ELI LILLY AND COMPANY

2017 FINANCIAL REPORT
NOTICE OF 2018 ANNUAL MEETING
PROXY STATEMENT

2017 FINANCIAL HIGHLIGHTS

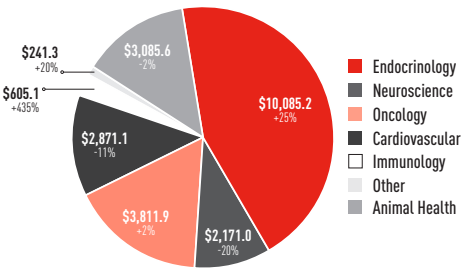
ELI LILLY AND COMPANY AND SUBSIDIARIES (DOLLARS IN MILLIONS, EXCEPT PER-SHARE DATA) Year Ended December 31	2017	2016	CHANGE %
REVENUE	**$ 22.871.3**	$ 21,222.1	8
RESEARCH AND DEVELOPMENT	**5,281.8**	4,796.4	1
RESEARCH AND DEVELOPMENT AS A PERCENT OF REVENUE	**23.1%**	24.7%	
NET INCOME (LOSS)	**$ (204.1)**	$ 2,737.6	NM
EARNINGS (LOSS) PER SHARE—DILUTED	**(0.19)**	2.58	NM
RECONCILING ITEMS[1]:			
U.S. Tax Reform Legislation	**1.81**	—	
Asset impairment, restructuring, and other special charges	**1.23**	0.29	
Acquired in-process research and development	**0.97**	0.02	
Amortization of intangible assets	**0.44**	0.44	
Boehringer Ingelheim Vetmedica inventory step-up	**0.03**	—	
Venezuela Devaluation Charge	**—**	0.19	
NON-GAAP EARNINGS PER SHARE—DILUTED[2]	**4.28**	3.52	22
DIVIDENDS PAID PER SHARE	**2.08**	2.04	
CAPITAL EXPENDITURES	**1,076.8**	1,037.0	4
EMPLOYEES	**40,655**	41,975	(3)

1. For more information on these reconciling items, see the Financial Results section of the Executive Overview on page F22 of the Financial Report. 2. Numbers may not add due to rounding.

REVENUE GROWTH ACROSS THERAPEUTIC AREAS

($ MILLIONS, PERCENT GROWTH)

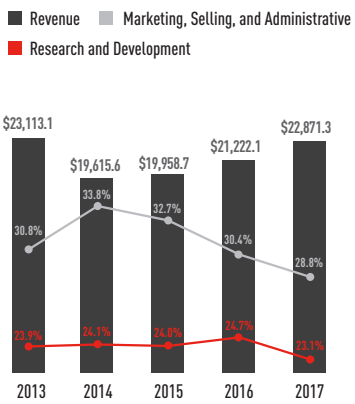
Revenue in Endocrinology increased 25 percent primarily driven by growth of Trulicity, Basaglar, Forteo, Jardiance, and Trajenta. Oncology grew 2 percent primarily due to higher volumes for Lartruvo and Cyramza, partially offset by lower volumes for Alimta, and Immunology grew due to higher volumes for Taltz. Revenue in Neuroscience decreased 20 percent driven by lower volumes for Strattera, Cymbalta, and Zyprexa due to loss of patent protection, and Cardiovascular decreased 11 percent driven by lower volumes for Cialis and Effient.



OPERATING EXPENSES

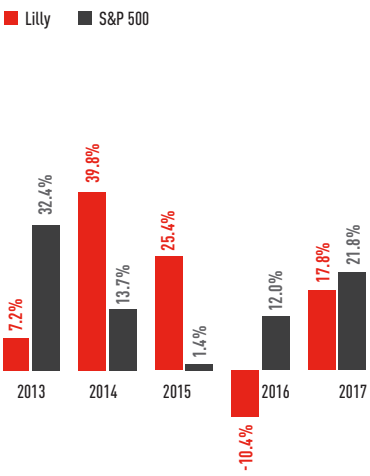
($ MILLIONS, PERCENT OF REVENUE)

Over the past four years, Lilly has maintained relatively flat operating expenses while growing revenue, resulting in consistent improvement in operating expense as a percent of revenue.



TOTAL SHAREHOLDER RETURN (TSR)

Over the past five years, Lilly's annualized total shareholder return has averaged 15 percent, compared to 16 percent for the S&P benchmark, due to the increase in the stock price and steady dividend stream.



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FINANCIAL REPORT

PROXY

Forward-Looking Statements

This Annual Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (Exchange Act). Forward-looking statements include all statements that do not relate solely to historical or current facts, and can generally be identified by the use of words such as “may,” “believe,” “will,” “expect,” “project,” “estimate,” “intend,” “anticipate,” “plan,” “continue,” or similar expressions.

In particular, information appearing under “Business,” “Risk Factors” and “Management's Discussion and Analysis of Financial Condition and Results of Operations” includes forward-looking statements. Forward-looking statements inherently involve many risks and uncertainties that could cause actual results to differ materially from those projected in these statements. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, it is based on management's current plans and expectations, expressed in good faith and believed to have a reasonable basis. However, we can give no assurance that any such expectation or belief will result or will be achieved or accomplished. The following include some but not all of the factors that could cause actual results or events to differ materially from those anticipated:

- the timing of anticipated regulatory approvals and launches of new products;
- market uptake of recently launched products;
- competitive developments affecting current products;
- the expiration of intellectual property protection for certain of our products;
- our ability to protect and enforce patents and other intellectual property;
- the impact of actions of governmental and private payers affecting pricing of, reimbursement for, and access to pharmaceuticals;
- regulatory compliance problems or government investigations;
- regulatory actions regarding currently marketed products;
- unexpected safety or efficacy concerns associated with our products;
- issues with product supply stemming from manufacturing difficulties or disruptions;
- regulatory changes or other developments;
- changes in patent law or regulations related to data-package exclusivity;
- litigation involving past, current, or future products as we are largely self-insured;
- unauthorized disclosure or misappropriation of trade secrets or other confidential data stored in our information systems, networks, and facilities, or those of third parties with whom we share our data;
- changes in tax law;
- changes in foreign currency exchange rates, interest rates, and inflation;
- asset impairments and restructuring charges;
- changes in accounting standards promulgated by the Financial Accounting Standards Board and the Securities and Exchange Commission;
- acquisitions and business development transactions and related integration costs;
- information technology system inadequacies or operating failures;
- reliance on third-party relationships and outsourcing arrangements; and
- the impact of global macroeconomic conditions.

Investors should not place undue reliance on forward-looking statements. You should carefully read the factors described in the “Risk Factors” section of this Annual Report for a description of certain risks that could, among other things, cause our actual results to differ from these forward-looking statements.

All forward-looking statements speak only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in this report. Except as is required by law, we expressly disclaim any obligation to publicly release any revisions to forward-looking statements to reflect events after the date of this report.

Business

Eli Lilly and Company (the “company” or “registrant” or "Lilly") was incorporated in 1901 in Indiana to succeed to the drug manufacturing business founded in Indianapolis, Indiana, in 1876 by Colonel Eli Lilly. We discover, develop, manufacture, and market products in two business segments—human pharmaceutical products and animal health products.

The mission of our human pharmaceutical business is to make medicines that help people live longer, healthier, more active lives. Our vision is to make a significant contribution to humanity by improving global health in the 21st century. Most of the products we sell today were discovered or developed by our own scientists, and our success depends to a great extent on our ability to continue to discover, develop, and bring to market innovative new medicines.

Our animal health business, operating through our Elanco division, develops, manufactures, and markets products for both food animals and companion animals. Elanco food animal products help the food industry produce an abundant supply of safe, nutritious and affordable food. Elanco companion animal products help pets live longer, healthier, happier lives.

We manufacture and distribute our products through facilities in the United States (U.S.), Puerto Rico, and 14 other countries. Our products are sold in approximately 125 countries.

Human Pharmaceutical Products

Our human pharmaceutical products include:

Endocrinology products, including:

- *Humalog*®, *Humalog Mix 75/25, Humalog U-100, Humalog U-200* and *Humalog Mix 50/50*, insulin analogs for the treatment of diabetes
- *Humulin*®*, Humulin 70/30, Humulin N, Humulin R, and Humulin U-500,* human insulins of recombinant DNA origin for the treatment of diabetes
- *Trulicity*®, for the treatment of type 2 diabetes (approved in the U.S. and Europe in 2014 and Japan in 2015)
- *Trajenta*®*,* for the treatment of type 2 diabetes
- *Jentadueto*® *and Jentadueto XR,* a combination of linagliptin (Trajenta) and metformin hydrochloride for use in the treatment of type 2 diabetes
- *Jardiance*®, for the treatment of type 2 diabetes (approved in the U.S., Europe, and Japan in 2014, cardiovascular data included in the European label in 2016) and to reduce the risk of cardiovascular death in adult patients with type 2 diabetes and established cardiovascular disease (approved in the U.S. in 2016)
- *Glyxambi*®, a combination tablet of linagliptin and empagliflozin (Jardiance) for the treatment of type 2 diabetes (approved in the U.S. in 2015 and Europe in 2016)
- *Synjardy*® *and Synjardy XR*, a combination tablet of empagliflozin and metformin hydrochloride for the treatment of type 2 diabetes (approved in the U.S. and Europe in 2015), extended release formulation approved in the U.S. in 2016
- *Basaglar*® (insulin glargine injection), a long-acting human insulin analog for the treatment of diabetes (launched in the U.S. in 2016 and in Japan and Europe in 2015 under the trade name Abasaglar™)
- *Forteo*®*,* for the treatment of osteoporosis in postmenopausal women and men at high risk for fracture and for glucocorticoid-induced osteoporosis in men and postmenopausal women
- *Evista*®*,* for the prevention and treatment of osteoporosis in postmenopausal women and for the reduction of the risk of invasive breast cancer in postmenopausal women with osteoporosis and postmenopausal women at high risk for invasive breast cancer

- *Humatrope®,* for the treatment of human growth hormone deficiency and certain pediatric growth conditions

Neuroscience products, including:

- *Cymbalta®*, for the treatment of major depressive disorder, diabetic peripheral neuropathic pain, generalized anxiety disorder, fibromyalgia, and chronic musculoskeletal pain due to chronic low back pain or chronic pain due to osteoarthritis
- *Zyprexa®,* for the treatment of schizophrenia, acute mixed or manic episodes associated with bipolar I disorder, and bipolar maintenance
- *Strattera®,* for the treatment of attention-deficit hyperactivity disorder
- *Prozac®,* for the treatment of major depressive disorder, obsessive-compulsive disorder, bulimia nervosa, and panic disorder
- *Amyvid®*, a radioactive diagnostic agent for positron emission tomography (PET) imaging of beta-amyloid neuritic plaques in the brains of adult patients with cognitive impairment who are being evaluated for Alzheimer's disease and other causes of cognitive decline

Oncology products, including:

- *Alimta®,* for the first-line treatment, in combination with another agent, of advanced non-small cell lung cancer (NSCLC) for patients with non-squamous cell histology; for the second-line treatment of advanced non-squamous NSCLC; as monotherapy for the maintenance treatment of advanced non-squamous NSCLC in patients whose disease has not progressed immediately following chemotherapy treatment; and in combination with another agent, for the treatment of malignant pleural mesothelioma
- *Erbitux®,* indicated both as a single agent and in combination with another chemotherapy agent for the treatment of certain types of colorectal cancers; and as a single agent, in combination with chemotherapy, or in combination with radiation therapy for the treatment of certain types of head and neck cancers
- *Cyramza®,* for the treatment of various cancers, with approvals as follows:
    - approved in 2014 in the U.S. and the European Union (EU), and in Japan in 2015, both as a single agent and in combination with another agent as a second-line treatment of advanced or metastatic gastric cancer
    - approved in 2014 in the U.S., and in the EU and Japan in 2016, in combination with another agent as a second-line treatment of metastatic NSCLC
    - approved in 2015 in the U.S., and in the EU and Japan in 2016, as a second-line treatment of metastatic colorectal cancer
- *Gemzar®,* for the treatment of pancreatic cancer; in combination with other agents, for the treatment of metastatic breast cancer, NSCLC, and advanced or recurrent ovarian cancer; and in the EU for the treatment of bladder cancer
- *Portrazza®*, approved in 2015 in the U.S. for use in combination with other agents as a first-line treatment of metastatic squamous NSCLC, and approved in 2016 in the EU for use in combination with other agents as a first-line treatment for epidermal growth factor receptor expressing squamous NSCLC
- *Lartruvo™*, approved in the U.S., and conditionally approved in the EU, in 2016 for use in combination with another agent for the treatment of soft tissue carcinoma
- *Verzenio™,* approved in the U.S. in 2017 indicated both as a single agent and in combination with another chemotherapy agent for the treatment of a certain type of advanced or metastatic breast cancer.

Immunology products, including:

- *Olumiant®,* approved in the EU and Japan in 2017 for the treatment of adults with moderately-to-severely active rheumatoid arthritis
- *Taltz®*, for the treatment of moderate-to-severe plaque psoriasis (approved the U.S. and EU in 2016) and active psoriatic arthritis (approved in Japan in 2016, in the U.S. in 2017, and in the EU in 2018)

Cardiovascular products, including:

- *Cialis®,* for the treatment of erectile dysfunction and benign prostatic hyperplasia
- *Effient®*, for the reduction of thrombotic cardiovascular events (including stent thrombosis) in patients with acute coronary syndrome who are managed with an artery-opening procedure known as percutaneous coronary intervention, including patients undergoing angioplasty, atherectomy, or stent placement

Animal Health Products

Our products for food animals include:

- *Rumensin®,* a cattle feed additive that improves feed efficiency and growth and also controls and prevents coccidiosis
- *Coban®, Maxiban®,* and *Monteban®,* anticoccidial agents for use in poultry
- *Posilac®*, a protein supplement to improve milk productivity in dairy cows
- *Optaflexx®* and *Paylean®,* leanness and performance enhancers for cattle and swine, respectively
- *Tylan®,* an antibiotic used to control certain diseases in cattle, swine, and poultry
- *Denagard®,* an antibiotic for the control and treatment of respiratory and enteric diseases in swine and poultry

Our products for companion animals include:

- *Trifexis®,* a monthly chewable tablet for dogs that kills fleas, prevents flea infestations, prevents heartworm disease, and controls intestinal parasite infections
- *Comfortis®*, a chewable tablet that kills fleas and prevents flea infestations on dogs
- *Interceptor® Plus,* a monthly chewable tablet that prevents heartworm disease and treats and controls adult hookworm, roundworm, whipworm and tapeworm in dogs
- *Galliprant®*, an anti-inflammatory tablet that targets the key receptor associated with canine Osteoarthritis pain
- Feline, canine, and rabies vaccines including: *Duramune®* and *Ultra™ Duramune®*, *Duramune Lyme®*, *Bronchi-Shield®*, *Fel-O-Vax®, ULTRA™ Fel-O-Vax®*, and *Fel-O-Guard®,* and *Rabvac®.*

Marketing

We sell most of our products worldwide. We adapt our marketing methods and product emphasis in various countries to meet local customer needs.

Human Pharmaceuticals—United States

In the U.S., we distribute human pharmaceutical products principally through independent wholesale distributors, with some sales directly to pharmacies. In 2017, 2016, and 2015, three wholesale distributors in the U.S. - McKesson Corporation, AmerisourceBergen Corporation, and Cardinal Health, Inc. - each accounted for between 9 percent and 18 percent of our consolidated total revenue. No other distributor accounted for more than 10 percent of consolidated total revenue in any of those years.

We promote our major human pharmaceutical products in the U.S. through sales representatives who call upon physicians and other health care professionals. We also promote to healthcare providers in medical journals and on-line health care channels, distribute literature and samples of certain products to physicians, and exhibit at medical meetings. In addition, we advertise certain products directly to consumers in the U.S., and we maintain websites with information about our major products. We supplement our employee sales force with contract sales organizations as appropriate to leverage our own resources and the strengths of our partners in various markets.

We maintain special business groups to service wholesalers, pharmacy benefit managers, managed care organizations, group purchasing organizations, government and long-term care institutions, hospitals, and certain retail pharmacies. We enter into arrangements with these organizations providing for discounts or rebates on our products.

Human Pharmaceuticals—Outside the United States

Outside the U.S, we promote our human pharmaceutical products to healthcare providers primarily through sales representatives and on-line health care channels. While the products marketed vary from country to country, endocrinology products constitute the largest single group in consolidated revenue. Distribution patterns vary from country to country. In most countries in which we operate, we maintain our own sales organizations, but in some smaller countries we market our products through independent distributors.

Human Pharmaceutical Marketing Collaborations

Certain of our human pharmaceutical products are marketed in arrangements with other pharmaceutical companies, including the following:

- We and Boehringer Ingelheim have a diabetes alliance under which we jointly develop and commercialize Trajenta, Jentadueto, Jardiance, Glyxambi, Synjardy, and Basaglar in major markets.
- Through September 30, 2015, Erbitux was marketed in the U.S. and Canada by Bristol-Myers Squibb Company and E.R. Squibb (collectively, BMS). Effective October 1, 2015, BMS transferred to us all commercialization rights for Erbitux in those two countries. Outside the U.S. and Canada, Erbitux is commercialized by Merck KGaA, and we receive royalties from Merck KGaA.
- Effient is co-promoted with us by Daiichi Sankyo Co., Ltd. (Daiichi Sankyo) in the U.S., Brazil, Mexico, and certain other countries. Through the end of 2015, we also co-promoted Effient with Daiichi Sankyo in major European markets. Effective January 2016, Daiichi Sankyo has been exclusively promoting Effient in major European markets; however, the economic results for these countries will continue to be shared in the same proportion as under the previous arrangement. We retain sole marketing rights in Canada, Australia, Russia, and certain other countries. Daiichi Sankyo retains sole marketing rights in Japan and certain other countries.

For additional information, see "Financial Statements and Supplementary Data - Note 4, Collaborations and Other Arrangements."

Animal Health Products

Our Elanco animal health business unit employs field salespeople throughout the U.S. and has an extensive sales force outside the U.S. Elanco sells its products primarily to wholesale distributors. Elanco promotes its products primarily to producers and veterinarians for food animal products and to veterinarians for companion animal products. Elanco also advertises certain companion animal products directly to pet owners in markets where it is consistent with allowable promotional practices.

Competition

Our human pharmaceutical products compete globally with products of many other companies in highly competitive markets. Our animal health products compete globally with products of animal health care companies as well as pharmaceutical, chemical, and other companies that operate animal health businesses.

Important competitive factors for both human pharmaceutical and animal health products include effectiveness, safety, and ease of use; price and demonstrated cost-effectiveness; marketing effectiveness; and research and development of new products, processes, and uses. Most new products that we introduce must compete with other branded or generic products already on the market or products that are later

developed by competitors. If competitors introduce new products or delivery systems with therapeutic or cost advantages, our products can be subject to decreased sales, progressive price reductions, or both.

We believe our long-term competitive success depends upon discovering and developing (either alone or in collaboration with others) or acquiring innovative, cost-effective human pharmaceutical and animal health products that provide improved outcomes and deliver value to payers, and continuously improving the productivity of our operations in a highly competitive environment. There can be no assurance that our efforts will result in commercially successful products, and it is possible that our products will be or become uncompetitive from time to time as a result of products developed by our competitors.

Generic Pharmaceuticals

One of the biggest competitive challenges we face is from generic pharmaceuticals. In the U.S. and the EU, the regulatory approval process for human pharmaceuticals (other than biological products (biologics)) exempts generics from costly and time-consuming clinical trials to demonstrate their safety and efficacy, allowing generic manufacturers to rely on the safety and efficacy of the innovator product. Therefore, generic manufacturers generally invest far less than we do in research and development and can price their products much lower than our branded products. Accordingly, when a branded non-biologic human pharmaceutical loses its market exclusivity, it normally faces intense price competition from generic forms of the product. Public and private payers typically encourage the use of generics as alternatives to brand-name drugs in their healthcare programs. Laws in the U.S. generally allow, and in many cases require, pharmacists to substitute generic drugs that have been rated under government procedures to be essentially equivalent to a brand-name drug. Where substitution is mandatory, it must be made unless the prescribing physician expressly forbids it. In many countries outside the U.S., intellectual property protection is weak, and we must compete with generic or counterfeit versions of our products. Many of our animal health products also compete with generics.

Biosimilars

Several of our current products, including Cyramza, Erbitux, Trulicity, Portrazza, and Taltz, and many of the new molecular entities (NMEs) in our research pipeline are biologics. Competition for Lilly's biologics may be affected by the approval of follow-on biologics, also known as biosimilars. A biosimilar is a subsequent version of an approved innovator biologic that, due to its physical and/or structural similarity to the original product, is approved based on an abbreviated data package that relies in part on the full testing required of the originator product. Globally, governments have or are developing regulatory pathways to approve biosimilars as alternatives to innovator-developed biologics, but the patent for the existing, branded product must expire in a given market before biosimilars may enter that market. The extent to which a biosimilar, once approved, will be substituted for the innovator biologic in a way that is similar to traditional generic substitution for non-biologic products, is not yet entirely clear, and will depend on a number of regulatory and marketplace factors that are still developing.

Biosimilars may present both competitive challenges and opportunities. For example, a competitor company has developed a version of insulin lispro which will compete with our product Humalog, and other companies are in the process of developing similar products. On the other hand, with our partner Boehringer Ingelheim, we developed Basaglar, a new insulin glargine product which has the same amino acid sequence as the product currently marketed by a competitor. This product has launched as a follow-on biologic in the U.S., and as a biosimilar in the EU, and Japan.

U.S. Private Sector Dynamics

In the U.S. private sector, consolidation and integration among healthcare providers is also a major factor in the competitive marketplace for human pharmaceuticals. Health plans and pharmaceutical benefit managers have been consolidating into fewer, larger entities, thus enhancing their purchasing strength and importance. Recently, CVS Health, a large pharmaceutical benefit manager and pharmacy chain, announced the planned acquisition of Aetna, a large national insurer.

Payers typically maintain formularies which specify coverage (the conditions under which drugs are included on a plan's formulary) and reimbursement (the associated out-of-pocket cost to the consumer). Formulary placement can lead to reduced usage of a drug for the relevant patient population due to coverage restrictions, such as prior authorizations and formulary exclusions, or due to reimbursement limitations which result in higher consumer out-of-pocket cost, such as non-preferred co-pay tiers, increased co-insurance levels, and higher deductibles. Consequently, pharmaceutical companies compete for formulary placement not only on the basis of product attributes such as efficacy, safety profile, or patient ease of use, but also by providing rebates. Price is an increasingly important factor in formulary decisions, particularly in treatment areas in which the payer has taken the position that multiple branded products are therapeutically comparable. These downward pricing pressures could negatively affect our future consolidated results of operations.

Patents, Trademarks, and Other Intellectual Property Rights

Overview

Intellectual property protection is critical to our ability to successfully commercialize our life sciences innovations and invest in the search for new medicines. We own, have applied for, or are licensed under, a large number of patents in the U.S. and many other countries relating to products, product uses, formulations, and manufacturing processes. In addition, as discussed below, for some products we have additional effective intellectual property protection in the form of data protection under pharmaceutical regulatory laws.

The patent protection anticipated to be of most relevance to human pharmaceuticals is provided by national patents claiming the active ingredient (the compound patent), particularly those in major markets such as the U.S., various European countries, and Japan. These patents may be issued based upon the filing of international patent applications, usually filed under the Patent Cooperation Treaty (PCT). Patent applications covering the compounds are generally filed during the Discovery Research Phase of the drug discovery process, which is described in the “Research and Development” section below. In general, national patents in each relevant country are available for a period of 20 years from the filing date of the PCT application, which is often years prior to the launch of a commercial product. Further patent term adjustments and restorations may extend the original patent term:

- Patent term adjustment is a statutory right available to all U.S. patent applicants to provide relief in the event that a patent is delayed during examination by the United States Patent and Trademark Office (USPTO).
- Patent term restoration is a statutory right provided to U.S. patents that claim inventions subject to review by the U.S. Food and Drug Administration (FDA). A single patent for a human pharmaceutical product may be eligible for patent term restoration to make up for a portion of the time invested in clinical trials and the FDA review process. Patent term restoration is limited by a formula and cannot be calculated until product approval due to uncertainty about the duration of clinical trials and the time it takes the FDA to review an application. There is a five-year cap on any restoration, and no patent may be extended for more than 14 years beyond FDA approval. Some countries outside the U.S. also offer forms of patent term restoration. For example, Supplementary Protection Certificates are sometimes available to extend the life of a European patent up to an additional five years. Similarly, in Japan, Korea, and Australia, patent terms can be extended up to five years, depending on the length of regulatory review and other factors.

Loss of effective patent protection for human pharmaceuticals typically results in the loss of effective market exclusivity for the product, which often results in severe and rapid decline in revenues for the product. However, in some cases the innovator company may be protected from approval of generic or other follow-on versions of a new medicine beyond the expiration of the compound patent through manufacturing trade

secrets, later-expiring patents on methods of use or formulations, or data protection that may be available under pharmaceutical regulatory laws. The primary forms of data protection are as follows:

- Regulatory authorities in major markets generally grant data package protection for a period of years following new drug approvals in recognition of the substantial investment required to complete clinical trials. Data package protection prohibits other manufacturers from submitting regulatory applications for marketing approval based on the innovator company's regulatory submission data for the drug. The base period of data package protection depends on the country. For example, the period is five years in the U.S. (12 years for new biologics as described below), 10 years in the EU, and eight years in Japan. The period begins on the date of product approval and runs concurrently with the patent term for any relevant patent.
- Under the Biologics Price Competition and Innovation Act of 2010, the FDA has the authority to approve biosimilars. A competitor seeking approval of a biosimilar must file an application to show its molecule is highly similar to an approved innovator biologic and include a certain amount of safety and efficacy data that the FDA will determine on a case-by-case basis. Under the data protection provisions of this law, the FDA cannot approve a biosimilar application until 12 years after initial marketing approval of the innovator biologic, subject to certain conditions.
- In the U.S., the FDA has the authority to grant additional data protection for approved drugs where the sponsor conducts specified testing in pediatric or adolescent populations within a specified time period. If granted, this "pediatric exclusivity" provides an additional six months of exclusivity, which is added to the term of data protection as well as to the term of any relevant patents, to the extent these protections have not already expired. While the term of the pediatric exclusivity attaches to the term of any relevant patent, pediatric exclusivity is a regulatory exclusivity, a bar to generic approval, not a patent right.
- Under the U.S. orphan drug law, a specific use of a drug or biologic can receive "orphan" designation if it is intended to treat a disease or condition affecting fewer than 200,000 people in the U.S., or affecting more than 200,000 people but not reasonably expected to recover its development and marketing costs through U.S. sales. Among other benefits, orphan designation entitles the particular use of the drug to seven years of market exclusivity, meaning that the FDA cannot (with limited exceptions) approve another marketing application for the same drug for the same indication until expiration of the seven-year period. Unlike pediatric exclusivity, the orphan exclusivity period is independent of and runs in parallel with any applicable patents.

Outside the major markets, the adequacy and effectiveness of intellectual property protection for human pharmaceuticals varies widely, and in a number of these markets we are unable to patent our products or to enforce the patents we receive for our products. Under the Trade-Related Aspects of Intellectual Property Agreement (TRIPs) administered by the World Trade Organization, more than 140 countries have agreed to provide non-discriminatory protection for most pharmaceutical inventions and to assure that adequate and effective rights are available to patent owners. Implementation of this agreement differs between developed and developing countries, with many developing countries limiting protection for biopharmaceutical products under their interpretation of "flexibilities" allowed under the agreement. Thus, certain types of patents, such as those on new uses of compounds or new forms of molecules, are not available in many developing countries. Further, many developing countries, and some developed countries, do not provide effective data package protection even though it is specified in TRIPs.

Certain of our Elanco animal health products are covered by patents or other forms of intellectual property protection. Historically, upon loss of effective market exclusivity for our animal health products, we have not generally experienced the rapid and severe declines in revenues that are common in the human pharmaceutical segment.

There is no assurance that the patents we are seeking will be granted or that the patents we hold will be found valid and enforceable if challenged. Moreover, patents relating to particular products, uses, formulations, or processes do not preclude other manufacturers from employing alternative processes or marketing alternative products or formulations that compete with our patented products. In addition, competitors or other third parties may assert claims that our activities infringe patents or other intellectual property rights held by them, or allege a third-party right of ownership in our existing intellectual property.

Our Intellectual Property Portfolio

We consider intellectual property protection for certain products, processes, uses, and formulations—particularly with respect to those products discussed below—to be important to our operations. For many of our products, in addition to the compound patent, we hold other patents on manufacturing processes, formulations, or uses that may extend exclusivity beyond the expiration of the compound patent.

The most relevant U.S. patent protection or data protection for our top-selling or recently launched patent-protected marketed products is as follows:

- Alimta is protected by a vitamin regimen patent (2021) plus pediatric exclusivity (2022).
- Cialis is protected by a compound patent plus pediatric exclusivity (May 2018) and a unit dose patent (exclusivity expected through at least September 2018).
- Cyramza is protected by biologics data package protection (2026).
- Effient is protected by patents covering methods of using Effient with aspirin (2023). The method patents were held unpatentable in an *inter partes* review (IPR) and we are appealing those decisions (for further information see "Financial Statements and Supplementary Data - Note 15, Contingencies").
- Forteo is protected by patents primarily covering its formulation and related processes (December 2018) and use patents (August 2019).
- Jardiance, and the related combination products Glyxambi and Synjardy, are protected by a compound patent (2025 not including possible patent extension).
- Lartruvo is protected by a compound patent (2027, not including possible patent extension) and by biologics data package protection (2028).
- Portrazza is protected by a compound patent (2025 not including possible patent extension), and by biologics data package protection (2027).
- Taltz is protected by a compound patent (2026 not including possible patent extension) and by biologic data package protection (2028).
- Trajenta and Jentadueto are protected by a compound patent (2023), and Boehringer Ingelheim has applied for a patent extension to 2025 under the patent restoration laws.
- Trulicity is protected by a compound patent (2024 not including possible patent extension) and by biologics data package protection (2026).
- Verzenio is protected by a compound patent (2029 not including possible patent extension).

Outside the U.S., important patent protection or data protection includes:

- Alimta in major European countries (vitamin regimen patent 2021) and Japan (patents covering use to treat cancer concomitantly with vitamins 2021).
- Cymbalta in Japan (data package protection January 2018).
- Forteo in Japan (data package protection July 2018; patent covering its formulation and related process August 2019).
- Lartruvo in major European countries (compound patent and data package protection 2026, not including possible patent extension).
- Olumiant in major European countries (compound patent 2029, not including possible patent extension) and Japan (compound patent 2033).
- Taltz in major European countries (compound patent and data package protection 2026, not including possible patent extension).

Baricitinib (Olumiant), has been submitted for regulatory review in the U.S. and is protected by a compound patent in the U.S. until 2030 (not including possible patent extension). Galcanezumab has been submitted for regulatory review in the U.S. and is protected by a compound patent (2033). Additional information about this molecule is provided in "Management's Discussion and Analysis - Executive Overview - Late-Stage Pipeline."

Worldwide, we sell all of our major products under trademarks that we consider in the aggregate to be important to our operations. Trademark protection varies throughout the world, with protection continuing in some countries as long as the mark is used, and in other countries as long as it is registered. Registrations are normally for fixed but renewable terms.

Patent Licenses

Most of our major products are not subject to significant license agreements. The compound patent for Cialis is the subject of a license agreement with GlaxoSmithKline (Glaxo), which assigns to us exclusively all rights in the compound. The agreement calls for royalties of a single-digit percentage of net sales. The agreement is not subject to termination by Glaxo for any reason other than a material breach by Lilly of the royalty obligation, after a substantial cure period. For information on our license and collaboration agreement with with Incyte Corporation related to Olumiant, see "Financial Statements and Supplementary Data - Note 4, Collaborations."

Patent Challenges

In the U.S., the Drug Price Competition and Patent Term Restoration Act of 1984, commonly known as the Hatch-Waxman Act, authorizes the FDA to approve generic versions of innovative human pharmaceuticals (other than biologics) without completion of safety and efficacy studies, i.e., a complete New Drug Application (NDA) by filing an Abbreviated New Drug Application (ANDA). In an ANDA, the generic manufacturer must demonstrate only "bioequivalence" between the generic version and the NDA-approved drug—not safety and efficacy. Establishing bioequivalence is generally straightforward and inexpensive for the generic company.

Absent a patent challenge, the FDA cannot approve an ANDA until after the innovator's patents expire. However, after the innovator has marketed its product for four years, a generic manufacturer may file an ANDA alleging that one or more of the patents listed in the innovator's NDA are invalid or not infringed. This allegation is commonly known as a "Paragraph IV certification." The innovator must then file suit against the generic manufacturer to protect its patents. The FDA is then prohibited from approving the generic company's application for a 30-month period (which can be shortened or extended by the trial court judge hearing the patent challenge). If one or more of the NDA-listed patents are challenged, the first filer(s) of a Paragraph IV certification may be entitled to a 180-day period of market exclusivity over all other generic manufacturers.

Generic manufacturers use Paragraph IV certifications extensively to challenge patents on innovative human pharmaceuticals. In addition, generic companies have shown willingness to launch "at risk," i.e., after receiving ANDA approval but before final resolution of their patent challenge. We are currently in litigation with numerous generic manufacturers in Hatch-Waxman litigation involving Forteo, Alimta, and Effient, among other products. For more information on Hatch-Waxman litigation involving the company, see "Financial Statements and Supplementary Data - Note 15, Contingencies".

Under the Biologics Price Competition and Innovation Act of 2009 (the BPCI Act), the FDA cannot approve a biosimilar application until data protection expires, 12 years after initial marketing approval of the innovator biologic. However, the Act does provide a mechanism for a competitor to challenge the validity of an innovator's patents as early as 4 years after initial marketing approval of the innovator biologic. The patent litigation scheme under the BPCI Act is complex, and interpretation of the BPCI Act is currently the subject of ongoing litigation. Specifically, courts have now held that biosimilar applicants are not required to engage in the BPCI Act litigation scheme. Patent holders still have the right to bring suit under normal patent law procedures if a biosimilar applicant attempts to commercialize a product prior to patent expiration.

In addition, there is a procedure in U.S. patent law known as IPR, which allows any member of the public to file a petition with the USPTO seeking the review of any issued U.S. patent. IPRs are conducted before Administrative Patent Judges in the USPTO using a lower standard of proof than used in federal district court. In addition, the challenged patents are not accorded the presumption of validity as they are in Federal District Court. We are now seeing instances where generic drug companies and some investment funds are

attempting to invalidate our patents by filing IPR challenges in the USPTO. For more information, see "Financial Statements and Supplementary Data - Note 15, Contingencies."

Outside the U.S., the legal doctrines and processes by which pharmaceutical patents can be challenged vary widely. In recent years, we have experienced an increase in patent challenges from generic manufacturers in many countries outside the U.S., and we expect this trend to continue. For more information on administrative challenges and litigation involving our Alimta patents in Europe and Japan, see "Financial Statements and Supplementary Data - Note 15, Contingencies."

Government Regulation of Our Operations

Our operations are regulated extensively by numerous national, state, and local agencies. The lengthy process of laboratory and clinical testing, data analysis, manufacturing development, and regulatory review necessary for governmental approvals is extremely costly and can significantly delay product introductions. Promotion, marketing, manufacturing, and distribution of human pharmaceutical and animal health products are extensively regulated in all major world markets. We conduct extensive post-marketing surveillance of the safety of the products we sell. In addition, our operations are subject to complex federal, state, local, and foreign laws and regulations concerning the environment, occupational health and safety, and privacy. Animal health product regulations address the administration of the product in or on the animal, and in the case of food animal products, the impact on humans who consume the food as well as the impact on the environment at the production site. Compliance with the laws and regulations affecting the manufacture and sale of current products and the discovery, development, and introduction of new products will continue to require substantial effort, expense, and capital investment.

Of particular importance is the FDA in the U.S. Pursuant to the Federal Food, Drug, and Cosmetic Act, the FDA has jurisdiction over all of our human pharmaceutical products and certain animal health products in the U.S. and administers requirements covering the testing, safety, effectiveness, manufacturing, quality control, distribution, labeling, marketing, advertising, dissemination of information, and post-marketing surveillance of those products. The U.S. Department of Agriculture and the U.S. Environmental Protection Agency also regulate some animal health products.

The FDA extensively regulates all aspects of manufacturing quality for human pharmaceuticals under its current Good Manufacturing Practices (cGMP) regulations. Outside the U.S., our products and operations are subject to similar regulatory requirements, notably by the European Medicines Agency in the EU and the Ministry of Health, Labor and Welfare in Japan. Specific regulatory requirements vary from country to country. We make substantial investments of capital and operating expenses to implement comprehensive, company-wide quality systems in our manufacturing, product development, and process development operations to ensure sustained compliance with cGMP and similar regulations. However, in the event we fail to adhere to these requirements in the future, we could be subject to interruptions in production, fines and penalties, and delays in new product approvals. Certain of our products are manufactured by third parties, and their failure to comply with these regulations could adversely affect us through failure to supply product to us or delays in new product approvals.

The marketing, promotional, and pricing practices of human pharmaceutical manufacturers, as well as the manner in which manufacturers interact with purchasers and prescribers, are subject to various other U.S. federal and state laws, including the federal anti-kickback statute and the False Claims Act and state laws governing kickbacks, false claims, unfair trade practices, and consumer protection. These laws are administered by, among others, the Department of Justice (DOJ), the Office of Inspector General of the Department of Health and Human Services, the Federal Trade Commission, the Office of Personnel Management, and state attorneys general. Over the past several years, the FDA, the DOJ, and many of these other agencies have increased their enforcement activities with respect to pharmaceutical companies and increased the inter-agency coordination of enforcement activities. Several claims brought by these agencies against Lilly and other companies under these and other laws have resulted in corporate criminal sanctions and very substantial civil settlements.

The U.S. Foreign Corrupt Practices Act of 1977 (FCPA) prohibits certain individuals and entities, including U.S. publicly traded companies, from promising, offering, or giving anything of value to foreign officials with the corrupt intent of influencing the foreign official for the purpose of helping the company obtain or retain business or gain any improper advantage. The FCPA also imposes specific recordkeeping and internal

controls requirements on U.S. publicly traded companies. As noted above, outside the U.S., our business is heavily regulated and therefore involves significant interaction with foreign officials. Additionally, in many countries outside the U.S., the health care providers who prescribe human pharmaceuticals are employed by the government and the purchasers of human pharmaceuticals are government entities; therefore, our interactions with these prescribers and purchasers are subject to regulation under the FCPA.

In addition to the U.S. application and enforcement of the FCPA, the various jurisdictions in which we operate and supply our products have laws and regulations aimed at preventing and penalizing corrupt and anticompetitive behavior. In recent years, several jurisdictions, including China, Brazil, and the United Kingdom (U.K.), have enhanced their laws and regulations in this area, increased their enforcement activities, and/or increased the level of cross-border coordination and information sharing.

It is possible that we could become subject to additional administrative and legal proceedings and actions, which could include claims for civil penalties (including treble damages under the False Claims Act), criminal sanctions, and administrative remedies, including exclusion from U.S. federal and other health care programs. It is possible that an adverse outcome in future actions could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

Regulations and Private Payer Actions Affecting Human Pharmaceutical Pricing, Reimbursement, and Access

In the U.S., we are required to provide rebates to the federal government and respective state governments on their purchases of our human pharmaceuticals under state Medicaid and Medicaid Managed Care programs (minimum of 23.1 percent plus adjustments for price increases over time) and rebates to private payers who cover patients in certain types of health care facilities that serve low-income and uninsured patients (known as 340B facilities). No rebates are required at this time in the Medicare Part B (physician and hospital outpatient) program where reimbursement is set on an "average selling price plus 4.3 percent" formula. Drug manufacturers are required to provide a discount of 50 percent of the cost of branded prescription drugs for Medicare Part D participants who are in the “doughnut hole” (the coverage gap in Medicare prescription drug coverage). Additionally, an annual fee is imposed on pharmaceutical manufacturers and importers that sell branded prescription drugs to specified government programs.

Rebates are also negotiated in the private sector. We give rebates to private payers who provide prescription drug benefits to seniors covered by Medicare and to private payers who provide prescription drug benefits to their customers. These rebates are affected by the introduction of competitive products and generics in the same class.

In most international markets, we operate in an environment of government-mandated cost-containment programs, which may include price controls, international reference pricing (to other countries’ prices), discounts and rebates, therapeutic reference pricing (to other, often generic, pharmaceutical choices), restrictions on physician prescription levels, and mandatory generic substitution.

Globally, public and private payers are increasingly restricting access to human pharmaceuticals based on assessments of comparative effectiveness and value, including through the establishment of formal health technology assessment processes. In addition, third party organizations, including professional associations, academic institutions, and non-profit entities associated with payers, are conducting and publishing comparative effectiveness and cost/benefit analyses on medicines, the impact of which are uncertain at this time.

We cannot predict the extent to which our business may be affected by these or other potential future legislative, regulatory, or payer developments. However, in general we expect that state, federal, and international legislative and regulatory developments could have further negative effects on pricing and reimbursement for our human pharmaceutical products.

Research and Development

Our commitment to research and development dates back more than 140 years. We invest heavily in research and development because we believe it is critical to our long-term competitiveness. At the end of 2017, we employed approximately 9,000 people in human pharmaceutical and animal health research and development activities, including a substantial number of physicians, scientists holding graduate or

postgraduate degrees, and highly skilled technical personnel. This number decreased to approximately 8,200 as of January 31, 2018, following a voluntary early retirement program in the U.S. Our research and development expenses were $5.28 billion in 2017, $5.24 billion in 2016, and $4.80 billion in 2015.

Our internal human pharmaceutical research focuses primarily on the areas of cancer, diabetes, neurodegeneration, immunology, and pain. We have a strong biotechnology research program, with more than half of our clinical-stage pipeline currently consisting of biologics. In addition to discovering and developing NMEs, we seek to expand the value of existing products through new uses, formulations, and therapeutic approaches that provide additional value to patients.

To supplement our internal efforts, we collaborate with others, including academic institutions and research-based pharmaceutical and biotechnology companies. We use the services of physicians, hospitals, medical schools, and other research organizations worldwide to conduct clinical trials to establish the safety and effectiveness of our human pharmaceutical products. We actively invest in external research and technologies that hold the promise to complement and strengthen our own efforts. These investments can take many forms, including licensing arrangements, co-development and co-marketing agreements, co-promotion arrangements, joint ventures, and acquisitions.

Our Elanco animal health innovation strategy is focused on identifying and developing promising technologies and potential products from internal and external sources to meet unmet veterinary, food producer, and pet owner needs. Our animal health scientists also leverage discoveries from our human health laboratories to develop products to enhance the health and wellbeing of farm animals and pets.

Human pharmaceutical development is time-consuming, expensive, and risky. On average, only one out of many thousands of molecules discovered by researchers ultimately becomes an approved medicine. The process from discovery to regulatory approval can take over a decade. Drug candidates can fail at any stage of the process, and even late-stage drug candidates sometimes fail to receive regulatory approval or achieve commercial success. The rate of innovation cycles leading to medical improvements over initial inventions is accelerating. This has increased the risk that we opt not to develop a late-stage asset or that new products fail to achieve commercial success due to technical obsolescence - displacement by follow-on competitor products - before the period of exclusivity has ended. After approval and launch of a product, we expend considerable resources on post-marketing surveillance and additional clinical studies to collect data and understand the benefits and potential risks of medicines as they are used as therapeutics. The following describes in more detail the research and development process for human pharmaceutical products:

Phases of New Drug Development

- **Discovery Research Phase**

  The earliest phase of new drug research and development, the discovery phase, can take many years. Scientists identify, design, and synthesize promising molecules, screening tens of thousands of molecules for their effect on biological targets that appear to play an important role in one or more diseases. Targets can be part of the body, such as a protein, receptor, or gene; or foreign, such as a virus or bacteria. Some targets have been proven to affect disease processes, but often the target is unproven and may later prove to be irrelevant to the disease or to yield insufficient clinical benefit. Molecules that have the desired effect on the target and meet other design criteria become candidate molecules and move to the next phase of development. The probability of any one candidate molecule becoming a commercial product is extremely low.

- **Early Development Phase**

  The early development phase involves refining candidate molecules, understanding how to manufacture them efficiently, and completing initial testing for safety and efficacy. Safety testing is done first in laboratory tests and animals as necessary, to identify toxicity and other potential safety issues that would preclude use in humans. In general, the first human tests (often referred to as Phase I) are conducted in small groups of healthy volunteers or patients to assess safety and find the potential dosing range. After a safe dose range has been established, the drug is typically administered to small populations of patients (Phase II) to look for initial signs of efficacy in treating the targeted disease, or biomarkers of the disease, and to continue to assess safety. In parallel, scientists work to identify safe, effective, and economical manufacturing processes. Long-term animal studies continue to test for potential safety

issues. Of the molecules that enter the early development phase, approximately 10 percent move on to the product phase. The early development phase can take several years to complete.

- **Product Phase**

  Product phase (Phase III) molecules have met initial safety requirements and, typically, shown initial evidence of efficacy. As a result, these molecules generally have a higher likelihood of success. The molecules are tested in much larger patient populations to demonstrate efficacy to a predetermined level of statistical significance and to continue to develop the safety profile. These trials are generally global in nature and are designed to generate the data necessary to submit the molecule to regulatory agencies for marketing approval. The potential new drug is generally compared with existing competitive therapies, placebo, or both. The resulting data is compiled and may be submitted to regulatory agencies around the world. Phase III testing varies by disease state, but can often last from three to four years.

- **Submission Phase**

  Once a molecule is submitted to regulatory agencies, the time to final marketing approval can vary from several months to several years, depending on variables such as the disease state, the strength and complexity of the data presented, the novelty of the target or compound, and the time required for the agency(ies) to evaluate the submission. There is no guarantee that a potential medicine will receive marketing approval, or that decisions on marketing approvals or indications will be consistent across geographic areas.

We believe our investments in research, both internally and in collaboration with others, have been rewarded by the large number of new molecules and new indications for existing molecules that we have in all stages of development. We currently have approximately 40 drug candidates across all stages of human testing and a larger number of projects in preclinical development. Among our new investigational molecules currently in the product phase of development or awaiting regulatory approval or launch are potential therapies for various cancers, Alzheimer's disease, pain, migraine, rheumatoid arthritis, psoriatic arthritis, and severe hypoglycemia. We are studying many other drug candidates in the earlier stages of development in our chosen priority areas. We are also developing new uses, formulations, or delivery methods for many of these molecules as well as several currently marketed products. See "Management's Discussion and Analysis - Executive Overview - Late-Stage Pipeline," for more information on certain of our product candidates.

Raw Materials and Product Supply

Most of the principal materials we use in our manufacturing operations are available from more than one source. However, we obtain certain raw materials primarily from only one source. In the event one of these suppliers was unable to provide the materials or product, we generally seek to maintain sufficient inventory to supply the market until an alternative source of supply can be implemented. However, in the event of an extended failure of a supplier, it is possible that we could experience an interruption in supply until we established new sources or, in some cases, implemented alternative processes.

The majority of our revenue comes from products produced in our own facilities. Our principal active ingredient manufacturing occurs at sites we own in the U.S., Ireland, and Puerto Rico. Finishing operations, including formulation, filling, assembling, delivery device manufacturing, and packaging, take place at a number of sites throughout the world. We utilize third parties for certain active ingredient manufacturing and finishing operations.

We manage our supply chain (including our own facilities, contracted arrangements, and inventory) in a way that should allow us to meet all expected product demand while maintaining flexibility to reallocate manufacturing capacity to improve efficiency and respond to changes in supply and demand. To maintain a stable supply of our products, we use a variety of techniques including comprehensive quality systems, inventory management, and back-up sites.

However, human pharmaceutical and animal health production processes are complex, highly regulated, and vary widely from product to product. Shifting or adding manufacturing capacity can be a very lengthy process requiring significant capital expenditures, process modifications, and regulatory approvals. Accordingly, if we were to experience extended plant shutdowns at one of our own facilities, extended failure of a contract supplier, or extraordinary unplanned increases in demand, we could experience an interruption in supply of certain products or product shortages until production could be resumed or expanded.

Quality Assurance

Our success depends in great measure upon customer confidence in the quality of our products and in the integrity of the data that support their safety and effectiveness. Product quality arises from a total commitment to quality in all parts of our operations, including research and development, purchasing, facilities planning, manufacturing, distribution, and dissemination of information about our medicines.

Quality of production processes involves strict control of ingredients, equipment, facilities, manufacturing methods, packaging materials, and labeling. We perform tests at various stages of production processes and on the final product to assure that the product meets all regulatory requirements and Lilly internal standards. These tests may involve chemical and physical chemical analyses, microbiological testing, testing in animals, or a combination thereof. Additional assurance of quality is provided by corporate quality-assurance groups that audit and monitor all aspects of quality related to human pharmaceutical and animal health manufacturing procedures and systems in company operations and at third-party suppliers.

Risk Factors

In addition to the other information contained in this Annual Report, the following risk factors should be considered carefully in evaluating our company. It is possible that our business, financial condition, liquidity, or results of operations could be materially adversely affected by any of these risks. Certain of these risks could also adversely affect the company's reputation.

- **Pharmaceutical research and development is very costly and highly uncertain; we may not succeed in developing or acquiring commercially successful products sufficient in number or value to replace revenues of products that have lost or will soon lose intellectual property protection.**

  There are many difficulties and uncertainties inherent in human pharmaceutical research and development and the introduction of new products. There is a high rate of failure inherent in new drug discovery and development. To bring a drug from the discovery phase to market can take over a decade and often costs in excess of $2 billion. Failure can occur at any point in the process, including in later stages after substantial investment. As a result, most funds invested in research programs will not generate financial returns. New product candidates that appear promising in development may fail to reach the market or may have only limited commercial success because of efficacy or safety concerns, inability to obtain necessary regulatory approvals or payer reimbursement or coverage, limited scope of approved uses, changes in the relevant treatment standards or the availability of new or better competitive products, difficulty or excessive costs to manufacture, or infringement of the patents or intellectual property rights of others. Regulatory agencies continue to establish increasingly high hurdles for the efficacy and safety of new products. Delays and uncertainties in drug approval processes can result in delays in product launches and lost market opportunity. In addition, it can be very difficult to predict revenue growth rates of new products.

  We cannot state with certainty when or whether our products now under development will be approved or launched; whether, if initially granted, such approval will be maintained; whether we will be able to develop, license, or otherwise acquire additional product candidates or products; or whether our products, once launched, will be commercially successful. We must maintain a continuous flow of successful new products and successful new indications or brand extensions for existing products sufficient both to cover our substantial research and development costs and to replace revenues that are lost as profitable products lose intellectual property exclusivity or are displaced by competing products or therapies. Failure to do so in the short-term or long-term would have a material adverse effect on our business, results of operations, cash flows, financial position, and prospects. See “Management’s Discussion and Analysis - Executive Overview - Late-Stage Pipeline” for more details.

