

## MARKET BASED OPPORTUNITY SCREENING WORKSHEET

### What is the Opportunity For Kodak?

Introduce to the consumer/personal market a line of multipurpose digital machines (inkjet printer, copier, fax and scanner) that output the full range of colored pages at a fraction of the cost per copy of current machines and quality that equals high-quality photos.

### What is the Market Need to be served?

- High quality photo printing (vivid colors that last a lifetime)
- Affordable colored ink for all colored copies from personal printers and copiers
- Confidence in the brand

### What is (are) the Market(s) to be served?

- Consumer print/copy markets primarily sold through big box retailers

### Is the opportunity compatible with our Strategic Focus? Strategic Competencies? Mission Statement?

- It is ideal for Kodak and immediately adjacent to their core business
- It is Kodak's big hope for replacing its rapidly declining non-digital film business (its historical mainstay)

### How is the Market Need currently being met?

- Competitors have been selling high quality, brand-name digital inkjet printers that produce copies with good color vibrancy but limited life (typically 15 years) and are expensive per copy (typically \$0.24) because of the cost of the ink cartridges.
- Current machine market is dominated by HP, Lexmark and Canon.
- Market for replacement ink cartridges is controlled by both the machine manufacturers and cartridge remanufacturers selling under no-name and big-box seller private labels.
- Paper market for photos is largely controlled by machine manufacturers who attempt to differentiate their quality by fine-tuning their particular machine/ink/paper system.
- Digital photo printing by services such as Kodak labs is available through retail store kiosks and on-line.

### What Product/Package Improvements are needed/desired by the market?

- Color prints that are brilliant and last a lifetime.
- Ability to print a page with color without having to view it as an investment decision; uncertain how low the cost per copy has to be to accomplish this, but reducing the cost by more than 50% (\$0.24 to \$0.10) would seem sufficient.

### Can we be Cost Competitive?

- Yes! Not only competitive but set a whole new low cost level as a result of what will be a technical breakthrough—using pigment based ink and placing the inkjet head in the machine rather than in the ink cartridge

## MARKET BASED OPPORTUNITY SCREENING WORKSHEET

### Have we the necessary Management Capability and Capacity?

- Yes, we have a strong marriage between Kodak people and new HP transplants into Kodak, including Antonio M. Perez, our new Kodak president.

### Can we handle the Technology?

- Yes, via Kodak people + new HP transplants + other strategic alliances.
- The ink and delivery system are highly protected by patents.

### Can we handle the Operations?

- Yes, either internally or a combination of internal and outsourcing, as we are doing with our line of digital cameras.

### Can we handle the Marketing? Do we have appropriate Distribution Channels?

- Yes, we have all of the marketing competencies needed.
- We have strong relationships with the Big Box retailers like Best Buy, Office Depot, Office Max and Staples but do not have the shelf space commitments enjoyed by HP and Canon (HP has double commitment due to its also offering PC's).

### Can we handle the Financing?

- Yes, our \$1+ billion cash flow will easily handle the estimated \$300 million development cost over several years plus follow-on market launch investments.

### What is the Current Size of the Market? Is it Too Large or Too Small?

- The \$50 billion printer industry is probably the right size for Kodak, given its \$10 billion size. It is certainly not too small.

### Is there a Competitive Opening? How must we Position our offering to obtain entry?

- We must both offer a demonstrably better system and offer it at a price that not only gains market share but also significantly increases the size of the market so that our competitors can gain revenue while losing share.

### Is there a reasonable basis for Competitive Advantage for us? What Strategic Competencies are involved?

- Two primary competitive advantages: (1) the cost structure of the new machine and ink technology and (2) patent protection coupled with the lead-time before non-protected proprietary technology could be "copied."
- Relative to smaller or new competitors, Kodak has competitive advantage with its brand and breadth of line of digital products as well as its host of competencies in product development, manufacturing and consumer marketing.

## MARKET BASED OPPORTUNITY SCREENING WORKSHEET

### Is there potential for Specialty Status for us? Which Features or Benefits will command a premium?

- Not much. This market is already experiencing commoditization under its current value proposition—our offering will accelerate it. (Normally, being “last to market” is clearly a contrarian strategy.)

