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# Kodak Struggles to Find Its Moment

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ROCHESTER, N.Y—After three decades of serial reorganizations, Eastman Kodak Co. is struggling to stay in the picture.

The 131-year-old company lost much of its film business to foreign competitors, then mishandled the transition to digital cameras. Now it is quickly burning through its cash as it remakes itself into a company that sells printers and ink.

On July 26, Kodak reported its fifth consecutive quarter of losses. The company's junk-rated debt coming due in two years has moved below 80 cents on the dollar, signaling the market sees a risk of default. The company's already battered stock has taken an especially tough pounding in recent days, falling 10% Wednesday to $1.77. Prior to this week, Kodak hadn't closed below $2 since the 1950s, according to the Center for Research in Security Prices at the University of Chicago.


Kodak had been raising money by suing companies for its portfolio of patents, including its image-preview patent. But the flow of settlements dried up this year, prompting Kodak last month to seek offers on some the patents themselves, a person familiar with the matter said.

In a sign of how far Kodak has fallen, analysts believe the patent portfolio is worth more than the company's stock-market value, which has fallen below $500 million.

After the company got a call from a banker late last month describing a private-equity firm's interest in buying a large stake in the company, Chief Executive Antonio Perez quickly assembled the board for a weekend conference call to approve a measure that would deter a hostile takeover, a person familiar with the matter said. Kodak announced a poison pill Aug. 1 that allows shareholders to buy stock at a discount if an outside investor acquires a big stake.

Kodak has struggled to revamp to make the move from their heritage product, film, to ink and printing

Some former executives say the company probably should have broken itself up and sold off the parts. Mr. Perez rejects that notion, and it would be complicated by the company's pension obligations. The board may be more flexible than its CEO, however. Rick Braddock, Kodak's presiding independent director, said a breakup doesn't make sense given the company's commitment to a turnaround. But he added, "I am not going to rule anything out."

technology, but the company has now resorted to selling off its patent portfolio, WSJ's Dana Mattioli reports. (Photo: AP Photo.)

Mr. Perez said he remains confident in the company's transition plan. He said the company will end the year with at least $1.6 billion in cash, up from $957 million now, because he expects intellectual property revenue, asset disposals—potentially including the patents—and sales to pick up in the second half.

"You can argue with the degree with which this plan is going to work," the chief executive said in an interview at the company's Rochester headquarters in its "Experience Kodak" room, which is filled with Kodak's new printers and digital cameras, as well as artifacts of the company's glory days. "It's not that it's not going to work."

Mark Ovaska for The Wall Street Journal

Kodak CEO Antonio Perez has fought against breaking up Kodak, even as the company has struggled.

Mr. Perez said the company's heavy cash burn this year reflects the timing of pension-plan contributions and intellectual-property settlements, not an underlying problem with the business. Kodak's printers are rapidly gaining market share, and the business will be highly profitable once a base of users is established and Kodak can start cashing in on ink sales, he said.

Separately, Kodak got a break earlier this month when a judge who had initially ruled against the company in a patent suit against Apple Inc. and BlackBerry maker Research In Motion Ltd. resigned before completing a second review of the case. Kodak alleges that the camera functions in Apple and RIM mobile phones violate its image-previewing patent. The case will now be assigned to a different judge. Mr. Perez has said the suit could bring in $1 billion. Apple and RIM declined to comment.

Wall Street remains concerned about the company's performance. "It was a disappointing quarter in cash-flow burn, topline growth and overall growth," said Chris Whitmore, an analyst with Deutsche Bank. "They're selling the family silver to keep the lights on."

Mr. Perez, 65 years old, is the fifth Kodak chief in about three decades to be charged with stopping the company's slide. Their approaches haven't lacked for creativity. Over the decades, the film giant tried diversifying into pharmaceuticals, bathroom cleaners and medical-testing devices. None did the trick.

A Hewlett-Packard Co. veteran, Mr. Perez picked printers. The plan puts him in competition with giants like H-P, Canon Inc. and Seiko Epson Corp., which together control nearly three-quarters of the market, according to technology data firm IDC.

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Kodak began selling printers to consumers in 2007. Its strategy was to turn the industry's prevailing approach on its head by offering a more expensive printer and cheaper ink. At its core was a bet that nanotechnology used in filmmaking would enable Kodak's scientists to produce an ink that wouldn't clog printer heads, which typically have to be replaced at each refill, adding to the cost.

By 2010, the company held 3% of the all-in-one inkjet printer market world-wide, according to IDC, up from 1% in 2008. Kodak's strategy is to subsidize the cost of the printers until its installed base is big enough to generate a lot of ink sales. Still, because its ink refills are cheaper, Kodak is able to sell its printers at a higher price than competitors.