- **We depend on products with intellectual property protection for most of our revenues, cash flows, and earnings; we have lost or will lose effective intellectual property protection for many of those products in the next several years, which has resulted and is likely to continue to result in rapid and severe declines in revenues.**

  A number of our top-selling human pharmaceutical products have recently lost, or will lose in the next several years, significant patent protection and/or data protection in the U.S. as well as key countries outside the U.S., as illustrated in the tables below:

Product	U.S. Revenues (2017) ($ in millions)	Percent of Worldwide Revenues (2017)	Patent / Data Protection - U.S.
Cialis	$ 1,358.6	6%	Compound patent plus pediatric exclusivity (May 2018) and unit dose patent with exclusivity expected through September 2018
Alimta	1,034.3	5%	Vitamin regimen patent plus pediatric exclusivity 2022
Forteo	965.2	4%	Formulation and related process patents December 2018; use patents August 2019
Effient	340.1	1%	Compound patent plus pediatric exclusivity October 2017
Strattera	284.9	1%	Use patent plus pediatric exclusivity May 2017

Product	Revenues Outside U.S. (2017) ($ in millions)	Percent of Worldwide Revenues (2017)	Patent / Data Protection - Major Europe / Japan
Alimta	$ 1,028.2	4%	Major European countries: vitamin regimen patent 2021 Japan: use patents to treat cancer concomitantly with vitamins 2021
Cialis	964.5	4%	Major European countries: compound patent November 2017
Forteo	783.8	3%	Japan: data package protection July 2018; formulation and related process patent August 2019
Cymbalta	642.2	3%	Japan: data package protection January 2018

  Certain other significant products no longer have effective exclusivity through patent protection or data protection. For non-biologic products, loss of exclusivity (whether by expiration or as a consequence of litigation) typically results in the entry of one or more generic competitors, leading to a rapid and severe decline in revenues, especially in the U.S. Historically, outside the U.S. the market penetration of generics following loss of exclusivity has not been as rapid or pervasive as in the U.S.; however, generic market penetration is increasing in many markets outside the U.S., including Japan, Europe, and many countries in the emerging markets. For biologics (such as Humalog, Humulin, Erbitux, Cyramza, Trulicity, and Taltz), loss of exclusivity may or may not result in the near-term entry of competitor versions (i.e., biosimilars) due to development timelines, manufacturing challenges, and/or uncertainties in the regulatory pathways for approval of the competitor versions. See “Management’s Discussion and Analysis - Executive Overview - Other Matters” and "Business - Patents, Trademarks, and Other Intellectual Property Rights" for more details.

- **Our long-term success depends on intellectual property protection; if our intellectual property rights are invalidated, circumvented, or weakened, our business will be adversely affected.**

  Our long-term success depends on our ability to continually discover, develop, and commercialize innovative new pharmaceutical products. Without strong intellectual property protection, we would be unable to generate the returns necessary to support the enormous investments in research and development and capital as well as other expenditures required to bring new drugs to the market.

Intellectual property protection varies throughout the world and is subject to change over time. In the U.S., in addition to the process for challenging patents which applies to our biologic products, the Hatch-Waxman Act provides generic companies powerful incentives to seek to invalidate our other human pharmaceutical patents. As a result, we expect that our U.S. patents on major pharmaceutical products will continue to be routinely challenged in litigation and administrative proceedings, and may not be upheld. In addition, a separate IPR process allows competitors to request review of issued patents by the USPTO without the protections of the Hatch-Waxman Act. As a result, our patents may be invalided via this review process. Although such a decision can be appealed to the courts, in certain circumstances a loss in such a proceeding could result in a competitor entering the market, while a win provides no precedential value - the same patent can still be challenged by other competitors. We face many generic manufacturer challenges to our patents outside the U.S. as well. The entry of generic competitors typically results in rapid and severe declines in revenues. In addition, competitors or other third parties may claim that our activities infringe patents or other intellectual property rights held by them. If successful, such claims could result in our being unable to market a product in a particular territory or being required to pay damages for past infringement or royalties on future sales. See “Business - Patents, Trademarks, and Other Intellectual Property Rights” and "Financial Statements and Supplementary Data - Note 15, Contingencies," for more details.

- **Our human pharmaceutical business is subject to increasing government price controls and other public and private restrictions on pricing, reimbursement, and access for our drugs, which could have a material adverse effect on our business.**

  Public and private payers are taking increasingly aggressive steps to control their expenditures for human pharmaceuticals by placing restrictions on pricing and reimbursement for, and patient access to, our medications. These pressures could negatively affect our future revenues and net income.

  We expect pricing, reimbursement, and access pressures from both governments and private payers inside and outside the U.S. to become more severe. For more details, see “Business - Regulations and Private Payer Actions Affecting Human Pharmaceutical Pricing, Reimbursement, and Access” and “Management’s Discussion and Analysis - Executive Overview - Other Matters.”

- **We face intense competition from multinational pharmaceutical companies, biotechnology companies, and lower-cost generic and biosimilar manufacturers, and such competition could have a material adverse effect on our business.**

  We compete with a large number of multinational pharmaceutical companies, biotechnology companies, and generic pharmaceutical companies. To compete successfully, we must continue to deliver to the market innovative, cost-effective products that meet important medical needs. Our product revenues can be adversely affected by the introduction by competitors of branded products that are perceived as superior by the marketplace, by generic or biosimilar versions of our branded products, and by generic or biosimilar versions of other products in the same therapeutic class as our branded products. Our revenues can also be adversely affected by treatment innovations that eliminate or minimize the need for treatment with our drugs. See “Business - Competition” and "Business - Research and Development" for more details.

- **Changes in foreign currency rates or devaluation of a foreign currency can materially affect our revenue, cost of sales, and operating expenses.**

  As a global company with substantial operations outside the U.S., we face foreign currency risk exposure from fluctuating currency exchange rates. While we manage a portion of these exposures through hedging and other risk management techniques, significant fluctuations in currency rates can have a material impact, either positive or negative, on our revenue, cost of sales, and operating expenses. In the event of an extreme devaluation of local currency, the price of our products could become unsustainable in the relevant market. See “Management’s Discussion and Analysis - Financial Condition” for more details.

- **Unanticipated changes in our tax rates or exposure to additional tax liabilities could increase our income taxes and decrease our net income.**

  We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Changes in the relevant tax laws, regulations, administrative practices, principles, and interpretations could adversely affect our future effective tax rates. The U.S. recently enacted tax reform legislation significantly revising the U.S. tax law and a number of other countries are actively considering or enacting tax changes. Modifications to key elements of the U.S. or international tax framework could have a material adverse effect on our consolidated operating results and cash flows. See “Management’s Discussion and Analysis - Executive Overview - Other Matters” and "Financial Statements and Supplementary Data - Note 13, Income Taxes" for more details.

- **Failure, inadequacy, or breach of our information technology systems, infrastructure, and business information could result in material harm to our business and reputation.**

  A great deal of confidential information owned by both us and our business partners is stored in our information systems, networks, and facilities or those of third parties. This includes valuable trade secrets and intellectual property, clinical trial information, corporate strategic plans, marketing plans, customer information, and personally identifiable information, such as employee and patient information (collectively, “confidential information”). We also rely to a large extent on the efficient and uninterrupted operation of complex information technology systems, infrastructure, and hardware (together “IT systems”), some of which are within the company’s control and some of which are within the control of third parties, to accumulate, process, store, and transmit large amounts of confidential information and other data. Maintaining the confidentiality, integrity and availability of our IT systems and confidential information is vital to our business.

  IT systems are vulnerable to system inadequacies, operating failures, service interruptions or failures, security breaches, malicious intrusions, or cyber-attacks from a variety of sources. Cyber-attacks are growing in their frequency, sophistication, and intensity, and are becoming increasingly difficult to detect, mitigate, or prevent. Cyber-attacks come in many forms, including the deployment of harmful malware, exploitation of vulnerabilities, denial-of-service attacks, the use of social engineering, and other means to compromise the confidentiality, integrity and availability of our IT systems, confidential information, and other data. Breaches resulting in the compromise, loss, theft, destruction, or unauthorized disclosure or use of confidential information, or the unauthorized access to, disruption of, or interference with our products and services, can occur in a variety of ways, including but not limited to, negligent or wrongful conduct by employees or others with permitted access to our systems and information, or wrongful conduct by hackers, competitors, certain governments, or other current or former company personnel. Our third party partners face similar risks.

  The failure or inadequacy of our IT systems, the compromise, loss, theft, destruction, or unauthorized disclosure or use of confidential information, or the unauthorized access to, disruption of, or interference with our products and services that rely on IT systems, could impair our ability to secure and maintain intellectual property rights; result in a product manufacturing interruption or failure, or in the interruption or failure of products or services that rely on IT systems; damage our operations, customer relationships, or reputation; or cause us to lose trade secrets or other competitive advantages. Unauthorized disclosure of personally identifiable information could expose us to sanctions for violations of data privacy laws and regulations around the world and could damage public trust in our company.

  To date, system inadequacies, operating failures, unauthorized access, service interruptions or failures, security breaches, malicious intrusions, cyber-attacks, and the compromise, loss, theft, destruction, or unauthorized disclosure or use of confidential information have not had a material impact on our consolidated results of operations. We have implemented measures to prevent, detect, respond to, and minimize these risks; however, these measures may not be successful. If they are not successful, any of these events could result in material financial, legal, business, or reputational harm to our business and reputation.

- **Significant economic downturns could adversely affect our business and operating results.**

  While human pharmaceuticals and companion animal health products have not generally been sensitive to overall economic cycles, prolonged economic slowdowns could lead to decreased utilization of our products, affecting our sales volume. Our food animal business may be affected by depressed prices for our customers' end products. Declining tax revenues attributable to economic downturns increase the pressure on governments to reduce human health care spending, leading to increasing government efforts to control drug prices and utilization. Additionally, some customers, including governments or other entities reliant upon government funding, may be unable to pay in a timely manner for our products. Also, if our customers, suppliers, or collaboration partners experience financial difficulties, we could experience slower customer collections, greater bad debt expense, and performance defaults by suppliers or collaboration partners. Similarly, in the event of a significant economic downturn, we could have difficulty accessing credit markets.

- **Pharmaceutical products can develop unexpected safety or efficacy concerns, which could have a material adverse effect on revenues and income.**

  Human pharmaceutical products receive regulatory approval based on data obtained in controlled clinical trials of limited duration. After approval, the products are used for longer periods of time by much larger numbers of patients; we and others (including regulatory agencies and private payers) collect extensive information on the efficacy and safety of our marketed products by continuously monitoring the use of our products in the marketplace. In addition, we or others may conduct post-marketing clinical studies on efficacy and safety of our marketed products. New safety or efficacy data from both market surveillance and post-marketing clinical studies may result in product label changes that could reduce the product's market acceptance and result in declining sales. Serious safety or efficacy issues that arise after product approval could result in voluntary or mandatory product recalls or withdrawals from the market. Safety issues could also result in costly product liability claims.

- **We face many product liability claims and are self-insured; we could face large numbers of claims in the future, which could adversely affect our business.**

  We are subject to a substantial number of product liability claims involving Actos®, Axiron®, Byetta®, Cialis, Cymbalta, and Prozac among other products. See "Financial Statements and Supplementary Data - Note 15, Contingencies" for more information on our current product liability litigation. Because of the nature of pharmaceutical products, we could become subject to large numbers of product liability claims for these or other products in the future, which could require substantial expenditures to resolve and, if involving marketed products, could adversely affect sales of the product. Due to a very restrictive market for product liability insurance, we are self-insured for product liability losses for all our currently marketed products.

- **Regulatory compliance problems could be damaging to the company.**

  The marketing, promotional, and pricing practices of human pharmaceutical manufacturers, as well as the manner in which manufacturers interact with purchasers, prescribers, and patients, are subject to extensive regulation. Many companies, including us, have been subject to claims related to these practices asserted by federal, state, and foreign governmental authorities, private payers, and consumers. These claims have resulted in substantial expense and other significant consequences to us. It is possible that we could become subject to such investigations and that the outcome could include criminal charges and fines, penalties, or other monetary or non-monetary remedies, including exclusion from U.S. federal and other health care programs. In addition, regulatory issues concerning compliance with cGMP regulations (and comparable foreign regulations) for pharmaceutical products can lead to product recalls and seizures, fines and penalties, interruption of production leading to product shortages, and delays in the approvals of new products pending resolution of the issues. See "Business - Government Regulation of Our Operations" for more details.

- **Manufacturing difficulties or disruptions could lead to product supply problems.**

  Pharmaceutical and animal health manufacturing is complex and highly regulated. Manufacturing difficulties at our facilities or contracted facilities, or the failure or refusal of a contract manufacturer to supply contracted quantities, could result in product shortages, leading to lost revenue. Such difficulties or disruptions could result from quality or regulatory compliance problems, natural disasters, mechanical or information technology system failures, or inability to obtain sole-source raw or intermediate materials. In addition, given the difficulties in predicting sales of new products and the very long lead times necessary for the expansion and regulatory qualification of pharmaceutical manufacturing capacity, it is possible that we could have difficulty meeting unanticipated demand for new products. See “Business - Raw Materials and Product Supply” for more details.

- **Reliance on third-party relationships and outsourcing arrangements could adversely affect our business.**

  We utilize third parties, including suppliers, distributors, alliances with other pharmaceutical and biotechnology companies, and third-party service providers, for selected aspects of product development, manufacture, commercialization, support for information technology systems, product distribution, and certain financial transactional processes. For example, we outsource the day-to-day management and oversight of our clinical trials to contract research organizations. Outsourcing these functions involves the risk that the third parties may not perform to our standards or legal requirements, may not produce reliable results, may not perform in a timely manner, may not maintain the confidentiality of our proprietary information, or may fail to perform at all. Failure of these third parties to meet their contractual, regulatory, confidentiality, or other obligations to us could have a material adverse effect on our business.

- **Our animal health segment faces risks related to increased generic competition, food and animal safety concerns, factors affecting global agricultural markets, and other risks.**

  The animal health operating segment may be impacted by, among other things, emerging restrictions and bans on the use of antibacterials in food-producing animals; perceived adverse effects on human health linked to the consumption of food derived from animals that utilize our products; increased regulation or decreased governmental support relating to the raising, processing, or consumption of food-producing animals; an outbreak of infectious disease carried by animals; adverse weather conditions and the availability of natural resources; adverse global economic conditions affecting agricultural markets; and failure of our research and development, acquisition, and licensing efforts to generate new products. The failure to manage these risks could have a material adverse effect on our revenues and income.

Management's Discussion and Analysis of Results of Operations and Financial Condition

RESULTS OF OPERATIONS

(Tables present dollars in millions, except per-share data)

General

Management's discussion and analysis of results of operations and financial condition, is intended to assist the reader in understanding and assessing significant changes and trends related to the results of operations and financial position of our consolidated company. This discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying footnotes in this Annual Report. Certain statements in this section of the Annual Report constitute forward-looking statements. Various risks and uncertainties, including those discussed in "Forward-Looking Statements" and "Risk Factors," may cause our actual results and cash generated from operations to differ materially from these forward-looking statements.

Executive Overview

This section provides an overview of our financial results, recent product and late-stage pipeline developments, and other matters affecting our company and the pharmaceutical industry. Earnings (loss) per share (EPS) data are presented on a diluted basis.

Financial Results

The following table summarizes our key operating results:

	Year Ended December 31,		Percent Change
	2017	2016	
Revenue	**$22,871.3**	$21,222.1	8
Gross margin	**16,801.1**	15,567.2	8
Gross margin as a percent of revenue	**73.5%**	73.4%	
Operating expense [(1)]	**$11,869.9**	$11,695.9	1
Acquired in-process research and development	**1,112.6**	30.0	NM
Asset impairment, restructuring, and other special charges	**1,673.6**	382.5	NM
Income before income taxes	**2,197.4**	3,374.0	(35)
Income Taxes	**2,401.5**	636.4	NM
Net income (loss)	**(204.1)**	2,737.6	NM
Earnings (loss) per share	**(0.19)**	2.58	NM

[(1)] Operating expense consists of research and development and marketing, selling, and administrative expenses.

NM - not meaningful

Revenue and gross margin increased in 2017. The increase in operating expense in 2017 was primarily due to an increase in marketing, selling, and administrative expense. Income before income taxes decreased in 2017 as higher asset impairment, restructuring, and other special charges, acquired in-process research and development (IPR&D) charges and, to a lesser extent, higher operating expense were partially offset by a higher gross margin. Tax expense exceeded income before income taxes in 2017 as a result of the 2017 Tax Act, resulting in a net loss for the year. Refer to "Results of Operations - Executive Overview - Other Matters - Tax Matters" for further discussion of the 2017 Tax Act.

The following highlighted items affect comparisons of our 2017 and 2016 financial results:

2017

Acquired IPR&D (Note 3 to the consolidated financial statements)

- We recognized acquired IPR&D charges of $1.11 billion (pretax), or $0.97 per share, primarily related to the acquisition of CoLucid Pharmaceuticals, Inc. (CoLucid).

Asset Impairment, Restructuring, and Other Special Charges (Note 5 to the consolidated financial statements)

- We recognized charges of $1.67 billion (pretax), or $1.23 per share, primarily associated with efforts to reduce our cost structure, including the U.S. voluntary early retirement program.

Income Tax Expense (Note 13 to the consolidated financial statements)

- We recognized a provisional tax expense of $1.91 billion, or $1.81 per share, due to the 2017 Tax Act. Refer to "Results of Operations - Executive Overview - Other Matters - Tax Matters" for further discussion of the 2017 Tax Act.

2016

Acquired IPR&D (Note 3 to the consolidated financial statements)

- We recognized acquired IPR&D charges of $30.0 million (pretax), or $0.02 per share, related to upfront fees paid in connection with a collaboration agreement with AstraZeneca to co-develop MEDI1814, a potential disease-modifying treatment for Alzheimer's disease.

Asset Impairment, Restructuring, and Other Special Charges (Note 5 to the consolidated financial statements)

- We recognized charges of $382.5 million (pretax), or $0.29 per share, related to integration and severance costs related to the acquisition of Novartis Animal Health (Novartis AH), other global severance costs, and asset impairments primarily related to the closure of an animal health manufacturing facility in Ireland.

Other-Net, (Income) Expense (Note 17 to the consolidated financial statements)

- We recognized charges of $203.9 million (pretax), or $0.19 per share, related to the impact of the Venezuelan financial crisis, including the significant deterioration of the bolívar.

Late-Stage Pipeline

Our long-term success depends to a great extent on our ability to continue to discover and develop innovative pharmaceutical products and acquire or collaborate on molecules currently in development by other biotechnology or pharmaceutical companies. We currently have approximately 40 potential new drugs in human testing or under regulatory review and a larger number of projects in preclinical research.

The following new molecular entities (NMEs) have been approved by regulatory authorities in at least one of the major geographies for use in the diseases described. The first quarter in which each NME initially was approved in any major geography for any indication is shown in parentheses:

Abemaciclib (Verzenio™) (Q3 2017)—a small molecule cell-cycle inhibitor, selective for cyclin-dependent kinases 4 and 6 for the treatment of metastatic breast cancer.

Baricitinib (Olumiant®) (Q1 2017)—a Janus tyrosine kinase inhibitor for the treatment of moderate-to-severe active rheumatoid arthritis (in collaboration with Incyte Corporation).

Olaratumab* (Lartruvo™) (Q4 2016)—a human IgG1 monoclonal antibody for the treatment of advanced soft tissue sarcoma.

The following NME has been submitted for regulatory review in at least one of the major geographies for potential use in the disease described. The first quarter in which the NME initially was submitted in any major geography for any indication is shown in parentheses:

Galcanezumab* (Q3 2017)—a once-monthly subcutaneously injected calcitonin gene-related peptide (CGRP) antibody for the treatment of migraine prevention. Refer to Item 3, "Legal Proceedings—Other Patent Litigation" in our filed 2017 Form 10-K for discussion of the lawsuit filed by Teva Pharmaceuticals International GMBH.

The following NMEs and diagnostic agent are currently in Phase III clinical trial testing for potential use in the diseases described. The first quarter in which each NME and diagnostic agent initially entered Phase III for any indication is shown in parentheses:

Flortaucipir (Q3 2015)**—a positron emission tomography (PET) tracer intended to image tau (or neurofibrillary) tangles in the brain, which are an indicator of Alzheimer's disease.

Lanabecestat (Q2 2016)—an oral beta-secretase cleaving enzyme (BACE) inhibitor for the treatment of early and mild Alzheimer's disease (in collaboration with AstraZeneca).

Lasmiditan (Q2 2015)—an oral 5-HT_{1F} agonist for the acute treatment of migraine.

Nasal glucagon* (Q3 2013)—a glucagon nasal powder formulation for the treatment of severe hypoglycemia in patients with diabetes treated with insulin.

Solanezumab* (Q2 2009)—an anti-amyloid beta monoclonal antibody for the treatment of preclinical Alzheimer’s disease.

Tanezumab* (Q3 2008)—an anti-nerve growth factor monoclonal antibody for the treatment of osteoarthritis pain, chronic low back pain, and cancer pain (in collaboration with Pfizer Inc. (Pfizer)).

Ultra-rapid Lispro* (Q3 2017)—an ultra-rapid insulin for the treatment of type 1 and type 2 diabetes.

* Biologic molecule subject to the U.S. Biologics Price Competition and Innovation Act

** Diagnostic agent

The following table reflects the status of each NME and diagnostic agent within our late-stage pipeline and recently approved products including developments since January 1, 2017:

Compound	Indication	U.S.	Europe	Japan	Developments
Endocrinology					
Nasal glucagon	Severe hypoglycemia	Phase III			Development of commercial manufacturing process is ongoing.
Ultra-rapid Lispro	Type 1 and 2 diabetes	Phase III			Initiated Phase III studies in third quarter of 2017.
Immunology					
Olumiant	Rheumatoid arthritis	Submitted	Launched		Approved and launched in Europe in first quarter of 2017. Received complete response letter from the U.S. Food and Drug Administration (FDA) in second quarter of 2017. Approved and launched in Japan in third quarter of 2017. Resubmitted in the U.S. in fourth quarter of 2017.
	Atopic dermatitis	Phase III			Initiated Phase III studies in fourth quarter of 2017.

Compound	Indication	U.S.	Europe	Japan	Developments
Neuroscience					
Flortaucipir	Alzheimer's disease	Phase III			Phase III trial is ongoing.
Galcanezumab	Cluster headache	Phase III			Phase III trials are ongoing.
	Migraine prevention	Submitted		Phase III	Three Phase III trials met primary endpoints. Submitted to regulatory authorities in the U.S. and Europe in third and fourth quarters of 2017, respectively.
Lanabecestat	Early and mild Alzheimer's disease	Phase III			Phase III trials are ongoing.
Lasmiditan	Migraine	Phase III			Acquired from CoLucid in first quarter of 2017. In third quarter of 2017, announced Phase III trial met primary endpoint. Submission to FDA expected in second half of 2018. See Note 3 to the consolidated financial statements for information on the acquisition.
Solanezumab	Preclinical Alzheimer's disease	Phase III			Phase III trial is ongoing.
Tanezumab	Osteoarthritis pain	Phase III			Granted Fast Track designation[1] from the FDA in second quarter of 2017.
	Chronic low back pain	Phase III			
	Cancer pain	Phase III			Phase III trial is ongoing.
Oncology					
Verzenio	Adjuvant breast cancer	Phase III			Initiated Phase III study in third quarter of 2017.
	Metastatic breast cancer	Launched	Submitted		Two Phase III trials met primary endpoints. Approved and launched in the U.S. in the third and fourth quarter of 2017, respectively. Submitted to regulatory authorities in Europe and Japan in third quarter of 2017.
	KRAS-mutant non-small cell lung cancer	Terminated			In fourth quarter of 2017, announced Phase III trial did not meet primary endpoint and further development of monotherapy in this indication has been discontinued.
Lartruvo	Soft tissue sarcoma	Launched		Phase III	Granted accelerated approval[2] by the FDA in fourth quarter of 2016 based on phase II data. Launched in the U.S. in the fourth quarter of 2016. Granted conditional approval[3] and launched in Europe in fourth quarter of 2016. Phase III trial is ongoing.

(1) The FDA's fast track program is designed to expedite the development and review of new therapies to treat serious conditions and address unmet medical needs.

(2) Continued approval for this indication may be contingent on verification and description of clinical benefit in a confirmatory Phase III trial.

(3) As part of a conditional marketing authorization, results from an ongoing Phase III study will need to be provided. This study is fully enrolled. Until availability of the full data, the Committee for Medicinal Products for Human Use will review the benefits and risks of Lartruvo annually to determine whether the conditional marketing authorization can be maintained.

There are many difficulties and uncertainties inherent in human pharmaceutical research and development and the introduction of new products. There is a high rate of failure inherent in new drug discovery and development. To bring a drug from the discovery phase to market can take over a decade and often costs in excess of $2 billion. Failure can occur at any point in the process, including in later stages after substantial investment. As a result, most funds invested in research programs will not generate financial returns. New product candidates that appear promising in development may fail to reach the market or may have only limited commercial success because of efficacy or safety concerns, inability to obtain necessary regulatory approvals or payer reimbursement or coverage, limited scope of approved uses, changes in the relevant treatment standards or the availability of new or better competitive products, difficulty or excessive costs to manufacture, or infringement of the patents or intellectual property rights of others. Regulatory agencies continue to establish increasingly high hurdles for the efficacy and safety of new products. Delays and uncertainties in drug approval processes can result in delays in product launches and lost market opportunity. In addition, it can be very difficult to predict revenue growth rates of new products.

We manage research and development spending across our portfolio of molecules, and a delay in, or termination of, any one project will not necessarily cause a significant change in our total research and development spending. Due to the risks and uncertainties involved in the research and development process, we cannot reliably estimate the nature, timing, and costs of the efforts necessary to complete the development of our research and development projects, nor can we reliably estimate the future potential revenue that will be generated from a successful research and development project. Each project represents only a portion of the overall pipeline, and none is individually material to our consolidated research and development expense. While we do accumulate certain research and development costs on a project level for internal reporting purposes, we must make significant cost estimations and allocations, some of which rely on data that are neither reproducible nor validated through accepted control mechanisms. Therefore, we do not have sufficiently reliable data to report on total research and development costs by project, by preclinical versus clinical spend, or by therapeutic category.

Other Matters

Elanco Animal Health

We are reviewing strategic alternatives for Elanco Animal Health (our animal health segment), including an initial public offering, merger, sale, or retention of the business, and will provide an update no later than the middle of 2018.

Patent Matters

We depend on patents or other forms of intellectual-property protection for most of our revenue, cash flows, and earnings. We lost patent exclusivity for the schizophrenia and bipolar mania indications for Zyprexa® in Japan in December 2015 and April 2016, respectively. Generic versions of Zyprexa launched in Japan in June 2016. The loss of exclusivity for Zyprexa in Japan has caused a rapid and severe decline in revenue for the product.

We lost our patent exclusivity for Strattera® in the U.S. in May 2017, and generic versions of Strattera were approved in the same month. As described in Note 15 to the consolidated financial statements, following the settlement related to the compound patent challenge for Effient®, generic products launched in the U.S. in the third quarter of 2017. The entry of generic competition for these products has caused a rapid and severe decline in revenue, which will, in the aggregate, have a material adverse effect on our consolidated results of operations and cash flows.

Our compound patent protection for Cialis® (tadalafil) and Adcirca® (tadalafil) expired in major European markets and the U.S. in November 2017. However, Cialis is protected by a unit dose patent in the U.S., where we expect exclusivity to end in late September 2018 at the earliest. We expect that the entry of generic competition into these markets following the loss of exclusivity will cause a rapid and severe decline in revenue for the affected products, which will, in the aggregate, have a material adverse effect on our consolidated results of operations and cash flows.

Additionally, as described in Note 15 to the consolidated financial statements, the Alimta® vitamin regimen patents, which provide us with patent protection for Alimta through June 2021 in Japan and major European countries, and through May 2022 in the U.S., have been challenged in each of these jurisdictions. Our vitamin regimen patents have also been challenged in other smaller European jurisdictions. Our compound patent for Alimta expired in the U.S. in January 2017, and expired in major European countries and Japan in December 2015. We expect that the entry of generic competition for Alimta following the loss of effective patent protection will cause a rapid and severe decline in revenue for the product, which will, in the aggregate, have a material adverse effect on our consolidated results of operations and cash flows. While the U.S. Patent and Trademark Office recently ruled in our favor regarding the validity of the vitamin regimen patent, the generic companies which filed petitions seeking *inter partes* review of our vitamin regimen patent have appealed these rulings as further described in Note 15 to the consolidated financial statements. We are aware that generic competitors have received approval to market generic versions of pemetrexed in major European markets, and that a generic product is currently on the market in at least one major European market. In light of the United Kingdom (U.K.) Supreme Court's judgment finding infringement in the U.K., Italy, France, and Spain, Actavis has withdrawn its previously launched-at-risk generic products from these markets. We will continue to seek to remove any generic pemetrexed products launched at risk in other European markets. Notwithstanding our patents, generic versions of Alimta were also approved in Japan starting in February 2016. As described in Note 15 to the consolidated financial statements, we do not currently anticipate that generic versions of Alimta will proceed to pricing approval.

The compound patent for Humalog® (insulin lispro) has expired in major markets. Thus far, the loss of compound patent protection for Humalog has not resulted in a rapid and severe decline in revenue. Global regulators have different legal pathways to approve similar versions of insulin lispro. A similar version of insulin lispro has received approval in the U.S. and could launch soon. We are also aware that a competitor's insulin lispro product has launched in certain European markets. Other manufacturers have efforts underway to bring to market a similar version of insulin lispro in the U.S. and Europe. While it is difficult to estimate the severity of the impact of similar insulin lispro products entering the market, we do not expect a rapid and severe decline in revenue; however, we expect competitive pressure and some loss of market share initially that would continue over time.

Foreign Currency Exchange Rates

As a global company with substantial operations outside the U.S., we face foreign currency risk exposure from fluctuating currency exchange rates, primarily the U.S. dollar against the euro, Japanese yen, and British pound. While we manage a portion of these exposures through hedging and other risk management techniques, significant fluctuations in currency rates can have a substantial impact, either positive or negative, on our revenue, cost of sales, and operating expenses. Over the past two years, we have seen significant foreign currency rate fluctuations between the U.S. dollar and several other foreign currencies, including the euro, British pound, and Japanese yen. While there is uncertainty in the future movements in foreign exchange rates, these fluctuations could negatively impact our future consolidated results of operations and cash flows.

The impact of the Venezuelan financial crisis, including the significant deterioration of the bolívar, resulted in a charge of $203.9 million in 2016. See Note 17 to the consolidated financial statements for additional information related to the charge. As of December 31, 2017, our Venezuelan subsidiaries represented a *de minimis* portion of our consolidated assets and liabilities. We continue to monitor other deteriorating economies and it is possible that additional charges may be recorded in the future. Any additional charges are not expected to have a material adverse effect on our future consolidated results of operations.

Trends Affecting Pharmaceutical Pricing, Reimbursement, and Access

United States

In the U.S., public concern over access to and affordability of pharmaceuticals continues to drive the regulatory and legislative debate. These policy and political issues increase the risk that taxes, fees, rebates, or other federal and state measures may be enacted. Key health policy proposals affecting biopharmaceuticals include a reduction in biologic data exclusivity, modifications to Medicare Parts B and D, language that would allow the Department of Health and Human Services to negotiate prices for biologics and drugs in Medicare, proposals that would require biopharmaceutical manufacturers to disclose proprietary drug pricing information, and state-level proposals related to prescription drug prices and reducing the cost of pharmaceuticals purchased by government health care programs. Several states enacted legislation in 2017 related to prescription drug pricing transparency. Savings projected under these proposals are targeted as a means to fund both health care expenditures and non-health care initiatives, or to manage federal and state budgets. The Bipartisan Budget Act, enacted on February 9, 2018, will require manufacturers of brand-name drugs, biologics, and biosimilars to pay a 70 percent discount in the Medicare Part D Coverage Gap, up from the current 50 percent discount. This increase in Coverage Gap discounts will be effective beginning in 2019.

In the private sector, consolidation and integration among healthcare providers is also a major factor in the competitive marketplace for human pharmaceuticals. Health plans, pharmaceutical benefit managers, wholesalers, and other supply chain stakeholders have been consolidating into fewer, larger entities, thus enhancing their purchasing strength and importance. Payers typically maintain formularies which specify coverage (the conditions under which drugs are included on a plan's formulary) and reimbursement (the associated out-of-pocket cost to the consumer). Formulary placement can lead to reduced usage of a drug for the relevant patient population due to coverage restrictions, such as prior authorizations and formulary exclusions, or due to reimbursement limitations which result in higher consumer out-of-pocket cost, such as non-preferred co-pay tiers, increased co-insurance levels and higher deductibles. Consequently, pharmaceutical companies compete for formulary placement not only on the basis of product attributes such as greater efficacy, fewer side effects, or greater patient ease of use, but also by providing rebates. Price is an increasingly important factor in formulary decisions, particularly in treatment areas in which the payer has taken the position that multiple branded products are therapeutically comparable. These downward pricing pressures could negatively affect future consolidated results of operations and cash flows.

The main coverage expansion provisions of the Affordable Care Act (ACA) are currently in effect through both state-based exchanges and the expansion of Medicaid. A trend has been the prevalence of benefit designs containing high out-of-pocket costs for patients, particularly for pharmaceuticals. In addition to the coverage expansions, many employers in the commercial market, driven in part by ACA changes such as the 2022 implementation of the excise tax on employer-sponsored health care coverage for which there is an excess benefit (the so-called "Cadillac tax"), continue to evaluate strategies such as private exchanges and wider use of consumer-driven health plans to reduce their healthcare liabilities over time. Repealing and replacing the ACA remains a priority for President Trump and Congress. Provisions included in final legislation could have a material adverse effect on our consolidated results of operations and cash flows. At the same time, the broader paradigm shift towards performance-based reimbursement and the launch of several value-based purchasing initiatives have placed demands on the pharmaceutical industry to offer products with proven real-world outcomes data and a favorable economic profile.

International

International operations also are generally subject to extensive price and market regulations. Cost-containment measures exist in a number of countries, including additional price controls and mechanisms to limit reimbursement for our products. Such policies are expected to increase in impact and reach, given the pressures on national and regional health care budgets that come from a growing aging population and ongoing economic challenges. In addition, governments in many emerging markets are becoming increasingly active in expanding health care system offerings. Given the budget challenges of increasing health care coverage for citizens, policies may be proposed that promote generics and biosimilars only and reduce current and future access to branded human pharmaceutical products.

Tax Matters

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Changes in the relevant tax laws, regulations, administrative practices, principles, and interpretations could adversely affect our future effective tax rates. The U.S. recently enacted tax reform legislation significantly revising U.S. tax law, and a number of other countries are actively considering or enacting tax changes. Other organizations, such as the Organisation for Economic Co-operation and Development and the European Commission, are active regarding tax-related matters which could influence international tax policy in countries in which we operate. While outcomes of these initiatives continue to develop and remain uncertain, modifications to key elements of the U.S. or international tax framework could have a material adverse effect on our consolidated results of operations and cash flows.

In December 2017, the President of the U.S. signed into law the Tax Cuts and Jobs Act (2017 Tax Act). The 2017 Tax Act includes significant changes to the U.S. corporate income tax system, such as the reduction in the corporate income tax rate, transition to a territorial tax system, changes to business related exclusions, deductions, and credits, and modifications to international tax provisions, including a one-time repatriation transition tax (also known as the 'Toll Tax') on unremitted foreign earnings. U.S. Generally Accepted Accounting Principles (GAAP) requires that the income tax accounting effects from a change in tax laws or tax rates be recognized in continuing operations in the reporting period that includes the enactment date of the change. These effects include, among other things, re-measuring deferred tax assets and liabilities, evaluating deferred tax assets for valuation allowances, and assessing the impact of the Toll Tax and certain other provisions of the 2017 Tax Act. We were not able to completely gather, analyze, and compute all impacts of the 2017 Tax Act; therefore, the estimated income tax expense of $1.91 billion that we recorded in December 2017 related to the 2017 Tax Act is a provisional amount based upon reasonable estimates and may change upon completion of our calculations (see Note 13 to the consolidated financial statements). In addition, changes in our interpretations of the new tax laws, along with subsequent regulations, interpretations, and guidance that have been and may be issued, may materially affect the estimates and assumptions used in recording the changes to our 2017 U.S. federal and state income tax expense that resulted from the 2017 Tax Act. Refer to "Results of Operations - Financial Condition" for discussion of the impact of the 2017 Tax Act on our liquidity.

Acquisitions

See Note 3 to the consolidated financial statements for discussion regarding our recent acquisitions of businesses and assets, including:

- Our acquisition of Boehringer Ingelheim Vetmedica, Inc.'s U.S. feline, canine, and rabies vaccine portfolio and other related assets (BIVIVP), completed on January 3, 2017, in an all-cash transaction for $882.1 million.
- Our acquisition of CoLucid, completed on March 1, 2017, for a cash purchase price of $831.8 million, net of cash acquired.

Operating Results—2017

Revenue

The following table summarizes our revenue activity by region:

	Year Ended December 31,		
	2017	2016	Percent Change
U.S. [1]	**$ 12,785.1**	$ 11,506.2	11
Outside U.S.	**10,086.3**	9,715.9	4
Revenue	**$ 22,871.3**	$ 21,222.1	8

Numbers may not add due to rounding.

[1] U.S. revenue includes revenue in Puerto Rico.

The following are components of the change in revenue compared with the prior year:

	2017 vs. 2016		
	U.S.	Outside U.S.	Consolidated
Volume	6%	5 %	6 %
Price	5%	(1)%	2 %
Foreign exchange rates	—%	— %	— %
Percent change	11%	4 %	8 %

Numbers may not add due to rounding.

In the U.S., the revenue increase in 2017 was driven by increased volume for new pharmaceutical products, including Trulicity®, Taltz®, Basaglar®, Lartruvo, and Jardiance®, and higher realized prices for several pharmaceutical products, primarily Forteo® and Cialis, as well as increased volume for companion animal products from the acquisition of BIVIP. The increase in revenue was partially offset by decreased volume due to loss of exclusivity for Strattera and Effient, as well as decreased demand for Cialis and food animal products. Cymbalta® revenue declined, as 2016 revenue benefited from reductions to the reserve for expected product returns of approximately $175 million.

Outside the U.S., the revenue increase in 2017 was due to increased volume for several new pharmaceutical products, primarily driven by Trulicity and Cyramza®. The increase in revenue was partially offset by competitive pressure and the loss of exclusivity for Alimta in several countries and lower volume from the loss of exclusivity for Zyprexa in Japan.

The following table summarizes our revenue activity in 2017 compared with 2016:

	Year Ended December 31,				
	2017			2016	
Product	U.S.[1]	Outside U.S.	Total	Total	Percent Change
Humalog	**$ 1,717.8**	**$ 1,147.4**	**$ 2,865.2**	$ 2,768.8	3
Cialis	**1,358.6**	**964.5**	**2,323.1**	2,471.6	(6)
Alimta	**1,034.3**	**1,028.2**	**2,062.5**	2,283.3	(10)
Trulicity	**1,609.8**	**419.9**	**2,029.8**	925.5	119
Forteo	**965.2**	**783.8**	**1,749.0**	1,500.0	17
Humulin®	**884.6**	**450.7**	**1,335.4**	1,365.9	(2)
Cyramza	**278.8**	**479.6**	**758.3**	614.1	23
Cymbalta	**114.9**	**642.2**	**757.2**	930.5	(19)
Erbitux®	**541.7**	**104.2**	**645.9**	687.0	(6)
Strattera	**284.9**	**333.3**	**618.2**	854.7	(28)
Zyprexa	**75.5**	**505.7**	**581.2**	725.3	(20)
Taltz	**486.0**	**73.2**	**559.2**	113.1	NM
Trajenta®[2]	**213.2**	**324.7**	**537.9**	436.6	23
Jardiance[3]	**290.4**	**157.0**	**447.5**	201.9	122
Basaglar	**311.1**	**121.0**	**432.1**	86.1	NM
Effient	**340.1**	**48.8**	**388.9**	535.2	(27)
Other human pharmaceutical products	**767.0**	**927.5**	**1,694.3**	1,564.3	8
Animal health products	**1,511.1**	**1,574.5**	**3,085.6**	3,158.2	(2)
Revenue	**$ 12,785.1**	**$ 10,086.3**	**$ 22,871.3**	$ 21,222.1	8

Numbers may not add due to rounding.

[1] U.S. revenue includes revenue in Puerto Rico.

[2] Trajenta revenue includes Jentadueto®.

[3] Jardiance revenue includes Glyxambi® and Synjardy®.

NM - not meaningful

Revenue of Humalog, our injectable human insulin analog for the treatment of diabetes, increased 2 percent in the U.S., primarily driven by higher realized prices due to changes in estimates for rebates and discounts, which decreased revenue in 2016 and increased revenue in 2017. Revenue outside the U.S. increased 6 percent, driven by increased volume and, to a lesser extent, higher realized prices, partially offset by the unfavorable impact of foreign exchange rates. A similar version of insulin lispro has received tentative approval in the U.S. and could launch soon. We are also aware that a competitor's insulin lispro product has launched in certain European markets. While it is difficult to estimate the severity of the impact of similar insulin lispro products entering the market, we do not expect a rapid and severe decline in revenue; however, we expect competitive pressure and some loss of market share initially that would continue over time. See "Results of Operations - Executive Overview - Other Matters" for more information.

Revenue of Cialis, a treatment for erectile dysfunction and benign prostatic hyperplasia, decreased 8 percent in the U.S., driven by decreased demand partially offset by higher realized prices. Revenue outside the U.S. decreased 4 percent, driven by the decreased volume, partially offset by higher realized prices. We lost our compound patent protection for Cialis in major European markets in November 2017 and now expect U.S. exclusivity for Cialis to end in late September 2018 at the earliest. See "Results of Operations - Executive Overview - Other Matters" for more information regarding our U.S. exclusivity. In addition to potential competition from generic tadalafil, we also currently face competition from generic sildenafil, which we expect to accelerate during 2018. We expect that the entry of generic competition following the loss of exclusivity will cause a rapid and severe decline in revenue.

Revenue of Alimta, a treatment for various cancers, decreased 6 percent in the U.S., driven by decreased demand due to competitive pressure. Revenue outside the U.S. decreased 13 percent, driven by competitive pressure and the loss of exclusivity in several countries. We have faced and remain exposed to generic entry in multiple countries that has eroded revenue and is likely to continue to erode revenue from current levels.

Revenue of Trulicity, a treatment for type 2 diabetes,increased 118 percent in the U.S., driven by increased share of market for Trulicity and growth in the GLP-1 class. Revenue outside the U.S. increased 123 percent.

Revenue of Forteo, an injectable treatment for osteoporosis in postmenopausal women and men at high risk for fracture and for glucocorticoid-induced osteoporosis in men and postmenopausal women, increased 25 percent in the U.S., driven by higher realized prices and increased volume, primarily due to wholesaler buying patterns. Revenue outside the U.S. increased 7 percent, driven by increased volume, partially offset by the unfavorable impact of foreign exchange rates and lower realized prices.

Revenue of Humulin, an injectable human insulin for the treatment of diabetes, increased 3 percent in the U.S., driven by higher realized prices. Revenue outside the U.S. decreased 11 percent, driven primarily by decreased volume and lower realized prices.

Revenue of Cyramza, a treatment for various cancers, increased 3 percent in the U.S., driven by increased volume. Revenue outside the U.S. increased 39 percent, primarily due to strong volume growth in Japan, partially offset by lower realized prices and, to a lesser extent, the unfavorable impact of foreign exchange rates.

Revenue of Cymbalta, a product for the treatment of major depressive disorder, diabetic peripheral neuropathic pain, generalized anxiety disorder, chronic musculoskeletal pain, and the management of fibromyalgia, decreased 57 percent in the U.S., driven by reductions to the reserve for expected product returns, which increased revenue by approximately $175 million in 2016. Revenue outside the U.S. decreased 3 percent driven by the loss of exclusivity in Canada and Europe, partially offset by increased volume in Japan.

Revenue of Erbitux, a treatment for various cancers, decreased 7 percent in the U.S. in 2017. The decrease was due to increased competition from immuno-oncology products.

Revenue of Strattera, a treatment for attention-deficit hyperactivity disorder, decreased 47 percent in the U.S., driven by the loss of exclusivity in the second quarter of 2017, partially offset by higher realized prices. The entry of generic competition following the loss of effective patent protection has caused a rapid and severe decline in revenue. Revenue outside the U.S. increased 4 percent, driven by increased volume in Japan, partially offset by lower realized prices and the unfavorable impact of foreign exchange rates, primarily the Japanese yen.

Worldwide food animal revenue decreased 8 percent, primarily driven by market access and competitive pressure in the U.S. for Posilac® and Optaflexx®, respectively. Worldwide companion animal revenue increased 10 percent, driven by the inclusion of $216.7 million in revenue from the acquisition of BIVIVP, partially offset by competitive pressure. We expect these pressures for both companion animal and food animal to continue, offset in part by new product launches.

Gross Margin, Costs, and Expenses

Gross margin as a percent of total revenue was 73.5 percent in 2017, an increase of 0.1 percentage points compared with 2016 primarily due to manufacturing efficiencies and higher realized prices, offset by the impact of foreign exchange rates on international inventories sold and product mix.

Research and development expenses increased 1 percent to $5.28 billion in 2017.

Marketing, selling, and administrative expenses increased 2 percent to $6.59 billion in 2017, driven by increased marketing expenses for new products that were partially offset by decreased expenses related to late life-cycle products.

We recognized acquired IPR&D charges of $1.11 billion in 2017 resulting from business development activity, primarily related to the acquisition of CoLucid. In 2016, we recognized acquired IPR&D charges of $30.0 million associated with the agreement with AstraZeneca to co-develop MEDI1814. See Note 3 to the consolidated financial statements for additional information.

We recognized asset impairment, restructuring, and other special charges of $1.67 billion in 2017. The charges are primarily associated with efforts to reduce our cost structure, including the U.S. voluntary early retirement program, asset impairments related to lower projected revenue for Posilac, and asset impairments and other special charges related to product rationalizations and site closures resulting from our acquisition and integration of Novartis AH. In 2016, we recognized $382.5 million of asset impairment, restructuring, and other special charges primarily associated with integration and severance costs related to the acquisition of Novartis AH, other global severance costs associated with actions taken to reduce cost structure, and asset impairments primarily related to the closure of an animal health manufacturing facility in Ireland. See Note 5 to the consolidated financial statements for additional information.

Other—net, (income) expense was income of $52.4 million in 2017, compared with expense of $84.8 million in 2016. Other—net, (income) expense in 2016 included a $203.9 million charge related to the impact of the Venezuelan financial crisis, including the significant deterioration of the bolívar, partially offset by net gains of $101.6 million on investments. See Note 17 to the consolidated financial statements for additional information.

During 2017, we recorded income tax expense of $2.40 billion which included a provisional tax charge of $1.91 billion, despite earning $2.20 billion of income before income taxes. The provisional tax charge is a result of the 2017 Tax Act, including the Toll Tax. Refer to “Results of Operations - Executive Overview - Other Matters - Tax Matters” for further discussion on the 2017 Tax Act. The effective tax rate in 2016 was 18.9 percent.

Operating Results—2016

Financial Results

The following table summarizes our key operating results:

	Year Ended December 31,		Percent Change
	2016	2015	
Revenue	$21,222.1	$19,958.7	6
Gross margin	15,567.2	14,921.5	4
Gross margin as a percent of revenue	73.4%	74.8%	
Operating expense [(1)]	$11,695.9	$11,329.4	3
Acquired in-process research and development	30.0	535.0	NM
Asset impairment, restructuring, and other special charges	382.5	367.7	4
Income before income taxes	3,374.0	2,790.0	21
Income Taxes	636.4	381.6	67
Net income	2,737.6	2,408.4	14
Earnings per share	2.58	2.26	14

[(1)] Operating expense consists of research and development and marketing, selling, and administrative expense.

NM - not meaningful

Revenue and gross margin increased in 2016. The increase in operating expense in 2016 was due to an increase in research and development expense, partially offset by a decrease in marketing, selling, and administrative expense. Net income and EPS increased in 2016 as a higher gross margin and lower acquired IPR&D charges, were partially offset by higher operating expense, a higher effective tax rate, and lower other income.

Certain items affect the comparisons of our 2016 and 2015 results. The 2016 highlighted items are summarized in the "Results of Operations - Executive Overview" section. The 2015 highlighted items are summarized as follows:

Acquisitions (Note 3 to the consolidated financial statements)

- We recognized expense of $153.0 million (pretax), or $0.10 per share, related to the fair value adjustments to Novartis AH acquisition date inventory that was sold.

Acquired IPR&D (Notes 3 and 4 to the consolidated financial statements)

- We recognized acquired IPR&D charges of $535.0 million (pretax), or $0.33 per share, related to upfront fees paid in connection with various collaboration agreements primarily with Pfizer, as well as the consideration paid to acquire the worldwide rights to Locemia Solutions' (Locemia) intranasal glucagon.

Asset Impairment, Restructuring, and Other Special Charges (Note 5 to the consolidated financial statements)

- We recognized charges of $367.7 million (pretax), or $0.25 per share, related to severance costs, integration costs, and intangible asset impairments.

Debt Repurchase (Notes 7 and 10 to the consolidated financial statements)

- We recognized net charges of $152.7 million (pretax), or $0.09 per share, attributable to the debt extinguishment loss of $166.7 million from the purchase and redemption of certain fixed-rate notes, partially offset by net gains from non-hedging interest rate swaps and foreign currency transactions associated with the related issuance of lower interest rate euro-denominated notes.

Revenue

The following table summarizes our revenue activity by region:

	Year Ended December 31,		
	2016	2015	Percent Change
U.S. [1]	$ 11,506.2	$ 10,097.4	14
Outside U.S.	9,715.9	9,861.3	(1)
Revenue	$ 21,222.1	$ 19,958.7	6

Numbers may not add due to rounding.

[1] U.S. revenue includes revenue in Puerto Rico.

The following are components of the change in revenue compared to the prior year:

	2016 vs. 2015		
	U.S.	Outside U.S.	Consolidated
Volume	12%	2 %	7%
Price	2%	(3)%	—%
Foreign exchange rates	—%	(1)%	—%
Percent change	14%	(1)%	6%

Numbers may not add due to rounding.

In the U.S., the volume increase in 2016 was driven by sales of several pharmaceutical products, including Trulicity, Humalog, Erbitux (due to the transfer of commercialization rights to us in the U.S. and Canada effective October 1, 2015), Taltz, and Jardiance, partially offset by decreased volume for Zyprexa. U.S. revenue also benefited from reductions to the Cymbalta reserve for expected product returns of approximately $175 million in 2016, favorably affecting both volume and price.

Outside the U.S., the volume increase in 2016 was driven by sales of several new pharmaceutical products, including Cyramza and Trulicity, partially offset by the losses of exclusivity for Cymbalta in Europe and Canada, Zyprexa in Japan, as well as Alimta in several countries.

The following table summarizes our revenue activity in 2016 compared with 2015:

	Year Ended December 31,				
	2016			2015	
Product	U.S.[1]	Outside U.S.	Total	Total	Percent Change
Humalog	$ 1,685.2	$ 1,083.6	$ 2,768.8	$ 2,841.9	(3)
Cialis	1,469.5	1,002.1	2,471.6	2,310.7	7
Alimta	1,101.0	1,182.3	2,283.3	2,493.1	(8)
Forteo	770.5	729.4	1,500.0	1,348.3	11
Humulin	861.8	504.1	1,365.9	1,307.4	4
Cymbalta	269.3	661.2	930.5	1,027.6	(9)
Trulicity	737.6	187.9	925.5	248.7	NM
Strattera	534.9	319.8	854.7	784.0	9
Zyprexa	69.8	655.5	725.3	940.3	(23)
Erbitux	581.1	105.9	687.0	485.0	42
Cyramza	270.1	344.0	614.1	383.8	60
Effient	465.6	69.6	535.2	523.0	2
Trajenta[2]	165.9	270.7	436.6	356.8	22
Other human pharmaceutical products	959.4	1,006.1	1,965.4	1,727.1	14
Animal health products	1,564.5	1,593.7	3,158.2	3,181.0	(1)
Revenue	$ 11,506.2	$ 9,715.9	$ 21,222.1	$ 19,958.7	6

Numbers may not add due to rounding.

(1) U.S. revenue includes revenue in Puerto Rico.

(2) Trajenta revenue includes Jentadueto.

NM - not meaningful

Revenue of Humalog decreased 5 percent in the U.S., driven by lower realized prices, partially offset by increased demand. Revenue outside the U.S. increased 1 percent, driven by increased volume and, to a lesser extent, higher realized prices, partially offset by the unfavorable impact of foreign exchange rates.

Revenue of Cialis increased 17 percent in the U.S., driven by higher realized prices. Revenue outside the U.S. decreased 5 percent, driven by the unfavorable impact of foreign exchange rates and decreased volume, partially offset by higher realized prices.