### Who are the most likely competitors? What will be their likely competitive response?

- HP, Canon and Lexmark are the chief competitors and they will have a very strong response. (HP generates 60% of its operating profits from this business.)
- The current industry business model is the familiar razor/razor blade approach with very low margins on the machine and high margins on consumables, particularly ink cartridges. The machine manufacturers are currently holding the price umbrella over remanufacturers, who are successful with prices that they only have to discount about 10%.
- They will certainly attempt to match Kodak’s cost structure with system innovations that equal or exceed Kodak’s—to what degree they can accomplish this is unclear. Time is certainly on our side. Although Kodak can keep the specifics of this development project secret, it will not be a total surprise, since 40 key people defected from HP to Kodak in 2003. The competitors are far too sophisticated to be sitting in a state of paralyzing fear—no doubt they will develop contingency plans to answer multiple scenarios.
- These major competitors are likely to try to choke off distribution through the big box retailers through their existing relationships and market power. They will likely be able to partially offset some of their manufacturing cost disadvantage with distribution cost advantages.

### Can we achieve significant/adequate Market Penetration? Estimate our Market Share for the First and Fifth Years.

- Given the 33% share of HP, the leader in this market, Kodak will do well to achieve 15% after 5 years and likely not exceed 3% in the first year. These shares translate into huge revenues for Kodak.
  - If we guess that 40% of the \$50 billion market or \$20 billion is the size of this particular market and it grows at 15% per year:
    - The 3% share yields \$0.6 billion in the first year and the 15% share yields \$6 billion, which would add 50% to the current size of Kodak. (Unfortunately, Kodak will continue to lose its legacy non-digital market at a rate that will largely offset this hoped-for gain.)
    - Assuming that Kodak gains share equally from each of the current players, the impact on HP in year 5 would be a reduction of share to about 28% but cushioned by a 67% increase of current revenues from this market.
- It is important to recognize that the early revenue will generate a lower rate of profit for two reasons: (1) the machine/consumable product mix will be heavily weighted toward the low profit machines until the need for replacement cartridges fully kicks in and (2) the marketing expenses will be a disproportionately high percentage of revenue during the launch.

## MARKET BASED OPPORTUNITY SCREENING WORKSHEET

### What is the expected Growth Rate for the market?

- Estimated at 15% per year due to the high growth rate for digital imaging and the expansion of the printing/copying market due to Kodak's 50% lower direct cost per copy (expected to be \$.10 for a 4x6 photo).

### What are the expected Profit Levels for the market?

- Gross margins are expected to be around 50% once a normal machine/consumable product mix is established.

### Are there any Threats to the market?

- None that are known today.

### Is there any potential for Product or Service Displacement?

- A technological breakthrough in e-paper with no printing could be a cataclysmic displacement. However, this seems highly improbable, given that a paperless world has been promoted for the past 25 years and failed to materialize significantly.

### What is the expected Return on Invested Capital?

- Profit = 50% Gross Margin – 17% SG&A – 6% R&D = 27% Operating Income Before Tax
- With Revenue at \$6 billion the Operating Income could be as high as \$1.6 billion in the fifth year.
- The development cost investment is anticipated to be around \$300 million. If we conservatively double this investment to \$600 million and add Working Capital of 20% of Revenue or \$1.2 billion, then the total Invested Capital for this opportunity would be \$1.8 billion.
- The Pre-tax ROIC =  $1.6 / 1.8 = 89\%$  is huge and has room for being 100% wrong on Operating Income and 50% wrong on Invested Capital (i.e., ROIC would be  $0.8 / 2.7 = 30\%$ ).
- An even greater return is the avoidance of continued erosion of our Market Value. Elimination of the current \$.50 per share dividend (after-tax) on 287.1 million shares would pay for the downside.

### What is the Downside Exposure to Financial Loss?

- The absolute worst out-of-pocket loss would be equal to the total cost of development through the launch, estimated at \$400 to \$750 million pre-tax. More likely the downside exposure would be \$300 million or less.

### Can we afford the Downside Exposure?

- \* In a bad-case scenario, Kodak could sell the product line to a competitor or license/sell the print engine and pigment-based ink system to one or more competitors similar to how Canon sold laser printer engines to OEMs like HP. (What if Kodak and HP partnered on this breakthrough? Would it make sense to rejuvenate the JV that existed from 2000 to 2003?)
- \* Yes, given our \$1+ billion cash flow (after-tax). We must afford this exposure because this is the opportunity that has the highest probability of transforming Kodak into a digital imaging company within a period of time that we can live with.

## MARKET BASED OPPORTUNITY SCREENING WORKSHEET

**Kodak should seize this opportunity with “pedal to the metal,” “full steam ahead!” Bon Voyage!**