EASTMAN KODAK CO
Form 10-Q
August 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 June 30, 2006

or

o **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.

YesNo
x o

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 o Non-accelerated filer o

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

YesNo
o 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 July 31, 2006

Common Stock, $2.50 par value	**287,253,472**

Eastman Kodak Company
Form 10-Q
June 30, 2006

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
(in millions, except per share data)	**2006**	**2005**	**2006**	**2005**
Net sales	$ 3,360	$ 3,686	$ 6,249	$ 6,518
Cost of goods sold	2,551	2,648	4,762	4,789
Gross profit	809	1,038	1,487	1,729
Selling, general and administrative expenses	620	650	1,229	1,231
Research and development costs	187	272	370	468
Restructuring costs and other	169	253	314	368
Loss from continuing operations before interest, other income (charges), net and income taxes	(167)	(137)	(426)	(338)
Interest expense	66	49	128	87
Other income (charges), net	2	(37)	28	(2)
Loss from continuing operations before income taxes	(231)	(223)	(526)	(427)
Provision (benefit) for income taxes	51	(68)	54	(125)
Loss from continuing operations	$ (282)	$ (155)	$ (580)	$ (302)
Earnings from discontinued operations, net of income taxes	$	$	$	$ 1
NET LOSS	$ (282)	$ (155)	$ (580)	$ (301)
Basic and diluted net loss per share:				
Continuing operations	$ (.98)	$ (.54)	$ (2.02)	$ (1.05)
Discontinued operations				
Total	$ (.98)	$ (.54)	$ (2.02)	$ (1.05)
Number of common shares used in basic net loss per share	287.3	287.1	287.2	287.0
Incremental shares from assumed conversion of options				
Number of common shares used in diluted net loss per share	287.3	287.1	287.2	287.0

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

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	**2006**	**2005**	**2006**	**2005**
CONSOLIDATED STATEMENT OF RETAINED EARNINGS				
Retained earnings at beginning of period, as previously reported	$ 6,417	$ 7,770	$ 6,402	$ 7,922
Effect of retroactive restatement for change in methodology of costing U.S. inventories from LIFO method to average cost method		209	315	215
Retained earnings at beginning of period, as restated	6,417	7,979	6,717	8,137
Net loss	(282)	(155)	(580)	(301)
Cash dividend declared	(72)	(72)	(72)	(72)
Loss from issuance of treasury stock	(1)	(2)	(3)	(14)
Retained earnings at end of quarter	$ 6,062	$ 7,750	$ 6,062	$ 7,750

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

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF FINANCIAL POSITION (Unaudited)

(in millions)	June 30, 2006	Dec. 31, 2005
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,055	$ 1,665
Receivables, net	2,580	2,760
Inventories, net	1,439	1,455
Deferred income taxes	111	100
Other current assets	132	116
Total current assets	5,317	6,096
Property, plant and equipment, net	3,250	3,778
Goodwill	2,174	2,141
Other long-term assets	3,510	3,221
TOTAL ASSETS	$ 14,251	$ 15,236
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable and other current liabilities	$ 3,655	$ 4,187
Short-term borrowings	284	819
Accrued income taxes	769	483
Total current liabilities	4,708	5,489
OTHER LIABILITIES		
Long-term debt, net of current portion	3,247	2,764
Pension and other postretirement liabilities	3,218	3,476
Other long-term liabilities	1,203	1,225
Total liabilities	12,376	12,954
SHAREHOLDERS EQUITY		
Common stock at par	978	978
Additional paid in capital	883	873
Retained earnings	6,062	6,717
Accumulated other comprehensive loss	(234)	(467)
Unvested stock	(4)	(6)
	7,685	8,095
Less: Treasury stock at cost	5,810	5,813
Total shareholders equity	1,875	2,282
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 14,251	$ 15,236

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

EASTMAN KODAK COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)