Revenue of Alimta decreased 5 percent in the U.S., driven by decreased demand due to competitive pressure. Revenue outside the U.S. decreased 11 percent, driven primarily by the loss of exclusivity in several countries. We faced exposure to generic entry in multiple countries that eroded revenue.

Revenue of Forteo increased 26 percent in the U.S., driven by higher realized prices. Revenue outside the U.S. decreased 1 percent, driven by lower realized prices, largely offset by increased volume and the favorable impact of foreign exchange rates.

Revenue of Humulin increased 13 percent in the U.S., driven by increased demand and, to a lesser extent, higher realized prices. The increase in realized prices resulted from a change in estimate of a government rebate in the first quarter of 2016. Revenue outside the U.S. decreased 7 percent, driven by the unfavorable impact of foreign exchange rates and, to a lesser extent, decreased volume and lower realized prices.

Revenue of Cymbalta was $269.3 million in the U.S. in 2016, compared to $144.6 million in 2015. U.S. revenue benefited from reductions to the Cymbalta reserve for expected product returns of approximately $175 million in 2016. Revenue outside the U.S. decreased 25 percent, driven by the loss of exclusivity.

Revenue of Trulicity was $737.6 million in the U.S., driven by growth in the GLP-1 market and increased share of market for Trulicity. Revenue outside the U.S. was $187.9 million.

Revenue of Strattera increased 7 percent in the U.S., driven by higher realized prices, partially offset by decreased volume. Revenue outside the U.S. increased 13 percent, driven by increased volume and, to a lesser extent, the favorable impact of foreign exchange rates, partially offset by lower realized prices.

Revenue of Zyprexa, a treatment for schizophrenia, decreased 16 percent outside the U.S., driven primarily by decreased volumes in Japan due to the entry of generic competition in June 2016 following the loss of patent exclusivity. Zyprexa revenue in Japan was $332.3 million in 2016, compared with $415.9 million in 2015.

Revenue of Erbitux increased to $581.1 million in the U.S. in 2016, compared to $386.7 million in 2015. The increase was due to the transfer of commercialization rights to us in the U.S. and Canada which occurred on October 1, 2015.

Revenue of animal health products in the U.S. increased 1 percent, primarily due to uptake of new companion animal products, partially offset by decreased revenue for food animal products. Animal health product revenue outside the U.S. decreased 3 percent driven by the unfavorable impact of foreign exchange rates.

Gross Margin, Costs, and Expenses

Gross margin as a percent of total revenue was 73.4 percent in 2016, a decrease of 1.4 percentage points compared with 2015 primarily due to a lower benefit from foreign exchange rates on international inventories sold.

Research and development expense increased 9 percent to $5.24 billion in 2016, driven primarily by higher late-stage clinical development costs and, to a lesser extent, higher charges related to development milestone payments.

Marketing, selling, and administrative expense decreased 1 percent to $6.45 billion in 2016, as reduced spending on late-life-cycle products was largely offset by expenses related to new products.

We recognized an acquired IPR&D charge of $30.0 million in 2016 associated with the agreement with AstraZeneca to co-develop MEDI1814. There were $535.0 million of acquired IPR&D charges in 2015 resulting from business development activity, primarily a collaboration with Pfizer and the acquisition of worldwide rights to Locemia's intranasal glucagon. See Notes 3 and 4 to the consolidated financial statements for additional information.

We recognized asset impairment, restructuring, and other special charges of $382.5 million in 2016. The charges are primarily associated with integration and severance costs related to the acquisition of Novartis AH, other global severance costs associated with actions taken to reduce cost structure, and asset impairments primarily related to the closure of an animal health manufacturing facility in Ireland. In 2015, we recognized $367.7 million of asset impairment, restructuring, and other special charges related to severance costs, integration costs for Novartis AH, and asset impairments. See Note 5 to the consolidated financial statements for additional information.

Other-net, (income) expense was expense of $84.8 million in 2016, compared with income of $100.6 million in 2015. Other expense in 2016 included a $203.9 million charge related to the impact of the Venezuelan financial crisis, including the significant deterioration of the bolívar, partially offset by net gains of $101.6 million on investments. Other income in 2015 included net gains of $236.7 million on investments, partially offset by a net charge of $152.7 million related to the repurchase of $1.65 billion of debt. See Note 17 to the consolidated financial statements for additional information.

Our effective tax rate was 18.9 percent in 2016, compared with 13.7 percent in 2015. The increase in the effective tax rate for 2016 reflects several factors in both years: in 2016, the unfavorable tax effect of the charge related to the impact of the Venezuelan financial crisis and certain asset impairment, restructuring, and other special charges; and in 2015, the favorable tax impact of the acquired IPR&D charges, net charges related to the repurchase of debt, and asset impairment, restructuring, and other special charges. The increase in the effective tax rate for 2016 was partially offset by a net discrete tax benefit.

FINANCIAL CONDITION

As of December 31, 2017, cash and cash equivalents was $6.54 billion, an increase of $1.95 billion, compared with $4.58 billion at December 31, 2016. Refer to the Consolidated Statements of Cash Flows for additional details on the significant sources and uses of cash for the years ended December 31, 2017 and December 31, 2016.

In addition to our cash and cash equivalents, we held total investments of $7.18 billion and $6.66 billion as of December 31, 2017 and December 31, 2016, respectively. See Note 7 to the consolidated financial statements for additional details.

As of December 31, 2017, total debt was $13.65 billion, an increase of $3.34 billion compared with $10.31 billion at December 31, 2016. The increase was primarily due to the cash proceeds of $2.23 billion from the issuance of fixed-rate notes and, to a lesser extent, the net increase in the balance of commercial paper outstanding of $1.40 billion, partially offset by the repayment of $630.6 million of long term debt. At December 31, 2017, we had a total of $5.57 billion of unused committed bank credit facilities, $5.00 billion of which is available to support our commercial paper program. See Note 10 to the consolidated financial statements for additional details. We believe that amounts accessible through existing commercial paper markets should be adequate to fund short-term borrowing needs.

For the 132nd consecutive year, we distributed dividends to our shareholders. Dividends of $2.08 per share and $2.04 per share were paid in 2017 and 2016, respectively. In the fourth quarter of 2017, effective for the dividend to be paid in the first quarter of 2018, the quarterly dividend was increased to $0.5625 per share, resulting in an indicated annual rate for 2018 of $2.25 per share.

Capital expenditures of $1.08 billion during 2017 were $39.8 million more than in 2016. We expect 2018 capital expenditures to be approximately $1.2 billion.

In 2017, we repurchased $359.8 million of shares under the $5.00 billion share repurchase program previously announced in October 2013. See Note 12 to the consolidated financial statements for additional details.

See "Results of Operations - Executive Overview - Other Matters - Patent Matters" for information regarding recent and upcoming losses of patent protection.

Pursuant to the 2017 Tax Act, the U.S. will transition to a territorial tax system effective January 1, 2018; therefore, we expect that future repatriations of cash from our foreign subsidiaries to the U.S. will result in immaterial or no tax payments. This change in tax law provides us with additional liquidity in the U.S. without the requirement to pay U.S. taxes as existed prior to the enactment of the new tax law. We believe cash provided by operating activities, along with available cash and cash equivalents, should be sufficient to fund our normal operating needs, including installment payments of the Toll Tax, dividends paid to shareholders, share repurchases, and capital expenditures. Over the course of 2018 and 2019, we plan to deploy the additional liquidity created from the tax law across our capital allocation priorities, including; funding our existing marketed products and pipeline, including capital investments, in line with our current strategy; investing in business development to bolster our future growth prospects; returning cash to shareholders via increases to the dividend and share buybacks; and reducing our gross debt.

Both domestically and abroad, we continue to monitor the potential impacts of the economic environment; the creditworthiness of our wholesalers and other customers, including foreign government-backed agencies and suppliers; the uncertain impact of health care legislation; and various international government funding levels.

In the normal course of business, our operations are exposed to fluctuations in interest rates and currency values. These fluctuations can vary the costs of financing, investing, and operating. We address a portion of these risks through a controlled program of risk management that includes the use of derivative financial instruments. The objective of controlling these risks is to limit the impact on earnings of fluctuations in interest and currency exchange rates. All derivative activities are for purposes other than trading.

Our primary interest rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest rate exposures, we strive to achieve an acceptable balance between fixed and floating rate debt positions and may enter into interest rate derivatives to help maintain that balance. Based on our overall interest rate exposure at December 31, 2017 and 2016, including derivatives and other interest

rate risk-sensitive instruments, a hypothetical 10 percent change in interest rates applied to the fair value of the instruments as of December 31, 2017 and 2016, respectively, would not have a material impact on earnings, cash flows, or fair values of interest rate risk-sensitive instruments over a one-year period.

Our foreign currency risk exposure results from fluctuating currency exchange rates, primarily the U.S. dollar against the euro, Japanese yen, and British pound; and the Swiss Franc against the euro. We face foreign currency exchange exposures when we enter into transactions arising from subsidiary trade and loan payables and receivables denominated in foreign currencies. We also face currency exposure that arises from translating the results of our global operations to the U.S. dollar at exchange rates that have fluctuated from the beginning of the period. We may enter into foreign currency forward or option derivative contracts to reduce the effect of fluctuating currency exchange rates (principally the euro, the Japanese yen, and the British pound). Our corporate risk-management policy outlines the minimum and maximum hedge coverage of such exposures. Gains and losses on these derivative contracts offset, in part, the impact of currency fluctuations on the existing assets and liabilities. We periodically analyze the fair values of the outstanding foreign currency derivative contracts to determine their sensitivity to changes in foreign exchange rates. A hypothetical 10 percent change in exchange rates (primarily against the U.S. dollar) applied to the fair values of our outstanding foreign currency derivative contracts as of December 31, 2017 and 2016, would not have a material impact on earnings, cash flows, or financial position over a one-year period. This sensitivity analysis does not consider the impact that hypothetical changes in exchange rates would have on the underlying foreign currency denominated transactions.

Off-Balance Sheet Arrangements and Contractual Obligations

We have no off-balance sheet arrangements that have a material current effect or that are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources. We acquire and collaborate on potential products still in development and enter into research and development arrangements with third parties that often require milestone and royalty payments to the third party contingent upon the occurrence of certain future events linked to the success of the asset in development. Milestone payments may be required contingent upon the successful achievement of an important point in the development life cycle of the pharmaceutical product (e.g., approval for marketing by the appropriate regulatory agency or upon the achievement of certain sales levels). If required by the arrangement, we may make royalty payments based upon a percentage of the sales of the pharmaceutical product in the event that regulatory approval for marketing is obtained. Because of the contingent nature of these payments, they are not included in the table of contractual obligations below.

Individually, these arrangements are generally not material in any one annual reporting period. However, if milestones for multiple products covered by these arrangements were reached in the same reporting period, the aggregate charge to expense could be material to the results of operations or cash flows in that period. See Note 4 to the consolidated financial statements for additional details. These arrangements often give us the discretion to unilaterally terminate development of the product, which would allow us to avoid making the contingent payments; however, we are unlikely to cease development if the compound successfully achieves milestone objectives. We also note that, from a business perspective, we view these payments as positive because they signify that the product is successfully moving through development and is now generating or is more likely to generate cash flows from sales of products.

Our current noncancelable contractual obligations that will require future cash payments are as follows:

	Payments Due by Period				
(Dollars in millions)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt, including interest payment[1]	$ 14,890.4	$ 1,264.0	$ 1,131.9	$ 1,993.9	$ 10,500.6
Capital lease obligations	13.4	4.7	6.8	1.9	—
Operating leases	773.2	130.8	224.9	171.8	245.7
Purchase obligations[2]	16,510.4	16,285.9	224.5	—	—
2017 Tax Act one-time Toll Tax - provisional[3]	3,245.7	259.7	519.3	519.3	1,947.4
Other long-term liabilities reflected on our balance sheet[4]	2,026.0	—	442.9	260.3	1,322.8
Total	$ 37,459.1	$ 17,945.1	$ 2,550.3	$ 2,947.2	$ 14,016.5

(1) Our long-term debt obligations include both our expected principal and interest obligations and our interest rate swaps. We used the interest rate forward curve at December 31, 2017, to compute the amount of the contractual obligation for interest on the variable rate debt instruments and swaps.

(2) We have included the following:

- Purchase obligations consisting primarily of all open purchase orders as of December 31, 2017. Some of these purchase orders may be cancelable; however, for purposes of this disclosure, we have not distinguished between cancelable and noncancelable purchase obligations.
- Contractual payment obligations with each of our significant vendors, which are noncancelable and are not contingent.

(3) The 2017 Tax Act provides an election to taxpayers subject to the Toll Tax to make payments over an eight-year period. We intend to make this election; therefore, we have included future Toll Tax payments accordingly. The amounts shown reflect the provisional amount of Toll Tax recorded at December 31, 2017; these amounts are subject to change (see Note 13 to the consolidated financial statements).

(4) We have included long-term liabilities consisting primarily of our nonqualified supplemental pension funding requirements and other post-employment benefit liabilities. We excluded long-term income taxes payable of $830.9 million, because we cannot reasonably estimate the timing of future cash outflows associated with those liabilities.

The contractual obligations table is current as of December 31, 2017. We expect the amount of these obligations to change materially over time as new contracts are initiated and existing contracts are completed, terminated, or modified.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

In preparing our financial statements in accordance with accounting principles generally accepted in the U.S., we must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures. Some of those judgments can be subjective and complex, and consequently actual results could differ from those estimates. For any given individual estimate or assumption we make, it is possible that other people applying reasonable judgment to the same facts and circumstances could develop different estimates. We believe that, given current facts and circumstances, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on our consolidated results of operations, financial position, or liquidity for the periods presented in this report. As discussed in Income Taxes later in this section, we were unable to completely assess all impacts of the 2017 Tax Act. Therefore, the estimate that we recorded is a provisional amount based upon reasonable estimates and may change upon completion of our calculations. Our most critical accounting estimates have been discussed with our audit committee and are described below.

Revenue Recognition and Sales Return, Rebate, and Discount Accruals

We recognize revenue from sales of products at the time title of goods passes to the buyer and the buyer assumes the risks and rewards of ownership. Provisions for returns, rebates, and discounts are established in the same period the related sales are recorded.

Sales Returns - Background and Uncertainties

We regularly review the supply levels of our significant products sold to major wholesalers in the U.S. and in major markets outside the U.S., primarily by reviewing periodic inventory reports supplied by our major wholesalers and available prescription volume information for our products, or alternative approaches. We attempt to maintain U.S. wholesaler inventory levels at an average of approximately one month or less on a consistent basis across our product portfolio. Causes of unusual wholesaler buying patterns include actual or anticipated product-supply issues, weather patterns, anticipated changes in the transportation network, redundant holiday stocking, and changes in wholesaler business operations. In the U.S., the current structure of our arrangements does not provide an incentive for speculative wholesaler buying and provides us with data on inventory levels at our wholesalers. When we believe wholesaler purchasing patterns have caused an unusual increase or decrease in the revenue of a major product compared with underlying demand, we disclose this in our product revenue discussion if we believe the amount is material to the product revenue trend; however, we are not always able to accurately quantify the amount of stocking or destocking in the retail channel. Wholesaler stocking and destocking activity historically has not caused any material changes in the rate of actual product returns.

When sales occur, we estimate a reserve for future product returns related to those sales. This estimate is based on several factors, including: historical return rates, expiration date by product (on average, approximately 24 months after the initial sale of a product to our customer), and estimated levels of inventory in the wholesale and retail channels, among others, as well as any other specifically-identified anticipated returns due to known factors such as the loss of patent exclusivity, product recalls and discontinuances, or a changing competitive environment. We maintain a returns policy that allows U.S. pharmaceutical customers to return product for dating issues within a specified period prior to and subsequent to the product's expiration date. Following the loss of exclusivity for a patent-dependent product, we expect to experience an elevated level of product returns as product inventory remaining in the wholesale and retail channels expires. Adjustments to the returns reserve have been and may in the future be required based on revised estimates to our assumptions, which would have an impact on our consolidated results of operations. We record the return amounts as a deduction to arrive at our net product sales. Once the product is returned, it is destroyed. Actual product returns have been less than 2 percent of our net revenue over the past three years and have not fluctuated significantly as a percentage of revenue.

Sales Rebates and Discounts - Background and Uncertainties

We establish sales rebate and discount accruals in the same period as the related sales. The rebate and discount amounts are recorded as a deduction to arrive at our net product revenue. Sales rebates and discounts that require the use of judgment in the establishment of the accrual include managed care, Medicare, Medicaid, chargebacks, long-term care, hospital, patient assistance programs, and various other programs. We base these accruals primarily upon our historical rebate and discount payments made to our customer segment groups and the provisions of current rebate and discount contracts.

The largest of our sales rebate and discount amounts are rebates associated with sales covered by managed care, Medicare, and Medicaid contracts. In determining the appropriate accrual amount, we consider our historical managed care, Medicare, and Medicaid rebate payments by product as a percentage of our historical sales as well as any significant changes in sales trends (e.g., patent expiries and product launches), an evaluation of the current managed care, Medicare, and Medicaid contracts, the percentage of our products that are sold via managed care, Medicare, and Medicaid contracts, and our product pricing. Although we accrue a liability for managed care, Medicare, and Medicaid rebates at the time we record the sale (when the product is shipped), the managed care, Medicare, and Medicaid rebate related to that sale is paid up to six months later. Because of this time lag, in any particular period our rebate adjustments may incorporate revisions of accruals for several periods.

Most of our rebates outside the U.S. are contractual or legislatively mandated and are estimated and recognized in the same period as the related sales. In some large European countries, government rebates are based on the anticipated budget for pharmaceutical payments in the country. A best estimate of these rebates, updated as governmental authorities revise budgeted deficits, is recognized in the same period as the related sale. If our estimates are not reflective of the actual pharmaceutical costs incurred by the government, we adjust our rebate reserves.

Financial Statement Impact

We believe that our accruals for sales returns, rebates, and discounts are reasonable and appropriate based on current facts and circumstances. Our global rebate and discount liabilities are included in sales rebates and discounts on our consolidated balance sheet. Our global sales return liability is included in other current liabilities and other noncurrent liabilities on our consolidated balance sheet. As of December 31, 2017, a 5 percent change in our global sales return, rebate, and discount liability would have led to an approximate $240 million effect on our income before income taxes.

The portion of our global sales return, rebate, and discount liability resulting from sales of our products in the U.S. was 87 percent and 85 percent as of December 31, 2017 and 2016, respectively.

The following represents a roll-forward of our most significant U.S. pharmaceutical sales return, rebate, and discount liability balances, including managed care, Medicare, and Medicaid:

(Dollars in millions)	2017	2016
Sales return, rebate, and discount liabilities, beginning of year	**$ 3,601.8**	$ 2,558.6
Reduction of net sales due to sales returns, discounts, and rebates[(1)]	**10,603.4**	8,732.8
Cash payments of discounts and rebates	**(10,033.2)**	(7,689.6)
Sales return, rebate, and discount liabilities, end of year	**$ 4,172.0**	$ 3,601.8

(1) Adjustments of the estimates for these returns, rebates, and discounts to actual results were approximately 1 percent of consolidated net sales for each of the years presented.

Product Litigation Liabilities and Other Contingencies

Background and Uncertainties

Product litigation liabilities and other contingencies are, by their nature, uncertain and based upon complex judgments and probabilities. The factors we consider in developing our product litigation liability reserves and other contingent liability amounts include the merits and jurisdiction of the litigation, the nature and the number of other similar current and past litigation cases, the nature of the product and the current assessment of the science subject to the litigation, and the likelihood of settlement and current state of settlement discussions, if any. In addition, we accrue for certain product liability claims incurred, but not filed, to the extent we can formulate a reasonable estimate of their costs based primarily on historical claims experience and data regarding product usage. We accrue legal defense costs expected to be incurred in connection with significant product liability contingencies when both probable and reasonably estimable.

We also consider the insurance coverage we have to diminish the exposure for periods covered by insurance. In assessing our insurance coverage, we consider the policy coverage limits and exclusions, the potential for denial of coverage by the insurance company, the financial condition of the insurers, and the possibility of and length of time for collection. Due to a very restrictive market for product liability insurance, we are self-insured for product liability losses for all our currently marketed products. In addition to insurance coverage, we also consider any third-party indemnification to which we are entitled, including the nature of the indemnification, the financial condition of the indemnifying party, and the possibility of and length of time for collection.

The litigation accruals and environmental liabilities and the related estimated insurance recoverables have been reflected on a gross basis as liabilities and assets, respectively, on our consolidated balance sheets.

Impairment of Indefinite-Lived and Long-Lived Assets

Background and Uncertainties

We review the carrying value of long-lived assets (both intangible and tangible) for potential impairment on a periodic basis and whenever events or changes in circumstances indicate the carrying value of an asset (or asset group) may not be recoverable. We identify impairment by comparing the projected undiscounted cash flows to be generated by the asset (or asset group) to its carrying value. If an impairment is identified, a loss is recorded equal to the excess of the asset's net book value over its fair value, and the cost basis is adjusted.

Goodwill and indefinite-lived intangible assets are reviewed for impairment at least annually and when certain impairment indicators are present. When required, a comparison of fair value to the carrying amount of assets is performed to determine the amount of any impairment.

Several methods may be used to determine the estimated fair value of acquired IPR&D, all of which require multiple assumptions. We utilize the “income method,” as described in Note 8 to the consolidated financial statements.

For acquired IPR&D assets, the risk of failure has been factored into the fair value measure and there can be no certainty that these assets ultimately will yield a successful product, as discussed previously in “Results of Operations - Executive Overview - Late-Stage Pipeline." The nature of the pharmaceutical business is high-risk and requires that we invest in a large number of projects to maintain a successful portfolio of approved products. As such, it is likely that some acquired IPR&D assets will become impaired in the future.

Estimates of future cash flows, based on what we believe to be reasonable and supportable assumptions and projections, require management’s judgment. Actual results could vary materially from these estimates.

Retirement Benefits Assumptions

Background and Uncertainties

Defined benefit pension plan and retiree health benefit plan costs include assumptions for the discount rate, expected return on plan assets, and retirement age. These assumptions have a significant effect on the amounts reported. In addition to the analysis below, see Note 14 to the consolidated financial statements for additional information regarding our retirement benefits.

Annually, we evaluate the discount rate and the expected return on plan assets in our defined benefit pension and retiree health benefit plans. We use an actuarially determined, plan-specific yield curve of high quality, fixed income debt instruments to determine the discount rates. In evaluating the expected return on plan assets, we consider many factors, with a primary analysis of current and projected market conditions, asset returns and asset allocations (approximately 80 percent of which are growth investments); and the views of leading financial advisers and economists. We may also review our historical assumptions compared with actual results, as well as the discount rates and expected return on plan assets of other companies, where applicable. In evaluating our expected retirement age assumption, we consider the retirement ages of our past employees eligible for pension and medical benefits together with our expectations of future retirement ages.

Financial Statement Impact

If the 2017 discount rate for the U.S. defined benefit pension and retiree health benefit plans (U.S. plans) were to change by a quarter percentage point, income before income taxes would change by $30.0 million. As of January 1, 2016, we changed the method used to estimate the service and interest cost components of the net periodic pension and retiree health benefit plan costs. Prior to this change, the service and interest costs were determined using a single weighted-average discount rate based on yield curves of high quality, fixed income debt instruments used to measure the benefit obligation at the beginning of the period. This new method uses the spot yield curve approach to estimate the service and interest costs by applying the specific spot rates along the yield curve to the projected cash outflows of our obligations. The new method provides a more precise measure of interest and service costs by improving the correlation between the projected benefit cash flows and the specific spot yield curve rates. The change does not affect the measurement of the total benefit obligations as the change in service and interest costs is recorded in the actuarial gains and losses recorded in accumulated other comprehensive loss. We accounted for this as a change in estimate prospectively beginning in 2016.

If the 2017 expected return on plan assets for U.S. plans were to change by a quarter percentage point, income before income taxes would change by $23.7 million. If our assumption regarding the 2017 expected age of future retirees for U.S. plans were adjusted by one year, our income before income taxes would be affected by $34.8 million. The U.S. plans, including Puerto Rico, represent approximately 75 percent and 80 percent of the total projected benefit obligation and total plan assets, respectively, at December 31, 2017.

Income Taxes

Background and Uncertainties

We prepare and file tax returns based upon our interpretation of tax laws and regulations and record estimates based on these judgments and interpretations. In the normal course of business, our tax returns are

subject to examination by various taxing authorities, which may result in future tax, interest, and penalty assessments by these authorities. Inherent uncertainties exist in estimates of many tax positions due to changes in tax law resulting from legislation, regulation, and/or as concluded through the various jurisdictions' tax court systems. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate resolution. The amount of unrecognized tax benefits is adjusted for changes in facts and circumstances. For example, adjustments could result from significant amendments to existing tax law, the issuance of regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of a tax examination. We believe our estimates for uncertain tax positions are appropriate and sufficient to pay assessments that may result from examinations of our tax returns. We recognize both accrued interest and penalties related to unrecognized tax benefits in income tax expense.

We have recorded valuation allowances against certain of our deferred tax assets, primarily those that have been generated from net operating losses and tax credit carryforwards in certain taxing jurisdictions. In evaluating whether we would more likely than not recover these deferred tax assets, we have not assumed any future taxable income or tax planning strategies in the jurisdictions associated with these carryforwards where history does not support such an assumption. Implementation of tax planning strategies to recover these deferred tax assets or future income generation in these jurisdictions could lead to the reversal of these valuation allowances and a reduction of income tax expense.

The 2017 Tax Act was enacted in December 2017 and introduced numerous significant changes to the U.S. corporate income tax system. In accordance with GAAP, we recorded an estimate of the changes to our U.S. federal and state income tax expense that resulted from the 2017 Tax Act, which included re-measuring deferred tax assets and liabilities, evaluating deferred tax assets for valuation allowances, and assessing the impact of the Toll Tax and certain other provisions of the 2017 Tax Act. Since we were unable to completely assess all impacts of the 2017 Tax Act, the estimate that we recorded is a provisional amount based upon reasonable estimates and may change upon completion of our calculations (refer to "Results of Operations - Executive Overview - Other Matters - Tax Matters" and Note 13 to the consolidated financial statements for further discussion on the 2017 Tax Act). Assimilation of the 2017 Tax Act will be ongoing as we continue to analyze the new law and as future directives are issued, including regulations, interpretations, and guidance, which may materially affect the estimates and assumptions used in recording the changes to 2017 U.S. federal and state income tax expense.

Financial Statement Impact

As of December 31, 2017, a 5 percent change in the amount of the provisional charge related to the 2017 Tax Act, uncertain tax positions, and the valuation allowance would result in a change in net income of $95.7 million, $33.5 million, and $35.5 million, respectively.

Acquisitions

Background and Uncertainties

To determine whether acquisitions or licensing transactions should be accounted for as a business combination or as an asset acquisition, we make certain judgments, which include assessing whether the acquired set of activities and assets would meet the definition of a business under the relevant accounting rules.

If the acquired set of activities and assets meets the definition of a business, assets acquired and liabilities assumed are required to be recorded at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets, where applicable, is recorded as goodwill. If the acquired set of activities and assets does not meet the definition of a business, the transaction is recorded as an acquisition of assets and, therefore, any acquired IPR&D that does not have an alternative future use is charged to expense at the acquisition date, and goodwill is not recorded. Refer to Note 3 to the consolidated financial statements for additional information.

The judgments made in determining estimated fair values assigned to assets acquired and liabilities assumed in a business combination, as well as estimated asset lives, can materially affect our consolidated results of

operations. The fair values of intangible assets, including acquired IPR&D, are determined using information available near the acquisition date based on expectations and assumptions that are deemed reasonable by management. Depending on the facts and circumstances, we may deem it necessary to engage an independent valuation expert to assist in valuing significant assets and liabilities.

The fair values of identifiable intangible assets are primarily determined using an "income method," as described in Note 8 to the consolidated financial statements.

The fair value of any contingent consideration liability that results from a business combination is determined using a market approach based on quoted market values, significant other observable inputs for identical or comparable assets or liabilities, or a discounted cash flow analysis. Estimating the fair value of contingent consideration requires the use of significant estimates and judgments, including, but not limited to, revenue and the discount rate.

Financial Statement Impact

As of December 31, 2017, a 5 percent change in the contingent consideration liability would result in a change in income before income taxes of $12.7 million.

LEGAL AND REGULATORY MATTERS

Information relating to certain legal proceedings can be found in Note 15 to the consolidated financial statements and is incorporated here by reference.

FINANCIAL EXPECTATIONS FOR 2018

For the full year of 2018, we expect EPS to be in the range of $4.39 to $4.49, which reflects the estimated impact of the 2017 Tax Act. We anticipate that total revenue will be between $23.0 billion and $23.5 billion. Revenue growth is expected to be driven by new products including Trulicity, Taltz, Basaglar, Jardiance, Verzenio, Cyramza, Olumiant and Lartruvo.

We anticipate that gross margin as a percent of revenue will be approximately 73 percent in 2018. Research and development expenses are expected to be in the range of $5.0 billion to $5.2 billion. Marketing, selling, and administrative expenses are expected to be in the range of $6.1 billion to $6.4 billion. Other—net, (income) expense is expected to be income in the range of $75 million to $175 million.

The 2018 tax rate is expected to be approximately 18.0 percent and reflects the estimated impact of the 2017 Tax Act. Refer to “Results of Operations - Executive Overview - Other Matters - Tax Matters” for further discussion of the 2017 Tax Act. The 2018 tax rate benefits from a lower corporate income tax rate, partially offset by the changes to certain business exclusions, deductions, credits, and international tax provisions and is subject to change based upon changes in our interpretations of the new tax law, along with subsequent regulations, interpretations, and guidance that have been and may be issued.

Capital expenditures are expected to be approximately $1.2 billion.

Financial Statements and Supplementary Data

Consolidated Statements of Operations

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions and shares in thousands, except per-share data) Year Ended December 31	2017	2016	2015
Revenue	**$ 22,871.3**	$ 21,222.1	$ 19,958.7
Costs, expenses, and other:			
Cost of sales	**6,070.2**	5,654.9	5,037.2
Research and development	**5,281.8**	5,243.9	4,796.4
Marketing, selling, and administrative	**6,588.1**	6,452.0	6,533.0
Acquired in-process research and development (Notes 3 and 4)	**1,112.6**	30.0	535.0
Asset impairment, restructuring, and other special charges (Note 5)	**1,673.6**	382.5	367.7
Other—net, (income) expense (Note 17)	**(52.4)**	84.8	(100.6)
	20,673.9	17,848.1	17,168.7
Income before income taxes	**2,197.4**	3,374.0	2,790.0
Income taxes (Note 13)	**2,401.5**	636.4	381.6
Net income (loss)	**$ (204.1)**	$ 2,737.6	$ 2,408.4
Earnings (loss) per share:			
Basic	**$ (0.19)**	$ 2.59	$ 2.27
Diluted	**$ (0.19)**	$ 2.58	$ 2.26
Shares used in calculation of earnings (loss) per share:			
Basic	**1,052,023**	1,058,324	1,061,913
Diluted	**1,052,023**	1,061,825	1,065,720

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income (loss)

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions) Year Ended December 31	2017	2016	2015
Net income (loss)	**$ (204.1)**	$ 2,737.6	$ 2,408.4
Other comprehensive income (loss):			
Change in foreign currency translation gains (losses)	**501.9**	(436.4)	(859.8)
Change in net unrealized gains and losses on securities	**(181.3)**	303.0	(138.1)
Change in defined benefit pension and retiree health benefit plans (Note 14)	**(576.6)**	(512.8)	572.9
Change in effective portion of cash flow hedges	**27.8**	11.7	(42.0)
Other comprehensive income (loss) before income taxes	**(228.2)**	(634.5)	(467.0)
Benefit (provision) for income taxes related to other comprehensive income (loss) items	**402.7**	(10.6)	(121.9)
Other comprehensive income (loss) (Note 16)[(1)]	**174.5**	(645.1)	(588.9)
Comprehensive income (loss)	**$ (29.6)**	$ 2,092.5	$ 1,819.5

(1) Other comprehensive loss in 2016 consists of $693.3 million of other comprehensive loss attributable to controlling interest and $48.2 million of other comprehensive income attributable to non-controlling interest. Other comprehensive income in 2017 consists of $199.0 million of other comprehensive income attributable to controlling interest and $24.5 million of other comprehensive loss attributable to non-controlling interest.

See notes to consolidated financial statements.

Consolidated Balance Sheets

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions, shares in thousands)	December 31	2017	2016
Assets			
Current Assets			
Cash and cash equivalents (Note 7)		**$ 6,536.2**	$ 4,582.1
Short-term investments (Note 7)		**1,497.9**	1,456.5
Accounts receivable, net of allowances of **$38.7 (2017)** and $40.3 (2016)		**4,546.3**	4,029.4
Other receivables		**715.9**	736.9
Inventories (Note 6)		**4,458.3**	3,561.9
Prepaid expenses and other		**1,447.5**	734.6
Total current assets		**19,202.1**	15,101.4
Other Assets			
Investments (Note 7)		**5,678.8**	5,207.5
Goodwill (Note 8)		**4,370.1**	3,972.7
Other intangibles, net (Note 8)		**4,029.2**	4,357.9
Sundry		**2,874.3**	1,913.8
Total other assets		**16,952.4**	15,451.9
Property and equipment, net (Note 9)		**8,826.5**	8,252.6
Total assets		**$ 44,981.0**	$ 38,805.9
Liabilities and Equity			
Current Liabilities			
Short-term borrowings and current maturities of long-term debt (Note 10)		**$ 3,706.6**	$ 1,937.4
Accounts payable		**1,410.7**	1,349.3
Employee compensation		**997.9**	896.9
Sales rebates and discounts		**4,465.1**	3,914.9
Dividends payable		**590.6**	548.1
Income taxes payable (Note 13)		**532.9**	119.1
Other current liabilities		**2,832.1**	2,220.9
Total current liabilities		**14,535.9**	10,986.6
Other Liabilities			
Long-term debt (Note 10)		**9,940.5**	8,367.8
Accrued retirement benefits (Note 14)		**3,513.9**	2,453.9
Long-term income taxes payable (Note 13)		**3,776.5**	688.9
Other noncurrent liabilities		**1,546.3**	2,228.2
Total other liabilities		**18,777.2**	13,738.8
Commitments and Contingencies (Note 15)			
Eli Lilly and Company Shareholders' Equity (Notes 11 and 12)			
Common stock—no par value Authorized shares: 3,200,000 Issued shares: **1,100,672 (2017)** and 1,101,586 (2016)		**687.9**	688.5
Additional paid-in capital		**5,817.8**	5,640.6
Retained earnings		**13,894.1**	16,046.3
Employee benefit trust		**(3,013.2)**	(3,013.2)
Accumulated other comprehensive loss (Note 16)		**(5,718.6)**	(5,274.0)
Cost of common stock in treasury		**(75.8)**	(80.5)
Total Eli Lilly and Company shareholders' equity		**11,592.2**	14,007.7
Noncontrolling interests		**75.7**	72.8
Total equity		**11,667.9**	14,080.5
Total liabilities and equity		**$ 44,981.0**	$ 38,805.9

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions, shares in thousands)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock in Treasury		Employee Benefit Trust	Shareholders' Equity
	Shares	Amount				Shares	Amount		
Balance at January 1, 2015	1,111,437	$ 694.6	$ 5,292.3	$16,482.7	$ (3,991.8)	810	$ (91.4)	$ (3,013.2)	$ 15,373.2
Net income				2,408.4					2,408.4
Other comprehensive loss, net of tax					(588.9)				(588.9)
Cash dividends declared per share: $2.01				(2,136.0)					(2,136.0)
Retirement of treasury shares	(9,877)	(6.2)		(743.3)		(9,877)	749.5		—
Purchase of treasury shares						9,877	(749.5)		(749.5)
Issuance of stock under employee stock plans, net	4,503	2.9	42.0			(14)	1.4		46.3
Stock-based compensation			217.8						217.8
Balance at December 31, 2015	1,106,063	691.3	5,552.1	16,011.8	(4,580.7)	796	(90.0)	(3,013.2)	14,571.3
Net income				2,737.6					2,737.6
Other comprehensive loss, net of tax					(693.3)				(693.3)
Cash dividends declared per share: $2.05				(2,167.6)					(2,167.6)
Retirement of treasury shares	(7,306)	(4.6)		(535.5)		(7,306)	540.1		—
Purchase of treasury shares			(60.0)			7,306	(540.1)		(600.1)
Issuance of stock under employee stock plans, net	2,829	1.8	(106.8)			(85)	9.5		(95.5)
Stock-based compensation			255.3						255.3
Balance at December 31, 2016	1,101,586	688.5	5,640.6	16,046.3	(5,274.0)	711	(80.5)	(3,013.2)	14,007.7
Net loss				**(204.1)**					**(204.1)**
Other comprehensive income, net of tax					**199.0**				**199.0**
Cash dividends declared per share: $2.12				**(2,234.6)**					**(2,234.6)**
Retirement of treasury shares	**(4,390)**	**(2.7)**		**(357.1)**		**(4,390)**	**359.8**		**—**
Purchase of treasury shares			**60.0**			**4,390**	**(359.8)**		**(299.8)**
Issuance of stock under employee stock plans, net	**3,476**	**2.1**	**(164.1)**			**(47)**	**4.7**		**(157.3)**
Stock-based compensation			**281.3**						**281.3**
Reclassification of stranded tax effects - provisional (Note 2)				**643.6**	**(643.6)**				**—**
Balance at December 31, 2017	**1,100,672**	**$ 687.9**	**$ 5,817.8**	**$13,894.1**	**$ (5,718.6)**	**664**	**$ (75.8)**	**$ (3,013.2)**	**$ 11,592.2**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions) Year Ended December 31	2017	2016	2015
Cash Flows from Operating Activities			
Net income (loss)	**$ (204.1)**	$ 2,737.6	$ 2,408.4
Adjustments to Reconcile Net Income (Loss) to Cash Flows from Operating Activities:			
Depreciation and amortization	**1,567.3**	1,496.6	1,427.7
Change in deferred income taxes	**(787.9)**	439.5	(748.4)
Stock-based compensation expense	**281.3**	255.3	217.8
Acquired in-process research and development	**1,112.6**	30.0	535.0
Other non-cash operating activities, net	**441.5**	376.1	263.3
Other changes in operating assets and liabilities, net of acquisitions and divestitures:			
Receivables—(increase) decrease	**(357.0)**	(709.4)	(304.5)
Inventories—(increase) decrease	**(253.9)**	(328.2)	(736.3)
Other assets—(increase) decrease	**(590.1)**	(265.5)	(288.5)
Income taxes payable—increase (decrease)	**3,489.6**	(304.8)	(17.8)
Accounts payable and other liabilities—increase (decrease)	**916.3**	1,123.8	207.9
Net Cash Provided by Operating Activities	**5,615.6**	4,851.0	2,964.6
Cash Flows from Investing Activities			
Purchases of property and equipment	**(1,076.8)**	(1,037.0)	(1,066.2)
Disposals of property and equipment	**40.7**	73.4	92.6
Cash released for pending acquisition (Note 3)	**—**	—	5,405.6
Proceeds from sales and maturities of short-term investments	**4,852.5**	1,642.0	2,161.8
Purchases of short-term investments	**(3,389.7)**	(1,327.4)	(842.2)
Proceeds from sales of noncurrent investments	**2,586.0**	2,086.0	3,068.4
Purchases of noncurrent investments	**(4,611.6)**	(4,346.0)	(3,226.5)
Proceeds from sale of product rights	**—**	—	410.0
Purchases of in-process research and development	**(1,086.8)**	(55.0)	(560.0)
Cash paid for acquisitions, net of cash acquired (Note 3)	**(882.1)**	(45.0)	(5,283.1)
Other investing activities, net	**(215.8)**	(130.1)	(133.6)
Net Cash Provided by (Used for) Investing Activities	**(3,783.6)**	(3,139.1)	26.8
Cash Flows from Financing Activities			
Dividends paid	**(2,192.1)**	(2,158.5)	(2,127.3)
Net change in short-term borrowings	**1,397.5**	1,293.2	(2,680.6)
Proceeds from issuance of long-term debt	**2,232.0**	1,206.6	4,454.7
Repayments of long-term debt	**(630.6)**	(0.2)	(1,955.7)
Purchases of common stock	**(299.8)**	(600.1)	(749.5)
Other financing activities, net	**(364.4)**	(300.8)	(52.6)
Net Cash Provided by (Used for) Financing Activities	**142.6**	(559.8)	(3,111.0)
Effect of exchange rate changes on cash and cash equivalents	**(20.5)**	(236.4)	(85.6)
Net increase (decrease) in cash and cash equivalents	**1,954.1**	915.7	(205.2)
Cash and cash equivalents at beginning of year	**4,582.1**	3,666.4	3,871.6
Cash and Cash Equivalents at End of Year	**$ 6,536.2**	$ 4,582.1	$ 3,666.4

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

ELI LILLY AND COMPANY AND SUBSIDIARIES
(Tables present dollars in millions, except per-share data)

Note 1: Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). The accounts of all wholly-owned and majority-owned subsidiaries are included in the consolidated financial statements. Where our ownership of consolidated subsidiaries is less than 100 percent, the noncontrolling shareholders' interests are reflected as a separate component of equity. All intercompany balances and transactions have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from those estimates. We issued our financial statements by filing with the Securities and Exchange Commission and have evaluated subsequent events up to the time of the filing.

Certain reclassifications have been made to prior periods in the consolidated financial statements and accompanying notes to conform with the current presentation.

All per-share amounts, unless otherwise noted in the footnotes, are presented on a diluted basis, that is, based on the weighted-average number of outstanding common shares plus the effect of incremental shares from our stock-based compensation programs.

Revenue recognition

We recognize revenue from sales of products at the time title of goods passes to the buyer and the buyer assumes the risks and rewards of ownership. Provisions for returns, discounts, and rebates are established in the same period the related sales are recognized.

In arrangements involving the delivery of more than one element (e.g., research and development, marketing and selling, manufacturing, and distribution), each required deliverable is evaluated to determine whether it qualifies as a separate unit of accounting. Our determination is based on whether the deliverable has "standalone value" to the customer. If a deliverable does not qualify as a separate unit of accounting, it is combined with the other applicable undelivered item(s) within the arrangement and these combined deliverables are treated as a single unit of accounting. The arrangement's consideration that is fixed or determinable is then allocated to each separate unit of accounting based on the relative selling price of each deliverable.

Initial fees we receive in collaborative and other similar arrangements from the partnering of our compounds under development are generally deferred and amortized into income through the expected product approval date. Initial fees may also be received for out-licensing agreements that include both an out-license of our marketing rights to commercialized products and a related commitment to supply the products. When we have determined that the marketing rights do not have standalone value, the initial fees received are generally deferred and amortized to income as net product sales over the term of the supply agreement.

Royalty revenue from licensees, which is based on third-party sales of licensed products and technology, is recorded as earned in accordance with the contract terms when third-party sales can be reasonably measured and collection of the funds is reasonably assured. This royalty revenue is included in collaboration and other revenue.

Profit-sharing due from our collaboration partners, which is based upon gross margins reported to us by our partners, is recognized as collaboration and other revenue as earned.

Developmental milestone payments earned by us are generally recorded in other–net, (income) expense. We immediately recognize the full amount of developmental milestone payments due to us upon the achievement of the milestone event if the event is objectively determinable and the milestone is substantive in its entirety. A milestone is considered substantive if the consideration earned 1) relates solely to past performance, 2) is

commensurate with the enhancement in the pharmaceutical or animal health product's value associated with the achievement of the important event in its development life cycle, and 3) is reasonable relative to all of the deliverables and payment terms within the arrangement. If a milestone payment to us is part of a multiple-element commercialization arrangement and is triggered by the initiation of the commercialization period (e.g., regulatory approval for marketing or launch of the product) or the achievement of a sales-based threshold, we amortize the payment to income as we perform under the terms of the arrangement. See Note 4 for specific agreement details.

Research and development expenses and acquired in-process research and development

Research and development expenses include the following:

- Research and development costs, which are expensed as incurred.
- Milestone payment obligations incurred prior to regulatory approval of the product, which are accrued when the event requiring payment of the milestone occurs.

Acquired in-process research and development (IPR&D) expense includes the initial costs of IPR&D projects, acquired directly in a transaction other than a business combination, that do not have an alternative future use.

Earnings per share

We calculate basic earnings per share (EPS) based on the weighted-average number of common shares outstanding and incremental shares from potential participating securities. We calculate diluted EPS based on the weighted-average number of common shares outstanding, including incremental shares from our stock-based compensation programs.

Foreign Currency Translation

Operations in our subsidiaries outside the United States (U.S.) are recorded in the functional currency of each subsidiary which is determined by a review of the environment where each subsidiary primarily generates and expends cash. The results of operations for our subsidiaries outside the U.S. are translated from functional currencies into U.S. dollars using the weighted average currency rate for the period. Assets and liabilities are translated using the period end exchange rates. The U.S. dollar effects that arise from translating the net assets of these subsidiaries are recorded in other comprehensive income (loss).

Other significant accounting policies

Our other significant accounting policies are described in the remaining appropriate notes to the consolidated financial statements.

Note 2: Implementation of New Financial Accounting Pronouncements

We elected to early adopt Accounting Standards Update 2018-02, *Income Statement-Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which allows a reclassification from accumulated other comprehensive loss (AOCL) to retained earnings for stranded tax effects resulting from the 2017 Tax Act (see Note 13). This standard allows us to reclassify the effect of remeasuring deferred tax liabilities and assets related to items within AOCL using the newly enacted 21 percent federal corporate income tax rate. The provisional effect of this early adoption was a reclassification from AOCL resulting in an increase to retained earnings of $643.6 million.

The following table provides a brief description of accounting standards that had not yet been adopted as of December 31, 2017 and could have a material effect on our financial statements:

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Accounting Standards Update 2014-09 and various other related updates, *Revenue from Contracts with Customers*	This standard replaced existing revenue recognition standards and requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity can apply the new revenue standard retrospectively to each prior reporting period presented or with the cumulative effect of initially applying the standard recognized at the date of initial application in retained earnings. We applied the latter approach.	This standard was effective January 1, 2018, and we adopted on that date.	Our evaluation of our contracts subject to this standard is complete and we do not expect the application of the new standard to these contracts to have a material impact to our consolidated statements of operations or balance sheets at initial implementation. We are also evaluating the new disclosures required by the standard to determine what additional information will need to be disclosed.
Accounting Standards Update 2016-01, *Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*	This standard requires entities to recognize changes in the fair value of equity investments with readily determinable fair values in net income (except for investments accounted for under the equity method of accounting or those that result in consolidation of the investee). An entity should apply the new standard through a cumulative effect adjustment to retained earnings as of the beginning of the fiscal year of adoption.	This standard was effective January 1, 2018, and we adopted on that date.	We will reclassify from accumulated other comprehensive income the after-tax amount of net unrealized gains resulting in an increase to retained earnings of approximately $105 million.

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Accounting Standards Update 2016-02, *Leases*	This standard was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under current GAAP, on the balance sheet and requiring additional disclosures about leasing arrangements. This standard requires a modified retrospective approach to adoption.	This standard is effective January 1, 2019, with early adoption permitted. We intend to adopt this standard on January 1, 2019.	We are in the process of determining the impact on our consolidated financial statements. We have selected a software solution to be compatible with our enterprise software system. Development of our selected solution is ongoing, as it is not yet fully compliant with the requirements of the standard. The timely readiness of the lease software system is critical to ensure an efficient and effective adoption of the standard.
Accounting Standards Update 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory*	This standard requires entities to recognize the income tax consequences of intra-entity transfers of assets other than inventory at the time of transfer. This standard requires a modified retrospective approach to adoption.	This standard was effective January 1, 2018, and we adopted on that date.	We currently estimate that the cumulative effect of initially applying the standard will result in an increase to deferred tax assets and retained earnings of approximately $2.5 billion.

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Accounting Standards Update 2017-07, *Compensation-Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*	This standard was issued to improve the transparency and comparability among organizations by requiring entities to separate their net periodic pension cost and net periodic postretirement benefit cost into a service cost component and other components. Currently, the costs of the other components along with the service cost component are classified based upon the function of the employee. This standard requires entities to classify the service cost component in the same financial statement line item or items as other compensation costs arising from services rendered by pertinent employees. The other components of net benefit cost will be presented separately from the line items that include the service cost component. When applicable, the service cost component is the only component eligible for capitalization. An entity should apply the new standard retrospectively for the classification of the service cost and other components and prospectively for the capitalization of the service cost component.	This standard was effective January 1, 2018, and we adopted on that date.	Upon adoption of this standard, pension and postretirement benefit cost components other than service costs are to be presented in other–net, (income) expense. The application of the new standard did not change consolidated net income at initial implementation and we do not expect it to have a material impact on an ongoing basis.

Note 3: Acquisitions

During 2017 and 2015, we completed the acquisitions of Boehringer Ingelheim Vetmedica, Inc.'s U.S. feline, canine, and rabies vaccine portfolio and other related assets (BIVIVP) and Novartis Animal Health (Novartis AH), respectively. Additionally, on October 1, 2015, Bristol-Myers Squibb Company and E.R. Squibb (collectively, BMS) transferred to us their commercialization rights with respect to Erbitux® in the U.S. and Canada (collectively, North America) through a modification of our existing arrangement. See Note 4 for additional information related to the Erbitux arrangement. We also had an immaterial acquisition of a business in 2016. These transactions, as further discussed in this note below in Acquisitions of Businesses, were accounted for as business combinations under the acquisition method of accounting. Under this method, the assets acquired and liabilities assumed were recorded at their respective fair values as of the acquisition date in our consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. The excess of the purchase price over the fair value of the acquired net assets, where applicable, has been recorded as goodwill. The results of operations of these acquisitions are included in our consolidated financial statements from the dates of acquisition.

In addition to the acquisitions of businesses, we also acquired assets in development in 2017, 2016, and 2015 which are further discussed in this note below in Asset Acquisitions. Upon acquisition, the acquired IPR&D charges related to these products were immediately expensed because the products had no alternative future use. For the years ended December 31, 2017, 2016, and 2015, we recorded acquired IPR&D charges of $1.11 billion, $30.0 million, and $535.0 million, respectively. The 2015 charges were associated with the transactions discussed below in Asset Acquisitions and the upfront fee of $200.0 million related to tanezumab. See Note 4 for additional information related to the tanezumab arrangement.

Acquisitions of Businesses

Boehringer Ingelheim Vetmedica, Inc. Vaccine Portfolio Acquisition

Overview of Transaction

On January 3, 2017, we acquired BIVIVP in an all-cash transaction for $882.1 million. Under the terms of the agreement, we acquired a manufacturing and research and development site, a U.S. vaccine portfolio including vaccines used for the treatment of bordetella, Lyme disease, rabies, and parvovirus, among others.

Assets Acquired and Liabilities Assumed

The following table summarizes the amounts recognized for assets acquired and liabilities assumed as of the acquisition date:

Estimated Fair Value at January 3, 2017		
Inventories	$	108.6
Marketed products[1]		297.0
Property and equipment		148.2
Other assets and liabilities - net		8.2
Total identifiable net assets		562.0
Goodwill[2]		320.1
Total consideration transferred - net of cash acquired	$	882.1

(1) These intangible assets, which are being amortized to cost of sales on a straight-line basis over their estimated useful lives, were expected to have a weighted average useful life of 10 years.

(2) The goodwill recognized from this acquisition is attributable primarily to expected synergies from combining the operations of BIVIVP with our legacy animal health business, future unidentified projects and products, and the assembled workforce of BIVIVP. The goodwill associated with this acquisition will be deductible for tax purposes.

Our consolidated statement of operations for the year ended December 31, 2017, includes BIVIVP revenue of $216.7 million. BIVIVP has been integrated into our animal health products segment and, as a result of these integration efforts, certain parts of the animal health business were operating on a combined basis during this period and we could not distinguish the operations between BIVIVP and our legacy animal health products business.

Novartis AH Acquisition

Overview of Transaction

On January 1, 2015, we acquired from Novartis AG all of the shares of certain Novartis subsidiaries and the assets and liabilities of other Novartis subsidiaries that were exclusively related to the Novartis AH business in an all-cash transaction for a total purchase price of $5.28 billion, $5.41 billion of which was funded by cash held in escrow at December 31, 2014.

