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EASTMAN KODAK CO  
Form 8-K  
May 14, 2004

1 of 165 pages

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 8-K

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Date of report (Date of earliest event reported): May 14, 2004

Eastman Kodak Company  
(Exact name of registrant as specified in charter)

New Jersey	1-87	16-0417150
-----		
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

343 State Street,  
Rochester, New York 14650  
-----  
(Address of Principal Executive Office) (Zip Code)

Registrant's telephone number, including area code (585) 724-4000  
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ITEM 5. OTHER EVENTS AND REGULATION FD DISCLOSURE

On February 9, 2004, the Company announced its intent to sell the assets and business of the Remote Sensing Systems operation, including the stock of Kodak's wholly owned subsidiary, Research Systems, Inc., collectively known as RSS, to ITT Industries. The Company accounted for RSS as a discontinued operation in its Form 10-Q quarterly report for the quarterly period ended March 31, 2004, which was filed on May 10, 2004. Accounting Principles Generally Accepted in the United States of America (U.S. GAAP) requires that when a component of an entity, such as RSS, has been reported as a discontinued operation, the financial statements for prior periods must also report the financial results of the component in discontinued operations.

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In addition, on August 21, 2003, the Company announced an organizational realignment in an effort to accelerate growth in the commercial and consumer digital imaging markets. To facilitate the Company's transition to its new business model, the corporate segment reporting structure also changed effective January 1, 2004, and the new segments were reflected in the Company's Form 10-Q quarterly report for the quarterly period ended March 31, 2004 as filed on May 10, 2004. U.S. GAAP requires that when a company changes its reportable segments, financial statements for prior periods must also be reported using the new segment reporting structure.

Because the Company plans to amend a previously filed registration statement, the Company must revise the prior period financial statements included or incorporated by reference in the registration statement to reflect the discontinued operation and new segment reporting structure for all periods presented. The purpose of this Form 8-K is to present the revised financial statements of the Company to include RSS as a discontinued operation and the Company's new segment reporting structure as of December 31, 2003 and 2002 and for the three years in the period ended December 31, 2003, including a revised management's discussion and analysis of the financial condition and results of operations, and revised selected financial data required by Item 301 of Regulation S-K for all periods presented.

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### 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 additional management judgment due to the sensitivity of the methods and assumptions necessary in determining the related asset, liability, revenue and expense amounts.

#### REVENUE RECOGNITION

Kodak 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 verifiable objective evidence of fair value (if software is not included or is incidental to the transaction) or Kodak-specific objective evidence of fair value if software is included and is other than incidental to the sales transaction as a whole. 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

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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.

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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 Vendor's 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.

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

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

### INVENTORIES

Kodak 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 management's estimates.

## 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 periodic restructuring actions. Therefore, future changes in the Company's strategy, the ongoing digital substitution, the continuing shift from overnight photofinishing to onsite processing 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

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impairment in the future.

In performing the annual assessment of goodwill for impairment, the Company determined that no material reporting units' carrying values were close to exceeding their respective fair values. See "Goodwill" under Note 1, "Significant Accounting Policies."

### INVESTMENTS IN EQUITY SECURITIES

Kodak holds minority interests in certain publicly traded and privately held companies having operations or technology within its strategic areas of focus. The Company's policy is to record an impairment charge on these investments when they experience declines in value that are considered to be other-than-temporary. Poor operating results of the investees or adverse changes in market conditions in the future may cause losses or an inability of the Company to recover its carrying value in these underlying investments. The remaining carrying value of the Company's investments in these equity securities is \$25 million at December 31, 2003.

### INCOME TAXES

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. At December 31, 2003, the Company has deferred tax assets for its net operating loss and foreign tax credit carryforwards of \$258 million and \$137 million, respectively, relating to which the Company has a valuation allowance of \$45 million and \$56 million, respectively. The Company has considered future market growth, 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.

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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 permanently reinvest its retained earnings. However, from time to time and to the extent that the Company can repatriate overseas earnings on 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 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

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positive impact on earnings.

### WARRANTY OBLIGATIONS

Management estimates expected product failure rates, material usage and service costs in the development of its warranty obligations. 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 POSTRETIREMENT BENEFITS

Kodak's defined benefit pension and other postretirement benefit costs and obligations are dependent on 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, salary growth, healthcare cost trend rate and other economic and demographic factors. The Company bases the discount rate assumption for its significant plans on the estimated rate at which annuity contracts could be purchased to discharge the pension benefit obligation. In estimating that rate, the Company looks to the AA-rated corporate long-term bond yield rate in the respective country as of the last day of the year in the Company's reporting period as a guide. The long-term expected rate of return on plan assets 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.

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The Company evaluates its expected long-term rate of return on plan asset (EROA) assumption annually for the Kodak Retirement Income Plan (KRIP). To facilitate this evaluation, every two to 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. Wilshire Associates, a consulting firm, completed a study (the Study) in September 2002, which led to several asset allocation shifts and a decrease in the EROA from 9.5% for the year ended December 31, 2002 to 9.0% for the year ended December 31, 2003. The EROA for 2004 will remain at 9.0%. Given the decrease in the discount rate of 50 basis points from 6.5% for 2003 to 6.0% for 2004 and increased recognition of unrecognized losses in accordance with Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," total pension income from continuing operations for the major funded and unfunded defined benefit plans in the U.S. is expected to decrease from \$42 million in 2003 to pension income from continuing operations in the range of \$10 million to \$20 million in 2004. This decrease in income will be partially offset by an expected decrease in pension expense from continuing operations in the Company's non-U.S. plans in the range of \$5 million to \$10 million in 2004. Additionally, due in part to the decrease in the discount rate from 6.5% for 2003 to 6.0% for 2004 and increased amortization expense relating to the unrecognized actuarial loss, the Company expects the cost of its most significant postretirement benefit plan, the U.S. plan, to be in a range of \$220 million to \$265 million in 2004, as compared with \$230 million in 2003. These estimates have been incorporated into the Company's earnings outlook for 2004.

Actual results that differ from our assumptions are recorded as

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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 recognized 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 postretirement benefit costs and obligations.

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In accordance with the guidance under SFAS No. 87, the Company is required to record an additional minimum pension liability in its Consolidated Statement of Financial Position that is at least equal to the unfunded accumulated benefit obligation of its defined benefit pension plans. In the fourth quarter of 2003, due to the improved performance in the global equity markets, partially offset by decreasing discount rates in 2003, the Company decreased its net additional minimum pension liability by \$167 million and recorded a corresponding credit to accumulated other comprehensive income (a component of shareholders' equity) of \$122 million, net of taxes of \$45 million. If the global equity markets' performance continues to improve and discount rates stabilize or improve in future periods, the Company may be in a position to further reduce its additional minimum pension liability and reverse the corresponding charges to shareholders' equity. Conversely, if the global equity markets' performance and discount rates were to decline in future periods, the Company may be required to increase its additional minimum pension liability and record additional charges to shareholders' equity. To mitigate the increase in its additional minimum pension liability and additional charges to shareholders' equity, the Company may elect to fund a particular plan or plans on a case-by-case basis.

### 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 sites that are presently unknown.

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### STOCK-BASED COMPENSATION

The Company accounts 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 Financial Accounting Standards Board (FASB) Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." Accordingly, no stock-based employee compensation cost is reflected in net earnings

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for the years ended December 31, 2003, 2002 and 2001, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. On February 18, 2004, the Company announced that it will begin expensing stock options starting January 1, 2005 using the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." The FASB is expected to issue an exposure draft during 2004 relating to a new accounting standard that will require the expensing of stock options. This new accounting standard may become effective on January 1, 2005, in which case the Company will follow the stock option expensing rules of the new standard.

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### NEW KODAK OPERATING MODEL AND REPORTING STRUCTURE

On August 21, 2003, the Company announced an organizational realignment in an effort to accelerate growth in the commercial and consumer digital imaging markets. The corporate segment reporting structure also changed to facilitate the Company's transition to its new business model, which includes an increased focus on strategic product groups, or SPGs, within each of the reporting segments.

As a result of the change in compositions of the reportable segments, the accompanying segment information for the years ended December 31, 2003, 2002, and 2001 have been presented in accordance with the new structure. The Company has four reportable segments under the new structure: Digital & Film Imaging Systems (D&FIS); Health Imaging; Commercial Imaging; and Graphic Communications. 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. A description of the new segments is as follows:

**Digital & Film Imaging Systems Segment:** The Digital and Film Imaging Systems segment derives revenues from consumer film products, sales of origination and print film to the entertainment industry, sales of professional film products, traditional and inkjet photo paper, chemicals, traditional and digital cameras, photoprocessing equipment and services, and digitization services, including online services.

**Health Imaging Segment:** The Health Imaging segment derives revenues from the sale of digital products, including laser imagers, media, computed and direct radiography equipment and healthcare information systems, as well as traditional medical products, including analog film, equipment, chemistry, services and specialty products for the mammography, oncology and dental fields.

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**Commercial Imaging Segment:** The Commercial Imaging segment is composed of document imaging products and services, commercial and government systems products and services, and optics. The Remote Sensing Systems business, which had been included in this segment as it was part of the commercial and government systems products and services, is now in the process of being sold to ITT Industries. It is accounted for in all periods presented as discontinued operations.

**Graphic Communications Segment:** The Graphic Communications segment is composed of the Company's equity investments in NexPress (Kodak's 50/50 joint venture with Heidelberg) and Kodak Polychrome Graphics (Kodak's 50/50 joint venture with Sun Chemical), and the graphics and wide-format inkjet businesses. This segment will also include the results of Scitex Digital Printing, which was acquired in January 2004 and has since been renamed Kodak Versamark, and the results of Heidelberg Digital LLC and



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Heidelberg's 50% share of NexPress upon the closing of this acquisition, which is expected to occur in May 2004.

All Other: All Other is composed of Kodak's display and components business for organic light emitting diode (OLED) displays, sensors and other small, miscellaneous businesses.

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### DETAILED RESULTS OF OPERATIONS

#### Net Sales from Continuing Operations by Reportable Segment and All Other

(in millions) 2001	2003	Change	2002	Change	
Digital & Film Imaging Systems					
Inside the U.S.	\$ 3,812	- 6%	\$ 4,034	-10%	\$ 4,482
Outside the U.S.	5,420	+ 9	4,968	+ 1	4,921
	-----	---	-----	---	-----
Total Digital & Film Imaging Systems	9,232	+ 3	9,002	- 4	9,403
	-----	---	-----	---	-----
Health Imaging					
Inside the U.S.	1,061	- 2	1,088	0	1,089
Outside the U.S.	1,370	+16	1,186	+ 1	1,173
	-----	---	-----	---	-----
Total Health Imaging	2,431	+ 7	2,274	+ 1	2,262
	-----	---	-----	---	-----
Commercial Imaging					
Inside the U.S.	334	- 9	366	- 9	401
Outside the U.S.	457	+ 8	425	- 3	437
	-----	---	-----	---	-----
Total Commercial Imaging	791	0	791	- 6	838
	-----	---	-----	---	-----
Graphic Communications					
Inside the U.S.	156	-10	174	- 2	178
Outside the U.S.	190	-17	228	+ 9	209
	-----	---	-----	---	-----
Total Graphic Communications	346	-14	402	+ 4	387
	-----	---	-----	---	-----
All Other					
Inside the U.S.	42	- 7	45	-20	56
Outside the U.S.	51	+46	35	+17	30
	-----	---	-----	---	-----
Total All Other	93	+16	80	- 7	86
	-----	---	-----	---	-----
Total Net Sales	\$12,893	+ 3%	\$12,549	- 3%	\$12,976
	=====	===	=====	===	=====

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

(in millions)

Digital & Film Imaging Systems	\$ 418	- 46%	\$ 771	- 2%	\$ 787
Health Imaging	481	+ 12	431	+ 33	323
Commercial Imaging	112	- 5	118	+ 40	84
Graphic Communications	(13)	-162	21	- 52	44

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All Other	(75)	-178	(27)	+ 51	(55)
	-----	-----	-----	-----	-----
Total of segments	923	- 30	1,314	+ 11	1,183
Strategic asset impairments	(3)		(32)		(12)
Impairment of Burrell Companies' net assets held for sale	(9)		-		-
Restructuring costs and other	(557)		(114)		(714)
Donation to technology enterprise	(8)		-		-
GE settlement	(12)		-		-
Patent infringement claim settlement	(14)		-		-
Prior year acquisition settlement	(14)		-		-
Legal settlements	(8)		-		-
Environmental reserve reversal	9		-		-
Wolf charge	-		-		(77)
Environmental reserve	-		-		(41)
Kmart charge	-		-		(20)
	-----	-----	-----	-----	-----
Consolidated total	\$ 307	- 74%	\$ 1,168	+266%	\$ 319
	=====	=====	=====	=====	=====

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Net Earnings (Loss) From Continuing Operations by Reportable Segment  
and All Other

(in millions) 2001	2003	Change	2002	Change	
Digital & Film Imaging Systems	\$ 353	- 36%	\$ 554	+ 3%	\$ 539
Health Imaging	389	+ 23	315	+ 41	223
Commercial Imaging	74	- 13	85	+ 49	57
Graphic Communications	(41)	- 8	(38)	-1800	(2)
All Other	(59)	-136	(25)	+ 29	(35)
	-----	-----	-----	-----	-----
Total of segments	716	- 20	891	+ 14	782
Strategic asset and venture investment impairments	(7)		(50)		(15)
Impairment of Burrell Companies' net assets held for sale	(9)		-		-
Restructuring costs and other	(557)		(114)		(714)
Donation to technology enterprise	(8)		-		-
GE settlement	(12)		-		-
Patent infringement claim settlement	(14)		-		-
Prior year acquisition settlement	(14)		-		-
Legal settlements	(8)		-		-
Environmental reserve reversal	9		-		-
Wolf charge	-		-		(77)
Environmental reserve	-		-		(41)

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Kmart charge	-	-	(20)
Interest expense	(147)	(173)	(218)
Other corporate items	11	14	8
Tax benefit - contribution of patents	13	-	-
Tax benefit - PictureVision subsidiary closure	-	45	-
Tax benefit - Kodak Imagex Japan	-	46	-
Income tax effects on above items and taxes not allocated to segments	226	102	356
	-----	-----	-----
Consolidated total	\$ 199	- 74%	\$ 761 +1148% \$ 61
	=====	=====	=====

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2003 COMPARED WITH 2002

RESULTS OF OPERATIONS - CONTINUING OPERATIONS

CONSOLIDATED

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Net worldwide sales were \$12,893 million for 2003 as compared with \$12,549 million for 2002, representing an increase of \$344 million, or 3% as reported, or a decrease of 3% excluding the favorable impact from exchange. The increase in net sales was primarily due to increased volumes and favorable exchange, which increased sales for 2003 by 1.4 and 5.5 percentage points, respectively. The increase in volumes was primarily driven by consumer digital cameras, Printer Dock products, inkjet media and entertainment print films in the Digital & Film Imaging Systems (D&FIS) segment, digital products in the Health Imaging segment, partially offset by decreased volumes for traditional consumer film products. Favorable exchange resulted from an increased level of sales in non-U.S. countries as the U.S. dollar weakened throughout 2003 in relation to most foreign currencies, particularly the Euro. In addition, the acquisition of PracticeWorks, Inc. (PracticeWorks) in the fourth quarter of 2003 accounted for an additional 0.4 percentage points of the increase in net sales. These increases were partially offset by decreases attributable to price/mix, which reduced sales for 2003 by approximately 4.3 percentage points. These decreases were driven primarily by price/mix declines in traditional products and services, and consumer digital cameras in the D&FIS segment, film and laser imaging systems in the Health Imaging segment, and graphic arts products in the Graphic Communications segment.

Net sales in the U.S. were \$5,405 million for the current year as compared with \$5,707 million for the prior year, representing a decrease of \$302 million, or 5%. Net sales outside the U.S. were \$7,488 million for the current year as compared with \$6,842 million for the prior year, representing an increase of \$646 million, or 9% as reported, or no change excluding the favorable impact of exchange.

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 for 2003 were \$3,880 million as compared with \$3,484 million for 2002, representing an increase of 11% as reported, or a decrease of 2% excluding the favorable impact of exchange. Net sales in the Asia Pacific region for 2003 were \$2,368 million compared with \$2,240 million for 2002 representing an increase of 6% as reported, or

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a decrease of 1% excluding the favorable impact of exchange. Net sales in the Canada and Latin America region for 2003 were \$1,240 million as compared with \$1,118 million for 2002, representing an increase of 11% as reported, or an increase of 5% excluding the favorable impact of exchange.

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The Company's major emerging markets include China, Brazil, Mexico, India, Russia, Korea, Hong Kong and Taiwan. Net sales in emerging markets were \$2,591 million for 2003 as compared with \$2,425 million for 2002, representing an increase of \$166 million, or 7% as reported, or an increase of 4% excluding the favorable impact of exchange. The emerging market portfolio accounted for approximately 20% and 35% of the Company's worldwide and non-U.S. sales, respectively, in 2003.

Sales growth in Russia, India and China of 26%, 17% and 12%, respectively, were the primary drivers of the increase in emerging market sales, partially offset by decreased sales in Taiwan, Hong Kong and Brazil of 19%, 10% and 7%, respectively. The increase in sales in Russia is a result of continued growth in the number of Kodak Express stores, which represent independently owned photo specialty retail outlets, and the Company's efforts to expand the distribution channels for Kodak products and services. Sales increases in India were driven by the continued success from the Company's efforts to increase the level of camera ownership and from the continued success of independently owned Photoshop retail stores. Sales growth in China resulted from strong business performance for all Kodak's operations in that region in the first, third and fourth quarters of 2003; however, this growth was partially offset by the impact of the Severe Acute Respiratory Syndrome (SARS) situation, particularly for consumer and professional products and services, which negatively impacted sales in China during the second quarter. The sales declines experienced in Hong Kong and Taiwan during 2003 are also a result of the impact of SARS. The sales decline in Brazil is reflective of the continued economic weakness experienced there.