	Six Months Ended June 30	
(in millions)	**2006**	**2005**
Cash flows relating to operating activities:		
Net loss	$ (580)	$ (301)
Adjustments to reconcile to net cash used in operating activities:		
Earnings from discontinued operations		(1)
Equity in earnings from unconsolidated affiliates	(7)	(12)
Depreciation and amortization	716	541
Purchased research and development		66
Loss (gain) on sales of businesses/assets	1	(16)
Restructuring costs, asset impairments and other non-cash charges	79	101
Benefit for deferred taxes	(237)	(122)
Decrease in receivables	216	69
Decrease (increase) in inventories	28	(72)
Decrease in liabilities excluding borrowings	(482)	(707)
Other items, net	(135)	24
Total adjustments	179	(129)
Net cash used in operating activities	(401)	(430)
Cash flows relating to investing activities:		
Additions to properties	(184)	(210)
Net proceeds from sales of businesses/assets	33	22
Acquisitions, net of cash acquired		(987)
(Investments in) distributions from unconsolidated affiliates	(9)	63
Marketable securities - purchases	(60)	(55)
Marketable securities - sales	57	45
Net cash used in investing activities	(163)	(1,122)
Cash flows relating to financing activities:		
Net (decrease) increase in borrowings with original maturity of 90 days or less	(21)	87
Proceeds from other borrowings	568	1,068
Repayment of other borrowings	(599)	(296)
Exercise of employee stock options		12
Net cash (used in) provided by financing activities	(52)	871
Effect of exchange rate changes on cash	6	(21)
Net decrease in cash and cash equivalents	(610)	(702)
Cash and cash equivalents, beginning of year	1,665	1,255
Cash and cash equivalents, end of quarter	$ 1,055	$ 553

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

EASTMAN KODAK COMPANY
NOTES TO FINANCIAL STATEMENTS (Unaudited)

NOTE 1: BASIS OF PRESENTATION

BASIS OF PRESENTATION

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

During the first quarter of 2005, the Company determined that property, plant and equipment was overstated by approximately $9 million ($5 million net of tax) as a result of the fact that interest, which had been capitalized during the construction period, had inadvertently not been written off at the time of the disposal of certain assets. The Company has assessed the impact of this item on each of the 2000-2004 annual periods and interim periods in 2004 and 2003 and determined that the impact of such errors is immaterial to each of these prior periods. The additional amount that should have been recorded as expense in each of the years 2000-2004 was less than $1.3 million per year on an after-tax basis. The Company has concluded that the $9 million adjustment ($5 million net of tax) is immaterial to the results of operations for the quarter ended March 31, 2005, the six months ended June 30, 2005, and the results for the full year 2005. Accordingly, the Company recorded an adjustment of $9 million in the six months ended June 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 six months ended June 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 six months ended June 30, 2005.

CHANGE IN ACCOUNTING METHODOLOGY

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

RECENT ACCOUNTING PRONOUNCEMENTS

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

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (an amendment of FASB Statements No. 133 and 140). This Statement permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity s first fiscal year that begins after September 15, 2006 (year ending December 31, 2007 for the Company). Additionally, the fair value 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.

NOTE 2: RECEIVABLES, NET

(in millions)	**June 30, 2006**	**December 31, 2005**
Trade receivables	$ 2,254	$ 2,447
Miscellaneous receivables	326	313
Total (net of allowances of $144 and $162 as of June 30, 2006 and December 31, 2005, respectively)	$ 2,580	$ 2,760

Of the total trade receivable amounts of $2,254 million and $2,447 million as of June 30, 2006 and December 31, 2005, respectively, approximately $288 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)	June 30, 2006	December 31, 2005
Finished goods	$ 899	$ 893
Work in process	235	243
Raw materials	305	319
Total	$ 1,439	$ 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 June 30, 2005		As of and for the Six Months Ended June 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	$ 1,523	$ 1,845	$ 1,523	$ 1,845	$ 1,140	$ 1,455
Cost of goods sold	$ 2,630	$ 2,648	$ 4,763	$ 4,789	$ 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 is as follows (in millions, except per share data):