As a condition to the clearance of the transaction under the Hart-Scott-Rodino Antitrust Improvements Act, following the closing of the acquisition of Novartis AH, we divested certain animal health assets in the U.S. related to the Sentinel® canine parasiticide franchise to Virbac Corporation for approximately $410.0 million.

The acquired Novartis AH business consisted of the research and development, manufacture, marketing, sale and distribution of veterinary products to prevent and treat diseases in pets, farm animals, and farmed fish. Under the terms of the agreement, we acquired manufacturing sites, research and development facilities, a global commercial infrastructure and portfolio of products, a pipeline of projects in development, and employees.

Assets Acquired and Liabilities Assumed

The following table summarizes the amounts recognized for assets acquired and liabilities assumed as of the acquisition date:

Estimated Fair Value at January 1, 2015		
Inventories	$	380.2
Acquired in-process research and development		298.0
Marketed products[(1)]		1,953.0
Property and equipment		199.9
Assets held for sale (primarily the U.S. Sentinel rights)		422.7
Accrued retirement benefits		(108.7)
Deferred income taxes		(60.1)
Other assets and liabilities - net		(73.0)
Total identifiable net assets		3,012.0
Goodwill[(2)]		2,271.1
Total consideration transferred - net of cash acquired	$	5,283.1

(1) These intangible assets, which are being amortized to cost of sales on a straight-line basis over their estimated useful lives, were expected to have a weighted average useful life of 19 years.

(2) The goodwill recognized from this acquisition is attributable primarily to expected synergies from combining the operations of Novartis AH with our legacy animal health business, future unidentified projects and products, and the assembled workforce of Novartis AH. Approximately $1.0 billion of the goodwill associated with this acquisition is deductible for tax purposes.

Asset Acquisitions

The following table and narrative summarizes our asset acquisitions during 2017, 2016, and 2015.

Counterparty	Compound(s) or Therapy	Acquisition Month	Phase of Development[1]	Acquired IPR&D Expense
CoLucid Pharmaceuticals, Inc. (CoLucid)	Oral therapy for the acute treatment of migraine - lasmiditan	March 2017	Phase III	$ 857.6
KeyBioscience AG (KeyBioscience)	Multiple molecules for treatment of metabolic disorders	July 2017	Phase II	55.0
Nektar Therapeutics (Nektar)	Immunological therapy - NKTR-358	August 2017	Phase I	150.0
CureVac AG (CureVac)	Cancer vaccines	November 2017	Pre-clinical	50.0
AstraZeneca	Antibody selective for amyloid-beta 42 (Aβ42) - MEDI1814	December 2016	Phase I	30.0
Innovent Biologics, Inc. (Innovent)	Monoclonal antibody targeting protein CD-20 Immuno-oncology molecule cMet monoclonal antibody	March 2015	Pre-clinical[2]	56.0
Hanmi Pharmaceutical Co., Ltd. (Hanmi)	BTK Inhibitor - HM71224	April 2015	Phase I	50.0
BioNTech AG (BioNTech)	Cancer immunotherapies	May 2015	Pre-clinical	30.0
Locemia Solutions	Intranasal glucagon	October 2015	Phase III	149.0
Undisclosed	Technology collaboration	December 2015	N/A	25.0
Halozyme Therapeutics, Inc. (Halozyme)	Recombinant human hyaluronidase enzyme - rHuPH20	December 2015	N/A	25.0

[1] The phase of development presented is as of the date of the arrangement and represents the phase of development of the most advanced asset acquired, where applicable.

[2] Prior to acquisition, Innovent's monoclonal antibody targeting protein CD-20 had received investigational new drug approval in China to begin Phase I development.

In connection with the arrangements described herein, our partners may be entitled to future royalties and/or commercial milestones based on sales should these products be approved for commercialization and/or milestones based on the successful progress of the compounds through the development process.

We acquired lasmiditan by acquiring CoLucid. Under the terms of the agreement, we acquired all shares of CoLucid for a cash purchase price of $831.8 million, net of cash acquired, plus net accrued liabilities assumed of $25.8 million. Substantially all of the value of CoLucid was related to lasmiditan, its only significant asset. The acquired IPR&D expense is not tax deductible.

Our collaboration agreement with KeyBioscience provides us with access to KeyBioscience's Dual Amylin Calcitonin Receptor Agonists (DACRAs), a potential new class of treatments for metabolic disorders such as type 2 diabetes, along with multiple molecules. Prior to entering into the agreement, KeyBioscience had initiated Phase II development of the lead molecule. The other assets included in the collaboration range from pre-clinical to Phase I development. Under the terms of the agreement, we receive worldwide rights to develop and commercialize these molecules.

Our collaboration with Nektar is to co-develop Nektar's compound which has the potential to treat a number of autoimmune and other chronic inflammatory conditions. Under the terms of the agreement, we are responsible for all costs of global commercialization. Nektar will have an option to co-promote in the U.S. under certain conditions.

Our global immuno-oncology collaboration with CureVac is to develop and commercialize up to five potential cancer vaccine products based on CureVac's proprietary RNActive® technology.

Our global collaboration agreement with AstraZeneca is to co-develop AstraZeneca's MEDI1814 compound being investigated for the treatment of Alzheimer's disease.

Our collaboration agreement with Innovent is to develop and commercialize a portfolio of cancer treatments. In China, we will be responsible for the commercialization efforts, while Innovent will lead the development and manufacturing efforts. Innovent also has co-promotion rights in China. We will be responsible for development, manufacturing, and commercialization efforts of Innovent's pre-clinical immuno-oncology molecules outside of China. Separate from the collaboration, we will continue the development of our cMet monoclonal antibody gene outside of China.

Our collaboration agreement with Hanmi is to develop and commercialize Hanmi's compound being investigated for the treatment of autoimmune and other diseases. We have rights to the molecule for all indications on a worldwide basis excluding Korea. We will be responsible for leading development, regulatory, manufacturing, and commercial efforts in our territories.

Our research collaboration with BioNTech is to discover novel cancer immunotherapies.

Our global collaboration and license agreement with Halozyme is to develop and commercialize products combining our proprietary compounds with Halozyme's ENHANZE™ platform to aid in the dispersion and absorption of other injected therapeutic drugs.

Note 4: Collaborations and Other Arrangements

We often enter into collaborative and other similar arrangements to develop and commercialize drug candidates. Collaborative activities may include research and development, marketing and selling (including promotional activities and physician detailing), manufacturing, and distribution. These arrangements often require milestone and royalty or profit-share payments, contingent upon the occurrence of certain future events linked to the success of the asset in development, as well as expense reimbursements or payments to the collaboration partner. Elements within a collaboration are separated into individual units of accounting if they have standalone value from other elements within the arrangement. In these situations, the arrangement consideration is allocated to the elements on a relative selling price basis. Revenue related to products we sell pursuant to these arrangements are included in net product revenue, while other sources of revenue (e.g., royalties and profit sharing due from our partner) are included in collaboration and other revenue.

The following table summarizes our collaboration and other revenue, which is included in revenue in the consolidated statements of operations:

	2017	2016	2015
Collaboration and other revenue	**$ 1,199.9**	$ 833.7	$ 808.1

Operating expenses for costs incurred pursuant to these arrangements are reported in their respective expense line item, net of any payments due to or reimbursements due from our collaboration partners, with such reimbursements being recognized at the time the party becomes obligated to pay. Each collaboration is unique in nature, and our more significant arrangements are discussed below.

Boehringer Ingelheim Diabetes Collaboration

We and Boehringer Ingelheim have a global agreement to jointly develop and commercialize a portfolio of diabetes compounds. Currently, included in the collaboration are Boehringer Ingelheim's oral diabetes products: Trajenta®, Jentadueto®, Jardiance®, Glyxambi®, and Synjardy®, as well as our basal insulin: Basaglar®.

The table below summarizes significant regulatory and commercialization events and milestones (deferred) capitalized for the compounds included in this collaboration:

	Year Launched			Milestones (Deferred) Capitalized[1]	
Product Family	U.S.	Europe	Japan	Year	Amount
Trajenta[2]	2011	2011	2011	Cumulative[4] - all prior to 2015	$ 446.4
Jardiance[3]	2014	2014	2015	Cumulative[4] - all prior to 2015	299.5
Basaglar	2016	2015	2015	2017	—
				2016	(187.5)
				2015	—
				Cumulative[4]	(250.0)

[1] In connection with the regulatory approvals of Basaglar in the U.S., Europe, and Japan, milestone payments received were recorded as deferred revenue and are being amortized through the term of the collaboration (2029) to collaboration and other revenue. In connection with the regulatory approvals of Trajenta and Jardiance, milestone payments made were capitalized as intangible assets and are being amortized to cost of sales.

[2] Jentadueto is included in the Trajenta family of product results.

[3] Glyxambi and Synjardy are included in the Jardiance family of product results.

[4] The cumulative amount represents the total initial amounts that were (deferred) or capitalized from the start of this collaboration through the end of the reporting period.

In the most significant markets, we and Boehringer Ingelheim share equally the ongoing development costs, commercialization costs, and agreed upon gross margin for any product resulting from the collaboration. We record our portion of the gross margin associated with Boehringer Ingelheim's compounds as collaboration and other revenue. We record our sales of Basaglar to third parties as net product revenue with the payments made to Boehringer Ingelheim for their portion of the gross margin recorded as cost of sales. For all compounds under this collaboration, we record our portion of the development and commercialization costs as research and development expense and marketing, selling, and administrative expense, respectively. Each company is entitled to potential performance payments depending on the sales of the molecules it contributes to the collaboration. These performance payments result in the owner of the molecule retaining a greater share of the agreed upon gross margin of that product. Subject to achieving these thresholds, in a given period, our reported revenue for Trajenta and Jardiance may be reduced by any performance payments we make related to these products. Similarly, performance payments we may receive related to Basaglar effectively reduce Boehringer Ingelheim's share of the gross margin, which reduces our cost of sales.

The following table summarizes our collaboration and other revenue recognized with respect to the Trajenta and Jardiance families of products and net product revenue recognized with respect to Basaglar:

	2017	2016	2015
Trajenta	**$ 537.9**	$ 436.6	$ 356.8
Jardiance	**447.5**	201.9	60.2
Basaglar	**432.1**	86.1	11.1

Erbitux

We have several collaborations with respect to Erbitux. The most significant collaborations are or, where applicable, were in Japan, and prior to the transfer of commercialization rights in the fourth quarter of 2015, North America (Bristol-Myers Squibb Company); and worldwide except North America (Merck KGaA). Certain rights to Erbitux outside North America will remain with Merck KGaA (Merck) upon expiration of that agreement.

The following table summarizes our revenue recognized with respect to Erbitux:

	2017	2016	2015
Net product revenue - BMS	**$ —**	$ —	$ 23.3
Net product revenue - third party	**548.2**	587.0	152.3
Collaboration and other revenue	**97.7**	100.0	309.4
Revenue	**$ 645.9**	$ 687.0	$ 485.0

Bristol-Myers Squibb Company

Pursuant to commercial agreements with BMS, we had been co-developing Erbitux in North America exclusively with BMS. On October 1, 2015, BMS transferred their commercialization rights to us with respect to Erbitux in North America pursuant to a modification of our existing arrangement, and we began selling Erbitux at that time. This modification did not affect our rights with respect to Erbitux in other jurisdictions. In connection with the modification of terms, we provide consideration to BMS based upon a tiered percentage of net sales of Erbitux in North America estimated to average 38 percent through September 2018. The transfer of the commercialization rights was accounted for as an acquisition of a business. The consideration to be paid to BMS was accounted for as contingent consideration liability. See Note 7 for discussion regarding the estimation of this liability.

The following table summarizes the amounts recognized for assets acquired and liabilities assumed as of the acquisition date:

Estimated Fair Value at October 1, 2015	
Marketed products[1]	$ 602.1
Deferred tax asset	232.2
Deferred tax liability	(228.2)
Other assets and liabilities - net	57.2
Total identifiable net assets	$ 663.3
Total consideration - contingent consideration liability[2]	$ (663.3)

[1] These intangible assets are being amortized to cost of sales using the straight-line method through the co-development period in North America as set forth in the original agreement, which was scheduled to expire in September 2018.

[2] See Note 7 for discussion on the estimation of the contingent consideration liability.

Including the Erbitux business as if we had acquired it on January 1, 2015, our combined consolidated unaudited pro forma revenue and total Erbitux revenue would have been approximately $20.2 billion and $735 million, respectively, for the year ended December 31, 2015. This unaudited pro forma financial information adjusts the historical consolidated revenue to give effect to pro forma events that are directly attributable to the acquisition. There would have been no material change to our historical consolidated net income. The unaudited pro forma financial information is not necessarily indicative of what our consolidated revenues would have been had we completed the acquisition on January 1, 2015. In addition, the unaudited pro forma financial information does not attempt to project the future results of operations of our combined company.

Merck KGaA

A development and license agreement grants Merck exclusive rights to market Erbitux outside of North America until December 2018. A separate agreement grants co-exclusive rights among Merck, BMS, and us in Japan and expires in 2032. This agreement was amended in 2015 to grant Merck exclusive commercialization rights in Japan but did not result in any changes to our rights.

Merck manufactures Erbitux for supply in its territory as well as for Japan. We receive a royalty on the sales of Erbitux outside of North America, which is included in collaboration and other revenue as the underlying sales occur. Royalties due to third parties are recorded as a reduction of collaboration and other revenue, net of any royalty reimbursements due from third parties.

Effient®

We are in a collaborative arrangement with Daiichi Sankyo Co., Ltd. (Daiichi Sankyo) to develop, market, and promote Effient. Marketing rights for major territories are shown below. We and Daiichi Sankyo each have exclusive marketing rights in certain other territories.

Territory	Marketing Rights	Selling Party
U.S.	Co-promotion	Lilly
Major European markets	Co-promotion	Pre-January 1, 2016, Lilly Post-January 1, 2016, Daiichi Sankyo
Japan	Exclusive	Daiichi Sankyo

Beginning January 1, 2016, while major European markets continue to be a co-promotion territory under the terms of our arrangement, Daiichi Sankyo exclusively promotes Effient in these markets. The economic results for the major European markets continue to be shared in the same proportion as they were previously.

The parties share approximately 50/50 in the profits, as well as in the costs of development and marketing in the co-promotion territories. A third party manufactures bulk product, and we continue to produce the finished product for our exclusive and co-promotion territories, including the major European markets.

We record net product revenue in our exclusive and co-promotion territories where we are the selling party. Profit-share payments due to Daiichi Sankyo for co-promotion countries where we are the selling party are recorded as marketing, selling, and administrative expenses. Beginning January 1, 2016, any profit-share payments due to us from Daiichi Sankyo for the major European markets are recorded as collaboration and other revenue. We also record our share of the expenses in these co-promotion territories as marketing, selling, and administrative expenses. In our exclusive territories, we pay Daiichi Sankyo a royalty specific to these territories. All royalties due to Daiichi Sankyo and the third-party manufacturer are recorded in cost of sales. Generic versions of Effient launched in the U.S. in the third quarter of 2017.

The following table summarizes our revenue recognized with respect to Effient:

	2017	2016	2015
Revenue	**$ 388.9**	$ 535.2	$ 523.0

Olumiant®

We have a worldwide license and collaboration agreement with Incyte Corporation (Incyte) which provides us the development and commercialization rights to its Janus tyrosine kinase inhibitor compound, now known as baricitinib (trade name Olumiant**)**, and certain follow-on compounds, for the treatment of inflammatory and autoimmune diseases. Incyte has the right to receive tiered, double-digit royalty payments on future global sales with rates ranging up to 20 percent if the product is successfully commercialized. The agreement provides Incyte with options to co-develop these compounds on an indication-by-indication basis by funding 30 percent of the associated development costs from the initiation of a Phase IIb trial through regulatory approval in exchange for increased tiered royalties ranging up to percentages in the high twenties. Incyte exercised its option to co-develop Olumiant in rheumatoid arthritis in 2010 and psoriatic arthritis and atopic dermatitis in 2017. The agreement calls for payments by us to Incyte associated with certain development, success-based regulatory, and sales-based milestones. In 2016, we incurred milestone-related expenses of $55.0 million in connection with regulatory submissions in the U.S. and Europe, which were recorded as research and development expense. In 2017, we capitalized as intangible assets $65.0 million and $15.0 million of milestones in connection with regulatory approvals in Europe and Japan, respectively, which are being amortized to cost of sales over the term of the collaboration. As a result of the molecule moving into Phase III testing for the atopic dermatitis indication, we incurred a $30.0 million developmental milestone, which was recorded as research and development expense in the fourth quarter of 2017. After receipt of this milestone payment, Incyte will be eligible to receive up to $250.0 million of additional payments from us contingent upon certain development and success-based regulatory milestones, of which $100.0 million relates to the U.S. regulatory decision for a first indication. Incyte is also eligible to receive up to $150.0 million of potential sales-based milestones.

Tanezumab

We have a collaboration agreement with Pfizer Inc. (Pfizer) to jointly develop and globally commercialize tanezumab for the treatment of osteoarthritis pain, chronic low back pain and cancer pain. Under the agreement, the companies share equally the ongoing development costs and, if successful, in gross margins and certain commercialization expenses. Following the U.S. Food and Drug Administration's (FDA's) decision in March 2015 to lift the partial clinical hold on tanezumab, certain Phase III trials resumed in July 2015. Upon the FDA's lifting of the partial clinical hold and the decision to continue the collaboration with Pfizer, we paid an upfront fee of $200.0 million, which was expensed as acquired IPR&D. As of December 31, 2017, Pfizer is eligible to receive up to $350.0 million in success-based regulatory milestones and up to $1.23 billion in a series of sales-based milestones, contingent upon the commercial success of tanezumab.

Lanabecestat

We have a collaboration agreement with AstraZeneca for the worldwide co-development and co-commercialization of AstraZeneca’s lanabecestat, an oral beta-secretase cleaving enzyme (BACE) inhibitor being investigated for the potential treatment of Alzheimer’s disease. We are responsible for leading development efforts, while AstraZeneca will be responsible for manufacturing efforts. If successful, both parties will take joint responsibility for commercialization. Under the agreement, both parties share equally in the ongoing development costs and, if successful, in gross margins and certain other costs associated with commercialization of the molecule. As a result of the molecule moving into Phase III testing, we incurred a $100.0 million developmental milestone, which was recorded as research and development expense in 2016. In 2017, as a result of the outcome of an interim analysis, we incurred a $50.0 million developmental milestone, which was recorded as research and development expense. As of December 31, 2017, AstraZeneca is eligible to receive up to $300.0 million of additional payments from us contingent upon the achievement of certain development and success-based regulatory milestones.

Note 5: Asset Impairment, Restructuring, and Other Special Charges

The components of the charges included in asset impairment, restructuring, and other special charges in our consolidated statements of operations are described below.

	2017	2016	2015
Severance:			
Human pharmaceutical products	**$ 601.0**	$ 85.9	$ 81.5
Animal health products	**96.4**	40.8	59.5
Total severance	**697.4**	126.7	141.0
Pension and post-retirement medical charges associated with U.S. early retirement program (see Note 14):			
Human pharmaceutical products	**446.7**	—	—
Animal health products	**67.0**	—	—
Total pension and post-retirement medical charges associated with U.S. early retirement program	**513.7**	—	—
Asset impairment (gains from facility sales) and other special charges:			
Human pharmaceutical products	**81.7**	(13.0)	24.6
Animal health products	**380.8**	268.8	202.1
Total asset impairment and other special charges	**462.5**	255.8	226.7
Total asset impairment, restructuring, and other special charges	**$ 1,673.6**	$ 382.5	$ 367.7

Severance costs recognized during the years ended December 31, 2017, 2016 and 2015 were incurred as a result of actions taken to reduce our cost structure, including severance costs recognized in 2017 associated with the U.S. voluntary early retirement program, as well as the integration of Novartis AH. During 2017, severance costs recognized in the U.S. and outside the U.S. were $412.5 million and $284.9 million, respectively. In relation to these charges, we paid approximately $300 million of the U.S. charges through January 31, 2018, and paid approximately half of the charges incurred outside the U.S. in 2017. Substantially all of the severance costs incurred during the year ended December 31, 2017 are expected to be paid in the next 12 months.

Asset impairment and other special charges related to animal health products recognized during the year ended December 31, 2017 resulted primarily from asset impairments related to lower projected revenue for Posilac® (rbST). The assets associated with Posilac were written down to their fair values, which were determined based upon a discounted cash flow valuation. Impairment charges were recorded for the associated fixed assets and intangible asset of $151.5 million and $50.0 million, respectively. We are exploring strategic options for Posilac, including seeking a buyer for the molecule and its Augusta, Georgia manufacturing site. The remaining book value of assets associated with Posilac subsequent to the impairment charge is not material. In addition, we incurred approximately $43.4 million of costs associated with the temporary shut down of our Puerto Rico facility following Hurricane Maria. The remaining asset impairment and other special charges recognized in 2017 were primarily related to integration costs and asset impairments due to product rationalizations and site closures resulting from our acquisition and integration of Novartis AH (refer to Note 8 for further detail relating to intangible asset impairments).

Asset impairment and other special charges recognized during the years ended December 31, 2016 and 2015 resulted primarily from integration costs and asset impairments due to product rationalization and site closures resulting from our acquisition and integration of Novartis AH, including the closure of a manufacturing facility in Ireland in 2016.

Note 6: Inventories

We state all inventories at the lower of cost or market. We use the last-in, first-out (LIFO) method for the majority of our inventories located in the continental U.S. Other inventories are valued by the first-in, first-out (FIFO) method. FIFO cost approximates current replacement cost.

Inventories at December 31 consisted of the following:

	2017	2016
Finished products	**$ 1,211.4**	$ 987.3
Work in process	**2,697.7**	2,117.2
Raw materials and supplies	**488.8**	435.3
Total (approximates replacement cost)	**4,397.9**	3,539.8
Increase to LIFO cost	**60.4**	22.1
Inventories	**$ 4,458.3**	$ 3,561.9

Inventories valued under the LIFO method comprised $1.56 billion and $1.43 billion of total inventories at December 31, 2017 and 2016, respectively.

Note 7: Financial Instruments

Financial instruments that potentially subject us to credit risk consist principally of trade receivables and interest-bearing investments. Wholesale distributors of life-science products account for a substantial portion of our trade receivables; collateral is generally not required. The risk associated with this concentration is mitigated by our ongoing credit-review procedures and insurance. A large portion of our cash is held by a few major financial institutions. We monitor our exposures with these institutions and do not expect any of these institutions to fail to meet their obligations. Major financial institutions represent the largest component of our investments in corporate debt securities. In accordance with documented corporate risk-management policies, we monitor the amount of credit exposure to any one financial institution or corporate issuer. We are exposed to credit-related losses in the event of nonperformance by counterparties to risk-management instruments but do not expect any counterparties to fail to meet their obligations given their high credit ratings.

We consider all highly liquid investments with a maturity of three months or less from the date of purchase to be cash equivalents. The cost of these investments approximates fair value.

Substantially all of our investments in debt and marketable equity securities are classified as available-for-sale. Investment securities with maturity dates of less than one year from the date of the balance sheet are classified as short-term. Available-for-sale securities are carried at fair value with the unrealized gains and losses, net of tax, reported in other comprehensive income (loss). The credit portion of unrealized losses on our debt securities considered to be other-than-temporary is recognized in earnings. The remaining portion of the other-than-temporary impairment on our debt securities is then recorded, net of tax, in other comprehensive income (loss). The entire amount of other-than-temporary impairment on our equity securities is recognized in earnings. We do not evaluate cost-method investments for impairment unless there is an indicator of impairment. We review these investments for indicators of impairment on a regular basis.

Investments in companies over which we have significant influence but not a controlling interest are accounted for using the equity method with our share of earnings or losses reported in other–net, (income) expense. We own no investments that are considered to be trading securities.

Our derivative activities are initiated within the guidelines of documented corporate risk-management policies and offset losses and gains on the assets, liabilities, and transactions being hedged. Management reviews the correlation and effectiveness of our derivatives on a quarterly basis.

For derivative instruments that are designated and qualify as fair value hedges, the derivative instrument is marked to market with gains and losses recognized currently in income to offset the respective losses and gains recognized on the underlying exposure. For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of gains and losses is reported as a component of AOCL and reclassified into earnings in the same period the hedged transaction affects earnings. For derivative and non-derivative instruments that are designated and qualify as net investment hedges, the effective portion of foreign currency translation gains or losses due to spot rate fluctuations are reported as a component of

AOCL. Hedge ineffectiveness is immediately recognized in earnings. Derivative contracts that are not designated as hedging instruments are recorded at fair value with the gain or loss recognized in current earnings during the period of change.

We may enter into foreign currency forward or option contracts to reduce the effect of fluctuating currency exchange rates (principally the euro, British pound, and the Japanese yen). Foreign currency derivatives used for hedging are put in place using the same or like currencies and duration as the underlying exposures. Forward and option contracts are principally used to manage exposures arising from subsidiary trade and loan payables and receivables denominated in foreign currencies. These contracts are recorded at fair value with the gain or loss recognized in other–net, (income) expense. We may enter into foreign currency forward and option contracts and currency swaps as fair value hedges of firm commitments. Forward contracts generally have maturities not exceeding 12 months. At December 31, 2017, we had outstanding foreign currency forward commitments to purchase 2.92 billion U.S. dollars and sell 2.46 billion euro; commitments to purchase 2.83 billion euro and sell 3.36 billion U.S. dollars; commitments to purchase 355.6 million British pounds and sell 476.1 million U.S. dollars; commitments to purchase 257.8 million U.S. dollars and sell 192.6 million British pounds, commitments to purchase 393.1 million U.S. dollars and sell 44.41 billion Japanese yen, and commitments to purchase 147.8 million Swiss francs and sell 150.2 million U.S. dollars, which will all settle within 30 days.

Foreign currency exchange risk is also managed through the use of foreign currency debt and cross-currency interest rate swaps. Our foreign currency-denominated notes had carrying amounts of $3.70 billion and $3.34 billion as of December 31, 2017 and 2016, respectively, have been designated as, and are effective as, economic hedges of net investments in certain of our euro-denominated and Swiss franc-denominated foreign operations. Our cross-currency interest rate swaps that convert a portion of our U.S. dollar-denominated floating rate debt to euro-denominated floating rate debt have also been designated as, and are effective as, economic hedges of net investments in certain of our euro-denominated foreign operations.

In the normal course of business, our operations are exposed to fluctuations in interest rates which can vary the costs of financing, investing, and operating. We address a portion of these risks through a controlled program of risk management that includes the use of derivative financial instruments. The objective of controlling these risks is to limit the impact of fluctuations in interest rates on earnings. Our primary interest-rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest-rate exposures, we strive to achieve an acceptable balance between fixed- and floating-rate debt and investment positions and may enter into interest rate swaps or collars to help maintain that balance.

Interest rate swaps or collars that convert our fixed-rate debt to a floating rate are designated as fair value hedges of the underlying instruments. Interest rate swaps or collars that convert floating-rate debt to a fixed rate are designated as cash flow hedges. Interest expense on the debt is adjusted to include the payments made or received under the swap agreements. Cash proceeds from or payments to counterparties resulting from the termination of interest rate swaps are classified as operating activities in our consolidated statements of cash flows. At December 31, 2017, substantially all of our total long-term debt is at a fixed rate. We have converted approximately 28 percent of our long-term fixed-rate notes to floating rates through the use of interest rate swaps.

We may enter into forward contracts and designate them as cash flow hedges to limit the potential volatility of earnings and cash flow associated with forecasted sales of available-for-sale securities.

We also may enter into forward-starting interest rate swaps, which we designate as cash flow hedges, as part of any anticipated future debt issuances in order to reduce the risk of cash flow volatility from future changes in interest rates. Upon completion of a debt issuance and termination of the swap, the change in fair value of these instruments is recorded as part of other comprehensive income (loss) and is amortized to interest expense over the life of the underlying debt.

The Effect of Risk Management Instruments on the Consolidated Statements of Operations

The following effects of risk-management instruments were recognized in other–net, (income) expense:

	2017	2016	2015
Fair value hedges:			
Effect from hedged fixed-rate debt	**$ (14.1)**	$ (30.8)	$ (11.9)
Effect from interest rate contracts	**14.1**	30.8	11.9
Cash flow hedges:			
Effective portion of losses on interest rate contracts reclassified from accumulated other comprehensive loss	**14.8**	15.0	13.7
Net (gains) losses on foreign currency exchange contracts not designated as hedging instruments	**97.9**	78.8	(28.2)

During the years ended December 31, 2017, 2016, and 2015, net losses related to ineffectiveness, as well as net losses related to the portion of our risk-management hedging instruments, fair value hedges, and cash flow hedges that were excluded from the assessment of effectiveness, were not material.

The Effect of Risk-Management Instruments on Other Comprehensive Income (Loss)

The effective portion of risk-management instruments that was recognized in other comprehensive income (loss) is as follows:

	2017	2016	2015
Cash flow hedges:			
Forward-starting interest rate swaps	**13.0**	(3.4)	(56.7)
Net investment hedges:			
Foreign currency-denominated notes	**(361.5)**	137.5	—
Cross-currency interest rate swaps	**(126.6)**	32.5	—
Foreign currency exchange contracts	**—**	31.9	—

Fair Value Hedges

There were no material terminations of interest rate swaps in 2017 and 2016. During the year ended December 31, 2015, we terminated certain interest rate swaps designated as fair value hedges with an aggregate notional amount of $876.0 million. The termination of certain interest rate swaps in 2015 was in connection with the note purchase and redemption discussed in Note 10. As a result of the terminations, we received cash of $20.2 million, which represented the fair value of the interest rate swaps at the time of termination. The related fair value adjustment was recorded as an increase to the carrying value of the underlying notes and was included as a component of the debt extinguishment loss.

Cash Flow Hedges

Upon issuance of the underlying fixed-rate notes in March 2015, which are discussed in Note 10, we terminated forward-starting interest rate contracts in designated cash flow hedging instruments with an aggregate notional amount of $1.35 billion and paid $206.3 million in cash to the counterparties for settlement. The settlement amount represented the fair value of the forward-starting interest rate contracts at the time of termination and was recorded in other comprehensive income (loss).

During the next 12 months, we expect to reclassify $14.8 million of pretax net losses on cash flow hedges from AOCL to other–net, (income) expense.

Fair Value of Financial Instruments

The following tables summarize certain fair value information at December 31 for assets and liabilities measured at fair value on a recurring basis, as well as the carrying amount and amortized cost of certain other investments:

Description	Carrying Amount	Cost[1]	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
December 31, 2017						
Cash equivalents	**$ 4,763.9**	**$ 4,763.9**	**$ 4,712.4**	**$ 51.5**	**$ —**	**$ 4,763.9**
Short-term investments:						
U.S. government and agency securities	**$ 217.8**	**$ 218.2**	**$ 217.8**	**$ —**	**$ —**	**$ 217.8**
Corporate debt securities	**1,182.3**	**1,183.2**	**—**	**1,182.3**	**—**	**1,182.3**
Asset-backed securities	**94.2**	**94.3**	**—**	**94.2**	**—**	**94.2**
Other securities	**3.6**	**3.6**	**—**	**3.6**	**—**	**3.6**
Short-term investments	**$ 1,497.9**					
Noncurrent investments:						
U.S. government and agency securities	**$ 360.0**	**$ 365.0**	**$ 360.0**	**$ —**	**$ —**	**$ 360.0**
Corporate debt securities	**3,464.3**	**3,473.5**	**—**	**3,464.3**	**—**	**3,464.3**
Mortgage-backed securities	**202.4**	**204.2**	**—**	**202.4**	**—**	**202.4**
Asset-backed securities	**653.9**	**656.0**	**—**	**653.9**	**—**	**653.9**
Other securities	**132.1**	**66.4**	**—**	**—**	**132.1**	**132.1**
Marketable equity securities	**281.3**	**131.0**	**281.3**	**—**	**—**	**281.3**
Cost and equity method investments[2]	**584.8**					
Noncurrent investments	**$ 5,678.8**					
December 31, 2016						
Cash equivalents	$ 2,986.8	$ 2,986.8	$ 2,699.4	$ 287.4	$ —	$ 2,986.8
Short-term investments:						
U.S. government and agency securities	$ 232.5	$ 232.6	$ 232.5	$ —	$ —	$ 232.5
Corporate debt securities	1,219.2	1,219.1	—	1,219.2	—	1,219.2
Asset-backed securities	4.3	4.3	—	4.3	—	4.3
Other securities	0.5	0.5	—	0.5	—	0.5
Short-term investments	$ 1,456.5					
Noncurrent investments:						
U.S. government and agency securities	$ 318.9	$ 323.8	$ 318.9	$ —	$ —	$ 318.9
Corporate debt securities	3,062.2	3,074.3	—	3,062.2	—	3,062.2
Mortgage-backed securities	183.1	185.4	—	183.1	—	183.1
Asset-backed securities	502.7	503.5	—	502.7	—	502.7
Other securities	153.7	77.6	—	—	153.7	153.7
Marketable equity securities	418.2	91.9	418.2	—	—	418.2
Cost and equity method investments[2]	568.7					
Noncurrent investments	$ 5,207.5					

[1] For available-for-sale debt securities, amounts disclosed represent the securities' amortized cost.

[2] Fair value disclosures are not applicable for cost method and equity method investments.

Description	Carrying Amount	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements Using: Significant Other Observable Inputs (Level 2)	Fair Value Measurements Using: Significant Unobservable Inputs (Level 3)	Fair Value
Short-term commercial paper borrowings					
December 31, 2017	**$ (2,696.8)**	**$ —**	**$ (2,690.6)**	**$ —**	**$ (2,690.6)**
December 31, 2016	(1,299.3)	—	(1,299.3)	—	(1,299.3)
Long-term debt, including current portion					
December 31, 2017	**$ (10,950.3)**	**$ —**	**$ (11,529.9)**	**$ —**	**$(11,529.9)**
December 31, 2016	(9,005.9)	—	(9,419.1)	—	(9,419.1)

Description	Carrying Amount	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
December 31, 2017					
Risk-management instruments					
Interest rate contracts designated as fair value hedges:					
Other receivables	**$ 0.8**	**$ —**	**$ 0.8**	**$ —**	**$ 0.8**
Sundry	**35.1**	**—**	**35.1**	**—**	**35.1**
Other current liabilities	**(0.2)**	**—**	**(0.2)**	**—**	**(0.2)**
Other noncurrent liabilities	**(10.5)**	**—**	**(10.5)**	**—**	**(10.5)**
Cross-currency interest rate contracts designated as net investment hedges:					
Other current liabilities	**(33.4)**	**—**	**(33.4)**	**—**	**(33.4)**
Other noncurrent liabilities	**(26.0)**	**—**	**(26.0)**	**—**	**(26.0)**
Foreign exchange contracts not designated as hedging instruments:					
Other receivables	**26.8**	**—**	**26.8**	**—**	**26.8**
Other current liabilities	**(36.0)**	**—**	**(36.0)**	**—**	**(36.0)**
Contingent consideration liabilities[(1)]:					
Other current liabilities	**(208.0)**	**—**	**—**	**(208.0)**	**(208.0)**
Other noncurrent liabilities	**(45.2)**	**—**	**—**	**(45.2)**	**(45.2)**
December 31, 2016					
Risk-management instruments					
Interest rate contracts designated as fair value hedges:					
Other receivables	$ 2.4	$ —	$ 2.4	$ —	$ 2.4
Sundry	37.0	—	37.0	—	37.0
Other noncurrent liabilities	(0.5)	—	(0.5)	—	(0.5)
Cross-currency interest rate contracts designated as net investment hedges:					
Sundry	31.4	—	31.4	—	31.4
Foreign exchange contracts not designated as hedging instruments:					
Other receivables	31.8	—	31.8	—	31.8
Other current liabilities	(21.7)	—	(21.7)	—	(21.7)
Contingent consideration liabilities[(1)]:					
Other current liabilities	(215.9)	—	—	(215.9)	(215.9)
Other noncurrent liabilities	(242.6)	—	—	(242.6)	(242.6)

[(1)] Contingent consideration liabilities primarily relate to the Erbitux arrangement with BMS discussed in Note 4.

Risk-management instruments above are disclosed on a gross basis. There are various rights of setoff associated with certain of the risk-management instruments above that are subject to an enforceable master netting arrangement or similar agreements. Although various rights of setoff and master netting arrangements or similar agreements may exist with the individual counterparties to the risk-management instruments above, individually, these financial rights are not material.

We determine our Level 1 and Level 2 fair value measurements based on a market approach using quoted market values, significant other observable inputs for identical or comparable assets or liabilities, or discounted cash flow analyses. Level 3 fair value measurements for other investment securities are determined using unobservable inputs, including the investments' cost adjusted for impairments and price

changes from orderly transactions. The fair values of cost and equity method investments are not readily available.

Contingent consideration liabilities primarily include contingent consideration related to Erbitux for which the fair value was estimated using a discounted cash flow analysis and Level 3 inputs, including projections representative of a market participant view for net sales in North America through September 2018 and an estimated discount rate. The amount to be paid is calculated as a tiered percentage of net sales (see Note 4) and will, therefore, vary directly with increases and decreases in net sales of Erbitux in North America. There is no cap on the amount that may be paid pursuant to this arrangement. The decrease in the fair value of the contingent consideration liabilities during the years ended December 31, 2017 and 2016 was due primarily to cash payments of $203.9 million and $231.0 million, respectively, related to Erbitux. The change in the fair value of the contingent consideration liabilities recognized in earnings during the years ended December 31, 2017, 2016, and 2015 due to changes in time value of money was not material.

The table below summarizes the contractual maturities of our investments in debt securities measured at fair value as of December 31, 2017:

	Maturities by Period				
	Total	Less Than 1 Year	1-5 Years	6-10 Years	More Than 10 Years
Fair value of debt securities	$ 6,174.9	$ 1,494.3	$ 4,200.8	$ 199.0	$ 280.8

A summary of the fair value of available-for-sale securities in an unrealized gain or loss position and the amount of unrealized gains and losses (pretax) in AOCL follows:

	2017	2016
Unrealized gross gains	**$ 184.7**	$ 352.6
Unrealized gross losses	**47.5**	34.1
Fair value of securities in an unrealized gain position	**1,434.2**	1,869.7
Fair value of securities in an unrealized loss position	**4,692.8**	3,262.3

We periodically assess our investment securities for other-than-temporary impairment losses. There were no other-than-temporary impairment losses recognized in 2017. Other-than-temporary impairment losses recognized during the year ended December 31, 2016 and December 31, 2015 totaled $53.0 million and $42.6 million, respectively. Other-than-temporary impairment losses recognized during these years related primarily to our cost and equity method investments.

For fixed-income securities, the amount of credit losses are determined by comparing the difference between the present value of future cash flows expected to be collected on these securities and the amortized cost. Factors considered in assessing credit losses include the position in the capital structure, vintage and amount of collateral, delinquency rates, current credit support, and geographic concentration.

For equity securities, factors considered in assessing other-than-temporary impairment losses include the length of time and the extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, our intent and ability to retain the securities for a period of time sufficient to allow for recovery in fair value, and general market conditions and industry specific factors.

As of December 31, 2017, the securities in an unrealized loss position include primarily fixed-rate debt securities of varying maturities, which are sensitive to changes in the yield curve and other market conditions. Approximately 95 percent of the fixed-rate debt securities in a loss position are investment-grade debt securities. As of December 31, 2017, we do not intend to sell, and it is not more likely than not that we will be required to sell, the securities in a loss position before the market values recover or the underlying cash flows have been received, and there is no indication of default on interest or principal payments for any of our debt securities.

Activity related to our investment portfolio, substantially all of which related to available-for-sale securities, was as follows:

	2017	2016	2015
Proceeds from sales	**$ 5,769.3**	$ 3,240.5	$ 4,733.3
Realized gross gains on sales	**176.0**	30.7	255.1
Realized gross losses on sales	**5.8**	14.6	10.3

Realized gains and losses on sales of investments are computed based upon specific identification of the initial cost adjusted for any other-than-temporary declines in fair value that were recorded in earnings.

Accounts Receivable Factoring Arrangements

We have entered into accounts receivable factoring agreements with financial institutions to sell certain of our non-U.S. accounts receivable. These transactions are accounted for as sales and result in a reduction in accounts receivable because the agreements transfer effective control over and risk related to the receivables to the buyers. Our factoring agreements do not allow for recourse in the event of uncollectibility, and we do not retain any interest in the underlying accounts receivable once sold. We derecognized $723.2 million and $661.6 million of accounts receivable as of December 31, 2017 and 2016, respectively, under these factoring arrangements. The cost of factoring such accounts receivable on our consolidated results of operations for the years ended December 31, 2017, 2016, and 2015 was not material.

Note 8: Goodwill and Other Intangibles

Goodwill

Goodwill by segment at December 31 was as follows:

	2017	2016
Human pharmaceutical products	**$ 1,366.8**	$ 1,366.4
Animal health	**3,003.3**	2,606.3
Total goodwill	**$ 4,370.1**	$ 3,972.7

Goodwill results from excess consideration in a business combination over the fair value of identifiable net assets acquired. Goodwill is not amortized but is reviewed for impairment at least annually and when impairment indicators are present. When required, a comparison of the fair value of the reporting unit to its carrying amount including goodwill is used to determine the amount of any impairment. See Note 3 for discussion of goodwill resulting from the acquisition of BIVIP. The remaining change in goodwill for the animal health segment is the result of foreign exchange translation adjustments.

No impairments occurred with respect to the carrying value of goodwill for the years ended December 31, 2017, 2016, and 2015.

Other Intangibles

The components of intangible assets other than goodwill at December 31 were as follows:

Description	2017 Carrying Amount, Gross	2017 Accumulated Amortization	2017 Carrying Amount, Net	2016 Carrying Amount, Gross	2016 Accumulated Amortization	2016 Carrying Amount, Net
Finite-lived intangible assets:						
Marketed products	**$ 7,682.0**	**$ (3,851.1)**	**$ 3,830.9**	$ 7,400.2	$ (3,301.4)	$ 4,098.8
Other	**171.2**	**(70.1)**	**101.1**	150.7	(71.8)	78.9
Total finite-lived intangible assets	**7,853.2**	**(3,921.2)**	**3,932.0**	7,550.9	(3,373.2)	4,177.7
Indefinite-lived intangible assets:						
Acquired in-process research and development	**97.2**	**—**	**97.2**	180.2	—	180.2
Other intangibles	**$ 7,950.4**	**$ (3,921.2)**	**$ 4,029.2**	$ 7,731.1	$ (3,373.2)	$ 4,357.9

Marketed products consist of the amortized cost of the rights to assets acquired in business combinations and approved for marketing in a significant global jurisdiction (U.S., Europe, and Japan) and capitalized milestone payments. For transactions other than a business combination, we capitalize milestone payments incurred at or after the product has obtained regulatory approval for marketing.

Other finite-lived intangibles consist primarily of the amortized cost of licensed platform technologies that have alternative future uses in research and development, manufacturing technologies, and customer relationships from business combinations.

Acquired IPR&D consists of the related costs capitalized, adjusted for subsequent impairments, if any. The costs of acquired IPR&D projects acquired directly in a transaction other than a business combination are capitalized if the projects have an alternative future use; otherwise, they are expensed immediately. The fair values of acquired IPR&D projects acquired in business combinations are capitalized as other intangible assets.

Several methods may be used to determine the estimated fair value of other intangibles acquired in a business combination. We utilize the “income method,” which is a Level 3 fair value measurement and applies a probability weighting that considers the risk of development and commercialization to the estimated future net cash flows that are derived from projected revenues and estimated costs. These projections are based on factors such as relevant market size, patent protection, historical pricing of similar products, and expected industry trends. The estimated future net cash flows are then discounted to the present value using an appropriate discount rate. This analysis is performed for each asset independently. The acquired IPR&D assets are treated as indefinite-lived intangible assets until completion or abandonment of the projects, at which time the assets are tested for impairment and amortized over the remaining useful life or written off, as appropriate.

See Note 3 for further discussion of intangible assets acquired in the acquisition of BIVIP and Note 4 for additional discussion of recent capitalized milestone payments.

Other indefinite-lived intangible assets are reviewed for impairment at least annually and when impairment indicators are present. Finite-lived intangible assets are reviewed for impairment when an indicator of impairment is present. When required, a comparison of fair value to the carrying amount of assets is performed to determine the amount of any impairment. When determining the fair value of indefinite-lived acquired IPR&D as well as the fair value of finite-lived intangible assets for impairment testing purposes, we utilize the "income method" discussed above. During the year, we had animal health intangible impairment charges of $135.5 million (comprised of $97.5 million impairment of finite-lived intangible assets and $38.0 million impairment of indefinite-lived intangible assets) charged to asset impairment, restructuring and other special charges on the consolidated statements of operations. These impairments were related to competitive pressures for certain companion animal products resulting in a reduction of revenue, as well as lower

projected revenue for Posilac (rbST). No material impairments occurred with respect to the carrying value of other intangible assets for the years ended December 31, 2016 and 2015.

Intangible assets with finite lives are capitalized and are amortized over their estimated useful lives, ranging from 3 to 20 years. As of December 31, 2017, the remaining weighted-average amortization period for finite-lived intangible assets is approximately 12 years.

Amortization expense related to finite-lived intangible assets was as follows:

	2017	2016	2015
Amortization expense	**$ 683.4**	$ 687.9	$ 631.8

The estimated amortization expense for each of the next five years associated with our finite-lived intangible assets as of December 31, 2017 is as follows:

	2018	2019	2020	2021	2022
Estimated amortization expense	$ 558.2	$ 352.2	$ 350.7	$ 349.0	$ 336.2

Amortization expense is included in either cost of sales, marketing, selling, and administrative or research and development depending on the nature of the intangible asset being amortized.

Note 9: Property and Equipment

Property and equipment is stated on the basis of cost. Provisions for depreciation of buildings and equipment are computed generally by the straight-line method at rates based on their estimated useful lives (12 to 50 years for buildings and 3 to 25 years for equipment). We review the carrying value of long-lived assets for potential impairment on a periodic basis and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Impairment is determined by comparing projected undiscounted cash flows to be generated by the asset to its carrying value. If an impairment is identified, a loss is recorded equal to the excess of the asset's net book value over its fair value, and the cost basis is adjusted.

At December 31, property and equipment consisted of the following:

	2017	2016
Land	**$ 192.7**	$ 197.6
Buildings	**7,425.6**	6,917.8
Equipment	**8,689.0**	7,864.7
Construction in progress	**1,783.8**	1,797.5
	18,091.1	16,777.6
Less accumulated depreciation	**(9,264.6)**	(8,525.0)
Property and equipment, net	**$ 8,826.5**	$ 8,252.6

Depreciation expense related to property and equipment and rental expense for all leases, including contingent rentals (not material), was as follows:

	2017	2016	2015
Depreciation expense	**$ 763.1**	$ 716.2	$ 717.6
Rental expense	**224.5**	221.0	225.7

The future minimum rental commitments under non-cancelable operating leases are as follows:

	2018	2019	2020	2021	2022	After 2022
Lease commitments	$ 130.8	$ 119.2	$ 105.7	$ 94.7	$ 77.1	$ 245.7

Capitalized interest costs were not material for the years ended December 31, 2017, 2016, and 2015.

Assets under capital leases included in property and equipment, net on the consolidated balance sheets, capital lease obligations entered into, and future minimum rental commitments are not material.

Note 10: Borrowings

Debt at December 31 consisted of the following:

	2017	2016
Short-term commercial paper borrowings	**$ 2,696.8**	$ 1,299.3
0.00 to 7.13 percent long-term notes (due 2018-2047)	**10,756.7**	8,776.5
Other long-term debt, including capitalized leases	**13.6**	14.4
Unamortized debt issuance costs	**(49.0)**	(37.5)
Fair value adjustment on hedged long-term notes	**229.0**	252.5
Total debt	**13,647.1**	10,305.2
Less current portion	**(3,706.6)**	(1,937.4)
Long-term debt	**$ 9,940.5**	$ 8,367.8

The weighted-average effective borrowing rate on outstanding commercial paper at December 31, 2017 was 1.34 percent.

At December 31, 2017, we had a total of $5.57 billion of unused committed bank credit facilities, which consisted primarily of a $1.20 billion credit facility that expires in August 2019 and a $3.80 billion 364-day facility that expires in December 2018, both of which are available to support our commercial paper program. There was $6.0 million outstanding under the revolving credit facilities as of December 31, 2017, and no amount was outstanding under these facilities as of December 31, 2016. Compensating balances and commitment fees are not material, and there are no conditions that are probable of occurring under which the lines may be withdrawn.

In May 2017, we issued $750.0 million of 2.35 percent fixed-rate notes due in May 2022, $750.0 million of 3.10 percent fixed-rate notes due in May 2027, and $750.0 million of 3.95 percent fixed-rate notes due in May 2047, with interest to be paid semi-annually. We are using the net proceeds of $2.23 billion from the sale of these notes for general corporate purposes, which may include the repayment of notes due in 2018 and 2019. Prior to such uses, we may temporarily invest the net proceeds in investment securities.

In May 2016, we issued Swiss franc-denominated notes consisting of Fr.200.0 million of 0.00 percent fixed-rate notes due in May 2018, Fr.600.0 million of 0.15 percent fixed-rate notes due in May 2024, and Fr.400.0 million of 0.45 percent fixed-rate notes due in May 2028, with interest to be paid annually. We used the net cash proceeds of the offering of $1.21 billion for general corporate purposes, which included the repayment at maturity of certain of our U.S. dollar denominated fixed-rate notes due March 2017.

In June 2015, we issued euro-denominated notes consisting of €600.0 million of 1.00 percent fixed-rate notes due in June 2022, €750.0 million of 1.63 percent fixed-rate notes due in June 2026, and €750.0 million of 2.13 percent fixed-rate notes due in June 2030 with interest to be paid annually. The net cash proceeds of the offering of $2.27 billion were used primarily to purchase and redeem certain higher interest rate U.S. dollar-denominated notes and to repay outstanding commercial paper. We paid $1.95 billion to purchase and redeem notes with an aggregate principal amount of $1.65 billion and a net carrying value of $1.78 billion in June 2015, resulting in a pretax debt extinguishment loss of $166.7 million, which was included in other–net, (income) expense in our consolidated statement of operations during the year ended December 31, 2015.

In March 2015, we issued $600.0 million of 1.25 percent fixed-rate notes due in March 2018, $800.0 million of 2.75 percent fixed-rate notes due in June 2025, and $800.0 million of 3.70 percent fixed-rate notes due in March 2045 with interest to be paid semi-annually. The proceeds from the issuance of the notes were used primarily to repay outstanding commercial paper issued in connection with our January 2015 acquisition of Novartis AH.

The aggregate amounts of maturities on long-term debt for the next five years are as follows:

	2018	2019	2020	2021	2022
Maturities on long-term debt	$1,008.8	$ 604.0	$ 2.7	$ 1.4	$1,467.4

We have converted approximately 28 percent of our long-term fixed-rate notes to floating rates through the use of interest rate swaps. The weighted-average effective borrowing rates based on long-term debt obligations and interest rates at December 31, 2017 and 2016, including the effects of interest rate swaps for hedged debt obligations, were 2.65 percent and 2.51 percent, respectively.

The aggregate amount of cash payments for interest on borrowings, net of capitalized interest, are as follows:

	2017	2016	2015
Cash payments for interest on borrowings	**$ 192.7**	$ 146.4	$ 129.6

In accordance with the requirements of derivatives and hedging guidance, the portion of our fixed-rate debt obligations that is hedged as a fair value hedge, is reflected in the consolidated balance sheets as an amount equal to the sum of the debt's carrying value plus the fair value adjustment representing changes in fair value of the hedged debt attributable to movements in market interest rates subsequent to the inception of the hedge.

Note 11: Stock-Based Compensation

Our stock-based compensation expense consists of performance awards (PAs), shareholder value awards (SVAs), and restricted stock units (RSUs). We recognize the fair value of stock-based compensation as expense over the requisite service period of the individual grantees, which generally equals the vesting period. We provide newly issued shares of our common stock and treasury stock to satisfy the issuance of PA, SVA, and RSU shares.