Gross profit was \$4,178 million for 2003 as compared with \$4,527 million for 2002, representing a decrease of \$349 million, or 8%. The gross profit margin was 32.4% in the current year as compared with 36.1% in the prior year. The decrease of 3.7 percentage points was attributable to declines in price/mix, which reduced gross profit margins by approximately 5.0 percentage points. This decrease was driven primarily by price/mix declines in traditional consumer film products, photofinishing, consumer digital cameras, and entertainment print films in the D&FIS segment, analog medical film and digital capture equipment in the Health Imaging segment, and graphic arts products in the Graphic Communications segment. The decline in price/mix was partially offset by favorable exchange, which increased gross margins by approximately 0.8 percentage points, and decreases in manufacturing cost, which favorably impacted gross profit margins by approximately 0.5 percentage points year-over-year due to reduced labor expense, favorable materials pricing and improved product yields. The acquisition of PracticeWorks in the fourth quarter of 2003 did not have a significant impact on the gross profit margin.

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Selling, general and administrative expenses (SG&A) were \$2,612 million for 2003 as compared with \$2,504 million for 2002, representing an increase of \$108 million, or 4%. SG&A increased slightly as a percentage of sales from 20.0% for the prior year to 20.3% for the current year. The net increase in SG&A is primarily attributable to an increase in the benefit rate and the occurrence of the following one-

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time charges: intellectual property settlement of \$12 million; patent infringement claim of \$14 million; settlement of outstanding issues relating to a prior year acquisition of \$14 million; write-down of the Burrell Companies' net assets held for sale of \$9 million; donation to a technology enterprise for research purposes amounting to \$8 million; legal settlement of \$8 million; strategic asset impairments of \$3 million; and unfavorable exchange of \$118 million due to an increased level of SG&A costs incurred in non-U.S. countries as most foreign currencies strengthened against the U.S. dollar in 2003. These items were partially offset by a reversal of environmental reserves of \$9 million and cost savings realized from position eliminations associated with ongoing focused cost reduction programs.

Research and development (R&D) costs were \$775 million for 2003 as compared with \$757 million for 2002, representing an increase of \$18 million, or 2%. The increase in R&D is primarily due to \$31 million of write-offs for purchased in-process R&D associated with two acquisitions made in 2003. These charges were partially offset by cost savings realized from position eliminations associated with ongoing focused cost reduction programs. As a percentage of sales, R&D costs remained flat at 6.0% for both the current and prior years.

Earnings from continuing operations before interest, other charges, net, and income taxes for 2003 were \$307 million as compared with \$1,168 million for 2002, representing a decrease of \$861 million, or 74%. The decrease is primarily the result of (1) the decline in gross profit margin and an increase in SG&A, and (2) net focused cost reduction charges of \$484 million incurred during 2003 as compared with \$98 million for 2002, an increase of \$386 million which was primarily due to the costs incurred under the Third Quarter, 2003 Restructuring Program.

Interest expense for 2003 was \$147 million as compared with \$173 million for 2002, representing a decrease of \$26 million, or 15%. The decrease in interest expense is almost entirely attributable to lower average interest rates in 2003 relative to 2002, which was driven mainly by the refinancing of the Company's \$144 million 9.38% Notes due March 2003 and the \$110 million 7.36% Notes due April 2003 with lower interest rate medium term notes and lower average interest rates on commercial paper during 2003.

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The other charges, net component includes principally investment income, income and losses from equity investments, foreign exchange, and gains and losses on the sales of assets and investments. Other charges for the current year were a net charge of \$51 million as compared with a net charge of \$101 million for 2002. The decrease in other charges is primarily attributable to increased income from the Company's equity investment in Kodak Polychrome Graphics, reduced losses from the Company's NexPress joint venture, the elimination of losses from the Company's equity investment in the Phogenix joint venture due to its dissolution in the second quarter of 2003, and lower non-strategic venture investment impairments.

The Company's effective tax benefit from continuing operations was \$90 million for the year ended December 31, 2003, representing an effective tax benefit rate from continuing operations of 83%, despite the fact that the Company had positive earnings from continuing operations before income taxes. The effective tax benefit rate from continuing operations of 83% differs from the U.S. statutory tax rate of 35% primarily due to earnings from operations in certain lower-taxed jurisdictions outside the U.S., coupled with losses incurred in certain

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jurisdictions that are benefited at a rate equal to or greater than the U.S. federal income tax rate.

The Company's effective tax rate from continuing operations was 15% for the year ended December 31, 2002. The effective tax rate from continuing operations of 15% is less than the U.S. statutory rate of 35% primarily due to the charges for the focused cost reductions and asset impairments being deducted in jurisdictions that have a higher tax rate than the U.S. federal income tax rate, and also due to discrete period tax benefits of \$45 million in connection with the closure of the Company's PictureVision subsidiary and \$46 million relating to the consolidation of the Company's photofinishing operations in Japan and the loss realized from the liquidation of a subsidiary as part of that consolidation. These benefits were partially offset by the impact of recording a valuation allowance to provide for certain tax benefits that the Company would be required to forgo in order to fully realize the benefits of its foreign tax credit carryforwards.

Excluding the effect of discrete period items, the effective tax rate from continuing operations was 18% and 26.5% in 2003 and 2002, respectively. The decrease from 26.5% in 2002 to 18% in 2003 is primarily due to increased earnings in certain lower-taxed jurisdictions outside the U.S. relative to total consolidated earnings.

Net earnings from continuing operations for 2003 were \$199 million, or \$.69 per basic and diluted share, as compared with net earnings from continuing operations for 2002 of \$761 million, or \$2.61 per basic and diluted share, representing a decrease of \$562 million, or 74%. The decrease in net earnings from continuing operations is primarily attributable to the reasons outlined above.

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### DIGITAL & FILM IMAGING SYSTEMS

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Net worldwide sales for the D&FIS segment were \$9,232 million for 2003 as compared with \$9,002 million for 2002, representing an increase of \$230 million, or 3% as reported, or a decrease of 3% excluding the favorable impact of exchange. Approximately 1.9 percentage points of the increase in net sales was attributable to increases related to volume, driven primarily by consumer digital cameras, Printer Dock products, inkjet media and entertainment print films, partially offset by volume declines for traditional consumer film products, and approximately 5.9 percentage points of the increase was attributable to favorable exchange. These increases were partially offset by price/mix declines, primarily driven by consumer digital cameras and traditional products and services, which reduced net sales by approximately 5.0 percentage points.

D&FIS segment net sales in the U.S. were \$3,812 million for the current year as compared with \$4,034 million for the prior year, representing a decrease of \$222 million, or 6%. D&FIS segment net sales outside the U.S. were \$5,420 million for the current year as compared with \$4,968 million for the prior year, representing an increase of \$452 million, or 9% as reported, or a decrease of 1% excluding the favorable impact of exchange.

Net worldwide sales of consumer film products, including 35mm film, Advantix film and one-time-use cameras, decreased 9% in 2003 as compared with 2002, reflecting declines due to lower volumes of 12% and price/mix declines of 3%, partially offset by favorable exchange of 6%.

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Sales of the Company's consumer film products within the U.S. decreased 18% in the current year as compared with the prior year, reflecting declines due to lower volumes of 17% and price/mix declines of 1%. Sales of the Company's consumer film products outside the U.S. decreased 2% in 2003 compared with 2002, reflecting declines in volume of 9% and price/mix declines of 2%, partially offset by favorable exchange of 9%. The lower film product sales are attributable to a declining industry demand driven primarily by the impact of digital substitution and retailer inventory reductions.

The U.S. film industry sell-through volumes decreased approximately 8% in 2003 as compared with 2002 primarily due to the impact of digital substitution. The Company's current estimate of worldwide consumer film industry volumes for 2003 is a decrease of approximately 8%. The Company maintained approximately flat year-over-year blended U.S. consumer film share as it has done for the past several consecutive years.

Net worldwide sales for photofinishing services (excluding equipment), including Qualex in the U.S. and Consumer Imaging Services (CIS) outside the U.S., decreased 15% in 2003 as compared with 2002, reflecting lower volumes and declines in price/mix, partially offset by favorable exchange. In the U.S., Qualex's sales for photofinishing services decreased 19% in 2003 as compared with 2002, and outside of the U.S., CIS sales decreased 8%. These decreases reflect the effects of a continued weak film industry.

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Net sales from the Company's consumer digital products and services, which include picture maker kiosks/media and retail consumer digital services revenue primarily from Picture CD and Retail.com, increased 6% in 2003 as compared with 2002, driven primarily by an increase in sales of kiosks and consumer digital services.

The Company's Ofoto business increased its sales 57% in 2003 as compared with 2002. Ofoto's sales represented less than 1% of the Company's consolidated net worldwide sales for 2003. Ofoto now has more than 11 million members and continues to be the market leader in the online photo services space.

Net worldwide sales of consumer digital cameras increased 79% in 2003 as compared with 2002, driven almost entirely by strong increases in volume, which were partially offset by declines in price/mix. Sales continue to be driven by strong consumer acceptance of the EasyShare digital camera system, as reflected in increased market share in a rapidly growing market.

Although some of Kodak's largest channels do not report share data, Kodak continues to hold one of the top U.S. digital camera market share positions in channels reporting share data, attaining the number three share position for the full year, after attaining the top spot for the fourth quarter alone. Outside of the U.S., Kodak placed in the top four market share positions in 6 out of 9 key markets in the fourth quarter, and in the top four in 5 out of 9 key markets for the full year. Consumer digital cameras were profitable on a fully allocated basis for the second half of 2003.

Kodak's new Printer Dock products, initially launched in the spring of 2003, experienced strong sales growth in the fourth quarter of 2003, strengthening their number two share position in the U.S. snapshot printer market and putting them on track to be a \$100 million business in the first full year of sales.

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Net worldwide sales of inkjet photo paper increased 32% in 2003 as compared with 2002, primarily due to higher volumes. Kodak continued to maintain its shared leader market share position in the U.S. in 2003. The double-digit revenue growth and the maintenance of market share are primarily attributable to strong underlying market growth and the continued growth and acceptance of a new line of small format inkjet papers.

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Net worldwide sales of professional film capture products, including color negative, color reversal and commercial black and white films, decreased 13% in 2003 as compared with 2002, primarily reflecting declines in volume and negative price/mix, partially offset by favorable exchange. Sales declines of professional film capture products resulted primarily from the ongoing impact of digital substitution. Net worldwide sales of professional sensitized output, including color negative paper and display materials, increased 2% in 2003 as compared with 2002, primarily reflecting an increase related to favorable exchange, partially offset by declines in volume and negative price/mix. In addition, net worldwide sales of professional digital cameras and digital writers increased during 2003.

Net worldwide sales of origination and print film to the entertainment industry increased 11% in 2003 as compared with 2002, primarily reflecting higher print film volumes and favorable exchange, partially offset by negative price/mix.

Gross profit for the D&FIS segment was \$2,861 million for 2003 as compared with \$3,219 million for 2002, representing a decrease of \$358 million or 11%. The gross profit margin was 31.0% in the current year as compared with 35.8% in the prior year. The 4.8 percentage point decrease was primarily attributable to decreases in price/mix that impacted gross profit margins by approximately 6.6 percentage points, partially offset by an increase in manufacturing cost improvements and favorable exchange, which impacted gross margins by approximately 0.7 and 1.1 percentage points, respectively. The decrease in price/mix was primarily due to the impact of digital substitution, resulting in a decrease in sales of higher margin traditional products, the impact of which was only partially offset by increased sales of lower margin digital products.

SG&A expenses for the D&FIS segment were \$1,962 million for 2003 as compared with \$1,935 million for 2002, representing an increase of \$27 million or 1%. The net increase in SG&A spending is primarily attributable to unfavorable exchange of \$96 million and an increase in the benefit rate, partially offset by cost savings realized from position eliminations associated with ongoing focused cost reduction programs. As a percentage of sales, SG&A expense decreased slightly from 21.5% in the prior year to 21.3% in the current year.

R&D costs for the D&FIS segment decreased \$32 million or 6% from \$513 million in 2002 to \$481 million in 2003. As a percentage of sales, R&D costs decreased slightly from 5.7% in the prior year to 5.2% in the current year. The decrease in R&D is primarily due to cost savings realized from position eliminations associated with ongoing focused cost reduction programs. These cost savings were partially offset by \$21 million of write-offs for purchased in-process R&D associated with an acquisition made in 2003.

Earnings from continuing operations before interest, other charges, net, and income taxes for the D&FIS segment decreased \$353 million, or



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46%, from \$771 million in 2002 to \$418 million in 2003, primarily as a result of the factors described above.

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### HEALTH IMAGING

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On October 7, 2003, the Company completed the acquisition of all of the outstanding shares of PracticeWorks, Inc., a leading provider of dental practice management software and digital radiographic imaging systems for approximately \$475 million in cash, inclusive of transaction costs, and assumed net debt of approximately \$20 million. This acquisition is expected to contribute approximately \$200 million in sales to the Health Imaging segment during the first full year. At the time of the acquisition, it was anticipated that the transaction would be slightly dilutive to earnings from the date of acquisition through the end of 2005 and accretive to earnings thereafter. However, based on ongoing success in the execution of the integration, it is anticipated to become accretive to earnings sometime during 2005, ahead of the original execution plan. This acquisition will enable Kodak to offer its customers a full spectrum of dental imaging products and services from traditional film to digital radiography and photography, and is expected to move Health Imaging into the leading position in the dental practice management and dental radiographic markets.

Net worldwide sales for the Health Imaging segment were \$2,431 million for 2003 as compared with \$2,274 million for 2002, representing an increase of \$157 million, or 7% as reported, or an increase of 2% excluding the favorable impact of exchange. The increase in sales was comprised of: (1) an increase from favorable exchange of approximately 5.4 percentage points, (2) the acquisition of PracticeWorks Inc. in October 2003, which accounted for approximately 2.0 percentage points of the sales increase as it contributed \$48 million to 2003 sales of dental systems, and (3) an increase in volume of approximately 2.9 percentage points, driven primarily by volume increases in digital products. These increases were partially offset by declines in price/mix of approximately 3.3 percentage points, which were related to both digital and traditional products.

Net sales in the U.S. were \$1,061 million for the current year as compared with \$1,088 for the prior year, representing a decrease of \$27 million, or 2%. Net sales outside the U.S. were \$1,370 million for 2003 as compared with \$1,186 million for 2002, representing an increase of \$184 million, or 16% as reported, or an increase of 6% excluding the favorable impact of exchange.

Net worldwide sales of digital products, which include laser printers (DryView imagers and wet laser printers), digital media (DryView and wet laser media), digital capture equipment (computed radiography capture equipment and digital radiography equipment), services, dental practice management software, and Healthcare Information Systems (HCIS) including Picture Archiving and Communications Systems (PACS), increased 14% in 2003 as compared with 2002. The increase in digital product sales was primarily attributable to favorable exchange, higher volumes of digital media, digital capture equipment and services, and the PracticeWorks acquisition. Service revenues increased due to an increase in digital equipment service contracts during 2003 as compared with the prior year. These increases were partially offset by declines in price/mix for digital media and digital capture equipment.

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Net worldwide sales of traditional products, including analog film, equipment, chemistry and services, decreased 1% in 2003 as compared with 2002, reflecting declines in volume and negative price/mix almost entirely offset by favorable exchange.

Gross profit for the Health Imaging segment was \$1,049 million for 2003 as compared with \$930 million for 2002, representing an increase of \$119 million, or 13%. The gross profit margin was 43.2% in 2003 as compared with 40.9% in 2002. The increase in the gross profit margin of 2.3 percentage points was primarily attributable to: (1) a decrease in manufacturing cost, which increased gross profit margins by approximately 3.2 percentage points, primarily due to favorable media and equipment manufacturing cost led by DryView digital media and digital capture equipment, complemented by lower service costs, (2) favorable exchange, which contributed approximately 1.1 percentage points to the gross profit margin, and (3) the acquisition of PracticeWorks in the fourth quarter of 2003, which increased gross profit margins by approximately 0.4 percentage points for the current year. These increases were partially offset by decreases attributable to price/mix, which negatively impacted gross profit margins by 2.4 percentage points due to lower prices for digital media, digital capture equipment and analog medical film.

SG&A expenses for the Health Imaging segment increased \$43 million, or 12%, from \$347 million for 2002 to \$390 million for 2003. As a percentage of sales, SG&A expenses increased from 15.3% for 2002 to 16.0% for 2003. The increase in SG&A expenses is primarily due to the acquisition of PracticeWorks, which had \$22 million of SG&A expenses in 2003, an increase in the benefit rate, and the unfavorable impact of exchange which accounted for \$16 million of the increase.

R&D costs for the Health Imaging segment increased \$26 million, or 17%, from \$152 million in 2002 to \$178 million in 2003. As a percentage of sales, R&D costs increased from 6.7% in 2002 to 7.3% in 2003. The increase is primarily due to \$12 million of R&D costs associated with the acquisition of PracticeWorks, \$10 million of which was a one-time write-off of purchased in-process R&D. The remainder of the increase is due to increased spending to drive growth in selected areas of the product portfolio.

Earnings from continuing operations before interest, other charges, net, and income taxes for the Health Imaging segment increased \$50 million, or 12%, from \$431 million for 2002 to \$481 million for 2003 due primarily to the reasons described above.

