net-of-tax amount of $60 million relating to the increase of the additional minimum pension liabilities is reflected in the accumulated other comprehensive loss component within the accompanying Consolidated Statement of Financial Position as of September 30, 2006.

The Company made contributions (funded plans) or paid benefits (unfunded plans) totaling approximately $52 million and $152 million relating to its major U.S. and non-U.S. defined benefit pension plans for the three and nine months ended September 30, 2006, respectively. The Company expects its contribution (funded plans) and benefit payment (unfunded plans) requirements for its major U.S. and non-U.S. defined benefit pension plans for the balance of 2006 to be approximately $50 million.

The amount of prepaid pension cost recognized as a component of other long-term assets in the Consolidated Statement of Financial Position for all major funded and unfunded U.S. and Non-U.S. defined benefit plans was $1,271 million and $1,119 million as of September 30, 2006 and December 31, 2005, respectively.

Postretirement benefit cost for the Company's U.S., United Kingdom and Canada postretirement benefit plans, which represent the Company's major postretirement plans, include:

(in millions)	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Components of net postretirement benefit cost				
Service cost	$ 2	$ 4	$ 8	$ 10
Interest cost	43	40	125	126
Amortization of:				
Prior service income	(11)	(13)	(35)	(40)
Actuarial loss	10	20	38	52
Other postretirement benefit cost before curtailment and settlement (gains) losses	44	51	136	148
Curtailment gain	(4)	(8)	(8)	(11)
Total net postretirement benefit cost	$ 40	$ 43	$ 128	$ 137

As a result of the cumulative impact of the ongoing position eliminations under its 2004-2007 Restructuring Program, as disclosed in Note 9, the Company incurred curtailment gains of $4 million and $8 million for the quarters ended September 30, 2006 and 2005, respectively.

The Company paid benefits totaling approximately $52 million and $170 million relating to its U.S., United Kingdom and Canada postretirement benefit plans for the three and nine months ended September 30, 2006, respectively. The Company expects to pay benefits of $59 million for postretirement plans for the balance of 2006.

NOTE 11: EARNINGS PER SHARE

Options to purchase 33.8 million and 34.8 million shares of common stock at weighted average per share prices of $46.12 and $48.46 for the three months ended September 30, 2006 and 2005, respectively, and options to purchase 32.3 and 29.8 million shares of common stock at weighted average per share prices of $47.15 and $53.42 for the nine months ended September 30, 2006 and 2005, respectively, were outstanding during the periods presented but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares for the respective periods and, therefore, the impact of these shares on the diluted earnings per share calculation would be anti-dilutive.

In addition, for the three and nine months ended September 30, 2006 and 2005, approximately 18.5 million shares related to the assumed conversion of the Company's Contingent Convertible Securities were not included in the denominator, and approximately $5 million and $15 million related to the after-tax interest expense on the Contingent Convertible Securities for the three months and nine months ended September 30, 2006 and 2005, respectively, were not adjusted for in the numerator for purposes of the computation of diluted earnings per share for the three and nine months ended September 30, 2006 and 2005, respectively. These items were not included in the computation because they are anti-dilutive to the Company's earnings per share.

NOTE 12: SHAREHOLDERS' EQUITY

The Company has 950 million shares of authorized common stock with a par value of $2.50 per share, of which 391 million shares had been issued as of September 30, 2006 and December 31, 2005. Treasury stock at cost consists of approximately 104 million shares at September 30, 2006 and December 31, 2005.

NOTE 13: COMPREHENSIVE LOSS

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in millions)	**2006**	**2005**	**2006**	**2005**
Net loss	$ (37)	$ (914)	$ (617)	$ (1,215)
Unrealized gains (losses) on available-for-sale securities	4	—	6	(3)
Realized and unrealized (losses) gains from hedging activity		(5)	1	7
Currency translation adjustments	30	44	54	(157)
Minimum pension liability adjustment	(60)	74	146	30
Total comprehensive loss	$ (63)	$ (801)	$ (410)	$ (1,338)

NOTE 14: ACQUISITIONS

Creo Inc.