Stock-based compensation expense and the related tax benefits were as follows:

	2017	2016	2015
Stock-based compensation expense	**$ 281.3**	$ 255.3	$ 217.8
Tax benefit	**70.5**	89.4	76.2

At December 31, 2017, additional stock-based compensation awards may be granted under the 2002 Lilly Stock Plan for not more than 98.3 million shares.

Performance Award Program

PAs are granted to officers and management and are payable in shares of our common stock. The number of PA shares actually issued, if any, varies depending on the achievement of certain pre-established earnings-per-share targets over a two-year period. PA shares are accounted for at fair value based upon the closing stock price on the date of grant and fully vest at the end of the measurement period. The fair values of PAs granted for the years ended December 31, 2017, 2016, and 2015 were $73.54, $72.00, and $70.34, respectively. The number of shares ultimately issued for the PA program is dependent upon the earnings achieved during the vesting period. Pursuant to this program, approximately 1.3 million shares, 0.5 million shares, and 0.5 million shares were issued during the years ended December 31, 2017, 2016, and 2015, respectively. Approximately 0.8 million shares are expected to be issued in 2018. As of December 31, 2017, the total remaining unrecognized compensation cost related to nonvested PAs was $64.1 million, which will be amortized over the weighted-average remaining requisite service period of 12 months.

Shareholder Value Award Program

SVAs are granted to officers and management and are payable in shares of our common stock. The number of shares actually issued, if any, varies depending on our stock price at the end of the three-year vesting period compared to pre-established target stock prices. We measure the fair value of the SVA unit on the grant date using a Monte Carlo simulation model. The model utilizes multiple input variables that determine the probability of satisfying the market condition stipulated in the award grant and calculates the fair value of the award. Expected volatilities utilized in the model are based on implied volatilities from traded options on our stock, historical volatility of our stock price, and other factors. Similarly, the dividend yield is based on historical experience and our estimate of future dividend yields. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. The weighted-average fair values of the SVA units granted during the years ended December 31, 2017, 2016, and 2015 were $66.25, $48.68, and $54.81, respectively, determined using the following assumptions:

(Percents)	2017	2016	2015
Expected dividend yield	**2.50%**	2.00%	2.50%
Risk-free interest rate	**1.38**	0.92	0.79
Volatility	**22.91**	21.68	20.37

Pursuant to this program, approximately 1.1 million shares, 1.0 million shares, and 1.4 million shares were issued during the years ended December 31, 2017, 2016, and 2015, respectively. Approximately 0.7 million shares are expected to be issued in 2018. As of December 31, 2017, the total remaining unrecognized compensation cost related to nonvested SVAs was $55.5 million, which will be amortized over the weighted-average remaining requisite service period of 20 months.

Restricted Stock Units

RSUs are granted to certain employees and are payable in shares of our common stock. RSU shares are accounted for at fair value based upon the closing stock price on the date of grant. The corresponding expense is amortized over the vesting period, typically three years. The fair values of RSU awards granted during the years ended December 31, 2017, 2016, and 2015 were $72.47, $71.46, and $71.69, respectively. The number of shares ultimately issued for the RSU program remains constant with the exception of forfeitures. Pursuant to this program, 1.4 million, 1.3 million, and 0.9 million shares were granted and approximately 0.9 million, 0.6 million, and 0.9 million shares were issued during the years ended December 31, 2017, 2016, and 2015, respectively. Approximately 1.0 million shares are expected to be issued in 2018. As of December 31, 2017, the total remaining unrecognized compensation cost related to nonvested RSUs was $119.0 million, which will be amortized over the weighted-average remaining requisite service period of 23 months.

Note 12: Shareholders' Equity

During 2017, 2016, and 2015, we repurchased $359.8 million, $540.1 million and $749.5 million, respectively, of shares associated with our $5.00 billion share repurchase program announced in 2013. As of December 31, 2017, there were $2.05 billion of shares remaining in that program. A payment of $60.0 million was made in 2016 for shares repurchased in 2017.

We have 5.0 million authorized shares of preferred stock. As of December 31, 2017 and 2016, no preferred stock was issued.

We have an employee benefit trust that held 50.0 million shares of our common stock at both December 31, 2017 and 2016, to provide a source of funds to assist us in meeting our obligations under various employee benefit plans. The cost basis of the shares held in the trust was $3.01 billion at both December 31, 2017 and 2016, and is shown as a reduction of shareholders' equity. Any dividend transactions between us and the trust are eliminated. Stock held by the trust is not considered outstanding in the computation of EPS. The assets of the trust were not used to fund any of our obligations under these employee benefit plans during the years ended December 31, 2017, 2016, and 2015.

Note 13: Income Taxes

2017 Tax Act
In December 2017, the President of the U.S. signed into law the Tax Cuts and Jobs Act (2017 Tax Act). The 2017 Tax Act includes significant changes to the U.S. corporate income tax system, such as the reduction in the corporate income tax rate from 35 percent to 21 percent, transition to a territorial tax system, changes to business related exclusions, deductions and credits, and modifications to international tax provisions, including a one-time repatriation transition tax (also known as the 'Toll Tax') on unremitted foreign earnings.

GAAP requires that the income tax accounting effects from a change in tax laws or tax rates be recognized in continuing operations in the reporting period that includes the enactment date of the change. These effects include, among other things, re-measuring deferred tax assets and liabilities, evaluating deferred tax assets for valuation allowances, and assessing the impact of the Toll Tax and certain other provisions of the 2017 Tax Act. Our accounting for the tax effects of the enactment of the 2017 Tax Act was not complete as of December 31, 2017; however, in certain cases, as described below, we have made a reasonable estimate. In other cases, we have not been able to make a reasonable estimate and continued to account for those items based on our existing accounting model under ASC 740, *Income Taxes*, and the provisions of the tax laws that were in effect immediately prior to enactment. For the items for which we were able to determine a reasonable estimate, we recognized a provisional amount of $1.91 billion, which is included as a component of income tax expense from continuing operations. This amount represents approximately $3.6 billion attributable to the Toll Tax, partially offset by the changes in deferred taxes resulting from the transition to a U.S. territorial tax system, including the re-measurement of deferred taxes.

Our estimate of the impact of the 2017 Tax Act is based upon our analysis and interpretations of currently available information. Uncertainties remain regarding the impact of the 2017 Tax Act due to future regulatory and rulemaking processes, prospects of additional corrective or supplemental legislation, and potential trade or other litigation. These uncertainties, along with our completion of the calculations and potential changes in

our initial assumptions as new information becomes available, could cause the actual charge to ultimately differ materially from the provisional amount recorded in 2017 related to the enactment of the 2017 Tax Act.

We have included provisional amounts based upon reasonable estimates for the following:

- Toll Tax

  The 2017 Tax Act imposes a one-time Toll Tax on unremitted foreign earnings and profits (E&P) at two different tax rates, with a higher tax rate applied to amounts held in cash and liquid assets. We have not yet completed our calculations of the items composing the Toll Tax, including the total post-1986 E&P of our foreign subsidiaries and amounts held as cash and liquid assets; therefore, we recorded a provisional amount of federal and state income taxes based upon a reasonable estimate. The amount is also subject to change as we assimilate the new laws and subsequent regulations, interpretations, and guidance as they are issued. Additionally, companies have the option to elect to pay the Toll Tax in eight installments. Provisional amounts were recorded to short-term and long-term income tax payable; these amounts may change when the Toll Tax calculation is complete. The impact to state income tax expense is also subject to change based upon revisions ultimately made to the Toll Tax calculation, changes in our assumptions related to state taxation of the income used to calculate the Toll Tax, and future guidance that may be issued.

- Re-measurement of deferred tax assets and liabilities

  The 2017 Tax Act reduced the U.S. corporate income tax rate from 35 percent to 21 percent effective January 1, 2018. GAAP requires deferred tax assets and liabilities to be measured at the enacted tax rate expected to apply when these temporary differences are to be realized or settled. As a result, we determined the amount recorded to income tax expense in continuing operations by using temporary differences that approximated our deferred tax balances at the date of enactment considering any material transactions that occurred between the enactment date and December 31, 2017. We assessed the need for valuation allowances as a result of re-measuring existing temporary differences and considering tax attribute balances; changes recorded to valuation allowances are also reflected in income tax expense from continuing operations. Re-measurement of the deferred tax assets and liabilities in addition to assessment of valuation allowances is subject to uncertainties given that approximated balances were utilized for the enactment date and tax accounting method changes may be considered.

  Under GAAP, the effect of a change in tax law is recorded as a component of the income tax expense related to continuing operations in the period of enactment. Adjusting the deferred taxes for temporary differences that arose from items of income or loss that were originally recorded in other comprehensive income through continuing operations results in a disproportionate tax effect in AOCL. ASU 2018-02, *Income Statement-Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* allows companies to reclassify the stranded tax effects that result from the 2017 Tax Act from AOCL to retained earnings with early adoption permitted. We early adopted the standard and recorded a provisional amount (see Note 2).

- Unremitted foreign earnings, executive compensation, and uncertain tax positions

  A provisional amount was recorded to reflect foreign withholding taxes and state income taxes for future repatriation of non-indefinitely reinvested earnings; no additional amount was recorded for outside basis differences in our foreign subsidiaries. We have made assumptions related to the creditability of those foreign withholding taxes; therefore, these amounts may change upon completion of our calculations.

  The 2017 Tax Act includes changes to the taxation of executive compensation. We have recorded a provisional amount based upon our estimates, interpretations of the new law, and external guidance. The provisional amount recorded could change based upon revisions to any of those assumptions.

  Relative to the provisional amounts recorded as a result of the 2017 Tax Act, we also recorded a provisional amount related to changes in uncertain tax positions. Future changes to the provisional amounts recorded, in addition to future changes to income tax expense for items for which reasonable estimates were not made, could change the recorded amount. The estimates and

assumptions used to record a provisional amount for uncertain tax positions could also change upon completion of our calculations and upon revisions related to subsequent regulations, interpretations, and guidance, if and when issued.

We could not make a reasonable estimate; therefore, we did not record a provisional amount for the following items:

- The 2017 Tax Act includes an international tax provision for the taxation of Global Intangible Low-Taxed Income (GILTI) effective January 1, 2018. Questions have surfaced as to whether the income taxes related to GILTI should be recorded in the period the tax arises or whether deferred taxes should be established for basis differences that upon reversal might be subject to GILTI. ASC 740 does not provide clear guidance on this topic and companies are allowed to make an accounting policy election. We have recorded no provisional amount for GILTI deferred taxes as more time is needed to analyze the data in order to make an accounting policy election.
- The 2017 Tax Act includes significant changes to the U.S. international tax provisions, including GILTI, Base Erosion Anti-abuse Tax, and Foreign Derived Intangible Income. For purposes of analyzing valuation allowances for net operating loss and tax credit carryforwards, we recorded no provisional amount for release of valuation allowances as more time is needed to analyze the data.

We will continue to assess the impact of the 2017 Tax Act on our consolidated financial statements during the measurement period, which should be no longer than one year from the 2017 Tax Act enactment date. As discussed above, the 2017 Tax Act included numerous changes to the U.S. tax system. We have made a good faith effort to identify items for which no reasonable estimate was made; however, additional items requiring accounting may be identified as we complete our analysis and new information becomes available. Therefore, no reasonable estimate has been made for items in the new tax law that have not been identified.

Deferred taxes are recognized for the future tax effects of temporary differences between financial and income tax reporting based on enacted tax laws and rates.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate resolution.

Following is the composition of income tax expense:

	2017	2016	2015
Current:			
Federal	**$ (100.6)**	$ (57.0)	$ 660.5
Foreign	**38.5**	378.9	422.0
State	**4.0**	(125.0)	47.5
2017 Tax Act - provisional	**3,247.5**	—	—
Total current tax expense	**3,189.4**	196.9	1,130.0
Deferred:			
Federal	**801.5**	517.0	(689.6)
Foreign	**(256.3)**	(83.3)	(66.0)
State	**0.4**	5.8	7.2
2017 Tax Act - provisional	**(1,333.5)**	—	—
Total deferred tax (benefit) expense	**(787.9)**	439.5	(748.4)
Income taxes	**$ 2,401.5**	$ 636.4	$ 381.6

Significant components of our deferred tax assets and liabilities as of December 31 are as follows:

	2017	2016
Deferred tax assets:		
Compensation and benefits	**$ 1,021.7**	$ 1,126.0
Tax loss carryforwards and carrybacks	**501.4**	327.3
Tax credit carryforwards and carrybacks	**473.0**	458.9
Purchases of intangible assets	**443.1**	620.3
Product return reserves	**88.4**	128.1
Other comprehensive loss on hedging transactions	**68.9**	123.3
Debt	**53.5**	95.3
Contingent consideration	**41.8**	142.7
Other	**555.8**	587.3
Total gross deferred tax assets	**3,247.6**	3,609.2
Valuation allowances	**(709.1)**	(648.3)
Total deferred tax assets	**2,538.5**	2,960.9
Deferred tax liabilities:		
Inventories	**(654.8)**	(955.5)
Intangibles	**(314.6)**	(604.2)
Property and equipment	**(282.1)**	(398.6)
Prepaid employee benefits	**(231.5)**	(265.3)
Financial instruments	**(41.5)**	(279.3)
Unremitted earnings	**(16.6)**	(673.6)
Total deferred tax liabilities	**(1,541.1)**	(3,176.5)
Deferred tax assets (liabilities) - net	**$ 997.4**	$ (215.6)

Deferred tax assets and liabilities reflect the provisional impact of re-measurement resulting from the 2017 Tax Act.

The deferred tax asset and related valuation allowance amounts for U.S. federal and state net operating losses and tax credits shown above have been reduced for differences between financial reporting and tax return filings.

At December 31, 2017, based on filed tax returns we have tax credit carryforwards and carrybacks of $692.0 million available to reduce future income taxes; $148.9 million, if unused, will expire by 2027. The remaining portion of the tax credit carryforwards is related to federal tax credits of $101.0 million, international tax credits of $129.0 million, and state tax credits of $313.1 million, all of which are substantially reserved.

At December 31, 2017, based on filed tax returns we had net operating losses and other carryforwards for international and U.S. federal income tax purposes of $3.21 billion: $6.5 million will expire by 2022; $640.5 million will expire between 2023 and 2037; and $2.56 billion of the carryforwards will never expire. Net operating losses and other carryforwards for international and U.S. federal income tax purposes are partially reserved. Deferred tax assets related to state net operating losses of $113.2 million and other state carryforwards of $2.5 million are fully reserved.

Domestic and Puerto Rican companies contributed approximately 15 percent, 70 percent, and 35 percent for the years ended December 31, 2017, 2016, and 2015, respectively, to consolidated income before income taxes. We have a subsidiary operating in Puerto Rico under a tax incentive grant effective through the end of 2031.

The 2017 Tax Act introduces international tax provisions that fundamentally change the U.S. taxation of foreign earnings. As a result, U.S. taxes previously accrued on unremitted foreign earnings have been reversed, and a provisional amount has been recorded to reflect amounts for foreign withholding taxes and state income taxes that would be owed upon future distributions of unremitted earnings of foreign subsidiaries that are not indefinitely reinvested. At December 31, 2017, due to the 2017 Tax Act, substantially all of the unremitted earnings of foreign subsidiaries are considered to not be indefinitely reinvested for continued use in our foreign operations. For the amount considered to be indefinitely reinvested, the amount of foreign withholding taxes and state income taxes that would be owed upon distribution is immaterial.

Cash payments of income taxes were as follows:

	2017	2016	2015
Cash payments of income taxes	**$ 246.5**	$ 700.6	$ 969.0

The 2017 Tax Act provides an election to taxpayers subject to the Toll Tax to make payments over an eight year period with the first payment due on the original filing due date of the 2017 federal income tax return. We intend to make this election; therefore, future cash payments of income taxes will include the Toll Tax installments.

Following is a reconciliation of the income tax expense applying the U.S. federal statutory rate to income before income taxes to reported income tax expense:

	2017	2016	2015
Income tax at the U.S. federal statutory tax rate	**$ 769.1**	$ 1,180.9	$ 976.5
Add (deduct):			
International operations, including Puerto Rico	**(428.9)**	(313.7)	(565.2)
General business credits	**(66.8)**	(58.3)	(69.2)
2017 Tax Act - provisional	**1,914.0**	—	—
Non-deductible acquired IPR&D - CoLucid (Note 3)	**300.1**	—	—
Other	**(86.0)**	(172.5)	39.5
Income taxes	**$ 2,401.5**	$ 636.4	$ 381.6

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows:

	2017	2016	2015
Beginning balance at January 1	**$ 853.4**	$ 1,066.6	$ 1,338.8
Additions based on tax positions related to the current year	**133.8**	73.4	131.3
Additions for tax positions of prior years	**97.5**	14.8	116.6
Reductions for tax positions of prior years	**(59.3)**	(15.2)	(45.2)
Settlements	**(2.4)**	(171.9)	(446.2)
Lapses of statutes of limitation	**(19.3)**	(110.0)	(4.0)
Changes related to the impact of foreign currency translation	**10.8**	(4.3)	(24.7)
Ending balance at December 31	**$ 1,014.5**	$ 853.4	$ 1,066.6

The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate was $670.9 million and $382.8 million at December 31, 2017 and 2016, respectively.

We file income tax returns in the U.S. federal jurisdiction and various state, local, and non-U.S. jurisdictions. We are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations in most major taxing jurisdictions for years before 2010.

The U.S. examination of tax years 2010-2012 commenced during the fourth quarter of 2013. In December 2015, we executed a closing agreement with the Internal Revenue Service which effectively settled certain matters for tax years 2010-2012. Accordingly, we reduced our gross uncertain tax positions by approximately $320 million in 2015. During 2016, we effectively settled the remaining matters related to tax years 2010-2012. As a result of this resolution, our gross uncertain tax positions were further reduced by approximately $140 million, and our consolidated results of operations benefited from an immaterial reduction in income tax expense. During 2016, we made cash payments of approximately $150 million related to tax years 2010-2012 after application of available tax credit carryforwards and carrybacks. The U.S. examination of tax years 2013-2015 began in 2016. While we believe it is reasonably possible that this audit could reach resolution within the next 12 months, the IRS examination of tax years 2013-2015 remains ongoing. Therefore, it is not possible to reasonably estimate the change to unrecognized tax benefits and the related future cash flows.

We recognize both accrued interest and penalties related to unrecognized tax benefits in income tax expense. We recognized income tax (benefit) expense related to interest and penalties as follows:

	2017	2016	2015
Income tax (benefit) expense	**$ 27.4**	$ (52.5)	$ 13.2

At December 31, 2017 and 2016, our accruals for the payment of interest and penalties totaled $170.7 million and $134.9 million, respectively.

Note 14: Retirement Benefits

We use a measurement date of December 31 to develop the change in benefit obligation, change in plan assets, funded status, and amounts recognized in the consolidated balance sheets at December 31 for our defined benefit pension and retiree health benefit plans, which were as follows:

	Defined Benefit Pension Plans		Retiree Health Benefit Plans	
	2017	2016	2017	2016
Change in benefit obligation:				
Benefit obligation at beginning of year	**$ 12,455.9**	$ 11,719.2	**$ 1,494.6**	$ 1,467.4
Service cost	**331.3**	277.7	**46.4**	39.1
Interest cost	**413.4**	420.8	**52.9**	53.2
Actuarial (gain) loss	**1,580.5**	806.5	**40.0**	50.9
Benefits paid	**(486.3)**	(454.5)	**(60.1)**	(59.8)
Plan amendments	**—**	—	**—**	(35.8)
Curtailment	**90.4**	—	**105.2**	—
Special termination benefit	**317.2**	—	**37.5**	—
Foreign currency exchange rate changes and other adjustments	**396.0**	(313.8)	**12.0**	(20.4)
Benefit obligation at end of year	**15,098.4**	12,455.9	**1,728.5**	1,494.6
Change in plan assets:				
Fair value of plan assets at beginning of year	**10,179.7**	9,995.6	**1,961.2**	1,943.7
Actual return on plan assets	**1,447.6**	853.4	**462.0**	68.9
Employer contribution	**414.3**	110.2	**9.1**	8.4
Benefits paid	**(486.3)**	(454.5)	**(60.1)**	(59.8)
Foreign currency exchange rate changes and other adjustments	**289.2**	(325.0)	**0.2**	—
Fair value of plan assets at end of year	**11,844.5**	10,179.7	**2,372.4**	1,961.2
Funded status	**(3,253.9)**	(2,276.2)	**643.9**	466.6
Unrecognized net actuarial loss	**5,645.5**	4,915.7	**182.0**	458.8
Unrecognized prior service (benefit) cost	**15.2**	21.7	**(395.0)**	(525.1)
Net amount recognized	**$ 2,406.8**	$ 2,661.2	**$ 430.9**	$ 400.3
Amounts recognized in the consolidated balance sheet consisted of:				
Sundry	**$ 106.8**	$ 29.7	**$ 869.0**	$ 689.3
Other current liabilities	**(64.8)**	(68.0)	**(7.1)**	(6.7)
Accrued retirement benefits	**(3,295.9)**	(2,237.9)	**(218.0)**	(216.0)
Accumulated other comprehensive (income) loss before income taxes	**5,660.7**	4,937.4	**(213.0)**	(66.3)
Net amount recognized	**$ 2,406.8**	$ 2,661.2	**$ 430.9**	$ 400.3

The unrecognized net actuarial loss and unrecognized prior service cost (benefit) have not yet been recognized in net periodic pension costs and are included in AOCL at December 31, 2017.

The workforce reduction plan initiated in 2017 included a curtailment loss of $159.0 million and a special termination benefit of $354.7 million as a result of a remeasurement as of October 31, 2017. The special termination benefits related to early retirement incentives offered as part of a voluntary early retirement program for the U.S. plan in the fourth quarter of 2017. This program allowed certain employees the opportunity to voluntarily leave the Company.

During 2018, we expect the following components of AOCL to be recognized as components of net periodic benefit cost:

	Defined Benefit Pension Plans	Retiree Health Benefit Plans
Unrecognized net actuarial loss	$ 366.1	$ 9.5
Unrecognized prior service (benefit) cost	5.1	(81.3)
Total	$ 371.2	$ (71.8)

We do not expect any plan assets to be returned to us in 2018.

The following represents our weighted-average assumptions as of December 31:

	Defined Benefit Pension Plans			Retiree Health Benefit Plans		
(Percents)	2017	2016	2015	2017	2016	2015
Discount rate for benefit obligation	**3.4%**	3.9%	4.3%	**3.7%**	4.3%	4.5%
Discount rate for net benefit costs	**3.9**	4.3	4.0	**4.3**	4.5	4.1
Rate of compensation increase for benefit obligation	**3.4**	3.4	3.4			
Rate of compensation increase for net benefit costs	**3.4**	3.4	3.4			
Expected return on plan assets for net benefit costs	**7.4**	7.4	7.4	**8.0**	8.0	8.0

We annually evaluate the expected return on plan assets in our defined benefit pension and retiree health benefit plans. In evaluating the expected rate of return, we consider many factors, with a primary analysis of current and projected market conditions; asset returns and asset allocations; and the views of leading financial advisers and economists. We may also review our historical assumptions compared with actual results, as well as the assumptions and trend rates utilized by similar plans, where applicable.

Given the design of our retiree health benefit plans, healthcare-cost trend rates do not have a material impact on our financial condition or results of operations.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	2018	2019	2020	2021	2022	2023-2027
Defined benefit pension plans	$ 603.9	$ 601.4	$ 611.6	$ 621.4	$ 639.5	$ 3,455.8
Retiree health benefit plans	92.8	94.8	96.5	98.7	98.5	496.3

Amounts relating to defined benefit pension plans with projected benefit obligations in excess of plan assets were as follows at December 31:

	2017	2016
Projected benefit obligation	**$ 13,025.0**	$ 10,597.0
Fair value of plan assets	**9,664.3**	8,291.2

Amounts relating to defined benefit pension plans and retiree health benefit plans with accumulated benefit obligations in excess of plan assets were as follows at December 31:

	Defined Benefit Pension Plans		Retiree Health Benefit Plans	
	2017	2016	2017	2016
Accumulated benefit obligation	**$ 11,956.7**	$ 9,805.4	**$ 225.1**	$ 222.7
Fair value of plan assets	**9,639.4**	8,285.2	**—**	—

The total accumulated benefit obligation for our defined benefit pension plans was $13.90 billion and $11.49 billion at December 31, 2017 and 2016, respectively.

Net pension and retiree health benefit expense included the following components:

	Defined Benefit Pension Plans			Retiree Health Benefit Plans		
	2017	2016	2015	2017	2016	2015
Components of net periodic (benefit) cost:						
Service cost	**$ 331.3**	$ 277.7	$ 315.7	**$ 46.4**	$ 39.1	$ 45.1
Interest cost	**413.4**	420.8	476.8	**52.9**	53.2	62.6
Expected return on plan assets	**(776.0)**	(752.1)	(782.3)	**(160.7)**	(150.2)	(150.0)
Amortization of prior service (benefit) cost	**5.7**	11.8	10.4	**(90.0)**	(85.8)	(91.1)
Recognized actuarial loss	**288.2**	285.6	383.2	**18.4**	19.1	38.0
Curtailment	**93.5**	—	—	**65.5**	—	—
Special termination benefit	**317.2**	—	—	**37.5**	—	—
Net periodic (benefit) cost	**$ 673.3**	$ 243.8	$ 403.8	**$ (30.0)**	$ (124.6)	$ (95.4)

As of January 1, 2016, we changed the method used to estimate the service and interest cost components of the net periodic pension and retiree health benefit plan costs. This new method uses the spot yield curve approach to estimate the service and interest costs by applying the specific spot rates along the yield curve to the projected cash outflows of our obligations. Previously, those costs were determined using a single weighted-average discount rate. The new method provides a more precise measure of interest and service costs by improving the correlation between the projected benefit cash flows and the specific spot yield curve rates. The change did not affect the measurement of the total benefit obligations as the change in service and interest costs is recorded in the actuarial gains and losses recorded in AOCL. We have accounted for this change as a change in estimate prospectively.

The following represents the amounts recognized in other comprehensive income (loss) for the years ended December 31, 2017, 2016, and 2015:

	Defined Benefit Pension Plans			Retiree Health Benefit Plans		
	2017	2016	2015	2017	2016	2015
Actuarial gain (loss) arising during period	**$ (915.1)**	$ (725.2)	$ 120.4	**$ 261.3**	$ (132.2)	$ 48.6
Plan amendments during period	**—**	—	0.4	**—**	35.8	—
Curtailment	**3.2**	—	—	**(39.7)**	—	—
Amortization of prior service (benefit) cost included in net income	**5.7**	11.8	10.4	**(90.0)**	(85.8)	(91.1)
Amortization of net actuarial loss included in net income	**288.2**	285.6	383.2	**18.4**	19.1	38.0
Foreign currency exchange rate changes and other	**(105.3)**	75.6	58.8	**(3.3)**	2.5	4.2
Total other comprehensive income (loss) during period	**$ (723.3)**	$ (352.2)	$ 573.2	**$ 146.7**	$ (160.6)	$ (0.3)

We have defined contribution savings plans that cover our eligible employees worldwide. The purpose of these plans is generally to provide additional financial security during retirement by providing employees with an incentive to save. Our contributions to the plans are based on employee contributions and the level of our match. Expenses under the plans totaled $169.1 million, $175.0 million, and $162.4 million for the years ended December 31, 2017, 2016, and 2015, respectively.

We provide certain other postemployment benefits primarily related to disability benefits and accrue for the related cost over the service lives of employees. Expenses associated with these benefit plans for the years ended December 31, 2017, 2016, and 2015 were not material.

Benefit Plan Investments

Our benefit plan investment policies are set with specific consideration of return and risk requirements in relationship to the respective liabilities. U.S. and Puerto Rico plans represent approximately 80 percent of our global investments. Given the long-term nature of our liabilities, these plans have the flexibility to manage an above-average degree of risk in the asset portfolios. At the investment-policy level, there are no specifically prohibited investments. However, within individual investment manager mandates, restrictions and limitations are contractually set to align with our investment objectives, ensure risk control, and limit concentrations.

We manage our portfolio to minimize concentration of risk by allocating funds within asset categories. In addition, within a category we use different managers with various management objectives to eliminate any significant concentration of risk.

Our global benefit plans may enter into contractual arrangements (derivatives) to implement the local investment policy or manage particular portfolio risks. Derivatives are principally used to increase or decrease exposure to a particular public equity, fixed income, commodity, or currency market more rapidly or less expensively than could be accomplished through the use of the cash markets. The plans utilize both exchange-traded and over-the-counter instruments. The maximum exposure to either a market or counterparty credit loss is limited to the carrying value of the receivable, and is managed within contractual limits. We expect all of our counterparties to meet their obligations. The gross values of these derivative receivables and payables are not material to the global asset portfolio, and their values are reflected within the tables below.

The defined benefit pension and retiree health benefit plan allocation for the U.S. and Puerto Rico currently comprises approximately 80 percent growth investments and 20 percent fixed-income investments. The growth investment allocation encompasses U.S. and international public equity securities, hedge funds, private equity-like investments, and real estate. These portfolio allocations are intended to reduce overall risk by providing diversification, while seeking moderate to high returns over the long term.

Public equity securities are well diversified and invested in U.S. and international small-to-large companies across various asset managers and styles. The remaining portion of the growth portfolio is invested in private alternative investments.

Fixed-income investments primarily consist of fixed-income securities in U.S. treasuries and agencies, emerging market debt obligations, corporate bonds, mortgage-backed securities, commercial mortgage-backed obligations, and any related repurchase agreements.

Hedge funds are privately owned institutional investment funds that generally have moderate liquidity. Hedge funds seek specified levels of absolute return regardless of overall market conditions, and generally have low correlations to public equity and debt markets. Hedge funds often invest substantially in financial market instruments (stocks, bonds, commodities, currencies, derivatives, etc.) using a very broad range of trading activities to manage portfolio risks. Hedge fund strategies focus primarily on security selection and seek to be neutral with respect to market moves. Common groupings of hedge fund strategies include relative value, tactical, and event driven. Relative value strategies include arbitrage, when the same asset can simultaneously be bought and sold at different prices, achieving an immediate profit. Tactical strategies often take long and short positions to reduce or eliminate overall market risks while seeking a particular investment opportunity. Event strategy opportunities can evolve from specific company announcements such as mergers and acquisitions, and typically have little correlation to overall market directional movements. Our hedge fund investments are made through limited partnership interests primarily in fund-of-funds structures to ensure diversification across many strategies and many individual managers. Plan holdings in hedge funds are valued based on net asset values (NAVs) calculated by each fund or general partner, as applicable, and we have the ability to redeem these investments at NAV.

Private equity-like investment funds typically have low liquidity and are made through long-term partnerships or joint ventures that invest in pools of capital invested in primarily non-publicly traded entities. Underlying investments include venture capital (early stage investing), buyout, and special situation investing. Private equity management firms typically acquire and then reorganize private companies to create increased long term value. Private equity-like funds usually have a limited life of approximately 10-15 years, and require a minimum investment commitment from their limited partners. Our private investments are made both directly into funds and through fund-of-funds structures to ensure broad diversification of management styles and

assets across the portfolio. Plan holdings in private equity-like investments are valued using the value reported by the partnership, adjusted for known cash flows and significant events through our reporting date. Values provided by the partnerships are primarily based on analysis of and judgments about the underlying investments. Inputs to these valuations include underlying NAVs, discounted cash flow valuations, comparable market valuations, and may also include adjustments for currency, credit, liquidity and other risks as applicable. The vast majority of these private partnerships provide us with annual audited financial statements including their compliance with fair valuation procedures consistent with applicable accounting standards.

Real estate is composed of both public and private holdings. Real estate investments in registered investment companies that trade on an exchange are classified as Level 1 on the fair value hierarchy. Real estate investments in funds measured at fair value on the basis of NAV provided by the fund manager are classified as such. These NAVs are developed with inputs including discounted cash flow, independent appraisal, and market comparable analyses.

Other assets include cash and cash equivalents and mark-to-market value of derivatives.

The cash value of the trust-owned insurance contract is invested in investment-grade publicly traded equity and fixed-income securities.

Other than hedge funds, private equity-like investments, and real estate, which are discussed above, we determine fair values based on a market approach using quoted market values, significant other observable inputs for identical or comparable assets or liabilities, or discounted cash flow analyses.

The fair values of our defined benefit pension plan and retiree health plan assets as of December 31, 2017 by asset category are as follows:

Asset Class	Total	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Valued at Net Asset Value[1]
Defined Benefit Pension Plans					
Public equity securities:					
U.S.	$ 466.2	$ 199.6	$ —	$ —	$ 266.6
International	2,934.2	955.1	—	—	1,979.1
Fixed income:					
Developed markets	3,182.9	28.7	2,468.2	—	686.0
Developed markets - repurchase agreements	(1,372.9)	—	(1,372.9)	—	—
Emerging markets	584.7	4.2	252.0	3.1	325.4
Private alternative investments:					
Hedge funds	2,984.6	—	—	—	2,984.6
Equity-like funds	1,639.6	—	—	16.8	1,622.8
Real estate	563.9	338.6	—	—	225.3
Other	861.3	119.2	602.8	2.2	137.1
Total	$11,844.5	$ 1,645.4	$ 1,950.1	$ 22.1	$ 8,226.9
Retiree Health Benefit Plans					
Public equity securities:					
U.S.	$ 43.0	$ 19.4	$ —	$ —	$ 23.6
International	182.5	61.3	—	—	121.2
Fixed income:					
Developed markets	71.2	—	63.5	—	7.7
Emerging markets	53.1	—	24.4	0.3	28.4
Private alternative investments:					
Hedge funds	256.0	—	—	—	256.0
Equity-like funds	137.0	—	—	1.6	135.4
Cash value of trust owned insurance contract	1,524.6	—	1,524.6	—	—
Real estate	33.0	33.0	—	—	—
Other	72.0	15.0	50.5	0.2	6.3
Total	$ 2,372.4	$ 128.7	$ 1,663.0	$ 2.1	$ 578.6

[1] Certain investments that are measured at fair value using the NAV per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy.

No material transfers between Level 1, Level 2, or Level 3 occurred during the year ended December 31, 2017. The activity in the Level 3 investments during the year ended December 31, 2017 was not material.

The fair values of our defined benefit pension plan and retiree health plan assets as of December 31, 2016 by asset category are as follows:

Asset Class	Total	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Valued at Net Asset Value[1]
Defined Benefit Pension Plans					
Public equity securities:					
U.S.	$ 402.4	$ 165.5	$ —	$ —	$ 236.9
International	2,285.6	770.5	—	—	1,515.1
Fixed income:					
Developed markets	2,631.3	27.2	1,983.0	—	621.1
Developed markets - repurchase agreements	(1,024.4)	—	(1,024.4)	—	—
Emerging markets	450.0	—	180.1	0.3	269.6
Private alternative investments:					
Hedge funds	2,904.6	—	—	—	2,904.6
Equity-like funds	1,355.0	—	0.2	16.8	1,338.0
Real estate	504.1	344.5	—	—	159.6
Other	671.1	365.0	108.1	—	198.0
Total	$ 10,179.7	$ 1,672.7	$ 1,247.0	$ 17.1	$ 7,242.9
Retiree Health Benefit Plans					
Public equity securities:					
U.S.	$ 38.7	$ 16.7	$ —	$ —	$ 22.0
International	146.3	52.0	—	—	94.3
Fixed income:					
Developed markets	68.0	—	58.4	—	9.6
Emerging markets	42.6	—	18.2	—	24.4
Private alternative investments:					
Hedge funds	261.0	—	—	—	261.0
Equity-like funds	116.0	—	—	1.7	114.3
Cash value of trust owned insurance contract	1,208.3	—	1,208.3	—	—
Real estate	34.8	34.8	—	—	—
Other	45.5	28.1	3.7	—	13.7
Total	$ 1,961.2	$ 131.6	$ 1,288.6	$ 1.7	$ 539.3

[1] Certain investments that are measured at fair value using the NAV per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy.

No material transfers between Level 1, Level 2, or Level 3 occurred during the year ended December 31, 2016. The activity in the Level 3 investments during the year ended December 31, 2016 was not material.

In 2018, we expect to contribute approximately $50 million to our defined benefit pension plans to satisfy minimum funding requirements for the year. Additional discretionary contributions are not expected to be significant.

Note 15: Contingencies

We are a party to various legal actions and government investigations. The most significant of these are described below. It is not possible to determine the outcome of these matters, and we cannot reasonably estimate the maximum potential exposure or the range of possible loss in excess of amounts accrued for any of these matters; however, we believe that, except as noted below with respect to the Alimta® patent litigation and administrative proceedings, the resolution of all such matters will not have a material adverse effect on

our consolidated financial position or liquidity, but could possibly be material to our consolidated results of operations in any one accounting period.

Litigation accruals, environmental liabilities, and the related estimated insurance recoverables are reflected on a gross basis as liabilities and assets, respectively, on our consolidated balance sheets. With respect to the product liability claims currently asserted against us, we have accrued for our estimated exposures to the extent they are both probable and reasonably estimable based on the information available to us. We accrue for certain product liability claims incurred but not filed to the extent we can formulate a reasonable estimate of their costs. We estimate these expenses based primarily on historical claims experience and data regarding product usage. Legal defense costs expected to be incurred in connection with significant product liability loss contingencies are accrued when both probable and reasonably estimable.

Alimta Patent Litigation and Administrative Proceedings

A number of generic manufacturers are seeking approvals in the U.S., Japan, and a number of countries in Europe to market generic forms of Alimta prior to the expiration of our vitamin regimen patents, alleging that those patents are invalid, not infringed, or both. We believe our Alimta vitamin regimen patents are valid and enforceable against these generic manufacturers. However, it is not possible to determine the ultimate outcome of the proceedings, and accordingly, we can provide no assurance that we will prevail. An unfavorable outcome could have a material adverse impact on our future consolidated results of operations, liquidity, and financial position. We expect that a loss of exclusivity for Alimta would result in a rapid and severe decline in future revenue for the product in the relevant market.

U.S. Patent Litigation and Administrative Proceedings

In the U.S., more than 10 Abbreviated New Drug Applications (ANDAs) seeking approval to market generic versions of Alimta prior to the expiration of our vitamin regimen patent (expiring in 2021 plus pediatric exclusivity expiring in 2022) have been filed by a number of companies, including Teva Parenteral Medicines, Inc. (Teva) and APP Pharmaceuticals, LLC (APP) pursuant to procedures set out in the Drug Price Competition and Patent Term Restoration Act of 1984 (the Hatch-Waxman Act). We have received favorable decisions from the U.S. Court of Appeals for the Federal Circuit (affirming the U.S. District Court for the Southern District of Indiana's decisions finding our U.S. vitamin regimen patent valid and infringed) against Teva, APP and two other defendants' proposed products, and similar favorable judgments have been entered by the U.S. District Court for the Southern District of Indiana against five other companies. The remaining ANDA applicants have agreed to a stay pending the appeal of the *inter partes* review (IPR) described below. In October 2017, the U.S. Patent and Trademark Office (USPTO) issued written decisions in our favor following IPR of our vitamin regimen patent, finding that the generic company petitioners failed to show that the claims in our patent are unpatentable. A number of these challengers have filed an appeal.

We currently have pending lawsuits in the U.S. District Court for the Southern District of Indiana alleging infringement against Dr. Reddy's Laboratories (Dr. Reddy), Hospira, Inc. (Hospira), Actavis LLC, and Apotex Inc. in response to their alternative forms of pemetrexed products, and a similar lawsuit was filed in the U.S. District Court for Delaware against Eagle Pharmaceuticals, Inc. The trial against Dr. Reddy completed in February 2018 and we expect a decision in mid-2018. The trial against Hospira is scheduled for December 2018.

European Patent Litigation and Administrative Proceedings

In July 2017, the U.K. Supreme Court ruled that commercialization of certain salt forms of pemetrexed (the active ingredient in Alimta), including pemetrexed products diluted in saline or dextrose, by Actavis Group ehf and other Actavis companies (collectively, Actavis) directly infringe our vitamin regimen patents in the U.K., Italy, France, and Spain. In February 2016, the U.K. High Court ruled that Actavis' commercialization of a different proposed product diluted in dextrose solution would not infringe the patent in the U.K., Italy, France, and Spain. This case has now been superseded by the U.K. Supreme Court's decision.

In June 2016, the German Federal Supreme Court granted our appeal against certain Actavis companies, vacating the prior German Court of Appeal's ruling that our vitamin regimen patent in Germany would not be infringed by a dipotassium salt form of pemetrexed, and returned the case to the Court of Appeal to reconsider issues relating to infringement.

In separate proceedings in May 2016 and June 2016, the German courts confirmed preliminary injunctions against Hexal AG (Hexal), which had stated its intention to launch a generic disodium salt product diluted in saline solution in Germany, and ratiopharm GmbH (ratiopharm), a subsidiary of Teva, which had stated its intention to launch a proposed alternative salt form of pemetrexed product diluted in dextrose solution. The German Court of Appeal affirmed the preliminary injunction against ratiopharm in May 2017. The preliminary injunction against Hexal was not appealed. The preliminary injunctions against both Hexal and ratiopharm will remain in place pending the outcome of the cases on the merits. In late 2016, the German courts issued preliminary injunctions against two other companies that had stated their intentions to launch a proposed alternative salt form of pemetrexed product diluted in dextrose solution. Hexal, Stada Arzneimittel AG and ratiopharm have separately challenged the validity of our vitamin regimen patent before the German Federal Patent court. The hearing will take place in mid-2018. We do not anticipate any generic entry into the German market at least until either the Court of Appeal considers the issues remanded by the German Federal Supreme Court in the proceedings against Actavis, or if the injunctions are lifted.

Additional legal proceedings are ongoing in various national courts of other European countries. We are aware that generic competitors have received approval to market generic versions of pemetrexed in major European markets, and that a generic product is currently on the market in France. In the light of the U.K. Supreme Court judgment finding infringement in the U.K., France, Italy and Spain, Actavis has withdrawn its previously launched-at-risk generic products from these markets. We will continue to seek to remove any generic pemetrexed products launched at risk in European markets and defend the patent against validity challenges.

Japanese Administrative Proceedings

Three separate sets of demands for invalidation of our two vitamin regimen patents, involving several companies, have been filed with the Japanese Patent Office (JPO). In February 2017, the Japan Intellectual Property High Court confirmed the decisions of the JPO upholding the validity of both our vitamin regime patents in the challenge initiated by Sawai Pharmaceutical Co., Ltd. and joined by three other companies. This decision is now final. In May 2017, the JPO resumed one of the two remaining sets of demands, brought by Nipro Corporation (Nipro). A decision from the JPO on the Nipro demand for invalidation is expected mid-2018. The other set of demands, brought by Hospira USA and Hospira Inc., remains suspended. If upheld through all challenges, these patents provide intellectual property protection for Alimta until June 2021. Notwithstanding our patents, generic versions of Alimta were approved in Japan starting in February 2016. We do not currently anticipate that generic versions of Alimta will proceed to pricing approval.

Effient Patent Litigation and Administrative Proceedings

We, along with Daiichi Sankyo, Daiichi Sankyo, Inc., and Ube Industries (Ube) are engaged in U.S. patent litigation involving Effient brought pursuant to procedures set out in the Hatch-Waxman Act. More than 10 different companies have submitted ANDAs seeking approval to market generic versions of Effient prior to the expiration of Daiichi Sankyo's and Ube's patents (expiring in 2023) covering methods of using Effient with aspirin, and alleging the patents are invalid. Beginning in March 2014, we filed lawsuits in the U.S. District Court for the Southern District of Indiana against these companies, seeking a ruling that the patents are valid and infringed. We entered into a settlement related to the compound patent challenge and following which settlement, generic products launched in the U.S. in the third quarter of 2017. The remaining cases have been consolidated and stayed. The entry of generic competition has caused a rapid and severe decline in revenue for the product.

In 2015, several generic pharmaceutical companies filed petitions with the USPTO, requesting IPR of the method-of-use patents. In September 2016, the USPTO determined that the method-of-use patents are invalid. In December 2017, the U.S. court of Appeals for the Federal Circuit affirmed the USPTO's decisions. Daiichi Sankyo and Ube filed a request for reconsideration. The consolidated lawsuit is currently stayed with respect to all parties pending the outcome of this appeal.

We believe the Effient method-of-use patents are valid and enforceable against these generic manufacturers. However, it is not possible to determine the outcome of the proceedings, and accordingly, we can provide no assurance that we will prevail.

Actos® Product Liability Litigation

We were named along with Takeda Chemical Industries, Ltd. and Takeda affiliates (collectively, Takeda) as a defendant in approximately 6,700 product liability cases in the U.S. related to the diabetes medication Actos, which we co-promoted with Takeda in the U.S. from 1999 until 2006. In general, plaintiffs in these actions alleged that Actos caused or contributed to their bladder cancer. Almost all of these cases were included as part of a resolution program announced by Takeda in April 2015 in which Takeda has paid approximately $2.4 billion to resolve the vast majority of the U.S. product liability lawsuits involving Actos. Although the vast majority of U.S. product liability lawsuits involving Actos are included in the resolution program, there may be additional cases pending against Takeda and us following completion of the resolution program.

We are also named along with Takeda as a defendant in three purported product liability class actions in Canada related to Actos, including one in Ontario (*Casseres et al. v. Takeda Pharmaceutical North America, Inc., et al. and Carrier et al. v. Eli Lilly et al.*), one in Quebec (*Whyte et al. v. Eli Lilly et al.*), and one in Alberta (*Epp v. Takeda Canada et al.*). We promoted Actos in Canada until 2009.

We believe these lawsuits are without merit, and we and Takeda are prepared to defend against them vigorously.

Cymbalta® Product Liability Litigation

We were named as a defendant in a purported class-action lawsuit in the U.S. District Court for the Central District of California (now called *Strafford et al. v. Eli Lilly and Company*) involving Cymbalta. The plaintiffs, purporting to represent a class of all persons within the U.S. who purchased and/or paid for Cymbalta, asserted claims under the consumer protection statutes of four states, California, Massachusetts, Missouri, and New York, and sought declaratory, injunctive, and monetary relief for various alleged economic injuries arising from discontinuing treatment with Cymbalta. In December 2014, the district court denied the plaintiffs' motion for class certification. Plaintiffs filed a petition with the U.S. Court of Appeals for the Ninth Circuit requesting permission to file an interlocutory appeal of the denial of class certification, which was denied. Plaintiffs filed a second motion for certification under the consumer protection acts of New York and Massachusetts. The district court denied that motion for class certification in July 2015. The district court dismissed the suits and plaintiffs appealed to the U.S. Court of Appeals for the Ninth Circuit. In June 2017, we moved to dismiss the appeal for lack of jurisdiction based on the U.S. Supreme Court's recent decision in *Microsoft v. Baker*. In November 2017, the U.S. Court of Appeals for the Ninth Circuit dismissed the suit. Plaintiffs continue to contest the dismissal.

We are named in approximately 140 lawsuits involving approximately 1,470 plaintiffs filed in various federal and state courts alleging injuries arising from discontinuation of treatment with Cymbalta. These include approximately 40 individual and multi-plaintiff cases filed in California state court, centralized in a California Judicial Counsel Coordination Proceeding pending in Los Angeles. The first individual product liability cases were tried in August 2015 and resulted in defense verdicts against four plaintiffs. We believe all these Cymbalta lawsuits and claims are without merit. We have reached a settlement framework that provides for a comprehensive resolution of nearly all of these personal injury claims, filed or unfiled, alleging injuries from discontinuing treatment with Cymbalta. There can be no assurances, however, that a final settlement will be reached.

Brazil–Employee Litigation

Our subsidiary in Brazil, Eli Lilly do Brasil Limitada (Lilly Brasil), is named in a lawsuit brought by the Labor Attorney for 15th Region in the Labor Court of Paulinia, State of Sao Paulo, Brazil, alleging possible harm to employees and former employees caused by exposure to heavy metals at a former Lilly manufacturing facility in Cosmopolis, Brazil, operated by the company between 1977 and 2003. The plaintiffs allege that some employees at the facility were exposed to benzene and heavy metals; however, Lilly Brasil maintains that these alleged contaminants were never used in the facility. In May 2014, the labor court judge ruled against Lilly Brasil. The judge's ruling orders Lilly Brasil to undertake several actions of unspecified financial impact, including paying lifetime medical insurance for the employees and contractors who worked at the Cosmopolis facility more than six months during the affected years and their children born during and after this period. While we cannot currently estimate the range of reasonably possible financial losses that could arise in the event we do not ultimately prevail in the litigation, the judge has estimated the total financial impact of the

ruling to be approximately 1.0 billion Brazilian real (approximately $300 million as of December 31, 2017) plus interest. We strongly disagree with the decision and filed an appeal in May 2014. We expect ruling on this appeal before the end of 2018.

We are also named in approximately 30 lawsuits filed in the same court by individual former employees making similar claims.

Lilly Brasil and Elanco Quimica Ltda. have been named in a lawsuit involving approximately 305 individuals alleging that the companies failed to provide warnings regarding exposure to heavy metals or proper equipment at the former Cosmopolis facility, and that this alleged failure could result in possible harm to employees, former employees, and their dependents. In June 2017, the court denied the plaintiffs' request for a preliminary injunction. In September 2017, the court dismissed the claims brought by all but the first named plaintiff. The plaintiffs are appealing that decision.

Lilly Brasil and Elanco Quimica Ltda. have also been named in a separate lawsuit involving approximately 105 individuals alleging that the companies failed to provide warnings regarding exposure to heavy metals or proper equipment at the former Cosmopolis facility, and that this alleged failure could result in possible harm to contractors and suppliers, and their dependents. In November 2017, the court dismissed the claims brought by all but the first named plaintiff.

We believe all of these lawsuits are without merit and are prepared to defend against them vigorously.

Agri Stats, Inc.

Agri Stats, Inc., our subsidiary, has been named as a co-defendant in four antitrust suits, including one putative class-action, filed in the U.S. District Court for the Northern District of Illinois. Plaintiffs consist of private direct and indirect purchasers of broiler chickens who allege that the defendants engaged in a conspiracy to limit U.S. chicken production and inflate prices. We believe these claims are without merit and are prepared to defend against them vigorously.

Product Liability Insurance

Because of the nature of pharmaceutical products, it is possible that we could become subject to large numbers of product liability and related claims in the future. Due to a very restrictive market for product liability insurance, we are self-insured for product liability losses for all our currently marketed products.

Note 16: Other Comprehensive Income (Loss)

The following table summarizes the activity related to each component of other comprehensive income (loss):

(Amounts presented net of taxes)	Foreign Currency Translation Gains (Losses)	Unrealized Net Gains (Losses) on Securities	Defined Benefit Pension and Retiree Health Benefit Plans	Effective Portion of Cash Flow Hedges	Accumulated Other Comprehensive Loss
Beginning balance at January 1, 2015	$ (498.4)	$ 99.7	$ (3,402.0)	$ (191.1)	$ (3,991.8)
Other comprehensive income (loss) before reclassifications	(861.8)	38.6	155.0	(36.9)	(705.1)
Net amount reclassified from accumulated other comprehensive loss	—	(128.2)	234.9	9.5	116.2
Net other comprehensive income (loss)	(861.8)	(89.6)	389.9	(27.4)	(588.9)
Balance at December 31, 2015	(1,360.2)	10.1	(3,012.1)	(218.5)	(4,580.7)
Other comprehensive income (loss) before reclassifications	(581.6)	206.7	(518.7)	(2.2)	(895.8)
Net amount reclassified from accumulated other comprehensive loss	74.5	7.2	159.2	9.8	250.7
Net other comprehensive income (loss)	(507.1)	213.9	(359.5)	7.6	(645.1)
Balance at December 31, 2016[1]	(1,867.3)	224.0	(3,371.6)	(210.9)	(5,225.8)
Other comprehensive income (loss) before reclassifications	**664.6**	**(15.7)**	**(543.4)**	**8.5**	**114.0**
Net amount reclassified from accumulated other comprehensive loss	**8.1**	**(110.6)**	**153.4**	**9.6**	**60.5**
Net other comprehensive income (loss)	**672.7**	**(126.3)**	**(390.0)**	**18.1**	**174.5**
Reclassifications of stranded tax effects - provisional (Note 2)	**(38.8)**	**15.8**	**(579.1)**	**(41.5)**	**(643.6)**
Ending balance at December 31, 2017[2]	**$ (1,233.4)**	**$ 113.5**	**$ (4,340.7)**	**$ (234.3)**	**$ (5,694.9)**

[1] Accumulated other comprehensive loss as of December 31, 2016 consists of $5,274.0 million of accumulated other comprehensive loss attributable to controlling interest and $48.2 million of accumulated other comprehensive income attributable to non-controlling interest.

