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KODK - Q1 2017 Eastman Kodak Co Earnings Call

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to Eastman Kodak First Quarter 2017 Earnings Conference Call. (Operator Instructions) And as a reminder, this conference may be recorded. I would now like to introduce your host for today's conference, Mr. Bill Love. Sir, you may begin.

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**William G. Love** - *Eastman Kodak Company - Director of IR and Treasurer*

Thank you, Sabrina, and good afternoon, everyone. My name is Bill Love, and I am Eastman Kodak Company's Treasurer and Director of Investor Relations. Welcome to our First Quarter 2017 Kodak Earnings Call. I'm sorry for the delay in starting our call. There were some technical difficulties by the provider, which we believe now have been resolved.

At 4:15 p.m. this afternoon, Kodak filed its annual report on Form 10-Q and issued its release on financial results for the first quarter 2017. You may access the presentation and webcast for Kodak -- for today's call on our Investor Center at investor.kodak.com. During today's call, we will be making certain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. All forward-looking statements are based upon Kodak's expectations and various assumptions. Future events or results may differ from those anticipated or expressed in the forward-looking statements. Important factors that could cause actual results or events to differ materially from these forward-looking statements include, among others, the risks, uncertainties and other factors described in more detail in Kodak's filings with the U.S. Securities and Exchange Commission from time to time.

There may be other factors that may cause Kodak's actual results to differ materially from the forward-looking statements. All forward-looking statements attributable to Kodak, or persons acting on its behalf, apply only as of the date of this presentation and are expressly qualified in their entirety by the cautionary statements included or referenced in this presentation. In addition, the release just issued and the presentation provided contains certain measures that are deemed non-GAAP measures. Reconciliations to the most directly comparable GAAP measures have been provided with the release and within the presentation on our website in our Investor Center at investor.kodak.com.

Speakers on today's call will be Jeff Clarke, Chief Executive Officer of Kodak; and Dave Bullwinkle, Chief Financial Officer of Kodak. Jeff will provide some opening remarks, his perspective on Kodak's financial performance and guidance for 2017. Then Dave will summarize first quarter 2017 results, provide an update on cost reductions and review cash performance before we open it up to questions.

I will now turn the call over to Kodak's CEO, Jeff Clarke.

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Thank you, Bill. Welcome, everyone, and thank you for joining the Q1 investor call for Kodak. On the call today, I'll talk about the company and divisional results for the first quarter of 2017, our decision to retain PROSPER and the impact to our divisions, certain headwinds the company faces, our 2017 forecast and my thoughts on the future trajectory of Kodak. Dave will then follow up with more details on net earnings, our cost reduction update and a detailed discussion of cash flow, after which we'll welcome your questions.

Starting on Slide 5. Kodak delivered first quarter revenues of $357 million, down from $377 million in the prior year quarter or 4% on a constant-currency basis. Operational EBITDA for the quarter was $8 million, consistent with our expectation but down $11 million compared to the first quarter of 2016 or $9 million on a constant-currency basis. Our cash use was $56 million, primarily due to an increased build of inventory and the year-to-year reduction in operational EBITDA.

On Slide 6. In early April, the company announced the decision to retain the PROSPER inkjet business. The decision was made following an in-depth management review of business operation and multiple discussions with prospective buyers. This was a pragmatic decision given the improvements in the business and the indications of interests received. Kodak is committed to multiple paths for maximizing shareholder value, including organic growth and inorganic transactions through mergers, acquisitions or divestitures. Last year, we saw the opportunity to accelerate the monetization of our PROSPER business through a divestiture. It began with serious, unsolicited indications of interest from significant industry participants. We hired an investment banker and featured the attributes of PROSPER and ULTRASTREAM at drupa, a major printing industry trade show, which created additional interest in the business. After comprehensive dialogue with multiple parties, we determined the interest we received did not meet our view of the value of the business. We will continue to be pragmatic in the approach we use to monetize businesses and drive shareholder value.

In the case of PROSPER, we are unable to complete the monetization despite a thorough process. Not every inorganic opportunity will succeed and most are not public, however, we will continue to pursue opportunities with the goal of maximizing shareholder value. With a $52 million annual annuity stream, we believe the PROSPER business is worth more than the net book value and the indications of interest received. We're presenting the PROSPER business within the Enterprise Inkjet Systems Division, beginning with this year's -- with this quarter's reporting. We expect EISD, which includes our legacy VERSAMARK business, PROSPER and our investment in ULTRASTREAM to be breakeven to slightly profitable for the full year 2017. This is a significant milestone to the division. Slide 6 also illustrates the growth of recurring revenues as our installed base increases. For the trailing 12-month period ending Q1 2016 and Q1 2017, recurring revenues grew by 27% and 37%, respectively.

Please move to Slide 7, so I can provide more granular insight into our EISD division. In order to compete in the highly competitive inkjet industry, it's necessary to introduce new technologies. As demonstrated on this slide, new products often take many years to develop but can generate earnings for decades. A good example of this life cycle is VERSAMARK, our legacy continuous and Drop-on-Demand inkjet offering introduced in 1998. VERSAMARK equipment sales include digital presses and imprinting systems. 20 years later, after significant industry profits -- significant profits, the majority of VERSAMARK revenues are from annuities today, and the business delivered $76 million of revenue and $23 million of operational EBITDA before corporate costs in 2016. We expect to continue managing through the profitable planned decline of this legacy inkjet business over the next 4 to 5 years.