	Three Months Ended June 30, 2005		
	As Previously Reported (1)	**LIFO to Average Cost Change in Costing Methodology Adjustments**	**As Adjusted**
Cost of goods sold	$ 2,630	$ 18	$ 2,648
Gross profit	1,056	(18)	1,038
Loss from continuing operations before interest, other income (charges), net and income taxes	(119)	(18)	(137)
Loss from continuing operations before income taxes	(205)	(18)	(223)
Benefit for income taxes	(64)	(4)	(68)
Loss from continuing operations	(141)	(14)	(155)
Net loss	$ (141)	$ (14)	$ (155)
Basic and diluted net loss per share	$ (.49)	$ (.05)	$ (.54)

	Six Months Ended June 30, 2005		
	As Previously Reported (1)	**LIFO to Average Cost Change in Costing Methodology Adjustments**	**As Adjusted**
Cost of goods sold	$ 4,763	$ 26	$ 4,789
Gross profit	1,755	(26)	1,729
Loss from continuing operations before interest, other income (charges), net and income taxes	(312)	(26)	(338)
Loss from continuing operations before income taxes	(401)	(26)	(427)
Benefit for income taxes	(119)	(6)	(125)
Loss from continuing operations	(282)	(20)	(302)
Net loss	(281)	(20)	(301)
Basic and diluted net loss per share	$ (.98)	$ (.07)	$ (1.05)

(1) Refer to footnote (1) on Page 9.

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 is 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

Components of the Company s Consolidated Statement of Cash Flows affected by the change in costing methodology for the six months ended June 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 is as follows (in millions):

	As Previously Reported	LIFO to Average Cost Change in Costing Methodology Adjustments	As Adjusted
Cash flows relating to operating activities:			
Net loss	$ (281)	$ (20)	$ (301)
Adjustments to reconcile to net cash used in operating activities:			
Benefit for deferred taxes	(133)	(10)	(143)
Increase in inventories	(98)	26	(72)
Decrease in liabilities excluding borrowings	(711)	4	(707)
Net cash used in operating activities	$ (430)	$	$ (430)

NOTE 4: GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $2,174 million and $2,141 million at June 30, 2006 and December 31, 2005, respectively. The changes in the carrying amount of goodwill by reportable segment for the six months ended June 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	8	13	3	25
Balance at June 30, 2006	$ 161	$ 579	$ 601	$ 833	$ 2,174

The purchase accounting adjustments of $8 million for the six months ended June 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 14, 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 June 30, 2006 and December 31, 2005 were as follows:

	As of June 30, 2006			
(in millions)	Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Amortization Period
Technology-based	$ 478	$ 185	$ 293	7 years
Customer-related	398	101	297	13 years
Other	205	68	137	7 years
Total	$ 1,081	$ 354	$ 727	9 years

	As of December 31, 2005			
(in millions)	Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Amortization Period
Technology-based	$ 481	$ 155	$ 326	7 years
Customer-related	397	77	320	13 years
Other	205	51	154	8 years
Total	$ 1,083	$ 283	$ 800	9 years

Amortization expense related to purchased intangible assets for the three months ended June 30, 2006 and 2005 was $36 million and $25 million, respectively. Amortization expense related to purchased intangible assets for the six months ended June 30, 2006 and 2005 was $74 million and $42 million, respectively.

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

2006	$	67
2007		131
2008		127
2009		114
2010		90
2011 and thereafter		198
Total	$	727

NOTE 5: INCOME TAXES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Loss from continuing operations before income taxes	$ (231)	$ (223)	$ (526)	$ (427)
Provision (benefit) for income taxes	51	(68)	54	(125)
Effective tax rate	(22.1)%	30.5%	(10.3)%	29.3%