[2] Accumulated other comprehensive loss as of December 31, 2017 consists of $5,718.6 million of accumulated other comprehensive loss attributable to controlling interest and $23.7 million of accumulated other comprehensive income attributable to non-controlling interest.

The tax effects on the net activity related to each component of other comprehensive income (loss) for the years ended December 31, were as follows:

Tax benefit (expense)	2017	2016	2015
Foreign currency translation gains/losses	**$ 170.8**	$ (70.6)	$ (2.0)
Unrealized net gains/losses on securities	**55.0**	(89.2)	48.5
Defined benefit pension and retiree health benefit plans	**186.6**	153.3	(183.0)
Effective portion of cash flow hedges	**(9.7)**	(4.1)	14.6
Benefit/(provision) for income taxes allocated to other comprehensive income (loss) items	**$ 402.7**	$ (10.6)	$ (121.9)

Except for the tax effects of foreign currency translation gains and losses related to our foreign currency-denominated notes, cross-currency interest rate swaps, and other foreign currency exchange contracts designated as net investment hedges (see Note 7), income taxes were not provided for foreign currency translation. Generally, the assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rate. For those operations, changes in exchange rates generally do not affect cash flows; therefore, resulting translation adjustments are made in shareholders' equity rather than in the consolidated statements of operations.

Reclassifications out of accumulated other comprehensive loss were as follows:

Details about Accumulated Other Comprehensive Loss Components	Year Ended December 31, 2017	2016	2015	Affected Line Item in the Consolidated Statements of Operations
Amortization of retirement benefit items:				
Prior service benefits, net	**$ (84.3)**	$ (74.0)	$ (80.7)	[1]
Actuarial losses	**306.6**	304.7	421.2	[1]
Total before tax	**222.3**	230.7	340.5	
Tax benefit	**(68.9)**	(71.5)	(105.6)	Income taxes
Net of tax	**153.4**	159.2	234.9	
Unrealized gains/losses on available-for-sale securities:				
Realized gains, net	**(170.2)**	(16.1)	(209.3)	Other—net, (income) expense
Impairment losses	**—**	27.3	12.0	Other—net, (income) expense
Total before tax	**(170.2)**	11.2	(197.3)	
Tax (benefit) expense	**59.6**	(4.0)	69.1	Income taxes
Net of tax	**(110.6)**	7.2	(128.2)	
Other, net of tax [2]	**17.7**	84.3	9.5	Other—net, (income) expense
Total reclassifications for the period, net of tax	**$ 60.5**	$ 250.7	$ 116.2	

[1] These accumulated other comprehensive loss components are included in the computation of net periodic pension cost (see Note 14).

[2] Amount for year ended December 31, 2016 included primarily $74.5 million of foreign currency translation losses.

Note 17: Other–Net, (Income) Expense

Other–net, (income) expense consisted of the following:

	2017	2016	2015
Interest expense	**$ 225.0**	$ 185.2	$ 161.2
Interest income	**(167.3)**	(108.7)	(87.0)
Venezuela charge	**—**	203.9	—
Debt extinguishment loss (Note 10)	**—**	—	166.7
Other income	**(110.1)**	(195.6)	(341.5)
Other–net, (income) expense	**$ (52.4)**	$ 84.8	$ (100.6)

For the years ended December 31, 2017, 2016, and 2015, other income is primarily related to net gains on investments (Note 7).

Due to the financial crisis in Venezuela and the significant deterioration of the bolívar, we changed the exchange rate used to translate the assets and liabilities of our subsidiaries in Venezuela which resulted in a charge of $203.9 million. Prior to this change, we used the Supplementary Foreign Currency Administration System (SICAD) rate; however, this official rate was discontinued in the first quarter of 2016. After considering several factors, including the future uncertainty of the Venezuelan economy, published exchange rates, and the limited amount of foreign currency exchanged, we changed to the Divisa Complementaria (DICOM) rate.

Note 18: Segment Information

We have two operating segments—human pharmaceutical products and animal health products. Our operating segments are distinguished by the ultimate end user of the product—humans or animals. Performance is evaluated based on profit or loss from operations before income taxes. The accounting policies of the individual segments are the same as those described throughout the notes to the consolidated financial statements.

Our human pharmaceutical products segment includes the discovery, development, manufacturing, marketing, and sales of human pharmaceutical products worldwide in the following therapeutic areas: endocrinology, oncology, cardiovascular, neuroscience, immunology, and other. We lost patent exclusivity for the schizophrenia and bipolar mania indications in December 2015 and April 2016, respectively, for Zyprexa® in Japan. Generic versions of Zyprexa were launched in Japan in June 2016. We lost our patent exclusivity for Strattera® in the U.S. in May 2017, and generic versions of Strattera were approved in the same month. As described in Note 15, following the settlement related to the compound patent challenge for Effient, generic products launched in the U.S. in the third quarter of 2017. The entry of generic competition into these markets following the loss of effective patent protection has caused a rapid and severe decline in revenue for the affected products. We lost our compound patent protection for Cialis® (tadalafil) and Adcirca® (tadalafil) in major European markets in November 2017. We also lost compound patent protection for Cialis and Adcirca in the U.S. in November 2017; however, we now expect U.S. exclusivity for Cialis to end at the earliest in late September 2018.

Our animal health segment, operating through our Elanco animal health division, includes the development, manufacturing, marketing, and sales of animal health products worldwide for both food and companion animals. Animal health products include Rumensin®, Posilac, Optaflexx®, Denagard®, Tylan®, Maxiban®, and other products for livestock and poultry, as well as Trifexis®, Interceptor®, Comfortis®, and other products for companion animals. The animal health segment amount for the year ended December 31, 2017 includes the results of operations from BIVIVP, which was acquired on January 3, 2017 (Note 3).

Most of our pharmaceutical products are distributed through wholesalers that serve pharmacies, physicians and other health care professionals, and hospitals. For the years ended December 31, 2017, 2016, and 2015, our three largest wholesalers each accounted for between 9 percent and 18 percent of consolidated total revenue. Further, they each accounted for between 14 percent and 22 percent of accounts receivable as of December 31, 2017 and 2016. Animal health products are sold primarily to wholesale distributors.

We manage our assets on a total company basis, not by operating segment, as the assets of the animal health business are intermixed with those of the pharmaceutical products business. Therefore, our chief operating decision maker does not review any asset information by operating segment and, accordingly, we do not report asset information by operating segment.

We are exposed to the risk of changes in social, political, and economic conditions inherent in foreign operations, and our results of operations and the value of our foreign assets are affected by fluctuations in foreign currency exchange rates.

The following table summarizes our revenue activity:

	2017	2016	2015
Segment revenue—to unaffiliated customers:			
Human pharmaceutical products:			
Endocrinology:			
Humalog®	**$ 2,865.2**	$ 2,768.8	$ 2,841.9
Trulicity®	**2,029.8**	925.5	248.7
Forteo®	**1,749.0**	1,500.0	1,348.3
Humulin®	**1,335.4**	1,365.9	1,307.4
Trajenta	**537.9**	436.6	356.8
Jardiance	**447.5**	201.9	60.2
Basaglar	**432.1**	86.1	11.1
Other Endocrinology	**688.3**	798.0	862.4
Total Endocrinology	**10,085.2**	8,082.8	7,036.8
Oncology:			
Alimta	**2,062.5**	2,283.3	2,493.1
Cyramza®	**758.3**	614.1	383.8
Erbitux	**645.9**	687.0	485.0
Other Oncology	**345.2**	137.4	147.9
Total Oncology	**3,811.9**	3,721.8	3,509.8
Cardiovascular:			
Cialis	**2,323.1**	2,471.6	2,310.7
Effient	**388.9**	535.2	523.0
Other Cardiovascular	**159.1**	218.6	234.3
Total Cardiovascular	**2,871.1**	3,225.4	3,068.0
Neuroscience:			
Cymbalta(1)	**757.2**	930.5	1,027.6
Strattera	**618.2**	854.7	784.0
Zyprexa	**581.2**	725.3	940.3
Other Neuroscience	**214.4**	209.8	183.5
Total Neuroscience	**2,171.0**	2,720.3	2,935.4
Immunology:			
Taltz®	**559.2**	113.1	—
Other Immunology	**45.9**	—	—
Total Immunology	**605.1**	113.1	—
Other human pharmaceutical products	**241.3**	200.5	227.7
Total human pharmaceutical products	**19,785.7**	18,063.9	16,777.7
Animal health products	**3,085.6**	3,158.2	3,181.0
Revenue	**$ 22,871.3**	$ 21,222.1	$ 19,958.7

	2017	2016	2015
Segment profits:			
Human pharmaceutical products	**$ 5,139.7**	$ 4,010.0	$ 4,026.7
Animal health products	**561.3**	663.7	597.9
Total segment profits	**$ 5,701.0**	$ 4,673.7	$ 4,624.6
Reconciliation of total segment profits to consolidated income before taxes:			
Segment profits	**$ 5,701.0**	$ 4,673.7	$ 4,624.6
Other profits (losses):			
Amortization of intangible assets (Note 8)	**(674.8)**	(683.3)	(626.2)
Asset impairment, restructuring, and other special charges (Note 5)	**(1,673.6)**	(382.5)	(367.7)
Venezuela charge (Note 17)	**—**	(203.9)	—
Acquired in-process research and development (Notes 3 and 4)	**(1,112.6)**	(30.0)	(535.0)
Inventory fair value adjustment related to acquisitions[2] (Note 3)	**(42.7)**	—	(153.0)
Debt repurchase charges, net[3] (Note 10)	**—**	—	(152.7)
Consolidated income before taxes	**$ 2,197.4**	$ 3,374.0	$ 2,790.0

Numbers may not add due to rounding.

(1) Cymbalta revenues benefited from reductions to the reserve for expected product returns of approximately $175 million during the year ended December 31, 2016.

(2) Inventory fair value adjustments in 2017 and 2015 relate to our acquisitions of BIVIVP and Novartis AH, respectively.

(3) We recognized pretax net charges of $152.7 million for the year ended December 31, 2015, attributable to the debt extinguishment loss of $166.7 million from the purchase and redemption of certain fixed-rate notes, partially offset by net gains from non-hedging interest rate swaps and foreign currency transactions associated with the related issuance of euro-denominated notes.

Depreciation and software amortization expense included in our segment profits was as follows:

	2017	2016	2015
Human pharmaceutical products	**$ 789.8**	$ 723.4	$ 720.7
Animal health products	**102.7**	89.9	80.8
Total depreciation expense and software amortization included in segment profits	**$ 892.5**	$ 813.3	$ 801.5

For internal management reporting presented to the chief operating decision maker, certain costs are fully allocated to our human pharmaceutical products segment and therefore are not reflected in the animal health segment's profit. Such items include costs associated with treasury-related financing, global administrative services, certain acquisition-related transaction costs, and certain manufacturing costs.

	2017	2016	2015
Geographic Information			
Revenue—to unaffiliated customers[1]:			
United States	**$ 12,785.1**	$ 11,506.2	$ 10,097.4
Europe	**3,943.2**	3,768.1	3,943.6
Japan	**2,419.7**	2,330.9	2,033.1
Other foreign countries	**3,723.3**	3,616.9	3,884.6
Revenue	**$ 22,871.3**	$ 21,222.1	$ 19,958.7
Long-lived assets[2]:			
United States	**$ 5,013.4**	$ 4,984.6	$ 4,576.8
Europe	**2,550.1**	2,140.7	2,306.4
Japan	**155.1**	92.4	89.2
Other foreign countries	**1,761.7**	1,776.8	1,724.2
Long-lived assets	**$ 9,480.3**	$ 8,994.5	$ 8,696.6

Numbers may not add due to rounding.

(1) Revenue is attributed to the countries based on the location of the customer.

(2) Long-lived assets consist of property and equipment, net, and certain sundry assets.

Note 19: Selected Quarterly Data (unaudited)

2017	Fourth	Third	Second	First
Revenue	**$ 6,160.7**	**$ 5,658.0**	**$ 5,824.3**	**$ 5,228.3**
Cost of sales	**1,624.8**	**1,566.1**	**1,551.6**	**1,327.7**
Operating expenses[1]	**3,253.7**	**2,874.9**	**2,958.3**	**2,783.0**
Acquired in-process research and development[2]	**50.0**	**205.0**	**—**	**857.6**
Asset impairment, restructuring, and other special charges[3]	**1,003.2**	**406.5**	**50.0**	**213.9**
Income before income taxes	**284.1**	**591.6**	**1,260.5**	**61.2**
Income taxes[4]	**1,941.0**	**36.0**	**252.5**	**172.0**
Net income (loss)	**(1,656.9)**	**555.6**	**1,008.0**	**(110.8)**
Earnings (loss) per share—basic	**(1.58)**	**0.53**	**0.96**	**(0.10)**
Earnings (loss) per share—diluted	**(1.58)**	**0.53**	**0.95**	**(0.10)**
Dividends paid per share	**0.52**	**0.52**	**0.52**	**0.52**
Common stock closing prices:				
High	**87.89**	**85.54**	**86.25**	**85.88**
Low	**81.94**	**77.07**	**76.98**	**74.58**

2016	Fourth	Third	Second	First
Revenue	$ 5,760.5	$ 5,191.7	$ 5,404.8	$ 4,865.1
Cost of sales	1,466.0	1,400.9	1,465.0	1,323.0
Operating expenses[1]	3,240.7	2,801.8	2,958.5	2,694.9
Acquired in-process research and development	30.0	—	—	—
Asset impairment, restructuring, and other special charges	147.6	45.5	58.0	131.4
Income before income taxes	892.0	970.7	944.5	566.8
Income taxes	120.2	192.7	196.8	126.7
Net income	771.8	778.0	747.7	440.1
Earnings per share—basic	0.73	0.74	0.71	0.42
Earnings per share—diluted	0.73	0.73	0.71	0.41
Dividends paid per share	0.51	0.51	0.51	0.51
Common stock closing prices:				
High	83.06	83.40	78.75	84.11
Low	65.97	76.85	72.57	69.06

[1] Includes research and development and marketing, selling, and administrative expenses.

[2] Acquired IPR&D charges in the first quarter were due to the CoLucid acquisition. See Note 3 for further discussion.

[3] Asset impairment, restructuring, and other special charges in the third quarter were primarily from asset impairments related to lower projected revenue for Posilac (rbST). In the fourth quarter, restructuring charges were primarily due to severance costs resulting from the U.S. voluntary early retirement program. See Note 5 for further discussion.

[4] Income taxes in the fourth quarter were due to the provisional charge resulting from the 2017 Tax Act. See Note 13 for further discussion.

Our common stock is listed on the New York Stock Exchange (NYSE) and the NYSE Euronext.

Management's Reports

Management's Report for Financial Statements—Eli Lilly and Company and Subsidiaries

Management of Eli Lilly and Company and subsidiaries is responsible for the accuracy, integrity, and fair presentation of the financial statements. The statements have been prepared in accordance with generally accepted accounting principles in the United States and include amounts based on judgments and estimates by management. In management's opinion, the consolidated financial statements present fairly our financial position, results of operations, and cash flows.

In addition to the system of internal accounting controls, we maintain a code of conduct (known as "*The Red Book*") that applies to all employees worldwide, requiring proper overall business conduct, avoidance of conflicts of interest, compliance with laws, and confidentiality of proprietary information. All employees must take training annually on *The Red Book* and are required to report suspected violations. A hotline number is published in *The Red Book* to enable employees to report suspected violations anonymously. Employees who report suspected violations are protected from discrimination or retaliation by the company. In addition to *The Red Book*, the chief executive officer and all financial management must sign a financial code of ethics, which further reinforces their ethical and fiduciary responsibilities.

The consolidated financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm. Their responsibility is to examine our consolidated financial statements in accordance with generally accepted auditing standards of the Public Company Accounting Oversight Board (United States). Ernst & Young's opinion with respect to the fairness of the presentation of the statements is included in our annual report. Ernst & Young reports directly to the audit committee of the board of directors.

Our audit committee includes five nonemployee members of the board of directors, all of whom are independent from our company. The committee charter, which is available on our website, outlines the members' roles and responsibilities and is consistent with enacted corporate reform laws and regulations. It is the audit committee's responsibility to appoint an independent registered public accounting firm subject to shareholder ratification, approve both audit and non-audit services performed by the independent registered public accounting firm, and review the reports submitted by the firm. The audit committee meets several times during the year with management, the internal auditors, and the independent public accounting firm to discuss audit activities, internal controls, and financial reporting matters, including reviews of our externally published financial results. The internal auditors and the independent registered public accounting firm have full and free access to the committee.

We are dedicated to ensuring that we maintain the high standards of financial accounting and reporting that we have established. We are committed to providing financial information that is transparent, timely, complete, relevant, and accurate. Our culture demands integrity and an unyielding commitment to strong internal practices and policies. Finally, we have the highest confidence in our financial reporting, our underlying system of internal controls, and our people, who are objective in their responsibilities and operate under a code of conduct and the highest level of ethical standards.

Management's Report on Internal Control Over Financial Reporting—Eli Lilly and Company and Subsidiaries

Management of Eli Lilly and Company and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. We have global financial policies that govern critical areas, including internal controls, financial accounting and reporting, fiduciary accountability, and safeguarding of corporate assets. Our internal accounting control systems are designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorization and are properly recorded, and that accounting records are adequate for preparation of financial statements and other financial information. A staff of internal auditors regularly monitors, on a worldwide basis, the adequacy and effectiveness of internal accounting controls. The general auditor reports directly to the audit committee of the board of directors.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "2013 *Internal Control—Integrated Framework"* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on our evaluation under this framework, we concluded that our internal control over financial reporting was effective as of December 31, 2017. However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The internal control over financial reporting has been assessed by Ernst & Young LLP as of December 31, 2017. Their responsibility is to evaluate whether internal control over financial reporting was designed and operating effectively.

David A. Ricks	Joshua L. Smiley
Chairman, President and Chief Executive Officer	*Senior Vice President and Chief Financial Officer*

February 20, 2018

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Eli Lilly and Company

Opinion on the Financial Statements

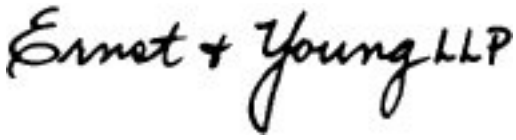
We have audited the accompanying consolidated balance sheets of Eli Lilly and Company and subsidiaries (the Company) as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated February 20, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.



We have served as the Company's auditor since 1940.

Indianapolis, Indiana

February 20, 2018

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Eli Lilly and Company

Opinion on Internal Control over Financial Reporting

We have audited Eli Lilly and Company and subsidiaries' internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Eli Lilly and Company and subsidiaries (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and our report dated February 20, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

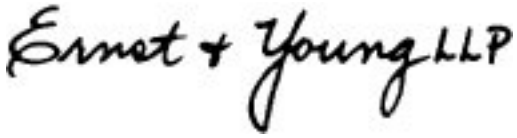
We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



Indianapolis, Indiana

February 20, 2018

Selected Financial Data (unaudited)

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions, except revenue per employee and per-share data)	2017	2016	2015	2014	2013
Operations					
Revenue	**$ 22,871.3**	$ 21,222.1	$ 19,958.7	$ 19,615.6	$ 23,113.1
Cost of sales	**6,070.2**	5,654.9	5,037.2	4,932.5	4,908.1
Research and development	**5,281.8**	5,243.9	4,796.4	4,733.6	5,531.3
Marketing, selling, and administrative	**6,588.1**	6,452.0	6,533.0	6,620.8	7,125.6
Other[1]	**2,733.8**	497.3	802.1	328.4	(341.2)
Income before income taxes	**2,197.4**	3,374.0	2,790.0	3,000.3	5,889.3
Income taxes[2]	**2,401.5**	636.4	381.6	609.8	1,204.5
Net income (loss)	**(204.1)**	2,737.6	2,408.4	2,390.5	4,684.8
Net income (loss) as a percent of revenue	**(0.9)%**	12.9%	12.1%	12.2%	20.3%
Net income (loss) per share—diluted	**$ (0.19)**	$ 2.58	$ 2.26	$ 2.23	$ 4.32
Dividends declared per share	**2.12**	2.05	2.01	1.97	1.96
Weighted-average number of shares outstanding—diluted (thousands)	**1,052,023**	1,061,825	1,065,720	1,074,286	1,084,766
Financial Position					
Current assets	**$ 19,202.1**	$ 15,101.4	$ 12,573.6	$ 11,928.3	$ 12,820.4
Current liabilities	**14,535.9**	10,986.6	8,229.6	9,741.0	8,123.8
Property and equipment—net	**8,826.5**	8,252.6	8,053.5	7,963.9	7,975.5
Total assets	**44,981.0**	38,805.9	35,568.9	36,307.6	35,210.8
Long-term debt	**9,940.5**	8,367.8	7,972.4	5,332.8	4,200.3
Total equity	**11,667.9**	14,080.5	14,590.3	15,388.1	17,640.7
Supplementary Data					
Return on total equity	**(1.5)%**	18.5%	16.1%	13.7%	29.5%
Return on assets	**(0.5)%**	7.5%	6.8%	6.8%	14.1%
Capital expenditures	**$ 1,076.8**	$ 1,037.0	$ 1,066.2	$ 1,162.6	$ 1,012.1
Depreciation and amortization	**1,567.3**	1,496.6	1,427.7	1,379.0	1,445.6
Effective tax rate[2]	**109.3 %**	18.9%	13.7%	20.3%	20.5%
Revenue per employee	**$ 563,000**	$ 506,000	$ 484,000	$ 501,000	$ 609,000
Number of employees	**40,655**	41,975	41,275	39,135	37,925
Number of shareholders of record	**25,300**	26,800	28,000	29,300	31,900

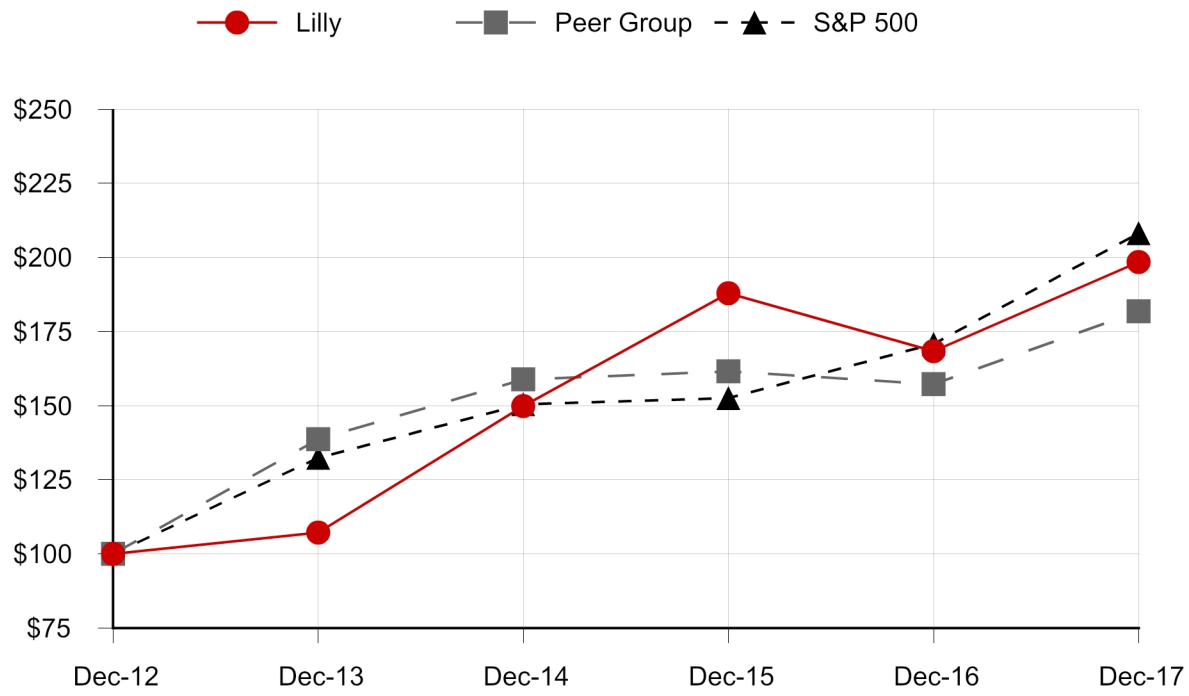
[1] Other includes acquired in-process research and development, asset impairment, restructuring, and other special charges, and other—net, (income) expense; See Note 3 to the consolidated financial statements for discussion regarding in-process research and development charges; See Note 5 to the consolidated financial statements for discussion regarding asset impairment, restructuring, and other special charges

[2] See Note 13 to the consolidated financial statements for discussion regarding income taxes

PERFORMANCE GRAPH

This graph compares the return on Lilly stock with that of the Standard & Poor's 500 Stock Index and our peer group for the years 2013 through 2017. The graph assumes that, on December 31, 2012, a person invested $100 each in Lilly stock, the S&P 500 Stock Index, and the peer groups' common stock. The graph measures total shareholder return, which takes into account both stock price and dividends. It assumes that dividends paid by a company are reinvested in that company's stock.

Value of $100 Invested on Last Business Day of 2012
Comparison of Five-Year Cumulative Total Return Among Lilly, S&P 500 Stock Index, Peer Group[(1)]



	Lilly	Peer Group	S&P 500
Dec-12	$ 100.00	$ 100.00	$ 100.00
Dec-13	$ 107.24	$ 138.74	$ 132.39
Dec-14	$ 149.87	$ 158.83	$ 150.51
Dec-15	$ 187.89	$ 161.53	$ 152.59
Dec-16	$ 168.40	$ 157.25	$ 170.84
Dec-17	$ 198.43	$ 181.79	$ 208.14

(1) We constructed the peer group as the industry index for this graph. It comprises the companies in the pharmaceutical and biotech industries that we used to benchmark the compensation of executive officers for 2017: AbbVie Inc.; Amgen Inc.; AstraZeneca PLC; Baxter International Inc.; Biogen Idec Inc.; Bristol-Myers Squibb Company; Celgene Corporation; Gilead Sciences Inc.; GlaxoSmithKline plc; Johnson & Johnson; Medtronic plc; Merck & Co., Inc.; Novartis AG.; Pfizer Inc.; Roche Holdings AG; Sanofi; and Shire plc.

Trademarks Used In This Report

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NOTICE OF 2018 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENT

Your vote is important

Please vote online, by telephone, or by signing, dating, and returning the enclosed proxy card by mail.

Table of Contents

Notice of 2018 Annual Meeting of Shareholders

To the holders of Common Stock of Eli Lilly and Company:

The 2018 Annual Meeting of Shareholders of Eli Lilly and Company will be held as shown below:

- **TIME AND DATE:** 11:00 a.m. EDT, Monday, May 7, 2018
- **LOCATION:** The Lilly Center Auditorium
  Lilly Corporate Center
  Indianapolis, Indiana 46285
- **ITEMS OF BUSINESS:** Election of the five directors listed in the proxy statement to serve three-year terms

  Approval, by non-binding vote, of the compensation paid to the company's named executive officers

  Ratification of Ernst & Young LLP as the principal independent auditors for 2018

  Approve amendments to the Articles of Incorporation to eliminate the classified board structure

  Approve amendments to the Articles of Incorporation to eliminate supermajority voting provisions

  Approve the Amended and Restated 2002 Lilly Stock Plan

  Shareholder proposal seeking support for the descheduling of cannabis

  Shareholder proposal requesting report regarding direct and indirect political contributions

  Shareholder proposal requesting report on policies and practices regarding contract animal laboratories

  Shareholder proposal requesting report on the extent to which risks related to public concern over drug pricing strategies are integrated into incentive compensation arrangements
- **WHO CAN VOTE:** Shareholders of record at the close of business on March 12, 2018

This proxy statement is dated March 19, 2018, and is first being sent or given to our shareholders on or about that date.

See the back page of this report for information regarding how to attend the meeting. Every shareholder vote is important. If you are unable to attend the meeting in person, please sign, date, and return your proxy card or voting instructions by mail, or vote by telephone or online promptly so that a quorum may be represented at the meeting.

By order of the Board of Directors,

Bronwen L. Mantlo
Secretary

March 19, 2018
Indianapolis, Indiana

Important notice regarding the availability of proxy materials for the shareholder meeting to be held May 7, 2018: The annual report and proxy statement are available at https://www.lilly.com/annualreport2017.

Proxy Statement Summary

General Information

This summary highlights information contained elsewhere in this proxy statement. It does not contain all the information you should consider, and you should read the entire proxy statement carefully before voting.

Meeting:	Annual Meeting of Shareholders	**Date:**	May 7, 2018
Time:	11:00 a.m. EDT	**Location:**	The Lilly Center Auditorium Lilly Corporate Center Indianapolis, Indiana 46285
Record Date:	March 12, 2018		

Items of Business:

- **Item 1**: Election of the five directors listed in this proxy statement to serve three-year terms.
- **Item 2**: Approval, by non-binding vote, of the compensation paid to the company's named executive officers.
- **Item 3**: Ratification of Ernst & Young LLP as the principal independent auditor for 2018.
- **Item 4**: Approve amendments to the Articles of Incorporation to eliminate the classified board structure.
- **Item 5**: Approve amendments to the Articles of Incorporation to eliminate supermajority voting provisions.
- **Item 6**: Approve the Amended and Restated 2002 Lilly Stock Plan.
- **Item 7**: Shareholder proposal seeking support for the descheduling of cannabis.
- **Item 8**: Shareholder proposal requesting report regarding direct and indirect political contributions.
- **Item 9**: Shareholder proposal requesting report on policies and practices regarding contract animal laboratories.
- **Item10**: Shareholder proposal requesting report on extent to which risks related to public concern over drug pricing strategies are integrated into incentive compensation arrangements.

What Is New In This Year's Proxy Statement

In February 2017, we welcomed Carolyn R. Bertozzi to the board. Dr. Bertozzi is the Anne T. and Robert M. Bass Professor of Chemistry and Professor of Chemical and Systems Biology and Radiology at Stanford University. She is an investigator for the Howard Hughes Medical Institute. In May 2017, John Lechleiter and Franklyn Prendergast retired from the board and on June 1, 2017, Dave Ricks succeeded John Lechleiter as Chairman.

Every year the Directors and Corporate Governance Committee conducts a robust assessment of the board's performance, board committee performance, and all board processes, based on input from all directors. We also conduct a detailed review of individual director performance at least every three years, when considering whether to nominate the director to a new three-year term. In 2017, we updated our process to include an assessment of each director every year.

The board has approved, and recommends that the shareholders approve, the following management proposals at this meeting. The board recommends approval of amendments to the company's Articles of Incorporation to eliminate the classified board structure (see Item 4 herein) and to eliminate supermajority voting provisions (see Item 5 herein). The board believes these two proposals balance shareholder interests and demonstrate its accountability and willingness to take steps that address shareholder-expressed concerns. Lastly, the board recommends approval of the company's amended and restated stock plan (see Item 6 herein). Stock incentive plans have been an integral part of the company's compensation programs

for more than 50 years. The board believes these plans enable the company to attract and retain top talent and focus employees on creating and sustaining shareholder value through increased employee stock ownership.

Highlights of 2017 Company Performance

The following provides a brief look at our 2017 performance in three dimensions: operating performance, innovation progress, and shareholder return. See our 2017 annual report on Form 10-K for more details.

Operating Performance

Performance highlights:

- 2017 revenue increased 8 percent to approximately $22.9 billion.
- 2017 earnings per share (EPS) were a loss of $0.19 on a reported basis and reflect charges associated with recently enacted U.S. tax reform legislation, activities associated with reducing the company's cost structure, and acquired in-process research and development charges.
- 2017 EPS increased 22 percent on a non-GAAP basis to $4.28.

*A reconciliation of measures prepared in accordance with generally accepted accounting principles (GAAP) and externally reported non-GAAP measures is included in Appendix A.

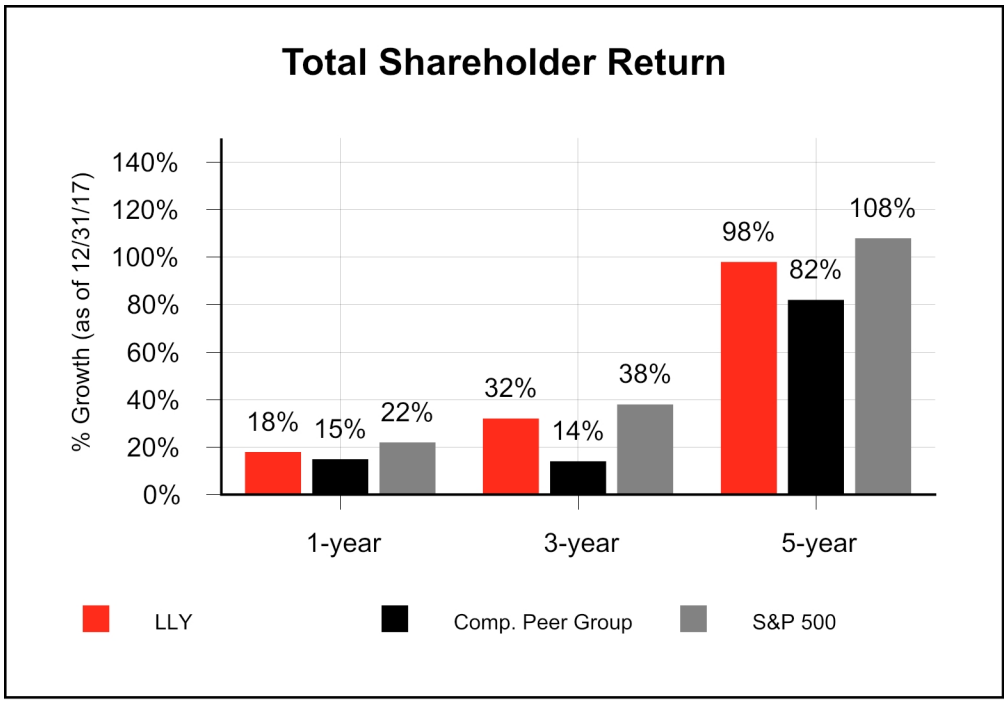
Innovation Progress

We made significant advances with our pipeline in 2017, including:

- U.S. approval of Verzenio™ (abemaciclib) indicated both as a single agent and in combination with another chemotherapy agent for treatment of certain types of advanced or metastatic breast cancer.
- U.S. and EU approval for Taltz® (ixekizumab) for the treatment of adults with active psoriatic arthritis.
- EU and Japan approvals for Olumiant® (baricitinib) for the treatment of moderate-to-severe active rheumatoid arthritis and rheumatoid arthritis, respectively. Olumiant is part of the company's collaboration with Incyte.
- U.S. approval of updates to the label for Trulicity® (dulaglutide) to include use in combination with basal insulin for adults with type 2 diabetes.
- Submission for regulatory approval of galcanezumab in the U.S. for migraine prevention and resubmission of baricitinib in the U.S. for rheumatoid arthritis.
- Phase 3 clinical trial initiations of ultra-rapid insulin for diabetes, empagliflozin for chronic heart failure, and baricitinib for atopic dermatitis.

Shareholder Return

We generated strong total shareholder returns (share price appreciation plus dividends, reinvested quarterly) through year-end 2017. Our returns exceeded the compensation peer group but slightly lagged the S&P 500 across the time periods presented below:



Governance

Further Information
See page 11

Item 1: Election of Directors

	Name and principal occupation	Public boards	Management recommendation	Vote required to pass
	**Katherine Baicker, Ph.D., 46** Dean, Harris School of Public Policy, University of Chicago *Director since 2011*		**Vote FOR**	**Majority of votes cast**
	**J. Erik Fyrwald, 58** President and Chief Executive Officer, Syngenta International AG *Director since 2005*		**Vote FOR**	**Majority of votes cast**
	**Jamere Jackson, 49** Chief Financial Officer, Nielsen Holdings plc *Director since 2016*		**Vote FOR**	**Majority of votes cast**
	**Ellen R. Marram, 71** President, The Barnegat Group LLC *Director since 2002* *Lead Independent Director since 2012*	Ford Motor Company	**Vote FOR**	**Majority of votes cast**
	**Jackson P. Tai, 67** Former Vice Chairman and Chief Executive Officer, DBS Group Holdings Ltd. and DBS Bank Ltd. *Director since 2013*	MasterCard Incorporated, Royal Philips NV, HSBC Holdings plc	**Vote FOR**	**Majority of votes cast**

Our Corporate Governance Policies Reflect Best Practices

The corporate governance practices that are bolded below were new or refreshed in 2017.

- ✓ Our board membership is marked by leadership, experience, and diversity.
- ✓ 13 of our 14 directors, and the members of all board committees, are independent.
- ✓ We have a strong, independent, clearly defined lead director role.
- ✓ We are committed to board refreshment, and seek to balance continuity and fresh perspectives.
- ✓ We conduct director orientation and continuing education programs for directors.
- ✓ ***We have an annual cap on director compensation.***

- ✓ Our board conducts a robust annual assessment of board performance - ***in 2017, we added an annual assessment of individual directors to this process.***
- ✓ We have a majority voting standard and resignation policy for the election of directors in uncontested elections.
- ✓ Our board values active shareholder engagement. As a result ***we have put forward for consideration at this year's annual meeting management proposals to eliminate our classified board structure and supermajority voting provisions.***
- ✓ We have no shareholder rights plan ("poison pill").
- ✓ The charters of the committees of the board clearly establish the committees' respective roles and responsibilities.
- ✓ Our board holds executive sessions of the independent directors at every regular board meeting and most committee meetings.
- ✓ Our independent directors have direct access to management and sole discretion to hire independent advisors at the company's expense.
- ✓ Our independent directors select, evaluate, and compensate our CEO. Our board compensates our other executive officers and ensures we have a strong succession plan for executive officer roles. ***This was particularly evident as we welcomed Dave Ricks as President, CEO, and board chair and three new executive committee members in 2017 and named four additional executive committee members effective 2018.***
- ✓ Our board actively oversees and approves our corporate strategy.
- ✓ Our board has a longstanding commitment to corporate responsibility.
- ✓ Our board oversees compliance and enterprise risk management practices.
- ✓ We have a comprehensive code of ethical and legal business conduct applicable to our board and all employees worldwide. This code is reviewed and approved annually by the board.
- ✓ We have a supplemental code for our CEO and all members of financial management, in recognition of their unique responsibilities to ensure proper accounting, financial reporting, internal controls, and financial stewardship.
- ✓ We have strong governance and disclosure of corporate political spending.
- ✓ We have transparent public policy engagement.
- ✓ We have meaningful stock ownership guidelines for our directors and executive officers.

Compensation

Further Information
See page 34

Item 2: Advisory Vote on Compensation Paid to Named Executive Officers

		Management recommendation	Vote required to pass
Item 2	Approve, by non-binding vote, compensation paid to the company's named executive officers	**Vote FOR**	Majority of votes cast

Our Executive Compensation Programs Reflect Best Practices

- ✓ We have had strong shareholder support of compensation practices: in 2017, over 97 percent of shares cast voted in favor of our executive compensation.
- ✓ Our compensation programs are designed to align with shareholder interests and link pay to performance through a blend of short- and long-term performance measures.
- ✓ Our Compensation Committee annually reviews compensation programs to ensure they provide incentives to deliver long-term, sustainable business results while discouraging excessive risk-taking or other adverse behaviors.
- ✓ We have a broad compensation recovery policy that applies to all executives and covers a wide range of misconduct.
- ✓ Our executive officers are subject to robust stock ownership guidelines and are prohibited from hedging or pledging their company stock.
- ✓ We do not have "top hat" retirement plans—supplemental plans are open to all employees and are limited to restoring benefits lost due to IRS limits on qualified plans.

- ✓ We do not provide tax gross-ups to executive officers (except for limited gross-ups related to international assignments).
- ✓ We have a very restrictive policy on perquisites.
- ✓ Our severance plans related to change-in-control generally require a double trigger.
- ✓ We do not have employment agreements with any of our executive officers.

Executive Compensation Summary for 2017

At the time the total target compensation was established at the end of 2016, target compensation for our named executive officers (the five officers whose compensation is disclosed in this proxy statement) was in the middle range of the company's peer group. Incentive compensation programs paid at or above target, consistent with the company's strong performance in 2017.

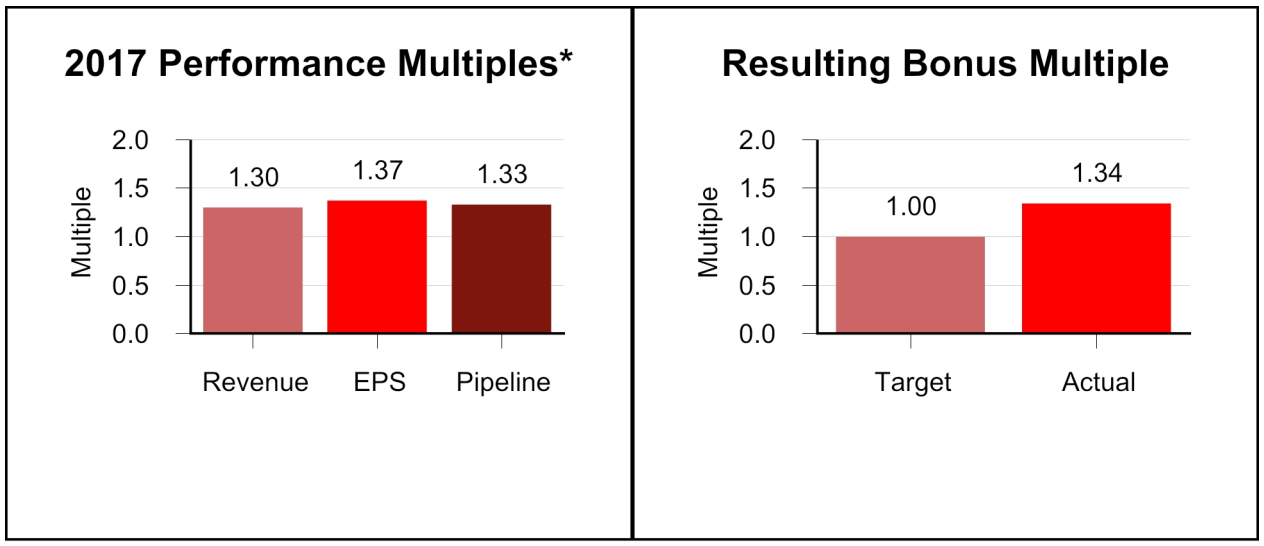
Pay for Performance

As described in the Compensation Disclosures and Analysis (CD&A), we link our incentive pay programs to a balanced mix of measures on three dimensions of company performance: operating performance; progress with our innovation pipeline; and shareholder return (both absolute and relative).

The summary below highlights how our incentive pay programs align with company performance. Please also see Appendix A for adjustments that were made to revenue and EPS for incentive compensation programs.

2017 Annual Cash Bonus Multiple

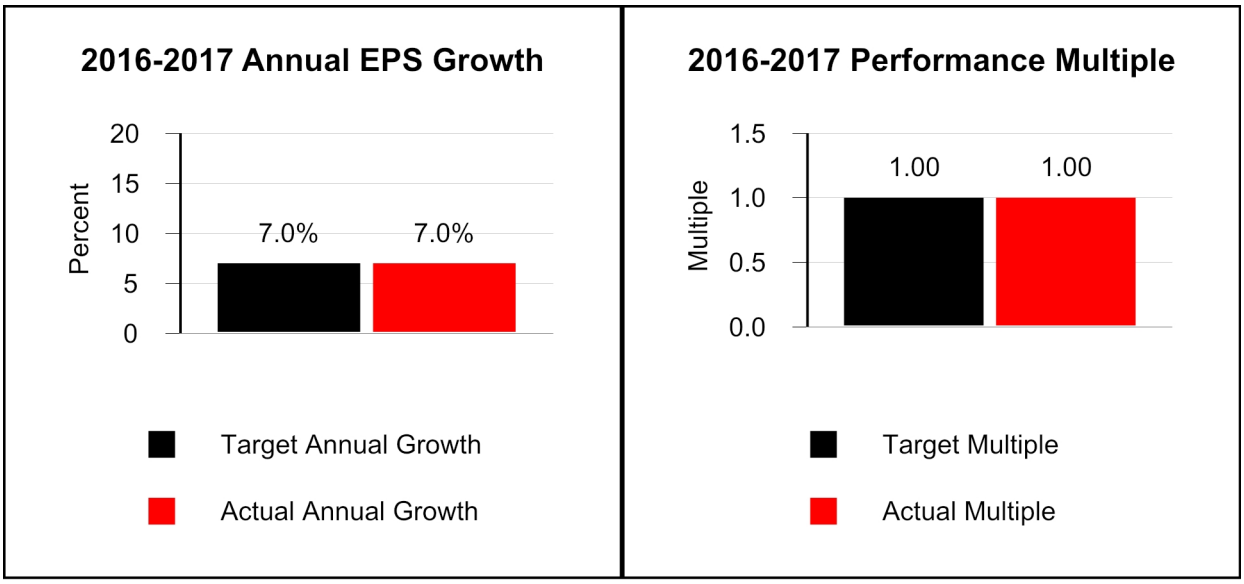
The company exceeded its annual cash bonus targets for revenue, EPS, and pipeline progress.



*Performance goal multiples are capped at 2.0.

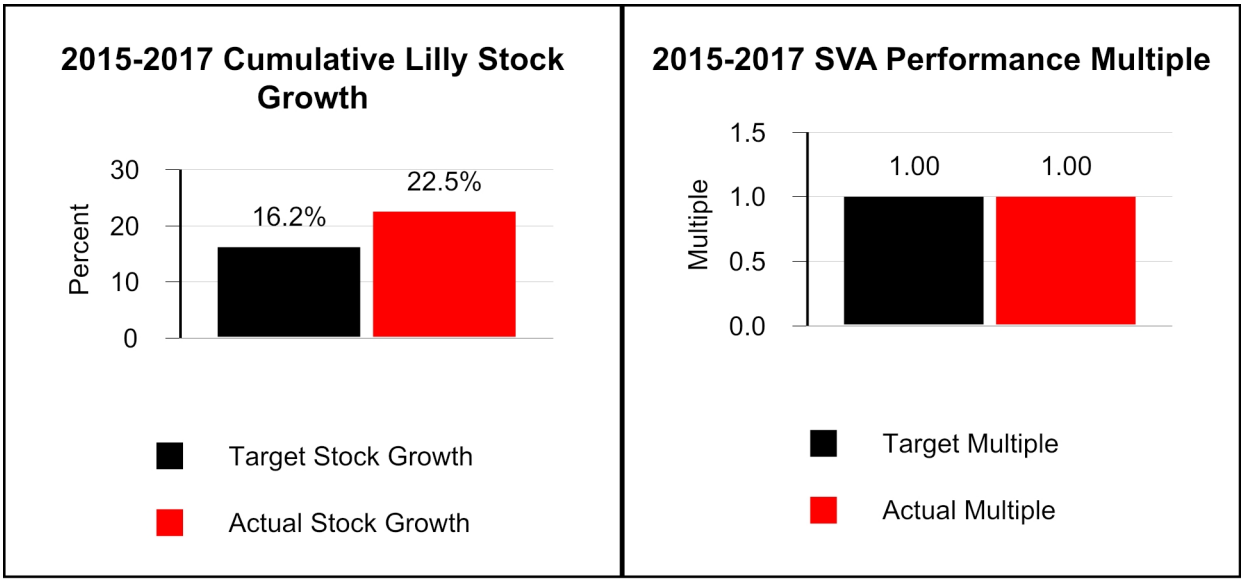
2017 Performance Award Multiple

We met the EPS growth targets under our Performance Award program, which has targets based on expected EPS growth of peer companies over a two-year period. This performance resulted in a Performance Award payout at target.



2017 Shareholder Value Award Multiple

Our stock price growth was in the target range (16.2% to 26.6%) under our Shareholder Value Award program, which is based on expected large-cap company returns over a three-year period. This performance resulted in a Shareholder Value Award payout at target.



Audit Matters

Further Information

Item 3: Ratification of Appointment of Principal Independent Auditor

See page 62

		Management recommendation	Vote required to pass
Item 3	Ratify the appointment of Ernst & Young LLP as the company's principal independent auditor for 2018	**Vote FOR**	Majority of votes cast

Management Proposals

Further Information

Item 4: Approve Amendments to the Articles of Incorporation to Eliminate the Classified Board Structure

See page 65

		Management recommendation	Vote required to pass
Item 4	Approve amendments to the articles of incorporation to eliminate the classified board structure	**Vote FOR**	80% of outstanding shares

Further Information

Item 5: Approve Amendments to the Articles of Incorporation to Eliminate Supermajority Voting Provisions

See page 66

		Management recommendation	Vote required to pass
Item 5	Approve amendments to the articles of incorporation to eliminate supermajority voting provisions	**Vote FOR**	80% of outstanding shares

Further Information

Item 6: Approve the Amended and Restated 2002 Lilly Stock Plan

See page 68

		Management recommendation	Vote required to pass
Item 6	Approve the amended and restated 2002 Lilly stock plan	**Vote FOR**	Majority of votes cast

Shareholder Proposals

Further Information

Item 7: Shareholder Proposal Seeking Support for the Descheduling of Cannabis

See page 77

		Management recommendation	Vote required to pass
Item 7	Proposal seeking support for the descheduling of cannabis	**Vote AGAINST**	Majority of votes cast

Further Information

Item 8: Shareholder Proposal Requesting Report Regarding Direct and Indirect Political Contributions

See page 78

		Management recommendation	Vote required to pass
Item 8	Proposal requesting report regarding direct and indirect political contributions	**Vote AGAINST**	Majority of votes cast

Further Information

Item 9: Shareholder Proposal Requesting Report on Policies and Practices Regarding Contract Animal Laboratories

See page 80

		Management recommendation	Vote required to pass
Item 9	Proposal requesting report on policies and practices regarding contract animal laboratories	**Vote AGAINST**	Majority of votes cast

Further Information

Item 10: Shareholder Proposal Requesting Report on the Extent to Which Risks Related to Public Concern Over Drug Pricing Strategies are Integrated into Incentive Compensation Arrangements

See page 82

		Management recommendation	Vote required to pass
Item 10	Proposal requesting report on the extent to which risks related to public concern over drug pricing strategies are integrated into incentive compensation arrangements	**Vote AGAINST**	Majority of votes cast

Other Information

How to Vote in Advance of the Meeting

Even if you plan to attend the 2018 Annual Meeting in person, we encourage you to vote prior to the meeting via one of the methods described below.

Visit the website listed on your proxy card or voting instruction form to vote **ONLINE**

Call the telephone number on your proxy card or voting instruction form to vote **BY TELEPHONE**

Sign, date, and return your proxy card or voting instruction form to vote **BY MAIL**

Further information on how to vote is provided at the end of the proxy statement under "Meeting and Voting Logistics."

Voting at our 2018 Annual Meeting

You may also opt to vote in person at the 2018 Annual Meeting, which will be held on Monday, May 7, 2018, at the Lilly Corporate Center, Indianapolis, IN 46285, at 11:00 a.m., EDT. See the section titled "Meeting and Voting Logistics" for more information.

Governance

Item 1. Election of Directors

Under the company's articles of incorporation, the board is divided into three classes with approximately one-third of the directors standing for election each year. The term for directors to be elected this year will expire at the annual meeting of shareholders held in 2021. Each of the director nominees listed below has agreed to serve that term. The following sections provide information about our directors, including their qualifications, the director nomination process, and director compensation.

