THE TYLER GROUP Financial Services

Sound Advice

The Ultimate Kodak Moment

By Rod Tyler, CFP, R. F. P. , CLU

It is late summer in Toronto as I begin to write this article about the once successful photographic juggernaut, The Eastman Kodak Company, also known as **"Kodak"**. It is a story about the once ubiquitous company that simply vanished. As I strolled around the neighbourhood with a freshly procured cup of tea from Starbucks, I came upon a movie location that was "shooting", just down the street from my condo. I decided to stop and speak to one of the many people who were attending to the truckloads of lights, cameras and equipment typical to the business of movie-making. The fellow I spoke to was a veteran of 46 years and who was in charge of lighting. He provided me with the answers to two questions that I asked. **Question One was:** "What is the name of the movie?" and **Question Two was:** "When did movies stop using film cameras and begin using digital cameras?" The answer to Question One was that the movie they were shooting was a made for TV series called, "Taken", and the answer to the second question was "… eight years ago".

In our family archive of photographs and film, I have another kind of visual memory, that of an 8 mm film taken by my father of my brother and me as young boys in the 1950's. When we recently viewed this home movie, it brought back a lot of memories, as it would for anybody. My father had befriended a very accomplished local photographer who convinced him of the wisdom of buying a brand-new 8 mm movie camera as well as a 35 mm camera. My dad must have saved for several months to have the money to buy such costly cameras and the film that went with it. This story is about the company that was once synonymous with the making of movies, like the one behind my condo in Toronto, and that also made home movies possible. It once used the advertising tagline to describe any photo taken in time and space as **"A Kodak Moment"**.

The history of business ventures is filled with the names of companies that invented or introduced revolutionary new services or products that never quite made it into production. You may remember a previous story of MARK TWAIN'S BUSINESS FOLLIES when he continued to fund the "Page Compositor Typesetting company", hoping to earn a spectacular return for the invention of the automatic typesetting machine. The matter of creating a start-up company and hoping to become a new Apple, Google or Amazon is an incredibly difficult challenge. For those of us without the depth of knowledge of an investment manager specializing in new start-up companies, hoping to strike it rich by investing in the next Facebook is unrealistic. You might as well buy a lottery ticket. The odds of success are about the same.

Elsewhere in this issue of *Sound Advice*, I wrote about how one investment manager, Jim Young, has approached such a challenge. In the article, **A Virtuous Circle of Continuous Innovation**, you will read how and why certain well-known, as well as lesser-known companies, continue to prosper in a world in which the

Today's world is increasingly influenced by the advance of new technologies.

Can technology oriented investments be good investments or are they too risky?

The answer to this question is the subject of this issue of *Sound Advice*.

only constant is change. And now to recount the story about the Kodak company and how, despite inventing many new photographic technologies, the Kodak company refused to take advantage of its own most innovative inventions.

George Eastman founded “The Eastman Kodak Company” in 1888, shortening it to Kodak because he said the letter K sounded like a strong, concise phonic. He and his mother conceived of the name based on three concepts: “that it should be short, easy to pronounce, and not resemble any name or be associated with anything else”. Using the same concepts in today’s world, think of Google or Facebook.

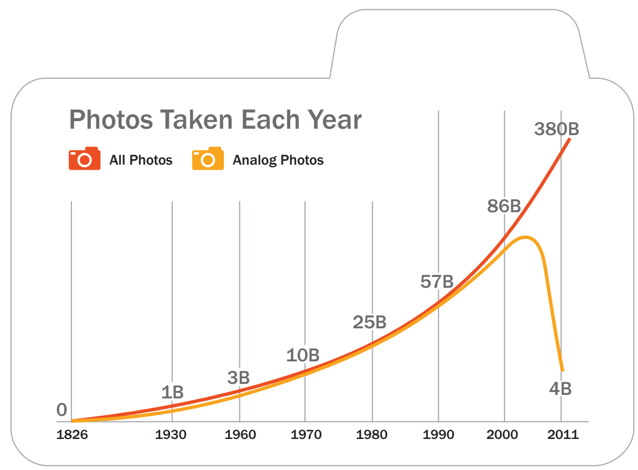
The name “Kodak” was once synonymous with photography. As a company it dominated not only the public mind of personal photography, but also many other commercial photographic applications, such as x-rays. Throughout the 20th century, in a time before digital technologies, movies were made using photographic film, and that was manufactured by Kodak. The invention of the IMAX camera and projector were based on the technology of using even larger 70 mm format film, there by enabling moviemakers to produce the stunning IMAX experience. Kodak had a virtual monopoly in the whole photographic realm, at least until the digital age intervened. It is noted that even today we continue to use the language of the past. When speaking about making movies, we still talk about “filming” movie scenes when in fact they are being recorded digitally.