The difference between the recorded provision (benefit) for the three months ended June 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)	3 Months Ended June 30, 2006	3 Months Ended June 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 was recording tax benefits on its U.S losses as of and for the three months ended June 30, 2005.	$ 32	$ (37)
The Company recorded discrete pre-tax charges for restructuring, asset impairments and a legal settlement charge totaling $259 million in the three months ended June 30, 2006, relating to which the Company recorded a tax benefit of $31 million. This benefit 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.	59	
The Company recorded discrete pre-tax charges for restructuring, asset sale gains, asset impairments and in-process R&D charges totaling $409 million in the three months ended June 30, 2005, relating to which the Company recorded a tax benefit of $122 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $143 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.		21
The Company recorded discrete tax charges in the three months ended June 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 $41 million includes a charge of $29 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 $29 million impact on the valuation allowance in the U.S.	41	
The Company recorded discrete tax charges in the three months ended June 30, 2005 relating primarily to tax rate changes, the establishment of a valuation allowance against deferred tax assets in Brazil, the planned remittance of earnings from subsidiary companies outside the U.S. and a change in estimate with respect to a tax benefit recorded in connection with a land donation in a prior period.		26
Total tax provision difference resulting from the Company s effective tax rate vs. the U.S. statutory rate	$ 132	$ 10

The difference between the recorded provision (benefit) for the six months ended June 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)	**6 Months Ended June 30, 2006**	**6 Months Ended June 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 was recording tax benefits on its U.S losses as of and for the six months ended June 30, 2005.	$ 75	$ (38)
The Company recorded discrete pre-tax charges for restructuring, asset impairments and a legal settlement charge totaling $491 million in the six months ended June 30, 2006, relating to which the Company recorded a tax benefit of $64 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $172 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.	108	
The Company recorded discrete pre-tax charges for restructuring, asset sale gains, asset impairments and in-process R&D charges totaling $615 million in the six months ended June 30, 2005, relating to which the Company recorded a tax benefit of $179 million. This benefit differs from the benefit that would have resulted using the U.S. statutory rate of $215 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.		36
The Company recorded discrete tax charges in the six months ended June 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 $55 million in the six months ended June 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.	55	
The Company recorded discrete tax charges in the six months ended June 30, 2005 relating primarily to tax rate changes, the establishment of a valuation allowance against deferred tax assets in Brazil, the planned remittance of earnings from subsidiary companies outside the U.S. and a change in estimate with respect to a tax benefit recorded in connection with a land donation in a prior period.		26
Total tax provision difference resulting from the Company s effective tax rate vs. the U.S. statutory rate	$ 238	$ 24

NOTE 6: COMMITMENTS AND CONTINGENCIES

Environmental

At June 30, 2006, the Company s undiscounted accrued liabilities for environmental remediation costs amounted to $181 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 June 30, 2006, estimated future investigation and remediation costs of $67 million are accrued for this site and are included in the $181 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 $19 million. At June 30, 2006, these costs are accrued and included in the $181 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 $38 million. The Company has obligations with estimated future investigation, remediation and monitoring costs of $8 million at other former sites. At June 30, 2006, these costs are accrued and included in the $181 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 $28 million. The closure of a plant located in West Virginia was announced in the third quarter of 2005 at a cost of $24 million and is included in the $28 million. At June 30, 2006, these costs are accrued and included in the $181 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 June 30, 2006, estimated future remediation costs of $21 million are accrued for these sites and are included in the $181 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 $2 million over the next four years. These expenditures are incurred as part of plant operations and, therefore, are not included in the environmental accrual at June 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 June 30, 2006 and December 31, 2005, the Company has recorded approximately $84 million and $75 million, respectively, of asset retirement obligations within other long-term liabilities in the accompanying Consolidated Statement of Financial Position. The Company s 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 June 30, 2006, the Company had outstanding letters of credit totaling $131 million and surety bonds in the amount of $96 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. Based on the current discovery schedule, the Company expects that claims construction hearings in the digital camera cases will take place in 2006. Both the Company and Sony Corporation seek unspecified damages and other relief. A Markman hearing is scheduled in the New York action for September 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 June 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 Company s financial condition and omitted material information regarding, among other things, the state of the Company s 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 filed on April 21, 2006. Plaintiff s memorandum in opposition was filed on June 23, 2006 and the Company s reply was filed on July 24, 2006. The Company intends to defend these lawsuits vigorously but is unable currently to predict the outcome of the litigation or to estimate the range of potential loss, if any.

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 Company s 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 Company s business, financial position, results of operations or cash flows.