In 2009, Kodak introduced the PROSPER series of continuous inkjet printing equipment with digital presses, imprinting systems and OEM equipment. PROSPER uses stream technology to deliver a continuous flow of ink to substrates with uniform dot size and accurate dot placement at very high speeds, which provides exceptional vibrancy and color consistency. PROSPER delivered $94 million of revenue and a negative $21 million of operational EBITDA in 2016. For the first quarter of 2017, PROSPER annuity revenues grew 26%.

The company had ambitious plans for PROSPER to operate across a broad set of applications. As we move further into its life cycle, it became clear PROSPER needed to be focused on high-volume applications. Our conclusion was affirmed during the sale process as most of the interest was in future application technologies. As a result, we have shifted our business model to focus on the sale of components, and a limited expansion of the installed base of presses to serve high-volume applications which drive levels of profitable annuities. After significant investment for many years, we expect PROSPER to contribute meaningfully to our revenues and earnings for the foreseeable future.

Our next-generation ULTRASTREAM technology, which we expect to be available in 2019, will combine the benefits of Drop-on-Demand and stream technology. However, the investment and time to market will be substantially less than our ambitious PROSPER program with a primary focus on OEM equipment and imprinting systems. Through Q1 2017, our total investment in ULTRASTREAM technology is approximately $19 million, with $3 million in 2015, $11 million last year in 2016 and $5 million in Q1 of 2017. We expect to invest an additional $12 million remaining -- remainder of 2017. ULTRASTREAM will greatly expand the market reach of this technology and have a broader application in PROSPER. We've entered into 19 letters of intent with partners for ULTRASTREAM technology, which will create new applications and drive market demand for the technology.

During Q1, we revised our divisional organizational structure. The Micro 3D Printing Business, previously within the Micro 3D Printing and Packaging Division, was combined with the Intellectual Property Solutions Division which is being renamed to the Advanced Materials and 3D Printing Technology Division, AM3D. The flexographic packaging business, formally a part of MPPD, is being reported as a dedicated division. We also announced several changes to our divisional management structure. Randy Vandagriff became President of EISD, replacing Phil Cullimore who left Kodak after leading several businesses at Kodak. Terry Taber will lead the AM3D organization, and Chris Payne will lead the flexographic packaging division. The changes in our divisional structure and management team will provide greater transparency into the flexographic packaging business, align the Micro 3D Printing business with other businesses in the early commercialization stage of their life cycle and places responsibility with experienced leaders to continue growing these businesses. We have recast the prior period to present our divisional results on a comparable basis for these changes.

Slide 8 presents the company's product portfolio grouped to show revenues for our growth engines, strategic other businesses and our planned declining businesses. Growth engines includes SONORA, PROSPER, FLEXCEL NX, Software and Solutions and AM3D. Strategic other businesses include plates, CTP, service in PSD, NEXPRESS and related toner businesses in PSD, entertainment and commercial film in CFD, consumer products licensing in CFD, Eastman Business Park and IP licensing. Planned declining businesses are product lines where we made the decision to stop new product development and to manage an orderly expected decline in the installed base and annuity base. These product families include the consumer inkjet in CFD, VERSAMARK in EISD and DIGIMASTER in PSD.

From Slide 8, you can see Q1 2017 revenues from our growth engines have increased by $15 million or 18% on a constant-currency basis when compared to Q1 2016 last year. Our strategic other businesses declined by $19 million or 8% primarily due to price erosion and lower volumes in PSD. The decrease in the planned declining businesses is $6 million or 14% due primarily to the expected decline in sales of our consumer inkjet business.

We're making progress in changing the trajectory for the full company as our growth engines now comprise 25% of the Q1 2017 company revenues.

Now I'll talk about the business by division which is presented on Slide 9 for the first quarter of 2017. All year-over-year comparisons have been recast to reflect the changes in our divisional structure and will be discussed in a constant-currency basis as shown in the bottom section of the slide.

Starting with Print Systems Division. First quarter revenues were $213 million, a 6% decline compared to 2016. Our operational EBITDA declined by $5 million compared to the prior year as we continue to face pricing pressures. Price erosion in the first quarter was 4%. Aluminum prices did not impact Q1 2017 significantly but will be a stronger headwind for us in 2017 than we originally anticipated when we gave guidance earlier this year. We've included a slide in the appendix presenting the historical London Metal Exchange aluminum prices over the past 6 years. The LME euro price is at a 5.5-year high and has increased from EUR 14.85 per metric ton to EUR 17.55 per metric ton from September 2016 to May 2017. The impact to 2017 will be year-over-year headwind of $13 million and an impact to guidance of $6 million.

For the quarter, overall plate volume was down 1% year-over-year, which we believe represents an increase in our market share. We continue to see solid growth in our environmentally advantaged SONORA Plates, which grew 24% year-over-year. SONORA now accounts for 17% of our total plate unit sales, and we expect to continued growth in 2017. PSD is a foundational business to Kodak, which consistently contribute significant revenues and cash generation. We're focused on balancing our objective of growing market share while mitigating the negative impact of higher aluminum cost and price erosion through productivity improvements.