On June 15, 2005, the Company completed the acquisition of Creo Inc. (Creo), a premier supplier of prepress and workflow systems used by commercial printers around the world. The acquisition of Creo uniquely positions the Company to be the preferred partner for its customers, helping them improve efficiency, expand their offerings and grow their businesses. The Company paid $954 million (excluding approximately $13 million in transaction related costs), or $16.50 per share, for all of the outstanding shares of Creo. The Company used its bank lines to initially fund the acquisition, which has been refinanced with a term loan under the Company's Secured Credit Agreement. Creo's extensive solutions portfolio is now part of the Company's Graphic Communications Group segment.

The following represents the total purchase price of the acquisition (in millions):

Cash paid at closing	$ 954
Transaction costs	13
Total purchase price	$ 967

Upon closing of an acquisition, the Company estimates the fair values of assets and liabilities acquired in order to consolidate the acquired balance sheet. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition and represents the final allocation of the purchase price.

At June 15, 2005 (in millions):

Current assets	$	352
Intangible assets (including in-process R&D)		292
Other non-current assets (including PP&E)		180
Goodwill		452
Total assets acquired	$	1,276
Current liabilities	$	248
Non-current liabilities		61
Total liabilities assumed	$	309
Net assets acquired	$	967

Of the $292 million of acquired intangible assets, approximately $36 million was assigned to in-process research and development assets that were written off at the date of acquisition. Approximately $48 million was initially assigned to in-process research and development assets during the second quarter of 2005, which was offset by a $12 million adjustment during the third quarter of 2005 due to a change in the third party valuation. These amounts were determined by identifying research and development projects that had not yet reached technological feasibility and for which no alternative future use existed. The value of the projects identified to be in progress was determined by estimating the future cash flows from the projects once commercialized, less costs to complete development and discounting these net cash flows back to their present value. The discount rate used for these research and development projects was 23%. The charges for the write-off were included as research and development costs in the Company's Consolidated Statement of Operations for the year ended December 31, 2005.

The remaining $256 million of intangible assets, which relate to developed technology, trademarks and customer relationships, have useful lives ranging from six to eight years. The $452 million of goodwill is assigned to the Company's Graphic Communications Group segment.

As of the acquisition date, management began to assess and formulate restructuring plans at Creo. As of June 30, 2006, management has completed its assessment and approved actions on these plans. Accordingly, the Company recorded a related liability of approximately $38 million. This liability is included in the current liabilities amount reported above and represents restructuring charges related to Creo net assets acquired. Refer to Note 9, "Restructuring Costs and Other," for further discussion of these restructuring charges.

Kodak Polychrome Graphics

Through April 1, 2005, the Company held a 50% interest in Kodak Polychrome Graphics (KPG). This joint venture between the Company and Sun Chemical Corporation was accounted for using the equity method of accounting. Summarized unaudited income statement information for KPG for the three months ended March 31, 2005 is as follows:

(in millions):

Net sales	$	439
Gross profit		149
Income from continuing operations		34
Net income		34

On April 1, 2005, the Company completed its acquisition of Kodak Polychrome Graphics (KPG) through the redemption of Sun Chemical Corporation's 50 percent interest in the joint venture. The transaction further established the Company as a leader in the graphic communications industry and will complement the Company's existing business in this market. Under the terms of the transaction, the Company redeemed all of Sun Chemical Corporation's shares in KPG by providing $317 million in cash (excluding $8 million in transaction costs) at closing and by entering into two notes payable arrangements, one that will be payable within the U.S. (the U.S. note) and one that will be payable outside of the U.S. (the non-U.S. note), that will require principal and interest payments of $200 million in the third quarter of 2006 (which has been paid during the third quarter 2006), and $50 million annually from 2008 through 2013. The total payments due under the U.S note and the non-U.S. note are $100 million and $400 million, respectively. The aggregate fair value of these note payable arrangements of approximately $395 million was recorded in the Companys Consolidated Statement of Financial Position as of the acquisition date and was presented as a non-cash investing activity in the Consolidated Statement of Cash Flows. KPG now operates within the Companys Graphic Communications Group segment.