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### COMMERCIAL IMAGING

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On February 9, 2004, the Company announced its intent to sell the assets and business of the Remote Sensing Systems operation, including the stock of Kodak's wholly owned subsidiary, Research Systems, Inc., collectively known as RSS, to ITT Industries for \$725 million in cash. RSS, a leading provider of specialized imaging solutions to the aerospace and defense community, is part of the Company's commercial & government systems' operation within the Commercial Imaging segment and its customers include NASA, other U.S. government agencies, and aerospace and defense companies. The sale of RSS is expected to result in an after-tax gain of approximately \$390 million. Taking into account both the after-tax gain on the sale and the loss of operational results of RSS, the Company expects that the sale will positively

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impact earnings by approximately \$1.31 per share in 2004. The after-tax gain and expected impact to earnings per share for 2004 as a result of the RSS sale excludes the potential impacts from any settlement or curtailment gains or losses that may be incurred in connection with the Company's pension and postretirement benefit plans, as these amounts are not currently determinable. The Company has accounted for the sale of RSS as a discontinued operation in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and, thus, all the financial results presented below for the Commercial Imaging segment exclude RSS.

Net worldwide sales for the Commercial Imaging segment remained constant at \$791 million for both 2003 and 2002, or a decrease of 6% excluding the favorable impact of exchange. Favorable exchange and price/mix, which contributed approximately 6.1 and 0.3 percentage points, respectively, to 2003 sales, respectively, was entirely offset by decreases due to volume of approximately 6.4 percentage points, primarily driven by declines in document imaging products and services.

Net sales in the U.S. were \$334 million for 2003 as compared with \$366 million for 2002, representing a decrease of \$32 million, or 9%. Net sales outside the U.S. were \$457 million in the current year as compared with \$425 million in the prior year, representing an increase of \$32 million, or 8%, or a decrease of 4% excluding the favorable impact of exchange.

Gross profit for the Commercial Imaging segment for 2003 decreased \$13 million, or 5%, from \$282 million for 2002 to \$269 million for 2003. The gross profit margin was 34.0% for 2003 as compared with 35.7% for 2002. The decrease in the gross profit margin of 1.7 percentage points was attributable to an increase in manufacturing cost, which negatively impacted gross profit margins by approximately 2.2 percentage points, partially offset by exchange, which favorably impacted gross profit margins by 0.5 percentage points.

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SG&A expenses for the Commercial Imaging segment remained constant at \$134 million for both 2003 and 2002. As a percentage of sales, SG&A expenses also remained constant at 16.9% for both years.

R&D costs for the Commercial Imaging segment decreased \$7 million, or 23%, from \$30 million for 2002 to \$23 million for 2003. As a percentage of sales, R&D costs decreased from 3.8% in 2002 to 2.9% in 2003.

Earnings from continuing operations before interest, other charges, net, and income taxes for the Commercial Imaging segment decreased \$6 million, or 5%, from \$118 million in 2002 to \$112 million in 2003. The decrease in earnings from operations is primarily attributable to the reasons outlined above.

### GRAPHIC COMMUNICATIONS

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Net worldwide sales for the Graphic Communications segment were \$346 million for 2003 as compared with \$402 million for 2002, representing a decrease of \$56 million, or 14% as reported, with no impact from exchange. The decrease in net sales was due to: (1) declines in volume of approximately 9.6 percentage points, which was primarily attributable to graphics products, and (2) declines due to price/mix of approximately 4.7 percentage points, which was also driven by graphics

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products.

Net sales in the U.S. were \$156 million for 2003 as compared with \$174 million for 2002, representing a decrease of \$18 million, or 10%. Net sales outside the U.S. were \$190 million in the current year as compared with \$228 million in the prior year, representing a decrease of \$38 million, or 17%, with no impact from exchange.

Net worldwide sales of graphic arts products to Kodak Polychrome Graphics (KPG), an unconsolidated joint venture affiliate in which the Company has a 50% ownership interest, decreased 14% in 2003 as compared with 2002, reflecting declines in both volume and price/mix in graphic arts film. This reduction was primarily due to the effects of digital substitution.

Gross profit for the Graphic Communications segment for 2003 decreased \$40 million, or 46%, from \$87 million for 2002 to \$47 million for 2003. The gross profit margin was 13.6% for 2003 as compared with 21.6% for 2002. The decrease in the gross profit margin of 8.0 percentage points was attributable to: (1) declines attributable to price/mix, which reduced gross profit margins by approximately 4.7 percentage points primarily due to declining contributions from traditional graphic arts products for the reasons outlined above, (2) unfavorable exchange, which negatively impacted gross profit margins by 2.8 percentage points, and (3) an increase in manufacturing cost, which negatively impacted gross profit margins by approximately 0.5 percentage points.

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SG&A expenses for the Graphics Communications segment remained constant at \$37 million for both 2003 and 2002. As a percentage of sales, SG&A expenses increased from 9.2% for 2002 to 10.7% for 2003, primarily due to the impact of unfavorable exchange and an increase in the benefit rate.

R&D costs for the Graphics Communications segment decreased \$6 million, or 21%, from \$29 million for 2002 to \$23 million for 2003. As a percentage of sales, R&D costs decreased from 7.2% in 2002 to 6.6% in 2003. The decline was primarily related to a decrease of approximately \$9 million in ENCAD Inc.'s R&D spending in 2003 as compared with 2002.

Earnings or losses from continuing operations before interest, other charges, net, and income taxes for the Graphics Communications segment decreased \$34 million, or 162%, from earnings of \$21 million in 2002 to losses of \$13 million in 2003. The decrease in earnings from operations is primarily attributable to the reasons outlined above.

KPG's earnings performance continues to improve driven primarily by its world-leading position in the growth segments of digital proofing and digital printing plates, coupled with favorable foreign exchange. KPG's operating profit has been positive for 14 consecutive quarters and has shown consistent improvement during that same period. The Company's equity in the earnings of KPG contributed positive results to other charges, net during 2003.

NexPress, the unconsolidated joint venture between Kodak and Heidelberg in which the Company has a 50% ownership interest, continues to increase unit placements of the NexPress 2100 Digital Production Color Press despite a weak printing market, with good customer acceptance.

On March 8, 2004, the Company announced that it had agreed with Heidelberger Druckmaschinen AG (Heidelberg) to purchase Heidelberg's 50 percent interest in NexPress, a 50/50 joint venture of Kodak and

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Heidelberg that makes high-end, on-demand digital color printing systems, and the equity of Heidelberg Digital LLC, a leading maker of digital black-and-white variable-data printing systems. Kodak also will acquire NexPress GmbH, a German subsidiary of Heidelberg that provides engineering and development support, and certain inventory, assets, and employees of Heidelberg's regional operations or market centers. The Company will not pay any cash at closing for the businesses being acquired. 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 are met during the next two calendar years ending December 31, 2005, the Company will pay a maximum of \$150 million in cash. Additional payments may also be made if certain sales goals are met during a five-year period following the closing of the transaction. This acquisition, which is expected to close in May 2004, advances the Company's strategy of diversifying its business portfolio, and accelerates its participation in the digital commercial printing industry. The Company expects this acquisition to incrementally increase revenue by approximately \$175 million over the remainder of 2004. The impact of these acquisitions to 2004 net earnings cannot be accurately estimated until the Company completes the acquisition.

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### OTHER

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Net worldwide sales for All Other were \$93 million for 2003 as compared with \$80 million for 2002, representing an increase of \$13 million, or 16%. Net sales in the U.S. were \$42 million in 2003 as compared with \$45 million for 2002, representing a decrease of \$3 million, or 7%. Net sales outside the U.S. were \$51 million in the current year as compared with \$35 million in the prior year, representing an increase of \$16 million, or 46%.

SK Display Corporation, the OLED panel manufacturing joint venture between Kodak and Sanyo, supplies OLED screens to the Company for its digital camera manufacturing, and continues to focus on improving manufacturing yields. Kodak supplies OLED chemicals and materials to SK Display, and has created a new generation of chemistry that is currently being tested.

Loss from continuing operations before interest, other charges, net, and income taxes for All Other increased \$48 million from a loss of \$27 million in 2002 to a loss of \$75 million in 2003. Increased levels of investment for the Company's display business primarily drove the increase in the loss from operations.

### RESULTS OF OPERATIONS - DISCONTINUED OPERATIONS

Earnings from discontinued operations for 2003 were \$66 million, or \$.23 per basic and diluted share, as compared with earnings from discontinued operations for 2002 of \$9 million, or \$.03 per basic and diluted share. The earnings from discontinued operations of \$66 million for 2003 reflects net of tax earnings of \$39 million related to the operations of RSS, and net of tax earnings of \$27 million primarily related to reversals of tax and environmental reserves as described below.

During the first quarter of 2003, the Company reversed a tax reserve of \$15 million through discontinued operations. The reversal of the tax

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reserve was triggered by the Company's repurchase of certain properties that were initially sold in connection with the 1994 divestiture of Sterling Winthrop Inc., which represented a portion of the Company's non-imaging health businesses. The repurchase of these properties will allow the Company to directly manage the environmental remediation that the Company is required to perform in connection with those properties, which will result in better overall cost control. In addition, the repurchase eliminated the uncertainty regarding the recoverability of tax benefits associated with the indemnification payments that were previously being made to the purchaser.

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During the fourth quarter of 2003, the Company recorded a net of tax credit of \$7 million through discontinued operations for the reversal of an environmental reserve, which was primarily attributable to positive developments in the Company's remediation efforts relating to a formerly owned manufacturing site in the U.S. In addition, during the fourth quarter of 2003, the Company reversed state income tax reserves of \$3 million, net of tax, through discontinued operations due to the favorable outcome of tax audits in connection with a formerly owned business.

The earnings from discontinued operations of \$9 million for 2002 reflects net of tax earnings of \$32 million related to the operations of RSS, and net of tax earnings of \$12 million related to the favorable outcome of litigation associated with the 1994 sale of Sterling Winthrop Inc. These earnings were partially offset by losses incurred from the shutdown of Kodak Global Imaging, Inc. (KGII), which amounted to \$35 million net of tax.

### NET EARNINGS

Net earnings for 2003 were \$265 million, or \$.92 per basic and diluted share, as compared with net earnings for 2002 of \$770 million, or \$2.64 per basic and diluted share, representing a decrease of \$505 million, or 66%. This decrease is primarily attributable to the reasons outlined above.

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### 2002 COMPARED WITH 2001

#### RESULTS OF OPERATIONS - CONTINUING OPERATIONS

#### CONSOLIDATED

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Net worldwide sales were \$12,549 million for 2002 as compared with \$12,976 million for 2001, representing a decrease of \$427 million, or 3% as reported, or a decrease of 4% excluding the favorable impact of exchange. Declines in volume accounted for approximately 1.5 percentage points of the sales decrease, driven primarily by volume decreases in traditional film and U.S. photofinishing services. Declines in price/mix reduced sales for 2002 by approximately 2.5 percentage points, driven primarily by traditional consumer film products and health film and laser imaging systems. These decreases were partially offset by favorable exchange, which increased 2002 sales by approximately 1.0 percentage point.

Net sales in the U.S. were \$5,707 million for the current year as compared with \$6,206 million for the prior year, representing a

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decrease of \$499 million, or 8%. Net sales outside the U.S. were \$6,842 million for the current year as compared with \$6,770 million for the prior year, representing an increase of \$72 million, or 1% as reported, or a decrease of 1% excluding the favorable impact from exchange.

Net sales in EAMER for 2002 were \$3,491 million as compared with \$3,333 million for 2001, representing an increase of 5% as reported, or 1% excluding the favorable impact of exchange. Net sales in the Asia Pacific region for 2002 increased slightly from \$2,231 million for 2001 to \$2,240 million for 2002, with no impact from exchange. Net sales in the Canada and Latin America region for 2002 were \$1,111 million as compared with \$1,206 million for 2001, representing a decrease of 8% as reported, or an increase of 6% excluding the negative impact of exchange.

Net sales in emerging markets were \$2,425 million for 2002 as compared with \$2,371 million for 2001, representing an increase of \$54 million, or 2%. Sales growth in China and Russia of 25% and 20%, respectively, were the primary drivers of the increase in sales in emerging markets, partially offset by decreased sales in Argentina, Brazil and Mexico of 53%, 11% and 6%, respectively. The sales growth in China resulted from strong business performance for health and consumer products. The increase in sales in Russia is a result of continued growth in the number of Kodak Express stores, which represent independently owned photo specialty retail outlets, and the Company's efforts to expand the distribution channels for Kodak products and services. The sales declines in Argentina, Brazil and Mexico were reflective of the continued economic weakness currently being experienced by many Latin American emerging market countries. The emerging market portfolio accounted for approximately 19% and 35% of the Company's worldwide and non-U.S. sales, respectively, in 2002.

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Gross profit was \$4,527 million for 2002 as compared with \$4,488 million for 2001, representing an increase of \$39 million, or 1%. The gross profit margin was 36.1% in the current year as compared with 34.6% in the prior year. The increase of 1.5 percentage points was primarily attributable to manufacturing cost, which favorably impacted gross profit margins by approximately 2.8 percentage points year-over-year due to reduced labor expense, favorable materials pricing and improved product yields. This increase was also attributable to costs associated with restructuring and the exit of an equipment manufacturing facility incurred in 2001 but not in the current year, which negatively impacted gross profit margins for 2001 by approximately 1.0 percentage point. The positive impacts to gross profit were partially offset by year-over-year price/mix declines, which reduced gross profit margins by approximately 2.3 percentage points. The price/mix decreases were primarily related to consumer film, health laser imaging systems and consumer color paper, and product shifts primarily in the D&FIS segment.

SG&A expenses were \$2,504 million for 2002 as compared with \$2,592 million for 2001, representing a decrease of \$88 million, or 3%. As a percentage of sales, SG&A expenses remained flat at 20.0% for both the current and prior years. The net decrease in SG&A is primarily attributable to the cost savings from the employment reductions and other non-severance related components of the Company's focused cost reductions, offset by acquisitions in the D&FIS and Graphic Communications segments and higher strategic venture investment impairments in 2002 when compared with 2001 of \$15 million.

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R&D costs were \$757 million for 2002 as compared with \$777 million for 2001, representing a decrease of \$20 million, or 3%. As a percentage of sales, R&D costs also remained constant at 6.0% for both the current and prior years.

Earnings from continuing operations before interest, other charges, net, and income taxes for 2002 were \$1,168 million as compared with \$319 million for 2001, representing an increase of \$849 million, or 266%. The primary reason for the increase in earnings from operations was a decrease in restructuring costs and asset impairments of \$580 million. Results for 2002 also benefited from the savings associated with restructuring programs implemented in 2001. In addition, results for 2001 included charges of \$138 million for the Wolf bankruptcy charge, environmental reserve and Kmart bankruptcy, and goodwill amortization charges of \$147 million.

Interest expense for 2002 was \$173 million as compared with \$218 million for 2001, representing a decrease of \$45 million, or 21%. The decrease in interest expense is primarily attributable to lower average borrowing levels and lower interest rates in 2002 relative to 2001.

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Other charges for the current year were a net charge of \$101 million as compared with a net charge of \$18 million for the prior year. The increase in other charges, net is primarily attributable to increased losses from the Company's NexPress and SK Display joint ventures as these business ventures are in the early stages of bringing their offerings to market, higher non-strategic venture investment impairments, higher losses related to minority interests and an increase in foreign exchange losses. This activity was partially offset by a gain recognized on the sale of assets in the current year.

The Company's effective tax rate from continuing operations decreased from 27% for 2001 to 15% for 2002. The effective tax rate from continuing operations of 15% for 2002 is less than the U.S. statutory rate of 35% primarily due to the charges for the focused cost reductions and asset impairments being deducted in jurisdictions that have a higher tax rate than the U.S. federal income tax rate, and also due to discrete period tax benefits of \$45 million in connection with the closure of the Company's PictureVision subsidiary and \$46 million relating to the consolidation of the Company's photofinishing operations in Japan and the loss realized from the liquidation of a subsidiary as part of that consolidation. These benefits were partially offset by the impact of recording a valuation allowance to provide for certain tax benefits that the Company would be required to forgo in order to fully realize the benefits of its foreign tax credit carryforwards.

The effective tax rate from continuing operations of 27% for 2001 is less than the U.S. statutory rate of 35% primarily because of a tax benefit from favorable tax settlements in the third quarter of 2001, which was partially offset by the impact of nondeductible goodwill amortization in 2001.

Excluding the items described above, the Company's effective tax rate from continuing operations decreased from 30.5% for 2001 to 26.5% for 2002. The lower effective tax rate from continuing operations in the current year as compared with the prior year is primarily attributable to the tax benefits from the elimination of goodwill amortization in 2002 and further increases in earnings in lower tax rate jurisdictions.

Net earnings from continuing operations for 2002 were \$761 million, or



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\$2.61 per basic and diluted share, as compared with net earnings from continuing operations for 2001 of \$61 million, or \$.21 per basic and diluted share, representing an increase of \$700 million. The increase in net earnings from continuing operations is primarily attributable to the reasons outlined above.

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### DIGITAL & FILM IMAGING SYSTEMS

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Net worldwide sales for the D&FIS segment were \$9,002 million for 2002 as compared with \$9,403 million for 2001, representing a decrease of \$401 million, or 4% as reported, with no net impact from exchange. Approximately 2.0 percentage points of the decrease was attributable to declines in volume, driven primarily by volume decreases in consumer and professional film and photofinishing, and approximately 2.0 percentage points of the decrease was attributable to declines due to price/mix, driven primarily by consumer film products.

D&FIS segment net sales in the U.S. were \$4,034 million for the current year as compared with \$4,482 million for the prior year, representing a decrease of \$448 million, or 10%. D&FIS segment net sales outside the U.S. were \$4,968 million for the current year as compared with \$4,921 million for the prior year, representing an increase of \$47 million, or 1% as reported, with no impact from exchange.

Net worldwide sales of consumer film products, including 35mm film, Advantix film and one-time-use cameras, decreased 6% in 2002 as compared with 2001, reflecting declines due to lower volumes of 2%, negative price/mix of 3%, and 1% negative impact of exchange. Sales of the Company's consumer film products within the U.S. decreased 12% in the current year as compared with the prior year, reflecting declines due to lower volumes of 7% and negative price/mix of 5%. The lower film product sales are attributable to a declining industry demand driven by a weak economy and the impact of digital substitution. Sales of the Company's consumer film products outside the U.S. remained flat, with declines related to negative exchange of 1% offsetting increases related to higher volumes of 1%.