NOTE 7: GUARANTEES

The Company guarantees debt and other obligations under agreements with certain customers. At June 30, 2006, these guarantees totaled a maximum of $149 million, with outstanding guaranteed amounts of $116 million. The maximum guarantee amount includes guarantees of up to: $147 million of customer amounts due to banks and leasing companies in connection with financing of customers purchases of product and equipment from the Company ($115 million outstanding), and $2 million to other third parties ($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 June 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 $719 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 $98 million. These guarantees expire in 2006 through 2012. 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.

The Company and its U.S. subsidiaries guarantee debt and other payment obligations owed to lenders and their affiliates under the $2.7 billion Secured Credit Agreement dated October 18, 2005. Essentially these obligations are included in the Company s Consolidated Statement of Financial Position. Due to the nature of this guarantee it is not practicable to determine the exact amount of obligations guaranteed to the specific lenders and their affiliates.

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 Company s financial position, results of operations or cash flows. Additionally, the fair value of the indemnifications that the Company issued during the quarter ended June 30, 2006 was not material to the Company s 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 June 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		(46)
2006 warranty provisions		44
Adjustments for changes in estimates		(1)
Accrued warranty obligations at June 30, 2006	$	55

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 six months ended June 30, 2006 amounted to $138 million. The change in the Company s deferred revenue balance in relation to these extended warranty arrangements from December 31, 2005 to June 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		272
Recognition of extended warranty arrangement revenue in 2006		(269)
Deferred revenue at June 30, 2006	$	186

NOTE 8: 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 second quarter of 2006:

(in millions)	Balance March 31, 2006	Costs Incurred	Reversals (1)	Cash Payments	Non- cash Settlements	Other Adjustments and Reclasses (2)	Balance June 30, 2006
2004-2007 Restructuring Program:							
Severance reserve	$ 269	$ 141	$	$ (118)	$	$ (12)	$ 280
Exit costs reserve	29	20	(1)	(15)		(4)	29
Total reserve	$ 298	$ 161	$ (1)	$ (133)	$	$ (16)	$ 309
Long-lived asset impairments and inventory write-downs	$	$ 14	$	$	$ (14)	$	$
Accelerated depreciation	$	$ 72	$	$	$ (72)	$	$
Pre-2004 Restructuring Programs:							
Severance reserve	$ 1	$	$	$ (1)	$	$	$
Exit costs reserve	12			(1)		1	12
Total reserve	$ 13	$	$	$ (2)	$	$ 1	$ 12
Total of all restructuring programs	$ 311	$ 247	$ (1)	$ (135)	$ (86)	$ (15)	$ 321

(1) During the three months ended June 30, 2006, the Company reversed $1 million of exit cost reserves, as exit costs were settled for amounts less than originally estimated. These reserve reversals were included in restructuring costs and other in the accompanying Statement of Operations for the three months ended June 30, 2006.

(2) The total restructuring charges of $247 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 June 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 losses, settlement losses, and special termination benefits of $(21) million, and (2) reclassifications to Other long-term liabilities for the restructuring-related impacts on the Company s environmental remediation liabilities of $(7) million. Additionally, the Other Adjustments and Reclasses column of the table above includes: (1) adjustments to the restructuring reserves of $9 million related to the Creo purchase accounting impacts that were charged appropriately to Goodwill as opposed to Restructuring charges, and (2) foreign currency translation adjustments of $4 million, which are reflected in Accumulated other comprehensive loss in the Consolidated Statement of Financial Position.

The costs incurred, net of reversals, which total $246 million for the three months ended June 30, 2006, include $72 million and $5 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 June 30, 2006. The remaining costs incurred, net of reversals, of $169 million were reported as restructuring costs and other in the accompanying Consolidated Statement of Operations for the three months ended June 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 second 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. 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 second quarter of 2006. As a result of these actions, the Company recorded charges of $175 million in the second quarter of 2006, which were composed of severance, long-lived asset impairments, exit costs and inventory write-downs of $141 million, $9 million, $20 million and $5 million, respectively. The severance costs related to the elimination of approximately 1,625 positions, including approximately 200 photofinishing, 900 manufacturing, and 525 administrative positions. The geographic composition of the positions to be eliminated includes approximately 600 in the United States and Canada and 1,025 throughout the rest of the world. Included in the 1,625 positions are approximately 25 positions related to Creo, which was acquired in 2005. The severance charge related to these positions is included in Goodwill as part of the purchase accounting related to Creo. The reduction of the 1,625 positions and the $161 million charges for severance and exit costs are reflected in the 2004-2007 Restructuring Program table below. The $9 million charge in the second quarter and the $46 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 six months ended June 30, 2006, respectively. The charges taken for inventory write-downs of $5 million and $6 million were reported in cost of goods sold in the accompanying Consolidated Statement of Operations for the three and six months ended June 30, 2006, respectively.