Moving on to the Enterprise Inkjet Systems Division. The division results presented on slide 9 include the results for Versamark systems and the Prosper business, which includes our continued investment in ULTRASTREAM.

For the first quarter of 2017, EISD revenues were $37 million compared to $34 million or growth of 12% compared to the prior year quarter. Operational EBITDA for the first quarter of 2017 was negative $1 million, an improvement of $5 million compared to the prior year period.

As I discussed previously, this is a milestone quarter for EISD as we are approaching an inflection point and expect the division to have positive Operational EBITDA going forward.

The Flexographic Packaging Division includes FLEXCEL NX Systems and Plates as well as letterpress and imprintable products and services. For the quarter, revenues were $33 million compared to $29 million in the prior year period, a 14% year-over-year growth. Operational EBITDA was $6 million, an increase of $2 million driven primarily by higher FLEXCEL NX Plates and CTP revenues. For the quarter, FLEXCEL NX revenues increased 19% and FLEXCEL NX plate volume grew 22% compared to the prior year quarter, reflecting consistent growth in all regions. I'm pleased with the execution of the Packaging business, which is our strongest performing product set. FLEXCEL NX continues to deliver strong revenue and volume growth driven by the value proposition, which provides substantial efficiencies to the printing operations of our customers. On April 20, we broke ground on a new manufacturing facility in Weatherford, Oklahoma for expansion of our FLEXCEL NX business. The Software Solutions Division includes PRINERGY Workflow Software as well as Kodak Technology Solutions. For the first quarter of 2017, SSD revenues were $21 million, flat with Q1 2016, primarily due to the divestitures of Design2Launch and Brand Protection Solutions. Operational EBITDA was $1 million, declined -- which declined by $1 million from the prior year quarter.

The Consumer and Film Division includes industrial films and chemicals motion picture, consumer inkjet and the consumer products group which include licensing of the Kodak brand.

For the quarter, revenues for CFD were $49 million, down 12% from $57 million driven primarily by an expected revenue decline in CIJ.

Operational EBITDA for CFD was negative $3 million, down $9 million for the quarter driven by a $3 million reduction in CIJ and $3 million due to lower motion picture film volume commitments than in the prior year period.

While CFD contributed negative EBITDA in Q1 2017, we expect positive EBITDA contribution for the full year.

We expect to see continued variability in the CFD business results this year due to one off industrial film orders, the timing of motion picture film productions, and our brand licensing business, which varies due to the timing and scalability of new licensees.

The Advanced Materials and 3D Printing Technology Division includes Micro 3D printing, the company's research lab as well as intellectual property licensing not directly related to the other business divisions. The prior year results are presented on a comparable basis. I'd like to show more granularity in the early commercialization products and the $8 million investment made in the first quarter of 2017. The first area of investment is our 3D printing technology, which is focused on copper mesh touch sensors. During Q1, we invested approximately $3 million on this technology and made the decision to focus on industrial applications going forward. We have multiple orders in the industrial design in our pipeline and shipped our first order for industrial film application this quarter. The second area of investment is in light-blocking materials. We invested approximately $2 million to commercialize this technology in Q1. We are pleased to announce we recently signed a term sheet to form an alliance with a major textile specialty fabric manufacturer to bring Kodak's light blocking technology for the market. We're on track for production this fall. The third area of investment is in our materials development for 3D printing. We invested approximately $1.5 million in Q1 for development projects to commercialize materials for major 3D printing customers. Carbon, a high-profile 3D printing company, has started to make orders under the supply agreement with Kodak to produce materials for the printers, and we expect additional orders in the remainder of 2017. We also recently signed an NRE and supply agreement with another significant 3D printing company and expect to produce materials which are revenue bearing through the remainder of 2017.

The fourth area of investment is for materials development for printed electronics where we invested approximately $1 million in Q1 2017.

Each of these focused investments is a growth opportunity for Kodak. We are encouraged by the pipeline for these investments, pleased we will begin to recognize revenues along three new areas and believe they each have potential to provide meaningful future revenue and earnings.

Continuing to our final division, Eastman Business Park. First quarter 2017 revenues were $4 million, flat with the prior year quarter. We continue to attract tenants to EBP with the addition in Q1 of our photonics-related business and an energy company. In addition to rent, each additional EBP tenant also consumes utilities resulting in improved financial profile for the division and overall lower cost to Kodak.

As a result of the decision to retain PROSPER and other minor reclassifications, we recast our 2016 revenue and operational EBITDA as shown on Slide 10. For 2016, full year revenue from continuing operations is $1.643 billion and operational EBITDA is $107 million.

Moving on to Slide 11. We've also adjusted our 2017 full year guidance to reflect the decision to retain PROSPER and the impact of supplier price increases for aluminum. With these changes, we forecast revenues of $1.5 billion to $1.6 billion and operational EBITDA of $105 million to $120 million, as shown on Slide 12. To provide a comparable view of operational performance, we've illustrated the impact of foreign exchange, the impact of supplier price increases in aluminum and expected decline of -- in the consumer inkjet business. This reflects an improvement of 40% to 60% in operational EBITDA from 2016.