Board Recommendation on Item 1

The Board of Directors recommends that you vote FOR each of the following nominees:

- **Katherine Baicker, Ph.D.**
- **J. Erik Fyrwald**
- **Jamere Jackson**
- **Ellen R. Marram**
- **Jackson P. Tai**

Board Operations and Governance

Board of Directors

Each of our directors is elected to serve until his or her successor is duly elected and qualified. If a nominee is unavailable for election, proxy holders may vote for another nominee proposed by the Board of Directors or, as an alternative, the Board of Directors may reduce the number of directors to be elected at the annual meeting.

Director Biographies

Set forth below is information as of March 8, 2018, regarding the nominees for election, which has been confirmed by each of them for inclusion in this proxy statement. We have provided the most significant experiences, qualifications, attributes, or skills that led to the conclusion that each director or director nominee should serve as one of our directors in light of our business and structure. Full biographies for each of our directors are available on our website at http://www.lilly.com/about/board-of-directors/Pages/board-of-directors.aspx.

No family relationship exists among any of our directors, director nominees, or executive officers. To the best of our knowledge, there are no pending material legal proceedings in which any of our directors or nominees for director, or any of their associates, is a party adverse to us or any of our affiliates, or has a material interest adverse to us or any of our affiliates. Additionally, to the best of our knowledge, there have been no events under any bankruptcy act, no criminal proceedings and no judgments, sanctions, or injunctions during the past 10 years that are material to the evaluation of the ability or integrity of any of our directors or nominees for director. There is no arrangement between any director or director nominee and any other person pursuant to which he or she was or is to be selected as a director or director nominee.

Class of 2018

The following five directors will seek election at this year's annual meeting. Four of these directors are standing for reelection; Jamere Jackson is seeking election for the first time. See “Item 1. Election of Directors” above for more information.

Katherine Baicker, Ph.D.
Age: 46, Director since 2011
Board Committees: Audit; Public Policy and Compliance

Industry Memberships: Panel of Health Advisers to the Congressional Budget Office; Editorial boards of Health Affairs and the Journal of Health Economics; Research Associate of the National Bureau of Economic Research; and Member of the National Academy of Medicine

Career Highlights

Harris School of Public Policy, University of Chicago

- Dean and the Emmett Dedmon Professor (2017 - present)

Harvard T.H. Chan School of Public Health, Department of Health Policy and Management

- Professor of health economics (2007 - 2017)
- C. Boyden Gray Professor (2014 - 2017) and Acting Chair, Department of Health Policy and Management (2014 - 2016)

Council of Economic Advisers, Executive Office of the President

- Member (2005 - 2007)
- Senior Economist (2001 - 2002)

Qualifications: Dr. Baicker is a leading researcher in the fields of health economics, public economics, and labor economics. As a valued adviser to numerous health care-related commissions and committees, her expertise in health policy and health care delivery is recognized in both academia and government.

J. Erik Fyrwald
Age: 58, Director since 2005
Board Committees: Public Policy and Compliance (chair)**;** Science and Technology

***Non-profit Boards*:** UN World Food Program Farm to Market Initiative; Crop Life International; and Swiss American Chamber of Commerce

Career Highlights

Syngenta International AG, a global Swiss-based agriculture technology company that produces agrochemicals and seeds

- President and Chief Executive Officer (2016 - present)

Univar, Inc., a leading distributor of chemicals and provider of related services

- President and Chief Executive Officer (2011 - 2016)

Nalco Company, a leading provider of water treatment products and services

- Chairman and Chief Executive Officer (2008 - 2011)

Ecolab, a leading provider of cleaning, sanitization, and water treatment products and services

- President (2012)

E.I. duPont de Nemours and Company, a global chemical company

- Group Vice President, agriculture and nutrition (2003 - 2008)

Qualifications: Mr. Fyrwald has a strong record of operational and strategic leadership in complex worldwide businesses with a focus on technology and innovation. He is an engineer by training and has significant CEO experience with Syngenta, Univar, and Nalco.

Jamere Jackson
Age: 49, Director since 2016
Board Committees: Audit; Finance

Non-profit Board: Future 5

Career Highlights

Nielsen Holdings plc, a global information, data, and measurement company

- Chief Financial Officer (2014 - present)

GE

- Vice President and CFO, GE Oil & Gas, drilling and surface division (2013 – 2014)
- Senior Executive, Finance, GE Aviation (2007 - 2013)
- Finance Executive, GE Corporate (2004 - 2007)

Qualifications: Through his senior financial roles at Nielsen and GE, Mr. Jackson brings to the board significant global financial expertise and a strong background in strategic planning. He has spent his professional career in a broad range of financial and strategic planning roles. He is an audit committee financial expert, based on his CFO experience and his training as a certified public accountant.

Ellen R. Marram
Age: 71, Director since 2002, Lead Independent Director since 2012
Board Committees: Compensation; Directors and Corporate Governance (chair)

***Public Board*:** Ford Motor Company
***Prior Public Boards*:** Cadbury plc; The New York Times Company
***Private Board*:** Newman's Own, Inc.
***Non-profit Boards*:** Wellesley College; New York-Presbyterian Hospital; Lincoln Center Theater; and Newman's Own Foundation

Career Highlights

The Barnegat Group LLC, provider of business advisory services
- President (2006 - present)

North Castle Partners, LLC, private equity firm
- Managing Director (2000 - 2006)

Tropicana Beverage Group
- President and Chief Executive Officer (1993 - 1998)

Nabisco Biscuit Company, a unit of Nabisco, Inc.
- President and Chief Executive Officer (1988 - 1993)

Qualifications: Ms. Marram is a former CEO with a strong marketing and consumer-brand background. Through her non-profit and private company activities, she has a special focus and expertise in wellness and consumer health. Ms. Marram has extensive corporate governance experience through service on other public company boards in a variety of industries.

Jackson P. Tai
Age: 67, Director since 2013
Board Committees: Audit; Finance

Public Boards: MasterCard Incorporated; Royal Philips NV; and HSBC Holdings plc
Prior Public Boards: The Bank of China Limited; Singapore Airlines; NYSE Euronext; ING Groep NV; CapitaLand (Singapore); DBS Group Holdings and DBS Bank
Private Board: Canada Pension Plan Investment Board
***Non-profit Boards*:** Metropolitan Opera; Rensselaer Polytechnic Institute

Career Highlights

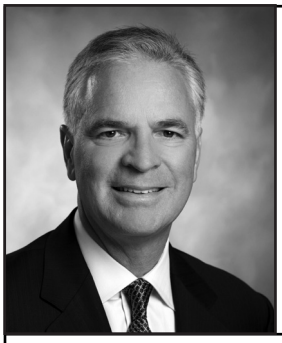
DBS Group Holdings and DBS Bank (formerly the Development Bank of Singapore), one of the largest financial services groups in Asia
- Vice Chairman and Chief Executive Officer (2002 - 2007)
- President and Chief Operating Officer (2001 - 2002)

J.P. Morgan & Co. Incorporated, a leading global financial institution
- 25-year career in investment banking, including senior management responsibilities in New York, Tokyo, and San Francisco

Qualifications: Mr. Tai is a former CEO with extensive experience in international business and finance, and is an audit committee financial expert. He has deep expertise in the Asia-Pacific region, a key growth market for Lilly. He also has broad corporate governance experience from his service on public company boards in the U.S., Europe, and Asia.

Class of 2019

The following five directors are serving terms that will expire in May 2019. Mr. Hoover will retire from the board on May 7, 2018. At that time, the board expects to reduce its size.



Ralph Alvarez
Age: 62, Director since 2009
Board Committees: Compensation (chair); Science and Technology

***Public Boards*:** Skylark Co., Ltd. (Mr. Alvarez is retiring from the Skylark board effective March 29, 2018); Lowe's Companies, Inc.; Dunkin' Brands Group, Inc.; and Realogy Holdings Corp.
***Prior Public Boards*:** McDonald's Corporation; KeyCorp

Memberships and Other Organizations: University of Miami: President's Council; School of Business Administration Board of Overseers

Career Highlights

Advent International Corporation, a leading global private equity firm
- Operating Partner (2017 - present)

Skylark Co., Ltd., a leading restaurant operator in Japan
- Chairman of the Board (2013 - present)

McDonald's Corporation
- President and Chief Operating Officer (2006 - 2009)

Qualifications: Through his senior executive and board positions at Skylark Co., Ltd. and McDonald's Corporation, as well as with other global restaurant businesses, Mr. Alvarez has extensive experience in consumer marketing, global operations, international business, and strategic planning. His international experience includes a special focus on Japan and emerging markets. He also has extensive corporate governance experience through his service on other public company boards.

Carolyn R. Bertozzi, Ph.D.
Age: 51, Director since 2017
Board Committees: Public Policy and Compliance; Science and Technology

***Public Board*: Catalent**
***Non-profit Boards*:** Broad Institute; Grace Science Foundation

Industry Memberships and Other Organizations: American Chemical Society; American Society for Biochemistry and Molecular Biology; American Chemical Society Publications, Editor-in-Chief of ACS Central Science; Institute of Medicine; National Academy of Sciences; and American Academy of Arts and Sciences

Honors: MacArthur Genius Award; Lemelson MIT Prize; Heinrich Wieland Prize, and National Academy of Sciences Award in the Chemical Sciences

Career Highlights

Stanford University
- Anne T. and Robert M. Bass Professor of Chemistry, Professor of Chemical and Systems Biology and Radiology by courtesy (2015 - present)

Howard Hughes Medical Institute
- Investigator (2000 - present)

University of California, Berkeley
- T.Z. and Irmgard Chu Professor of Chemistry and Professor of Molecular and Cell Biology (1996 - 2015)

Qualifications: Dr. Bertozzi is a prominent researcher and academician. She has extensive experience at Stanford University and the University of Berkeley, California, two major research institutions. Her deep expertise spans the disciplines of chemistry and biology, with an emphasis on studies of cell surface glycosylation associated with cancer, inflammation and bacterial infection, and exploiting this knowledge for development of diagnostic and therapeutic approaches.

R. David Hoover
Age: 72, Director since 2009
Board Committees: Finance (chair); Directors and Corporate Governance

***Public Boards*:** Ball Corporation; Edgewell Personal Care Co.
Prior Public Boards: Qwest International, Inc.; Steelcase, Inc.
Non-profit Boards: Children's Hospital Colorado; DePauw University

***Memberships and Other Organizations*:** Indiana University Kelley School of Business, Dean's Council

Career Highlights

Ball Corporation, a provider of packaging products, aerospace and other technologies and services to commercial and governmental customers
- Chairman (2002 - 2013)
- Chairman and CEO (2010 - 2011)
- President and Chief Executive Officer (2001 - 2010)
- Chief Operating Officer (2000 - 2001)
- Chief Financial Officer (1998 - 2000)

Qualifications: Mr. Hoover has extensive CEO experience at Ball Corporation, with a strong record of leadership in operations and strategy. He has deep financial expertise as a result of his experience as CEO and CFO of Ball. He also has extensive corporate governance experience through his service on other public company boards.

Juan R. Luciano
Age: 56, Director since 2016
Board Committees: Finance; Public Policy and Compliance

Public Boards: Archer Daniels Midland Company; Wilmar

***Non-profit Boards*:** Boys and Girls Clubs of America; Economic Club of Chicago; Commercial Club of Chicago; and The Business Council

Career Highlights

Archer Daniels Midland Company, a global food-processing and commodities-trading company

- Chairman (January 2016 - present)
- Chief Executive Officer and President (2015 - present)
- President (2014 - 2015)
- Executive Vice President and Chief Operating Officer (2011 - 2014)

The Dow Chemical Company, a multinational chemical company

- Executive Vice President and President, Performance Division (2010 - 2011)

Qualifications: Mr. Luciano has CEO and global business experience with Archer Daniels Midland Company, where he has established a reputation for strong result-oriented and strategic leadership, as well as many years of global leadership experience at The Dow Chemical Company. He brings to the board a strong technology and operations background, along with expertise in the food and agriculture sectors, an expanding area of focus for Lilly and its Elanco business.

Kathi P. Seifert
Age: 68, Director since 1995
Board Committees: Audit; Compensation

***Public Board*:** Investors Community Bank
***Private Board*:** Appvion, Inc.
***Prior Public Boards*:** Albertsons; Revlon Consumer Products Co.; Supervalue Inc.; and Lexmark International, Inc.

Non-profit Boards: Community Foundation for the Fox Valley Region; Fox Cities Building for the Arts; Fox Cities Chamber of Commerce; New North; Greater Fox Cities Area Habitat for Humanity; and Riverview Gardens

Career Highlights

Kimberly-Clark Corporation, a global consumer products company

- Executive Vice President (1999 - 2004)

Katapult, LLC, a provider of pro bono mentoring and consulting services to non-profit organizations

- Chairman (2004 - present)

Qualifications: Ms. Seifert is a retired senior executive of Kimberly-Clark. She has strong expertise in consumer marketing and brand management, having led sales and marketing for several worldwide brands, with a special focus on consumer health. She has extensive corporate governance experience through her other board positions.

Class of 2020

The following four directors are serving terms that will expire in May 2020.

Michael L. Eskew
Age: 68, Director since 2008
Board Committees: Audit (chair); Compensation; Directors and Corporate Governance

***Public Boards*:** 3M Corporation; IBM Corporation; and Allstate Insurance Company

***Non-profit Boards*:** Chairman of the board of trustees of The Annie E. Casey Foundation

Career Highlights

United Parcel Service, Inc., a global shipping and logistics company
- Chairman and Chief Executive Officer (2002 - 2007)
- Vice Chairman (2000 - 2002)
- UPS Board of Directors (1998 - 2014)

Qualifications: Mr. Eskew has CEO experience with UPS, where he established a record of success in managing complex worldwide operations, strategic planning, and building a strong consumer-brand focus. He is an audit committee financial expert, based on his CEO experience and his service on other U.S. company audit committees. He has extensive corporate governance experience through his service on the boards of other companies.

William G. Kaelin, Jr., M.D.
Age: 60, Director since 2012
Board Committees: Finance; Science and Technology (chair)

Industry Memberships: National Academy of Medicine; National Academy of Sciences; Association of American Physicians; and American Society of Clinical Investigation

***Honors*:** Canada Gairdner International Award; Lefoulon-Delalande Prize - Institute of France; and Albert B. Lasker Prize

Career Highlights

Dana-Farber/Harvard Cancer Center
- Professor of Medicine (2002 - present)

Brigham and Women's Hospital
- Professor (2002 - present)

Howard Hughes Medical Institute
- Investigator (2002 - present)
- Assistant Investigator (1998 - 2002)

Qualifications: Dr. Kaelin is a prominent medical researcher and academician. He has extensive experience at Harvard Medical School, a major medical institution, as well as special expertise in oncology—a key component of Lilly's business. He also has deep expertise in basic science, including mechanisms of drug action, and experience with pharmaceutical discovery research.

David A. Ricks
Age: 50, Director since 2017
Board Committees: none

Industry Memberships: Pharmaceutical Research and Manufacturers of America (PhRMA)

Non-profit Boards: Board of Governors for Riley Children's Foundation; Central Indiana Community Partnership

Career Highlights

Eli Lilly and Company

- Chairman of the Board, President and CEO (2017 - present)
- Senior Vice President and President, Lilly Bio-Medicines (2012 - 2016)

Qualifications: Mr. Ricks was named President and CEO on January 1, 2017, and joined the board at that time. He became Chairman of the Board on June 1, 2017. Mr. Ricks joined Lilly in 1996 and most recently served as president of Lilly Bio-Medicines. He has deep expertise in product development, global sales and marketing, as well as public policy. He has significant global experience in the company's commercial operations.

Marschall S. Runge, M.D., Ph.D.
Age: 63, Director since 2013
Board Committees: Public Policy and Compliance; Science and Technology

Industry Membership: Experimental Cardiovascular Sciences Study Section of the National Institutes of Health

Non-profit Board: UMHS

Career Highlights

University of Michigan

- CEO, Michigan Medicine (2015 - present)
- Executive Vice President for Medical Affairs (2015 - present)
- Dean, Medical School (2015 - present)

University of North Carolina, School of Medicine

- Executive Dean (2010 - 2015); Chair of the Department of Medicine (2000 - 2015)
- Principal Investigator and Director of the North Carolina Translational and Clinical Sciences Institute

Qualifications: Dr. Runge brings the unique perspective of a practicing physician who has a broad background in health care, clinical research, and academia. He has extensive experience as a practicing cardiologist, a strong understanding of health care facility systems, and deep expertise in biomedical research and clinical trial design.

Director Qualifications and Nomination Process

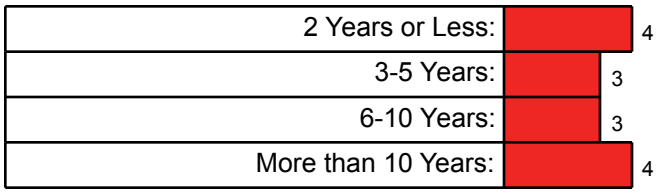
Director Qualifications

The board assesses board candidates by considering the following:

Experience: Our directors are responsible for overseeing the company's business consistent with their fiduciary duties. This significant responsibility requires highly skilled individuals with various qualities, attributes, and professional experience. The board is well-rounded, with a balance of relevant perspectives and experience, as illustrated in the following charts:

Board Tenure: In 2016 and 2017, the board added three new independent members: Mr. Juan R. Luciano, Mr. Jamere Jackson, and Dr. Carolyn R. Bertozzi, as well as Mr. David A. Ricks. Also in 2016 and 2017, three members retired from the board: Ms. Karen Horn, Dr. John Lechleiter, and Dr. Frank Prendergast. Mr. David Hoover will retire in May 2018.

As the following chart demonstrates, our director composition also reflects a mix of tenure on the board, which provides an effective balance of historical perspective and an understanding of the evolution of our business with fresh perspectives and insights.



Diversity: The board strives to achieve diversity in the broadest sense, including persons diverse in geography, gender, ethnicity, and experiences. Although the board does not establish specific diversity goals or have a standalone diversity policy, the board's overall diversity is an important consideration in the director selection and nomination process. The Directors and Corporate Governance Committee assesses the effectiveness of board diversity efforts in connection with the annual nomination process as well as in new director searches. The company's 14 directors range in age from 46 to 72 and include four women and four ethnically diverse members.

Character: Board members should possess the personal attributes necessary to be an effective director, including unquestioned integrity, sound judgment, a collaborative spirit, and commitment to the company, our shareholders, and other constituencies.

Director Refreshment

The committee performs periodic assessments of the overall composition and skills of the board in order to ensure that the board and management are actively engaged in succession planning for directors, and that our board reflects the viewpoints, diversity, and expertise necessary to support our complex and evolving business. The committee, with input from all board members, also considers the contributions of the individual directors.

The results of these assessments inform the board's recommendations on nominations for directors at the annual meeting each year and help provide us with insight on the types of experiences, skills, and other characteristics we should be seeking for future director candidates. Based on this assessment, the committee has recommended that the directors in the 2018 class be elected at the 2018 annual meeting.

The board delegates the director screening process to the Directors and Corporate Governance Committee, which receives input from other board members. Potential directors are identified from several sources, including executive search firms retained by the committee, incumbent directors, management, and shareholders.

The committee employs the same process for evaluating all candidates, including those submitted by shareholders. The committee initially evaluates a candidate based on publicly available information and any additional information supplied by the party recommending the candidate. If the candidate appears to satisfy the selection criteria and the committee's initial evaluation is favorable, the committee, assisted by management or a search firm, gathers additional data on the candidate's qualifications, availability, probable level of interest, and any potential conflicts of interest. If the committee's subsequent evaluation continues to be favorable, the candidate is contacted by the Chairman of the Board and one or more of the independent directors, including the lead independent director, for direct discussions to determine the mutual level of interest in pursuing the candidacy. If these discussions are favorable, the committee recommends that the board nominate the candidate for election by the shareholders (or to select the candidate to fill a vacancy, as applicable).

Director Compensation

Director compensation is reviewed and approved annually by the board, on the recommendation of the Directors and Corporate Governance Committee. Directors who are employees receive no additional compensation for serving on the board.

Cash Compensation

The following table shows the retainers and meeting fees for all non-employee directors in effect in 2017.

Board Retainers (annual, paid in monthly installments)		Committee Retainers (annual, paid in monthly installments)	
Annual Board Retainer	$110,000	Audit Committee; Science and Technology Committee members (including the chairs)	$6,000
Annual Retainers (in addition to annual board retainer):		Compensation Committee; Directors and Corporate Governance Committee; Finance Committee; Public Policy and Compliance Committee members (including the chairs)	$3,000
Lead Independent Director	$30,000		
Audit Committee Chair	$18,000		
Science and Technology Committee Chair	$15,000		
Compensation Committee Chair; Directors and Corporate Governance Committee Chair; Finance Committee Chair; Public Policy and Compliance Committee Chair	$12,000		

Directors are reimbursed for customary and usual travel expenses in connection with their travel to and from board meetings and other company events. Directors may also receive additional cash compensation for serving on ad hoc committees that may be assembled from time to time.

Stock Compensation

Directors are required to hold meaningful equity ownership positions in the company, and may not sell the equity compensation they earn as a director until after leaving the board. A significant portion of director compensation is in the form of deferred Lilly stock payable after they leave the board. Directors are required to hold Lilly stock, directly or through company plans, valued at not less than five times their annual board retainer; new directors are allowed five years to reach this ownership level. All directors serving at least five years have satisfied these guidelines, and all other directors are making progress toward these requirements.

In 2017, non-employee directors received $160,000 of equity compensation (but no more than 7,500 shares), deposited annually in a deferred stock account in the Lilly Directors' Deferral Plan (as described below). This award is prorated for time served and payable beginning the second January following the director's departure from board service.

Annual Compensation Cap for Directors

In 2017, the board approved a cap to the total annual compensation (retainers, fees, and stock allocation) for non-employee directors of $800,000. The cap is intended to avoid excessive director compensation and is

included in both our Directors' Deferral Plan and in the Amended and Restated 2002 Lilly Stock Plan being considered by shareholders at this year's annual shareholders meeting.

Lilly Directors' Deferral Plan: The Lilly Directors' Deferral Plan allows non-employee directors to defer receipt of all or part of their cash compensation until after their service on the board has ended. Each director can choose to invest the amounts deferred in one or both of the following two accounts:

Deferred Stock Account. This account allows the director, in effect, to invest his or her deferred cash compensation in company stock. Funds in this account are credited as hypothetical shares of company stock based on the closing stock price on pre-set monthly dates. In addition, the annual stock compensation award as described above is also credited to this account. The number of shares credited is calculated by dividing the $160,000 annual compensation figure by the closing stock price on a pre-set annual date. Hypothetical dividends are "reinvested" in additional shares based on the market price of the stock on the date dividends are paid. Actual shares are issued on the second January following the director's departure from board service.

Deferred Compensation Account. Funds in this account earn interest each year at a rate of 120 percent of the applicable federal long-term rate, compounded monthly, as established the preceding December by the U.S. Treasury Department under Section 1274(d) of the Internal Revenue Code of 1986 (the Internal Revenue Code). The aggregate amount of interest that accrued in 2017 for the participating directors was $140,541, at a rate of 2.7 percent. The rate for 2018 is 3.1 percent.

Both accounts may generally only be paid in a lump sum or in annual installments for up to 10 years, beginning the second January following the director's departure from board service. Amounts in the deferred stock account are paid in shares of company stock.

2017 Compensation for Non-Employee Directors

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)[1]	All Other Compensation and Payments ($)[2]	Total ($)[3]
Mr. Alvarez	$131,000	$160,000	$0	$291,000
Dr. Baicker	$119,000	$160,000	$0	$279,000
Dr. Bertozzi	$109,083	$146,667	$0	$255,750
Mr. Eskew	$140,000	$160,000	$0	$300,000
Mr. Fyrwald	$131,000	$160,000	$17,000	$308,000
Mr. Hoover	$128,000	$160,000	$0	$288,000
Mr. Jackson	$119,000	$160,000	$0	$279,000
Dr. Kaelin	$134,000	$160,000	$13,500	$307,500
Mr. Luciano	$116,000	$160,000	$0	$276,000
Ms. Marram	$158,000	$160,000	$30,000	$348,000
Dr. Runge	$119,000	$160,000	$0	$279,000
Ms. Seifert	$119,000	$160,000	$24,000	$303,000
Mr. Tai	$119,000	$160,000	$30,000	$309,000
Retired				
Dr. Lechleiter	$129,167	$66,667	$10,000	$205,834
Dr. Prendergast	$49,583	$66,667	$0	$116,250

[1] Each non-employee director received an award of stock valued at $160,000 (approximately 1,924 shares), except Dr. Lechleiter and Dr. Prendergast, who retired from the board in May 2017, and Dr. Bertozzi, who joined the board in February 2017, who received a pro-rated award for a partial year of service. This stock award and all prior stock awards are fully vested; however, the shares are not issued until the second January following the director's departure from board service, as described above under "Lilly Directors' Deferral Plan." The column shows the grant date fair value for each director's stock award computed in

accordance with FASB ASC Topic 718, based on the closing stock price on the grant date. See Note 11 of the consolidated financial statements in the company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 for additional detail regarding assumptions underlying the valuation of equity awards. Aggregate outstanding stock awards are shown in the "Common Stock Ownership by Directors and Executive Officers" table in the "Stock Units Not Distributable Within 60 Days" column.

[2] This column consists of amounts donated by the Eli Lilly and Company Foundation, Inc. ("Foundation") under its matching gift program, which is generally available to U.S. employees as well as non-employee directors. Under this program, the Foundation matched 100 percent of charitable donations over $25 made to eligible charities, up to a maximum of $30,000 per year for each individual. The Foundation matched these donations via payments made directly to the recipient charity. The amounts for Dr. Kaelin, Ms. Marram, Ms. Seifert, and Mr. Tai include matching contributions for donations made at the end of 2016 (Dr. Kaelin - $13,500; Ms. Marram - $8,000; Ms. Seifert - $21,750, and Mr. Tai - $30,000), for which the matching contribution was not paid until 2017.

[3] Directors do not participate in a company pension plan or non-equity incentive plan.

2018 Director Compensation

In 2017, the Directors and Corporate Governance Committee reviewed the company's compensation for independent directors, including a peer group analysis. As a result of this analysis, the committee recommended, and the board approved an increase in the annual stock award for non-employee directors from $160,000 to $175,000 (but retained the cap of 7,500 shares) to be effective starting with the 2018 stock award. The increase reflected a market increase in total director compensation, which the committee proposed as an increase to equity rather than cash compensation. In addition, the committee recommended, and the board approved, an increase to the lead independent director's retainer from $30,000 to $35,000 to reflect increased expectations for the role over time. All other director compensation remains unchanged from 2017.

Director Independence

The board annually determines the independence of directors based on a review by the Directors and Corporate Governance Committee. No director is considered independent unless the board has determined that he or she has no material relationship with the company, either directly or as a partner, significant shareholder, or officer of an organization that has a material relationship with the company. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. To evaluate the materiality of any such relationship, the board has adopted categorical independence standards consistent with the New York Stock Exchange (NYSE) listing standards, except that the "look-back period" for determining whether a director's prior relationship(s) with the company impairs independence is extended from three to four years.

The company's process for determining director independence is set forth in our Standards for Director Independence, which can be found on our website at https://www.lilly.com/who-we-are/governance, along with our Corporate Governance Guidelines.

On the recommendation of the Directors and Corporate Governance Committee, the board determined that each current non-employee director is independent. Prior to expiration of his board term in 2017, the board reached the same conclusion regarding Dr. Prendergast, and determined that the members of each committee also meet our independence standards. The board determined that none of the non-employee directors, has had during the last four years (i) any of the relationships identified in the company's categorical independence standards or (ii) any other material relationship with the company that would compromise his or her independence. The table that follows includes a description of categories or types of transactions, relationships, or arrangements the board considered in reaching its determinations.

Director	Organization	Type of Organization	Director Relationship to Organization	Primary Type of Transaction/ Relationship/ Arrangement between Lilly and Organization	2017 Aggregate Percentage of Organization's Revenue
Dr. Baicker	University of Chicago	Educational Institution	Employee	Research grants	Less than 0.1 percent
Dr. Bertozzi	Stanford University	Educational Institution	Employee	Research grants	Less than 0.1 percent
Mr. Fyrwald	Syngenta International AG	For-profit Corporation	Executive Officer	Purchase of products	Less than 0.1 percent
Mr. Jackson	Nielsen Holdings plc	For-profit Corporation	Executive Officer	Purchase of products	Less than 0.1 percent
Dr. Kaelin	Harvard University	Educational Institution	Employee	Research grants	Less than 0.1 percent
	Brigham and Women's Hospital	Health Care Institution	Employee	Research grants	Less than 0.1 percent
	Dana-Farber Cancer Institute	Health Care Institution	Employee	Research grants	Less than 0.1 percent
Mr. Luciano	Archer Daniels Midland	For-profit Corporation	Executive Officer	Purchase of products	Less than 0.1 percent
				Sale of products	Less than 0.1 percent of Lilly's revenue
Dr. Runge	University of Michigan Medical School	Educational Institution	Executive Officer	Research grants	Less than 0.1 percent

In addition to the foregoing relationships, the Directors and Corporate Governance Committee considered a proposed commercial arrangement under discussion by the company and ADM, where Mr. Luciano serves as CEO. Mr. Luciano has not been involved in discussions about the potential transaction and Mr. Luciano would not have any direct personal or financial interest in the commercial arrangement. The anticipated size of the commercial arrangement would be less than 1.5 percent of ADM's annual revenue.

All of the transactions described above were entered into at arm’s length in the normal course of business and, to the extent they are commercial relationships, have standard commercial terms. Aggregate payments to each of the organizations, in each of the last four fiscal years, did not exceed the greater of $1 million or 2 percent of that organization's consolidated gross revenues in a single fiscal year for the relevant four-year period. No director had any direct business relationships with the company or received any direct personal benefit from any of these transactions, relationships, or arrangements.

Committees of the Board of Directors

The duties and membership of the six board-appointed committees are described below. All committee members are independent as defined in the NYSE listing requirements and Lilly's independence standards. The members of the Audit and Compensation Committees each meet the additional independence requirements applicable to them as members of those committees.

The Directors and Corporate Governance Committee makes recommendations to the board regarding director committee membership and selection of committee chairs. The board has no set policy for rotation of committee members or chairs but annually reviews committee memberships and chair positions, seeking the best blend of continuity and fresh perspectives.

The chair of each committee determines the frequency and agenda of committee meetings. The Audit, Compensation, and Public Policy and Compliance Committees meet alone in executive session on a regular basis; all other committees meet in executive session as needed.

Membership and Meetings of the Board and Its Committees

In 2017, each director attended at least 80 percent of the total number of meetings of the board and the committees on which he or she served during his or her tenure as a board or committee member. In addition, all board members are expected to attend the annual meeting of shareholders, and all directors then serving attended the annual meeting in 2017. Current committee membership and the number of meetings of the board and each committee in 2017 are shown in the table below.

Name	Board	Audit	Compensation	Directors and Corporate Governance	Finance	Public Policy and Compliance	Science and Technology
Mr. Alvarez	✓		C				✓
Dr. Baicker	✓	✓				✓	
Dr. Bertozzi	✓					✓	✓
Mr. Eskew	✓	C	✓	✓			
Mr. Fyrwald	✓					C	✓
Mr. Hoover	✓			✓	C		
Mr. Jackson	✓	✓			✓		
Dr. Kaelin	✓				✓		C
Mr. Luciano	✓				✓	✓	
Ms. Marram	LD		✓	C			
Mr. Ricks	✓						
Dr. Runge	✓					✓	✓
Ms. Seifert	✓	✓	✓				
Mr. Tai	✓	✓			✓		
Number of 2017 Meetings	8	10	8	6	8	4	8

C Committee Chair
LD Lead Independent Director

All six committee charters are available online at https://www.lilly.com/who-we-are/governance, or upon request to the company's corporate secretary.

Audit Committee

Assists the board in fulfilling its oversight responsibilities by monitoring:

- the integrity of financial information provided to the shareholders and others
- management's systems of internal controls and disclosure controls
- the performance of internal and independent audit functions
- the company's compliance with legal and regulatory requirements.

The committee has sole authority to appoint or replace the independent auditor, subject to shareholder ratification.

The Board of Directors has determined that Mr. Eskew, Mr. Jackson, and Mr. Tai are audit committee financial experts, as defined in the SEC rules.

Compensation Committee

The Compensation Committee:

- oversees the company’s global compensation philosophy and policies

- establishes the compensation of our chief executive officer (CEO) and other executive officers
- acts as the oversight committee with respect to the company's deferred compensation plans, management stock plans, and other management incentive compensation programs
- reviews succession plans for the CEO and other key senior leadership positions
- reviews, monitors, and oversees stock ownership guidelines for executive officers.

Compensation Committee Interlocks and Insider Participation

None of the Compensation Committee members:

- has ever been an officer or employee of the company
- is or has been a participant in a related person transaction with the company (see "Review and Approval of Transactions with Related Persons" for a description of our policy on related person transactions)
- has any other interlocking relationships requiring disclosure under applicable SEC rules.

Directors and Corporate Governance Committee

The Directors and Corporate Governance Committee:

- leads the process for director recruitment, together with the lead independent director
- recommends to the board candidates for membership on the board and its committees, as well as for the role of lead independent director
- oversees matters of corporate governance, including board performance, director independence and compensation, corporate governance guidelines, and shareholder engagement on governance matters.

Finance Committee

Reviews and makes recommendations to the board regarding financial matters, including:

- capital structure and strategies
- dividends
- stock repurchases
- capital expenditures
- investments, financing, and borrowings
- benefit plan funding and investments
- financial risk management
- significant business development opportunities.

Public Policy and Compliance Committee

The Public Policy and Compliance Committee:

- oversees the processes by which the company conducts its business so that the company will do so in a manner that complies with laws and regulations and reflects the highest standards of integrity
- reviews and makes recommendations regarding policies, practices, and procedures of the company that relate to public policy and social, political, and economic issues.

Science and Technology Committee

The Science and Technology Committee:

- reviews and makes recommendations regarding the company's strategic research goals and objectives
- reviews new developments, technologies, and trends in pharmaceutical research and development
- reviews the progress of the company's product pipeline
- reviews the scientific aspects of significant business development opportunities
- oversees matters of scientific and medical integrity and risk management.

Board Oversight of Compliance and Risk Management

The board, together with its committees, oversees the processes by which the company conducts its business to ensure the company operates in a manner that complies with laws and regulations and reflects the highest standards of integrity.

The company also has an enterprise risk management program overseen by its chief ethics and compliance officer, who reports directly to the CEO. Enterprise risks are identified and prioritized by management through both top-down and bottom-up processes. The top priorities are overseen by a board committee or the full board. Company management is charged with managing risk through robust internal processes and controls. The enterprise risk management program as a whole is reviewed annually at a full board meeting, and enterprise risks are also addressed in periodic business function reviews and at the annual board and senior management strategy session.

Code of Ethics

The board approves the company's code of ethics, which is set out in:

The Red Book: a comprehensive code of ethical and legal business conduct applicable to all employees worldwide and to our Board of Directors. The Red Book is reviewed and approved annually by the board.

Code of Ethical Conduct for Lilly Financial Management: a supplemental code for our CEO and all members of financial management, in recognition of their unique responsibilities to ensure proper accounting, financial reporting, internal controls, and financial stewardship.

These documents are available online at: https://www.lilly.com/who-we-are/governance/ethics-and-compliance-program and https://www.lilly.com/ethical-conduct-for-financial-management, or upon request to the company's corporate secretary. In the event of any amendments to, or waivers from, a provision of the code affecting the chief executive officer, chief financial officer, chief accounting officer, controller, or persons performing similar functions, we intend to post on the above website within four business days after the event a description of the amendment or waiver as required under applicable Securities and Exchange Commission rules. We will maintain that information on our website for at least 12 months.

Highlights of the Company’s Corporate Governance

The company is committed to good corporate governance, which promotes the long-term interests of shareholders and other company stakeholders, builds confidence in our company leadership, and strengthens accountability for the board and company management. The board has adopted corporate governance guidelines that set forth the company's basic principles of corporate governance. The section that follows outlines key elements of the guidelines and other governance matters. Investors can learn more by reviewing the corporate governance guidelines, which are available online at https://www.lilly.com/who-we-are/governance or upon request to the company’s corporate secretary.

Role of the Board

The directors are elected by the shareholders to oversee the actions and results of the company’s management. The board exercises oversight over a broad range of areas, but the board's key responsibilities include:

- providing general oversight of the business
- approving corporate strategy
- approving major management initiatives
- selecting, compensating, evaluating, and, when necessary, replacing the chief executive officer, and compensating other key senior leadership positions
- ensuring that an effective succession plan is in place for all key senior leadership positions and

reviewing the broader talent management process, including diversity and inclusion
- overseeing the company's ethics and compliance program and management of significant business risks
- nominating, compensating, and evaluating directors
- overseeing the company's enterprise risk management program.

The board takes an active role in its oversight of our corporate strategy. Each year, the board and executive management closely examine the company's strategy, including key risks and decisions facing the company. Decisions reached in this session are updated throughout the year, including as the board discusses the company's financial performance, the performance of our business units, and progress in our pipeline.

Board Composition and Requirements

Mix of Independent Directors and Officer-Directors

There should always be a substantial majority (75 percent or more) of independent directors. The CEO should be a member of the board.

Voting for Directors

In an uncontested election, directors are elected by a majority of votes cast. An incumbent nominee who fails to receive a greater number of votes "for" than "against" his or her election will tender his or her resignation from the board (following the certification of the shareholder vote). The board, on recommendation of the Directors and Corporate Governance Committee, will decide whether to accept the resignation. The company will promptly disclose the board's decision, including, if applicable, the reasons the board rejected the resignation.

Director Tenure and Retirement Policy

Non-employee directors must retire no later than the date of the annual meeting that follows their seventy-second birthday. The Directors and Corporate Governance Committee has authority to recommend exceptions to this policy. The committee, with input from all board members, also considers the contributions of the individual directors annually, with a more robust assessment at least every three years when considering whether to nominate directors to new three-year terms. The company has not adopted term limits because the board believes that arbitrary term limits on a director's service are not appropriate.

Other Board Service

In general, no director may serve on more than three other public company boards. The Directors and Corporate Governance Committee may approve exceptions if it determines that the additional service will not impair the director's effectiveness on the Lilly board. The Directors and Corporate Governance Committee reviewed an exception request for Mr. Alvarez (who serves on four other company boards), considering his attendance record and continued engagement in board matters. Upon review, the committee determined that he could effectively balance his other board responsibilities and continue to be a strong contributor to the Lilly board.

Board Confidentiality Policy

The board has adopted a Confidentiality Policy, applicable to all current and future members of the board. The policy prohibits a director from sharing confidential information obtained in his or her role as a director with any outside party except under limited circumstances where the director is seeking legal advice or is required to disclose information by order of law. The Confidentiality Policy can be viewed on the company's website: http://www.lilly.com/about/corporate-governance/Pages/corporate-governance.aspx.

Leadership Structure; Oversight of Chairman, CEO, and Senior Management

Leadership Structure

The board currently believes that combining the role of Chairman of the Board and CEO, coupled with a strong lead independent director position (see the description of the role below), is the most efficient and effective

leadership model for the company, fostering clear accountability, effective decision making, and alignment on corporate strategy. The board periodically reviews its leadership structure and developments in the area of corporate governance to ensure that this approach continues to strike the appropriate balance for the company and our stakeholders. Such a review was conducted most recently during the succession-management process relating to the appointment of Mr. Ricks.

Board Independence

The board has put in place a number of governance practices to ensure effective independent oversight, including:

- ***Executive sessions of the independent directors***: held after every regular board meeting.

- ***Annual performance evaluation of the chairman and CEO***: conducted by the independent directors, the results of which are reviewed with the CEO and considered by the Compensation Committee in establishing the CEO's compensation for the next year.

- ***A strong, independent, clearly defined lead independent director role***: The lead independent director's responsibilities include:
  - leading the board's processes for selecting and evaluating the CEO
  - presiding at all meetings of the board at which the chairman is not present
  - serving as a liaison between the chairman and the independent directors
  - if requested by major shareholders, ensuring that she is available for consultation and direct communication
  - approving meeting agendas and schedules and generally approving information sent to the board
  - conducting executive sessions of the independent directors
  - overseeing the independent directors' annual performance evaluation of the chairman and CEO
  - together with the Directors and Corporate Governance Committee, leading the director recruitment process.

  The lead independent director also has authority to call meetings of the independent directors and to retain advisors for the independent directors.

  The lead independent director is appointed annually by the board. Currently Ms. Marram is the lead independent director.

- ***Director access to management and independent advisors***: Independent directors have direct access to members of management whenever they deem it necessary, and the company's executive officers attend part of each regularly scheduled board meeting. The independent directors and all committees are also free to retain their own independent advisors, at company expense, whenever they feel it would be desirable to do so.

CEO Succession Planning

The Compensation Committee, board, and CEO annually review the company's succession plans for the CEO and other key senior leadership positions. The independent directors also meet without the CEO to discuss CEO succession planning.

During these reviews, the CEO and directors discuss:

- future candidates for the CEO and other senior leadership positions
- succession timing
- development plans for the highest-potential candidates.

The company ensures that the directors have multiple opportunities to interact with the company's top leadership talent in both formal and informal settings to allow them to most effectively assess the candidates' qualifications and capabilities. In 2016, the board followed this process, and the independent directors also met

without the CEO present when selecting Mr. Ricks to succeed Dr. Lechleiter as president and CEO of the company, effective January 1, 2017.

The independent directors and the CEO maintain a confidential plan for the timely and efficient transfer of the CEO's responsibilities in the event of an emergency or his sudden departure, incapacitation, or death.

Board Education and Annual Performance Assessment

The company engages in a comprehensive orientation process for incoming new directors. Directors also attend ongoing continuing educational sessions on areas of particular relevance or importance to our company, and we hold periodic mandatory training sessions for the Audit Committee.

Every year the Directors and Corporate Governance Committee conducts a robust assessment of the board's performance, board committee performance, and all board processes, based on input from all directors. We also conduct a detailed review of individual director performance at least every three years, when considering whether to nominate the director to a new three-year term. In 2017, we updated our process to include an assessment of each director every year.

Conflicts of Interest and Transactions with Related Persons

Conflicts of Interest

Directors must disclose to the company all relationships that could create a conflict or an appearance of a conflict. The board, after consultation with counsel, takes appropriate steps to identify actual or apparent conflicts and ensure that all directors voting on an issue are disinterested. A director may be excused from discussions on the issue, as appropriate.

Review and Approval of Transactions with Related Persons

The board has adopted a policy and procedures for review, approval, and monitoring of transactions involving the company and related persons (directors and executive officers, their immediate family members, or shareholders of more than 5 percent of the company's outstanding stock). The policy covers any related-person transaction that meets the minimum threshold for disclosure in the proxy statement under the relevant SEC rules (generally, transactions involving amounts exceeding $120,000 in which a related person has a direct or indirect material interest).

***Policy**:* Related-person transactions must be approved by the board or by a committee of the board consisting solely of independent directors, who will approve the transaction only if they determine that it is in the best interests of the company. In considering the transaction, the board or committee will consider all relevant factors, including:

- the company's business rationale for entering into the transaction
- the alternatives to entering into a related-person transaction
- whether the transaction is on terms comparable to those available to third parties, or in the case of employment relationships, to employees generally
- the potential for the transaction to lead to an actual or apparent conflict of interest and any safeguards imposed to prevent such actual or apparent conflicts
- the overall fairness of the transaction to the company.

***Procedures**:*

- Management or the affected director or executive officer will bring the matter to the attention of the chairman, the lead independent director, the chair of the Directors and Corporate Governance Committee, or the corporate secretary.
- The chairman and the lead independent director shall jointly determine (or, if either is involved in the transaction, the other shall determine) whether the matter should be considered by the board or by one of its existing committees.

- If a director is involved in the transaction, he or she will be recused from all discussions and decisions about the transaction.
- The transaction must be approved in advance whenever practicable, and if not practicable, must be ratified, if appropriate, as promptly as practicable.
- The board or relevant committee will review the transaction annually to determine whether it continues to be in the company's best interests.

The Directors and Corporate Governance Committee has approved the following employment relationships that are considered related-party transactions under the SEC rules.

We have four current or former employees who are relatives or related persons of current or former executive officers. Dr. John Bamforth, Vice President, Global Marketing, Bio-Medicines, is the spouse of Dr. Susan Mahony, an executive officer. Myles O'Neill, Senior Vice President, and President, Manufacturing Operations, is the spouse of Dr. Fionnuala Walsh, a former executive officer. Andrew Lechleiter, General Manager, Hong Kong and Macau, is the son of Dr. John Lechleiter, Lilly's former chairman of the board. Finally, William Grose, former Consultant Engineer, is the partner of Johna Norton, an executive officer. For 2017, these four employees received cash and equity compensation totaling between $165,000 and $1,780,000.

All four individuals participate or participated in the company's benefit programs generally available to U.S. employees. Their compensation is consistent with the compensation paid to other employees at their levels and with the Company's overall compensation principles based on their years of experience, performance, and positions within the company.

Communication with the Board of Directors

You may send written communications to one or more members of the board, addressed to:

Board of Directors
Eli Lilly and Company
c/o Corporate Secretary
Lilly Corporate Center
Indianapolis, IN 46285

Shareholder Engagement on Governance Issues

Each year, the company engages large shareholders and other key constituents to discuss areas of interest or concern related to corporate governance, as well as any specific issues for the coming proxy season. In 2017, we spoke with a number of our largest investors. Issues discussed included shareholders' perspectives regarding a potential management proposal to eliminate the company's classified board and supermajority voting requirements, proxy access, board composition and recruitment, the company's executive compensation, and shareholders' ability to amend the bylaws, among other topics. The overall tone of these conversations was productive and positive, and the investors with whom we spoke were generally supportive of our performance and our overall compensation and governance policies, although a few shareholders shared differing views on some of our governance practices. This feedback has been discussed by our CEO and chair, the lead independent director, our Compensation Committee, and our Directors and Corporate Governance Committee, and it was a key input into board discussions on corporate governance topics. As a result of these discussions and its own deliberations, the board decided to put forward the two management proposals described below. We are committed to continuing to engage with our investors to ensure their diverse perspectives are thoughtfully considered.

Management Proposals to Eliminate Classified Board and Supermajority Voting Requirements

Each year between 2007 and 2012, our management put forward proposals to eliminate the company's classified board structure. The proposals did not pass because they failed to receive a "supermajority vote" of 80 percent of the outstanding shares, as required in the company's articles of incorporation. In addition, in 2010, 2011, and 2012, we submitted management proposals to eliminate the supermajority voting requirements themselves. Those proposals also fell short of the required 80 percent vote.

Prior to 2012, these proposals received support ranging from 72 to 77 percent of the outstanding shares. In 2012, the vote was approximately 63 percent of the outstanding shares, driven in part by a 2012 NYSE rule revision prohibiting brokers from voting their clients' shares on corporate governance matters absent specific instructions from such clients. We have resubmitted both proposals this year for consideration at the 2018 Annual Meeting (see Items 4 and 5). We will continue to engage with our shareholders on these and other topics to ensure that we continue to demonstrate strong corporate governance and accountability to shareholders.

Shareholder Proposals

If a shareholder wishes to have a proposal considered for inclusion in next year's proxy statement, he or she must submit the proposal in writing so that we receive it by November 19, 2018. Proposals should be addressed to the company's corporate secretary, Lilly Corporate Center, Indianapolis, Indiana 46285. In addition, the company's bylaws provide that any shareholder wishing to propose any other business at the annual meeting must give the company written notice by November 19, 2018, and no earlier than September 20, 2018. That notice must provide certain other information as described in the bylaws. Copies of the bylaws are available online at https://www.lilly.com/who-we-are/governance or upon request to the company's corporate secretary.

Shareholder Recommendations and Nominations for Director Candidates

A shareholder who wishes to recommend a director candidate for evaluation should forward the candidate's name and information about the candidate's qualifications to:

Chair of the Directors and Corporate Governance Committee
c/o Corporate Secretary
Lilly Corporate Center
Indianapolis, IN 46285

The candidate must meet the selection criteria described above and must be willing and expressly interested in serving on the board.

Under Section 1.9 of the company's bylaws, a shareholder who wishes to directly nominate a director candidate at the 2019 annual meeting (i.e., to propose a candidate for election who is not otherwise nominated by the board through the recommendation process described above) must give the company written notice by November 19, 2018, and no earlier than September 20, 2018. The notice should be addressed to the corporate secretary at the address provided above. The notice must contain prescribed information about the candidate and about the shareholder proposing the candidate as described in more detail in Section 1.9 of the bylaws. A copy of the bylaws is available online at https://www.lilly.com/who-we-are/governance. The bylaws will also be provided by mail upon request to the corporate secretary.

We have not received any notice regarding shareholder nominations for board candidates or other shareholder business to be presented at the 2018 shareholders' meeting.

Ownership of Company Stock

Common Stock Ownership by Directors and Executive Officers

The following table sets forth the number of shares of company common stock beneficially owned by the directors, the named executive officers, and all directors and executive officers as a group, as of February 16, 2018. None of the stock or stock units owned by any of the listed individuals has been pledged as collateral for a loan or other obligation.

Beneficial Owners	Common Stock [1]		
	Shares Owned [2]	Stock Units Distributable Within 60 Days [3]	Stock Units Not Distributable Within 60 Days [4]
Ralph Alvarez	—	—	39,627
Katherine Baicker, Ph.D.	—	—	15,001
Carolyn R Bertozzi, Ph.D.	—	—	1,764
Enrique A. Conterno	143,553	—	66,837
Michael L. Eskew	—	—	37,020
J. Erik Fyrwald	100	—	58,059
Michael J. Harrington	92,363	—	12,778
R. David Hoover	1,500	—	36,492
Jamere Jackson	—	—	2,459
William G. Kaelin, Jr., M.D.	—	—	13,516
Juan R. Luciano	—	—	5,428
Jan M. Lundberg, Ph.D.	199,220	—	27,871
Ellen R. Marram	1,000	—	52,373
David A. Ricks	136,553 [5]	—	12,222
Marschall S. Runge, M.D., Ph.D.	—	—	9,327
Kathi P. Seifert	3,533	—	65,061
Joshua L. Smiley	24,868	—	7,947
Jackson P. Tai	42,141	—	8,799
All directors and executive officers as a group (28 people):	1,179,936	—	586,114

[1] The sum of the "Shares Owned" and "Stock Units Distributable Within 60 Days" columns represents the shares considered "beneficially owned" for purposes of disclosure in the proxy statement. Unless otherwise indicated in a footnote, each person listed in the table possesses sole voting and sole investment power with respect to their shares. No person listed in the table owns more than 0.02 percent of the outstanding common stock of the company. All directors and executive officers as a group own approximately 0.11 percent of the outstanding common stock of the company.

[2] This column includes the number of shares of common stock held individually as well as the number of 401(k) Plan shares held by the beneficial owners indirectly through the 401(k) Plan.

[3] This column sets forth restricted stock units that vest within 60 days of February 16, 2018.

[4] For the executive officers, this column reflects restricted stock units that will not vest within 60 days of February 16, 2018. For the independent directors, this column includes the number of stock units credited to the directors' accounts in the Lilly Directors' Deferral Plan.

[5] The shares shown for Mr. Ricks include 11,389 shares that are owned by a family foundation for which he is a director. Mr. Ricks has shared voting power and shared investment power with respect to the shares held by the foundation.

Principal Holders of Stock
To the best of the company's knowledge, the only beneficial owners of more than 5 percent of the outstanding shares of the company's common stock, as of December 31, 2017, are the shareholders listed below:

Name and Address	Number of Shares Beneficially Owned	Percent of Class
Lilly Endowment Inc. (the Endowment) 2801 North Meridian Street Indianapolis, IN 46208	123,075,804	11.2%
The Vanguard Group 100 Vanguard Blvd. Malvern, PA 19355	72,222,397	6.5%
BlackRock, Inc. 55 East 52nd Street New York, NY 10055	63,854,112	5.8%
Wellington Management Group LLP 280 Congress Street Boston, MA 02210	56,663,547	5.1%

The Endowment has sole voting and sole dispositive power with respect to all of its shares. The Board of Directors of the Endowment is composed of N. Clay Robbins, chairman, president & chief executive officer; Mary K. Lisher; William G. Enright; Daniel P. Carmichael; Charles E. Golden; Eli Lilly II; David N. Shane; Craig Dykstra; and Jennett M. Hill.