As a result of initiatives implemented under the 2004-2007 Restructuring Program, the Company recorded $72 million and $154 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Operations for the three and six months ended June 30, 2006, respectively. The accelerated depreciation relates to long-lived assets accounted for under the held and used model of SFAS No. 144. The second quarter amount of $72 million relates to $71 million of manufacturing facilities and equipment, and $1 million of administrative facilities and equipment that will be used until their abandonment. The year-to-date amount of $154 million relates to $4 million of photofinishing facilities and equipment, $149 million of manufacturing facilities and equipment, and $1 million of administrative facilities and equipment that will be used until their abandonment. The Company will incur approximately $91 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 June 30, 2006, the Company has recorded charges of $2,435 million, which was composed of severance, long-lived asset impairments, exit costs, inventory write-downs, and accelerated depreciation of $1,146 million, $308 million, $222 million, $62 million, and $697 million, respectively. The severance costs related to the elimination of approximately 20,550 positions, including approximately 6,025 photofinishing, 9,500 manufacturing, 1,075 research and development and 3,950 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 June 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	$	$

As a result of the initiatives already implemented under the 2004-2007 Restructuring Program, severance payments will be paid during periods through 2007 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 $247 million recorded in the second quarter of 2006, excluding reversals, included $56 million applicable to the Film and Photofinishing Systems Group segment, $5 million applicable to the Graphic Communications Group segment, and $2 million applicable to the Consumer Digital Imaging Group segment. The balance of $184 million was applicable to manufacturing, research and development, and administrative functions, which are shared across all segments.

Pre-2004 Restructuring Programs

At June 30, 2006, the Company had remaining exit costs reserves of $12 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 9: 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 six months ended June 30 are as follows:

	Three Months Ended June 30,				Six Months Ended June 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	$ 9	$ 30	$ 10	$ 46	$ 19	$ 60	$ 21
Interest cost	82	45	89	43	164	87	179	85
Expected return on plan assets	(130)	(56)	(130)	(52)	(260)	(109)	(260)	(104)
Amortization of:								
Prior service cost		4		7		9		15
Actuarial loss	2	21	9	14	6	46	19	31
Pension (income) expense before special termination benefits, curtailment losses and settlements	(24)	23	(2)	22	(44)	52	(2)	48
Special termination benefits		29		4		31		45
Curtailment (gain) loss	(7)	3		21	(7)	5		17
Settlement loss (gain)	8	(3)			8	(5)		
Net pension (income) expense	(23)	52	(2)	47	(43)	83	(2)	110
Other plans including unfunded plans		6		2		10		4
Total net pension (income) expense	$ (23)	$ 58	$ (2)	$ 49	$ (43)	$ 93	$ (2)	$ 114

For the quarters ended June 30, 2006 and 2005, $29 million and $4 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 $4 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 June 30, 2006.

As a result of the cumulative impact of the ongoing position eliminations under its Pre-2004 and 2004-2007 Restructuring Programs, as disclosed in Note 8, the Company incurred curtailment gains and losses with respect to certain of its retirement plans in the second 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 a decrease in the additional minimum pension liabilities of $65 million during the second quarter of 2006. This decrease is reflected in the pension and other postretirement liabilities component within the accompanying Consolidated Statement of Financial Position as of June 30, 2006. The net-of-tax amount of $54 million relating to the decrease 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 June 30, 2006.