The U.S. film industry volume decreased approximately 3% in 2002 as compared with 2001 due to continuing economic weakness and the impact of digital substitution. For the fifth consecutive year, the Company has met its goal of maintaining full year U.S. consumer film market share.

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Net worldwide photofinishing sales, including Qualex in the U.S. and CIS outside the U.S., decreased 4% in 2002 as compared with 2001, 5% of which was attributable to lower volumes, partially offset by 1% favorable impact of exchange. In the U.S., Qualex's processing volumes (wholesale and on-site) decreased approximately 14% in 2002 as compared with 2001, which is composed of decreases in wholesale and on-site processing volumes of 13% and 16%, respectively. These declines reflect the effects of a continued weak film industry, the adverse impact of several hundred store closures by a major U.S. retailer, and the impact of digital substitution. During the current year, CIS revenues in Europe benefited from the acquisition of: (1) Spector Photo Group's wholesale photofinishing and distribution operations in France, Germany, and Austria, (2) ColourCare Limited's wholesale processing and printing operations in the United Kingdom, and (3) Percolor photofinishing operations in Spain. These benefits were partially

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offset by weak industry trends for photofinishing in the second half of the year.

Net sales from the Company's consumer digital products and services, which include picture maker kiosks/media and consumer digital services revenue from Picture CD, "You've Got Pictures" and Retail.com, remained flat in 2002 as compared with 2001. The Company has broadly enabled the retail industry in the U.S. with its picture maker kiosks and is focused on bringing to market new kiosk offerings, creating new kiosk channels, expanding internationally and continuing to increase the media burn per kiosk. Net worldwide sales of thermal media used in picture maker kiosks increased 11% in the current year as compared with the prior year.

Net worldwide sales of consumer digital cameras increased 10% in 2002 as compared with 2001 due to strong consumer acceptance of the EasyShare digital camera system, despite sensor component shortages earlier in the year. As a result, consumer digital camera market share increased modestly in 2002 compared with 2001.

Net worldwide sales of inkjet photo paper increased 43% in 2002 as compared with 2001, primarily due to higher volumes. The double-digit revenue growth and the maintenance of market share are primarily attributable to strong underlying market growth, introduction of new products, continued promotional activity at key accounts and success in broadening channel distribution.

Net worldwide sales of professional sensitized products, including color negative, color reversal and commercial black and white films and sensitized paper, decreased 13% in 2002 as compared with 2001, reflecting primarily a decline in volume, with no impact from exchange. Overall sales declines were primarily the result of ongoing digital substitution and continued economic weakness in markets worldwide.

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Net worldwide sales of origination and print film to the entertainment industry remained flat in 2002 as compared with 2001, with a 1% favorable impact from exchange offset by a 1% decline attributable to lower volumes. The decrease in volumes of net worldwide film sales was primarily attributable to economic factors impacting origination film for commercials and independent feature films, partially offset by an increase in print film volumes.

Gross profit for the D&FIS segment was \$3,219 million for 2002 as compared with \$3,402 million for 2001, representing a decrease of \$183 million or 5%. The gross profit margin was 35.8% in the current year as compared with 36.2% in the prior year. The 0.4 percentage point decrease was primarily attributable to decreases due to price/mix that impacted gross profit margins by approximately 3.0 percentage points, partially offset by an increase due to productivity/cost improvements that impacted gross margins by approximately 2.6 percentage points.

SG&A expenses for the D&FIS segment were \$1,935 million for 2002 as compared with \$1,963 million for 2001, representing a decrease of \$28 million or 1%. The net decrease in SG&A spending is primarily attributable to cost reduction activities and expense management, partially offset by increases in SG&A expense related to CIS photofinishing acquisitions in Europe. As a percentage of sales, SG&A expense increased from 20.9% in the prior year to 21.5% in the current year.

R&D costs for the D&FIS segment decreased \$29 million or 5% from \$542

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million in 2001 to \$513 million in 2002. As a percentage of sales, R&D costs decreased slightly from 5.8% in the prior year to 5.7% in the current year.

Earnings from continuing operations before interest, other charges, net, and income taxes for the D&FIS segment decreased \$16 million, or 2%, from \$787 million in 2001 to \$771 million in 2002, reflecting the combined effects of lower sales and a lower gross profit margin, partially offset by SG&A and R&D cost reductions and the elimination of goodwill amortization in 2002, which was \$110 million in 2001.

### HEALTH IMAGING

Net worldwide sales for the Health Imaging segment were \$2,274 million for 2002 as compared with \$2,262 million for 2001, representing an increase of \$12 million, or 1% as reported, or an increase of 2% excluding the negative net impact of exchange. The increase in sales was attributable to an increase in price/mix and volume of approximately 0.4 and 1.1 percentage points, respectively, primarily due to laser imaging systems and equipment services, partially offset by a decrease from negative exchange of approximately 0.8 percentage points.

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Net sales in the U.S. decreased slightly from \$1,089 million for the prior year to \$1,088 million for the current year. Net sales outside the U.S. were \$1,186 million for 2002 as compared with \$1,173 million for 2001, representing an increase of \$13 million, or 1% as reported, or an increase of 2% excluding the negative impact of exchange.

Net worldwide sales of digital products, which include laser printers (DryView imagers and wet laser printers), digital media (DryView and wet laser media), digital capture equipment (computed radiography capture equipment and digital radiography equipment), services and Picture Archiving and Communications Systems (PACS), increased 5% in 2002 as compared with 2001. The increase in digital product sales was primarily attributable to higher digital media, service, digital capture and PACS volumes as the market for these products continues to grow.

Net worldwide sales of traditional products, including analog film, equipment, chemistry and services, decreased 4% in 2002 as compared with 2001. The decrease in sales was primarily attributable to a net decline in sales of analog film products. This net decrease was partly mitigated by an increase in sales of Mammography and Oncology (M&O) analog film products. Analog film products (excluding M&O) decreased 8% in 2002 as compared with 2001, reflecting declines due to volume, exchange and price/mix of approximately 5%, 2% and 1%, respectively. Although analog film volumes declined on a worldwide basis, current sales levels reflect an increase in traditional film market share. M&O sales increased 6% in the current year as compared with the prior year, reflecting higher volumes of approximately 8%, partially offset by decreases in price/mix and exchange of approximately 1% and 1%, respectively.

Gross profit for the Health Imaging segment was \$930 million for 2002 as compared with \$869 million for 2001, representing an increase of \$61 million, or 7%. The gross profit margin was 40.9% in 2002 as compared with 38.4% in 2001. The 2.5 percentage point increase was attributable to productivity/cost improvements, which increased gross profit margins

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by 2.9 percentage points due to favorable media and equipment manufacturing cost led by DryView digital media, analog medical film, laser imaging equipment and PACS, which were complemented by lower service costs and improved supply chain management. The positive effects of productivity/cost on gross profit margins were partially offset by a decrease in price/mix that impacted margins by approximately 0.5 percentage points due to declining digital laser media and analog medical film prices.

SG&A expenses for the Health Imaging segment decreased \$20 million, or 5%, from \$367 million for 2001 to \$347 million for 2002. As a percentage of sales, SG&A expenses decreased from 16.2% for 2001 to 15.3% for 2002. The decrease in SG&A expenses is primarily a result of cost reduction activities and expense management.

R&D costs for the Health Imaging segment remained constant at \$152 million for 2002 and 2001. As a percentage of sales, R&D costs remained unchanged at 6.7% for both years.

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Earnings from continuing operations before interest, other charges, net, and income taxes for the Health Imaging segment increased \$108 million, or 33%, from \$323 million for 2001 to \$431 million for 2002. The increase in earnings from operations and the resulting operational earnings margin are primarily attributable to the combined effects of improvements in gross profit margins, lower SG&A expense, and the elimination of goodwill amortization in 2002, which was \$28 million in 2001.

### COMMERCIAL IMAGING

Net worldwide sales for the Commercial Imaging segment for 2002 decreased from \$838 million for 2001 to \$791 million for 2002, representing a decrease of \$47 million, or 6%, or a decrease of 7% excluding the favorable impact of exchange. The decrease in sales was attributable to declines in volume of approximately 9.0 percentage points primarily related to document imaging products and services, partially offset by increases due to price/mix of approximately 1.6 percentage points and favorable exchange of approximately 1.1 percentage points.

Net sales in the U.S. were \$366 million for 2002 as compared with \$401 million for 2001, representing a decrease of \$35 million, or 9%. Net sales outside the U.S. were \$425 million in the current year as compared with \$437 million in the prior year, representing a decrease of \$12 million, or 3%, or a decrease of 5% excluding the favorable impact of exchange.

Gross profit for the Commercial Imaging segment for 2002 decreased slightly from \$286 million for 2001 to \$282 million for 2002. The gross profit margin was 35.7% for 2002 as compared with 34.1% for 2001. The increase in the gross profit margin of 1.6 percentage points was due to declines in manufacturing cost, which improved margins by approximately 1.4 percentage points, and favorable exchange, which improved gross profit margins by 0.2 percentage points.

SG&A expenses for the Commercial Imaging segment decreased \$26 million, or 16%, from \$160 million for 2001 to \$134 million for 2002. As a percentage of sales, SG&A expenses decreased from 19.1% for 2001 to 16.9% for 2002. The primary contributors to the decrease in SG&A

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expenses were cost reductions from the prior year restructuring actions, which had a larger impact on the results of 2002 as compared with 2001.

R&D costs for the Commercial Imaging segment decreased \$3 million, or 9%, from \$33 million for 2001 to \$30 million for 2002. As a percentage of sales, R&D costs decreased from 3.9% in 2001 to 3.8% in 2002.

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Earnings from continuing operations before interest, other charges, net, and income taxes for the Commercial Imaging segment increased \$34 million, or 40%, from \$84 million in 2001 to \$118 million in 2002. The increase in earnings from operations is primarily attributable to overall expense management and the elimination of goodwill amortization in 2002, which was \$9 million in 2001.

### GRAPHIC COMMUNICATIONS

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Net worldwide sales for the Graphic Communications segment were \$402 million for 2002 as compared with \$387 million for 2001, representing an increase of \$15 million, or 4% as reported, with no impact from exchange. The increase in net sales was due to increases in volume of approximately 5.0 percentage points, which was primarily driven by inkjet products. The increases in volume were partially offset by declines due to price/mix of approximately 0.9 percentage points, which was primarily driven by graphics products.

Net sales in the U.S. were \$174 million for 2002 as compared with \$178 million for 2001, representing a decrease of \$4 million, or 2%. Net sales outside the U.S. were \$228 million in the current year as compared with \$209 million in the prior year, representing an increase of \$19 million, or 9%, with no impact from exchange.

Net worldwide sales for inkjet products were a contributor to the net increase in Graphic Communications sales as these revenues increased 175% in 2002 as compared with 2001. The increase in sales was attributable to the 2002 acquisition of ENCAD, Inc., which represented approximately 17% of total net worldwide Graphic Communications segment sales for 2002 and virtually all of the 175% increase in sales of inkjet products. The acquisition of ENCAD has improved the Company's channel to the inkjet printer market.

Net worldwide sales of graphic arts products to Kodak Polychrome Graphics (KPG), an unconsolidated joint venture affiliate in which the Company has a 50% ownership interest, decreased 10% in 2002 as compared with 2001, reflecting declines in both volume and price/mix in graphic arts film. This reduction was primarily due to the effects of digital substitution. The Company's equity in the earnings of KPG contributed positive results to other charges, net during 2002, but was not material to the Company's results from operations.

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Gross profit for the Graphic Communications segment remained constant at \$87 million for both 2002 and 2001. The gross profit margin was 21.6% for 2002 as compared with 22.5% for 2001. The decrease in the gross profit margin of 0.9 percentage points was attributable to: (1) declines attributable to price/mix, which reduced gross profit margins by approximately 4.0 percentage points primarily due to declining

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contributions from traditional graphic arts products for the reasons outlined above, (2) unfavorable exchange, which negatively impacted gross profit margins by approximately 0.5 percentage points. These declines were partially offset by an increase in gross profit margins resulting from a decrease in manufacturing cost, which favorably impacted margins by approximately 3.6 percentage points. ENCAD comprised approximately 16% of the gross profit dollars for 2002 and contributed to the year-over-year decrease in the gross profit margin percentage.

SG&A expenses for the Graphics Communications segment increased \$17 million, or 85%, from \$20 million for 2001 to \$37 million for 2002. As a percentage of sales, SG&A expenses increased from 5.2% for 2001 to 9.2% for 2002. The increase in SG&A expenses was entirely due to the acquisition of ENCAD, Inc. in 2002, which increased SG&A by \$23 million.

R&D costs for the Graphics Communications segment increased \$6 million, or 26%, from \$23 million for 2001 to \$29 million for 2002. As a percentage of sales, R&D costs increased from 5.9% in 2001 to 7.2% in 2002. The increase is entirely due to the acquisition of ENCAD, Inc. in 2002, which increased R&D costs by \$8 million.

Earnings from continuing operations before interest, other charges, net, and income taxes for the Graphics Communications segment decreased \$23 million, or 52%, from \$44 million in 2001 to \$21 million in 2002. The decrease in earnings from operations is primarily attributable to the reasons outlined above.

### ALL OTHER

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Net worldwide sales for All Other were \$80 million for 2002 as compared with \$86 million for 2001, representing a decrease of \$6 million, or 7%. Net sales in the U.S. were \$45 million in 2002 as compared with \$56 million for 2001, representing a decrease of \$11 million, or 20%. Net sales outside the U.S. were \$35 million in the current year as compared with \$30 million in the prior year, representing an increase of \$5 million, or 17%.

Loss from continuing operations before interest, other charges, net, and income taxes for All Other decreased \$28 million from a loss of \$55 million in 2001 to a loss of \$27 million in 2002. The reduction in the loss from operations was primarily attributable to cost reductions in certain miscellaneous businesses and the benefit of current year manufacturing cost.

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### RESULTS OF OPERATIONS - DISCONTINUED OPERATIONS

Earnings from discontinued operations for 2002 were \$9 million, or \$.03 per basic and diluted share, as compared with earnings from discontinued operations for 2001 of \$15 million, or \$.05 per basic and diluted share. The earnings from discontinued operations of \$9 million reflects net of tax earnings of \$32 million related to the operations of RSS, and net of tax earnings of \$12 million related to the favorable outcome of litigation associated with the 1994 sale of Sterling Winthrop Inc. These earnings were partially offset by losses incurred from the shutdown of Kodak Global Imaging, Inc. (KGII), which amounted to \$35 million net of tax.

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The earnings from discontinued operations of \$15 million for 2001 reflects net of tax earnings of \$20 million related to the operations of RSS, partially offset by net of tax losses of \$5 million related to KGII's operations.

### SUMMARY

(in millions, except per share data)

	2003	Change	2002	Change	2001
Net sales from continuing operations	\$12,893	+ 3%	\$12,549	- 3%	\$12,976
Earnings from continuing operations before interest, other charges, net, and income taxes	307	- 74	1,168	+266	319
Earnings from continuing operations	199	- 74	761	+1148	61
Earnings from discontinued operations	66	+633	9	- 40	15
Net earnings	265	- 66	770	+913	76
Basic and diluted earnings per share:					
Continuing operations	.69	- 74	2.61	+1143	.21
Discontinued operations	.23	+667	.03	- 40	.05
Total	.92	- 65	2.64	+915	.26

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 one-time items, which are described below, should be considered to better understand the Company's results of operations that were generated from normal operational activities.

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2003

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

Charges of \$557 million (\$378 million after tax) related to focused cost reductions implemented in the first and third quarters. 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."

Charges of \$16 million (\$10 million after tax) related to venture investment impairments and other asset write-offs incurred in the second and fourth quarters. See MD&A and Note 7, "Investments," for further discussion of venture investment impairments.

Charges of \$31 million (\$19 million after tax), including \$21 million (\$13 million after tax) in the first quarter and \$10 million (\$6 million after tax) in the fourth quarter, related to purchased in-process R&D.

Charges of \$14 million (\$9 million after tax) connected with the settlement of a patent infringement claim.

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Charges of \$12 million (\$7 million after tax) related to an intellectual property settlement.

Charges of \$14 million (\$9 million after tax) connected with the settlement of certain issues relating to a prior-year acquisition.

Charges of \$8 million (\$5 million after tax) for a donation to a technology enterprise.

Charges of \$8 million (\$5 million after tax) for legal settlements.

Reversal of \$9 million (\$6 million after tax) for an environmental reserve.

Income tax benefits of \$13 million, which included tax benefits related to the donation of patents in the first and fourth quarters, amounting to \$8 million and \$5 million, respectively.

2002

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

Charges of \$114 million (\$80 million after tax) related to focused cost reductions implemented in the third and fourth quarters. See further discussion in the Restructuring Costs and Other section of MD&A and Note 16, "Restructuring Costs and Other."

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Charges of \$50 million (\$34 million after tax) related to venture investment impairments and other asset write-offs incurred in the second, third and fourth quarters. See MD&A and Note 7, "Investments," for further discussion of venture investment impairments.

Income tax benefits of \$121 million, including a \$45 million tax benefit related to the closure of the PictureVision subsidiary in the second quarter, a \$46 million benefit from the loss realized on the liquidation of a Japanese photofinishing operations subsidiary in the third quarter, an \$8 million benefit from a fourth quarter property donation, and a \$22 million benefit relating to the decline in the year-over-year operational effective tax rate.

2001

The Company's results from continuing operations for the year included the following one-time items:

Charges of \$824 million (\$579 million after tax) related to the restructuring programs implemented in the second, third and fourth quarters and other asset impairments.

A charge of \$41 million (\$28 million after tax) for environmental exposures.