Ironically, in a company as large as Kodak, it achieved its prominence by continually investing in new technologies. By the 1990’s, it could claim a century-long history of introducing new cameras, new markets and new excellence in photographic supplies and marketing.

By the 1990’s however, even though it still dominated the photographic and film business, there were signs that something was changing. Kodak’s original business was based on selling inexpensive cameras and then profiting by selling consumables such as film, chemicals and photographic paper. In 1976, it sold 90 percent of all film and 75 percent of the cameras in the United States. Even as other equipment manufacturers, such as Nikon, Canon, and Pentax began to produce high quality cameras, Kodak continued to sell the necessary consumables and declined to take advantage of its own digital advantages and patents.

In the 1970’s, the Japanese competitor, Fujifilm, entered the U.S. market and began to chip away at the Kodak monopoly. Fujifilm began selling its own brand of film, chemicals and paper at reduced prices.

Sadly, although it was Kodak who first developed the digital camera in 1975, they stopped developing this new device because management thought that it could potentially deprive Kodak of its primary revenue from the photographic film business. **Kodak’s company executives had lived their entire careers as managers of a company whose business model had remained constant for almost a century. They were oblivious to any other possibility.** In 1980, Kodak provided Apple with one of the first consumer versions of a digital camera, the “Apple Quicktake”. Kodak, fearful of the decline of its traditional business of photographic film, chemicals and paper, **declined to put their own name on the camera that they had invented**. Like the Titanic, they sailed right into an iceberg and sank. By 2012, Kodak, whose business worth in 1996 was valued at $28 Billion, filed for bankruptcy. It eventually sold many of its valuable patents for a mere $525 million to a group of “new age” companies, including *Apple, Google, Facebook, Amazon, Microsoft, Samsung, Adobe Systems*, and *HTC*.



So what can we learn from this surprising example of a hugely successful company that existed over the span of 124 years, and its sudden, but inevitable collapse?

I suggest that Andy Grove of the iconic technology company named Intel got it right when he said: “Only the paranoid survive”. What Grove meant was that in the rapidly transformative world of technology, one must continuously innovate. Resting on one’s laurels is a certain recipe for failure. The managers of Kodak had become incapable of understanding this concept, even though their own research and development scientists had invented the digital camera. A successful technology company must continuously put their intellectual capital or their technological expertise to work. Such a company tests their ideas. If an idea works, they will continue to develop it, creating new products and services. If not, the company will scrap it and quickly move on. As one writer said: “Learn to fail fast”, meaning to learn from mistakes and move to the next idea. In the accompanying article, ***A Virtuous Circle of Continuous Innovation***, we will learn from Jim Young of Invesco Trimark, just how this is done in some of the most successful, modern companies.

A Virtuous Circle of Continuous

INNOVATION

An interview with Jim Young, Trimark US Companies Fund

In the previous article, *The Ultimate Kodak Moment*, I described the rise and fall of the 124-year-old company Kodak. In August of this year I spoke with Jim Young, of **Invesco Trimark US Companies Fund.**

I asked Jim how an investment manager of large US companies searches for qualities that embrace his idea of a *"virtuous circle of continuous innovation."*

Here's part of what Jim Young had to say:

"We live in a rapidly changing world. This presents many opportunities for companies to create the products of the future. But it also gives rise to risks for those who fail to keep pace. Product commoditization and outdated business models threaten the long term viability of many businesses today. Think of the impact the internet has had on retail and media companies.