On Slide 13. To provide perspective, we have categorized our divisions and businesses to illustrate the improvement in the quality of the company's operational EBITDA from 2014 through 2017. As you can see in the item circled in green, the core business of Kodak has improved markedly from $10 million in 2014 to the midpoint of our guidance of $100 million in 2017. These divisions represent the business of Kodak going forward and show a strong trajectory. Our consumer inkjet business declined from $80 million in 2014 to a plan of $10 million for the full year 2017 as we manage the orderly expected decline in the installed printer base. Intellectual property revenues are often nonrecurring and impacted by the timing of transactions in 2014 with a $70 million nonrecurring EBITDA, with a 2017 projection of up to $5 million of nonrecurring EBITDA. Foreign exchange had a material cumulative impact of $44 million from 2014 through 2016 when compared to current exchange rates. This slide demonstrates the significant progress in improving the quality of recurring earnings per Kodak while overcoming foreign exchange headwinds and the planned decline in the consumer inkjet business.

To summarize on Slide 14. We are retaining the PROSPER inkjet business and continue investment in the next generation ULTRASTREAM technology. We expect strong execution in the SONORA Plates, FLEXCEL NX packaging and PROSPER businesses. We expect to have year-on-year improvements in comparable operational EBITDA and cash flow for 2017. The quality of earnings have improved materially over the last 4 years and will continue to improve in 2017.

I'll now turn it over to Dave to discuss details on net earnings, our cost reduction update and cash flow performance.

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**David E. Bullwinkle** - *Eastman Kodak Company - CFO and SVP*

Thanks, Jeff, and good afternoon. Today, the company filed its Form 10-Q for the quarter ended March 31, 2017, with the Securities and Exchange Commission. As always, I recommend you read this filing in its entirety.

As we have noted, our first quarter performance is consistent with our expectations, and we are pleased with growth in key product areas. We have adjusted our full year 2017 guidance for revenues of $1.5 billion to $1.6 billion and operational EBITDA of $105 million to $120 million. This change in guidance corresponds to the reclassification of PROSPER and ULTRASTREAM as well as related corporate support costs into operational EBITDA and the impact of higher-than-expected aluminum costs for the remainder of the year.

Today, I will share further details on the full company results, an update on our cost structure and cash flow results and our full year cash flow outlook. First, a few important updates in notable items in the quarter in our Form 10-Q filed today with the SEC, which is summarized on Slide 16. On April 7, we announced Kodak will retain the PROSPER business. This business, including our investments in ULTRASTREAM, was previously reported as discontinued operations and is now included in continuing operations as part of the Enterprise Inkjet Systems Division along with our legacy VERSAMARK business. Prior period results have been recast to reflect comparable year-over-year reporting. As part of this recast, $12 million of additional depreciation and amortization expense related to the PROSPER business was recorded in other operating expense net. Please refer to Note 10, Other Operating Expense Net, in our Form 10-Q. In addition, beginning with this quarterly report, Micro 3D Printing and the operations of the previous Intellectual Property Solutions Division were combined into a new division called Advanced Materials and 3D Printing Technology Division or AM3D. The flexographic packaging business is now reported as a dedicated division comprising flexographic equipment, consumables and services, including FLEXCEL NX and legacy letterpress and APPROVAL products and services. We have made these changes to increase transparency in our packaging business and to reflect the way we allocate resources within our portfolio of businesses. Prior period results have been recast to reflect these organizational changes. A summary of 2016 quarterly results by division is included in the appendix to this presentation on a recast basis. You can find additional information regarding these changes in Note 1, Basis of Presentation and Recent Accounting Pronouncements Reclassifications; Note 20, Segment Information; and Note 21, Discontinued Operations in our Form 10-Q.

Now for the GAAP financial results for the first quarter. On Slide 17, as we reported in our earnings release, net earnings for 2017 on a GAAP basis were $7 million compared to a net loss of $15 million in the first quarter of 2016, an improvement of $22 million. Adjusted for $12 million of one-time depreciation and amortization expense catch-up for PROSPER, a $10 million one-time legal settlement in the first quarter of 2016 and $5 million of lower pension income in Q1 of 2017, all partially offset by the $22 million favorable impact from the revaluation of the derivative embedded in the Series A preferred stock, the year-over-year improvement in net earnings is $27 million, which is driven by $11 million of lower depreciation and amortization expense and $8 million of lower interest expense.

Diluted earnings per share in the first quarter 2017 were $0.05 per share compared to a loss of $0.43 per share in the prior year quarter. Now for an update on operating costs, as shown on Slide 18. Since December 31, 2013, operating expense on a run-rate basis had been reduced by 47%, and corporate costs are down 36%. The key driver of these cost improvements is reduced headcount, which is down 31% over the same period due to increases in productivity. For full year 2017, we expect a modest reduction in operating expenses, including corporate costs, as we are approaching a cost structure consistent with our current business model. On a full year basis, our target for corporate costs is 5% of revenue, down from approximately 6% in 2013 in our current run rate. We will continue to maximize efficiencies within our cost structure throughout all areas of the company through continuous streamlining and simplification efforts. We expect total operating expenses of 17% of revenue for the full year 2017.

