EASTMAN KODAK CO
Form 10-K
March 01, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the year ended December 31, 2006 or

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

For the transition period from _________ to _________

Commission File Number 1-87

EASTMAN KODAK COMPANY
(Exact name of registrant as specified in its charter)

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	**Name of each exchange on which registered**
Common Stock, $2.50 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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).
Yes o No x

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2006, was approximately $6.8 billion. The registrant has no non-voting common stock.

The number of shares outstanding of the registrant's common stock as of February 21, 2007 was 287,513,753 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

PART III OF FORM 10-K

The following items in Part III of this Form 10-K incorporate by reference information from the Notice of 2007 Annual Meeting and Proxy Statement:

Item 10 -	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE
Item 11 -	EXECUTIVE COMPENSATION
Item 12 -	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS
Item 13 -	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE
Item 14 -	PRINCIPAL ACCOUNTING FEES AND SERVICES

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PART I

ITEM 1. BUSINESS

Eastman Kodak Company (the Company or Kodak) is the world's foremost imaging innovator, providing leading products and services to the photographic, graphic communications and healthcare markets. With sales of $13.3 billion in 2006, the Company is committed to a digitally oriented growth strategy focused on helping people better use meaningful images and information in their life and work. Consumers use Kodak's system of digital and traditional image capture products and services to take, print, store and share their pictures anytime, anywhere; businesses effectively communicate with customers worldwide using Kodak solutions for prepress, conventional and digital printing and document imaging; creative professionals rely on Kodak technology to uniquely tell their story through moving or still images; and leading healthcare organizations rely on Kodak's innovative products, services and customized workflow solutions to help improve patient care and maximize efficiency and information sharing within and across their enterprises.

In 2003, the Company announced a comprehensive strategy to be implemented through 2007 to complete its transformation as the leader of the traditional photographic industry to a leadership position in digital imaging markets. Solid progress was achieved during 2006 in each area of this strategy. The Company holds a leading position in key digital product categories where it participates. For the year ended December 31, 2006, the Company achieved a level of digital revenues that exceeded traditional revenues. Additionally, through the 2005 acquisitions of KPG and Creo, the Company has essentially completed its $3 billion investment and acquisition plan included in the 2003 strategy.

For 2007, the Company's strategy is to continue to focus on the following metrics:

- Net cash generation
- Earnings growth from digital products and services
- Revenue growth from digital products and services

In addition the Company's priorities for 2007 also include:

- Achieve market success with new products, including consumer inkjet and CMOS, and Graphic Communications Group (GCG) product line extensions and new market opportunities within GCG
- Continue progress toward the installation of our target cost model, including the focus on selling, general, and administrative (SG&A) expenses, and completion of the traditional restructuring

REPORTABLE SEGMENTS

As of and for the year ended December 31, 2006, the Company reported financial information for four reportable segments: Consumer Digital Imaging Group (CDG), Film and Photofinishing Systems Group (FPG), Graphic Communications Group (GCG) and Health Group (KHG). The balance of the Company's operations, which individually and in the aggregate do not meet the criteria of a reportable segment, are reported in All Other.

The following business discussion is based on the four reportable segments and All Other as they were structured as of and for the year ended December 31, 2006. The Company's sales, earnings and assets by reportable segment for these four reportable segments and All Other for the past three years are shown in Note 23, "Segment Information."

CONSUMER DIGITAL IMAGING GROUP (CDG) SEGMENT

Sales from continuing operations of the CDG segment for 2006, 2005 and 2004 were (in millions) $2,920, $3,215 and $2,366, respectively.

The Company is a global leader in providing digital photography products and services for consumer markets. Kodak holds top three market shares in the major markets it participates in such as digital still cameras, snapshot printers, retail photo kiosks, and online imaging services.

CDGs mission is to enhance peoples lives and social interactions through the capabilities of digital imaging technology, combined with Kodaks unique consumer knowledge, brand and intellectual property. This focus has led to a full range of product and service offerings to the consumer. CDGs strategy is to extend picture taking, picture search/organizing, creativity, sharing and printing to bring innovative new experiences to consumers in ways that extend Kodaks legendary heritage in ease of use.

Digital Products: Consumer digital products include digital cameras, home imaging accessory products, and self-contained home printers and printer media. This product line fuels Kodaks participation in the high revenue growth personal device and home accessory digital markets. Products are sold directly to retailers or distributors, and are also available to customers through the Internet at the Kodak store (www.kodak.com.). Kodaks full line of camera products and accessories enable the consumer to personalize their digital camera and their photographic experience. In January 2007 Kodak introduced a new line of Digital Picture Frames that play customizable slideshows of pictures and videos that can be set to music.

Retail Printing: In January 2007, the Retail Printing Group was redefined to manage Kodaks complete set of digital printing hardware, media and infrastructure offerings to retailers. This consolidation will enable a complete set of resources to be applied to bringing innovative service products to retailers, and as such will add scale and stability to CDGs ongoing revenue, cash flows and earnings. Kodaks product and service offerings to retailers include retail kiosks, color paper, processing chemistry, retail store merchandising and identity programs, after sale service and support, web infrastructure support, and wholesale printing services. Kodak Picture Kiosks and associated media, with approximately 85,000 installations worldwide, are sold directly to major retailers and provide consumers with a flexible array of output products from their digital images. These products include high-quality custom printed products, and the ability to automatically create collages and interactive, picture-movie DVDs set to music.

On-Line Web Services: Kodak Gallery, which has more than 50 million members, is a leading online merchandise and sharing service in the category. The Kodakgallery.com site provides consumers with a secure and easy way to view, store and share their photos with friends and family, and to receive Kodak prints and other creative products from their pictures, such as photo books, frames, calendars, and a host of other personalized merchandise. In 2006, Kodak entered a partnership to develop and sell a line of branded Martha Stewart photo products on Kodak Gallery. Products are distributed directly to consumers homes, or through relationships with major retailers. Additionally, the site is a chosen partner for leading companies such as Adobe, Apple, Microsoft, and Amazon.

Kodak also distributes Kodak EasyShare desktop software at no charge to consumers, which provides easy organization and editing tools, and unifies the experience between digital cameras, home printers, and the Kodak Gallery services.

Imaging Sensors: Kodaks line of CMOS sensors provides an attractive market opportunity, including mobile, automotive and industrial sectors. Kodak has leading sensor architecture intellectual property positions, and operates with an asset light manufacturing strategy that includes partnerships with key industry players for large-scale semiconductor manufacturing.

All-in-One Inkjet Printers: In February 2007, Kodak introduced the Kodak All-in-One Ink Jet Printing System as a major initiative to drive future revenue growth and earnings. Four key components enable an expected breakthrough market entry: 1) a proprietary high-speed inkjet printing system; 2) nanoparticle pigment-based inks, 3) instant-dry, porous papers; and 4) Kodaks unique Image Science technologies. Additionally, the system is designed with a permanent print head. This unique offering is targeting the high-volume document and photo printer market with a breakthrough value proposition that saves consumers 50% on everything they print. The Inkjet Operating Model leverages Kodak technology and the efficiency of the current industry infrastructure to achieve an asset light approach to deliver this unmatched value proposition to the marketplace.

Kodak aims for superior customer satisfaction in all of its products and services. In 2006, for the third year in a row, Kodak ranked as the highest brand in customer satisfaction among digital cameras in the $200-$399 price segment (nearly half of the U.S. market), according to *J.D. Power and Associates*. Kodak EasyShare Photo Printers earned highest levels of customer satisfaction in *J.D. Power and Associates Snapshot Printer survey*.

Marketing and Competition: The Company faces competition from other online service companies, consumer electronics and printer manufacturers in the markets in which it competes, generally competing on price and technological advances. Rapid price declines shortly after product introduction are common in this environment, as producers are continually introducing new models with enhanced capabilities, such as improved resolution and/or optical systems in cameras.

The key elements of CDGs marketing strategy emphasize ease of use, quality and the complete solution offered by Kodak products and services. This is communicated through a combination of in-store presentation on-line, public relations and advertising. The Companys advertising programs actively promote the segments products and services in its various markets, and its principal trademarks, trade dress and corporate symbol are widely used and recognized. Kodak is frequently noted by trade and business publications as one of the most recognized and respected brands in the world.

FILM AND PHOTOFINISHING SYSTEMS GROUP (FPG) SEGMENT

Sales from continuing operations of the FPG segment for 2006, 2005 and 2004 were (in millions) $4,156, $5,325 and $7,051, respectively.

This segment is composed of traditional photographic products and services used to create motion pictures, capture and print photographs, and for professional and commercial imaging applications. The Company manufactures and markets films (motion picture, consumer, professional, industrial and aerial), one-time-use and re-loadable film cameras, consumer and professional color photographic papers, photographic processing chemicals, wholesale photofinishing services, on-site event imaging solutions, and equipment service and support.

The market for consumer and professional films and certain industrial and aerial films are in decline due to digital substitution. The market for motion picture films remains stable with significant impact from digital substitution still expected to be some time away. The continued future impact of digital substitution on these film markets is difficult to predict due to a number of factors, including the pace of digital technology adoption, the underlying economic strength or weakness in major world markets, and the timing of digital infrastructure installation. Film usage continues to decline as consumers continue to migrate from a film-only household, to a dual-use (digital camera and film) household, or digital only household.

Marketing and Competition: The fundamental elements of the Companys strategy with respect to the photographic products in this segment are to create a sustainable business serving customers for traditional products while aggressively managing our cost structure for those businesses that are in decline. Selective innovation plays a key element in this strategy.

The Companys strategy for the entertainment imaging business is to sustain motion picture films position as the pre-eminent capture medium for the creation of motion pictures, television dramas, commercials and a number of other types of theatrical productions. Selective investments to sustain films superior image capture and quality characteristics are part of this strategy. Kodak has the leading share of the origination film market by a significant margin, led by the widely acclaimed Vision II series of motion picture films.

The distribution of motion pictures to theaters on print film is another important element of the business, one that the Company works hard to preserve. Price competition is a bigger factor in this segment of the motion picture market, but the Company continues to maintain the leading share position.

In the consumer and professional film markets, Kodak continues to maintain the leading worldwide share position despite continuing strong competition as the market declines. The exit of several smaller participants, along with the move of retailers to a 2-brand strategy, has enabled the Company to secure a number of preferred contract renewals with leading retailers in Europe and North America strengthening our position as the market consolidates. In 2006, Kodak continued to offer selective innovation, upgrading our family of one-time-use cameras with improved film and introducing a new family of Kodak Professional Portra films, which won significant acclaim and industry awards. Price increases during 2006 led to the most stable pricing in nearly a decade.

Declines in the market for color photographic papers moderated during 2006, led by increased demand for digital printing. The Companys strategy to capitalize on this trend is to offer a variety of color paper formulations designed to optimize digital printing workflows in consumer and professional photo processing labs. The Company also offers to professional and commercial labs an industry-leading family of digital workflow software designed to improve their workflows and enhance our position as a supplier of consumables. Kodaks paper business also benefited from industry consolidation, gaining volume as several smaller participants have left the market.

Traditional products and services for the consumer are sold direct to retailers and through distributors throughout the world. Price competition continues to exist in all marketplaces. To be more cost competitive with its traditional product offerings, the Company is continuing to rationalize capacity and restructure its go-to-market model. As previously outlined, digital product offerings are substituting for some of the traditional film products, as a large number of consumers actively use digital cameras. While this substitution to date has had an impact primarily on the Companys film and paper sales, and processing services in the U.S., Japan and Western Europe, there are declining sales in emerging markets as well.

Throughout the world, almost all Entertainment Imaging products are sold directly to studios, laboratories, independent filmmakers or production companies. Quality and availability are important factors for these products, which are sold in a price competitive environment. As the industry moves to digital formats, the Company anticipates that it will face new competitors, including some of its current customers and other electronics manufacturers.

GRAPHIC COMMUNICATIONS GROUP (GCG) SEGMENT

Sales from continuing operations of the Graphic Communications Group segment for 2006, 2005 and 2004 were (in millions) $3,632, $2,990 and $1,344, respectively.

The Graphic Communications Group segment serves a variety of customers in the creative, in-plant, data center, commercial printing, packaging, newspaper and digital service bureau market segments with a range of software, media and hardware products that provide customers with a variety of solutions for prepress equipment, workflow software, digital and traditional printing, document scanning and multi-vendor IT services. Products include digital and traditional prepress consumables, including plates, chemistry, and media; workflow and proofing software; color and black and white electrophotographic equipment and consumables; high-speed, high-volume continuous inkjet printing systems; wide-format inkjet printers; high-speed production document scanners; micrographic peripherals; and media (including micrographic films). The Company also provides maintenance and professional services for Kodak and other manufacturers products, as well as providing imaging services to customers.

Marketing and Competition: Throughout the world, graphic communications products are sold through a variety of direct and indirect channels. The end users of these products include businesses in the commercial printing, data center, in-plant and digital service provider market segments. While there is price competition, the Company has been able to maintain price by adding more attractive features to its products through technological advances. The Company has developed a wide-range portfolio of digital products; workflow, equipment, media, and services to meet the needs of customers who are interested in converting from traditional analog to digital technology. Maintenance and professional services for the Companys products are sold either through product distribution channels or directly to the end users.

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The growth in digital solutions has negatively affected the sale of traditional graphic films. As a result, the Company has become more active in digital printing products and services in order to participate in this growth segment through the acquisitions of Scitex Digital Printing, renamed Kodak Versamark, the NexPress-related entities, KPG and Creo. Traditional graphic products, primarily consisting of graphic films and chemistry, were formerly sold directly by the Company to the KPG joint venture.

In addition, a range of inkjet products for digital printing and proofing are sold through direct and indirect means. Document scanners are sold primarily through a two-tiered distribution channel to a number of different industries. The Company remains competitive by focusing on developing digital solutions based on inkjet, thermal and electro-photographic technologies by comprehensive workflow, training and service systems.

HEALTH GROUP SEGMENT (KHG) SEGMENT

Sales from continuing operations of the Health Group segment for 2006, 2005 and 2004 were (in millions) $2,497, $2,655 and $2,686, respectively.

Products and services of the Health Group segment enable healthcare customers (e.g., hospitals, imaging centers, etc.) to capture, process, integrate, archive and display images and information in a variety of forms. These products and services provide intelligent decision support through the entire patient pathway from research to detection to diagnosis to treatment. The Health Group segment also provides products and services that help customers improve workflow in their facilities, which in turn helps them enhance the quality and productivity of healthcare delivery.

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, advanced picture-archiving and communications systems (PACS), and healthcare information systems (HCIS). Products of the Health Group segment also include traditional analog medical films, chemicals, and processing equipment. The Company’s history in traditional analog imaging has made it a 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.

The Company announced on January 10, 2007 that it has reached an agreement to sell the Health Group to Onex Corporation for as much as $2.55 billion. The transaction is expected to close in the first half of 2007. As a result, KHG will be reported as a discontinued operation beginning in the first quarter of 2007.

Marketing and Competition: In the U.S., Canada and Latin America, health imaging consumables and analog equipment are sold through distributors. A significant portion of digital equipment and solutions is sold direct to end users, with the balance sold through distributors and OEMs. In the U.S., individual hospitals or groups of hospitals represented by, as buying agents, group purchasing organizations (GPOs), account for a significant portion of consumables and equipment sales industry-wide. The Health Group segment has secured long-term contracts with many of the major GPOs and, thus, has positioned itself well against competitors. In Europe, consumables and analog equipment are sold through distributors and value added service providers (VASPs) as well as direct to end users. Hospitals in Europe, which are a mix of private and government-funded types, employ a highly regimented tender process in acquiring medical imaging products. In addition to creating a competitive pricing environment, this process can result in a delay of up to 6 to 18 months between the time the tender is delivered to the hospital and the time the hospital makes a decision on the vendor. Additionally, the government-funded hospitals’ budgets tend to be limited and restricted. Government reimbursement policies often drive the use of particular types of equipment and influence the transition from analog to digital imaging. These policies vary widely among European countries. In Asia and Japan, sales of all products are split between distributors and end users. In Europe, Asia and Japan, consumables and analog equipment are often sold as part of a media/equipment bundle. Digital equipment and solutions are sold direct to end-users and through OEMs in these three geographic areas.

Worldwide, the medical imaging market is crowded with a range of strong competitors. To compete aggressively, the Company’s Health Group segment has developed a full portfolio of value-adding products and services. Some competitors offer digital solutions similar to those of Kodak, and other competitors offer similar analog solutions or a mix of analog and digital. The Health Group segment has a wide range of solutions from analog to digital as well as solutions combining both analog and digital technologies. Moreover, the segment’s portfolio is expanding into new areas, thus enabling the segment to offer solutions that combine medical images and information, such as patient reports, into one unified package for medical practitioners. The Company will continue to innovate products and services to meet the changing needs and preferences of the marketplace.

ALL OTHER

Sales from continuing operations comprising All Other for 2006, 2005 and 2004 were (in millions) $69, $83 and $70, respectively.

All Other is composed of the Company□s display business, business development and other small, miscellaneous businesses. The development initiatives in consumer inkjet technologies continue to be reported in All Other through the end of 2006.

CHANGE IN REPORTING STRUCTURE

In December 2006, the Company announced that effective January 1, 2007 the Film and Photofinishing Systems Group would be called the Film Products Group, and that certain strategic product groups (SPG□s) previously included in FPG would become part of CDG. Also effective January 1, 2007, consumer inkjet systems, formerly reported in All Other, would become part of CDG. This change in structure is to align the Company□s reporting structure to the way in which the Company manages its business effective January 1, 2007. The most significant change, the transfer of photographic paper and photofinishing services to CDG from FPG, reflects the increasing manner in which images captured or generated by CDG products and services are printed and shared. CDG will be the Company□s primary point of contact for the digital picture-taking consumer, providing a full range of products and services for capturing, storing, printing and sharing images. Additionally, the new structure will concentrate FPG's portfolio exclusively on film-related and entertainment imaging businesses. The following indicates the changes from the old reporting structure to the new reporting structure that will be implemented beginning in the first quarter of 2007:

Consumer Digital Imaging Group Segment (CDG): This segment will include photographic paper and photofinishing services, formerly part of FPG, and consumer inkjet systems, formerly part of All Other.

Film Products Group Segment (FPG): The Film Products Group segment will no longer include photographic paper and photofinishing services, since they will become part of CDG. Additionally, the non-destructive testing business, formerly included in the FPG segment, will be included in the Health Group segment.

Graphic Communications Group Segment (GCG): There are no changes to the composition of the GCG segment from 2006. However, as the GCG segment completes its integration process and further aligns the discrete businesses, starting in the first quarter of 2007, the GCG segment results will be reported using its new organizational structure, as described in Item 7, □Management□s Discussion and Analysis of Financial Condition and Report of Operations.□

Health Group Segment (KHG): The Company announced on January 10, 2007 that it has reached an agreement to sell the Health Group to Onex Corporation for as much as $2.55 billion. The transaction is expected to close in the first half of 2007. As a result, the results of operations and assets, net of liabilities, to be sold, inclusive of the non-destructive testing business formerly included in FPG, will be reported as a discontinued operation beginning in the first quarter of 2007.