The following represents the total purchase price of the acquisition (in millions):

Cash paid at closing	$	317
Transaction costs		8
Notes payable		395
Total purchase price	$	720

Upon closing of an acquisition, the Company estimates the fair values of assets and liabilities acquired in order to consolidate the acquired balance sheet. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition and represents the final allocation of the purchase price.

At April 1, 2005 (in millions):

Current assets	$	487
Intangible assets (including in-process R&D)		160
Other non-current assets (including PP&E)		179
Goodwill		235
Total assets acquired	$	1,061
Current liabilities	$	262
Non-current liabilities		79
Total liabilities assumed	$	341
Net assets acquired	$	720

Of the $160 million of acquired intangible assets, approximately $16 million was assigned to research and development assets that were written off at the date of acquisition. This amount was determined by identifying research and development projects that had not yet reached technological feasibility and for which no alternative future uses exist. The value of the projects identified to be in progress was determined by estimating the future cash flows from the projects once commercialized, less costs to complete development and discounting these net cash flows back to their present value. The discount rate used for these research and development projects was 22%. The charges for the write-off were included as research and development costs in the Companys Consolidated Statement of Operations for the year ended December 31, 2005.

The remaining $144 million of intangible assets, which relate to developed technology, trademarks and customer relationships, have useful lives ranging from three to sixteen years. The $235 million of goodwill is assigned to the Companys Graphic Communications Group segment.

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As of the acquisition date, management began to assess and formulate restructuring plans at KPG. As of March 31, 2006, management completed its assessment and approved actions on these plans. Accordingly, the Company recorded a related liability of approximately $8 million on these approved actions. This liability is included in the current liabilities amount reported above and represents restructuring charges related to the net assets acquired. To the extent such actions related to the Company's historical ownership in the KPG joint venture, the restructuring charges were reflected in the Company's Consolidated Statement of Operations. Refer to Note 9, Restructuring Costs and Other, for further discussion of these restructuring charges.

The unaudited pro forma combined historical results, as if KPG had been acquired at the beginning of 2005, are estimated to be:

(in millions, except per share data)		Nine Months Ended September 30, 2005
Net sales	$	10,510
Loss from continuing operations	$	(1,199)
Basic and diluted net loss per share from continuing operations	$	(4.16)
Number of common shares used in:		
Basic and diluted net loss per share		288.1

The pro forma results include amortization of the intangible assets presented above, depreciation related to the fixed asset step-up, and the interest expense related to acquisition-related debt, and exclude the write-off of research and development assets that were acquired.

Pro-forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations of the Company and the Company's significant acquisitions since January 1, 2005, KPG and Creo, as if the acquisitions had occurred as of the beginning of the periods presented. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of the Company that would have been reported had the acquisitions been completed as of the beginning of the periods presented, and should not be taken as representative of the future consolidated results of operations or financial condition of the Company. Pro forma results were as follows for the nine months ended September 30, 2005:

(in millions, except per share data)		Nine Months Ended September 30, 2005
Net sales	$	10,795
Loss from continuing operations	$	(1,253)
Basic and diluted net loss per share from continuing operations	$	(4.35)
Number of common shares used in:		
Basic and diluted net loss per share		288.1

The pro forma results include amortization of the intangible assets, depreciation related to the fixed asset step-up, and the interest expense related to acquisition-related debt, and exclude the write-off of research and development assets that were acquired.

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NOTE 15: SEGMENT INFORMATION

The Company realigned its operations effective January 1, 2006, and changed the corporate segment reporting structure beginning with the first quarter, 2006.

As of and for the year ended December 31, 2005, the Company had three reportable segments: Digital & Film Imaging Systems (D&FIS), Health Group, and Graphic Communications Group. The balance of the Company's operations, which individually and in the aggregate did not meet the criteria of a reportable segment, was reported in All Other. The bridge from the previous segment reporting to the new reporting structure is outlined below:

Consumer Digital Imaging Group Segment (CDG): The Consumer Digital Imaging Group segment encompasses digital capture, kiosks, home printing systems, digital imaging services and imaging sensors. This segment provides consumers and professionals with digital products and services, and includes the licensing activities related to the Company's intellectual property in this product category.