A charge of \$20 million (\$14 million after tax) for the Kmart bankruptcy.

Income tax benefits of \$31 million, including a favorable tax settlement of \$11 million and a \$20 million benefit relating to the decline in the year-over-year operational effective tax rate.



## RESTRUCTURING COSTS AND OTHER

Currently, the Company is being adversely impacted by the progressing digital substitution. As the Company continues to adjust its operating model in light of changing business conditions, it is probable that ongoing cost reduction activities will be required from time to time.

In accordance with this, the Company periodically announces planned restructuring programs (Programs), which often consist of a number of restructuring initiatives. These Program announcements provide estimated ranges relating to the number of positions to be eliminated and the total restructuring charges to be incurred. The actual charges for initiatives under a 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 fiscal 2003:

(in millions)	Balance Dec. 31, 2002	Costs Incurred	Adjust- ments	Cash Pay- ments	Non- cash Settle- ments	Balance Dec. 31, 2003
Q3 2003 Program:						
Severance reserve	\$ -	\$231	\$ -	\$ (51)	\$ -	\$180
Exit costs reserve	-	40	-	(28)	-	12
	----	----	----	-----	-----	----
Total reserve	\$ -	\$271	\$ -	\$ (79)	\$ -	\$192
	=====	=====	=====	=====	=====	=====
Long-lived asset impairments	\$ -	\$109	\$ -	\$ -	\$ (109)	\$ -
Accelerated depreciation and inventory write-downs	-	22	-	-	(22)	-
Q1 2003 Program:						
Severance reserve	\$ -	\$ 67	\$ -	\$ (44)	\$ -	\$ 23
Exit costs reserve	-	8	-	(4)	-	4
	----	----	----	-----	-----	----
Total reserve	\$ -	\$ 75	\$ -	\$ (48)	\$ -	\$ 27
	=====	=====	=====	=====	=====	=====
Long-lived asset impairments	\$ -	\$ 5	\$ -	\$ -	\$ (5)	\$ -
Accelerated depreciation and inventory write-downs	-	25	-	-	(25)	-
Phogenix:						
Exit costs reserve	\$ -	\$ 9	\$ -	\$ -	\$ -	\$ 9

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Long-lived asset impairments	-	6	-	-	(6)	-
Inventory write-downs	-	2	-	-	(2)	-

Q4 2002 Program:

Severance reserve	\$ 53	\$ 21	\$ -	\$ (62)	\$ -	\$ 12
Exit costs reserve	17	-	-	(9)	-	8
	----	----	----	-----	-----	----
Total reserve	\$ 70	\$ 21	\$ -	\$ (71)	\$ -	\$ 20
	=====	=====	=====	=====	=====	=====
Accelerated depreciation and inventory write-downs	\$ -	\$ 24	\$ -	\$ -	\$ (24)	\$ -

2001 Programs:

Severance reserve	\$ 65	\$ -	\$ (12)	\$ (47)	\$ -	\$ 6
Exit costs reserve	18	-	-	(5)	-	13
	----	----	----	-----	-----	----
Total reserve	\$ 83	\$ -	\$ (12)	\$ (52)	\$ -	\$ 19
	=====	=====	=====	=====	=====	=====
Total of all restructuring programs	\$153	\$569	\$ (12)	\$ (250)	\$ (193)	\$267
	=====	=====	=====	=====	=====	=====

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The costs incurred and adjustments, which total \$557 million for the year ended December 31, 2003, include \$73 million of charges related to accelerated depreciation and inventory write-downs, which were reported in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The remaining costs incurred and adjustments of \$484 million were reported as restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003.

2004-2006 Restructuring Program

In addition to completing the remaining initiatives under the Third Quarter, 2003 Restructuring Program, the Company announced on January 22, 2004 that it plans to develop and execute a new cost reduction program throughout the 2004 to 2006 timeframe. The objective of these actions is to achieve a business model appropriate for the Company's traditional businesses, and to sharpen the Company's competitiveness in digital markets. As a result of the actions, the Company expects cost savings in the range of \$800 million to \$1,000 million for full year 2007.

The Program is expected to result in total charges of \$1.3 billion to \$1.7 billion over the three-year period, of which \$700 million to \$900 million are related to severance, with the remainder relating to the disposal of buildings and equipment. Overall, Kodak's worldwide facility square footage will be reduced by approximately one-third. Approximately 12,000 to 15,000 positions worldwide are expected to be eliminated through these actions primarily in global manufacturing, selected traditional businesses and corporate administration. Maximum single year cash usage under the new program is expected to be approximately \$200 million.

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### Third Quarter, 2003 Restructuring Program

During the third quarter of 2003, the Company announced that it intends to implement a series of cost reduction actions during the last two quarters of 2003 and the first two quarters of 2004, which were expected to result in pre-tax charges totaling \$350 million to \$450 million. It is anticipated that these actions will result in a reduction of approximately 4,500 to 6,000 positions worldwide, primarily relating to the rationalization of global manufacturing assets, reduction of corporate administration and R&D, and the consolidation of the infrastructure and administration supporting the Company's consumer imaging and professional products and services operations. The Company expects the 2004 cost savings as a result of these actions to be \$275 million to \$325 million, with annual savings of \$300 million to \$400 million thereafter.

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The Company implemented certain actions under this Program during 2003. As a result of these actions, the Company recorded charges of \$381 million in continuing operations in 2003, which was composed of severance, long-lived asset impairments, exit costs and inventory write-downs of \$231 million, \$109 million, \$40 million and \$1 million, respectively. The severance costs related to the elimination of approximately 3,850 positions, including approximately 1,675 manufacturing, 1,125 administrative, 800 photofinishing and 250 research and development positions. The geographic composition of the positions to be eliminated includes approximately 2,550 in the United States and Canada and 1,300 throughout the rest of the world. The reduction of the 3,850 positions and the \$271 million charges for severance and exit costs are reflected in the Third Quarter, 2003 Restructuring Program table below. The \$109 million charge for long-lived asset impairments was included in restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The charges taken for inventory write-downs of \$1 million were reported in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003.

The following table summarizes the activity with respect to the severance charges and exit costs recorded in connection with the focused cost reductions that were announced in the third quarter of 2003 and the remaining balances in the related reserves at December 31, 2003:

(dollars in millions)

	Number of Employees	Severance Reserve	Exit Costs Reserve	Total
	-----	-----	-----	-----
Q3, 2003 charges	1,700	\$123	-	\$123
Q3, 2003 utilization	(100)	(3)	-	(3)
	-----	----	---	----
Balance at 9/30/03	1,600	120	-	120
Q4, 2003 charges	2,150	108	40	148
Q4, 2003 utilization	(2,025)	(48)	(28)	(76)
	-----	----	---	----
Balance at 12/31/03	1,725	\$180	\$12	\$192
	=====	=====	====	=====

The severance charges of \$231 million and the exit costs of \$40 million taken in 2003 were reported in restructuring costs and other in the

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accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The severance costs and exit costs require the outlay of cash, while the long-lived asset impairments and inventory write-downs represent non-cash items. Severance payments relating to the third quarter restructuring actions will be paid during the period through 2005, since, in many instances, the employees whose positions were eliminated can elect or are required to receive their severance payments over an extended period of time. Most exit costs are expected to be paid during 2004. However, certain costs, such as long-term lease payments, will be paid over periods after 2004.

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As a result of initiatives implemented under the Third Quarter, 2003 Restructuring Program, the Company recorded \$21 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. 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 \$21 million relates to \$20 million of manufacturing facilities and equipment and \$1 million of photofinishing facilities and equipment that will be used until their abandonment. The Company will incur accelerated depreciation charges of \$10 million, \$8 million and \$3 million in the first, second and third quarters of 2004, respectively, as a result of the initiatives implemented under the Third Quarter, 2003 Restructuring Program.

The charges of \$402 million recorded in 2003 included \$210 million applicable to the D&FIS segment, \$20 million to the Health Imaging segment and \$9 million to the Commercial Imaging segment. The remaining \$163 million was applicable to manufacturing, research and development, and administrative functions, which are shared across segments.

With respect to the Third Quarter, 2003 Program, the Company anticipates completing the remaining initiatives originally contemplated under the Program by the end of the second quarter of 2004. As a result of these initiatives, an additional 1,700 to 1,900 positions will be eliminated throughout the world by the end of the second quarter of 2004. The estimated cost to complete these remaining initiatives will be in the range of \$150 million to \$170 million. The Company expects the 2004 cost savings as a result of all actions contemplated under the Third Quarter, 2003 Restructuring Program to be \$250 million to \$300 million in 2004, with annual savings of \$275 million to \$375 million thereafter.

### First Quarter, 2003 Restructuring Program

In the early part of the first quarter of 2003, as part of its continuing focused cost reduction efforts and in addition to the remaining initiatives under the Fourth Quarter, 2002 Restructuring Program, the Company announced its First Quarter, 2003 Restructuring Program that included new initiatives to further reduce employment within a range of 1,800 to 2,200 employees. A significant portion of these new initiatives relates to the rationalization of the Company's photofinishing operations in the U.S. and Europe. Specifically, as a result of declining film and photofinishing volumes and in response to global economic and political conditions, the Company began to implement initiatives to 1) close certain photofinishing operations in the U.S. and EAMER, 2) rationalize manufacturing capacity by eliminating manufacturing positions on a worldwide basis, and 3) eliminate selling, general and administrative positions, particularly in the D&FIS segment.

The total restructuring charge for continuing operations recorded in 2003 relating to the First Quarter, 2003 Restructuring Program was \$81 million, which was composed of severance, exit costs, long-lived asset impairments and inventory write-downs of \$67 million, \$8 million, \$5 million and \$1 million, respectively. The severance charge related to the elimination of 1,850 positions, including approximately 1,225 photofinishing, 325 administrative and 300 manufacturing positions. The geographic composition of the 1,850 positions to be eliminated includes approximately 1,100 in the United States and Canada and 750 throughout the rest of the world. The reduction of 1,850 positions and the total severance and exit charges of \$75 million are reflected in the First Quarter, 2003 Restructuring Program table below. The remaining actions anticipated under the First Quarter, 2003 Restructuring Program are expected to be completed during the first quarter of 2004.

The following table summarizes the activity with respect to the severance and exit costs charges recorded in connection with the focused cost reductions that were announced in the first quarter of 2003 and the remaining balances in the related reserves at December 31, 2003:

(dollars in millions)

	Number of Employees	Severance Reserve	Exit Costs Reserve	Total
	-----	-----	-----	-----
Q1, 2003 charges	425	\$ 28	\$ -	\$ 28
Q1, 2003 utilization	(150)	(2)	-	(2)
	-----	-----	-----	-----
Balance at 3/31/03	275	26	-	26
Q2, 2003 charges	500	20	4	24
Q2, 2003 utilization	(500)	(13)	-	(13)
	-----	-----	-----	-----
Balance at 6/30/03	275	33	4	37
Q3, 2003 charges	925	19	4	23
Q3, 2003 utilization	(400)	(12)	(1)	(13)
	-----	-----	-----	-----
Balance at 9/30/03	800	40	7	47
Q4, 2003 utilization	(625)	(17)	(3)	(20)
	-----	-----	-----	-----
Balance at 12/31/03	175	\$ 23	\$ 4	\$ 27
	=====	=====	=====	=====

The charges of \$80 million for severance, long-lived asset impairments and exit costs reserves were reported in restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The charges taken for inventory write-downs of \$1 million were reported in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The severance and exit costs require the outlay of cash, while the inventory write-downs and long-lived asset impairments represent non-cash items. Severance payments will be paid during the period through 2005 since, in many instances, the employees whose positions were eliminated can elect or are required to receive their severance payments over an extended period of time. Most exit costs are expected to be paid during 2004. However, certain costs, such as long-term lease payments, will be paid over periods after 2004.

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As a result of initiatives implemented under the First Quarter, 2003 Restructuring Program, the Company recorded \$24 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. 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 \$24 million relates to lab equipment used in photofinishing that will be used until their abandonment. The Company will incur accelerated depreciation charges of \$8 million in the first quarter of 2004 and \$1 million in the second quarter of 2004 as a result of the initiatives implemented under the First Quarter, 2003 Restructuring Program.

Cost savings resulting from the implementation of all First Quarter, 2003 Restructuring Program actions are in line with the original estimate of approximately \$35 million to \$50 million in 2003 and are expected to be \$65 million to \$85 million on an annual basis thereafter.

The total restructuring charges of \$105 million recorded in 2003 under the First Quarter, 2003 Restructuring Program included \$85 million applicable to the D&FIS segment, \$4 million applicable to the Commercial Imaging segment and \$1 million applicable to the Graphic Communications segment. The remaining \$15 million was applicable to manufacturing, research and development, and administrative functions, which are shared across all segments.

In addition to the \$105 million of restructuring charges recorded in 2003 under the First Quarter, 2003 Restructuring Program, the Company recorded \$17 million of charges in the second quarter associated with the Company's exit from the D&FIS segment's Phogenix joint venture with Hewlett Packard. The \$17 million charge included approximately \$2 million of inventory write-downs, \$6 million of long-lived asset impairments and \$9 million of exit costs. The inventory write-downs were reported in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The long-lived asset impairments and exit costs were reported in restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The exit costs, which represent the only cash portion of the charge, are expected to be paid during 2004.

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### Fourth Quarter, 2002 Restructuring Program

During the fourth quarter of 2002, the Company announced a planned Program consisting of a number of focused cost reduction initiatives designed to deploy manufacturing assets more effectively in order to provide competitively-priced products to the global market. In the announcement, the Company discussed the restructuring initiatives under its Fourth Quarter, 2002 Restructuring Program that would begin in the fourth quarter of 2002 and extend into 2003. These initiatives were expected to affect a total of 1,300 to 1,700 positions worldwide, including approximately 150 positions in the Company's U.S. research and development organizations, 500 positions in its U.S. one-time-use camera assembly operations, 300 positions in its Mexico sensitizing operations and 550 positions in its global manufacturing and logistics organization. Specific initiatives included the relocation of the one-time-use camera assembly operations in Rochester, New York and the graphic arts and x-ray film sensitizing operations in Mexico to other

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Kodak locations.

The total restructuring charge for continuing operations recorded in 2002 for these initiatives that were implemented was \$116 million, which was composed of severance, inventory write-downs, long-lived asset impairments and exit costs of \$55 million, \$7 million, \$37 million and \$17 million, respectively. The severance charge related to the elimination of 1,150 positions, including approximately 525 manufacturing and logistics, 300 service and photofinishing, 175 administrative and 150 research and development positions. The geographic composition of the 1,150 positions eliminated included approximately 775 in the United States and Canada and 375 throughout the rest of the world. The charge for the long-lived asset impairments includes the write-off of \$13 million relating to equipment used in the manufacture of cameras and printers, \$13 million for sensitized manufacturing equipment, \$5 million for lab equipment used in photofinishing and \$6 million for other assets that were scrapped or abandoned immediately. The reduction of 1,150 positions and the \$72 million charge for severance and exit costs are reflected in the Fourth Quarter, 2002 Restructuring Program table below. These amounts exclude the fourth quarter elimination of 150 positions and the restructuring charges relating to the shutdown of Kodak Global Imaging, Inc., as these charges were reflected in the loss from discontinued operations for the year ended December 31, 2002.

During 2003, the Company recorded additional severance charges of \$21 million in continuing operations relating to 675 positions that were contemplated under its Fourth Quarter, 2002 Restructuring Program, including the relocation of Mexican sensitizing operations and the U.S. one-time-use camera assembly operations. The 675 positions that were eliminated included approximately 500 manufacturing and 175 administrative positions. The geographic composition of the 675 positions included approximately 425 in the U.S. and Canada and 250 throughout the rest of the world. The reduction of 675 positions and the related severance charges of \$21 million are reflected in the Fourth Quarter, 2002 Restructuring Program table below. All actions anticipated under the Fourth Quarter, 2002 Restructuring Program were completed in the third quarter of 2003. A total of 1,825 positions were eliminated under the Fourth Quarter, 2002 Restructuring Program.

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The following table summarizes the activity with respect to the severance and exit costs charges recorded in connection with the focused cost reductions that were announced in the fourth quarter of 2002 and the remaining balance in the related reserves at December 31, 2003:

(dollars in millions)

	Number of Employees	Severance Reserve	Exit Costs Reserve	Total
	-----	-----	-----	-----
Q4, 2002 charges	1,150	\$ 55	\$ 17	\$ 72
Q4, 2002 utilization	(250)	(2)	-	(2)
	-----	-----	-----	-----
Balance at 12/31/02	900	53	17	70
Q1, 2003 charges	450	16	-	16
Q1, 2003 utilization	(850)	(24)	(2)	(26)
	-----	-----	-----	-----

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Balance at 3/31/03	500	45	15	60
Q2, 2003 charges	25	1	-	1
Q2, 2003 utilization	(500)	(11)	(4)	(15)
	-----	-----	-----	-----
Balance at 6/30/03	25	35	11	46
Q3, 2003 charges	200	4	-	4
Q3, 2003 utilization	(225)	(8)	(2)	(10)
	-----	-----	-----	-----
Balance at 9/30/03	0	31	9	40
Q4, 2003 utilization	0	(19)	(1)	(20)
	-----	-----	-----	-----
Balance at 12/31/03	0	\$ 12	\$ 8	\$ 20
	=====	=====	=====	=====

The severance charges taken in 2003 of \$21 million were reported in restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The severance and exit costs require the outlay of cash, while the inventory write-downs and long-lived asset impairments represent non-cash items. Severance payments will continue into 2004 since, in many instances, the employees whose positions were eliminated can elect or are required to receive their severance payments over an extended period of time. Most exit costs are expected to be paid during 2004. However, certain costs, such as long-term lease payments, will be paid over periods after 2004.