While acknowledging that Mr. Perez inherited a difficult business challenge, people inside the company say missteps have slowed Kodak's transformation. Early versions of Kodak's printers were plagued by problems, like printhead failures that required Kodak to cover the cost of replacements, said a person familiar with the matter. By the time the company sorted out the complications, the recession had set in.

Kodak's board of directors maintains its support for Mr. Perez and his strategy. In September 2009, it talked him out of retiring and renewed his contract through 2013. Kodak's shift to a new strategy "is really one of the hardest business transitions I have ever seen," said Mr. Braddock, the presiding director.

For generations, Kodak reaped profits from one high-margin product: film. With the credo "You press the button, we do the rest," Kodak's affordable film and cameras transformed photography from a highly skilled pursuit to a pastime of the everyman.

By the 1980s, troubles were mounting as foreign film competitors took share from Kodak and digital technologies emerged. Kodak says it invented the world's first digital camera in 1975 and spent hundreds of millions of dollars developing digital technology. Yet the fear of cannibalizing its film sales paralyzed the company when it came time to go to market.

Kodak's struggles have taken a toll on Rochester. In 2004, Kodak employed 16,300 workers in the city. As of 2010, that number was just 7,100. Over the same period, the company's global work force has shrunk to 18,800 from 54,800.

Kodak's insular corporate culture, encouraged by the town's isolation, bears much of the blame for Kodak's failure to adapt, former employees say. A retired board member says an outside consultant hired by management in the early 1990s prepared a report titled "The Poisoned Inheritance" criticizing the company's inwardly focused culture. Management's reaction? "Ho hum," he said, adding that few independent directors even saw the report.

Mr. Perez joined Kodak in 2003 as president and chief operating officer following a 25-year-career at H-P, where he headed the company's inkjet printer business. At H-P, he led an effort to acquire Kodak, during which he says he became fascinated by the company's intellectual property. Leaving H-P after Carly Fiorina beat him out for the top post, Mr. Perez took his printer know-how to Kodak.

When he was tapped by the board to become chief executive in 2005, Mr. Perez was given three goals: Shrink the film business, create a new digital company and manage its pension and health-care costs for retirees. Each is enormously expensive. The company says restructuring film alone cost $3.4 billion over four years. The company's operations don't generate enough cash to cover all the expenses.

From early on, Kodak began amassing patents related to film and coating technology. It's registered more than 11,000 patents, with many of the new ones focused on digital technology like its image-previewing patent. To fund the massive investment his digital strategy required, Mr. Perez started litigating and licensing Kodak's digital-imaging patents, a strategy that brought in $1.9 billion from 2008 to 2010.

The drought in income from patents suits this year prompted the company to look more seriously at selling patents, one board member said. The plan was approved at a meeting in Connecticut in mid-July, this director said. Kodak is also looking to sell off or lease 2.5 million square feet at what used to be its major manufacturing center in Rochester, Kodak Park.

Mr. Perez says he spent his first months at Kodak wandering its sites and factories, assembling an internal group of "rebels" to get to know the operations. During a weekly meeting with his "R-team," he learned of a continuous inkjet project one of the labs was working on. Because of the company's film background, Kodak had the capability to make pigment-based ink that wouldn't clog the nozzles of printing heads.

Mr. Perez said he presented a number of digital businesses to the board. They included document scanners, high-tech display panels and new sensor technology. "I started with 11, and I told the board that at least 30% of them were the wrong ones, but I didn't know which ones," Mr. Perez said.

The board approved all 11 digital businesses, but Mr. Perez and management later stopped pursuing two of them. The company's fate now rests primarily on printing. Kodak originally forecast that its consumer printers would break even in 2010, but later pushed the time frame to 2011.

A former executive who recently left the division says Kodak overestimated its ability to penetrate the printer market and there are doubts internally about whether the 2011 target can be met. Mounting competition has pushed down printer prices, raising another hurdle to profitability.

Revenue from sales of consumer inkjet printers and ink grew by 48% in the second quarter. "We are taking share from everyone," said Mr. Braddock, the director. Mr. Perez said the business could become instantly profitable by eliminating its subsidies for consumers who buy its printers, but that doing so would hurt efforts to build a base for ink sales.

Kodak's commercial printing business, geared toward publishers and marketers, has even further to go. The company aims to sell room-size machines that can print thousands of pages a minute, each of them with different content. So far, it has only a few dozen customers and is building the complicated machines by hand.

In the second quarter, losses in the commercial group swelled to $45 million from $17 million a year earlier, due largely to unanticipated costs of adapting the complicated technology to customers' environments.

Mr. Perez, who has surrounded himself with former H-P executives, is pressing ahead with printing. To keep up employees' morale, he draws on his experience as a former runner, saying when he used to run 10,000-meter races, the last two kilometers were always the hardest.

"At the same time, this is the time you can lose the race," he said. "So keep running."

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