The Company made contributions (funded plans) or paid benefits (unfunded plans) totaling approximately $39 million relating to its major U.S. and non-U.S. defined benefit pension plans in the second quarter of 2006. 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 $84 million.

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:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	**2006**	**2005**	**2006**	**2005**
Components of net postretirement benefit cost				
Service cost	$ 3	$ 3	$ 6	$ 6
Interest cost	42	43	82	86
Amortization of:				
Prior service income	(12)	(13)	(24)	(27)
Actuarial loss	13	16	28	32
Other postretirement benefit cost before curtailment and settlement (gains) losses	46	49	92	97
Curtailment gain	(4)		(4)	(3)
Total net postretirement benefit cost	$ 42	$ 49	$ 88	$ 94

As a result of the cumulative impact of the ongoing position eliminations under its Pre-2004 and 2004-2007 Restructuring Programs, as disclosed in Note 8, the Company incurred curtailment gains of $4 million and $0 million for the quarters ended June 30, 2006 and 2005, respectively.

The Company paid benefits totaling approximately $56 million relating to its U.S., United Kingdom and Canada postretirement benefit plans in the second quarter of 2006. The Company expects to pay benefits of $131 million for postretirement plans for the balance of 2006.

NOTE 10: EARNINGS PER SHARE

Options to purchase 32.1 million and 33.8 million shares of common stock at weighted average per share prices of $47.26 and $49.23 for the three months ended June 30, 2006 and 2005, respectively, and options to purchase 31.6 and 27.2 million shares of common stock at weighted average per share prices of $47.67 and $55.90 for the six months ended June 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 six months ended June 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 $10 million related to the after-tax interest expense on the Contingent Convertible Securities for the three months and six months ended June 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 six months ended June 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 11: 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 June 30, 2006 and December 31, 2005. Treasury stock at cost consists of approximately 104 million shares at June 30, 2006 and December 31, 2005.

NOTE 12: COMPREHENSIVE LOSS

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	**2006**	**2005**	**2006**	**2005**
Net (loss)	$ (282)	$ (155)	$ (580)	$ (301)
Unrealized gains (losses) on available-for-sale securities		(2)	2	(3)
Realized and unrealized (losses) gains from hedging activity	(2)	12	1	12
Currency translation adjustments	6	(102)	24	(201)
Minimum pension liability adjustment	54	(119)	206	(44)
Total comprehensive loss	$ (224)	$ (366)	$ (347)	$ (537)

NOTE 13: 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 and net assets acquired. Refer to Note 8, 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, 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 Company s 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 Company s 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 Company s 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 Company s Graphic Communications Group segment.

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 will be reflected in the Company s Consolidated Statement of Operations. Refer to Note 8, 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)	**Six Months Ended June 30, 2005**
Net sales	$ 6,957
Loss from continuing operations	$ (304)
Basic and diluted net loss per share from continuing operations	$ (1.06)
Number of common shares used in:	
Basic and diluted net loss per share	287.0

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 three and six months ended June 30, 2005:

(in millions, except per share data)	**Three Months Ended June 30, 2005**	**Six Months Ended June 30, 2005**
Net sales	$ 3,807	$ 7,242
Loss from continuing operations	$ (218)	$ (400)
Basic and diluted net loss per share from continuing operations	$ (.76)	$ (1.39)
Number of common shares used in:		
Basic and diluted net loss per share	287.1	287.0

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.

NOTE 14: 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.

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), 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.

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.

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. 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 six months ended June 30, 2005 as follows:

(in millions)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Consumer Digital Imaging Group	$ 2	$ 5
Film and Photofinishing Systems Group	9	23
Graphic Communications Group	(8)	(22)
Health Group	8	17
All Other	(11)	(23)
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 six months ended June 30, 2005 for each of the segments as follows:

(in millions)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Consumer Digital Imaging Group	$ 5	$ 9
Film and Photofinishing Systems Group	8	11
Graphic Communications Group	1	1
Health Group	3	4
All Other	1	1
Consolidated impact	$ 18	$ 26