Our view is that the best way for companies to ensure they remain relevant and financially healthy is to foster a culture of innovation, reinvestment and execution. If pursued with intensity, this approach can create a "virtuous cycle of enduring prosperity."

Innovative products that satisfy the needs of customers can drive market share gains and command attractive pricing. This ensures healthy margins that can be reinvested in further innovation and other market development opportunities, as well as efficient manufacturing and logistics. All of these elements must be constantly improved to ensure competitive strength. Innovation is the lynchpin of the virtuous cycle and to sustain it, it must become engrained in the culture of the business. This requires a heavy commitment to research and development, a sense of urgency and employee alignment.

We most often think of innovation happening in the technology and life science industries but, in fact, there is room for innovation in all industries, as we've seen with those who improve the quality of their processes and customer offering by rapidly adopting new technologies or methodologies. Today change is a constant, and the only way to prosper in a changing world is to embrace it and attempt to shape it."

The first example cited by Jim Young is Honeywell. This is a company that was once primarily a computer company, and then branched off into several other businesses. Most recently it has focused on three primary businesses where it can maintain a significant strategic advantage. As Jim describes Honeywell's operations, he points out the inherent risk faced by all businesses producing a commodity which some other company can then produce even more cheaply. Jim describes how Honeywell avoids becoming just another technology company producing a commodity.

"**Honeywell** is a multi-industry conglomerate that operates in the transport, building controls and performance materials sectors. Within transport they are noted for jet engines, avionic controls and automobile turbo chargers. These are engineering and software intensive products that continually evolve in terms of sophistication, reliability and energy efficiency. Honeywell has steadily gained market share in all of these areas based on leading edge performance and excellence in manufacturing. Many of the engineering and software skills developed in the transport sector are directly transferable to building controls for security, energy management and connectivity. Margins in all sectors have been rising for a number of years, driven by strong pricing as customers understand the value of these products. As a result, the company has been able to fund an aggressive product development program in all divisions that has resulted in steady earnings and cash flow growth. This constant evolution of products to include more functionality and value guards against competitive inroads from rivals."

In a second example, Trimark US Companies Fund owns the biotechnology company Celgene. Normally, this area of investment in biotechnology is considered very speculative, even if it could ultimately provide huge rewards. Here's how Jim Young describes how he has addressed this particular investing challenge.

"Another company that has grown successfully for many years and positioned itself for further growth is **Celgene**, a leading immuno-oncology company. Although they have a number of established products that will continue to grow for many years, they have invested heavily in their own pipeline of new products and they have funded the development of new products from roughly 30 partners. They are now involved in some of the most exciting new approaches in cancer research including engineered T-cells and cancer metabolism. This relentless approach to discovering or partnering to stay at the forefront of science in cancer and immunology is critical for any company to build and maintain a franchise in this highly competitive arena."

"These are examples of two individual companies that have built a culture of innovation that will enable them to compete and succeed in the future. The constant flow of high value-added new

products that solve problems and meet needs is the key to sustainable growth and wealth building in a future where change occurs rapidly."

The message that resonates is that an experienced investment manager like Jim Young of Invesco Trimark has the ability to carefully analyze companies for their investment potential and in doing so provides the unitholders of a mutual fund the possibility of participating in the long-term growth of these same companies. Ultimately, this reduces investor risk and increases the chances of investment success.

Jim Young, CFA
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Jim Young is a vice president and portfolio manager for Trimark Investments. Mr. Young began his investment career in 1977 as an analyst at Ontario Hydro Pension Fund. He has also worked as a senior vice president at Prudential-Bache Securities and was vice president, U.S. equities, at Royal Bank Investment Management prior to joining the company in 1999. Mr. Young earned an MBA from McMaster University, and he holds the Chartered Financial Analyst designation.

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