All Other: In February 2007, the Company announced its entry into the consumer inkjet business. Beginning with the first quarter of 2007, the results of the consumer inkjet business, formerly included in All Other, will be reported within the CDG segment. There are no other changes to the composition of All Other.

FINANCIAL INFORMATION BY GEOGRAPHIC AREA

Financial information by geographic area for the past three years is shown in Note 23, □Segment Information.□

RAW MATERIALS

The raw materials used by the Company are many and varied, and are generally readily available. Silver is one of the essential materials used in the manufacture of films and papers. The Company purchases silver from numerous suppliers under annual agreements or on a spot basis. Paper base is an essential material in the manufacture of photographic papers. The Company has contracts to acquire paper base from certified photographic paper suppliers over the next several years. Lithographic aluminum is the primary material used in the manufacture of offset printing plates. The Company procures raw aluminum coils from several suppliers on a spot basis or under contracts generally in place over the next one to three years.

SEASONALITY OF BUSINESS

Sales and earnings of the CDG segment are linked to the timing of holidays, vacations and other leisure or gifting seasons. In 2006, sales of digital products were highest in the last four months of the year. Digital capture and home printing products have experienced peak sales in this period as a result of the December holidays. Sales are normally lowest in the first quarter due to the absence of holidays and fewer people taking vacations during that time. These trends are expected to continue as the Company continues to experience growth in sales of digital products.

Sales and earnings of the FPG segment are linked to the timing of holidays, vacations and other leisure activities. Sales and earnings are normally strongest in the second and third quarters as demand is high due to heavy vacation activity and events such as weddings and graduations.

Sales and earnings of the GCG segment exhibit modestly higher levels in the fourth quarter. This is driven primarily by the sales of continuous inkjet, electrophotographic printing, and document scanner products due to seasonal customer demand linked to commercial year-end budgeting processes.

With respect to the KHG segment, the sales of consumable products, which generate the major portion of the earnings of this segment, tend to occur uniformly throughout the year. Sales of equipment products, which carry lower margins than consumables, are highest in the fourth quarter as purchases by healthcare customers are linked to their year-end capital budget process. This pattern is also reflected in the third month of each quarter.

RESEARCH AND DEVELOPMENT

Through the years, the Company has engaged in extensive and productive efforts in research and development.

Research and development expenditures for the Companys four reportable segments and All Other for 2006, 2005 and 2004 were as follows:

(in millions)	2006	2005	2004
Consumer Digital Imaging Group	$ 171	$ 179	$ 164
Film & Photofinishing Systems Group	40	89	155
Graphic Communications Group	198	278	145
Health Group	138	162	180
All Other	163	184	192
Total	$ 710	$ 892	$ 836

For an explanation of the trends in research and development expenditures in each of the segments and All Other see the discussion for each segment in Item 7, Managements Discussion and Analysis of Financial Condition and Results of Operations.

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Research and development is headquartered in Rochester, New York. Other U.S. groups are located in Boston, Massachusetts; Dallas, Texas; Oakdale, Minnesota; New Haven, Connecticut; and San Jose and San Diego, California. Outside the U.S., groups are located in England, France, Iceland, Israel, Germany, Japan, China, Singapore and Canada. These groups work in close cooperation with manufacturing units and marketing organizations to develop new products and applications to serve both existing and new markets.

It has been the Companys general practice to protect its investment in research and development and its freedom to use its inventions by obtaining patents. The ownership of these patents contributes to the Companys ability to provide leadership products and to generate revenue from licensing. The Company holds portfolios of patents in several areas important to its business, including digital cameras and image sensors; network photo sharing and fulfillment; flexographic and lithographic printing plates and systems, digital printing workflow and color management, proofing systems; color and black & white electrophotographic printing systems; wide-format, continuous, and home inkjet printers; inkjet inks, media and printing systems; thermal dye transfer and dye sublimation printing systems; digital cinema; color negative films, processing and papers; x-ray films, mammography systems, computed radiography, digital radiography, photothermographic dry printing, medical and dental image and information systems; and organic light-emitting diodes. Each of these areas is important to existing and emerging business opportunities that bear directly on the Companys overall business performance.

The Companys major products are not dependent upon one single, material patent. Rather, the technologies that underlie the Companys products are supported by an aggregation of patents having various remaining lives and expiration dates. There is no individual patent or group of patents the expiration of which is expected to have a material impact on the Companys results of operations.

ENVIRONMENTAL PROTECTION

The Company is subject to various laws and governmental regulations concerning environmental matters. The U.S. federal environmental legislation and state regulatory programs having an impact on the Company include the Toxic Substances Control Act, the Resource Conservation and Recovery Act (RCRA), the Clean Air Act, the Clean Water Act, the NY State Chemical Bulk Storage Regulations and the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (the Superfund Law).

It is the Companys policy to carry out its business activities in a manner consistent with sound health, safety and environmental management practices, and to comply with applicable health, safety and environmental laws and regulations. The Company continues to engage in a program for environmental protection and control.

Based upon information presently available, future costs associated with environmental compliance are not expected to have a material effect on the Companys capital expenditures, earnings or competitive position. However, such costs could be material to results of operations in a particular future quarter or year.

Environmental protection is further discussed in the Notes to Financial Statements, Note 11, Commitments and Contingencies.

EMPLOYMENT

At the end of 2006, the Company employed approximately 40,900 full time equivalent people, of whom approximately 20,600 were employed in the U.S. The actual number of employees may be greater because some individuals work part time.

The current employment amounts are expected to decline more over the next year as a result of the personnel reductions yet to be made under the 2004-2007 cost reduction program. On February 8, 2007, the Company updated the ranges for anticipated restructuring activity. The Company now expects that the total employment reductions will be in the range of 28,000 to 30,000 positions and total charges will be in the range of $3.6 billion to 3.8 billion. See Item 7, Managements Discussion and Analysis of Financial Condition and Results of Operations for further discussion on this restructuring program.

AVAILABLE INFORMATION

The Company files many reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. These reports, and amendments to these reports, are made available free of charge as soon as reasonably practicable after being electronically filed with or furnished to the SEC. They are available through the Companys website at www.Kodak.com. To reach the SEC filings, follow the links to Corporate, and then Investor Center. The Company also makes available free of charge through its website, at www.Kodak.com/go/annualreport, its summary annual report to shareholders and proxy statement.

The public may also read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site, at www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

We have included the CEO and CFO certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as exhibits to this report. We have also included these certifications with the Form 10-K filed on March 2, 2006. Additionally, we filed with the New York Stock Exchange (NYSE) the CEO certification, dated June 5, 2006, regarding our compliance with the NYSE's corporate governance listing standards pursuant to Section 303A.12(a) of the listing standards, and indicated that the CEO was not aware of any violations of the listing standards by the Company.

ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this report and in other documents that the Company files with the Securities and Exchange Commission are risks and uncertainties that could cause the actual future results of the Company to differ from those expressed or implied in the forward-looking statements contained in this document and other public statements the Company makes. Additionally, because of the following risks and uncertainties, as well as other variables affecting our operating results, the Company's past financial performance should not be considered an indicator of future performance.

If we do not effectively execute our digital transformation, this could adversely affect our operations, revenue and ability to compete.

The Company continues with its transformation from a traditional products and services company to a primarily digital products and services company. This transformation includes an aggressive restructuring program to reduce its traditional infrastructure to cost-effectively manage the declining traditional business and to reduce its general and administrative costs to the level necessary to compete profitably in the digital markets. The Company expects these actions to be largely completed by the end of 2007. As a result of the digital transformation, the Company has established three key financial metrics against which it will measure success: net cash generation, earnings growth from digital products and services, and revenue growth from digital products and services. Accordingly, the success of the Company's transformation is dependent upon the execution of the Company's transformation initiatives including (1) managing the amount and timing of the cost savings resulting from the restructuring of its traditional infrastructure and the reductions in general and administrative costs, (2) Kodak's ability to continue its development and sale of digital products and services that deliver competitive margins in each of its segments, (3) the Company's ability to manage the traditional business for cash generation in a cost-effective manner and (4) the Company's ability to continue to successfully integrate its acquisitions, including KPG and Creo. If Kodak cannot continue to successfully execute its transformation initiatives, the Company's ability to compete as a profitable and growing digital company could be negatively affected, which could adversely affect its results of operations and its ability to generate cash.

If we fail to comply with the covenants contained in our Secured Credit Agreement, including the two financial covenants, our ability to meet our financial obligations could be severely impaired.

There are affirmative, negative and financial covenants contained in the Company's Secured Credit Agreement. These covenants are typical for a secured credit agreement of this nature. The Company's failure to comply with these covenants could result in a default under the Secured Credit Agreement. If an event of default were to occur and is not waived by the lenders, then all outstanding debt, interest and other payments under the Secured Credit Agreement could become immediately due and payable and any unused borrowing availability under the revolving credit facility of the Secured Credit Agreement could be terminated by the lenders. The failure of the Company to repay any accelerated debt under the Secured Credit Agreement could result in acceleration of the majority of the Company's unsecured outstanding debt obligations.

If we cannot effectively manage transitions of our products and services, this could adversely affect our revenues.

The industries in which Kodak competes are rapidly changing and becoming increasingly more complex. Kodak’s ability to successfully transition its existing products to new offerings requires that the Company make accurate predictions of the product development schedule as well as volumes, product mix, customer demand, sales channels, and configuration. The process of developing new products and services is complex and often uncertain due to the frequent introduction of new products by competitors that offer improved performance and pricing. Kodak may anticipate demand and perceived market acceptance that differs from the product’s realizable customer demand and revenue stream. Further, in the face of intense industry competition, any unanticipated delay in implementing certain product strategies (including digital products, category expansion and digitization) or in the development, production or marketing of a new product could decrease any advantage Kodak may have to be the first or among the first to market and could adversely affect Kodak’s revenues. Kodak’s failure to carry out a product rollout in the time frame anticipated and in the quantities appropriate to customer demand, or at all, could adversely affect future demand for the Company’s products and services and have an adverse effect on its business. This risk is exacerbated when a product has a short life cycle or a competitor introduces a new product just before Kodak’s introduction of a similar product.

Our results are subject to risks related to our significant investment in developing and introducing new products, such as consumer inkjet printers and CMOS semiconductors. These risk include: difficulties and delays in the development, production, testing and marketing of products; customer acceptance of products; resources we must devote to the development of new technology; and the ability to differentiate our products and compete with other companies in the same markets.

If we cannot effectively anticipate trends and respond to changing customer preferences, this could aversely affect our revenues.

Due to changes in technology, the market for traditional photography products and services is in decline and, as a result, product development has focused on digital capture devices (digital cameras and scanners) designed to improve the image acquisition or digitalization process, software products designed to enhance and simplify the digital workflow, output devices (thermal and inkjet printers and commercial printing systems and solutions) designed to produce high quality documents and images, and media (thermal and silver halide) optimized for digital workflows. Kodak’s success depends in part on its ability to develop and introduce new products and services in a timely manner that keep pace with technological developments and that are accepted in the market. The Company continues to introduce new consumer and commercial digital product offerings, however, there can be no assurance that the Company will be successful in anticipating and developing new products, product enhancements or new solutions and services to adequately address changing technologies and customer requirements. In addition, if the Company is unable to anticipate and develop improvements to its current technology, to adapt its products to changing customer preferences or requirements or to continue to produce high quality products in a timely and cost-effective manner in order to compete with products offered by its competitors, this could adversely affect the revenues of the Company.

If we cannot adequately protect our intellectual property, our business could be harmed.

Kodak has made substantial investments in technologies and has filed patent applications and obtained patents to protect its intellectual property rights as well as the interests of the Company licensees. The execution and enforcement of licensing agreements protects the Company’s intellectual property rights and provides a revenue stream in the form of royalties that enables Kodak to further innovate and provide the marketplace with new products and services. There is no assurance that such measures alone will be adequate to protect the Company’s intellectual property.

Our revenue and earnings may suffer if we cannot continue to implement our intellectual property licensing strategies.

The Company’s ability to execute its intellectual property licensing strategies could also affect the Company’s revenue and earnings. Kodak’s failure to develop and properly manage new intellectual property could adversely affect market positions and business opportunities. Furthermore, the Company’s failure to identify and implement licensing programs, including identifying appropriate licensees, could adversely affect the profitability of Kodak’s operations.

Our revenue, earnings and expenses may suffer if we cannot continue to license or enforce our intellectual property rights.

Kodak relies upon patent, copyright, trademark and trade secret laws in the United States and similar laws in other countries, and agreements with its employees, customers, suppliers and other parties, to establish, maintain and enforce its intellectual property rights. Any of the Company’s direct or indirect intellectual property rights could, however, be challenged, invalidated or circumvented, or such intellectual property rights may not be sufficient to permit the Company to take advantage of current market trends or otherwise to provide competitive advantages, which could result in costly product redesign efforts, discontinuance of certain product offerings or other competitive harm. Further, the laws of certain countries do not protect proprietary rights to the same extent as the laws of the United States. Therefore, in certain jurisdictions, Kodak may be unable to protect its proprietary technology adequately against unauthorized third party copying or use, which could adversely affect its competitive position. Also, because of the rapid pace of technological change in the information technology industry, much of our business and many of our products rely on key technologies developed or licensed by third parties, and we may not be able to obtain or continue to obtain licenses and technologies from these third parties at all or on reasonable terms.

Our revenue, earnings and expenses may suffer if third parties assert that we violate their intellectual property rights.

Third parties may claim that the Company or customers indemnified by Kodak are infringing upon their intellectual property rights. In recent years, individuals and groups have begun purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from large companies like the Company. Even if Kodak believes that the claims are without merit, the claims can be time-consuming and costly to defend and distract management’s attention and resources. Claims of intellectual property infringement also might require the Company to redesign affected products, enter into costly settlement or license agreements or pay costly damage awards, or face a temporary or permanent injunction prohibiting Kodak from marketing or selling certain of its products. Even if the Company has an agreement to indemnify it against such costs, the indemnifying party may be unable to uphold its contractual agreement to Kodak. If we cannot or do not license the infringed technology at all or on reasonable terms or substitute similar technology from another source, our revenue and earnings could suffer.

If we are not successful in transitioning certain financial processes and administrative functions to a global shared services model and outsourcing some of the work to third parties, our business performance, cost savings and cash flow could be adversely impacted.

The Company continues to migrate various administrative and financial processes, such as general accounting, accounts payable, credit and collections, call centers and human resources processes to a global shared services model to more effectively manage its costs. Delays in the migration to the global shared services model and to third party vendors could adversely impact the Company’s ability to meet its cost reduction goals. Also, if third party vendors do not perform to Kodak’s standards, such as a delay in collection of customer receipts, the Company’s cash flow could be negatively impacted.

Our inability to develop and implement e-commerce strategies that align with industry standards, could adversely affect our business.

In the event Kodak were unable to develop and implement e-commerce strategies that are in alignment with consumer trends, the Company’s business could be adversely affected. The availability of software and standards related to e-commerce strategies is of an emerging nature. Kodak’s ability to successfully align with the industry standards and services and ensure timely solutions requires the Company to make accurate predictions of the future accepted standards and services.

System integration issues could adversely affect our revenues and earnings.

Portions of our IT infrastructure may experience interruptions, delays or cessations of service or product errors in connection with systems integration or migration work that takes place from time to time; in particular, installation of SAP within our Graphic Communications Group. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive. Such disruption could adversely affect our ability to fulfill orders and interrupt other processes. Delayed sales, higher costs or lost customers resulting from these disruptions could adversely affect our financial results, stock price and reputation.

Our inability to effectively manage our acquisitions could adversely impact our revenues and earnings.

In 2005, Kodak completed two large business acquisitions in its Graphic Communications Group segment in order to strengthen and diversify its portfolio of businesses, while establishing itself as a leader in the graphic communications market. The Company is accelerating the current restructuring of its traditional manufacturing infrastructure. In the event that Kodak fails to effectively manage the continuing decline of its more traditional businesses while simultaneously integrating these acquisitions, it could fail to obtain the expected synergies and favorable impact of these acquisitions. Such a failure could cause Kodak to lose market opportunities and experience a resulting adverse impact on its revenues and earnings.

Our inability to complete divestitures and other portfolio actions could adversely impact our financial position.

In January 2007, Kodak announced that it has reached an agreement to sell the Health Group to Onex Corporation. The transaction is expected to close in the first half of 2007. In the event that the Company is unable to complete the divestiture of the Health Group, it could fail to realize the favorable impacts to the Company created through the reduction of debt and other uses. Such a failure could cause Kodak to experience an adverse impact on its financial position.

Economic trends in our major markets could adversely affect net sales.

Economic downturns and declines in consumption in Kodaks major markets may affect the levels of both commercial and consumer sales. Purchases of Kodaks consumer products are to a significant extent discretionary. Accordingly, weakening economic conditions or outlook could result in a decline in the level of consumption and could adversely affect Kodaks results of operations.

If we do not timely implement our planned inventory reductions, this could adversely affect our cash flow.

Unanticipated delays in the Companys plans to continue inventory reductions in 2007 could adversely impact Kodaks cash flow outlook. Planned inventory reductions could be compromised by slower sales due to the competitive environment for digital products, and the continuing decline in demand for traditional products, which could also place pressures on Kodaks sales and market share. In the event Kodak is unable to successfully manage these issues in a timely manner, they could adversely impact the planned inventory reductions.

Delays in our plans to improve manufacturing productivity and control cost of operations could negatively impact our gross margins.

Kodaks failure to successfully manage operational performance factors could delay or curtail planned improvements in manufacturing productivity. Delays in Kodaks plans to improve manufacturing productivity and control costs of operations, including its ongoing restructuring actions to significantly reduce its traditional manufacturing infrastructure, could negatively impact the gross margins of the Company. Furthermore, if Kodak is unable to successfully negotiate raw material costs with its suppliers, or incurs adverse pricing on certain of its commodity-based raw materials, reduction in the gross margins could occur.

We depend on third party suppliers and, therefore, our revenue and gross margins could suffer if we fail to manage supplier issues properly.

Kodaks operations depend on its ability to anticipate the needs for components, products and services and Kodaks suppliers ability to deliver sufficient quantities of quality components, products and services at reasonable prices in time for Kodak to meet its schedules. Given the wide variety of products, services and systems that Kodak offers, the large number of suppliers and contract manufacturers that are dispersed across the globe, and the long lead times that are required to manufacture, assemble and deliver certain components and products, problems could arise in planning production and managing inventory levels that could seriously harm Kodak. Other supplier problems that Kodak could face include component shortages, excess supply and risks related to terms of its contracts with suppliers.

We have outsourced a significant portion of our overall worldwide manufacturing operations and face the risks associated with relying on third party manufacturers and external suppliers.

We have outsourced a significant portion of our overall worldwide manufacturing operations to third parties and various service providers. To the extent that we rely on third party manufacturing relationships, we face the risk that those manufacturers may not be able to develop manufacturing methods appropriate for our products, they may not be able to quickly respond to changes in customer demand for our products, they may not be able to obtain supplies and materials necessary for the manufacturing process, they may experience labor shortages and/or disruptions, manufacturing costs could be higher than planned and the reliability of our products could decline. If any of these risks were to be realized, and assuming similar third-party manufacturing relationships could not be established, we could experience interruptions in supply or increases in costs that might result in our being unable to meet customer demand for our products, damage our relationships with our customers, and reduce our market share, all of which could adversely affect our results of operations and financial condition.