Film and Photofinishing Systems Group Segment (FPG): The Film and Photofinishing Systems Group segment encompasses consumer and professional film, photographic paper and photofinishing, aerial and industrial film, and entertainment products and services. This segment provides consumers, professionals and cinematographers with traditional products and services.

Health Group Segment (KHG): There are no changes to the Health Group segment. The Health Group segment provides digital medical imaging and information products, and systems and solutions, which are key components of sales and earnings growth. These include laser imagers, digital print films, computed and digital radiography systems, dental radiographic imaging systems, dental practice management software (DPMS), advanced picture-archiving and communications systems (PACS), and healthcare information solutions (HCIS). Products of the Health Group segment also include traditional analog medical and dental films, chemicals, and processing equipment and related services. The Company's history in traditional analog imaging has made it a worldwide leader in this area and has served as the foundation for building its important digital imaging business. The Health Group segment serves the general radiology market and specialty health markets, including dental, mammography, orthopedics and oncology. The segment also provides molecular imaging for the biotechnology research market.

Graphic Communications Group Segment (GCG): As of January 1, 2006, the Graphic Communications Group segment consists of Kodak Polychrome Graphics LLP (KPG), a leader in the graphic communications industry; Creo, Inc., a premier supplier of prepress and workflow systems used by commercial printers worldwide; NexPress Solutions, Inc., a producer of digital color and black and white printing solutions; Kodak Versamark, Inc., a provider of continuous inkjet technology; and Encad, Inc., a maker of wide-format inkjet printers, inks and media. The Company's Document Products and Services organization, which includes market-leading production and desktop document scanners, microfilm, worldwide service and support and business process services operations, is also part of this segment.

As of July 1, 2006, as a result of the ongoing integration of acquisitions within the Graphic Communications Group segment, the GCG segment consists of the following strategic product groups: digital prepress consumables, including digital plates, chemistry, media and services; NexPress Color equipment, consumables and services, and direct image press equipment; commercial inkjet printing solutions, including Versamark equipment, consumables and service; workflow software, output devices, proofing equipment, and services; electrophotographic black and white equipment and consumables, document scanners and services, wide-format inkjet, imaging services; and traditional products including analog plates, graphics and other films, paper, media equipment, archival products.

All Other: All Other is composed of the Company's display business, inkjet systems, business development and other small, miscellaneous businesses. The development initiatives in consumer inkjet technologies continue to be reported in All Other.

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The Company currently has four reportable segments based on the aggregation of similar products and services: Consumer Digital Imaging Group (CDG); Film and Photofinishing Systems Group (FPG); Graphic Communications Group (GCG); and Health Group (KHG). The balance of the Company's operations, which individually and in the aggregate do not meet the criteria of a reportable segment, are reported in All Other.

During the fourth quarter of 2005, the Company changed its methodology for allocating post employment benefit costs for retirees to the segments to which these costs are primarily attributable. This reallocation had insignificant impacts on the individual line items comprising the consolidated and segment earnings (losses) from continuing operations before interest, other income (charges), net and income taxes, as amounts were reclassified between the (1) cost of goods sold, (2) selling, general and administrative expense, and (3) research and development costs expense lines.

Additionally, effective January 1, 2006, the Company changed its cost allocation methodologies related to distribution costs, indirect selling, general and administrative expenses, and corporate research and development costs.

The changes in cost allocation methodologies referred to above increased (decreased) segment earnings (losses) from continuing operations before interest, other income (charges), net and income taxes for the three and nine months ended September 30, 2005 as follows:

(in millions)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Consumer Digital Imaging Group	$ 6	$ 11
Film and Photofinishing Systems Group	7	30
Graphic Communications Group	(8)	(30)
Health Group	7	24
All Other	(12)	(35)
Consolidated impact	$ —	$ —

Further, as described in Note 3, “Inventories, Net,” on January 1, 2006, the Company elected to change its method of costing its U.S. inventories from the LIFO method to the average cost method. This change increased cost of goods sold for the three and nine months ended September 30, 2005 for each of the segments as follows:

(in millions)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Consumer Digital Imaging Group	$ 1	$ 10
Film and Photofinishing Systems Group	1	12
Graphic Communications Group	—	1
Health Group	1	5
All Other	—	1
Consolidated impact	$ 3	$ 29

Prior period results have been adjusted to reflect the changes in segment reporting structure, the changes in cost allocation methodologies outlined above, and the change in inventory costing method. Segment financial information is shown below:

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	2006	2005	2006	2005
Net sales from continuing operations:				
Consumer Digital Imaging Group	$ 640	$ 659	$ 1,766	$ 1,883
Film and Photofinishing Systems Group	1,074	1,353	3,143	4,124

Graphic Communications Group	880	886	2,658	2,048
Health Group	597	635	1,837	1,955
All Other	13	20	49	61
Consolidated total	$ 3,204	$ 3,553	$ 9,453	$ 10,071

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	**2006**	**2005**	**2006**	**2005**
Earnings (loss) from continuing operations before interest, other income (charges), net and income taxes:				
Consumer Digital Imaging Group	$ 24	$ (61)	$ (149)	$ (171)
Film and Photofinishing Systems Group	139	174	281	489
Graphic Communications Group	31	7	84	(69)
Health Group	68	96	192	283
All Other	(48)	(61)	(142)	(170)
Total of segments	214	155	266	362
Restructuring costs and other	(212)	(278)	(686)	(823)
Legal settlement	—	—	(4)	—
Interest expense	(74)	(57)	(202)	(144)
Other income (charges), net	54	(9)	82	(11)
Consolidated loss from continuing operations before income taxes	$ (18)	$ (189)	$ (544)	$ (616)

	At September 30, 2006	At December 31, 2005
Segment total assets:		
Consumer Digital Imaging Group	$ 2,060	$ 1,964
Film and Photofinishing Systems Group	4,588	5,346
Graphic Communications Group	3,401	3,416
Health Group	2,233	2,331
All Other	100	123
Total of segments	12,382	13,180
Cash and marketable securities	1,116	1,680
Deferred income tax assets	765	550
Other corporate assets/reserves	(203)	(174)
Consolidated total assets	$ 14,060	$ 15,236

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

New Company Operating Model and Change in Reporting Structure:

The Company realigned its operations effective January 1, 2006, and changed the corporate segment reporting structure beginning with the first quarter of 2006.

As of and for the year ended December 31, 2005, the Company had three reportable segments: Digital & Film Imaging Systems (D&FIS), Health Group, and Graphic Communications Group. The balance of the Company's operations, which individually and in the aggregate did not meet the criteria of a reportable segment, was reported in All Other. The bridge from the previous segment reporting to the new reporting structure is outlined below:

Consumer Digital Imaging Group Segment (CDG): The Consumer Digital Imaging Group segment encompasses digital capture, kiosks, home printing systems, digital imaging services and imaging sensors. This segment provides consumers and professionals with digital products and services, and includes the licensing activities related to the Company's intellectual property in this product category.

Film and Photofinishing Systems Group Segment (FPG): The Film and Photofinishing Systems Group segment encompasses consumer and professional film, photographic paper and photofinishing, aerial and industrial film, and entertainment products and services. This segment provides consumers, professionals and cinematographers with traditional products and services.

Health Group Segment (KHG): There are no changes to the Health Group segment. The Health Group segment provides digital medical imaging and information products, and systems and solutions, which are key components of sales and earnings growth. These include laser imagers, digital print films, computed and digital radiography systems, dental radiographic imaging systems, dental practice management software (DPMS), advanced picture-archiving and communications systems (PACS), and healthcare information solutions (HCIS). Products of the Health Group segment also include traditional analog medical and dental films, chemicals, and processing equipment and related services. The Company's history in traditional analog imaging has made it a worldwide leader in this area and has served as the foundation for building its important digital imaging business. The Health Group segment serves the general radiology market and specialty health markets, including dental, mammography, orthopedics and oncology. The segment also provides molecular imaging for the biotechnology research market.