As a result of initiatives implemented under the Fourth Quarter, 2002 Restructuring Program, the Company recorded \$24 million of accelerated depreciation on long-lived assets in cost of goods sold in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The accelerated depreciation relates to long-lived assets accounted for under the held and used model of SFAS No. 144, and the full year amount of \$24 million was comprised of \$15 million relating to equipment used in the manufacture of cameras, \$6 million for lab equipment used in photofinishing and \$3 million for sensitized manufacturing equipment that was used until their abandonment in 2003.

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Cost savings resulting from the implementation of all Fourth Quarter, 2002 Restructuring Program actions are in line with the original estimate of approximately \$90 million to \$95 million in 2003 and \$205 million to \$210 million on an annual basis thereafter.

The full year 2003 charges of \$45 million included \$31 million of charges applicable to the D&FIS segment, \$3 million relating to the Graphic Communications segment and \$11 million associated with manufacturing, research and development, and administrative functions, which are shared across all segments. The fourth quarter 2002 charges of \$116 million included \$40 million of charges applicable to the D&FIS segment, \$19 million applicable to the Commercial Imaging segment and \$2 million applicable to the Health Imaging segment. The remaining \$55 million was associated with manufacturing, research and development, and administrative functions, which are shared across all segments.

### 2001 Restructuring Programs

At December 31, 2002, the Company had remaining severance and exit costs reserves of \$65 million and \$18 million, respectively, relating to the restructuring plans it implemented during 2001. During the first quarter of 2003, the Company completed the severance actions associated with the 2001 Restructuring Programs and recorded a reversal



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of \$12 million of reserves through restructuring costs and other in the accompanying Consolidated Statement of Earnings for the year ended December 31, 2003. The completion of the 2001 Restructuring Programs resulted in the elimination of the remaining 200 positions included in the original plans. A total of 6,425 positions were eliminated under the 2001 Restructuring Programs.

The remaining severance reserve of \$6 million as of December 31, 2003 has not been paid since, in many instances, the employees whose positions were eliminated could elect or were required to receive their severance payments over an extended period of time. However, these payments will be made by the end of 2004. Most of the remaining exit costs reserves of \$13 million as of December 31, 2003 represent long-term lease payments, which will be paid over periods after 2004.

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### LIQUIDITY AND CAPITAL RESOURCES

2003

The Company's cash and cash equivalents increased \$681 million during 2003 to \$1,250 million at December 31, 2003. The increase resulted primarily from \$1,645 million of cash flows from operating activities and \$270 million of cash provided by financing activities, partially offset by \$1,267 million of cash flows used in investing activities.

The net cash provided by operating activities of \$1,645 million for the year ended December 31, 2003 was partially attributable to net earnings of \$265 million which, when adjusted for earnings from discontinued operations, equity in losses from unconsolidated affiliates, gain on sale of assets, depreciation and goodwill amortization, purchased research and development, benefit for deferred income taxes and restructuring costs, asset impairments and other charges, provided \$1,237 million of operating cash. Also contributing to net cash provided by operating activities were a decrease in inventories of \$123 million, an increase in liabilities excluding borrowings of \$62 million, the cash receipt of \$19 million in connection with the Sterling Winthrop settlement, a decrease in accounts receivable of \$15 million, and the \$130 million impact from the change in other items, net. The net cash used in investing activities of \$1,267 million was utilized primarily for business acquisitions of \$697 million, of which \$59 million related to the purchase of minority interests in China and India, capital expenditures of \$500 million, and investments in unconsolidated affiliates of \$89 million. These uses of cash were partially offset by net proceeds from the sale of assets of \$24 million. The net cash provided by financing activities of \$270 million was primarily the result of the net increase in borrowings of \$588 million and the exercise of employee stock options of \$12 million, which were partially offset by dividend payments of \$330 million.

Net working capital, excluding short-term borrowings, increased to \$1,151 million from \$474 million at year-end 2002. Including short-term borrowings, net working capital increased to positive \$205 million from negative \$968 million at year-end 2002. This increase is mainly attributable to higher cash balances and a reduction in short-term debt, partially offset by higher accounts payable and other current liabilities. The decrease in short-term debt is primarily because the Company no longer regularly accesses the commercial paper (short-term debt) market in managing its working capital to fund its operating and investing activities. During the second quarter of 2003, the Company issued \$550 million of long-term debt to replace \$550 million of short-

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term debt resulting in improved working capital. Additionally, on October 10, 2003, the Company issued \$1,075 million of long-term debt, comprised of \$500 million of Senior Notes due 2013 and \$575 million of Convertible Senior Notes due 2033, a portion of which has been used to repay commercial paper, thus improving working capital. See further discussion in this section relating to these long-term debt issuances.

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The Company maintains \$2,467 million in committed bank lines of credit and \$1,722 million in uncommitted bank lines of credit to ensure continued access to short-term borrowing capacity. On September 5, 2003, the Company filed a shelf registration statement on Form S-3 (the new debt shelf registration) for the issuance of up to \$2,000 million of new debt securities. Pursuant to Rule 429 under the Securities Act of 1933, \$650 million of remaining unsold debt securities under a prior shelf registration statement were included in the new debt shelf registration, thus giving the Company the ability to issue up to \$2,650 million in public debt. These funding alternatives provide the Company with sufficient flexibility and liquidity to meet its working capital and investing needs. However, the success of future public debt issuances will be dependent on market conditions at the time of such an offering.

The Company's primary estimated future uses of cash for 2004 include the following: dividend payments, debt reductions, and acquisitions. The Company has a dividend policy whereby it makes semi-annual payments which, when declared, will be paid on the Company's 10th business day each July and December to shareholders of record on the first business day of the preceding month. On April 15, 2003, the Company's Board of Directors declared a semi-annual cash dividend of \$.90 per share on the outstanding common stock of the Company. This dividend was paid on July 16, 2003 to shareholders of record at the close of business on June 2, 2003. On September 24, 2003, the Company's Board of Directors approved the reduction of the amount of the annual dividend to \$.50 per share. On that same date, the Company's Board of Directors declared a semi-annual cash dividend of \$.25 per share on the outstanding common stock of the Company. This dividend was paid on December 12, 2003 to the shareholders of record as of the close of business on November 3, 2003.

Capital additions were \$500 million in 2003, with the majority of the spending supporting new products, manufacturing productivity and quality improvements, infrastructure improvements, and ongoing environmental and safety initiatives. For the full year 2004, the Company expects its capital spending, excluding acquisitions, to be approximately \$550 million.

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During 2003, the Company expended \$250 million against the related restructuring reserves, primarily for the payment of severance benefits. Employees whose positions were eliminated could elect to receive severance payments for up to two years following their date of termination.

For 2004, the Company expects to generate \$485 million to \$615 million in investable cash flow, which represents cash flow after dividends but before acquisitions and excludes the impacts on cash from the purchase and sale of marketable securities, the impacts from debt and transactions in the Company's own equity, such as stock repurchases and the proceeds from the exercise of stock options. The investable cash flow range of \$485 million to \$615 million does not include \$725 million of expected pre-tax cash proceeds from the February 2004

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announced sale of the Remote Sensing Systems operation, including Research Systems, Inc., to ITT Industries, Inc., nor does it consider the cash impact of the NexPress acquisition, which was announced in March 2004, once it becomes a Kodak wholly owned subsidiary. The Company believes that its cash flow from operations will be sufficient to cover its working capital and capital investment needs and the funds required for future debt reduction, dividend payments, or modest acquisitions. The Company's cash balances and financing arrangements will be used to bridge timing differences between expenditures and cash generated from operations.

The Company has \$2,225 million in committed revolving credit facilities, which are available for general corporate purposes including the support of the Company's commercial paper program. The credit facilities are comprised of the \$1,000 million 364-day committed revolving credit facility (364-Day Facility) expiring in July 2004 and a 5-year committed facility at \$1,225 million expiring in July 2006 (5-Year Facility). If unused, they have a commitment fee of \$4.5 million per year at the Company's current credit rating of Baa3 and BBB- from Moody's and Standard & Poors (S&P), respectively. Interest on amounts borrowed under these facilities is calculated at rates based on spreads above certain reference rates and the Company's credit rating. Under the 364-Day Facility and 5-Year Facility, there is a financial covenant that requires the Company to maintain a debt to EBITDA (earnings before interest, income taxes, depreciation and amortization) ratio of not greater than 3 to 1. In the event of violation of the covenant, the facility would not be available for borrowing until the covenant provisions were waived, amended or satisfied. The Company was in compliance with this covenant at December 31, 2003. The Company does not anticipate that a violation is likely to occur.

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The Company has other committed and uncommitted lines of credit at December 31, 2003 totaling \$242 million and \$1,722 million, respectively. These lines primarily support borrowing needs of the Company's subsidiaries, which include term loans, overdraft coverage, letters of credit and revolving credit lines. Interest rates and other terms of borrowing under these lines of credit vary from country to country, depending on local market conditions. Total outstanding borrowings against these other committed and uncommitted lines of credit at December 31, 2003 were \$138 million and \$316 million, respectively. These outstanding borrowings are reflected in the short-term borrowings and long-term debt, net of current portion balances in the accompanying Consolidated Statement of Financial Position at December 31, 2003.

At December 31, 2003, the Company had \$304 million in commercial paper outstanding, with a weighted-average interest rate of 2.95%. To provide additional financing flexibility, the Company has an accounts receivable securitization program, which provides for borrowings up to a maximum of \$250 million. At December 31, 2003, the Company had no outstanding borrowings under this program.

On October 10, 2003, the Company completed the offering and sale of \$500 million aggregate principal amount of Senior Notes due 2013 (the Notes), which was made pursuant to the Company's new debt shelf registration. Interest on the Notes will accrue at the rate of 7.25% per annum and is payable semiannually. The Notes are not redeemable at the Company's option or repayable at the option of any holder prior to maturity. The Notes are unsecured and unsubordinated obligations and rank equally with all of the Company's other unsecured and unsubordinated indebtedness. After issuance of the above debt, the

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Company has \$2,150 million of availability remaining under the new debt shelf registration.

Concurrent with the offering and sale of the Notes, on October 10, 2003, the Company completed the private placement of \$575 million aggregate principal amount of Convertible Senior Notes due 2033 (the Convertible Securities) to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933. Interest on the Convertible Securities will accrue at the rate of 3.375% per annum and is payable semiannually. The Convertible Securities are unsecured and rank equally with all of the Company's other unsecured and unsubordinated indebtedness.

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As a condition of the private placement, the Company agreed to initially file within 90 days and make effective within 180 days after the earliest date of original issuance of the Convertible Securities, a shelf registration statement under the Securities Act of 1933 relating to the resale of the Convertible Securities and the common stock to be issued upon conversion of the Convertible Securities pursuant to a registration rights agreement. The Company filed this shelf registration statement on January 6, 2004, and made it effective on February 6, 2004.

The Convertible Securities contain a number of conversion features that include substantive contingencies. The Convertible Securities are convertible by the holders at an initial conversion rate of 32.2373 shares of the Company's common stock for each \$1,000 principal amount of the Convertible Securities, which is equal to an initial conversion price of \$31.02 per share. The holders may convert their Convertible Securities, in whole or in part, into shares of the Company's common stock under any of the following circumstances: (1) during any calendar quarter, if the price of the Company's common stock is greater than or equal to 120% of the applicable conversion price for at least 20 trading days during a 30 consecutive trading day period ending on the last trading day of the previous calendar quarter; (2) during any five consecutive trading day period following any 10 consecutive trading day period in which the trading price of the Convertible Securities for each day of such period is less than 105% of the conversion value, and the conversion value for each day of such period was less than 95% of the principal amount of the Convertible Securities (the Parity Clause); (3) if the Company has called the Convertible Securities for redemption; (4) upon the occurrence of specified corporate transactions such as a consolidation, merger or binding share exchange pursuant to which the Company's common stock would be converted into cash, property or securities; and (5) if the credit rating assigned to the Convertible Securities by either Moody's or S&P is lower than Ba2 or BB, respectively, which represents a three notch downgrade from the Company's current standing, or if the Convertible Securities are no longer rated by at least one of these services or their successors (the Credit Rating Clause).

The Company may redeem some or all of the Convertible Securities at any time on or after October 15, 2010 at a purchase price equal to 100% of the principal amount of the Convertible Securities plus any accrued and unpaid interest. Upon a call for redemption by the Company, a conversion trigger is met whereby the holder of each \$1,000 Convertible Senior Note may convert such note to shares of the Company's common stock.

The holders have the right to require the Company to purchase their Convertible Securities for cash at a purchase price equal to 100% of

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the principal amount of the Convertible Securities plus any accrued and unpaid interest on October 15, 2010, October 15, 2013, October 15, 2018, October 15, 2023 and October 15, 2028, or upon a fundamental change as described in the offering memorandum filed under Rule 144A in conjunction with the private placement of the Convertible Securities. As of December 31, 2003, the Company reserved 18,536,447 shares in treasury stock to cover potential future conversions of these Convertible Securities into common stock.

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Certain of the conversion features contained in the Convertible Securities are deemed to be embedded derivatives as defined under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." These embedded derivatives include the Parity Clause, the Credit Rating Clause, and any specified corporate transaction outside of the Company's control such as a hostile takeover. Based on an external valuation, these embedded derivatives were not material to the Company's financial position, results of operations or cash flows. In addition, as the contingencies surrounding the conversion features are substantive, the shares to be potentially issued upon triggering a conversion event will be excluded from the earnings per share calculation until such time as a contingency lapses and the effect of issuing such shares is dilutive. If and when a contingency lapses and the effect of issuing such shares is dilutive, then the shares issued would be included in the denominator of the earnings per share calculation, and the interest expense incurred on the Convertible Securities would be excluded from the numerator of the earnings per share calculation for the respective period.

Long-term debt and related maturities and interest rates were as follows at December 31, 2003 and 2002 (in millions):

Country	Type	Maturity	2003		2002	
			Weighted-Average Interest Rate	Amount Outstanding	Weighted-Average Interest Rate	Amount Outstanding
U.S.	Term note	2003	-	\$ -	9.38%	\$ 144
U.S.	Term note	2003	-	-	7.36%	110
U.S.	Term note	2004	1.72% *	200	-	-
U.S.	Term note	2005	1.73% *	100	-	-
U.S.	Medium-term	2005	7.25%	200	7.25%	200
U.S.	Medium-term	2006	6.38%	500	6.38%	500
U.S.	Term note	2008	3.63%	249	-	-
U.S.	Term note	2008	9.50%	34	9.50%	34
U.S.	Term note	2013	7.25%	500	-	-
U.S.	Term note	2018	9.95%	3	9.95%	3
U.S.	Term note	2021	9.20%	10	9.20%	10
U.S.	Convertible	2033	3.38%	575	-	-
China	Bank loans	2003	-	-	5.49%	114
China	Bank loans	2004	5.50%	225	5.58%	252
China	Bank loans	2005	5.45%	106	5.53%	124
Qualex	Term notes	2004-2008	5.53%	49	6.12%	44
Chile	Bank loans	2004	-	-	2.61%	10
Other				8		6
				-----		
				\$2,759	-----	
				=====	=====	
					\$1,551	
					=====	

\* Represents debt with a variable interest rate.

The Company's debt ratings were downgraded during 2003 by each of the three major rating agencies. Moody's, Standard & Poors (S&P) and Fitch ratings for long-term debt (L/T) and short-term debt (S/T), including their outlook, at the beginning and end of 2003 were as follows:

	December 31, 2002			December 31, 2003		
	L/T	S/T	Outlook	L/T	S/T	Outlook
Moody's	Baa1	P-2	Stable	Baa3	P-3	Negative
S&P	BBB+	A-2	Stable	BBB-	A-3	Negative
Fitch	A-	F2	Negative	BBB-	F3	Negative

The long-term and short-term debt rating downgrades and negative outlooks reflect the rating agencies' concerns about (1) the Company's weakened sales and profitability in the core photographic businesses due to continuing pricing pressure from competitors, (2) continued digital substitution, including doubts about the profit potential of digital imaging relative to conventional photography, (3) unfavorable economic factors, including reduced leisure travel, (4) potential future restructuring actions that may restrict cash flow, slowing efforts to reduce debt, (5) the likelihood that debt reduction will be slowed in the short to medium term due to the Company's rising business risk, investment strategies, and the rapid pace at which it has made its recent acquisitions, and (6) the financial burden of its significant unfunded postretirement benefit liabilities.

These credit rating actions have limited the Company's access to commercial paper borrowings. As a result and as noted before, on October 10, 2003, the Company issued \$1,075 million of long-term debt through an offering and sale of \$500 million of Senior Notes due 2013 and a concurrent private placement of \$575 million of Convertible Senior Notes due 2033, which were filed in a shelf registration statement on January 6, 2004 and made effective on February 6, 2004. With the proceeds received from the \$1,075 million of long-term debt issued, the Company retired approximately \$550 million of outstanding commercial paper and all of the outstanding borrowings under the accounts receivable securitization program, which amounted to approximately \$60 million. The remaining proceeds were used to fund the PracticeWorks, Inc. acquisition. For 2004, the Company expects interest expense to increase relative to 2003 as a result of the replacement of outstanding commercial paper with new long-term debt. For example, the Company's outstanding commercial paper at December 31, 2003 had a weighted-average annual interest rate of 2.95% as compared with an annual interest rate of 7.25% on the Senior Notes and 3.375% on the Convertible Senior Notes, representing a weighted-average difference of 2.34 percentage points.

The Company is in compliance with all covenants or other requirements set forth in its credit agreements and indentures. Further, the Company does not have any rating downgrade triggers that would accelerate the maturity dates of its debt, with the exception of the following: the outstanding borrowings, if any, under the accounts receivable securitization program if the Company's credit ratings from S&P or Moody's were to fall below BBB- and Baa3, respectively, and such condition continued for a period of 30 days. However, as previously noted, the Company had no outstanding borrowings under this program as of December 31, 2003. Additionally, the Company estimates that letters of credit or other financial support could be required in support of

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insurance, environmental and supplier obligations of up to \$117 million. Further downgrades in the Company's credit rating or disruptions in the capital markets could impact borrowing costs and the nature of its funding alternatives. However, the Company has access to \$2,225 million in committed revolving credit facilities to meet unanticipated funding needs should it be necessary.