If our planned improvements in supply chain efficiency are delayed, this could adversely affect our revenues and earnings.

As the Company continues with its transformation from a traditional products and services company to a digital products and services company, Kodaks planned improvement in supply chain efficiency, if delayed, could adversely affect its business by preventing shipments of certain products to be made in their desired quantities and in a timely and cost-effective manner. The planned efficiencies could be compromised if Kodak expands into new markets with new applications that are not fully understood or if the portfolio broadens beyond that anticipated when the plans were initiated. Any unforeseen changes in manufacturing capacity could also compromise our supply chain efficiencies.

The competitive pressures we face could harm our revenue, gross margins and market share.

The markets in which we do business are highly competitive, and we encounter aggressive price competition for all our products and services from numerous companies globally. Over the past several years, price competition in the market for film and digital cameras and related products and services has been particularly intense as competitors have aggressively cut prices and lowered their profit margins for these products. In the Health Group and Graphic Communications Group segments, aggressive pricing tactics have intensified in the contract negotiations as competitors vie for customers and market share. Our results of operations and financial condition may be adversely affected by these and other industry-wide pricing pressures. If the Company is unable to obtain pricing or programs sufficiently competitive with current and future competitors, Kodak could also lose market share, adversely affecting its revenue and gross margins.

If we fail to manage distribution of our products and services properly, our revenue, gross margins and earnings could be adversely impacted.

We use a variety of different distribution methods to sell our products and services, including third-party resellers and distributors and both direct and indirect sales to both enterprise accounts and customers. Successfully managing the interaction of direct and indirect channel efforts to reach various potential customer segments for our products and services is a complex process. Moreover, since each distribution method has distinct risks and costs, our failure to implement the most advantageous balance in the delivery model for our products and services could adversely affect our revenue, gross margins and earnings.

We may provide financing and financial guarantees to our customers, some of which may be for significant amounts.

The competitive environment in which we operate may require us to provide customer financing to a customer in order to win a contract. Customer financing arrangements may include all or a portion of the purchase price for our products and services, as well as working capital. In some circumstances, these loans can be significant. We may also assist customers in obtaining financing from banks and other sources and may also provide financial guarantees on behalf of our customers. Our success may be dependent, in part, upon our ability to provide customer financing on competitive terms and on our customers creditworthiness. If we are unable to provide competitive financing arrangements to our customers or if we extend credit to customers that are not creditworthy, this could adversely impact our revenues, profitability and financial position.

Economic uncertainty in developing markets could adversely affect our revenue and earnings.

Kodak conducts business in developing markets with economies that tend to be more volatile than those in the United States and Western Europe. The risk of doing business in developing markets such as China, India, Brazil, Argentina, Mexico, Russia and other economically volatile areas could adversely affect Kodaks operations and earnings. Such risks include the financial instability among customers in these regions, political instability and potential conflicts among developing nations and other non-economic factors such as irregular trade flows that need to be managed successfully with the help of the local governments. Kodaks failure to successfully manage economic, political and other risks relating to doing business in developing countries and economically and politically volatile areas could adversely affect its business.

Because we sell our products and services worldwide, we are subject to changes in currency exchange rates and interest rates that may adversely impact our operations and financial position.

Kodak, as a result of its global operating and financing activities, is exposed to changes in currency exchange rates and interest rates, which may adversely affect its results of operations and financial position. Exchange rates and interest rates in certain markets in which the Company does business tend to be more volatile than those in the United States and Western Europe. There can be no guarantees that the economic situation in developing markets or elsewhere will not worsen, which could result in future effects on earnings should such events occur.

Management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2006. If we discover a material weakness in the future, we may not be able to provide reasonable assurance regarding the reliability of our financial statements. As a result, our business, brand and operating results could be harmed.

Effective internal control over financial reporting is necessary for the Company to provide reasonable assurance with respect to our financial reports. If the Company cannot provide reasonable assurance with respect to its financial reports, its business, brand and operating results could be harmed. As disclosed in the Companys 2005 Annual Report on Form 10-K, and in its Quarterly Reports on Form 10-Q for each of the first three quarters of 2006, managements assessment of the Companys internal controls over financial reporting identified a material weakness in the Companys internal controls related to the completeness and accuracy of the Companys deferred income tax valuation allowance account. During the year ended December 31, 2006, the Company has made significant progress in executing the remediation plans that were established to address the material weakness identified above. This resulted in material improvements in the Companys internal control over financial reporting, including the successful remediation of the material weakness in internal controls related to the completeness and accuracy of the Companys deferred income tax valuation allowance account as of December 31, 2006. Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls or fraud. Therefore, even effective internal controls over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements.

If we cannot protect our reputation due to product quality and liability issues, our business could be harmed.

Kodak products are becoming increasingly sophisticated and complicated to design and build as rapid advancements in technologies occur. Although Kodak has established internal procedures to minimize risks that may arise from product quality and liability issues, there can be no assurance that Kodak will be able to eliminate or mitigate occurrences of these issues and associated damages. Kodak may incur expenses in connection with, for example, product recalls, service and lawsuits, and Kodaks brand image and reputation as a producer of high-quality products could suffer.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's worldwide headquarters is located in Rochester, New York.

The CDG segment of Kodak's business in the United States is headquartered in Rochester, New York. Kodak Gallery operations are managed from Emeryville, California. Kodak Inkjet Systems operations are located in San Diego, California and Rochester, New York. Many of CDG's businesses rely on manufacturing assets, company-owned or through relationships with design and manufacturing partners, which are located close to end markets and/or supplier networks.

The FPG segment of Kodak's business is centered in Rochester, New York, where film and photographic chemicals and related materials are manufactured. Other manufacturing facilities in Windsor, Colorado, Harrow, England, and Xiamen, China produce photographic paper. Additional manufacturing facilities supporting the business are located in China, Mexico, France, India, Brazil and Russia. There are a number of photofinishing laboratories in the U.S. and distribution sites throughout the world.

Products in the GCG segment are manufactured in the United States, primarily in Rochester, New York; Dayton, Ohio; Columbus, Georgia; Weatherford, Oklahoma; Windsor, Colorado; and San Diego, California. Manufacturing facilities outside the United States are located in the United Kingdom, Germany, South Africa, Israel, Bulgaria, China, Japan, Canada and Mexico. The segment provides digital and traditional products and services including prepress consumables, workflow and proofing software, color and black-and-white electrophotographic equipment and consumables, high-speed, high-volume continuous inkjet printing systems, wide-format inkjet printers, high-speed production document scanners, and micrographic peripherals and media (including micrographic films).

Products in the KHG segment are manufactured in the United States, primarily in Rochester, New York; Windsor, Colorado; Oakdale, Minnesota; and White City, Oregon. Manufacturing facilities outside the United States are located in Brazil, China, France, Germany, India and Mexico. The segment provides digital and traditional products and services including picture archiving and communications systems, radiology information systems, enterprise and departmental healthcare information systems, digital and computed radiography systems, laser imaging, mammography and oncology systems, x-ray film systems for general radiography, and dental imaging products.

Properties within a country may be shared by all segments operating within that country.

Regional distribution centers are located in various places within and outside of the United States. The Company owns or leases administrative, manufacturing, marketing and processing facilities in various parts of the world. The leases are for various periods and are generally renewable.

The Company has significantly reduced its property portfolio as a result of the 2004-2007 Restructuring Program. Under this program, the Company plans to reduce its traditional manufacturing infrastructure by two-thirds below 2004 levels. The program is expected to be largely complete by year-end 2007. During 2006, the Company made significant progress towards achieving this goal and remains committed to this plan.

ITEM 3. LEGAL PROCEEDINGS

During March 2005, the Company was contacted by members of the Division of Enforcement of the SEC concerning the announced restatement of the Company's financial statements for the full year and quarters of 2003 and the first three unaudited quarters of 2004. An informal inquiry by the staff of the SEC into the substance of that restatement is continuing. The Company continues to fully cooperate with this inquiry, and the staff has indicated that the inquiry should not be construed as an indication by the SEC or its staff that any violations of law have occurred.

On June 13, 2005, a purported shareholder class action lawsuit was filed against the Company and two of its 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 were consolidated in the Western District of New York and the lead plaintiffs were John Dudek and the Alaska Electrical Pension Fund. The complaints filed in each of these actions (collectively, the "Complaints") sought 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. An amended complaint was filed on January 20, 2006, containing essentially the same allegations as the original complaint but adding an additional named defendant. Defendants' motion to dismiss was argued on October 3, 2006 and granted on November 1, 2006. The plaintiffs did not appeal.

On or about November 9, 2005, the Company was served with a purported shareholder 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.

The Company is named a Potentially Responsible Party ("PRP") along with seven other companies in connection with certain alleged environmental contamination at the Rochester Fire Academy, located in Rochester, New York. The Company provided flammable materials to the Fire Academy, which were used in fire-fighting training. The Company and the seven other PRPs have been negotiating with the New York State Attorney General's office. On November 15, 2005, the New York State Attorney General filed a complaint in the U.S. District Court, Western District of New York against all eight PRPs seeking recovery of expenses to remediate the site. The companies have reached a conceptual settlement with the NYS Attorney General, which if mutually acceptable terms are reached and the court approves the settlement, would result in the Company paying approximately $196,000.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

Pursuant to General Instructions G (3) of Form 10-K, the following list is included as an unnumbered item in Part I of this report in lieu of being included in the Proxy Statement for the Annual Meeting of Shareholders.

			Date First Elected	
Name	**Age**	**Positions Held**	**an Executive Officer**	**to Present Office**
Robert L. Berman	49	Senior Vice President	2002	2005
Philip J. Faraci	51	Senior Vice President	2005	2005
Carl E. Gustin, Jr.	55	Senior Vice President	1994	1994
Joyce P. Haag	56	General Counsel and Senior Vice President	2005	2005
Mary Jane Hellyar	53	Senior Vice President	2005	2005
Kevin J. Hobert	42	Senior Vice President	2005	2005
James T. Langley	56	Senior Vice President	2003	2003
William J. Lloyd	67	Senior Vice President	2005	2005
Antonio M. Perez	61	Chairman of the Board, Chief Executive Officer	2003	2005

Frank S. Sklarsky	50	Chief Financial Officer and Executive Vice President	2006	2006
Diane E. Wilfong	45	Chief Accounting Officer and Corporate Controller	2006	2006

Executive officers are elected annually in February.

All of the executive officers have been employed by Kodak in various executive and managerial positions for at least five years, except: Mr. Hobert, who joined the Company on September 30, 2002; Mr. Perez, who joined the Company on April 2, 2003; Mr. Lloyd, who joined the Company on June 16, 2003; Mr. Langley, who joined the Company on August 18, 2003; Mr. Faraci, who joined the Company on December 6, 2004; and Mr. Sklarsky who joined the Company on October 30, 2006.

The executive officers’ biographies follow:

Robert L. Berman

Mr. Berman was appointed to the position of Director, Human Resources in January 2002 and was elected a Vice President of the Company in February 2002. In March 2005, he was elected a Senior Vice President by the Board of Directors. Prior to this position, Mr. Berman was the Associate Director of Human Resources and the Director and Divisional Vice President of Human Resources for Global Operations. His responsibility in that role included leadership in the delivery of strategic and operational human resources services to Kodak’s global manufacturing, supply chain and regional operations around the world. He has held a variety of key human resources positions for Kodak over his 24 year career, including the Director and Divisional Vice President of Human Resources for the Consumer Imaging business and the Human Resources Director for Kodak Colorado Division.

Philip J. Faraci

Mr. Faraci was named President, Consumer Digital Imaging Group in September 2005, effective January 1, 2006. He oversees Kodak’s consumer, digital capture, printing, kiosk, and imaging systems businesses. He joined Kodak as Director, Inkjet Systems Program in December 2004. In February 2005, he was elected a Senior Vice President of the Company. In June 2005, he was also named Director, Corporate Strategy & Business Development.

Prior to Kodak, Mr. Faraci served as Chief Operating Officer of Phogenix Imaging and President and General Manager of Gemplus Corporation’s Telecom Business Unit. Prior to these roles, he spent 22 years at Hewlett-Packard, where he served as Vice President and General Manager of the Consumer Business Organization and Senior Vice President and General Manager for the Inkjet Imaging Solutions Group.

Carl E. Gustin, Jr.

Mr. Gustin joined Kodak as Vice President and General Manager of the Digital and Applied Imaging Division in August 1994. In October 1995, he was appointed to his present position as Chief Marketing Officer and Senior Vice President, Eastman Kodak Company, in addition to his role as acting President and General Manager of Digital and Applied Imaging, which he held through 1996.

As Chief Marketing Officer, Mr. Gustin has been breaking new ground in the areas of advertising and marketing in an effort to fuel new market growth while further enhancing and broadening the reach of the Kodak brand. His areas of responsibility include: corporate-wide general marketing, internet marketing, customer relationship marketing, presence marketing, corporate branding, new business incubation, multicultural marketing, business research and corporate design, as well as providing leadership and direction for the marketing functions across the Company.

Joyce P. Haag

Ms. Haag began her Kodak career in 1981, as a lawyer on the Legal Staff. She was elected Assistant Secretary in December 1991 and elected Corporate Secretary in February 1995. In January 2001, she was appointed to the additional position of Assistant General Counsel. In August 2003, she became Director, Marketing, Antitrust, Trademark & Litigation Legal Staff and in March 2004, she became General Counsel, Europe, Africa and Middle Eastern Region (EAMER). In July 2005, she was promoted to General Counsel and Senior Vice President.

Prior to joining the Kodak Legal Staff, Ms. Haag was an associate with Boylan, Brown, Code, Fowler Vigdor & Wilson LLP in Rochester, New York.

Mary Jane Hellyar

Mary Jane Hellyar joined Eastman Kodak Company in 1982 as a research scientist in the Kodak Research Laboratories. She held a variety of positions within R&D and in 1988 she joined film manufacturing as a product engineer for motion picture films. In 1992 Ms. Hellyar was named director of the Chemicals Development Division, responsible for process development of chemical components for Kodak. Following a one-year program at the Sloan School, she joined Consumer Imaging in the strategic planning function in 1994. In 1995 Ms. Hellyar became director of the Color Product Platform, responsible for development and commercialization of color negative films, papers and chemicals.

Effective May 1999, Ms. Hellyar was named general manager, Consumer Film Business, Consumer Imaging and was elected to Corporate Vice President. Subsequently, her responsibilities were expanded as general manager, Capture and Traditional Media, and in 2003 she added responsibilities for professional films.

In November 2004, Hellyar was named President, Display and Components Group. In January 2005, the Board of Directors elected her to Senior Vice President.

In September 2005, the Company moved to four vertical businesses. Ms. Hellyar became President, Film & Photofinishing Systems Group, while also continuing responsibility for Kodak□s Display business.

In January 2007, Mr. Hellyar□s business was renamed the Film Products Group reflecting its three core businesses: Entertainment Imaging, Film Capture, and Aerial and Industrial Markets. At the same time she assumed the added responsibility of President, Entertainment Imaging.

Kevin J. Hobert

Kevin Hobert was appointed President of Kodak□s Health Group and a Senior Vice President of the Company in February 2005.

Prior to his current position, Mr. Hobert was General Manager, Digital Capture Systems and Vice President of Kodak□s Health Group. He drove significant process and product improvements that delivered revenue growth and improved margins. Under his leadership, the computed radiography business achieved the number two position worldwide, a digital radiography business was established and breast cancer computer aided detection, Kodak□s first FDA PMA product, was introduced to the market.

Mr. Hobert joined Kodak in 2002 from General Electric Medical Systems (GEMS), a division of General Electric Co., with 11 years experience in the medical imaging market. At GE he was responsible for leading GEMS□ global business comprised of digital, analog and mobile radiography market segments and remote, classical and multipurpose fluoroscopy market segments.

James T. Langley

Mr. Langley is President, Graphic Communications Group, and Senior Vice President. He joined Kodak as President, Commercial Printing, in August 2003. The Commercial Printing Group was renamed Graphic Communications Group in May 2004. In September 2003 he was elected to Senior Vice President of the Company.

He was Vice President of Commercial Printing at HP from March 2000 to August 2002. Prior to that assignment, Mr. Langley served for three years as Vice President of Inkjet Worldwide Office Printers, responsible for expanding the presence of HP□s inkjet products in new, higher-end markets. From August 1993 to June 1997, Mr. Langley served as the general manager of HP□s Vancouver Printer Division.

William J. Lloyd

Mr. Lloyd is Chief Technical Officer, and Senior Vice President. He joined Kodak in June 2003 as Director, Portfolio Planning and Analysis. In October 2003, he was named Director, Inkjet Systems Program, and was elected to Vice President of the Company. In February 2005, he was elected to Senior Vice President. His current title became effective March 1, 2005.

Prior to Kodak, Mr. Lloyd was President of the consulting firm, Inwit, Inc. focused on imaging technology. From November 2000 until March 2002, he served as Executive Vice President and Chief Technology Officer (CTO) of Gemplus International, the leading provider of smart card-based secure solutions for the wireless and financial markets.

In 2000, Mr. Lloyd served as the Co-CEO during the startup phase of Phogenix Imaging, a joint venture between Eastman Kodak and Hewlett-Packard.

Mr. Lloyd has extensive expertise in imaging and printing technologies, stemming from his 31-year career at Hewlett-Packard Company where he was Group Vice President and CTO for consumer imaging and printing. In his career at HP, Mr. Lloyd held a variety of positions in product development and research both in the U.S. and Japan. During his tenure in Japan (from 1990 until 1993) he directed the establishment of a branch of HP Laboratories.

Antonio M. Perez

Antonio M. Perez joined Kodak as President and Chief Operating Officer in April 2003, and was elected to the Company's Board of Directors in October 2004. In May 2005, he was elected Chief Executive Officer and on January 1, 2006, he became Chairman of the Company's Board of Directors.

Mr. Perez is leading the digital transformation of Kodak, aimed at delivering innovative digital products and services to consumer and commercial customers in the fastest-growing segments of the imaging industry.

Mr. Perez has extensive expertise in digital imaging technologies, stemming from a 25-year career at Hewlett-Packard Company (HP), where he was a corporate vice president and a member of the company's Executive Council. As President of HP's Consumer Business, Mr. Perez spearheaded the company's efforts to build a business in digital imaging and electronic publishing, ultimately generating worldwide revenue of more than $16 billion.

Prior to that assignment, Mr. Perez served as President and CEO of HP's inkjet imaging business. During the five years in which he led the business, the installed base of inkjet printers grew from 17 million to 100 million worldwide, with total revenue of more than $10 billion.

Just prior to joining Kodak, Mr. Perez served as an independent consultant for large investment firms, providing counsel on the effect of technology shifts on financial markets.