Moving on to the company cash performance presented on Slide 19. Beginning in the first quarter 2017, the company adopted ASU 2016-18, which requires a reporting of cash equivalents and restricted cash along with cash in the beginning period and ending period balances on the statement of cash flows. For further information on this change, please refer to Note 1, Basis of Presentation and Recent Accounting Pronouncements, in our Form 10-Q; and Note 2, Cash, Cash Equivalents and Restricted Cash. As shown on the slide, the company ended the first quarter with $422 million in total cash, cash equivalents and restricted cash, a decrease of $56 million from December 31, 2016, which was within our expectations and consistent with the directional information I provided on our last earnings call in March. Cash and cash equivalents reported on the balance sheet were $378 million, down $56 million from $434 million at December 31, 2016. During the quarter, cash used in operating activities was $53 million, driven primarily by our seasonal build in inventory of $40 million and lower trade AP of $24 million; a decrease in liabilities, excluding trade payables of $20 million, partially offset by $30 million of cash sourced from lower receivables. Cash used in operating activities increased by $32 million compared to the first quarter of 2016, primarily related to a decline of $13 million in cash flow from net earnings and a $19 million decline in cash flow from balance sheet changes as presented on the slide.

Cash used in investing activities was $4 million in the first quarter of 2017 as compared to a use of $5 million in the prior year period. Capital investments were higher by $2 million in 2017 related to additional investment and manufacturing automation within PSD and investments for the new FLEXCEL NX packaging line in Weatherford, Oklahoma. Also in the first quarter, the company received net sale proceeds of $3 million from the sale of small legacy equity investments and excess equipment. Cash used in financing activities was $3 million in the quarter, primarily reflecting the dividend payment on the Series A preferred stock.

Finally, as disclosed in our Form 10-Q, we remain in compliance with our covenant under our credit agreements. In particular, the company's EBITDA used in the secured leverage ratio as calculated under the first lien term loan credit agreement, exceeded the EBITDA necessary to satisfy the covenant ratio by $31 million.

To summarize, the company's first quarter 2017 performance was what we expected and reflects continued good execution in our key product areas, including PROSPER, SONORA and FLEXCEL NX. For the balance of 2017, we expect continued growth in full year revenues and earnings for Kodak's growth engines. We will also be focused on delivering a return on our investments for profitable growth. As in 2016, we continue to expect seasonality to skew stronger performance to the second half of the year in revenue, operational EBITDA and cash.

As shown on Slide 20, consistent with our adjusted guidance for operational EBITDA, we have updated our cash outlook for 2017 to be within a range of flat to a use of $10 million of cash. This updated range reflects the inclusion of PROSPER and ULTRASTREAM and its continuing operations and the expected higher aluminum costs. When compared to our prior outlook, cash from working capital improved by $5 million, offset by a $5 million increase in capital expenditures and $5 million of restructuring related to PROSPER for actions completed in the first quarter. In total, for the remaining 9 months of the year, we expect to generate cash. The increase in cash used in working capital in the first quarter will transition to a source of cash for the company as presented in the slide. Inventory and accounts payable balances will be impacted by increases in sales volumes consistent with historical seasonality and provide a large source of cash for the company.

Turning to Slide 21, we have also provided a list of the potential upsides for opportunities and risks we currently see for the balance of 2017. As discussed earlier, aluminum prices and foreign exchange are headwinds. For every 1% change in the U.S. dollar aluminum price per metric ton, the impact on operational EBITDA is approximately $500,000. With regard to foreign exchange, we have provided a sensitivity of the U.S. dollar versus foreign currencies, including the euro, Japanese yen and pound sterling. As presented, a 1% change impacts revenue by about $7 million and operational EBITDA by approximately $500,000.

For 2017, we see possible upsides in 3 of our growth engines, which are growth above expectations in SONORA Plates and FLEXCEL NX Plates and higher-than-anticipated PROSPER printhead component volumes. On the risk side, we have identified slower monetization of brand licensing than currently planned, additional time needed to commercialize technologies and higher-than-expected price erosion within PSD as possible downsides. Our plan for the year is achievable. We will continue to monitor and manage these opportunities and risks throughout the year.

We will now open the call to your questions. Operator, please remind participants of the instructions to ask questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And your first question will come from the line of Shannon Cross of Cross Research.

**Shannon Siemsen Cross** - *Cross Research LLC - Co-Founder, Principal and Analyst*

I wanted to know a little bit more about what's going on with PROSPER just in terms of end market demand, positioning, as you look to 2019, I just want to understand a little bit more about this company or the division, I guess, since you've decided to retain it at this point.

