Negative Exposure for Kodak

BY ANDREW MARTIN
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At least Eastman Kodak didn't pin its latest turnaround effort on the fax machine. Just the same, as one securities analyst said, Wall Street worries that the once pre-eminent film company is jumping "from one buggy whip business to another."

Antonio M. Perez, Kodak's chief executive, has poured hundreds of millions of dollars into transforming Kodak into a giant in the inkjet printer business, even as printouts are increasingly being replaced with electronic copies on computers, tablets and smartphones.

"You will see that that business is going to be a gorgeous business for this company," Mr. Perez told analysts in July. While it is difficult to know whether Mr. Perez's strategy will succeed, two things are certain: Kodak is burning through a lot of cash to pursue it; and many investors are highly skeptical.

Consumer inkjet revenue at Kodak grew 48 percent in the second quarter, but since the first of the year, Kodak shares have lost about three-quarters of their value. And in recent weeks, rumors about the company going bankrupt have been rife. The stock fell 2.4 percent to close at $1.24 on Thursday.

Mr. Perez, who was named the chief executive in 2005, declined to comment for this article, citing the quiet period before the next earnings are announced on Nov. 3. Company officials deny that Kodak is considering a bankruptcy filing.

A Kodak spokesman said that Mr. Perez had pursued inkjet printers because the company had "a treasure trove" of inkjet technology in its research and development unit and that the business was "well positioned for ongoing success."

"Our corporate strategy is focused on core strengths at the intersection of materials science and digital imaging science," Christopher Veronda, the spokesman, said in an e-mail. "This is squarely in that arena." In addition, Kodak officials said that inkjet printers were just part of a turnaround strategy that also included a focus on commercial printing, packaging and workplace software.

Critics of Kodak's direction are impatient.

Working on a store display of Kodak printers. The company has invested hundreds of millions in the inkjet printer business. (Marilynn K. Yee/The New York Times)

Gregg Abella, a co-principal at Investment Partners Asset Management, said he was tired of hearing Mr. Perez say the company would turn around in a year or two. And he questioned why the Kodak board had not been more assertive in steering Mr. Perez on a different course.

"How on earth did the board listen to this guy for the past six years and not do anything about it?" Mr. Abella said. "There is an expectation when you buy into the stock or bonds of a Fortune 500 company that the board will respond to deteriorating financial conditions before it becomes nothing more than a call option on its intellectual property."

Chris Whitmore, the analyst who likened Kodak's printer strategy to a buggy whip, said the company still had not recovered from its first misstep: its failure to fully embrace digital cameras after sales of Kodak's signature yellow-box film collapsed.

"The big story here is that their core business — the yellow box business — got cannibalized by the digital camera, which ironically they invented," said Mr. Whitmore, who works at Deutsche Bank Securities.

Mr. Perez is the latest Kodak chief executive to try to remake the company after its dominance in film was eroded by more nimble competitors and digital technology. A former Hewlett-Packard executive who lost the top job there to Carly Fiorina, Mr. Perez laid out a strategy that included closing film plants and refocusing the company. He leased out the company's patent portfolio, which generated $1.9 billion from 2008 to 2010, to finance his turnaround efforts.

And Mr. Perez poured money into businesses that he thought would eventually pay dividends, including consumer inkjet printers, in effect taking on his former employer, H.P. Mr. Perez rejected the traditional razor-blade model used by most printer manufacturers who offered relatively cheap printers and made their money on the ink.

Instead, Kodak charged slightly higher prices for its printers and sold its ink relatively cheap. "We think it will give us an opportunity to disrupt the industry's business model and address consumers' main dissatisfaction: the cost of ink," Mr. Perez told Businessweek in 2007.

To date, Kodak's consumer inkjet business has captured about 6 percent of the United States market, according to the market research firm IDC. In contrast, H.P. commands about 60 percent of the market, which is expected to remain relatively flat or even decline.

"Technologically, I think the product is fine," said Marco Boer, a vice president for I.T. Strategies, a digital printing market research firm. "But is it going to save Kodak? Even if inkjet was a phenomenal success, I am not sure if any company could grow that business fast enough to offset declines in Kodak's other businesses."

Ken Luskin, a disgruntled Kodak investor who runs Intrinsic Value Asset Management, said Mr. Perez's turnaround strategy was the story of how "a company has been run into the ground by one guy's ego needs."

"He said, 'I'm going to rub this in Hewlett-Packard's face.' This is why they are doing this," Mr. Luskin said.

But Mark Kaufman, an analyst at Rafferty Capital, is more bullish on Kodak's prospects. He said the company had better technology than its competitors in commercial and consumer printers. In addition, he said Kodak's proposed sale of some of its patents could generate more than $2 billion and put the company in a position to be sold, or thrive on its own.

"They might be able to pull it off on their own because it's superior technology," he said.

Few would question that Mr. Perez has faced an unusually formidable task. The year that Mr. Perez was named chief executive, 2005, the company posted losses of nearly $1.3 billion.

Kodak was created by the inventor George Eastman in the late 19th century. It quickly became a household name by marketing film under the slogan, "You press the button, we do the rest." Kodak thrived using the same razor-and-blade strategy, selling cameras for low prices and making its money on the film.

In 1975, a Kodak scientist invented the world's first digital camera, which was about the size of a toaster. At that time, Kodak controlled about 90 percent of the film market and 85 percent of camera sales in the United States, according to Harvard researchers.

But Kodak's phenomenal success in film would also be its undoing, making its managers complacent and slow to adapt to change. When Fuji began eating away at Kodak's film business in the 1970s, Kodak executives ignored internal warnings because "they didn't believe the American public would buy another film," according to "Changing Focus: Kodak and the Battle to Save a Great American Company," by Alecia Swasy.

In one notorious incident from the early 1990s, Kodak's chief at the time, Kay R. Whitmore, fell asleep during a meeting with Microsoft's founder, Bill Gates.

By then, it was clear that Kodak needed to make significant changes to stay relevant, with its film business in a steep decline. During the previous decade, the company acquired companies that made in-vitro blood analyzers, floppy disks, aspirin and Lysol in an attempt to reverse the decline, the Harvard study said.

"Let's face realities," said Ulysses Yannas, a broker at Buckman, Buckman & Reid who has followed Kodak for four decades and applauds Mr. Perez's efforts. "This company was very, very badly managed throughout the '60s, '70s, '80s and '90s. It was run like a civil service."

Mr. Perez vowed to turn the company around by 2008. While that has yet to happen, Kodak officials say three-quarters of the company's revenue now comes from digital products. A decade ago, most of its revenue still came from film. In addition, in the most recent quarter, Kodak's main growth areas grew 22 percent, led by the 48 percent increase in consumer inkjet revenue.

"We remain focused on our strategy to become a profitable, sustainable digital company," Mr. Veronda, the spokesman, said in an e-mail.■