From June 2000 to December 2001, Mr. Perez was President and CEO of Gemplus International, where he led the effort to take the company public. While at Gemplus, he transformed the company into the leading Smart Card-based solution provider in the fast-growing wireless and financial markets. In the first fiscal year, revenue at Gemplus grew 70%, from $700 million to $1.2 billion.

Frank S. Sklarsky

Mr. Sklarsky joined Kodak on October 30, 2006 as Executive Vice President, and became the Chief Financial Officer effective November 13, 2006.

Prior to joining Kodak, Mr. Sklarsky was Executive Vice President and Chief Financial Officer of ConAgra Foods Inc.

Prior to joining ConAgra in 2004, Mr. Sklarsky was Vice President, Product Finance, at DaimlerChrysler, a position he held between 2001 and 2004. He returned to DaimlerChrysler to assist with the company's turnaround efforts after spending more than one year as Vice President, Corporate Finance, and Vice President of Dell's $5 billion consumer business. He first joined DaimlerChrysler in 1983, and held a series of increasingly responsible finance positions before leaving for Dell in 2000. At the time of his departure for Dell, he was DaimlerChrysler's Vice President, Corporate Financial Activities. Prior to DaimlerChrysler, Mr. Sklarsky, a certified public accountant, served as a Senior Accountant at Ernst & Young International from 1978 to 1981.

Diane E. Wilfong

Ms. Wilfong was appointed Controller in September 2006. She began her Kodak career in July 1999, as Director – Finance and Vice President, Kodak Professional Division. In late 2000, she was named Assistant to the Chairman and President and Chief Executive Officer, where she served the Chairman's office in an executive capacity until early 2003. At that time, she took an operating line position as General Manager, Graphics and Printing Systems SPG, in the Commercial Imaging Group (now the Graphic Communications Group). In late June 2005, Ms. Wilfong was appointed Director, Corporate Audit.

Prior to joining Kodak, Ms. Wilfong was Chief Financial Officer of Corning Asahi Video Products of Corning Incorporated, in Corning, New York. Ms. Wilfong joined Corning in 1990 and held a variety of management positions in its finance organization. Before joining Corning, Ms. Wilfong was an Audit Manager with PricewaterhouseCoopers in the Charlotte, North Carolina office of the firm.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Eastman Kodak Company common stock is principally traded on the New York Stock Exchange under the symbol "EK." There are 63,219 shareholders of record of common stock as of January 31, 2007.

MARKET PRICE DATA

	2006		2005	
Price per share:	**High**	**Low**	**High**	**Low**
1st Quarter	$ 30.91	$ 23.49	$ 35.19	$ 30.87
2nd Quarter	28.68	22.49	33.10	24.63
3rd Quarter	23.87	18.93	29.24	23.97
4th Quarter	27.57	21.93	25.14	20.77

DIVIDEND INFORMATION

The Company has a dividend policy whereby it makes semi-annual payments of dividends, when declared, on the Company's 10th business day each July and December to shareholders of record on the close of the first business day of the preceding month.

On May 10, 2006, the Board of Directors declared a semi-annual cash dividend of $.25 per share payable to shareholders of record at the close of business on June 1, 2006. This dividend was paid on July 18, 2006. On October 17, 2006, the Board of Directors declared a semi-annual cash dividend of $.25 per share payable to shareholders of record at the close of business on November 1, 2006. This dividend was paid on December 14, 2006. The total dividends paid for the year ended December 31, 2006 was $144 million.

On May 11, 2005, the Board of Directors declared a semi-annual cash dividend of $.25 per share payable to shareholders of record at the close of business on June 1, 2005. This dividend was paid on July 15, 2005. On October 18, 2005, the Board of Directors declared a semi-annual cash dividend of $.25 per share payable to shareholders of record at the close of business on November 1, 2005. This dividend was paid on December 14,

2005. The total dividends paid for the year ended December 31, 2005 was $144 million.

PERFORMANCE GRAPH - SHAREHOLDER RETURN

The following graph compares the performance of the Company's common stock with the performance of the Standard & Poor's 500 Composite Stock Price Index and the Dow Jones Industrial Index by measuring the changes in common stock prices from December 31, 2001, plus reinvested dividends.

The graph assumes that $100 was invested on December 31, 2001 in each of the Company's common stock, the Standard & Poor's 500 Composite Stock Price Index and the Dow Jones Industrial Index, and that all dividends were reinvested. In addition, the graph weighs the constituent companies on the basis of their respective market capitalizations, measured at the beginning of each relevant time period.

ITEM 6. SELECTED FINANCIAL DATA

Refer to Summary of Operating Data on page 150.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The accompanying consolidated financial statements and notes to consolidated financial statements contain information that is pertinent to management's discussion and analysis of the financial condition and results of operations. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities.

The Company believes that the critical accounting policies and estimates discussed below involve the most complex management judgments due to the sensitivity of the methods and assumptions necessary in determining the related asset, liability, revenue and expense amounts.

REVENUE RECOGNITION

The Company's revenue transactions include sales of the following: products; equipment; software; services; equipment bundled with products and/or services and/or software; integrated solutions, and intellectual property licensing. The Company recognizes revenue when it is realized or realizable and earned. For the sale of multiple-element arrangements whereby equipment is combined with services, including maintenance and training, and other elements, including software and products, the Company allocates to, and recognizes revenue from, the various elements based on their fair value. For full service solutions sales, which consist of the sale of equipment and software which may or may not require significant production, modification or customization, there are two acceptable methods of accounting: percentage of completion accounting and completed contract accounting. For certain of the Company's full service solutions, the completed contract method of accounting is being followed by the Company. This is due to insufficient historical experience resulting in the inability to provide reasonably dependable estimates of the revenues and costs applicable to the various stages of such contracts as would be necessary under the percentage of completion methodology. When the Company does have sufficient historical experience and the ability to provide reasonably dependable estimates of the revenues and the costs applicable to the various stages of these contracts, the Company will account for these full service solutions under the percentage of completion methodology. The timing and the amount of revenue recognized from the licensing of intellectual property depend upon a variety of factors, including the specific terms of each agreement and the nature of the deliverables and obligations. When the Company has continuing obligations related to a licensing arrangement, revenue related to the ongoing arrangement is recognized over the period of the obligation. Revenue is only recognized after all of the following criteria are met: (1) the Company has entered into a legally binding arrangement with a licensee of Kodak's intellectual property, (2) Kodak has delivered the technology or intellectual property rights, (3) licensee payment is deemed fixed or determinable and free of significant uncertainties, and (4) collection from the licensee is reasonably assured.

At the time revenue is recognized, the Company also records reductions to revenue for customer incentive programs in accordance with the provisions of Emerging Issues Task Force (EITF) Issue No. 01-09, Accounting for Consideration Given from a Vendor to a Customer (Including a Reseller of the Vendors Products). Such incentive programs include cash and volume discounts, price protection, promotional, cooperative and other advertising allowances and coupons. For those incentives that require the estimation of sales volumes or redemption rates, such as for volume rebates or coupons, the Company uses historical experience and internal and customer data to estimate the sales incentive at the time revenue is recognized. In the event that the actual results of these items differ from the estimates, adjustments to the sales incentive accruals would be recorded.

Incremental direct costs of a customer contract in a transaction that results in the deferral of revenue are deferred and netted against revenue in proportion to the related revenue recognized in each period if: (1) an enforceable contract for the remaining deliverable items exists; and (2) delivery of the remaining items in the arrangement is expected to generate positive margins allowing realization of the deferred costs. Incremental direct costs are defined as costs that vary with and are directly related to the acquisition of a contract, which would not have been incurred but for the acquisition of the contract.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company records and maintains a provision for doubtful accounts for customers based on a variety of factors including the Companys historical experience, the length of time the receivable has been outstanding and the financial condition of the customer. In addition, the Company regularly analyzes its customer accounts and, when it becomes aware of a specific customers inability to meet its financial obligations to the Company, such as in the case of bankruptcy filings or deterioration in the customers overall financial condition, records a specific provision for uncollectible accounts to increase the allowance to the amount that is estimated to be uncollectible. If circumstances related to specific customers were to change, the Companys estimates with respect to the collectibility of the related receivables could be further adjusted. However, losses in the aggregate have not exceeded managements expectations.

INVENTORIES

Inventories are stated at the lower of cost or market. The cost of all of the Companys inventories is determined by either the first-in, first-out (FIFO) or average cost method, which approximates current cost. The Company provides inventory reserves for excess, obsolete or slow-moving inventory based on changes in customer demand, technology developments or other economic factors.

The Company reduces the carrying value of its inventory based on estimates of what is excess, slow-moving and obsolete, as well as inventory whose carrying value is in excess of net realizable value. These write-downs are based on current assessments about future demands, market conditions and related management initiatives. If, in the future, the Company determined that market conditions and actual demands are less favorable than those projected and, therefore, inventory was overvalued, the Company would be required to further reduce the carrying value of the inventory and record a charge to earnings at the time such determination was made. If, in the future, the Company determined that inventory write-downs were overstated and, therefore, inventory was undervalued, the Company would recognize the increase to earnings through higher gross profit at the time the related undervalued inventory was sold. However, actual results have not differed materially from managements estimates.

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 Kodaks inventory in the U.S. was costed using the last-in, first-out (LIFO) method. The new method of accounting for inventory in the U.S. is deemed preferable because the average cost method provides better matching of revenue and expenses given the rapid technological change in the Companys products. The average cost method also better reflects the cost of inventory on the Companys 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.

VALUATION OF LONG-LIVED ASSETS, INCLUDING GOODWILL AND PURCHASED INTANGIBLE ASSETS

The Company reviews the carrying value of its long-lived assets, including goodwill and purchased intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company assesses the recoverability of the carrying value of long-lived assets, other than goodwill and purchased intangible assets with indefinite useful lives, by first grouping its long-lived assets with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities (the asset group) and, secondly, estimating the undiscounted future cash flows that are directly associated with and expected to arise from the use of and eventual disposition of such asset group. The Company estimates the undiscounted cash flows over the remaining useful life of the primary asset within the asset group. If the carrying value of the asset group exceeds the estimated undiscounted cash flows, the Company records an impairment charge to the extent the carrying value of the long-lived asset exceeds its fair value. The Company determines fair value through quoted market prices in active markets or, if quoted market prices are unavailable, through the performance of internal analyses of discounted cash flows or external appraisals. The undiscounted and discounted cash flow analyses are based on a number of estimates and assumptions, including the expected period over which the asset will be utilized, projected future operating results of the asset group, discount rate and long-term growth rate.

To assess goodwill for impairment, the Company performs an assessment of the carrying value of its reporting units on an annual basis or when events and changes in circumstances occur that would more likely than not reduce the fair value of the Company’s reporting units below their carrying value. If the carrying value of a reporting unit exceeds its fair value, the Company would record an impairment charge to earnings to the extent the carrying amount of the reporting unit goodwill exceeds its implied fair value. The Company estimates the fair value of its reporting units through internal analyses and external valuations, which utilize income and market valuation approaches through the application of capitalized earnings, discounted cash flow and market comparable methods. These valuation techniques are based on a number of estimates and assumptions, including the projected future operating results of the reporting unit, discount rate, long-term growth rate and appropriate market comparables.

The Company’s assessments of impairment of long-lived assets, including goodwill and purchased intangible assets, and its periodic review of the remaining useful lives of its long-lived assets are an integral part of the Company’s ongoing strategic review of the business and operations, and are also performed in conjunction with the Company’s ongoing restructuring actions. Therefore, changes in the Company’s strategy, the Company’s ongoing digital transformation and other changes in the operations of the Company could impact the projected future operating results that are inherent in the Company’s estimates of fair value, resulting in impairments in the future. Additionally, other changes in the estimates and assumptions, including the discount rate and expected long-term growth rate, which drive the valuation techniques employed to estimate the fair value of long-lived assets and goodwill could change and, therefore, impact the assessments of impairment in the future.

In performing the annual assessment of goodwill for impairment, the Company determined that no material reporting units’ carrying values exceeded their respective fair values. See “Goodwill” under Note 1, “Significant Accounting Policies.”

INCOME TAXES

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, “Accounting for Income Taxes.” The asset and liability approach underlying SFAS No. 109 requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and tax basis of the Company’s assets and liabilities.

The Company records a valuation allowance to reduce its net deferred tax assets to the amount that is more likely than not to be realized. The valuation allowance as of December 31, 2006 of $1,849 million is attributable to $324 million of foreign net deferred tax assets, including certain net operating loss and capital loss carryforwards and $1,525 million of U.S. net deferred tax assets, including certain tax credits, which the Company believes it is not more likely than not that the assets will be realized. The Company has considered forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which the Company operates and prudent and feasible tax planning strategies in determining the need for these valuation allowances. If Kodak were to determine that it would not be able to realize a portion of its net deferred tax asset in the future, for which there is currently no valuation allowance, an adjustment to the net deferred tax assets would be charged to earnings in the period such determination was made. Conversely, if the Company were to make a determination that it is more likely than not that the deferred tax assets, for which there is currently a valuation allowance, would be realized, the related valuation allowance would be reduced and a benefit to earnings would be recorded.

The Company’s effective tax rate considers the impact of undistributed earnings of subsidiary companies outside of the U.S. Deferred taxes have not been provided for the potential remittance of such undistributed earnings, as it is the Company’s policy to indefinitely reinvest its retained earnings. However, from time to time and to the extent that the Company can repatriate overseas earnings on essentially a tax-free basis, the Company’s foreign subsidiaries will pay dividends to the U.S. Material changes in the Company’s working capital and long-term investment requirements could impact the decisions made by management with respect to the level and source of future remittances and, as a result, the Company’s effective tax rate. See Note 15, “Income Taxes.”

The Company operates within multiple taxing jurisdictions worldwide and is subject to audit in these jurisdictions. These audits can involve complex issues, which may require an extended period of time for resolution. Although management believes that adequate provision has been made for such issues, there is the possibility that the ultimate resolution of such issues could have an adverse effect on the earnings of the Company. Conversely, if these issues are resolved favorably in the future, the related provisions would be reduced, thus having a positive impact on earnings.

WARRANTY OBLIGATIONS

Management estimates expected product failure rates, material usage and service costs in the development of its warranty obligations. At the time revenue is recognized, the Company provides for the estimated costs of its warranties as a charge to cost of goods sold. Estimates are based on historical warranty experience and related costs to repair. Actual results have not differed materially from management’s estimates. In the event that the actual results of these items differ from the estimates, an adjustment to the warranty obligation would be recorded.

PENSION AND OTHER POSTRETIREMENT BENEFITS

The Company accounts for its defined benefit pension plans and its other postretirement benefits in accordance with SFAS No. 87, “Employers’ Accounting for Pensions,” SFAS No. 88, “Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,” SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other than Pensions,” and SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans.” These standards require that the amounts recognized in the financial statements be determined on an actuarial basis. See Note 17, “Retirement Plans,” and Note 18, “Other Postretirement Benefits,” for disclosure of (i) the nature of the Company’s plans, (ii) the amount of income and expense included in the Company’s Consolidated Statement of Operations for the years ended December 31, 2006, 2005 and 2004, (iii) the Company’s contributions and estimated future funding requirements and (iv) the amount of unrecognized losses at December 31, 2006 and 2005.

Kodak’s defined benefit pension and other postretirement benefit costs and obligations are dependent on the Company’s assumptions used by actuaries in calculating such amounts. These assumptions, which are reviewed annually by the Company, include the discount rate, long-term expected rate of return on plan assets (EROA), salary growth, healthcare cost trend rate and other economic and demographic factors. Actual results that differ from our assumptions are recorded as unrecognized gains and losses and are amortized to earnings over the estimated future service period of the plan participants to the extent such total net unrecognized gains and losses exceed 10% of the greater of the plan’s projected benefit obligation or the market-related value of assets. Significant differences in actual experience or significant changes in future assumptions would affect the Company’s pension and other postretirement benefit costs and obligations.

Generally, the Company bases the discount rate assumption for its significant plans on high quality corporate long-term bond yields in the respective countries as of the measurement date. Specifically, for its U.S. and Canada plans, the Company determines a discount rate using a cash flow model to incorporate the expected timing of benefit payments and a AA-rated high quality corporate bond yield curve. For the Company’s other non-U.S. plans, the discount rates are determined by comparison to published local long-term high quality bond indices.

The EROA assumption is based on a combination of formal asset and liability studies, historical results of the portfolio, and management’s expectation as to future returns that are expected to be realized over the estimated remaining life of the plan liabilities that will be funded with the plan assets. The salary growth assumptions are determined based on the Company’s long-term actual experience and future and near-term outlook. The healthcare cost trend rate assumptions are based on historical cost and payment data, the near-term outlook and an assessment of the likely long-term trends.

The Company reviews its EROA assumption annually for the Kodak Retirement Income Plan (KRIP). To facilitate this review, every three years, or when market conditions change materially, the Company undertakes a new asset and liability study to reaffirm the current asset allocation and the related EROA assumption. In March 2005, a new asset and liability modeling study was completed and the KRIP EROA assumption for 2005 and 2006 was 9.0%. The KRIP EROA assumption is expected to remain at 9.0% for 2007 as well. Given the increase in the discount rate of 50 basis points from 5.50% for 2006 to 6.00% for 2007, changes in demographic assumptions resulting from the completion of assumption studies in 2005, and a decrease in amortization expense relating to unrecognized actuarial losses in accordance with SFAS No. 87, total pension income from continuing operations before special termination benefits, curtailments and settlements for the major funded and unfunded defined benefit plans in the U.S. is expected to increase from $99 million in 2006 to $133 million in 2007. Pension expense from continuing operations before special benefits, curtailments and settlements in the Company’s major funded and unfunded non-U.S. defined benefit plans is projected to decrease from $85 million in 2006 to $54 million in 2007, which is primarily attributable to decreased service cost and amortization expense relating to the unrecognized prior service cost from the Company’s restructuring actions. Additionally, due in part to the increase in the discount rate from 5.50% for 2006 to 5.75% for 2007 and an increase in amortization expense relating to the unrecognized actuarial losses, the Company expects the cost, before curtailment and settlement gains and losses, of its most significant postretirement benefit plan, the U.S. plan, to approximate $184 million in 2007, as compared with $175 million for 2006.

The following table illustrates the sensitivity to a change to certain key assumptions used in the calculation of expense for the year ending December 31, 2007 and the projected benefit obligation (PBO) at December 31, 2006 for the Company’s major U.S. and non-U.S. defined benefit pension plans:

	Impact on 2007 Pre-Tax Pension Expense Increase (Decrease)		**Impact on PBO December 31, 2006 Increase (Decrease)**	
(in millions)	**U.S.**	**Non-U.S.**	**U.S.**	**Non**
Change in assumption:				
25 basis point decrease in discount rate	$ (2)	$ 12	$ 150	$
25 basis point increase in discount rate	2	(12)	(142)	
25 basis point decrease in EROA	15	8		
25 basis point increase in EROA	(15)	(8)		

ENVIRONMENTAL COMMITMENTS

Environmental liabilities are accrued based on estimates of known environmental remediation exposures. The liabilities include accruals for sites owned by Kodak, sites formerly owned by Kodak, and other third party sites where Kodak was designated as a potentially responsible party (PRP). The amounts accrued for such sites are based on these estimates, which are determined using the ASTM Standard E 2137-01, “Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters.” The overall method includes the use of a probabilistic model that forecasts a range of cost estimates for the remediation required at individual sites. The Company’s estimate includes equipment and operating costs for remediation and long-term monitoring of the sites. Such estimates may be affected by changing determinations of what constitutes an environmental liability or an acceptable level of remediation. Kodak’s estimate of its environmental liabilities may also change if the proposals to regulatory agencies for desired methods and outcomes of remediation are viewed as not acceptable, or additional exposures are identified. The Company has an ongoing monitoring and identification process to assess how activities, with respect to the known exposures, are progressing against the accrued cost estimates, as well as to identify other potential remediation issues that are presently unknown.