**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Yes, as you can see, we're coming off a very strong demand in Q4 and continued demand in Q1. So we're now -- our recurring revenues were up 37%, our imprinting systems are now at a little over 1,300, and we've got installed presses of 64. And so there continues to be strong demand for PROSPER. And notably, PROSPER this year, after over $100 million of cumulative investment, we'll move to breakeven as an entity. EISD as a -- if you maybe -- if we could move to Slide 7 just to illustrate this, as you can see we've provided some additional information for you on PROSPER. And you can see VERSAMARK, which is at the late stage of its life cycle, is turning up nice profits. PROSPER, as you see, last year, delivered $21 million investment, $94 million. That will be close to 0 this year, so we expect significant continued improvement on PROSPER as we now have grown the installed base, and we'll continue to invest in ULTRASTREAM. So the bottom line is that ULTRASTREAM, in talking to our customers and through the sale process, it became very clear that there is a significant interest in a product with the features of ULTRASTREAM for OEMs to build around. Also, we expect to have significant head sales, our imprinting systems with ULTRASTREAM. For PROSPER, we continue to see strong growth in imprinting sales, but we are not going to go out and invest the loss of $1 million or over $1 million to sell presses in the environments to build a base for a non-high volume applications. So we'll continue to look at -- to answer your question around customers, we continue to look at existing customers that have already proven that PROSPER works in their environments. We'll continue to look for high-volume newspaper accounts where -- such as the Channel Islands, where we can have significant cost savings for situations where there look to be flying newspapers in, so that works very well, and then in other high-volume applications. So we expect strong continued growth and we expect -- as a division, after many years of losses, we expect this division to break even and then be well positioned for significant growth going forward.

**Shannon Siemsen Cross** - *Cross Research LLC - Co-Founder, Principal and Analyst*

And just to be clear, so these are '16, so '17, understand breakeven for PROSPER, ULTRASTREAM, still some investment obviously. Is it '18 or is it '19 where we start to see significant improvement? I'm just trying to understand...

**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Well, you're going to see cash, you're going to see profitability -- or see positive EBITDA, including all loaded costs and cash flow growth from '17 into '18. And then when ULTRASTREAM comes in, you're going to see strong growth. So we're going to benefit from the trajectory of PROSPER in '17 and '18. And then '19, you'll see continued growth in the PROSPER base while you'll see the start of a new revenue streams from ULTRASTREAM. You'll also see less investment. As you can see on this chart, you make investments about every 10 years. You need to bring new knowledge to the market every 10 years. So the investment, once ULTRASTREAM is built and most of the future investments happening by OEMs as opposed to Kodak, you're going to see a lot more profitability because we're not intending, as you can see from this slide, to build the very expensive digital press in ULTRASTREAM, that will be -- our partners will be doing that.

**Shannon Siemsen Cross** - *Cross Research LLC - Co-Founder, Principal and Analyst*

Okay. And then in terms of FLEXCEL, can you talk a bit more about the end market there as well given the growth of opportunities? And since you're now breaking it out as a separate division, in terms of -- I know you've made some investment there, I think, for capacity, but how should we think about the next couple of years with this division?

**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Well, I mean, the trajectory on the business is quite strong. So our FLEXCEL business is our highest-performing business and it's our most differentiated business and has the highest moats around it of all of our business versus the competition. So we believe the FLEXCEL market itself, the packaging market itself, is growing about 4%. We grew -- we've grown double-digits. The fourth -- in 2016, we grew 16%, and so 4x the market, and we continued and accelerated that strength on the first quarter. So we're growing many times the market here. The reason is we have higher resolution of the print solution because of the proprietary thermal imaging layer, but also we save money for the printers because of less waste and much more efficient processes that use less ink at -- and other items. So this business continues to grow well. We expect that we -- from a customer's perspective, it's both trade shops and packaging printers that are using it. And this year, as you saw last year, we delivered roughly $32 million before corporate profitability -- before corporate costs, and we expect continued economies of scale, which will drive over 20% improvement in EBITDA contribution, both before corporate costs and below corporate costs. So very, very strong performance expected and continued in the FLEXCEL packaging division.

**Shannon Siemsen Cross** - *Cross Research LLC - Co-Founder, Principal and Analyst*

Okay, great. And then maybe one question for Dave. In terms of corporate costs, what are your thoughts about sort of a continued optimization? Or are you basically at the level of the run rate that you need? Or how do we think about it relative to where your revenue is? Obviously, your headcount is down substantially over the last few years, I'm just trying to understand what sort of a baseline would be?

**David E. Bullwinkle** - *Eastman Kodak Company - CFO and SVP*

Sure. So as I shared in my remarks, we're at a run rate of 6% right now of revenue. We expect for '17 to be at 5%, and we also expect to continue to get simplification benefits using shared services, those sorts of things, standardizing our approaches across not only corporate costs but the entire company to drive that 5% on what we expect to be at least stable revenue going forward and focusing on our investments to increase revenue. So at 5%, hopefully, it starts to trend downward. We will continue to do things to utilize our shared services environment which we -- as you can





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tell from the slide, we've done very well so far, but we've got more opportunity in all parts of the organization, which I mentioned in the slide -- in my remarks, rather.

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**Shannon Siemsen Cross** - *Cross Research LLC - Co-Founder, Principal and Analyst*

Right. And then I guess just -- and I know you discussed a little bit but in terms of the working capital, just can you be a little bit more specific about opportunities there? Or -- obviously factoring the year, but I'm just curious in terms of absolute customization or focus on cash. You guys have been focused on cash for years, so...