Graphic Communications Group Segment (GCG): As of January 1, 2006, the Graphic Communications Group segment consists of Kodak Polychrome Graphics LLC (KPG), a leader in the graphic communications industry; Creo Inc., a premier supplier of prepress and workflow systems used by commercial printers worldwide; NexPress Solutions, Inc., a producer of digital color and black and white printing solutions; Kodak Versamark, Inc., a provider of continuous inkjet technology; and Encad, Inc., a maker of wide-format inkjet printers, inks and media. The Company's Document Products and Services organization, which includes market-leading production and desktop document scanners, microfilm, worldwide service and support and business process services operations, is also part of this segment.

As of July 1, 2006, as a result of the ongoing integration of acquisitions within the Graphic Communications Group segment, the GCG segment consists of the following strategic product groups: digital prepress consumables, including digital plates, chemistry, media and services; NexPress Color equipment, consumables and services, and direct image press equipment; commercial inkjet printing solutions, including Versamark equipment, consumables and service; workflow software, output devices, proofing equipment, and services; electrophotographic black and white equipment and consumables, document scanners and services, wide-format inkjet, imaging services; and traditional products including analog plates, graphics and other films, paper, media equipment, archival products.

All Other: All Other is composed of the Company's display business, inkjet systems, business development and other small, miscellaneous businesses. The development initiatives in consumer inkjet technologies continue to be reported in All Other.

During the fourth quarter of 2005, the Company changed its methodology for allocating post employment benefit costs for retirees to the segments to which these costs are primarily attributable. This reallocation had insignificant impacts on the individual line items comprising the consolidated and segment earnings (losses) from continuing operations before interest, other income (charges), net and income taxes, as amounts were reclassified between the (1) cost of goods sold, (2) selling, general and administrative expense, and (3) research and development costs expense lines.

Additionally, effective January 1, 2006, the Company changed its cost allocation methodologies related to distribution costs, indirect selling, general and administrative expenses, and corporate research and development costs.

The changes in cost allocation methodologies referred to above increased (decreased) segment earnings (losses) from continuing operations before interest, other income (charges), net and income taxes for the three and nine months ended September 30, 2005 as follows:

(in millions)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Consumer Digital Imaging Group	$ 6	$ 11
Film and Photofinishing Systems Group	7	30
Graphic Communications Group	(8)	(30)
Health Group	7	24
All Other	(12)	(35)
Consolidated impact	$ —	$ —

Further, as described in Note 3, "Inventories, Net," on January 1, 2006, the Company elected to change its method of costing its U.S. inventories from the LIFO method to the average cost method. This change increased cost of goods sold for the three and nine months ended September 30, 2005 for each of the segments as follows:

(in millions)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Consumer Digital Imaging Group	$ 1	$ 10
Film and Photofinishing Systems Group	1	12
Graphic Communications Group	—	1
Health Group	1	5
All Other	—	1
Consolidated impact	$ 3	$ 29

Prior period results have been adjusted to reflect the changes in segment reporting structure, the changes in cost allocation methodologies outlined above, and the change in inventory costing method.

SUMMARY

	Three Months Ended September 30			Nine Months Ended September 30		
(in millions, except per share data)	2006	2005	Change	2006	2005	Change
Net sales	$ 3,204	$ 3,553	- 10%	$ 9,453	$ 10,071	- 6
Earnings (loss) from continuing operations before interest, other income (charges), net and income taxes	2	(123)	+102%	(424)	(461)	+ 8
Loss from continuing operations before income taxes	(18)	(189)	+90%	(544)	(616)	+12
Loss from continuing operations	(37)	(915)	+96%	(617)	(1,217)	+49
Earnings from discontinued operations	—	1		—	2	

Net loss	(37)	(914)	+96%	(617)	(1,215)	+49%
Basic and diluted net loss per share:						
Continuing operations	(.13)	(3.19)	+96%	(2.15)	(4.23)	+49%
Discontinued operations		.01			.01	
Total	(.13)	(3.18)	+96%	(2.15)	(4.22)	+49%