STOCK-BASED COMPENSATION

The Company accounts for its stock options and other forms of stock-based compensation in accordance with SFAS No. 123R, Share-Based Payment, as interpreted by Financial Accounting Standards Board (FASB) Staff Positions No. 123R-1, 123R-2, 123R-3, 123R-4, 123 R-5, and 123 R-6, using the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, effective January 1, 2005.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the following assumptions. Expected volatilities are based on historical volatility of the Companys stock, managements estimate of implied volatility of the Companys stock, and other factors. The expected term of options granted is derived from the vesting period of the award, as well as historical exercise behavior, and represents the period of time that options granted are expected to be outstanding. The risk-free rate is calculated using the U.S. Treasury yield curve, and is based on the expected term of the option. The Company uses historical data to estimate forfeitures.

The Company early adopted the provisions of SFAS No. 123R on January 1, 2005, utilizing the modified prospective approach of adoption. Previously, the Company accounted for its employee stock incentive plans under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and the related interpretations under FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation. Accordingly, no stock-based employee compensation cost was reflected in net earnings for the year ended December 31, 2004, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

KODAK OPERATING MODEL AND REPORTING STRUCTURE

As of and for the year ended December 31, 2006 the Company had four reportable segments: Consumer Digital Imaging Group (CDG), Film & Photofinishing Systems Group (FPG), Graphic Communications Group (GCG), and Health Group (KHG). The balance of the Companys operations, which individually and in the aggregate do not meet the criteria of a reportable segment, are reported in All Other. A description of the segments is as follows:

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

Film & Photofinishing Systems Group Segment (FPG): The FPG 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.

Graphic Communications Group Segment (GCG): The Graphic Communications Group segment serves a variety of customers in the creative, in-plant, data center, commercial printing, packaging, newspaper and digital service bureau market segments with a range of software, media and hardware products that provide customers with a variety of solutions for prepress equipment, workflow software, digital and traditional printing, document scanning and multi-vendor IT services. Products include digital and traditional prepress consumables, including plates, chemistry, and media; workflow and proofing software; color and black and white electrophotographic equipment and consumables; high-speed, high-volume continuous inkjet printing systems; wide-format inkjet printers; high-speed production document scanners; micrographic peripherals; and media (including micrographic films). The Company also provides maintenance and professional services for Kodak and other manufacturers products, as well as providing imaging services to customers.

Health Group Segment (KHG): The KHG segment provides digital medical imaging and information products, and systems and solutions, which are key components of sales and earnings growth. These include laser imagers, digital print films, computed and digital radiography systems, dental radiographic imaging systems, dental practice management software (DPMS), advanced picture-archiving and communications systems (PACS), and healthcare information solutions (HCIS). Products of the Health Group segment also include traditional analog medical and dental films, chemicals, and processing equipment and related services. The Company's history in traditional analog imaging has made it a worldwide leader in this area and has served as the foundation for building its important digital imaging business. The Health Group segment serves the general radiology market and specialty health markets, including dental, mammography, orthopedics and oncology. The segment also provides molecular imaging for the biotechnology research market.

All Other: All Other is composed of Kodak's display business, business development and other small, miscellaneous businesses. The development initiatives in consumer inkjet technologies continue to be reported in All Other through the end of 2006.

Prior period segment results have been restated to conform to the current period segment reporting structure.

DETAILED RESULTS OF OPERATIONS
Net Sales from Continuing Operations by Reportable Segment and All Other (1)

(in millions)		2006	Change		2005	Change		2004
Consumer Digital Imaging Group								
Inside the U.S.	$	1,872	- 8%	$	2,034	+41%	$	1
Outside the U.S.		1,048	-11		1,181	+28		
Total Consumer Digital Imaging Group		2,920	- 9		3,215	+36		2
Film & Photofinishing Systems Group								
Inside the U.S.		1,359	-23		1,767	-29		2
Outside the U.S.		2,797	-21		3,558	-22		4
Total Film & Photofinishing Systems Group		4,156	-22		5,325	-24		7
Graphic Communications Group								
Inside the U.S.		1,248	+16		1,079	+ 84		
Outside the U.S.		2,384	+25		1,911	+152		
Total Graphic Communications Group		3,632	+21		2,990	+122		1
Health Group								
Inside the U.S.		914	-13		1,052	- 6		1
Outside the U.S.		1,583	- 1		1,603	+2		1
Total Health Group		2,497	- 6		2,655	- 1		2
All Other								
Inside the U.S.		52	+11		47	+15		
Outside the U.S.		17	-53		36	+24		
Total All Other		69	-17		83	+19		
Total Net Sales	$	13,274	- 7%	$	14,268	+6%	$	13

(1) Sales are reported based on the geographic area of destination.

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

(in millions)		2006	Change		2005	Change
Consumer Digital Imaging Group	$	1	+101%	$	(131)	+31%
Film & Photofinishing Systems Group		358	- 34		540	- 37
Graphic Communications Group		141	+444		(41)	+55

Health Group		278	- 25		370	- 24
All Other		(214)	+7		(231)	+10
Total of segments		564	+11		507	-37
Restructuring costs and other		(768)			(1,118)	
Adjustments to legal reserves/(settlements)		2			(21)	
Interest expense		(262)			(211)	
Other income (charges), net		118			44	
Consolidated loss from continuing operations before income taxes	$	(346)	+57%	$	(799)	- 607%

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2006 COMPARED WITH 2005

RESULTS OF OPERATIONS - CONTINUING OPERATIONS

CONSOLIDATED

Worldwide Revenues

Net worldwide sales were $13,274 million for 2006 as compared with $14,268 million for 2005, representing a decrease of $994 million or 7%. The decrease in net sales was primarily due to declines in volumes and unfavorable price/mix, which decreased sales by approximately 9.1 and 2.8 percentage points, respectively. The decrease in volumes was primarily driven by declines in the consumer film capture SPG, photofinishing services SPG, and consumer output SPG within the FPG segment; the consumer digital capture SPG within the CDG segment; the digital output SPG and radiology film SPG within the KHG segment; and the traditional prepress consumables SPG within the GCG segment. Unfavorable price/mix was primarily driven by the consumer film capture SPG and consumer output SPG within the FPG segment; the kiosk SPG and consumer digital capture SPG within the CDG segment; and the traditional prepress consumables SPG and digital prepress consumables SPG within the GCG segment. These decreases were partially offset by the acquisitions of Kodak Polychrome Graphics (KPG) and Creo in the prior year, which together contributed $639 million or approximately 4.4 percentage points of an increase to the current year. Sales were also positively impacted by favorable foreign exchange, which increased net sales by $68 million or approximately 0.5 percentage points.

Net sales in the U.S. were $5,445 million for 2006 as compared with $5,979 million for the prior year, representing a decrease of $534 million, or 9%. Net sales outside the U.S. were $7,829 million for the current year as compared with $8,289 million for the prior year, representing a decrease of $460 million, or 6%, which includes the positive impact of foreign currency fluctuations of $68 million, or approximately 1%.

Digital Strategic Product Groups Revenues

The Companys digital product sales, including new technologies product sales, were $7,736 million for 2006 as compared with $7,428 million for the prior year, representing an increase of $308 million, or 4%, primarily driven by the Creo and KPG acquisitions, partially offset by the decline in digital cameras within the consumer digital capture SPG of the CDG segment. Product sales from new technologies, which are included in digital product sales, were $49 million in the current year and $57 million in the prior year.

Traditional Strategic Product Groups Revenues

Net sales of the Companys traditional products were $5,538 million for 2006 as compared with $6,840 million for the prior year, representing a decrease of $1,302 million, or 19%, primarily driven by declines in the consumer film capture SPG, the photofinishing services SPG and the consumer output SPG.

Foreign Revenues

The Companys operations outside the U.S. are reported in three regions: (1) the Europe, Africa and Middle East region (EAMER), (2) the Asia Pacific region and (3) the Canada and Latin America region. Net sales in EAMER were $4,065 million for 2006 as compared with $4,223 million for 2005, representing a decrease of $158 million, or 4%. The decrease in net sales for the year included the favorable impact of foreign currency fluctuations of 1%. Net sales in the Asia Pacific region were $2,396 million for 2006 as compared with $2,652 million for 2005, representing a decrease of $256 million, or 10%. The impact of foreign exchange on net sales for the period was immaterial. Net sales in the Canada and Latin America region were $1,368 million for 2006 as compared with $1,414 million for 2005, representing a decrease of $46 million, or 3%. The decrease in net sales for the year included the favorable impact of foreign currency fluctuations of 2%.

Gross Profit

Gross profit was $3,368 million for 2006 as compared with $3,618 million for 2005, representing a decrease of $250 million, or 7%. The gross profit margin was 25.4% in the current year as compared with 25.4% in the prior year. Favorable price/mix and foreign exchange positively impacted gross profit margins by approximately 0.7 percentage points and 0.1 percentage points, respectively. Additionally, the prior year acquisitions of KPG and Creo favorably impacted gross profit margins by approximately 0.3 percentage points.

These increases were offset by declines in volume, which reduced gross profit margins by approximately 0.6 percentage points, and increased manufacturing and other costs, which reduced gross profit margins by approximately 0.5 percentage points and were largely driven by increased silver and aluminum commodity costs.

The positive price/mix impact referred to above was primarily driven by extensions and amendments of existing license arrangements and a new licensing arrangement within the consumer digital capture SPG. The non-recurring portions of these licensing arrangements contributed approximately 1.4% of revenue to consolidated gross profit dollars in the current year, as compared with 0.4% of revenue to consolidated gross profit dollars for similar arrangements in the prior year. The positive impact of these arrangements was partially offset by negative price/mix within the consumer film capture SPG and consumer output SPG within the FPG segment; the digital capture solutions SPG within the KHG segment; and the kiosk SPG and consumer digital capture SPG within the CDG segment. The volume declines were primarily driven by the consumer film capture SPG and consumer output SPG within the FPG segment; and the consumer digital capture SPG within the CDG segment.

Selling, General and Administrative Expenses

SG&A expenses were $2,389 million for 2006 as compared with $2,668 million for the prior year, representing a decrease of $279 million, or 10%. SG&A as a percentage of sales decreased from 19% from the prior year to 18% in the current year. The decrease in SG&A is primarily attributable to ongoing Company-wide cost reduction initiatives, partially offset by $45 million of spending related to the Company's exploration of strategic alternatives for the Health Group. The Company announced on January 10, 2007 that it has reached an agreement to sell the Health Group to Onex Corporation for as much as $2.55 billion. The transaction is expected to close in the first half of 2007.

Research and Development Costs

R&D costs were $710 million for 2006 as compared with $892 million for 2005, representing a decrease of $182 million, or 20%. R&D as a percentage of sales was 5% for the current year as compared with the prior year of 6%. This decrease was primarily driven by: (1) write-offs in the prior year of purchased in-process R&D associated with acquisitions made during 2005 of $54 million, (2) significant spending reductions related to traditional products and services, (3) lower R&D spending related to the display business, and (4) integration synergies within the GCG segment.

Restructuring Costs and Other

Restructuring costs and other were $471 million for 2006 as compared with $690 million for 2005, representing a decrease of $219 million or 32%. These costs, as well as the restructuring-related costs reported in cost of goods sold, are discussed in further detail under "RESTRUCTURING COSTS AND OTHER" below.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes

The loss from continuing operations before interest, other income (charges), net and income taxes for 2006 was $202 million as compared with a loss of $632 million for 2005, representing an improvement in earnings of $430 million. This change is attributable to the reasons described above.

Interest Expense

Interest expense for 2006 was $262 million as compared with $211 million for the prior year, representing an increase of $51 million, or 24%. Higher interest expense is primarily attributable to increased levels of debt associated with the prior year acquisitions of KPG and Creo, and higher interest rates.

Other Income (Charges), Net
The other income (charges), net component includes investment income, income and losses from equity investments, gains and losses on the sales of assets and investments and foreign exchange gains and losses. Other income for the current year was $118 million as compared with other income of $44 million for the prior year. The increase of $74 million is primarily attributable to: (1) a year-over-year increase in interest income of $35 million, (2) lower losses on foreign exchange, which resulted in an increase in other income of $28 million, and (3) lower impairment charges recorded in the current year than in the prior year, which increased other income by $33 million. These increases were partially offset by lower gains on sales of property, assets and investments, which declined $9 million from prior year, and a loss on the early extinguishment of debt in the current year of $9 million.

Loss From Continuing Operations Before Income Taxes
The loss from continuing operations before income taxes for 2006 was $346 million as compared with a loss of $799 million for 2005, representing an improvement in earnings of $453 million. This change is attributable to the reasons described above.

Income Tax (Benefit) Provision
The Company's annual effective tax rate from continuing operations increased from a provision rate of 69% for 2005 to a provision rate of 73% for 2006. The change is primarily attributable to the inability to recognize a benefit from losses in the U.S. and in certain jurisdictions outside the U.S., as a result of the requirement to record a valuation allowance against net deferred tax assets in those jurisdictions that the Company has determined it is no longer more likely than not that these net deferred tax assets will be realized.

During the year ended December 31, 2006, the Company recorded a tax provision of $254 million representing an income tax rate on losses from continuing operations of 73%. The income tax rate of 73% for the year ended December 31, 2006 differs from the Company's statutory tax rate of 35% primarily due to the inability to benefit losses in the U.S. and in certain jurisdictions outside the U.S., which resulted in the recording of the valuation allowance charge against net deferred tax assets in the amount of $393 million. Some of the other significant items that caused the difference from the statutory tax rate include: (1) non-U.S. tax benefits of $40 million associated with restructuring costs and property sales of $728 million; (2) a benefit of $16 million associated with rate differentials on operations outside the U.S.; (3) a benefit of $14 million associated with export sales and manufacturing credits; and (4) a tax charge of $13 million resulting from changes to the allocation of the purchase price to the respective jurisdictions associated with the finalization of purchase accounting for KPG and Creo.

On October 3, 2006, the Company filed a claim for a federal tax refund of approximately $650 million related to a 1994 loss recognized on the sale of shares of stock in a subsidiary that was disallowed at that time under Internal Revenue Service (IRS) regulations. Since that time, the IRS has issued new regulations that serve as the basis for this refund claim. Due to the uncertainty of the claim, the Company, in accordance with its accounting policies, has not recorded a tax benefit related to this refund claim.

Valuation Allowance — Outside the U.S.
During the fourth quarter of 2006, based on the Company's assessment of positive and negative evidence regarding the realization of the net deferred tax assets, the Company recorded additional valuation allowances of $90 million against its net deferred tax assets in certain jurisdictions outside the U.S. In accordance with SFAS No. 109, the Company's assessment included the evaluation of scheduled reversals of deferred tax assets and liabilities, estimates of projected future taxable income, carryback potential and tax planning strategies. Based on the Company's assessment of realizability, the Company concluded that it was no longer more likely than not that these net deferred tax assets would be realized and, as such, recorded a valuation allowance of $90 million.

Loss From Continuing Operations
The loss from continuing operations for 2006 was $600 million, or $2.09 per basic and diluted share, as compared with a loss from continuing operations for 2005 of $1,354 million, or $4.70 per basic and diluted share, representing an improvement in earnings of $754 million. This change is attributable to the reasons described above.

CONSUMER DIGITAL IMAGING GROUP

Worldwide Revenues
Net worldwide sales for the Consumer Digital Imaging Group (CDG) segment were $2,920 million for 2006 as compared with $3,215 million for 2005, representing a decrease of $295 million, or 9%. The decrease in net sales was comprised of: (1) declines in volumes, which reduced net sales by approximately 5.8 percentage points, driven primarily by the consumer digital capture SPG, and (2) unfavorable price/mix, which decreased sales by approximately 3.8 percentage points, driven primarily by declines in the kiosk SPG and consumer digital capture SPG. The negative price/mix impact includes the positive effects to the consumer digital capture SPG of extensions and amendments of existing license arrangements and a new licensing arrangement, portions of which were non-recurring. These arrangements provide the Company with a return on portions of historical R&D investments and similar opportunities are expected to have a continuing impact on the results of operations. These declines were partially offset by positive foreign exchange, which increased net sales by approximately 0.4 percentage points.

CDG segment net sales in the U.S. were $1,872 million for the current year as compared with $2,034 million for the prior year, representing a decrease of $162 million, or 8%. CDG segment net sales outside the U.S. were $1,048 million for the current year as compared with $1,181 million for the prior year, representing a decrease of $133 million, or 11%.

Net worldwide sales of consumer digital capture products, which include consumer digital cameras, accessories, memory products, imaging sensors, and intellectual property royalties, decreased 17% in 2006 as compared with the prior year, primarily reflecting volume decreases, as well as negative price/mix. The negative price/mix impact includes the positive impacts of extensions and amendments of existing license arrangements and a new licensing arrangement, as mentioned above. These arrangements provide the Company with a return on portions of historical R&D investments and similar opportunities are expected to have a continuing impact on the results of operations. According to the NPD Groups consumer tracking service, Kodak EasyShare digital cameras were number one in unit market share in the U.S. for the year 2006. On a year-to-date basis through November, the Company remains in the top three unit market share position on a worldwide basis for consumer digital cameras.

Net worldwide sales of picture maker kiosks/media (the kiosk SPG) increased 11% in 2006 as compared with 2005, as a result of significant volume increases, partially offset by negative price/mix. Sales continue to be driven by strong consumable sales at retail locations with 4x6 media volumes increasing 53% versus last year.

Net worldwide sales of the home printing solutions SPG, which includes inkjet photo paper and printer docks/media, decreased 2% in the current year as compared with the prior year, driven by negative price/mix, partially offset by volume increases. On a year-to-date basis through November, the Companys printer dock product held a leading market share position in the U.S., U.K., and Australia.

Gross Profit
Gross profit for the CDG segment was $675 million for 2006 as compared with $598 million for the prior year, representing an increase of $77 million or 13%. The gross profit margin was 23.1% in the current year as compared with 18.6% in the prior year. The 4.5 percentage point increase was primarily attributable to improvements in price/mix, which impacted gross profit margins by approximately 4.8 percentage points, primarily due to extensions and amendments to existing license arrangements during the current year, and a new licensing arrangement, as mentioned above. The impact of the non-recurring portions of these licensing arrangements contributed approximately 6.5% of revenue to segment gross profit dollars in 2006, as compared with 1.8% of revenue to segment gross profit dollars for similar arrangements in 2005. Additionally, foreign exchange positively impacted gross profit margins by approximately 0.2 percentage points. These increases were partially offset by increased manufacturing costs, which reduced gross profit margins by approximately 0.3 percentage points, and volume declines, which negatively impacted gross profit margins by approximately 0.2 percentage points.

