42 Paine Road
Cumberland RI
02864-4234
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Sirs:

I believe that I have a perspective that is of value to the court considering the bankruptcy of Eastman Kodak. At the time of my retirement from Kodak in December 1998 my title was Vice President, Strategic Initiatives and I was a direct report to the CEO George Fisher. My primary activity in the last few years of my 37 year career with Kodak was to analyze the strategic implications of the substitution of digital technology for silver halide technology for the Company. This places me in a good position to assess the future of Kodak as described in the attached document. I suggest that this document can provide a useful reference for the Court to raise questions during the proceedings relative to this case. In the interests of full disclosure I should also add that I am a relatively small unsecured creditor of the Company having lost ~~my~~ "non-qualified" pension of $41K per year.

Terrence W Faulkner

Terrence W Faulkner
terrywfaulkner@gmail.com
401-475-0590

The Future of Kodak
Version 1.1
By Terrence W Faulkner

The future of the Eastman Kodak Company is uncertain. I suggest that the bankruptcy court should consider this question. "How can the "present value" of the Eastman Kodak Company be maximized? I propose that the answer turns on whether or not we believe that a smaller EK can emerge from Chapter 11 as a continuing value-generating firm. Some companies that successfully emerge from Chapter11 fail within a few years. I think that there is a case to be made that Kodak falls into this category. Assuming that this will be the case, how can the bankruptcy court maximize value for the aggregate of all the stakeholders in EK? I will consider the stakeholders in four categories; creditors (including suppliers), employees, retirees and the Rochester community. That question will be explored in the following paragraphs.

The strategy of the current Senior Management is to rely heavily on Kodak's entry into the ink jet printer business. This is a market where Kodak faces well-entrenched competitors such as HP, Epson and Canon. Kodak's current ink jet patent portfolio is weak compared with these firms and the amount of R&D resources it can devote to ink jet technology is small relative to competitors. Kodak is also weak relative to these competitors in terms of its access to distribution channels and relationships with the current customer base. Kodak's current market share is very small, especially on a WW basis in an industry where WW scale is important. To the extent that it has a publically enunciated strategy it is to undermine the industry business model by selling ink at cut-rate prices; which, if successful, would substantially reduce profit margins and make that business less attractive. We must also recognize that the ink jet printer industry is in competition with other forms of printing such as xerography. An even more important alternative is the rapidly growing category of soft display for information distribution in the form of tablet PCs. This means of distributing images and documents poses a significant threat to the future growth potential of the entire ink jet printer industry. People are clearly increasingly willing to accept soft display in place of hard copy. Even if Kodak were to shed all of its legacy costs, I do not believe that an ink jet printer business will enable Kodak to be viable.

Furthermore, we should consider past strategic decisions (such as the divestment of the Health business where the Company had a strong value-generating position). Kodak was recognized as a leader in this market. It seems odd that it should have been divested to, in part, fund the entry into the much less attractive ink jet printer business. It may also be useful to compare the strategies followed by Kodak and Fuji over the last decade. Fuji has successfully diversified beyond consumer photography, which was its core business. It has strengthened its existing non-silver halide businesses and, based on important skills and technologies that it possessed, entered new businesses. It is now successful in a variety of businesses including medical systems and services, data storage media and services, specialty chemicals, flat panel display materials, optical devices, etc. Kodak, on the other hand, has abandoned important technologies like OLED where it once held the leading position. These considerations raise questions about the quality of the strategic thinking of Kodak's current senior management.

While what remains of the silver halide business does supply cash flow, all of the segments of that market are continuing to decline. The consumer film market is close to being eliminated by digital cameras, smart phones and camera-equipped tablets. The color paper business is in similar decline as consumers are increasingly willing to forgo prints and share their images on line especially in social networks like Facebook. The professional photography market has moved to digital capture because that provides higher image quality; lower running costs and greater flexibility. The motion picture industry is rapidly converting to digital capture and projection. Graphic arts films are being replaced by digital technology even as the printing industry is facing the same threat from soft display distribution as described above in the discussion of the threat facing ink jet printing.

My conclusion is that it is probable that if Kodak were to emerge from Chapter 11; it is, within a year or two, destined to enter Chapter 7 and be liquidated. The paragraphs that follow are based on that belief.

The bankruptcy court should consider the interests of the aggregate of all stakeholders. It may appear that some of these (employees, retirees receiving health benefits) will benefit by having Kodak successfully exit bankruptcy. But in a scenario where the new Kodak continues to be value consuming and then enters Chapter 7 bankruptcy those benefits will have turned out to be temporary and the residual value of the Company will have been further reduced. It is true that those current employees who are retained will benefit during the short time before Kodak finally collapses. In this scenario it would be better for the bankruptcy court to conclude that the Company should be liquidated sooner rather than later with all of its assets being sold. In my view this would certainly be to the benefit of the secured creditors. Creditors, including suppliers (Collins Ink provides a good example), are likely to remain very skittish about their relationship with a Kodak that "successfully" exits Chapter 11 because of the uncertainty about its future. The consequences for other stakeholders would be mixed but might be beneficial for some.

Current estimates are that the liabilities of the Company are greater than the value of the assets. That estimate is necessarily based on certain assumptions. But it is possible that liquidation might result in assets such as the patent portfolio and the brand name commanding a higher price in an auction than they would if Kodak was expected to continue as a going concern. Markets dislike uncertainty and nothing could provide clearer certainty than the liquidation of Kodak. Given a very successful auction of assets with the benefits going first to the secured creditors, there might even be a small amount left over to spread among the unsecured creditors. The impact on health benefits is less clear. My understanding is that Kodak asserts that it has the right to cancel any benefit program at any time. Kodak has made it clear that if it is to have any future its legacy costs must be dramatically reduced. It is probable that in a scenario where Kodak emerges from Chapter 11 as a going (but value consuming) concern that health benefits for retirees would be eliminated as a part of that effort. The Rochester community is another stakeholder but they have already weathered the worst of the Kodak decline. The number of Kodak employees in Rochester is now less than a tenth of what it was at the peak. There are significantly more retirees in the Rochester area than current employees and the interests of the community are more closely aligned with the interests of the retirees than with any of the other stakeholders. As for the shareowners –

they made a bad bet and they lost. That is unfortunate but unavoidable under any credible scenario.

Postscript: I have described above what I think should happen. I am pessimistic about what will happen. I expect that Kodak will emerge from Chapter 11 and continue as a value-consuming firm. When it does finally fail there won't even be enough left to reimburse all of the secured creditors.