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**David E. Bullwinkle** - *Eastman Kodak Company - CFO and SVP*

Yes, so we've done a good job in improving our DSO and our DSI. What we're challenged with now, of course, is the trajectory in revenue with respect to working capital. We did build inventory in the first quarter by $40 million. That is typical for us seasonally, although it's a little bit more pronounced this quarter, and we will -- that's where the largest source of cash or the change will come from for the remainder of the year. As Jeff mentioned, good growth in packaging is what we're seeing with PSD, the plates and the CTP business, of course, is where we built that inventory. So the largest opportunity for us is inventory, and we've shown good performance there. Really, all across working capital, we've shown improvement in days, in DSI, DPO and DSO, all around 3 days on a year-over-year basis, if you're doing like a 4-quarter average. So we've got good trajectory and good acceleration there, and we now need to deliver on the revenue growth to start to see the working capital perform.

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Yes, just one comment on this. I'm really pleased with the performance of the company on this. The cash conversion cycle, over the last 4 quarters, is 93 days versus 103 in the prior fourth quarter. So it's about a 10% improvement in cash conversion cycle, driven by the improved DSO, DSI and payables, but the biggest performance being on inventory. And that is fighting actually some issues around mix because our consumer inkjet business has very low inventory requirements, very high terms, whereas our packaging business has, at least, today, because we have the inventory shipped from Japan; in the future, we'll be making that in Weatherford as well, has very long cycle. So our fastest-growing business has a difficult cash conversion cycle, our fast declining business has a good one, yet we're still improving, overcoming that mix by 10%. So I'm pleased with our ability to manage working capital. And you saw in one of Dave's slide, it's an important part of our projection this quarter in order to drive the cash flow growth.

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**Operator**

(Operator Instructions) And the next question will come from the line of Gary Ribe with MACRO Consulting Group.

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**Gary Ribe**

I just had one quick one before I ask a couple of other ones. The cash from the year, the use of $10 million to 0, you guys, I think, used $50 million, maybe a little bit more, I don't have it right in front of me, in the quarter. So is that one that you guys are going to generate somewhere between $40 million and $50 million of cash for the remainder of the year?

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**David E. Bullwinkle** - *Eastman Kodak Company - CFO and SVP*

So you cut out a little bit, but I think your question is we use $50 million -- so I'd give you the actual numbers, $56 million in the first quarter. And yes, we do expect to increase cash over the remainder of the year by $46 million to get to that low end of range and, of course, at a breakeven perspective, $56 million. Most of that's going to come from our working capital. We used roughly $30 million in -- I'm sorry, $30 million increase in cash used from working capital on a year-over-year basis. The rough use was about $40 million to $50 million in Q1 of 2017 and primarily, again, in inventory, which we have the most control over in terms of the PSD business, which is where we see the concentration.

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**Gary Ribe**

Got it. I guess, this other one is a little bit higher level. How are you guys thinking about ROI on this R&D expense stuff? You spent $8 million this quarter. It seems like there might be some stuff on the horizon, but like how do you think about that going forward?

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Excellent type of question, Gary, and it's something we spend an enormous amount of time on. One of the challenges of Kodak is, the last 10 years, the company's revenue has declined. And so we need to make some focused investments in the printing industry. So we're a printing company. And today, our portfolio is very much focused on offset printing, which is a business that has provided significant profits for us, but it is an industry that's in decline, it's a segment of the industry in decline. The other faster-growing parts of the industry are in packaging printing. And there, we have a product that is, frankly, spot-on and delivering and executing very well with strong growth at the top and bottom line. The only investments we need to make in that business is really around adding capacity. And so the ROI on one of our largest investments this year, which is building the factory for packaging growth, to support packaging growth in Oklahoma, is quite good. So that is a -- because of the growth of the business, you've got an ROI with a payback of a couple of years, which isn't bad for a bricks-and-mortar factory. In terms of the next fastest growth, so from a scale of what's growing fast in the printing industry, the slowest part is where we're currently concentrated, to the offset part. The next fastest-growing is packaging. The next faster-growing, growing faster than packaging is in digital printing. This is where the largest investments over the last decade have been made by Kodak primarily around PROSPER and now we're on ULTRASTREAM. PROSPER from an ROI, I think is pretty clear, was a very long ROI. It took over 10 years of investment, and we're just now getting to breakeven on it. The good news going forward is there is minimal investment required. We have an installed base, and it will grow well. And the next generation after PROSPER, ULTRASTREAM, as we mentioned, will be a fraction of the investment of PROSPER because we're using a more derivative of existing technologies strategy than trying to create something brand-new like PROSPER was. So we're building off that in a more incremental basis. So from that perspective ...

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**Gary Ribe**

Those all seems like rationale areas to be allocating capital. I guess my question was more focused on this Advanced Materials Division kind of -- the expansion of FLEXCEL is great, investing in ULTRASTREAM makes total sense. But this other division, how do you -- it's more centered around that.