Selling, General and Administrative Expenses
SG&A expenses for the CDG segment decreased $48 million, or 9%, from $551 million in 2005 to $503 million in the current year, and remained constant as a percentage of sales at 17%. This decrease was primarily driven by a decline in advertising spending as a result of focused cost reduction activities.

Research and Development Costs
R&D costs for the CDG segment decreased $8 million, or 4%, from $179 million in 2005 to $171 million in the current year and remained constant as a percentage of sales at 6%.

Earnings (Loss) From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the CDG segment were $1 million in 2006 compared with a loss of $131 million in 2005, representing an increase in earnings of $132 million or 101%, as a result of the factors described above.

FILM AND PHOTOFINISHING SYSTEMS GROUP

Worldwide Revenues
Net worldwide sales for the Film and Photofinishing Systems Group (FPG) segment were $4,156 million for 2006 as compared with $5,325 million for 2005, representing a decrease of $1,169 million, or 22%. The decrease in net sales was comprised of: (1) lower volumes, which decreased 2006 sales by approximately 20.5 percentage points, driven primarily by declines in the consumer film capture SPG, the consumer output SPG, and the photofinishing services SPG; and (2) declines related to negative price/mix, which reduced net sales by approximately 1.9 percentage points, primarily driven by the consumer film capture SPG and the consumer output SPG. These declines were partially offset by favorable foreign exchange, which increased net sales by approximately 0.4 percentage points.

FPG segment net sales in the U.S. were $1,359 million for the current year as compared with $1,767 million for 2005, representing a decrease of $408 million, or 23%. FPG segment net sales outside the U.S. were $2,797 million for 2006 as compared with $3,558 million for the prior year, representing a decrease of $761 million, or 21%.

Net worldwide sales of the consumer film capture SPG, including consumer roll film (35mm and APS film), one-time-use cameras (OTUC), professional films, reloadable traditional film cameras and batteries/videotape, decreased 29% in 2006 as compared with 2005, primarily reflecting industry volume declines.

Net worldwide sales for the consumer and professional output SPGs, which include color negative paper and photochemicals, decreased 20% in 2006 as compared with 2005, primarily reflecting industry volume declines and negative price/mix.

Net worldwide sales for the photofinishing services SPG, which includes equipment and photofinishing services at retail on-site and Qualex in the U.S. and CIS (Consumer Imaging Services) outside the U.S., decreased 45% in 2006 as compared with 2005, reflecting continuing volume declines in the development and processing of consumer films.

Net worldwide sales for the entertainment imaging SPGs, including origination, intermediate, and print films for the entertainment industry decreased 2%, primarily reflecting origination film volume declines and negative price/mix for print film, partially offset by volume increases for intermediate film. These results also reflect more conservative motion picture release strategies by major studios including the maturation of industry practice regarding simultaneous worldwide releases of major feature films.

Gross Profit
Gross profit for the FPG segment was $1,068 million for 2006 as compared with $1,630 million for the prior year, representing a decrease of $562 million or 34%. The gross profit margin was 25.7% in the current year as compared with 30.6% in 2005. The 4.9 percentage point decrease was primarily attributable to increased manufacturing costs, which reduced gross profit margins by approximately 4.3 percentage points. These increased costs were driven by increased depreciation expense principally due to asset useful life changes in the third quarter of 2005 and higher silver costs. Volume declines negatively impacted gross profit margins by approximately 0.7 percentage points, partially offset by the favorable impact of foreign exchange, which increased gross profit margins by approximately 0.2 percentage points. The impact of price/mix on gross profit margins was not significant.

Selling, General and Administrative Expenses
SG&A expenses for the FPG segment decreased $331 million, or 33%, from $1,001 million in 2005 to $670 million in the current year, and decreased as a percentage of sales from 19% in the prior year to 16% in the current year. The decline in SG&A was attributable to ongoing Company-wide cost reduction initiatives.

Research and Development Costs
R&D costs for the FPG segment decreased $49 million, or 55%, from $89 million in 2005 to $40 million in the current year and decreased as a percentage of sales from 2% in the prior year to 1% in the current year. The decrease in R&D was primarily attributable to significant reductions in spending related to traditional products and services.

Earnings From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the FPG segment were $358 million in 2006 compared with earnings of $540 million in 2005, representing a decrease of $182 million or 34%, resulting from the factors outlined above.

GRAPHIC COMMUNICATIONS GROUP

On April 1, 2005, the Company became the sole owner of KPG through the redemption of Sun Chemical Corporation’s 50 percent interest in the KPG joint venture. Under the terms of the transaction, the Company redeemed all of Sun Chemical’s shares in KPG by providing $317 million in cash 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 required a principal and interest payment of $200 million in the third quarter of 2006, and payments of $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 notes payable arrangements of approximately $395 million as of the acquisition date was recorded as long-term debt in the Company’s Consolidated Statement of Financial Position.

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 Company paid $954 million (excluding approximately $11 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.

During the second quarter of 2006, the Company indicated that, as a result of ongoing integration of acquisitions within the Graphic Communications Group, it had become increasingly difficult to report results by the discrete businesses that were acquired. Therefore, beginning with the third quarter of 2006, results for the GCG segment are reported using the following SPG structure:

- Digital Prepress Consumables – digital plates, chemistry, media and services
- NexPress Color – equipment, consumables and services for NexPress color products, and direct image press equipment
- Commercial Inkjet Printing Solutions – Versamark equipment, consumables and service
- Workflow and Prepress – workflow software, output devices, proofing equipment, and services
- Other Digital – electrophotographic black and white equipment and consumables, document scanners and services, wide-format inkjet, imaging services
- Traditional – analog plates, graphics and other films, paper, media equipment, archival products

As the GCG segment completes its integration process and further aligns the discrete businesses, starting in the first quarter of 2007, the GCG segment results will be reported using the following organizational structure:

- Enterprise Solutions - workflow software and digital controller development
- Digital Printing Solutions - all continuous inkjet and electrophotographic products, including equipment, consumables and service
- Prepress Solutions - prepress consumables; output devices; wide-format inkjet printers, media, and inks; proofing hardware, media and software; and related services
- Document Imaging Business - document scanners and services, and imaging services

Worldwide Revenues
Net worldwide sales for the Graphic Communications Group segment were $3,632 million for 2006 as compared with $2,990 million for the prior year, representing an increase of $642 million, or 21%. The increase in net sales was primarily due to the KPG and Creo acquisitions in 2005, which together contributed $639 million or approximately 21.4 percentage points to the year-over-year increase in sales. Also contributing to the increase in net sales were volume increases, which increased sales by approximately 4.3 percentage points and which were largely attributable to the digital prepress consumables SPG, and favorable foreign exchange, which increased sales by approximately 0.8 percentage points.

These increases were partially offset by negative price/mix, which decreased 2006 net sales by approximately 5.0 percentage points, primarily driven by the digital prepress consumables SPG, the traditional prepress consumables SPG, the NexPress color SPG, and the workflow and prepress SPG.

Net sales in the U.S. were $1,248 million for 2006 as compared with $1,079 million for the prior year, representing an increase of $169 million, or 16%. Net sales outside the U.S. were $2,384 million in 2006 as compared with $1,911 million for the prior year, representing an increase of $473 million, or 25%.

Digital Strategic Product Groups Revenues
The Graphic Communications Group segment digital product sales are comprised of the digital prepress consumables SPG; NexPress color SPG; commercial inkjet printing solutions SPG; workflow and prepress systems SPG; and other digital SPGs.

Digital product sales for the Graphic Communications Group segment were $3,085 million for 2006 as compared with $2,437 million for the prior year, representing an increase of $648 million, or 27%. The increase in digital product sales was primarily attributable to the acquisitions of KPG and Creo in the prior year, which generated revenues in the workflow and prepress SPG and the digital prepress consumables SPG.

Net worldwide sales for the NexPress color SPG increased 41% driven by strong volume increases. Sales from NexPress color equipment and consumables increased 50% from the prior year, while direct image press equipment sales declined 24% year-over-year. The installed base of digital production color presses continues to grow, resulting in higher page volumes and increased consumables revenue.

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Net worldwide sales of commercial inkjet printing solutions increased 3% year-over-year, reflecting volume increases for services and consumables, partially offset by negative price/mix.

Net worldwide sales of other digital products and services decreased 6% year-over-year, primarily driven by volume declines. Sales declines for electrophotographic black and white equipment and consumables, and wide-format inkjet, were partially offset by sales increases for document scanners.

Traditional Strategic Product Groups Revenues
Segment traditional product sales are primarily comprised of sales of traditional graphics products, including films, paper, media, equipment and analog plates. These sales were $547 million for 2006 compared with $553 million for the prior year, representing a decrease of $6 million, or 1%. The decrease in sales was primarily attributable to declines in analog plates and graphic films as the industry continues to transition to digital partially offset by the impact of the acquisition of KPG in the prior year.

Gross Profit
Gross profit for the Graphic Communications Group segment was $1,034 million for 2006 as compared with $799 million in the prior year, representing an increase of $235 million, or 29%. This increase was primarily attributable to the acquisitions of KPG and Creo in 2005, which together contributed $197 million to the year-over-year increase in gross profit. The gross profit margin was 28.5% in 2006 as compared with 26.7% in the prior year period. The increase in the gross profit margin of 1.8 percentage points was primarily attributable to favorable price/mix, which increased gross profit margins by approximately 1.1 percentage points and was largely driven by the workflow and prepress SPG and the digital prepress consumables SPG. Also contributing to the increase in gross profit margins were: (1) reductions in manufacturing and other costs, which increased gross profit margins by approximately 0.4 percentage points, and (2) the acquisitions of Creo and KPG, which increased gross profit margins by approximately 0.6 percentage points. These increases were partially offset by unfavorable foreign exchange, which negatively impacted gross profit margins by approximately 0.4 percentage points. The

impact from volume on gross profit margins was not significant.

Selling, General and Administrative Expenses
SG&A expenses for the Graphic Communications Group segment were $695 million for 2006 as compared with $562 million in the prior year, representing an increase of $133 million, or 24%, and remained constant as a percentage of sales at 19%. The increase in SG&A is primarily attributable to $148 million of SG&A costs associated with the acquired KPG and Creo businesses, and redistribution of corporate costs associated with bringing acquired businesses into the Kodak portfolio, partially offset by integration synergies.

Research and Development Costs
R&D costs for the Graphic Communications Group segment decreased $80 million, or 29%, from $278 million for 2005 to $198 million for 2006, and decreased as a percentage of sales from 9% for 2005 to 5% for the current year. The decrease was primarily driven by $52 million of write-offs in 2005 for purchased in-process R&D associated with acquisitions, and was also driven by integration synergies.

Earnings (Loss) From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the Graphic Communications Group segment were $141 million in 2006 compared with a loss of $41 million in 2005. This increase in earnings is attributable to the reasons outlined above.

HEALTH GROUP

Worldwide Revenues
Net worldwide sales for the Health Group segment were $2,497 million for 2006 as compared with $2,655 million for the prior year, representing a decrease of $158 million, or 6%. The decrease in sales was attributable to declines in volume of approximately 5.6 percentage points, primarily driven by the digital output and radiology film SPGs, partially offset by the growth in the digital capture, and healthcare information SPGs. Unfavorable price/mix reduced sales by approximately 0.8 percentage points, primarily driven by the digital capture SPG and digital output SPG, partially offset by favorable price/mix in the dental SPG. These decreases were partially offset by favorable foreign exchange, which increased sales by approximately 0.4 percentage points.

Net sales in the U.S. were $914 million for 2006 as compared with $1,052 million for 2005, representing a decrease of $138 million, or 13%. Net sales outside the U.S. were $1,583 million for 2006 as compared with $1,603 million for the prior year, representing a decrease of $20 million, or 1%.

Digital Strategic Product Groups' Revenues
Health Group segment digital sales, which include digital output (DryView laser imagers/media and wet laser printers/media), digital capture systems (computed radiography and digital radiography equipment), digital dental systems (practice management software and digital and computed radiography capture equipment), healthcare information solutions (Picture Archiving and Communications Systems (PACS), Radiology Information Systems (RIS) and Information Management Solutions (IMS)), and associated services were $1,682 million for 2006 as compared with $1,719 million for 2005, representing a decrease of $37 million, or 2%. This sales decline was driven by lower revenues in the digital output SPG, partially offset by growth in the digital capture SPG, digital dental SPG, and healthcare information solutions SPG.

Traditional Strategic Product Groups' Revenues
Segment traditional product sales, including analog and dental film, equipment, service, and chemistry, were $815 million for 2006 as compared with $936 million for 2005, representing a decrease of $121 million, or 13%. This decline was largely driven by declines in traditional radiology film sales.

Gross Profit
Gross profit for the Health Group segment was $912 million for 2006 as compared with $1,021 million in the prior year, representing a decrease of $109 million, or 11%. The gross profit margin was 36.5% in 2006 as compared with 38.5% in the prior year. The decrease in the gross profit margin of 2.0 percentage points was principally attributable to: (1) unfavorable price/mix, which negatively impacted gross profit margins by approximately 2.0 percentage points, primarily driven by the digital capture SPG, and (2) volume declines, which reduced gross profit margins by approximately 0.2 percentage points, primarily driven by the digital output and

radiology film SPGs. These declines were partially offset by favorable foreign exchange, which positively impacted gross profit margins by approximately 0.3 percentage points. The impact of manufacturing costs did not have a significant impact on gross profit margin, as higher silver and raw material costs were more than offset by cost reduction activities and operational improvements.

Selling, General and Administrative Expenses
SG&A expenses for the Health Group segment increased $8 million, or 2%, from $489 million in 2005 to $497 million for the current year, and increased as a percentage of sales from 18% in 2005 to 20% in the current year. The increase in SG&A expenses is primarily attributable to $37 million of costs related to the exploration of strategic alternatives for the Health Group, which was announced on May 4, 2006, partially offset by a favorable legal settlement in the second quarter of 2006 and other cost reductions. The Company announced on January 10, 2007 that it has reached an agreement to sell the Health Group to Onex Corporation for as much as $2.55 billion. The transaction is expected to close in the first half of 2007.

Research and Development Costs
R&D costs for 2006 decreased $24 million, or 15%, from $162 million in 2005 to $138 million, and remained constant as a percentage of sales at 6%. This decrease was primarily driven by cost reduction actions implemented in March 2006, which have been primarily focused on the digital output and digital capture SPGs, to reduce overall R&D spending for the Health Group. The year-over-year decrease was also partially due to the write-off of $2 million of purchased in-process R&D in 2005 related to the acquisition of Orex Computed Radiography Ltd.

Earnings From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the Health segment decreased $92 million, or 25%, from $370 million for 2005 to $278 million for 2006 due to the reasons described above.

ALL OTHER

Worldwide Revenues
Net worldwide sales for All Other were $69 million for 2006 as compared with $83 million for 2005, representing a decrease of $14 million, or 17%. Net sales in the U.S. were $52 million for 2006 as compared with $47 million for the prior year, representing an increase of $5 million, or 11%. Net sales outside the U.S. were $17 million in 2006 as compared with $36 million in the prior year, representing a decrease of $19 million, or 53%.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
The loss from continuing operations before interest, other income (charges), net and income taxes for All Other was $214 million in 2006 as compared with a loss of $231 million in 2005. This improvement in earnings was primarily driven by overall SG&A cost reductions of $18 million, and reductions in R&D spending for the display business of $26 million, partially offset by costs associated with the Company's new consumer inkjet printers, which were announced in February 2007.

(LOSS) EARNINGS FROM DISCONTINUED OPERATIONS, NET OF INCOME TAXES

The loss from discontinued operations for 2006 was $1 million, or $.00 per basic and diluted share, as compared with earnings from discontinued operations for 2005 of $150 million, or $.52 per basic and diluted share. The 2005 earnings from discontinued operations were primarily related to a $203 million reversal of certain tax accruals as a result of a settlement between the Company and the Internal Revenue Service on the audit of the tax years 1993 through 1998. These accruals had been established in 1994 in connection with the Company's sale of its pharmaceutical, consumer health and household products businesses during that year. The tax accrual reversals were partially offset by a pension settlement charge of $54 million resulting from the finalization of the transfer of pension assets to ITT Industries, Inc. (ITT) in connection with the sale of the Company's Remote Sensing Systems business (RSS) in August 2004.

LOSS FROM CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF INCOME TAXES

There was no loss from cumulative effect of accounting change, net of income taxes for 2006. The loss from cumulative effect of an accounting change, net of income taxes, of $57 million or $.20 per basic and diluted share for 2005 was the result of the Company's adoption of Financial Accounting Standards Board Interpretation No. (FIN) 47, "Accounting for Conditional Asset Retirement Obligations," as of December 31, 2005. Under FIN 47, the Company is required to record an obligation and an asset for the present value of the estimated cost of fulfilling its legal obligation with respect to the retirement of an asset when the timing or method of settling that obligation is conditional upon a future event (for example, the sale of, exiting from or disposal of an asset - the "settlement date"). The primary application of FIN 47 to the Company is with respect to asbestos remediation. The $57 million charge represents the present value of the Company's asset retirement obligations (net of the related unamortized asset) relating to facilities with estimated settlement dates. Refer to further discussion in the "New Accounting Pronouncements" section of Item 7 for further information.

NET LOSS

The consolidated net loss for 2006 was $601 million, or a loss of $2.09 per basic and diluted share, as compared with a net loss for 2005 of $1,261 million, or a loss of $4.38 per basic and diluted share, representing an increase in earnings of $660 million or 52%. This improvement is attributable to the reasons outlined above.

2005 COMPARED WITH 2004

RESULTS OF OPERATIONS – CONTINUING OPERATIONS

CONSOLIDATED

Worldwide Revenues
Net worldwide sales were $14,268 million for 2005 as compared with $13,517 million for 2004, representing an increase of $751 million or 6%. This increase in net sales was primarily attributable to the acquisitions of KPG, Creo and NexPress, which contributed $1,562 million or approximately 11.6 percentage points to sales, and favorable exchange, which increased sales by approximately 0.5 percentage points. These increases were partially offset by declines in volumes and declines in price/mix, which decreased 2005 sales by approximately 1.9 and 4.6 percentage points, respectively. The decrease in volumes was primarily driven by declines in the consumer film capture SPG, the photofinishing services SPG, and the consumer output SPG within the FPG segment, and the digital output, film capture, and output SPGs within the Health Group segment. The decrease in price/mix was primarily driven by the film capture SPG within the FPG segment; the consumer digital capture SPG within the CDG segment; and the digital capture SPG within the Health Group segment.

Net sales in the U.S. were $5,979 million for 2005 as compared with $5,658 million for the prior year, representing an increase of $321 million, or 6%. Net sales outside the U.S. were $8,289 million for 2005 as compared with $7,859 million for 2004, representing an increase of $430 million, or 5%, which includes a favorable impact from exchange of 1%.