The Company guarantees debt and other obligations under agreements with certain affiliated companies and customers. At December 31, 2003, these guarantees totaled a maximum of \$363 million, with outstanding guaranteed amounts of \$161 million. The maximum guarantee amount includes guarantees of up to: \$160 million of debt for KPG (\$50 million outstanding); \$7 million for other unconsolidated affiliates and third parties (\$7 million outstanding); and \$196 million of customer amounts due to banks in connection with various banks' financing of customers' purchase of products and equipment from Kodak (\$104 million outstanding). The KPG debt facility and the related guarantee mature on December 31, 2005, but may be renewed at KPG's, the joint ventures partners' and the bank's discretion. The guarantees for the other unconsolidated affiliates and third party debt mature between January 2004 and May 2006. The customer financing agreements and related guarantees typically have a term of 90 days for product and short-term equipment financing arrangements, and up to 5 years for long-term equipment financing arrangements. These guarantees would require payment from Kodak only in the event of default on payment by the respective debtor. In some cases, particularly for guarantees related to equipment financing, the Company has collateral or recourse provisions to recover and sell the equipment to reduce any losses that might be incurred in connection with the guarantee. Management believes the likelihood is remote that material payments will be required under any of the guarantees disclosed above. With respect to the guarantees that the Company issued in the year ended December 31, 2003, the Company assessed the fair value of its obligation to stand ready to perform under these guarantees by considering the likelihood of occurrence of the specified triggering events or conditions requiring performance as well as other assumptions and factors. Through internal analyses and external valuations, the Company determined that the fair value of the guarantees was not material to the Company's financial position, results of operations or cash flows.

The Company also guarantees debt owed to banks for some of its consolidated subsidiaries. The maximum amount guaranteed is \$592 million, and the outstanding debt under those guarantees, which is recorded within the short-term borrowings and long-term debt, net of current portion components in the accompanying Consolidated Statement of Financial Position, is \$423 million. These guarantees expire in 2004 and 2005, with the majority expiring in 2004.

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The Company may provide up to \$100 million in loan guarantees to support funding needs for SK Display Corporation, an unconsolidated affiliate in which the Company has a 34% ownership interest. As of December 31, 2003, the Company has not been required to guarantee any of the SK Display Corporation's outstanding debt.

The Company issues indemnifications in certain instances when it sells businesses and real estate, and in the ordinary course of business with its customers, suppliers, service providers and business partners. Further, the Company indemnifies its directors and officers who are, or were, serving at Kodak's request in such capacities. Historically, costs incurred to settle claims related to these indemnifications have not been material to the Company's financial position, results of

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operations or cash flows. Additionally, the fair value of the indemnifications that the Company issued during the year ended December 31, 2003 was not material to the Company's financial position, results of operations or cash flows.

Due to improved performance in the global equity markets in 2003, partially offset by the decline in the discount rates from December 31, 2002 to December 31, 2003, the Company decreased its additional minimum pension liability by \$167 million and recorded a corresponding credit to the accumulated other comprehensive (loss) income component of equity of \$122 million, net of tax benefits of \$45 million. The decrease in the additional minimum pension liability of \$167 million was recorded in the postretirement liabilities component on the Consolidated Statement of Financial Position at December 31, 2003. The decrease in this component of \$68 million from December 31, 2002 to December 31, 2003 is primarily attributable to the decrease in the additional minimum pension liability and the decrease in the accrued pension benefit liability, partially offset by the impact of foreign exchange. The Company recorded the reduction in the deferred income tax asset of \$45 million in the other long-term assets component within the Consolidated Statement of Financial Position. The net increase in this component of \$326 million from December 31, 2002 to December 31, 2003 is partially attributable to the increase in the prepaid pension asset, partially offset by the decrease in the deferred income tax asset. The increase in the prepaid pension asset is primarily attributable to \$42 million of pension income from continuing operations generated from the U.S. pension plans in 2003 and the impact of foreign exchange.

During the fourth quarter of 2003, the Company funded one of its non-U.S. defined benefit pension plans in the amount of approximately \$18 million. The Company does not expect to have significant funding requirements relating to its defined benefit pension plans in 2004.

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Qualex, a wholly owned subsidiary of Kodak, has a 50% ownership interest in Express Stop Financing (ESF), which is a joint venture partnership between Qualex and a subsidiary of Dana Credit Corporation (DCC), a wholly owned subsidiary of Dana Corporation. Qualex accounts for its investment in ESF under the equity method of accounting. ESF provides a long-term financing solution to Qualex's photofinishing customers in connection with Qualex's leasing of photofinishing equipment to third parties, as opposed to Qualex extending long-term credit. As part of the operations of its photofinishing services, Qualex sells equipment under a sales-type lease arrangement and records a long-term receivable. These long-term receivables are subsequently sold to ESF without recourse to Qualex and, therefore, these receivables are removed from Qualex's books. ESF incurs debt to finance the purchase of the receivables from Qualex. This debt is collateralized solely by the long-term receivables purchased from Qualex and, in part, by a \$60 million guarantee from DCC. Qualex provides no guarantee or collateral to ESF's creditors in connection with the debt, and ESF's debt is non-recourse to Qualex. Qualex's only continued involvement in connection with the sale of the long-term receivables is the servicing of the related equipment under the leases. Qualex has continued revenue streams in connection with this equipment through future sales of photofinishing consumables, including paper and chemicals, and maintenance.

Although the lessees' requirement to pay ESF under the lease agreements is not contingent upon Qualex's fulfillment of its servicing obligations, under the agreement with ESF, Qualex would be responsible



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for any deficiency in the amount of rent not paid to ESF as a result of any lessee's claim regarding maintenance or supply services not provided by Qualex. Such lease payments would be made in accordance with the original lease terms, which generally extend over 5 to 7 years. To date, the Company has incurred no such material claims, and Qualex does not anticipate any significant situations where it would be unable to fulfill its service obligations under the arrangement with ESF. ESF's outstanding lease receivable amount was approximately \$367 million at December 31, 2003.

Effective July 22, 2003, ESF entered into an agreement amending the Receivables Purchase Agreement (RPA), which represents the financing arrangement between ESF and its banks. Under the amended RPA agreement, maximum borrowings were lowered to \$257 million. Total outstanding borrowings under the RPA at December 31, 2003 were \$248 million. The amended RPA extends through July 2004, at which time the RPA can be extended or terminated. If the RPA were terminated, ESF would need to find an alternative financing solution for new borrowings. Pursuant to the ESF partnership agreement between Qualex and DCC, commencing October 6, 2003, Qualex no longer sells its lease receivables to ESF. Qualex currently is utilizing the services of Imaging Financial Services, Inc., a wholly owned subsidiary of General Electric Capital Corporation, as an alternative financing solution for prospective leasing activity with its customers.

At December 31, 2003, the Company had outstanding letters of credit totaling \$121 million and surety bonds in the amount of \$113 million primarily to ensure the completion of environmental remediations and payment of possible casualty and workers' compensation claims.

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As of December 31, 2003, the impact that our contractual obligations are expected to have on our liquidity and cash flow in future periods is as follows:

(in millions)	Total	2004	2005	2006	2007	2008	2009+
Long-term debt	\$2,759	\$457	\$422	\$507	\$ 2	\$283	\$1,088
Operating lease obligations	485	123	101	75	57	42	87
Purchase obligations (1)	985	266	238	124	98	80	179
	-----	-----	-----	-----	-----	-----	-----
Total (2)	\$4,229	\$846	\$761	\$706	\$157	\$405	\$1,354
	=====	=====	=====	=====	=====	=====	=====

(1) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

(2) Funding requirements for the Company's major defined benefit retirement plans and other postretirement benefit plans are not included as such amounts have not been determined. In 2003, the Company made contributions to its major defined benefit retirement plans and other postretirement benefit plans of \$149 million (\$24 million relating to its U.S. defined benefit plans) and \$248 million (\$245 million relating to its U.S. other postretirement benefits plan), respectively. The Company expects to contribute approximately \$5 million and \$258 million, respectively, to its U.S. defined benefit

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plans and other postretirement benefit plans in 2004.

2002

The Company's cash and cash equivalents increased \$121 million during 2002 to \$569 million at December 31, 2002. The increase resulted primarily from \$2,204 million of cash flows from operating activities, partially offset by \$758 million of cash flows used in investing activities and \$1,331 million of cash used in financing activities.

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The net cash provided by operating activities of \$2,204 million for the year ended December 31, 2002 was partially attributable to (1) net earnings of \$770 million which, when adjusted for depreciation and amortization, and restructuring costs, asset impairments and other charges, provided \$1,668 million of operating cash, (2) a decrease in accounts receivable of \$276 million, (3) a decrease in inventories of \$93 million, and (4) proceeds from the surrender of its Company-owned life insurance policies of \$187 million. The net cash used in investing activities of \$758 million was utilized primarily for capital expenditures of \$571 million, investments in unconsolidated affiliates of \$123 million, business acquisitions of \$72 million, of which \$60 million related to the purchase of minority interests in China and India, and net purchases of marketable securities of \$13 million. These uses of cash were partially offset by proceeds from the sale of properties of \$27 million. The net cash used in financing activities of \$1,331 million was primarily the result of net debt repayments of \$597 million, dividend payments of \$525 million and the repurchase of 7.4 million Kodak shares held by KRIP for \$260 million. Of the \$260 million expended, \$205 million was repurchased under the 1999 stock repurchase program, which is now completed. The balance of the amount expended of \$55 million was repurchased under the 2000 stock repurchase program.

Net working capital, excluding short-term borrowings, decreased to \$474 million at December 31, 2002 from \$797 million at December 31, 2001. This decrease is primarily attributable to an increase in accounts payable and other current liabilities, an increase in accrued income taxes, lower receivables and lower inventories partially offset by a higher cash balance.

On April 11, 2002, the Company's Board of Directors declared a semi-annual cash dividend of \$.90 per share on the outstanding common stock of the Company. This dividend was paid on July 16, 2002 to shareholders of record at the close of business on June 3, 2002. On October 10, 2002, the Company's Board of Director's declared a semi-annual cash dividend of \$.90 per share on the outstanding common stock of the Company. This dividend was paid to the shareholders of record at the close of business on December 13, 2002.

Capital additions were \$571 million in 2002, with the majority of the spending supporting new products, manufacturing productivity and quality improvements, infrastructure improvements, and ongoing environmental and safety initiatives.

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The cash outflows for severance and exit costs associated with the restructuring charges recorded in 2002 will be more than offset by the tax savings associated with the restructuring actions, primarily due to the tax benefit of \$46 million relating to the consolidation of its photofinishing operations in Japan recorded in the third quarter 2002

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restructuring charge. During 2002, the Company expended \$216 million against the related restructuring reserves, primarily for the payment of severance benefits, which were mostly attributable to the 2001 restructuring actions. The remaining severance-related actions associated with the total 2001 restructuring charge were completed by the end of the first quarter of 2003, and the remaining severance payments of \$6 million at December 31, 2003 will be made by the end of 2004. Employees whose positions were eliminated could elect to receive severance payments for up to two years following their date of termination.

2001

Net cash provided by operating activities in 2001 was \$2,206 million, as net earnings of \$76 million, adjusted for depreciation and amortization, and restructuring costs, asset impairments and other charges, provided \$1,398 million of operating cash. Also contributing to operating cash was a decrease in receivables of \$246 million and a decrease in inventories of \$465 million. This was partially offset by decreases in liabilities, excluding borrowings, of \$113 million related primarily to severance payments for restructuring programs and reductions in accounts payable and accrued benefit costs. Net cash used in investing activities of \$1,188 million in 2001 was utilized primarily for capital expenditures of \$738 million, investments in unconsolidated affiliates of \$141 million, and business acquisitions of \$306 million. Net cash used in financing activities of \$808 million in 2001 was primarily the result of stock repurchases and dividend payments as discussed below.

The Company declared cash dividends per share of \$.44 in each of the first three quarters and \$.89 in the fourth quarter of 2001. Total cash dividends of \$643 million were paid in 2001. In October 2001, the Company's Board of Directors approved a change in dividend policy from quarterly dividend payments to semi-annual dividend payments. Dividends, when declared, will be paid on the 10th business day of July and December to shareholders of record on the first business day of the preceding month. These payment dates serve to better align the dividend disbursements with the seasonal cash flow pattern of the business, which is more concentrated in the second half of the year. This action resulted in the Company making five dividend payments in 2001.

Net working capital, excluding short-term borrowings, decreased to \$797 million from \$1,420 million at year-end 2000. This decrease is mainly attributable to lower receivable and inventory balances, as discussed above.

Capital additions, excluding equipment purchased for lease, were \$675 million in 2001, with the majority of the spending supporting new products, manufacturing productivity and quality improvements, infrastructure improvements, ongoing environmental and safety initiatives, and renovations due to relocations associated with restructuring actions taken in 1999.

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Under the \$2,000 million stock repurchase program announced on April 15, 1999, the Company repurchased \$44 million of its shares in 2001. As of March 2, 2001, the Company suspended the stock repurchase program in a move designed to accelerate debt reduction and increase financial flexibility. At the time of the suspension of the program, the Company had repurchased approximately \$1,800 million of its shares under this program.

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The net cash cost of the restructuring charge recorded in 2001 was approximately \$182 million after tax, which was recovered through cost savings in less than two years. The severance-related actions associated with this charge were completed by the end of the first quarter of 2003, and the remaining severance payments of \$6 million at December 31, 2003 will be made by the end of 2004.

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### OTHER

Cash expenditures for pollution prevention and waste treatment for the Company's current facilities were as follows:

(in millions)	2003	2002	2001
Recurring costs for pollution prevention and waste treatment	\$ 74	\$ 67	\$ 68
Capital expenditures for pollution prevention and waste treatment	8	12	27
Site remediation costs	2	3	2
	----	----	----
Total	\$ 84	\$ 82	\$ 97
	=====	=====	=====

At December 31, 2003 and 2002, the Company's undiscounted accrued liabilities for environmental remediation costs amounted to \$141 million and \$148 million, respectively. These amounts are reported in other long-term liabilities in the accompanying Consolidated Statement of Financial Position.

The Company is currently implementing a Corrective Action Program required by the Resource Conservation and Recovery Act (RCRA) at the Kodak Park site in Rochester, NY. As part of this program, the Company has completed the RCRA Facility Assessment (RFA), a broad-based environmental investigation of the site. The Company is currently in the process of completing, and in some cases has completed, RCRA Facility Investigations (RFI) and Corrective Measures Studies (CMS) for areas at the site. The previous estimate for future investigation and remediation costs was reduced by \$8 million for the following reasons: (1) approval of Final Corrective Measures for four investigation areas, (2) approval for a single investigation approach for the site's industrial sewers and building waste water collection system, and (3) completion with no further action approvals at seventeen Solid Waste Management Units. At December 31, 2003, estimated future investigation and remediation costs of \$57 million are accrued for this site and are included in the \$141 million reported in other long-term liabilities.

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The Company has retained certain obligations for environmental remediation and Superfund matters related to certain sites associated with the non-imaging health businesses sold in 1994. At the Ohio site, agreements reached with the Ohio Environmental Protection Agency in regard to the calculation of clean-up levels, as well as the long term viability of the facility as an industrial site, allowed the previous estimate to be reduced by \$13 million. At December 31, 2003, estimated future remediation costs of \$35 million are accrued for these sites and are included in the \$141 million reported in other long-term liabilities.

The Company has obligations relating to two former manufacturing sites located outside of the United States. At December 31, 2003, estimated

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future investigation, remediation and monitoring costs of \$20 million are accrued for these sites and are included in the \$141 million reported in other long-term liabilities.

As a result of the ongoing monitoring and identification process, the Company has identified seven additional operating sites with an estimated future investigation, remediation and monitoring cost of \$21 million. These costs are accrued and are included in the \$141 million reported in other long-term liabilities.

Additionally, the Company has approximately \$8 million accrued in the \$141 million reported in other long-term liabilities at December 31, 2003 for remediation relating to other facilities, which are not material to the Company's financial position, results of operations, cash flows or competitive position.

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

A Consent Decree was signed in 1994 in settlement of a civil complaint brought by the U.S. Environmental Protection Agency and the U.S. Department of Justice. In connection with the Consent Decree, the Company is subject to a Compliance Schedule, under which the Company has improved its waste characterization procedures, upgraded one of its incinerators, and is evaluating and upgrading its industrial sewer system. The total expenditures required to complete this program are currently estimated to be approximately \$16 million over the next five years. These expenditures are incurred as part of plant operations and, therefore, are not included in the environmental accrual at December 31, 2003.

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

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

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

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

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### NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," an Interpretation of Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements." FIN 46 addresses the consolidation by business enterprises of variable interest entities (VIEs) either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB completed deliberations of proposed modifications to FIN 46 (Revised Interpretations) resulting in multiple effective dates based on the nature and creation date of the VIE. The Revised Interpretations must be applied to all VIEs no later than the end of the first interim or annual reporting period ending after March 15, 2004. However, prior to the required application of the Revised Interpretations, its provisions must be adopted by the end of the first interim or annual reporting period that ends after December 15, 2003 (for the year ended December 31, 2003 for the Company) for VIEs considered to be special purpose entities (SPEs). SPEs for this provision include any entity whose activities are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements. The Company's only material SPE as of December 31, 2003 was related to its equity investment in ESF. Refer to Note 7, "Investments," for the disclosures required under FIN 46 on ESF. The Company is currently evaluating the effect that the adoption of FIN 46 for non-SPE VIEs created prior to February 1, 2003 will have

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on its financial position, results of operations and cash flows. The Company did not have a material exposure to loss as of December 31, 2003 in relation to any VIEs that it had created or obtained an interest in after January 31, 2003.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have any impact on the Company's financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance were recorded as equity, be recorded as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets, and certain obligations that can be settled with shares of stock. The Company adopted SFAS No. 150 on June 1, 2003. The adoption of this statement did not have any effect on the Company's financial position, results of operations or cash flows.