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Yes, I was going to get to that, so thank you, Gary. So the -- relative to the prior investments, obviously, these are more modest. These investments are taking technologies that have been built, have been commercialized in some areas. In the case of Advanced Materials, the #1 thing that we've built off Advanced Materials have been the inks and toners owners that support our existing printing businesses and our FLEXCEL business. But let's dive into the specifics on them. And that's why we showed some more information there. We look at these ROIs very closely. And let's go through each one. So let's start off with Micro 3D Printing. That is a derivative of using the same thermal imaging layer that has been so successful with packaging and moving up the value chain into printing logic, printing touchscreen sensors, batteries, areas like that. This is an area where the company has been at this for about 4 or 5 years. We've refocused the investment to be focused on copper mesh as opposed to silver and copper mesh. And for the first time, as you heard in my remarks, we now have signed contracts and people delivering product on that. So there's not a lot of future investment required in this area, and we now have revenue streams associated with it because the product has been designed and refocused now on the industrial applications. So that -- so yes, there's some investment now in Q1 and a little bit more throughout the rest of the year, but -- when the revenues will come in and then start to cover that. On the light-blocking materials, the investment on this was significant, in the single millions of dollars over the last couple of quarters. And we saw significant opportunities with the fastest-growing part of printing, which is starting to move into areas where these, both light-blocking and supplying 3D, are significant growth engines. So I'll take them in 2 pieces. On the light-blocking, we have a contract in place to make significant amounts of this material with one of the largest textile providers in the world. And so it will be very focused -- the investment on that is very focused to investment, supporting a contract for profitable revenue, which will start this year, okay? So very focused investment with a set customer. And then the fastest -- the third area is around advanced materials for 3D printing. There's no question that the fastest-growing part of the entire printing business is printing dimensionally, printing 3D. In this case, we are supplying 2 of the largest players in this industry. We have a signed contract and a supply arrangement with Carbon, which you may have recently read is now going to be printing sneakers for adidas in a very high-profile situation. So we'll be providing materials to that company in terms of toners that will support many of their different product lines. That's going to be -- Carbon's going to grow at significant rates, and we'll be able to supply them at significant rates in support of their growth. We also are supplying another player in this industry. And in this one, as you saw in my remarks, the ROI is supported by a nonrecurring engineering payment agreements with them. So they're going to pay for the engineering and a set of structures around a supply agreement where we're already prosecuting on the supply agreement. So in these cases, from an ROI, what we've got in 3 of the 4 areas -- the fourth area, which is about $1 million a year, is around advanced printed electronics, this is for printing on glass and very high-profile opportunities where we're close to reaching customers. So to answer your question, we invested about $8 million this quarter. We have 3 sets of revenue streams out of the 4 areas, and we are soon to announce a revenue stream on the other. So when we look at the ROIs, we look at one of the markets, one is the ability to commercialize it with real-time tracks in the near term. And that's how we drive our investment.

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**Gary Ribe**

Got it. And so these contracts, are they in the guidance for this year?

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

They are. That's why -- we saw this coming, we've now -- we've signed them. Some of them were signed when guidance were given. Some of them have evolved during the year as per our plan. The pipeline is very strong to commercialize these products, and these are with significant players. These are -- if you're going to be kind of the Intel inside of the printing industry, where we're going to be providing materials to major players that count on in building their products, you want to line up with the big players. And we've mentioned some of them -- some of the other ones, we can only refer to today as a major textile manufacturer that you would certainly know if I said the name, but we want to keep this confidential at this point. But we have real contracts with real companies, and you'll see improvement in this division every quarter going forward.

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**Gary Ribe**

Got it, okay. And then, I guess, just kind of one more big picture question. Is that kind of a like -- an interesting collection of businesses and assets there. And like at what point do you guys -- you mentioned strategic stuff, M&A, it's probably tougher given kind of the balance sheet, also divestiture. Like can you just kind of speak high level if whether or not this collection of businesses together kind of makes sense in what you guys are thinking on that level and as you look at kind of places you can find cash and places you can invest cash and that sort of thing?

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**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

Yes. So Gary, I think we've proven that we'll be quite pragmatic as we evaluate dispositions and/or acquisitions. So PROSPER is a fast-growing -- as I stated, across the scheme of printing, PROSPER, the enterprise inkjet part of the printing industry, is a very significant growth area. But yes, we were willing to accelerate monetization if we could do it. We did get the price we wanted and, as such, we're going to keep going because, from a shareholder value, we are pragmatic both ways. We are happy to keep things if we think they're going to hit our ROIs, and we're willing to sell them if we think that is a faster monetization for shareholders. So I would think that all areas -- we're quite broad across the portfolio of technologies and products that you can sell into the printing business. So we have a lot of latitude here in terms of being able to attack the industry with different technologies. There are some synergies across, most notably the software business with all of the printing areas. But each of the areas I think we can be pragmatic with if a combination made sense that could get us a value ahead of the value we would be able to achieve on our own. Operator, are there any more questions?

**Operator**

There are no further questions at this time.

**Jeffrey J. Clarke** - *Eastman Kodak Company - CEO and Director*

So thank you very much for joining the Q1 earnings call for Kodak. As I -- Dave and I talked about, we are seeing strong execution across the SONORA area, the FLEXCEL NX area and the PROSPER area. This is driving strong year-over-year improvements on a comparable basis. We do have headwinds on aluminum prices and on currency. But as you can see, we believe that we can overcome them and go hit the guidance that we're giving you now. So I appreciate you very much -- appreciate your time very much, and thank you.

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.