Digital Strategic Product Groups' Revenues
The Company's digital product sales, including new technologies product sales of $57 million, were $7,428 million for 2005 as compared with $5,153 million, including new technologies of $46 million, for the prior year, representing an increase of $2,275 million, or 44%, primarily driven by the digital portion of KPG and Creo, the consumer digital capture SPG, the kiosk SPG, and the home printing solutions SPG.

Traditional Strategic Product Groups' Revenues
Net sales of the Company's traditional products were $6,840 million for 2005 as compared with $8,364 million for the prior year, representing a decrease of $1,524 million, or 18%, primarily driven by declines in the film capture SPG, the photofinishing services SPG, and the consumer output SPG.

Foreign Revenues
The Company's operations outside the U.S. are reported in three regions: (1) the Europe, Africa and Middle East region (EAMER), (2) the Asia Pacific region, and (3) the Canada and Latin America region. Net sales in EAMER were $4,223 million for 2005 as compared with $4,038 million for 2004, representing an increase of $185 million, or 5%, which includes an insignificant impact from exchange. Net sales in the Asia Pacific region were $2,652 million for 2005 as compared with $2,549 million for 2004, representing an increase of $103 million, or 4%,

which includes a favorable impact from exchange of 1%. Net sales in the Canada and Latin America region were $1,414 million for 2005 as compared with $1,272 million for 2004, representing an increase of $142 million, or 11%, which includes a favorable impact from exchange of 2%.

Gross Profit

Gross profit was $3,618 million for 2005 as compared with $3,916 million for 2004, representing a decrease of $298 million, or 8%. The gross profit margin was 25.4% in 2005 as compared with 29.0% in 2004. The 3.6 percentage point decrease was primarily attributable to: (1) price/mix, which reduced gross profit margins by approximately 3.7 percentage points, (2) declines in volumes, which reduced gross profit margins by approximately 0.1 percentage points, and (3) manufacturing costs, which reduced gross profit margins by approximately 0.2 percentage points. The negative price/mix impact was primarily driven by consumer digital cameras, one-time-use cameras, traditional consumer and digital health products and services, partially offset by the year-over-year increase in royalty income relating to digital capture. These decreases were partially offset by exchange, which favorably impacted gross profit margins by approximately 0.4 percentage points.

Included in 2005 manufacturing costs is $139 million of additional depreciation expense related to the change in estimate of the useful lives of production machinery and equipment as a result of the faster-than-expected decline in the Company's traditional film and paper business. During the third quarter of 2005, the Company revised the useful lives of production machinery and equipment from 3-20 years to 3-5 years and manufacturing-related buildings from 10-40 years to 5-20 years. Also included in 2005 manufacturing costs were accelerated depreciation charges of $391 million related to the 2004-2007 Restructuring Program, compared with accelerated depreciation charges of $152 million in 2004.

Selling, General and Administrative Expenses

SG&A expenses were $2,668 million for 2005 as compared with $2,491 million for 2004, representing an increase of $177 million, or 7%. SG&A increased as a percentage of sales from 18% for 2004 to 19% for 2005. The increase in SG&A was primarily attributable to SG&A related to acquisitions of $293 million, unfavorable legal settlements totaling $21 million, and unfavorable exchange of $6 million, partially offset by cost reduction initiatives.

Research and Development Costs

R&D costs were $892 million for 2005 as compared with $836 million for 2004, representing an increase of $56 million, or 7%. R&D as a percentage of sales remained unchanged at 6%. The dollar increase in R&D was primarily attributable to write-offs for purchased in-process R&D associated with acquisitions made in 2005 for $54 million and increases in R&D spend related to newly-acquired businesses of $95 million, partially offset by significant reductions in R&D spending related to traditional products.

Restructuring Costs and Other

Restructuring costs and other were $690 million for 2005 as compared with $695 million for 2004, representing a decrease of $5 million or 1%.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes

The loss from continuing operations before interest, other income (charges), net and income taxes for 2005 was $632 million as compared with a loss of $106 million for 2004, representing an increase in the loss of $526 million. This increase was attributable to the reasons described above.

Interest Expense

Interest expense for 2005 was $211 million as compared with $168 million in the prior year. This increase is related to higher interest rates in 2005 and higher debt levels in 2005 as a result of borrowings to finance acquisitions.

Other Income (Charges), Net

The other income (charges), net component includes investment income, income and losses from equity investments, foreign exchange, and gains and losses on the sales of assets and investments. Other income for 2005 was $44 million as compared with other income of $161 million for 2004. The decline of $117 million is primarily attributable to proceeds from two favorable legal settlements totaling $101 million in 2004, with no similar favorable legal settlements in 2005. Also contributing to the decline for 2005 was a loss on foreign exchange of $31 million due to the unhedged U.S. dollar denominated note payable outside of the U.S. relating to the KPG acquisition versus foreign exchange losses of $10 million in 2004. On July 28, 2005, the Company entered into currency forward hedge contracts that will substantially offset foreign exchange gains or losses arising from this note payable.

The decline was also impacted by $44 million of charges, including a $19 million impairment of the investment in Lucky Film as a result of an other-than-temporary decline in the market value of Lucky's stock and a $25 million asset impairment. Additionally, equity income from joint ventures declined by $18 million due to the acquisitions of KPG and NexPress, which were formerly accounted for under the equity method, and have been consolidated in the Company's Statement of Operations and included in the Graphic Communications Group segment since the date of acquisition. These items were partially offset by a net year-over-year increase of $59 million from gains on the sale of properties and capital assets.

Loss From Continuing Operations Before Income Taxes
The loss from continuing operations before income taxes for 2005 was $799 million as compared with a loss of $113 million for 2004, representing an increase in the loss of $686 million. This change was attributable to the reasons described above.

Income Tax (Benefit) Provision
The Company's annual effective tax rate from continuing operations decreased from a benefit rate of 161% for 2004 to a provision rate of 69% for 2005. The change is primarily attributable to the inability to recognize a benefit from losses in the U.S. as a result of the requirement to record a valuation allowance against U.S. net deferred tax assets where it is not more likely than not that these benefits will be realized.

During the year ended December 31, 2005, the Company recorded a tax provision of $555 million representing an income tax rate on losses from continuing operations of 69%. The income tax rate of 69% for the year ended December 31, 2005 differs from the Company's statutory tax rate of 35% primarily due to the inability to benefit losses in the U.S., which resulted in the recording of the valuation allowance charge against net U.S. deferred tax assets in the amount of $955 million. Some of the other significant items that caused the difference from the statutory tax rate include: (1) non-U.S. tax benefits of $106 million associated with total worldwide restructuring costs of $1,143 million; (2) a benefit of $101 million associated with rate differentials on operations outside the U.S.; (3) a benefit of $28 million associated with export sales and manufacturing credits; (4) a tax charge of $29 million associated with the remittance of earnings from subsidiary companies outside of the U.S. in connection with the American Jobs Creation Act of 2004; and (5) a tax benefit of $44 million resulting from the Company's audit settlement with the Internal Revenue Service for tax years covering 1993 through 1998.

Valuation Allowance - U.S.
During the third quarter of 2005, based on the Company's assessment of positive and negative evidence regarding the realization of the net deferred tax assets, the Company recorded a valuation allowance of approximately $778 million against its U.S. net deferred tax assets. In accordance with SFAS No. 109, the Company's assessment included the evaluation of scheduled reversals of deferred tax assets and liabilities, estimates of projected future taxable income, carryback potential and tax planning strategies.

Prior to the Company's third quarter 2005 assessment of realizability, it was believed, based on available evidence including tax planning strategies, that the Company would more likely than not realize its net U.S. deferred tax assets. The third quarter 2005 assessment considered the following significant matters based upon some recent changes that occurred in the quarter:

- In July 2005, management announced plans to significantly accelerate its restructuring efforts and to significantly reduce the assets supporting its traditional business by the end of 2007. This global plan includes accelerating the reduction of traditional film assets from $2.9 billion in January 2004 to approximately $1 billion by 2007 and terminating approximately 10,000 employees. These actions will have a negative impact on Kodak's ability to generate taxable income in the U.S.
- On October 18, 2005, the Company entered into a new secured credit facility pursuant to which the borrowings in the U.S. are collateralized by certain U.S. assets, including the Company's intellectual property assets. Thus, management determined that the previous tax planning strategy to sell the U.S. intellectual property to a foreign subsidiary to generate taxable income in the U.S. was no longer prudent

nor feasible and should not be relied upon as part of the third quarter assessment of realizability of the Company□s U.S. deferred tax assets.

Based upon the Company□s above-mentioned September 30, 2005 assessment of realizability, the Company concluded that it was no longer more likely than not that the U.S. net deferred tax assets would be realized and, as such, recorded a valuation allowance of approximately $778 million.

In the fourth quarter of 2005, the Company updated its assessment of the realizability of its net deferred tax assets. As a result of the Company□s assessment of positive and negative evidence regarding the realization of the net deferred tax assets, which included the evaluation of scheduled reversals of deferred tax assets and liabilities, estimates of projected future taxable income, carryback potential and tax planning strategies, the Company maintained that it was still no longer more likely than not that the U.S. net deferred tax assets would be realized and, as such, increased the valuation allowance by approximately $183 million relating to deferred tax benefits generated in the fourth quarter. In addition, the Company expects to record a valuation allowance on all U.S. tax benefits generated in the future until an appropriate level of profitability in the U.S. is sustained or until the Company is able to generate enough taxable income through other tax planning strategies and transactions. Both the net deferred tax asset balances and the offsetting valuation allowance included estimates attributable to the acquisitions of KPG and Creo. Deferred tax amounts attributable to these businesses were finalized during 2006 with the completion of the Company□s purchase accounting for these acquired entities.

As of December 31, 2005, the Company had a valuation allowance of $1,116 million relating to its net deferred tax assets in the U.S. of $1,195 million. The valuation allowance of $1,116 million is attributable to (i) the charges totaling $961 million that were recorded in the third and fourth quarters of 2005 and (ii) a valuation allowance of $155 million recorded in a prior year for certain state tax carryforward deferred tax assets relating to which the Company believes it is not more likely than not that the assets will be realized. The remaining net deferred tax assets in excess of the valuation allowance of $79 million relate to certain foreign tax credit deferred tax assets which the Company believes it is more likely than not that the assets will be realized.

Valuation Allowance □ Outside the U.S.
As of December 31, 2005, the Company had a valuation allowance of approximately $212 million relating to its deferred tax assets outside of the U.S. of $569 million. The valuation allowance of $212 million is attributable to certain net operating loss and capital loss carryforwards which the Company believes it is not more likely than not that the assets will be realized.

(Loss) Earnings From Continuing Operations
The loss from continuing operations for 2005 was $1,354 million, or $4.70 per basic and diluted share, as compared with earnings from continuing operations for 2004 of $69 million, or $.24 per basic and diluted share, representing a decrease of $1,423 million. This decrease in earnings from continuing operations is attributable to the reasons described above.

CONSUMER DIGITAL IMAGING GROUP (CDG)

Worldwide Revenues
Net worldwide sales for the CDG segment were $3,215 million for 2005 as compared with $2,366 million for 2004, representing an increase of $849 million, or 36%. The increase in net sales was primarily attributable to volume increases, which increased net sales by approximately 53 percentage points, partially offset by negative price/mix, which decreased net sales by approximately 17 percentage points. The volume increases were largely driven by the consumer digital capture SPG and home printing solutions SPG. The negative price/mix impact was driven primarily by the home printing solutions SPG and consumer digital capture SPG. Foreign exchange did not have a significant impact on net sales.

CDG segment net sales in the U.S. were $2,034 million for 2005 as compared with $1,440 million for 2004, representing an increase of $594 million, or 41%. CDG segment net sales outside the U.S. were $1,181 million for 2005 as compared with $926 million for the 2004, representing an increase of $255 million, or 28%, which includes a favorable impact from exchange of 1%.

Net worldwide sales of consumer digital capture products, which include consumer digital cameras, accessories, memory products, imaging sensors, and intellectual property royalties, increased 30% in 2005 as compared with the prior year, primarily reflecting strong volume increases and favorable exchange, partially offset by negative price/mix.

Net worldwide sales of picture maker kiosks/media (the kiosk SPG) increased 37% in 2005 as compared with 2004, as a result of strong volume increases and favorable exchange. Sales continue to be driven by strong market acceptance of Kodak's new generation of kiosks and an increase in consumer demand for digital printing at retail.

Net worldwide sales of the home printing solutions SPG, which includes inkjet photo paper and printer docks/media, increased 57% in 2005 as compared with 2004 driven by sales of printer docks and associated thermal media. For full year 2005, Kodak's printer dock product held the number-one market share position (on a unit basis) in the United States, Canada, Germany, Australia and the United Kingdom. However, inkjet paper sales in 2005 declined year over year, as volume growth was more than offset by lower pricing. Industry growth for inkjet paper continues to slow as a result of improving retail printing solutions, and alternative home printing solutions.

Gross Profit
Gross profit for the CDG segment was $598 million for 2005 as compared with $463 million for the prior year period, representing an increase of $135 million or 29%. The gross profit margin was 18.6% in 2005 as compared with 19.6% in 2004. The 1.0 percentage point decrease was primarily attributable to negative price/mix, which reduced gross profit margins by approximately 10.4 percentage points. This decline from negative price/mix was partially offset by positive results from initiatives to reduce manufacturing costs, which improved gross profit margins by approximately 8.0 percentage points; volume increases, which favorably impacted gross profit margins by approximately 1.2 percentage points; and foreign exchange, which favorably impacted gross profit margins by approximately 0.1 percentage points. The negative price/mix impact was primarily driven by the home printing solutions SPG and the consumer digital capture SPG, partially offset by the year-over-year increase in royalty income relating to digital capture.

Selling, General and Administrative Expenses
SG&A expenses for the CDG segment increased $63 million, or 13%, from $488 million in 2004 to $551 million in 2005, and decreased as a percentage of sales from 21% for 2004 to 17% for 2005. The dollar increase is primarily attributable to increased advertising costs.

Research and Development Costs
R&D costs for the CDG segment increased $15 million, or 9%, from $164 million in 2004 to $179 million in 2005 and decreased as a percentage of sales from 7% in 2004 to 6% in 2005.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
The loss from continuing operations before interest, other income (charges), net and income taxes for the CDG segment was $131 million in 2005 compared with a loss of $189 million in 2004, representing an improvement in earnings of $58 million or 31%, as a result of the factors described above.

FILM AND PHOTOFINISHING SYSTEMS GROUP (FPG)

Worldwide Revenues
Net worldwide sales for the FPG segment were $5,325 million for 2005 as compared with $7,051 million for 2004, representing a decrease of $1,726 million, or 24%. The decrease in net sales was primarily attributable to volume declines (primarily in the consumer film capture SPG, the photofinishing services SPG, and the consumer output SPG), which decreased sales by approximately 23.1 percentage points. Negative price/mix, largely driven by the consumer film capture SPG and the consumer output SPG, decreased sales by approximately 2.0 percentage points. These declines were partially offset by favorable exchange, which increased net sales by approximately 0.7 percentage points.

FPG segment net sales in the U.S. were $1,767 million for 2005 as compared with $2,476 million for 2004, representing a decrease of $709 million, or 29%. FPG segment net sales outside the U.S. were $3,558 million for 2005 as compared with $4,575 million for 2004, representing a decrease of $1,017 million, or 22%, which includes a favorable impact from exchange of 1%.

Net worldwide sales of the film capture SPG, including consumer roll film (35mm and APS film), one-time-use cameras (OTUC), professional films, reloadable traditional film cameras and batteries/videotape, decreased 31% in 2005 as compared with 2004, primarily reflecting volume declines and negative price/mix, partially offset by favorable exchange.

Net worldwide sales for the consumer and professional output SPGs, which include color negative paper and photochemicals, decreased 19% in 2005 as compared with 2004, primarily reflecting volume declines and unfavorable price/mix, partially offset by favorable exchange. The volume declines are largely driven by the substantial reduction of direct sales of minilab equipment, which began in the third quarter of 2005, as the Company has shifted its focus to providing minilab services.

Net worldwide sales for the photofinishing services SPG, which includes equipment and photofinishing services at retail on-site and Qualex in the U.S. and CIS (Consumer Imaging Services) outside the U.S., decreased 47% in 2005 as compared with 2004, reflecting continuing volume declines in the development and processing of consumer films.

Net worldwide sales for the entertainment film SPGs, including origination and print films for the entertainment industry increased 1%, primarily reflecting volume increases and favorable exchange, partially offset by overall negative price/mix.

Gross Profit
Gross profit for the FPG segment was $1,630 million for 2005 as compared with $2,176 million for the prior year period, representing a decrease of $546 million or 25%. The gross profit margin was 30.6% in 2005 as compared with 30.9% in 2004. The 0.3 percentage point decrease was primarily attributable to increased manufacturing costs, which negatively impacted gross profit margins by approximately 0.6 percentage points, and volume declines, which negatively impacted gross profit margins by approximately 0.5 percentage points. These declines were partially offset by favorable exchange, which positively impacted gross profit margins by approximately 0.6 percentage points, and positive price/mix, which positively impacted gross profit margins by approximately 0.2 percentage points.

Selling, General and Administrative Expenses
SG&A expenses for the FPG segment decreased $166 million, or 14%, from $1,167 million in 2004 to $1,001 million in 2005, and increased as a percentage of sales from 17% for 2004 to 19% for 2005. The dollar decrease is primarily attributable to cost reduction actions. These cost reduction actions are being outpaced by the decline of traditional product sales, which resulted in a minor year-over-year increase of SG&A as a percentage of sales.

Research and Development Costs
R&D costs for the FPG segment decreased $66 million, or 43%, from $155 million in 2004 to $89 million in 2005 and remained constant as a percentage of sales at 2%. The decrease in R&D was primarily attributable to spending reductions related to traditional products and services.

Earnings From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the FPG segment were $540 million in 2005 compared with $854 million in 2004, representing a decrease of $314 million or 37%, as a result of the factors described above.

GRAPHIC COMMUNICATIONS GROUP

On May 1, 2004, Kodak completed the acquisition of the NexPress-related entities, which develop high quality on-demand digital color printing systems and manufacture digital black and white printing systems. There was no consideration paid to Heidelberg at closing. Under the terms of the acquisition, Kodak and Heidelberg agreed to use a performance-based earn-out formula whereby Kodak will make periodic payments to Heidelberg over a two-year period, if certain sales goals are met. If all sales goals were met during the two calendar years ended December 31, 2005, the Company would have paid a maximum of $150 million in cash. For both the first calendar year (2004) and for the second calendar year (2005), there were no amounts paid to Heidelberg. Additional payments may also be made relating to the incremental sales of certain products in excess of a stated minimum number of units sold during a five-year period following the closing of the transaction.

On April 1, 2005, the Company became the sole owner of KPG through the redemption of Sun Chemical Corporation's 50 percent interest in the KPG joint venture. This transaction further established the Company as a leader in the graphic communications industry and complements the Company's existing business in this market. Under the terms of the transaction, the Company redeemed all of Sun Chemical's shares in KPG by providing $317 million in cash (excluding $7 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 as of the acquisition date was recorded as long-term debt in the Company's Consolidated Statement of Financial Position.