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EITF Issue No. 03-05, "Applicability of AICPA Statement of Position (SOP) 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software," effective September 30, 2003, states that, only software and software-related elements are in the scope of SOP 97-2. The adoption of EITF No. 03-05 did not have a material impact on the Company's financial position, results of operations or cash flows.

In December 2003, the FASB issued a revision of SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits." SFAS No. 132 requires that companies disclose more information about plan assets, benefit obligations, cash flows, benefit costs and other relevant information. Companies are required to disclose plan assets by category and a description of investment policies, strategies and target allocation percentages for these asset categories. Cash flows must include projections of future benefit payments, and an estimate of contributions to be made in the next year to fund pension and other postretirement benefit plans. In addition, companies are required to disclose various elements of pension and other postretirement benefit costs on a quarterly basis. Certain provisions of SFAS No. 132 were effective and were implemented as of and for the year ended December 31, 2003. Certain of the other provisions will be effective for quarterly and annual periods beginning after December 15, 2003. Refer to Note 17, "Retirement Plans," for these new disclosures.

In January 2004, the FASB issued FASB Staff Position (FSP) No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP No. 106-1 allows the sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act, which

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was signed into law in December 2003, introduces a prescription drug benefit under Medicare as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare. The guidance in this FSP is effective for interim or annual financial statements of fiscal years ending after December 7, 2003. In accordance with FSP No. 106-1, the Company has elected to defer accounting for the effects of the Act. Refer to Note 18, "Other Postretirement Benefits," for disclosures required by FSP No. 106-1.

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### 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 and investors should not use historical trends to anticipate results or trends in future periods.

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Kodak recently announced plans to emphasize digital technology to expand into a range of commercial businesses in order to create a more balanced and diversified business portfolio while accelerating the implementation of its existing digital product strategies in the consumer markets. Kodak expects to incur restructuring charges in relation to these initiatives. The expected benefits from these initiatives are subject to many estimates and assumptions, including assumptions regarding: (1) the amount and timing of cost savings and cash flow that Kodak can achieve from its traditional consumer film and paper businesses; (2) the speed at which consumer transition from traditional photography to digital photography occurs; (3) Kodak's ability to develop new digital businesses in its commercial, consumer and health markets; (4) Kodak's ability to identify and complete compatible strategic acquisitions consistent with its growth timeline; and (5) the costs and timing of activities undertaken in connection with these initiatives. In addition, these estimates and assumptions are subject to significant economic, competitive and other uncertainties that are beyond Kodak's control. If these assumptions are not realized, or if other unforeseen events occur, Kodak's results of operations could be adversely affected, as it may not be able to grow its business, and its ability to compete could be negatively affected.

Unanticipated delays in implementing certain product strategies (including digital products, category expansion, digitization, and OLED displays) could adversely affect Kodak's revenues. Kodak's ability to successfully transition its existing products and develop and deploy new products requires that Kodak 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 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 delay in the development, production or marketing of a



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new product could decrease any advantage Kodak may have to be the first or among the first to market. 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 Kodak's products and services and have an adverse effect on its business.

Kodak's ability to implement its intellectual property licensing strategies could also affect the Company's revenue and earnings. Kodak has invested millions of dollars in technologies and needs to protect its intellectual property. The establishment and enforcement of licensing agreements provides a revenue stream in the form of royalties that protects Kodak's ability to further innovate and help the marketplace grow. Kodak's failure to properly manage the development of its intellectual property could adversely affect the future of these patents and the market opportunities that could result from the use of this property. Kodak's failure to manage the costs associated with the pursuit of these licenses could adversely affect the profitability of these operations.

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In the event Kodak were unable to develop and implement e-commerce strategies that are in alignment with the trend toward industry standards and services, 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.

Kodak's completion of planned information systems upgrades, including SAP, if delayed, could adversely affect its business. As Kodak continues to expand the planned information services, the Company must continue to balance the investment of the planned deployment with the need to upgrade the vendor software. Kodak's failure to successfully upgrade to the vendor-supported version could result in risks to system availability, which could adversely affect the business.

Kodak has recently completed various business acquisitions and intends to complete various other business acquisitions in the future, particularly in its Health Imaging and Commercial Imaging segments, in order to strengthen and diversify its portfolio of businesses. At the same time, Kodak needs to streamline and simplify its traditional businesses, including its photofinishing operations in the United States and EAMER. In the event that Kodak fails to effectively manage the portfolio 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.

In 2004, Kodak continues to focus on reduction of inventories and capital expenditures, improvement in receivable performance, and improvement in manufacturing productivity.

Unanticipated delays in the Company's plans to continue inventory reductions in 2004 could adversely impact Kodak's cash flow outlook. Planned inventory reductions could be compromised by slower sales that could result from continued weak global economic conditions. Purchasers' uncertainty about the extent of the global economic downturn could result in lower demand for products and services. In addition, the competitive environment and the transition to digital

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products and services could also place pressures on Kodak's 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.

If Kodak exceeds its 2004 capital spending plan, this factor could adversely impact the Company's cash flow outlook. Further, if Kodak deems it necessary to spend more on regulatory requirements or if unanticipated general maintenance obligations arise that require more capital spending than planned, the increased spending could have an adverse impact on Kodak's cash flow.

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Unanticipated delays in the Company's plans to continue the improvement of its accounts receivable collection and to reduce the number of days sales outstanding could also adversely impact Kodak's cash outlook. A continued weak economy could slow customer payment patterns. In addition, competitive pressures in major segments may cause the financial condition of certain of Kodak's customers to deteriorate. These same pressures may adversely affect the Company's efforts to shorten customer payment terms. Kodak's ability to manage customer risk while maintaining a competitive market share may adversely affect continued accounts receivable improvement in 2004.

Delays in Kodak's plans to improve manufacturing productivity and control costs of operations could negatively impact the gross margins of the Company. Kodak's failure to successfully manage operational performance factors could delay or curtail planned improvements in manufacturing productivity. Accelerating digital substitution could result in lower volumes in the factory than planned, which would also negatively impact gross margins. 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. Additionally, delays in the Company's execution of increasing manufacturing capabilities for certain of its products in some of its emerging markets, particularly China where it is more cost competitive, could adversely impact gross margins.

Kodak's 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 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. The unforeseen changes in manufacturing capacity could also compromise the supply chain efficiencies.

Competition remains intense in the imaging sector in the photography, commercial and health segments. On the photography side, price competition has been driven somewhat by consumers' conservative spending behaviors during times of a weak world economy, international tensions and the accompanying concern over war and terrorism. On the health and commercial side, aggressive pricing tactics intensified in the contract negotiations as competitors were vying for customers and market share domestically. If the pricing and programs are not sufficiently competitive with those offered by Kodak's current and future competitors, Kodak may lose market share, adversely affecting its revenue and gross margins.

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The impact of continuing customer consolidation and buying power could have an adverse impact on Kodak's revenue, gross margins, and earnings.

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In the competitive consumer retail environment, there is a movement from small individually owned retailers to larger and commonly known mass merchants. In the commercial environment, there is a continuing consolidation of various group purchasing organizations. The resellers and distributors may elect to use suppliers other than Kodak. Kodak's challenge is to successfully negotiate contracts that provide the most favorable conditions to the Company in the face of price and aggressive competitors.

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 like China, India, Brazil, Argentina, Mexico, Russia and other economically volatile areas could adversely affect Kodak's 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. Kodak's 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.

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. For example, in early 2002, the United States dollar was eliminated as Argentina's monetary benchmark, resulting in significant currency devaluation. 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.

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CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements in this report may be forward-looking in nature, or "forward-looking statements" as defined in the United States Private Securities Litigation Reform Act of 1995. For example, references to the Company's revenue, cash flow expectations and future focused cost reductions for 2004 are forward-looking statements.

Actual results may differ from those expressed or implied in forward-looking statements. In addition, any forward-looking statements represent the Company's estimates only as of the date they are made, and should not be relied upon as representing the Company's estimates as of any subsequent date. While the Company may elect to update forward-looking statements at some point in the future, the Company specifically disclaims any obligation to do so, even if its estimates change. The forward-looking statements contained in this report are subject to a number of factors and uncertainties, including the successful: implementation of the recently announced digitally-oriented growth strategy, including the related implementation of future focused cost reductions; implementation of product strategies (including digital products, category expansion, digitization, and OLED displays); implementation of intellectual property licensing strategies; development and implementation of e-commerce strategies; completion of information systems upgrades, including SAP, our enterprise system

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software; completion of various portfolio actions; reduction of inventories and capital expenditures; improvement in receivables performance; improvement in manufacturing productivity and techniques; improvement in supply chain efficiency; and the development of the Company's business in emerging markets like China, India, Brazil, Mexico, and Russia. The forward-looking statements contained in this report are subject to the following additional factors and uncertainties: inherent unpredictability of currency fluctuations and raw material costs; competitive actions, including pricing; the nature and pace of technology evolution, including the analog-to-digital transition; continuing customer consolidation and buying power; general economic, business, geo-political and public health conditions; and other factors and uncertainties disclosed herein and from time to time in the Company's other filings with the Securities and Exchange Commission, including but not limited to the items discussed in "Risk Factors" as set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this report.

Any forward-looking statements in this report should be evaluated in light of these important factors and uncertainties as well as the risk factors and other cautionary information contained herein.

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### MARKET PRICE DATA

Price per share:	2003		2002	
	High	Low	High	Low
1st Quarter	\$41.08	\$26.88	\$34.30	\$25.58
2nd Quarter	32.46	26.99	35.49	28.15
3rd Quarter	30.10	20.39	32.36	26.30
4th Quarter	25.83	20.43	38.48	25.60

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### SUMMARY OF OPERATING DATA

A summary of operating data for 2003 and for the four years prior is shown on page 162.

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### FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

#### REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of  
Eastman Kodak Company

In our opinion, the accompanying consolidated statements of earnings, financial position, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Eastman Kodak Company (the Company) at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit

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to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," and No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," on January 1, 2002.

PricewaterhouseCoopers LLP  
Rochester, New York

February 10, 2004 except for Note 25, as to which the date is March 8, 2004, and except for Note 22 and Note 23, as to which the date is May 10, 2004

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Eastman Kodak Company  
CONSOLIDATED STATEMENT OF EARNINGS

(in millions, except per share data)	For the Year Ended December 31,		
	2003	2002	2001
Net sales	\$12,893	\$12,549	\$12,976
Cost of goods sold	8,715	8,022	8,488
	-----	-----	-----
Gross profit	4,178	4,527	4,488
Selling, general and administrative expenses	2,612	2,504	2,592
Research and development costs	775	757	777
Goodwill amortization	-	-	147
Restructuring costs and other	484	98	653
	-----	-----	-----
Earnings from continuing operations before interest, other charges, net, and income taxes	307	1,168	319
Interest expense	147	173	218
Other charges, net	51	101	18
	-----	-----	-----
Earnings from continuing operations before income taxes	109	894	83
(Benefit) provision for income taxes	(90)	133	22
	-----	-----	-----
Earnings from continuing operations	\$ 199	\$ 761	\$ 61
	=====	=====	=====
Earnings from discontinued operations, net of income tax provision of \$12, \$6 and \$10, respectively	\$ 66	\$ 9	\$ 15
	=====	=====	=====
NET EARNINGS	\$ 265	\$ 770	\$ 76
	=====	=====	=====

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Basic and diluted net earnings

(loss) per share:

Continuing operations	\$ .69	\$ 2.61	\$ .21
Discontinued operations	.23	.03	.05
	-----	-----	-----
Total	\$ .92	\$ 2.64	\$ .26
	=====	=====	=====

Cash dividends per share	\$ 1.15	\$ 1.80	\$ 2.21
	=====	=====	=====

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

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Eastman Kodak Company  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
(in millions, except share and per  
share data)

	At December 31,	
	2003	2002
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,250	\$ 569
Receivables, net	2,328	2,197
Inventories, net	1,073	1,054
Deferred income taxes	602	505
Other current assets	130	157
Assets of discontinued operations	72	52
	-----	-----
Total current assets	5,455	4,534
	-----	-----
Property, plant and equipment, net	5,051	5,378
Goodwill	1,364	961
Other long-term assets	2,883	2,558
Assets of discontinued operations	65	63
	-----	-----
<b>TOTAL ASSETS</b>	<b>\$14,818</b>	<b>\$13,494</b>
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and other current liabilities	\$ 3,614	\$ 3,322
Short-term borrowings	946	1,442
Accrued income taxes	654	709
Liabilities of discontinued operations	36	29
	-----	-----
Total current liabilities	5,250	5,502
Long-term debt, net of current portion	2,302	1,164
Postretirement liabilities	3,344	3,412
Other long-term liabilities	650	632
Liabilities of discontinued operations	8	7
	-----	-----
Total liabilities	11,554	10,717
	-----	-----

Commitments and Contingencies (Note 11)

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SHAREHOLDERS' EQUITY

Common stock, \$2.50 par value; 950,000,000 shares authorized; 391,292,760 shares issued in 2003 and 2002; 286,580,671 and 285,933,179 shares outstanding in 2003 and 2002	978	978
Additional paid in capital	850	849
Retained earnings	7,527	7,611
Accumulated other comprehensive loss	(231)	(771)
Unearned restricted stock	(8)	-
	-----	-----
	9,116	8,667
Treasury stock, at cost 104,712,089 shares in 2003 and 105,359,581 shares in 2002	5,852	5,890
	-----	-----
Total shareholders' equity	3,264	2,777
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$14,818	\$13,494
	=====	=====

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

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Eastman Kodak Company  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in millions, except share and per share data)

	Common Stock*	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasur Stock
Shareholders' Equity December 31, 2000	\$978	\$ 871	\$ 7,869	\$(482)	\$(5,800)
Net earnings	-	-	76	-	
Other comprehensive income (loss):					
Unrealized losses on available-for-sale securities (\$34 million pre-tax)	-	-	-	(21)	
Reclassification adjustment for gains on available-for-sale securities included in net earnings (\$13 million pre-tax)	-	-	-	8	
Unrealized gain arising from hedging activity (\$6 million pre-tax)	-	-	-	4	
Reclassification adjustment for hedging related losses included in net earnings (\$48 million pre-tax)	-	-	-	29	
Currency translation adjustments	-	-	-	(98)	
Minimum pension liability adjustment (\$60 million pre-tax)	-	-	-	(37)	
Other comprehensive loss	-	-	-	(115)	

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Comprehensive loss				-----	
Cash dividends declared (\$2.21 per common share)	-	-	(514)	-	
Treasury stock repurchased (947,670 shares)	-	-	-	-	(4)
Treasury stock issued under employee plans (1,393,105 shares)	-	(25)	-	-	8
Tax reductions - employee plans	-	3	-	-	
	-----	-----	-----	-----	-----
Shareholders' Equity December 31, 2001	\$978	\$ 849	\$ 7,431	\$(597)	\$(5,76)

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Eastman Kodak Company  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY Cont'd.

(in millions, except share and per share data)

	Common Stock*	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock
Shareholders' Equity December 31, 2001	\$978	\$ 849	\$ 7,431	\$(597)	\$(5,767)
Net earnings	-	-	770	-	-
Other comprehensive income (loss):					
Unrealized gains on available-for-sale securities (\$11 million pre-tax)	-	-	-	6	-
Unrealized loss arising from hedging activity (\$27 million pre-tax)	-	-	-	(19)	-
Reclassification adjustment for hedging related losses included in net earnings (\$24 million pre-tax)	-	-	-	15	-
Currency translation adjustments	-	-	-	218	-
Minimum pension liability adjustment (\$577 million pre-tax)	-	-	-	(394)	-
Other comprehensive loss	-	-	-	(174)	-
Comprehensive income				-----	
Cash dividends declared (\$1.80 per common share)	-	-	(525)	-	-
Treasury stock repurchased (7,354,316 shares)	-	-	-	-	(260)
Treasury stock issued under employee plans (2,357,794 shares)	-	(1)	(65)	-	137
Tax reductions - employee plans	-	1	-	-	-
	-----	-----	-----	-----	-----
Shareholders' Equity December 31, 2002	\$978	\$ 849	\$ 7,611	\$(771)	\$(5,890)

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Eastman Kodak Company  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY Cont'd.



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(in millions, except share and per share data)

	Common Stock*	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Unearned Restrict- ed T Stock
Shareholders' Equity December 31, 2002	\$978	\$ 849	\$ 7,611	\$ (771)	\$ -
Net earnings	-	-	265	-	-
Other comprehensive income (loss):					
Unrealized gains on available-for-sale securities (\$18 million pre-tax)	-	-	-	11	-
Unrealized loss arising from hedging activity (\$42 million pre-tax)	-	-	-	(25)	-
Reclassification adjustment for hedging related losses included in net earnings (\$29 million pre-tax)	-	-	-	19	-
Currency translation adjustments	-	-	-	413	-
Minimum pension liability adjustment (\$167 million pre-tax)	-	-	-	122	-
Other comprehensive income	-	-	-	540	-
Comprehensive income				-----	
Cash dividends declared (\$1.15 per common share)	-	-	(330)	-	-
Treasury stock issued for stock option exercises (337,940 shares)	-	-	(10)	-	-
Unearned restricted stock issuances (309,552 shares)	-	-	(9)	-	(8)
Tax reductions - employee plans	-	1	-	-	-
Shareholders' Equity December 31, 2003	==== \$978	===== \$ 850	===== \$ 7,527	===== \$ (231)	===== \$ (8)