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 June 30		Six Months Ended June 30	
(in millions)	2006	2005	2006	2005
Net sales from continuing operations:				
Consumer Digital Imaging Group	$ 628	$ 671	$ 1,126	$ 1,224
Film and Photofinishing Systems Group	1,153	1,503	2,069	2,771
Graphic Communications Group	908	794	1,778	1,162
Health Group	655	694	1,240	1,320
All Other	16	24	36	41
Consolidated total	$ 3,360	$ 3,686	$ 6,249	$ 6,518

(in millions)	Three Months Ended June 30 2006	Three Months Ended June 30 2005	Six Months Ended June 30 2006	Six Months Ended June 30 2005
Earnings (loss) from continuing operations before interest, other income (charges), net and income taxes:				
Consumer Digital Imaging Group	$ (79)	$ (52)	$ (173)	$ (110)
Film and Photofinishing Systems Group	113	244	142	315
Graphic Communications Group	22	(42)	53	(76)
Health Group	78	109	124	187
All Other	(51)	(57)	(94)	(109)
Total of segments	83	202	52	207
Restructuring costs and other	(246)	(339)	(474)	(545)
Legal settlement	(4)		(4)	
Interest expense	(66)	(49)	(128)	(87)
Other income (charges), net	2	(37)	28	(2)
Consolidated loss from continuing operations before income taxes	$ (231)	$ (223)	$ (526)	$ (427)

	At June 30, 2006	At December 31, 2005
Segment total assets:		
Consumer Digital Imaging Group	$ 1,984	$ 1,964
Film and Photofinishing Systems Group	4,839	5,346
Graphic Communications Group	3,420	3,416
Health Group	2,251	2,331
All Other	76	123
Total of segments	12,570	13,180
Cash and marketable securities	1,074	1,680
Deferred income tax assets	804	550
Other corporate assets/reserves	(197)	(174)
Consolidated total assets	$ 14,251	$ 15,236

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.

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.

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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.

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 six months ended June 30, 2005 as follows:

(in millions)	**Three Months Ended June 30, 2005**	**Six Months Ended June 30, 2005**
Consumer Digital Imaging Group	$ 2	$ 5
Film and Photofinishing Systems Group	9	23
Graphic Communications Group	(8)	(22)
Health Group	8	17
All Other	(11)	(23)
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 six months ended June 30, 2005 for each of the segments as follows:

(in millions)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Consumer Digital Imaging Group	$ 5	$ 9
Film and Photofinishing Systems Group	8	11
Graphic Communications Group	1	1
Health Group	3	4
All Other	1	1
Consolidated impact	$ 18	$ 26

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 June 30			Six Months Ended June 30		
(in millions, except per share data)	2006	2005	Change	2006	2005	Change
Net sales	$ 3,360	$ 3,686	- 9%	$ 6,249	$ 6,518	- 4%
Loss from continuing operations before interest, other income (charges), net and income taxes	(167)	(137)	-22%	(426)	(338)	-26%
Loss from continuing operations before income taxes	(231)	(223)	- 4%	(526)	(427)	-23%
Loss from continuing operations	(282)	(155)	-82%	(580)	(302)	-92%
Earnings from discontinued operations					1	
Net loss	(282)	(155)	-82%	(580)	(301)	-93%
Basic and diluted net loss per share:						
Continuing operations	(.98)	(.54)	-81%	(2.02)	(1.05)	-92%
Discontinued operations						
Total	(.98)	(.54)	-81%	(2.02)	(1.05)	-92%

Net Sales from Continuing Operations by Reportable Segment and All Other

	Three Months Ended June 30			Six Months Ended June 30		
(in millions)	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Consumer Digital Imaging Group						
Inside the U.S.	$ 378	$ 391	-3%	$ 653	$ 695	- 6%
Outside the U.S.	250	280	- 11	473	529	- 11
Total Consumer Digital Imaging Group	628	671	- 6	1,126	1,224	- 8
Film and Photofinishing Systems Group						
Inside the U.S.	391	512	-24	675	914	- 26
Outside the U.S.	762	991	-23	1,394	1,857	- 25
Total Film and Photofinishing Systems Group	1,153					