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 through a 7-Year Term Loan under the Company's new Secured Credit Facilities completed on October 18, 2005.

Worldwide Revenues
Net worldwide sales for the Graphic Communications Group segment were $2,990 million for 2005 as compared with $1,344 million for the prior year period, representing an increase of $1,646 million, or 122%, which includes a favorable impact from exchange of less than 1%. The increase in net sales was primarily due to the KPG, Creo and NexPress acquisitions, which contributed $1,561 million in sales.

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Net sales in the U.S. were $1,079 million for 2005 as compared with $587 million for the prior year, representing an increase of $492 million, or 84%. Net sales outside the U.S. were $1,911 million in 2005 as compared with $757 million for the prior year period, representing an increase of $1,154 million, or 152% as reported, which includes a favorable impact from exchange of approximately 1%.

Digital Strategic Product Groups' Revenues
The Graphic Communications Group segment's digital product sales consist of KPG digital revenues; Creo, a supplier of prepress systems; NexPress Solutions, a producer of digital color and black and white printing solutions; Kodak Versamark, a leader in continuous inkjet technology; document scanners; Encad, Inc., a maker of wide-format inkjet printers; and service and support.

Digital product sales for the Graphic Communications Group segment were $2,437 million for 2005 as compared with $1,048 million for the prior year, representing an increase of $1,389 million, or 133%. The increase in digital product sales was primarily attributable to the KPG, Creo and NexPress acquisitions.

Traditional Strategic Product Groups' Revenues
The Graphic Communications Group segment's traditional product sales are primarily comprised of sales of traditional graphics products, KPG's analog plates and other films, and microfilm products. These sales were $553 million for 2005 compared with $296 million for the prior year, representing an increase of $257 million, or 87%. This increase is primarily attributable to the acquisition of KPG.

Gross Profit
Gross profit for the Graphic Communications Group segment was $799 million for 2005 as compared with $337 million in the prior year, representing an increase of $462 million, or 137%. The gross profit margin was 26.7% in 2005 as compared with 25.1% in the prior year. The increase in the gross profit margin of 1.6 percentage points was primarily attributable to: (1) reductions in manufacturing and other costs, which positively impacted gross profit margins by approximately 3.3 percentage points, and (2) volume increases related to Versamark products and services of approximately 1.7 percentage points. These positive impacts on gross profit margin were partially offset by the negative impact of acquisitions on gross profit margins of approximately 2.9 percentage points, and by negative price/mix of approximately 0.5 percentage points. Foreign exchange did not have a significant impact on segment gross profit margin.

Selling, General and Administrative Expenses
SG&A expenses for the Graphic Communications Group segment were $562 million for 2005 as compared with $283 million in the prior year, representing an increase of $279 million, or 99%, and decreased as a percentage of sales from 21% in 2004 to 19% in 2005. The dollar increase in SG&A is primarily attributable to the acquisitions of KPG, Creo and NexPress, while the decrease in SG&A as a percentage of sales is primarily attributable to the increase in sales as a result of the acquisitions, as well as the fact that the acquired businesses generally have lower SG&A as a percentage of sales.

Research and Development Costs
R&D costs for the Graphic Communications Group segment increased $133 million, or 92%, from $145 million for 2004 to $278 million for 2005, and decreased as a percentage of sales from 11% in 2004 to 9% in 2005. The dollar increase was primarily attributable to the write-off of in-process R&D associated with the KPG and Creo acquisitions of $52 million, as well as increased levels of R&D spending associated with the acquired companies of $95 million.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
The loss from continuing operations before interest, other income (charges), net and income taxes for the Graphic Communications Group segment was $41 million in 2005 compared with a loss of $91 million in 2004. This improvement in earnings of $50 million is attributable to the reasons described above.

HEALTH GROUP

Worldwide Revenues
Net worldwide sales for the Health Group segment were $2,655 million for 2005 as compared with $2,686 million for the prior year, representing a decrease of $31 million, or 1%. The decrease in sales was primarily attributable to decreases in price/mix of approximately 2.4 percentage points, primarily driven by the digital capture SPG, digital output SPG, and the traditional medical film portion of the film capture and output SPG. These decreases were partially offset by increases in volume, primarily driven by the digital capture SPG and the services SPG, which contributed approximately 1.0 percentage points to the increase in sales. Sales were also favorably impacted by exchange of approximately 0.3 percentage points.

Net sales in the U.S. were $1,052 million for 2005 as compared with $1,114 million for 2004, representing a decrease of $62 million, or 6%. Net sales outside the U.S. were $1,603 million for 2005 as compared with $1,572 million for the prior year, representing an increase of $31 million, or 2%, which includes a favorable impact from exchange of less than 1%.

Digital Strategic Product Groups Revenues
Health Group segment digital sales, which include digital products (DryView laser imagers/media and wet laser printers/media), digital capture equipment (computed radiography capture equipment and digital radiography equipment), services, dental systems (practice management software and digital radiography capture equipment) healthcare information systems (Picture Archiving and Communications Systems (PACS)), and Radiology Information Systems (RIS), were $1,719 million for 2005 as compared with $1,693 million for 2004, representing an increase of $26 million, or 2%. The increase in digital product sales was primarily attributable to volume increases and favorable exchange, partially offset by negative price/mix.

Traditional Strategic Product Groups Revenues
Health Group segment's traditional product sales, including analog film, equipment, and chemistry, were $936 million for 2005 as compared with $993 million for 2004, representing a decrease of $57 million, or 6%. The primary drivers were lower volumes and unfavorable price/mix for the film capture and output SPG, partially offset by favorable exchange.

Gross Profit
Gross profit for the Health Group segment was $1,021 million for 2005 as compared with $1,132 million in the prior year, representing a decrease of $111 million, or 10%. The gross profit margin was 38.5% in 2005 as compared with 42.1% in 2004. The decrease in the gross profit margin of 3.6 percentage points was principally attributable to: (1) price/mix, which negatively impacted gross profit margins by 2.6 percentage points driven by the digital capture SPG, digital output SPG and the traditional medical film portion of the film capture and output SPG, and (2) an increase in manufacturing cost, which decreased gross profit margins by approximately 1.3

percentage points due to an increase in silver and raw material costs. These decreases were partially offset by favorable exchange, which contributed approximately 0.4 percentage points to the gross profit margins.

Selling, General and Administrative Expenses
SG&A expenses for the Health Group segment increased $21 million, or 4%, from $468 million in 2004 to $489 million for 2005 and increased as a percentage of sales from 17% in 2004 to 18% in 2005. The increase in SG&A expenses is primarily attributable to increases in certain corporate overhead costs. SG&A was also negatively impacted by costs associated with the OREX acquisition of approximately $6 million.

Research and Development Costs
R&D costs for 2005 were $162 million as compared with the prior year of $180 million, representing a decrease of $18 million or 10%, and decreased as a percentage of sales from 7% to 6%. This decrease is a result of reduced R&D spending related to traditional products and services.

Earnings From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
Earnings from continuing operations before interest, other income (charges), net and income taxes for the Health Group segment decreased $114 million, or 24%, from $484 million for the prior year to $370 million for 2005 due to the reasons described above.

ALL OTHER

Worldwide Revenues
Net worldwide sales for All Other were $83 million for 2005 as compared with $70 million for 2004, representing an increase of $13 million, or 19%. Net sales in the U.S. were $47 million for 2005 as compared with $41 million for 2004, representing an increase of $6 million, or 15%. Net sales outside the U.S. were $36 million in 2005 as compared with $29 million in the prior year, representing an increase of $7 million, or 24%.

Loss From Continuing Operations Before Interest, Other Income (Charges), Net and Income Taxes
The loss from continuing operations before interest, other income (charges), net and income taxes for All Other was $231 million in 2005 as compared with a loss of $257 million in 2004, representing an improvement in earnings of $26 million or 10%.

EARNINGS FROM DISCONTINUED OPERATIONS, NET OF INCOME TAXES

Earnings from discontinued operations for 2005 were $150 million, or $.52 per basic and diluted share and were primarily related to a $203 million reversal of certain tax accruals as a result of a settlement between the Company and the Internal Revenue Service on the audit of the tax years 1993 through 1998. These accruals had been established in 1994 in connection with the Company's sale of its pharmaceutical, consumer health and household products businesses during that year. The tax accrual reversals were partially offset by a pension settlement charge of $54 million resulting from the finalization of the transfer of pension assets to ITT Industries, Inc. (ITT) in connection with the sale of the Company's Remote Sensing Systems business (RSS) in August 2004. Earnings from discontinued operations for 2004 were $475 million or $1.66 per basic and diluted share and were primarily related to the gain on the sale of RSS to ITT in August 2004.

LOSS FROM CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF INCOME TAXES

The loss from cumulative effect of an accounting change, net of income taxes, of $57 million or $.20 per basic and diluted share is the result of the Company's adoption of Financial Accounting Standards Board Interpretation No. (FIN) 47, "Accounting for Conditional Asset Retirement Obligations," as of December 31, 2005. Under FIN 47, the Company is required to record an obligation and an asset for the present value of the estimated cost of fulfilling its legal obligation with respect to the retirement of an asset when the timing or method of settling that obligation is conditional upon a future event (for example, the sale of, exiting from or disposal of an asset - the "settlement date"). The primary application of FIN 47 to the Company is with respect to asbestos remediation. The $57 million charge represents the present value of the Company's asset retirement obligations (net of the related unamortized asset) relating to facilities with estimated settlement dates. Refer to further discussion in the "New Accounting Pronouncements" section of Item 7 for further information.

NET (LOSS) EARNINGS

The net loss for 2005 was $1,261 million, or a loss of $4.38 per basic and diluted share, as compared with net earnings for 2004 of $544 million, or $1.90 per basic and diluted share, representing a decrease of $1,805 million, or 332%. This decrease is attributable to the reasons outlined above.

SUMMARY

(in millions, except per share data)		2006	Change		2005	Change
Net sales from continuing operations	$	13,274	- 7%	$	14,268	+6
Loss from continuing operations before interest, other income (charges), net, and income taxes		(202)	+68		(632)	-496
(Loss) earnings from continuing operations		(600)	+56		(1,354)	-2,062
(Loss) earnings from discontinued operations		(1)	-101		150	- 68
Cumulative effect of accounting change		—			(57)	
Net (loss) earnings	$	(601)	+52%	$	(1,261)	-332
Basic and diluted net (loss) earnings per share:						
Continuing operations	$	(2.09)	+55%	$	(4.70)	-2,058
Discontinued operations		—	-100		.52	- 69
Cumulative effect of accounting change		—			(.20)	
Total	$	(2.09)	+52%	$	(4.38)	- 331

The Company's results as noted above include certain one-time items, such as charges associated with focused cost reductions and other special charges. These items, which are described below, should be considered to better understand the Company's results of operations that were generated from normal operational activities.

2006

The Company's results from continuing operations for the year included the following:

Charges of $768 million, net of reversals, ($718 million after tax) related to focused cost reductions implemented primarily under the 2004-2007 Restructuring Program. See further discussion in the Restructuring Costs and Other section of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Note 16, "Restructuring Costs and Other."

Income of $46 million ($33 million after tax) related to property and asset sales related to focused cost reduction actions.

Charges of $11 million ($10 million after tax) related to impairment charges for assets sold or held for sale.

Reversals, net of $2 million ($2 million after tax) related to legal settlements.

Income tax charge of $90 million to establish a valuation allowance against the Company's net deferred tax assets in certain countries outside the U.S., portions of which are reflected in the restructuring amount presented above.

2005

The Company's results from continuing operations for the year included the following:

Charges of $1,118 million ($1,020 million after tax) related to focused cost reductions implemented primarily under the 2004-2007 Restructuring Program. See further discussion in the Restructuring Costs and Other section of Management□s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Note 16, □Restructuring Costs and Other.□

Net charges of $52 million ($38 million after tax) related to purchased in-process R&D incurred in the second quarter (adjusted for credits of $12 million ($2 million after tax) in the third quarter) related to the acquisitions of KPG and Creo.

Charges of $44 million ($35 million after tax) related to a $19 million impairment of the investment in Lucky Film and a $25 million ($16 million after tax) asset impairment.

Charges of $21 million ($21 million after tax) related to unfavorable legal settlements.

Other income of $41 million ($39 million after tax) related to the gain on the sale of properties in connection with restructuring actions.

Income tax charges of $6 million related to a change in estimate with respect to a tax benefit recorded in connection with a land donation.

Income tax charge of $961 million to establish a valuation allowance against the Company□s net deferred tax assets in the U.S., portions of which are reflected in the restructuring amount presented above.

2004

The Company□s results from continuing operations for the year included the following:

Charges of $889 million ($620 million after tax) related to focused cost reductions implemented primarily under the Third Quarter, 2003 Restructuring Program and 2004-2007 Restructuring Program. See further discussion in the Restructuring Costs and Other section of MD&A and Note 16, □Restructuring Costs and Other.□

Charges of $12 million ($7 million after tax), including $2 million ($1 million after tax) for inventory write-downs and $10 million ($6 million after tax) for the write-off of fixed assets related to Kodak□s historical ownership interest in the NexPress joint venture in connection with the acquisition of the NexPress-related entities incurred in the second and fourth quarters.

Charges of $15 million ($10 million after tax) related to purchased in-process R&D incurred in the first and third quarters.

Charges of $6 million ($4 million after tax) related to a legal settlement.

Other income of $101 million ($63 million after tax) related to two favorable legal settlements.

Income tax charges of $31 million related to valuation allowances for restructuring related deferred tax assets.

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, and (4) the total restructuring charges to be incurred.

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 was as follows for the year ended December 31, 2006:

(in millions)	Balance Dec. 31, 2005	Charges	Reversals	Cash Payments (1)	Non-cash Settlements	Other Adjustments and Reclasses (2)	Balance Dec. 31, 2006
2004-2007 Restructuring Program:							
Severance reserve	$ 271	$ 318	$ (3)	$ (416)	$ —	$ 58	$ 228
Exit costs reserve	23	69	(1)	(67)	—	—	24
Total reserve	$ 294	$ 387	$ (4)	$ (483)	$ —	$ 58	$ 252
Long-lived asset impairments and inventory write-downs	$ —	$ 100	$ —	$ —	$ (100)	$ —	$ —
Accelerated depreciation	—	285	—	—	(285)	—	—
Pre-2004 Restructuring Programs:							
Severance reserve	$ 2	$ —	$ —	$ (2)	$ —	$ —	$ —
Exit costs reserve	13	—		(3)	—	1	11
Total reserve	$ 15	$ —	$ —	$ (5)	$ —	$ 1	$ 11
Total of all restructuring programs	$ 309	$ 772	$ (4)	$ (488)	$ (385)	$ 59	$ 263

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(1) During the year ended December 31, 2006, the Company paid $548 million related to restructuring. Of this total amount, $488 million was recorded against restructuring reserves, while $60 million was recorded against pension and other postretirement liabilities.

(2) The total restructuring charges of $772 million, excluding reversals, 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 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 December 31, 2006 or 2005. Accordingly, the Other Adjustments and Reclasses column of the table above includes: (1) reclassifications to Other long-term assets and Pension and other postretirement liabilities for the position elimination-related impacts on the Company’s pension and other postretirement employee benefit plan arrangements, including net curtailment gains, settlement gains, and special termination benefits of $37 million, and (2) reclassifications to Other long-term liabilities for the restructuring-related impacts on the Company’s environmental

remediation liabilities of $(9) million. Additionally, the Other Adjustments and Reclasses column of the table above includes: (1) adjustments to the restructuring reserves of $20 million related to the KPG and Creo purchase accounting impacts that were charged appropriately to Goodwill as opposed to Restructuring charges, and (2) foreign currency translation adjustments of $10 million, which are reflected in Accumulated other comprehensive loss in the Consolidated Statement of Financial Position.

The costs incurred, net of reversals, which total $768 million for the year ended December 31, 2006, include $285 million and $12 million of charges related to accelerated depreciation and inventory write-downs, respectively, which were reported in cost of goods sold in the accompanying Consolidated Statement of Operations for the year ended December 31, 2006. The remaining costs incurred, net of reversals, of $471 million, were reported as restructuring costs and other in the accompanying Consolidated Statement of Operations for the year ended December 31, 2006. The severance reserve and exit costs reserve generally 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 was to achieve a business model appropriate for the Companys traditional businesses, and to sharpen the Companys 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 related to severance, with the remainder relating to the disposal of buildings and equipment. Overall, Kodaks 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 fourth quarter of 2006 under this program and an understanding of the estimated remaining actions to be taken, the Company expected that the employment reductions and total charges under this program would be within the ranges of 25,000 to 27,000 positions and $3.0 billion to $3.4 billion, respectively. On February 8, 2007, the Company updated the ranges for anticipated restructuring activity. The Company now expects that the total employment reductions will be in the range of 28,000 to 30,000 positions and total charges will be in the range of $3.6 billion to $3.8 billion.

The Company implemented certain actions under this program during 2006. As a result of these actions, the Company recorded charges of $768 million in 2006, net of reversals, which were composed of severance, long-lived asset impairments, exit costs, accelerated depreciation, and inventory write-downs of $315 million, $88 million, $68 million, $285 million and $12 million, respectively. The severance costs related to the elimination of approximately 5,625 positions, including approximately 500 photofinishing, 2,950 manufacturing, 375 research and development and 1,800 administrative positions. The geographic composition of the positions to be eliminated includes approximately 2,675 in the United States and Canada and 2,950 throughout the rest of the world. The reduction of the 5,625 positions and the $387 million charges for severance and exit costs are reflected in the 2004-2007 Restructuring Program table below. The $88 million charge for long-lived asset impairments was included in restructuring costs and other in the accompanying Consolidated Statement of Operations for the year ended December 31, 2006. The charges taken for inventory write-downs of $12 million were reported in cost of goods sold in the accompanying Consolidated Statement of Operations for the year ended December 31, 2006.

As a result of initiatives implemented under the 2004-2007 Restructuring Program, the Company recorded $285 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Operations for the year ended December 31, 2006. The accelerated depreciation relates to long-lived assets accounted for under the held and used model of SFAS No. 144. The year-to-date amount of $285 million relates to $11 million of photofinishing facilities and equipment, $271 million of manufacturing facilities and equipment, and $3 million of administrative facilities and equipment that will be used until their abandonment. The Company will record approximately $33 million of additional accelerated depreciation in 2007 related to the initiatives implemented in 2006. Additional amounts of accelerated depreciation may be recorded in 2007 as the Company continues to execute its 2004-2007 Restructuring Program.

Under this program, on a life-to-date basis as of December 31, 2006, the Company has recorded charges of $2,731 million, which were composed of severance, long-lived asset impairments, exit costs, inventory write-downs and accelerated depreciation of $1,233 million, $350 million, $252 million, $68 million and $828 million, respectively. The severance costs related to the elimination of approximately 23,375 positions, including approximately 6,200 photofinishing, 10,900 manufacturing, 1,375 research and development and 4,900 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 December 31, 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				