Net Sales from Continuing Operations by Reportable Segment and All Other

	Three Months Ended September 30			Nine Months Ended September 30		
(in millions)	2006	2005	Change	2006	2005	Change
Consumer Digital Imaging Group						
Inside the U.S.	$ 401	$ 400	+ 0%	$ 1,054	$ 1,095	- 4%
Outside the U.S.	239	259	- 8	712	788	- 10
Total Consumer Digital Imaging Group	640	659	- 3	1,766	1,883	- 6
Film and Photofinishing Systems Group						
Inside the U.S.	350	445	-21	1,025	1,359	- 25
Outside the U.S.	724	908	-20	2,118	2,765	- 23
Total Film and Photofinishing Systems Group	1,074	1,353	-21	3,143	4,124	- 24
Graphic Communications Group						
Inside the U.S.	314	331	- 5	941	738	+28
Outside the U.S.	566	555	+ 2	1,717	1,310	+31
Total Graphic Communications Group	880	886	- 1	2,658	2,048	+30
Health Group						
Inside the U.S.	215	260	-17	692	778	- 11
Outside the U.S.	382	375	+ 2	1,145	1,177	- 3
Total Health Group	597	635	- 6	1,837	1,955	- 6
All Other						
Inside the U.S.	8	10	-20	38	33	+15
Outside the U.S.	5	10	-50	11	28	-61
Total All Other	13	20	-35	49	61	- 20
Consolidated total	$ 3,204	$ 3,553	-10%	$ 9,453	$ 10,071	- 6%

(Loss) Earnings from Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes by Reportable Segment and All Other

	Three Months Ended September 30			Nine Months Ended September 30		
(in millions)	2006	2005	Change	2006	2005	Change
Consumer Digital Imaging Group	$ 24	$ (61)	+139%	$ (149)	$ (171)	+13%
Percent of Sales	4%	(9)%		(8)%	(9)%	

Film and Photofinishing Systems Group	$ 139	$ 174	-20%	$ 281	$ 489	-43%
Percent of Sales	13%	13%		9%	12%	
Graphic Communications Group	$ 31	$ 7	+343%	$ 84	$ (69)	+222%
Percent of Sales	4%	1%		3%	(3)%	
Health Group	$ 68	$ 96	- 29%	$ 192	$ 283	- 32%
Percent of Sales	11%	15%		10%	14%	
All Other	$ (48)	$ (61)	+21%	$ (142)	$ (170)	+16%
Percent of Sales	(369)%	(305)%		(290)%	(279)%	
Total of segments	$ 214	$ 155	+38%	$ 266	$ 362	- 27%
Percent of Sales	7%	4%		3%	4%	
Restructuring costs and other	(212)	(278)		(686)	(823)	
Legal settlement	—	—		(4)	—	
Interest expense	(74)	(57)		(202)	(144)	
Other income (charges), net	54	(9)		82	(11)	
Consolidated loss from continuing operations before income taxes	$ (18)	$ (189)	+90%	$ (544)	$ (616)	+12%

COSTS AND EXPENSES

	Three Months Ended September 30			Nine Months Ended September 30		
(in millions)	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Gross profit	$ 874	$ 922	- 5%	$ 2,361	$ 2,651	-11%
Percent of Sales	27.3%	25.9%		25.0%	26.3%	
Selling, general and administrative expenses	$ 565	$ 670	- 16%	$ 1,794	$ 1,901	- 6%
Percent of Sales	17.6%	18.9%		19.0%	18.9%	
Research and development costs	$ 170	$ 212	- 20%	$ 540	$ 680	- 21%
Percent of Sales	5.3%	6.0%		5.7%	6.8%	

2006 COMPARED WITH 2005

Third Quarter

RESULTS OF OPERATIONS — CONTINUING OPERATIONS

CONSOLIDATED

Worldwide Revenues

Net worldwide sales were $3,204 million for the third quarter of 2006 as compared with $3,553 million for the third quarter of 2005, representing a decrease of $349 million or 10%. The decrease in net sales was primarily due to declines in volumes and unfavorable price/mix, which decreased third quarter sales by approximately 8.0 and 2.5 percentage points, respectively. The decrease in volumes was primarily driven by declines in the consumer film capture Strategic Product Gr