The Vanguard Group provides investment management services for various clients. It has sole voting power with respect to 1,396,140 of its shares and sole dispositive power with respect to 70,638,700 of its shares.

BlackRock, Inc. provides investment management services for various clients. It has sole voting power with respect to 54,703,471 of its shares and sole dispositive power with respect to all of its shares.

Wellington Management Group LLP provides investment management services for various clients. It has shared voting power with respect to 10,291,969 shares and shared dispositive power with respect to all of its shares.

Compensation

Item 2. Advisory Vote on Compensation Paid to Named Executive Officers

Section 14A of the Securities Exchange Act of 1934 provides the company's shareholders with the opportunity to approve, on an advisory basis, the compensation of the company's named executive officers as disclosed in the proxy statement. Our compensation philosophy is designed to attract and retain highly talented individuals and motivate them to create long-term shareholder value by achieving top-tier corporate performance while embracing the company's values of integrity, excellence, and respect for people.

The Compensation Committee and the Board of Directors believe that our executive compensation aligns well with our philosophy and with corporate performance. Executive compensation is an important matter for our shareholders. We routinely review our compensation practices and engage in ongoing dialogue with our shareholders to ensure our practices are aligned with stakeholder interests and reflect best practices.

We request shareholder approval, on an advisory basis, of the compensation of the company's named executive officers as disclosed in this proxy statement. As an advisory vote, this proposal is not binding on the company. However, the Compensation Committee values input from shareholders and will consider the outcome of the vote when making future executive compensation decisions.

Board Recommendation on Item 2

The Board of Directors recommends that you vote FOR the approval, on an advisory basis, of the compensation paid to the named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis (CD&A), the compensation tables, and related narratives provided below in this proxy statement.

Compensation Discussion and Analysis

This CD&A describes our executive compensation philosophy, the Compensation Committee's process for setting executive compensation, the elements of our compensation program, the factors the committee considered when setting executive compensation in 2017, and how the company's results affected incentive payouts for 2017 performance.

Say-on-Pay Results for 2017

At last year's annual meeting, more than 97 percent of the shares cast voted in favor of the company's Say-on-Pay proposal on executive compensation. Management and the Compensation Committee view this vote as supportive of the company's overall approach toward executive compensation.

Our Philosophy on Compensation

At Lilly, our mission is to make medicines that help people live longer, healthier, more active lives. To accomplish our mission, we must attract, engage, and retain highly talented individuals who are committed to the company's core values of integrity, excellence, and respect for people. Our compensation programs are designed to help us achieve these goals while balancing the long-term interests of our shareholders and customers.

Objectives

Our compensation and benefits programs are based on the following objectives:

- ***Reflect individual and company performance.*** We reinforce a high-performance culture by linking pay with individual performance and company performance. As employees assume greater responsibilities, the proportion of total compensation based on company performance and shareholder returns increases. We perform an annual review to ensure the programs provide incentives to deliver long-term, sustainable business results while discouraging excessive risk-taking or other adverse behaviors.

- ***Attract and retain talented employees.*** Compensation opportunities should be competitive with our peer group and reflect the level of job impact and responsibilities. Retention of talent is an important factor in the design of our compensation and benefit programs.

- ***Implement broad-based programs.*** While the amount of compensation paid to employees varies, the overall structure of our compensation and benefit programs is broadly similar across the organization to encourage and reward all employees who contribute to our success.

- ***Consider shareholder input.*** Management and the Compensation Committee consider the results of our annual Say-on-Pay vote and other sources of shareholder feedback when designing compensation and benefit programs.

Compensation Committee's Processes and Analyses

Process For Setting Compensation

The Compensation Committee considers the following in determining executive compensation:

- ***Assessment of the executive's individual performance and contribution***.
  - *CEO*: Generally, the independent directors, under the direction of the lead independent director, meet with the CEO at the beginning of each year to agree upon the CEO's performance objectives for the year. At the end of the year, the independent directors meet to assess the CEO's achievement of those objectives along with other factors, including contribution to the company's performance and ethics and integrity. The year-end evaluation is used in setting the CEO's compensation for the next year. In June 2016, David A. Ricks was appointed to serve as CEO, effective January 1, 2017, and his 2017 compensation for the role of Chairman, President, and CEO was set at that time.
  - *Other Executive Officers*: The committee receives individual performance assessments and compensation recommendations from the CEO and exercises its judgment based on the board's knowledge and interactions with the executive officers. Each executive officer's performance assessment is based on achievement of objectives established between such executive officer and the CEO at the start of the year, as well as other factors, including the demonstration of Lilly values and leadership behaviors. For new executive officers, compensation is set by the Compensation Committee at time of promotion or offer**.**

- ***Assessment of company performance***. The Compensation Committee considers company performance in two ways:
  - As a factor in establishing target compensation for the coming year, the committee considers overall company performance during the prior year across a variety of metrics.
  - To determine payouts under the cash and equity incentive programs, the committee establishes specific company performance goals related to revenue, EPS, progress of our pipeline portfolio, stock price growth, and total shareholder return (TSR) relative to our peer companies.

- ***Peer group analysis***. The committee uses peer group data as a market check for compensation decisions but does not use this data as the sole basis for its compensation targets. The company does not target a specific position within that range of market data.

- ***Input from an independent compensation consultant concerning executive pay***. The role of the independent compensation consultant is described under the "Compensation Committee Matters" section that follows the CD&A.

Competitive Pay Assessment

Our peer group comprises companies that directly compete with us, operate in a similar business model, and employ people with the unique skills required to operate an established biopharmaceutical company. The committee selects a peer group whose median market cap and revenues are broadly similar to Lilly. The committee reviews the peer group at least every three years. The committee reviewed the peer group for purposes of assessing competitive pay in June 2015 and decided to include Abbvie, Amgen, AstraZeneca, Baxter, Biogen, Bristol-Myers Squibb, Celgene, Gilead, GlaxoSmithKline, Hoffman-La Roche, Johnson & Johnson, Medtronic, Merck, Novartis, Pfizer, Sanofi-Aventis, and Shire Plc. With the exception of Johnson & Johnson, Novartis, and Pfizer, peer companies were no greater than three times our size with regard to both measures. The committee included these three companies despite their size because they compete directly with Lilly, have similar business models, and seek to hire from the same pool of management and scientific talent.

When determining pay levels, the committee considers an analysis provided by management of peer group pay for each executive officer position (except CEO) along with internal factors such as the performance and experience of each executive officer. The independent compensation consultant for the committee provides a

similar analysis when recommending pay levels for the CEO. This analysis includes a comparison of actual total direct compensation for Lilly's CEO in the prior year to the peer group, as well as a comparison of current target total direct compensation for Lilly's CEO to the most recent available data for the peer group. In the aggregate, the company's target total compensation to named executive officers was in the middle range of the peer group at the end of 2017.

Components of Our Compensation

Our executive compensation has three components:

- base salary;
- annual cash bonus, which is calculated based on company performance relative to internal targets for revenue, EPS, and the progress of the pipeline; and
- two different forms of equity incentives:
  - performance awards-equity awards that vest over three years with a performance component measuring the company's two-year growth in EPS relative to the expected peer group growth followed by a 13-month service-vesting period; and
  - shareholder value awards, which are performance-based equity awards that pay out based on absolute company stock price growth and TSR relative to peers, both measured over a three-year period, followed by a one-year holding period.

Executives also receive a company benefits package, described below under "Other Compensation Practices and Information - Employee Benefits."

Adjustments to Reported Financial Results

The Compensation Committee has authority to adjust the reported revenue and EPS upon which incentive compensation payouts are determined to eliminate the distorting effect of unusual income or expense items. These items may affect year-over-year growth percentages or comparability with peer companies. The committee considers the adjustments approved by the Audit Committee for reporting non-GAAP EPS and other adjustments, based on guidelines approved by the committee prior to the performance period. Further details on the adjustments for 2017 and the rationale for making these adjustments are set forth in Appendix A, "Summary of Adjustments Related to the Annual Cash Bonus and Performance Award." For ease of reference, throughout the CD&A and the other compensation disclosures, we refer simply to "revenue" and "EPS" but we encourage you to review the information in Appendix A to understand the adjustments from GAAP revenue and EPS that were approved.

1. Base Salary

Base salaries are reviewed and established annually and may be adjusted upon promotion, following a change in job responsibilities, or to maintain market competitiveness. Salaries are based on each person's level of contribution, responsibility, expertise, and competitiveness with peer group data.

Base salary increases are established based upon a corporate budget for salary increases, which is set considering company performance over the prior year, expected company performance for the following year, and general external trends. In setting salaries, the Compensation Committee seeks to retain, motivate, and reward successful performers while maintaining affordability within the company's business plan.

2. Annual Cash Bonus

The Eli Lilly and Company Bonus Plan (Bonus Plan) is designed to reward the achievement of the company's financial plans and pipeline objectives for the year. The bonus is based on three areas of company performance relative to internal targets: revenue, EPS, and pipeline progress.

Company performance goals and individual bonus targets are set at the beginning of each year. Actual payout can range from 0 to 200 percent of an individual's bonus target. The Compensation Committee references the

annual operating plan to establish performance targets and to assess the relative weighting for each objective. The 2017 weightings remained unchanged from the prior year:

Goal	Weighting
Revenue performance	25%
EPS performance	50%
Pipeline progress	25%

Based on this weighting, the company bonus multiple is calculated as follows:

(0.25 x revenue multiple) + (0.50 x EPS multiple) + (0.25 x pipeline multiple) = company bonus multiple

The annual cash bonus payout is calculated as follows:

company bonus multiple x individual bonus target x base salary earnings = payout

To preserve tax deductibility of bonus payouts in 2017, executive officers are subject to the Executive Officer Incentive Plan (EOIP). Under the EOIP, the maximum annual cash bonus allowable is calculated based on non-GAAP net income (generally described in "Adjustments to Reported Results" in Appendix A) for the year. For the CEO, the maximum bonus award is 0.3 percent of non-GAAP net income. For other executive officers, the maximum amount is 0.15 percent of non-GAAP net income. None of the executive officers will receive an annual cash bonus payment unless the company has positive non-GAAP net income for the year.

Once the maximum payout for an executive officer is determined, the Compensation Committee has the discretion to reduce (but not increase) the amount to be paid. In exercising this discretion, the committee intends to award the lesser of (i) the bonus they would have received under the Bonus Plan or (ii) the EOIP maximum payout.

3. Equity Incentives

The company grants two types of equity incentives to executive officers—performance awards and shareholder value awards. Performance awards are designed to focus company leaders on multi-year operational performance relative to peer companies. Shareholder value awards align earned compensation with long-term growth in shareholder value and relative TSR performance within our industry. The Compensation Committee has the discretion to adjust downward (but not upward) any executive officer's equity award payout from the amount yielded by the applicable formula.

Performance Awards

Performance awards vest over three years. Potential shares are based on achieving EPS growth targets over a two-year performance period, followed by an additional 13-month service-vesting period during which the award is held in the form of restricted stock units. The growth-rate targets are set relative to the median expected EPS growth for our peer group. These awards do not accumulate dividends during the two-year performance period, but they do accumulate dividend equivalent units during the service-vesting period.

The Compensation Committee believes EPS growth is an effective measure of operational performance because it is closely linked to shareholder value, is broadly communicated to the public, is easily understood by employees, and allows for objective comparisons to peer group performance. Consistent with our compensation objectives, company performance exceeding the expected peer group median will result in above-target payouts, while company performance lagging the expected peer group median will result in below-target payouts. Possible payouts range from 0 to 150 percent of the target, depending on EPS growth over the performance period.

The measure of EPS used in the performance award program differs from the measure used in our annual cash bonus program in two ways. First, the EPS goal in the bonus program is set with reference to internal goals that align to our annual operating plan for the year, while the EPS goal in the performance award program is set based on the expected growth rates of our peer group. Second, the bonus program measures EPS over a one-year period, while the performance award program measures EPS over a two-year period. In a given year, the bonus program may pay out above target while the performance award pays out below target (or vice versa).

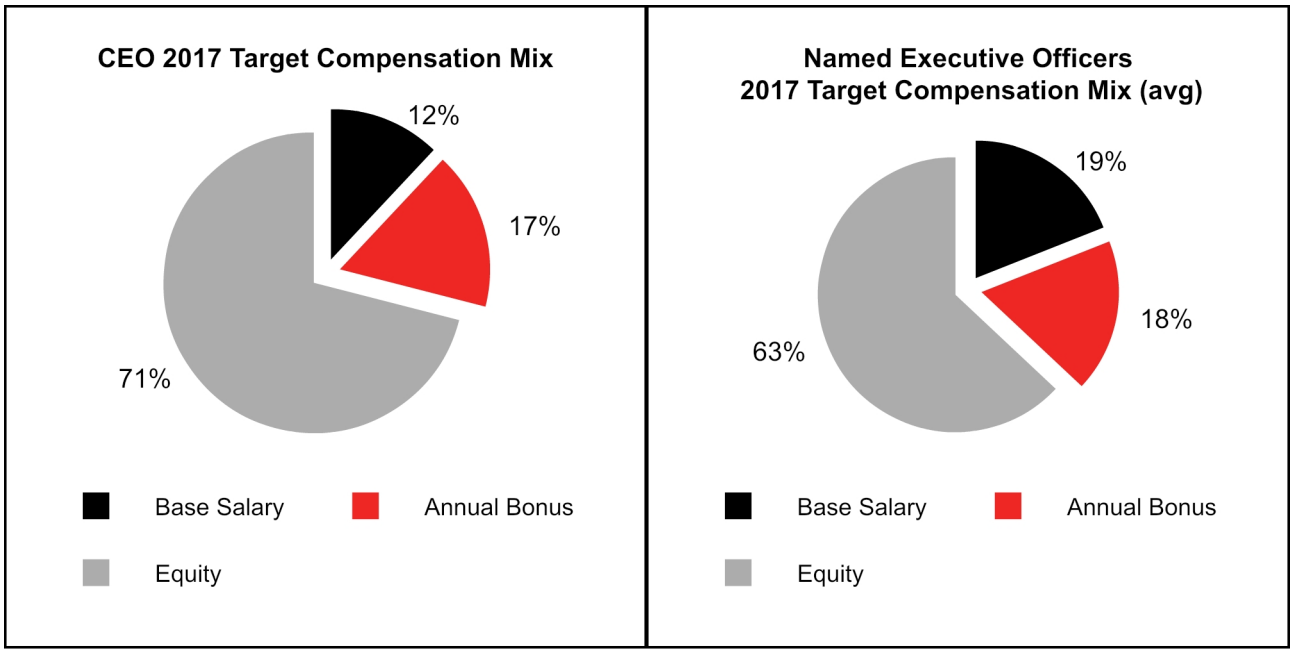
Shareholder Value Awards

Shareholder value awards are earned based on Lilly's share price (and beginning with 2016 grants, relative TSR performance). Shareholder value awards have a three-year performance period, and any shares paid are subject to a one-year holding requirement. No dividends are accrued during the performance period. Shareholder value awards pay above target if Lilly's stock outperforms an expected rate of return and below target if Lilly's stock underperforms that expected rate of return. The expected rate of return is based on the three-year TSR that a reasonable investor would consider appropriate when investing in a basket of large-cap U.S. companies, as determined by the Compensation Committee. The minimum price to achieve target is calculated by multiplying the starting share price of Lilly's stock by the three-year compounded expected rate of return less Lilly's dividend yield. Executive officers receive no payout if Lilly's TSR for the three-year period is zero or negative. Possible payouts are based on share price growth and range from 0 to 150 percent of the target amount.

Beginning with the 2016-2018 shareholder value awards, a modifier based on Lilly's three-year cumulative TSR relative to our peer companies' median TSR performance will be applied to executive officer payouts. If Lilly's TSR is above the median of our peers, the payout is increased by 1 percent for every percentage point that Lilly's TSR exceeds the median (up to a maximum of 20 percent). Likewise, if Lilly's TSR is below the median, the payout will be reduced by up to a maximum of 20 percent. The committee added the relative TSR modifier to the shareholder value award program because it ensures executive officers' rewards align with shareholder experience while also encouraging strong performance within the industry.

Pay for Performance

The mix of compensation for the CEO and other named executive officers reflects our desire to link executive compensation with company performance. As reflected in the charts below, a substantial portion of the target pay for all named executive officers is performance-based. Both the annual cash bonus and equity payouts are contingent upon company performance, with the bonus factoring in performance over a one-year period, and equity compensation factoring in performance over two- and three-year periods (as described above under "Components of Our Compensation—3. Equity Incentives").



2017 Target Total Compensation

Performance Review Process

In setting potential executive officer compensation for 2017, the Compensation Committee considered both individual and company performance during 2016.

2016 Individual Named Executive Officer Performance

A summary of the committee's review of the individual named executive officers is provided below:

David Ricks, Chairman, President and Chief Executive Officer: Mr. Ricks became CEO and President on January 1, 2017, and Chairman on June 1, 2017. Mr. Ricks' 2017 compensation opportunity was determined by the committee with input from its independent consultant and using competitive market data as context. Mr. Ricks was promoted based in part on his experience and success in his prior roles. Prior to his appointment as President and CEO, Mr. Ricks was President, Lilly Bio-Medicines for nearly five years where he successfully guided Lilly Bio-Medicines through a period of profound change. As President, Lilly Bio-Medicines, Mr. Ricks had experience in the areas of product development, global sales and marketing as well as public policy. He is well respected inside and outside the company, consistently builds exceptional teams, and sets high standards of performance. Prior to being named President, Lilly Bio-Medicines, Mr. Ricks led Lilly's business operations in Canada, China, and the U.S.

Enrique Conterno, Senior Vice President and President, Lilly Diabetes and President Lilly USA: Under Mr. Conterno's leadership, the Diabetes business had a very strong year in 2016 with volume growth of 28 percent. Mr. Conterno effectively partnered across the value cycle to drive the Diabetes business's strategic plan and provided leadership across our human health commercial businesses. Additionally, effective January 2017, Mr. Conterno assumed additional geographic responsibilities and was named President, Lilly USA. In this role, he led the U.S. affiliate through organization and structural changes as Lilly Diabetes became the host for the company's human pharmaceutical commercial operations in the U.S., China, Japan, and Canada.

Derica Rice (retired), Executive Vice President, Global Services and Chief Financial Officer: Mr. Rice demonstrated strong partnership with business leaders in 2016 by facilitating the completion of the acquisition of Vetmedica. Mr. Rice took an active role in partnering with R&D on portfolio management and business development. Mr. Rice also successfully facilitated key leadership transitions in his function.

Jan Lundberg, Executive Vice President, Science and Technology and President, Lilly Research Laboratories: Under Dr. Lundberg's leadership, Lilly Research Laboratories achieved significant pipeline progression in 2016 including regulatory approvals for Taltz, and Lartruvo®, and the launch of Phase 3 trials for all but one planned program. Dr. Lundberg played a key leadership role in increasing the company's focus on external research and initiatives to expand the company's research presence, which yielded positive results under his leadership.

Michael Harrington, Senior Vice President and General Counsel: Mr. Harrington was effective and influential in his role as General Counsel in 2016 and he was a productive partner with the executive team. Under Mr. Harrington, the company prevailed in several key patent lawsuits, including defending patent protection for Alimta®. Mr. Harrington also led a company initiative to increase protection of Lilly's intellectual property assets and improve cyber security.

Target Compensation

The information below reflects total compensation at target for named executive officers for 2017. The actual compensation received in 2017 is summarized below in "2017 Compensation Payouts."

Rationale for Changes to Named Executive Officer Target Compensation

The committee established 2017 target total compensation opportunities for each named executive officer based on the named executive officer's 2016 performance, internal relativity, and peer group data. In anticipation of Dr. John Lechleiter's retirement at the end of 2016, the board appointed Mr. Ricks as President and CEO effective January 1, 2017. The committee set Mr. Ricks' 2017 base salary and bonus target in August 2016 in conjunction with his appointment and approved the value of his 2017 equity in December 2016 to reflect his promotion. For the other named executive officers, the committee approved salary increases, aligned with the company's annual increase guidelines. Bonus targets as a percentage of base salary for all named executive officers remained unchanged from the prior year. In light of the Diabetes business's strong performance, Mr. Conterno also received an increase in his equity award.

Base Salary

The following table outlines the salary increase for each named executive approved by the committee in December 2016, except for Mr. Ricks, who took the role of President and CEO in January 2017. Each named executive officer's actual base salary earned during 2017 is reflected in the Summary Compensation Table in the "Executive Compensation" section of this proxy.

Name	2016 Annual Base Salary	2017 Annual Base Salary	Increase (effective March 1, 2017)
Mr. Ricks	N/A	$1,400,000	—
Mr. Conterno	$731,511	$768,100	5%
Mr. Rice (retired)	$1,071,306	$1,092,700	2%
Dr. Lundberg	$1,007,855	$1,028,000	2%
Mr. Harrington	$835,280	$860,300	3%

Annual Cash Bonus Targets

Based on a review of internal relativity, peer group data, and individual performance, the committee decided to retain the same bonus targets for all named executive officers in 2017. Bonus targets are shown in the table below as a percentage of each named executive officer's base salary earnings:

Name	2016 Bonus Target	2017 Bonus Target
Mr. Ricks	N/A	150%
Mr. Conterno	80%	80%
Mr. Rice (retired)	100%	100%
Dr. Lundberg	100%	100%
Mr. Harrington	80%	80%

Total Equity Program - Target Grant Values

For 2017 equity grants, the committee set the total target values for named executive officers based on internal relativity, individual performance, and peer group data. Named executive officers have 60 percent of their equity target allocated to shareholder value award and 40 percent to performance award. Total target values for the 2016 and 2017 equity grants to the named executive officers were as follows:

Name	2016 Annual Equity Grant	2017 Annual Equity Grant
Mr. Ricks	N/A	$8,500,000
Mr. Conterno	$2,200,000	$2,500,000
Mr. Rice (retired)	$3,800,000	$3,800,000
Dr. Lundberg	$3,600,000	$3,600,000
Mr. Harrington	$2,300,000	$2,300,000

Performance Goals for 2017 Incentive Programs

Annual Cash Bonus Goals

The Compensation Committee established the company performance targets using the company's 2017 corporate operating plan approved by the Board of Directors in 2016. These targets are described below under "2017 Compensation Payouts."

Performance Awards – 2017-2019 Performance Award (PA)

In February 2017, the committee established a cumulative, compounded two-year EPS growth target of 5.3 percent per year based on investment analysts' EPS growth estimates for our peer group companies at that time.

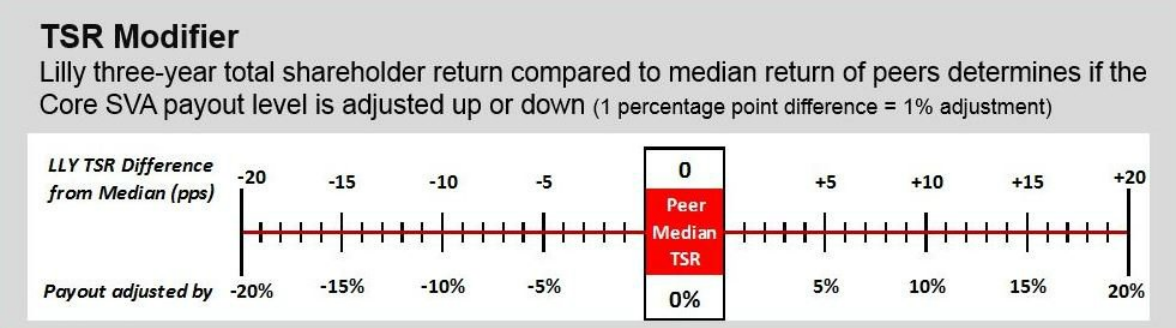
Payouts for the 2017-2019 performance award range from 0 to 150 percent of the target, as illustrated in the chart below:

Shareholder Value Awards – 2017-2019 Shareholder Value Award (SVA)

For purposes of establishing the stock price target for the shareholder value awards, the starting price was $72.15 per share, the average closing stock price for all trading days in November and December 2016. The target share price was established using the expected annual rate of return for large-cap companies (8 percent), less an assumed Lilly dividend yield of 2.88 percent. To determine payout, the ending price will be the average of the closing prices of company stock for all trading days in November and December 2019. The award is designed to deliver no payout to executive officers if the shareholder return (including projected dividends) is zero or negative. Possible payouts based on share price ranges are illustrated in the grid below.

Ending Stock Price	Less than $65.80	$65.80-$74.79	$74.80-$83.79	$83.80-$92.79	$92.80-$101.79	Greater than $101.79
Compounded Annual Share Price Growth Rate (excluding dividends)	Less than (3.0%)	(3.0%)-1.2%	1.2-5.1%	5.1%-8.8%	8.8%-12.2%	Greater than 12.2%
Percent of Target	0%	50%	75%	100%	125%	150%

Executive officer awards are subject to a relative TSR modifier, as outlined in the grid below. The number of shares to be paid will increase or decrease by 1 percent for every percentage point Lilly's three-year TSR deviates from our peer group's median three-year TSR, capped at 20 percent.



Special Retention Restricted Stock Unit Grant

The Compensation Committee approved a special retention grant of $3 million in restricted stock units for Enrique Conterno, Senior Vice President and President, Lilly Diabetes and President, Lilly USA. This type of award is rare at Lilly—we have not delivered a special grant to an executive officer (other than an external hire) in a number of years. Mr. Conterno is a talented leader who built the diabetes business into our largest franchise and accepted the additional responsibility as head of Lilly USA. His leadership of diabetes and across the enterprise is critical to delivering on our strategy under our new Chairman and CEO. In particular, we value the continuity of his leadership in a time of significant transition at the company. The award has a four-year vesting period, and it will be forfeited if Mr. Conterno resigns or retires from the company prior to December 11, 2021.

2017 Compensation Payouts

The information in this section reflects the amounts paid to named executive officers for the annual cash bonus and for equity awards granted in prior years for which the relevant performance period ended in 2017.

Company Performance

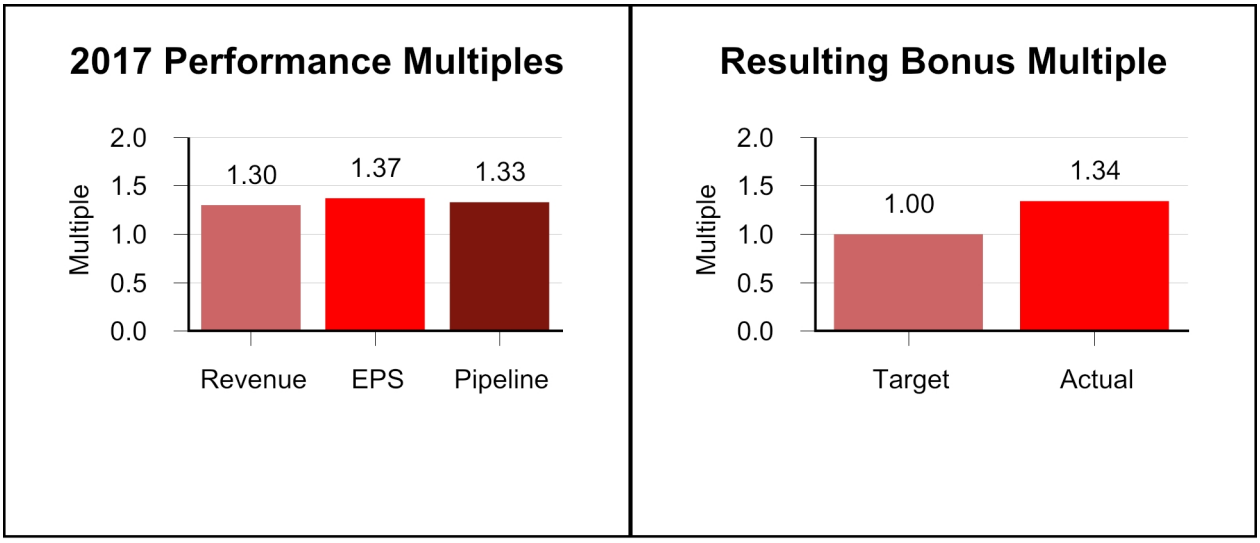
In 2017 we exceeded both our annual revenue and EPS targets. We also made significant progress on our pipeline, meeting or exceeding all of our pipeline targets. Key pipeline highlights include first regulatory approval for Verzenio and Olumiant, along with nine other new approvals, indications, or line extensions.

Annual Cash Bonus

The company's performance compared to targets for revenue, EPS, and pipeline progress, as well as the resulting bonus multiple, is illustrated below.

	2017 Corporate Target	Adjusted Results*	Multiple
Revenue	$22.3 billion	$22.9 billion	1.30
EPS	$4.15	$4.28	1.37
Pipeline score	3.00	3.65	1.33
Resulting Bonus Multiple			1.34

*See Appendix A, “Summary of Adjustments Related to the Annual Cash Bonus and Performance Award”.



The Science and Technology Committee's assessment of the company's progress toward achieving product pipeline goals is detailed below:

Activity	Objective	Achievement
Approvals	1 new drug first approval 9 other approvals	2 new drug first approvals 9 other approvals
Potential new drug Phase 3 starts	2	2
Potential new drug Phase 1 starts	9-10	11
Potential new indication or line extension Phase 3 starts	2	4
Plan Boldly	Meet industry benchmark for speed of development	Plans exceeded industry benchmark
Deliver to Launch	Meet planned project timelines	Delivered faster than project plans
Qualitative Assessment	Chief scientific officer's assessment of performance against strategic objectives	

Based on the recommendation of the Science and Technology Committee, the Compensation Committee certified a pipeline score of 3.65, resulting in a pipeline multiple of 1.33.

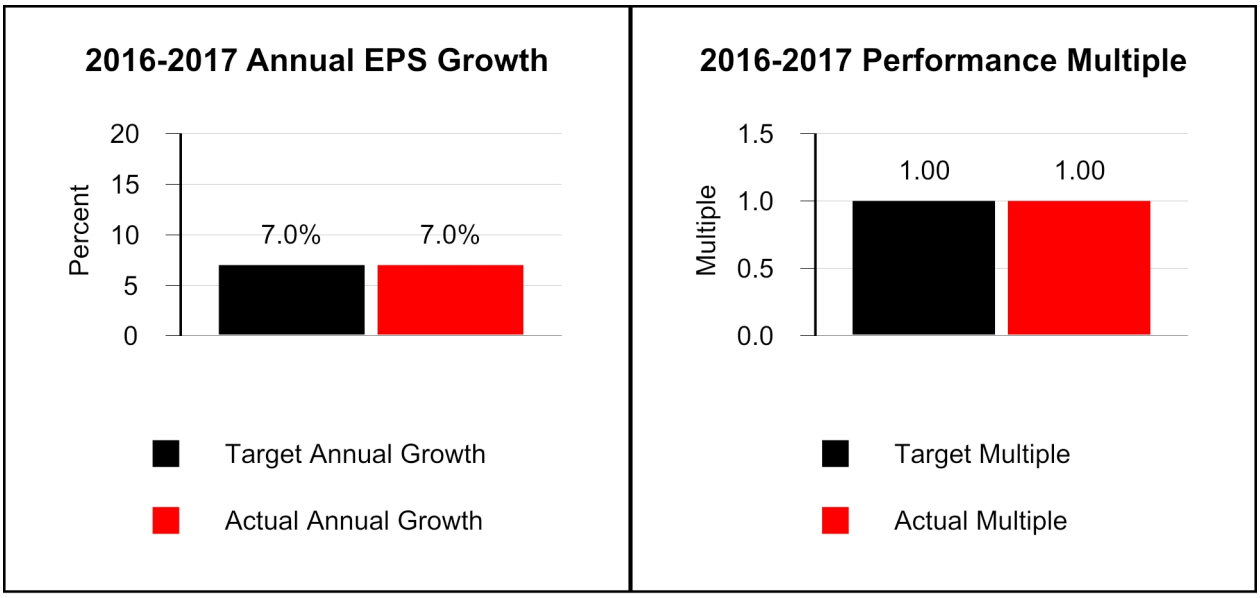
When combined, the revenue, EPS, and pipeline multiples yielded a bonus multiple of 1.34.

(0.25 x 1.30) + (0.50 x 1.37) + (0.25 x 1.33) = 1.34 bonus multiple

The cash bonus amounts paid to named executive officers for 2017 are reflected in the Summary Compensation Table.

2016-2018 Performance Award

The target cumulative EPS for the 2016-2018 performance award was set in the first quarter of 2016 reflecting expected industry growth of 7.0 percent each year over the two-year performance period of 2016-2017. The company's actual annual EPS growth for the two-year period was 7.0 percent. This outcome was largely driven by volume growth from our newer products.

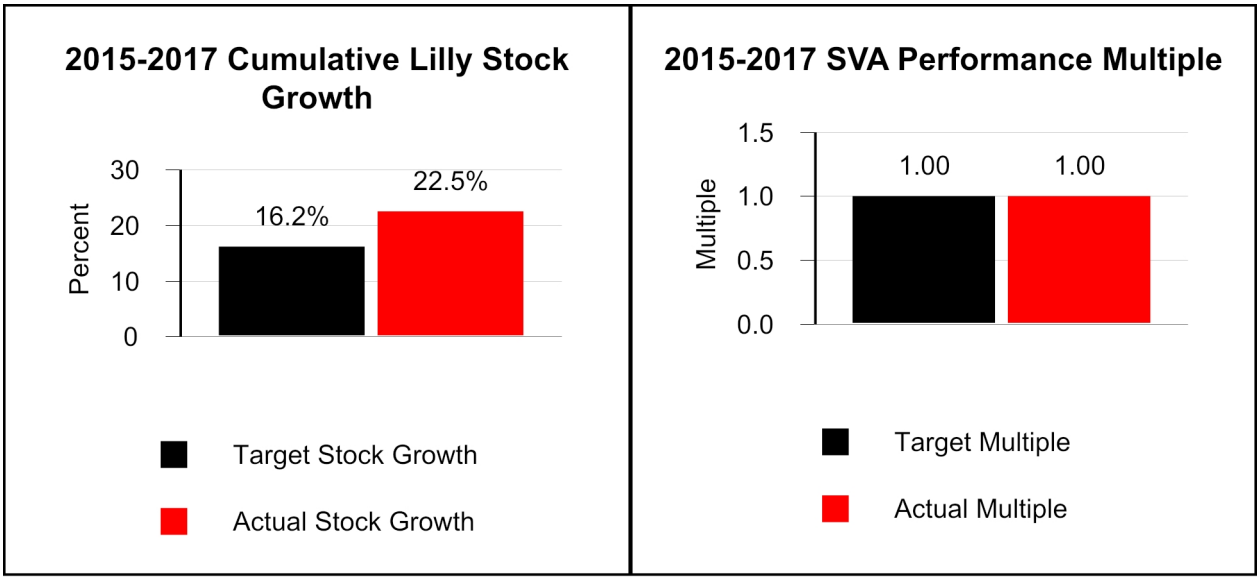


For the named executive officers, the number of shares earned and subject to an additional 13-month service-vesting period under the 2016-2018 performance award is reflected in the table below (this information is also included in footnote 5 to the "Outstanding Equity Awards" table in the "Executive Compensation" section below):

Name	Target Shares	RSUs Earned
Mr. Ricks	N/A	N/A
Mr. Conterno	12,222	12,222
Mr. Rice (retired)	21,111	21,111
Dr. Lundberg	20,000	20,000
Mr. Harrington	12,778	12,778

2015-2017 Shareholder Value Award

The target stock price range of $80.30 to $86.17 (16.2% to 24.6% stock price growth) for the 2015-2017 shareholder value award was set in 2015 based on a beginning stock price of $69.13, which was the average closing price for Lilly stock for all trading days in November and December 2014. The ending stock price of $84.70 represents a stock price growth of approximately 22.5 percent over the relevant three-year period. The company’s performance compared to target (and the resulting payout multiple) for this award is shown below.



The shares paid to named executive officers during 2018 for the 2015-2017 shareholder value award were as follows:

Name	Target Shares	Shares Paid Out
Mr. Ricks	N/A	N/A
Mr. Conterno	22,507	22,507
Mr. Rice (retired)	42,764	42,764
Dr. Lundberg	38,262	38,262
Mr. Harrington	25,883	25,883

Other Compensation Practices and Information

Employee Benefits

The company offers core employee benefits coverage to:

- provide our workforce with a reasonable level of financial support in the event of illness or injury
- provide post-retirement income
- enhance productivity and job satisfaction through benefit programs that focus on overall well-being.

The benefits available are the same for all U.S. employees and include medical and dental coverage, disability insurance, and life insurance. In addition, The Lilly Employee 401(k) plan (401(k) Plan) and The Lilly Retirement Plan (the Retirement Plan) provide U.S. employees a reasonable level of retirement income reflecting employees' careers with the company. To the extent that any employee's retirement benefit exceeds Internal Revenue Service (IRS) limits for amounts that can be paid through a qualified plan, the company also offers a nonqualified pension plan and a nonqualified savings plan. These plans provide only the difference between the calculated benefits and the IRS limits, and the formula is the same for all U.S. employees. The cost of employee benefits is partially borne by the employee, including each executive officer.

Perquisites

The company provides very limited perquisites to executive officers. The company generally does not allow personal use of the corporate aircraft. In rare cases when the security and efficiency benefits outweigh the expense, the corporate aircraft is made available to Mr. Ricks for personal use. The company did not incur any expenses for personal use of its aircraft in 2017 by Mr. Ricks, and he did not receive any other

perquisites. Depending on seat availability, family members and personal guests may accompany executive officers who are traveling for business on the company aircraft. There is no incremental cost to the company for these trips by family members and personal guests.

The Lilly Deferred Compensation Plan

Members of senior management may defer receipt of part or all of their cash compensation under The Lilly Deferred Compensation Plan (Deferred Compensation Plan), which allows executives to save for retirement in a tax-effective way at minimal cost to the company. Under this unfunded plan, amounts deferred by the executive are credited at an interest rate of 120 percent of the applicable federal long-term rate, as described in more detail following the "Nonqualified Deferred Compensation in 2017" table.

Severance Benefits

Except in the case of a change in control of the company, the company is not obligated to pay severance to executive officers upon termination of their employment; any such payments are at the discretion of the Compensation Committee.

The company has adopted change-in-control severance pay plans for nearly all employees, including the executive officers. The plans are intended to preserve employee morale and productivity and encourage retention in the face of the disruptive impact of an actual or rumored change in control. In addition, the plans are intended to align executive and shareholder interests by enabling executives to evaluate corporate transactions that may be in the best interests of the shareholders and other constituents of the company without undue concern over whether the transactions may jeopardize the executives' own employment.

Highlights of our change-in-control severance plans

- *all regular employees are covered*
- *double trigger generally required*
- *no tax gross-ups*
- *up to two-year pay protection*
- *18-month benefit continuation*

Although benefit levels may differ depending on the employee's job level and seniority, the basic elements of the plans are comparable for all eligible employees:

- ***Double trigger***. Unlike "single trigger" plans that pay out immediately upon a change in control, our plans require a "double trigger"—a change in control followed by an involuntary loss of employment within two years. This is consistent with the plan's intent to provide employees with financial protection upon loss of employment. With respect to unvested equity, accrued performance will be used to determine the number of shares earned under an award, but vesting does not accelerate immediately upon a change in control. Rather the performance-adjusted awards will convert to restricted stock units that continue to vest with the new company. Shares will pay out upon the earlier of the completion of the original award period; upon a covered termination; or if the successor entity does not assume, substitute, or otherwise replace the awards.

- ***Covered terminations***. Employees are eligible for payments if, within two years of the change in control, their employment is terminated (i) without cause by the company or (ii) for good reason by the employee, each as is defined in the plan. See "Executive Compensation - Payments Upon Termination or Change in Control" for a more detailed discussion, including a discussion of what constitutes a change in control.

- ***Employees who suffer a covered termination receive up to two years of pay and 18 months of benefits protection***. These provisions assure employees a reasonable period of protection of their income and core employee benefits.

- *Severance payment.* Eligible terminated employees would receive a severance payment ranging from six months' to two years' base salary. Executives are all eligible for two years' base salary plus two times the then-current year's target bonus.
- *Benefit continuation.* Basic employee benefits such as health and life insurance would continue for 18 months following termination of employment, unless the individual becomes eligible for coverage with a new employer. All employees would receive an additional two years of both age and years-of-service credit for purposes of determining eligibility for retiree medical and dental benefits.

- ***Accelerated vesting of equity awards***. Any unvested equity awards would vest at the time of a covered termination.

- ***Excise tax***. In some circumstances, the payments or other benefits received by the employee in connection with a change in control could exceed limits established under Section 280G of the Internal Revenue Code. The employee would then be subject to an excise tax on top of normal federal income tax. The company does not reimburse employees for these taxes. However, the amount of change in control-related benefits will be reduced to the 280G limit if the effect would be to deliver a greater after-tax benefit than the employee would receive with an unreduced benefit.

Share Ownership and Retention Guidelines; Prohibition on Hedging and Pledging Shares

Share ownership and retention guidelines help to foster a focus on long-term growth. The CEO is required to own company stock valued at least six times annual base salary. During 2017, the holding requirement for other executive officers ranged from two to three times annual base salary depending on the position. Beginning in 2018, the holding requirement for other executive officers will range from two to four times annual base salary depending on the position. Until the required number of shares is reached, the executive officer must retain 50 percent of shares net of taxes received from new equity payouts. Our executives have a long history of maintaining significant levels of company stock. As of December 31, 2017, Mr. Ricks held shares valued at approximately 8 times his annual salary. The following table shows the share requirements for the named executive officers:

Name	Share Requirement 2017	2018	Owns Required 2018 Shares
Mr. Ricks	six times base salary	six times base salary	Yes
Mr. Conterno	three times base salary	four times base salary	Yes
Mr. Rice (retired)	three times base salary	four times base salary	Yes
Dr. Lundberg	three times base salary	four times base salary	Yes
Mr. Harrington	three times base salary	four times base salary	Yes

Executive officers are also required to hold all shares received from equity program payouts, net of acquisition costs and taxes, for at least one year, even once share ownership requirements have been met. For performance awards, this holding requirement is met by the 13-month service-vesting period that applies after the end of the performance period.

Non-employee directors and employees are not permitted to hedge their economic exposures to company stock through short sales or derivative transactions. Non-employee directors and all members of senior management are prohibited from pledging any company stock (i.e., using company stock as collateral for a loan or trading shares on margin).

Executive Compensation Recovery Policy

All incentive awards are subject to forfeiture upon termination of employment prior to the end of the performance or vesting period or for disciplinary reasons. In addition, the Compensation Committee has adopted an executive compensation recovery policy that gives the Compensation Committee broad discretion

to claw back incentive payouts from any member of senior management (approximately 150 employees) whose misconduct results in a material violation of law or company policy that causes significant harm to the company or who fails in his or her supervisory responsibility to prevent such misconduct by others.

Additionally, the company can recover all or a portion of any executive officer incentive compensation in the case of materially inaccurate financial statements or material errors in the performance calculation, whether or not they result in a restatement and whether or not the executive officer has engaged in wrongful conduct.

The recovery policy covers any incentive compensation awarded or paid to an employee at a time when he or she is a member of senior management. Subsequent changes in status, including retirement or termination of employment, do not affect the company's rights to recover compensation under the policy. Recoveries under the plan can extend back as far as three years.

Looking Ahead to 2018 Compensation

Lilly's Board of Directors unanimously elected Joshua L. Smiley to assume the role of Senior Vice President and Chief Financial Officer effective January 1, 2018, succeeding Mr. Rice, who retired from the company at the end of 2017. In connection with his appointment, Mr. Smiley will receive a base salary of $875,000 and will be eligible for an annual cash bonus with a target of 95 percent of base salary. Mr. Smiley received an equity award in February 2018 as part of the company's annual equity incentive program with a grant value of $2.3 million. One hundred percent of this grant value was delivered in the form of performance-based equity: 60 percent in shareholder value awards and 40 percent in performance awards.

The Compensation Committee approved new share ownership guidelines for named executive officers other than the CEO. While the CEO's requirement remains six times his annual base salary, the named executive officers' requirement increased from three times to four times annual base salary.

Executive Compensation

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($) [1]	Option Awards ($)	Non-Equity Incentive Plan Compensation ($) [2]	Change in Pension Value ($) [3]	All Other Compensation ($) [4]	Total Compensation ($)
David A. Ricks	2017	$1,400,000	$0	$10,200,000	$0	$2,814,000	$1,347,991	$84,000	$15,845,991
Chairman, President, and Chief Executive Officer	2016	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	2015	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Enrique A. Conterno	2017	$762,002	$0	$6,000,000	$0	$816,866	$999,426	$45,720	$8,624,014
Senior Vice President and President, Lilly Diabetes and President, Lilly USA	2016	$727,960	$0	$2,200,000	$0	$681,371	$935,408	$43,678	$4,588,417
	2015	$705,653	$0	$2,270,000	$0	$852,075	$0 [5]	$42,339	$3,870,067
Derica W. Rice (retired)	2017	$1,089,134	$0	$4,560,000	$0	$1,459,440	$1,719,690	$65,348	$8,893,612
Executive Vice President, Global Services and Chief Financial Officer	2016	$1,067,805	$0	$3,800,000	$0	$1,249,332	$1,739,429	$64,068	$7,920,634
	2015	$1,045,200	$0	$4,313,000	$0	$1,514,495	$0 [5]	$62,712	$6,935,407
Jan M. Lundberg, Ph.D.	2017	$1,024,643	$0	$4,320,000	$0	$1,373,021	$618,333	$61,479	$7,397,476
Executive Vice President, Science and Technology and President, Lilly Research Laboratories	2016	$1,007,855	$0	$3,600,000	$0	$1,179,190	$627,381	$60,471	$6,474,897
	2015	$1,007,855	$0	$3,859,000	$0	$1,460,382	$390,645	$60,471	$6,778,353
Michael J. Harrington	2017	$856,130	$0	$2,760,000	$0	$917,771	$1,657,718	$51,368	$6,242,987
Senior Vice President and General Counsel	2016	$827,400	$0	$2,300,000	$0	$774,446	$1,441,954	$49,644	$5,393,444
	2015	$784,167	$0	$2,610,500	$0	$946,881	$391,899	$47,050	$4,780,497

[1] This column shows the grant date fair value of performance awards and shareholder value awards computed in accordance with FASB ASC Topic 718. See Note 11 of the consolidated financial statements in the company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 for additional detail regarding assumptions underlying the valuation of equity awards. All values in the "Stock Awards" column were based upon the probable outcome of performance conditions as of the grant date, which vary year to year. For 2017, the probable outcome of the performance awards at the time of grant was at maximum. As a result, the values in the "Stock Awards" column are above target. For Mr. Conterno, this column shows both the grant date fair value of performance awards and shareholder value awards, as well as a special retention grant of $3 million he received in recognition of his leadership in delivering the company's strategy and providing continuity in a time of significant transition at the company; this special retention grant will vest on December 11, 2021, and it will be forfeited if Mr. Conterno resigns or retires from the company prior to that date.

For purposes of comparison, the supplemental table below shows the total target grant values approved by the committee:

Name	2015 Total Equity	2016 Total Equity	2017 Total Equity
Mr. Ricks	N/A	N/A	$8,500,000
Mr. Conterno	$2,000,000	$2,200,000	$2,500,000
Mr. Rice (retired)	$3,800,000	$3,800,000	$3,800,000
Dr. Lundberg	$3,400,000	$3,600,000	$3,600,000
Mr. Harrington	$2,300,000	$2,300,000	$2,300,000

The table below shows the minimum, target, and maximum payouts (using the grant date fair value) for the 2017-2019 performance awards included in the Summary Compensation Table.

Name	Payout Date	Minimum Payout	Target Payout	Maximum Payout
Mr. Ricks	January 2019	$0	$3,400,000	$5,100,000
Mr. Conterno	January 2019	$0	$1,000,000	$1,500,000
Mr. Rice (retired)	January 2019	$0	$1,520,000	$2,280,000
Dr. Lundberg	January 2019	$0	$1,440,000	$2,160,000
Mr. Harrington	January 2019	$0	$920,000	$1,380,000

The table below shows the minimum, target, and maximum payouts (using the grant date fair value) for the 2017-2019 shareholder value awards included in the Summary Compensation Table.

Name	Payout Date	Minimum Payout	Target Payout	Maximum Payout
Mr. Ricks	January 2019	$0	$5,100,000	$7,650,000
Mr. Conterno	January 2019	$0	$1,500,000	$2,250,000
Mr. Rice (retired)	January 2019	$0	$2,280,000	$3,420,000
Dr. Lundberg	January 2019	$0	$2,160,000	$3,240,000
Mr. Harrington	January 2019	$0	$1,380,000	$2,070,000

[2] Payments under the Bonus Plan for performance in each of the respective years. All bonuses paid to named executive officers were part of a non-equity incentive plan.

[3] The amounts in this column reflect the change in pension value for each individual, calculated by our actuary, and are affected by additional service accruals and pay earned, as well as actuarial assumption changes. The changes in pension values in 2017 were driven to a large extent by a lower discount rate which increased the net present value of pensions. The design of the pension benefit did not change. See the Pension Benefits in 2017 table below for information about the standard actuarial assumptions used. No named executive officer received preferential or above-market earnings on deferred compensation.

[4] The amounts in this column are solely company matching contributions for each individual's 401(k) plan and nonqualified savings plan contributions. The company does not reimburse executives for taxes outside of the limited circumstance of taxes related to employee relocation or a prior international assignment. There were no reportable perquisites or personal benefits.

[5] In 2015, the net present value of the pension benefits for Mr. Conterno and Mr. Rice reflect no change from the previous year due to an increase in the discount rate over the prior year. For the other named executive officers, increases in pensionable earnings offset the impact of the 2015 increased discount rate.

Grants of Plan-Based Awards During 2017

The compensation plans under which the grants in the following table were made are described in the CD&A and consist of the bonus plan (a non-equity incentive plan) and the 2002 Lilly Stock Plan (which provides for performance awards, shareholder value awards, and restricted stock units).

To receive a payout under the performance award or the shareholder value award, a participant must remain employed with the company through the end of the relevant award period (except in the case of death, disability, retirement, or redundancy). No dividends accrue on either performance awards or shareholder value awards during the performance period. Non-preferential dividends accrue during the 13-month service-vesting period (following the two-year performance period) and are paid upon vesting.

Name	Award	Grant Date[2]	Compensation Committee Action Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[1]			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock or Option Awards: Number of Shares of Stock, Options, or Units	Grant Date Fair Value of Equity Awards
				Threshold ($)	Target ($)	Maximum ($)	Threshold (# shares)	Target (# shares)	Maximum (# shares)		
Mr. Ricks	Annual Bonus	—	—	$52,500	$2,100,000	$4,200,000					
	2017-2019 PA [3]	2/9/2017	12/12/2016				23,117	46,233	69,350		$5,100,000
	2017-2019 SVA [4]	2/9/2017	12/12/2016				39,045	78,089	117,134		$5,100,000
										0	
Mr. Conterno	Annual Bonus	—	—	$15,240	$609,601	$1,219,203					
	2017-2019 PA [3]	2/9/2017	12/12/2016				6,799	13,598	20,397		$1,500,000
	2017-2019 SVA [4]	2/9/2017	12/12/2016				11,484	22,967	34,451		$1,500,000
	RSU [5]	12/11/2017	12/11/2017							34,615	$3,000,000
Mr. Rice (retired)	Annual Bonus	—	—	$27,228	$1,089,134	$2,178,269					
	2017-2019 PA [3]	2/9/2017	12/12/2016				10,335	20,669	31,004		$2,280,000
	2017-2019 SVA [4]	2/9/2017	12/12/2016				17,455	34,910	52,365		$2,280,000
										0	
Dr. Lundberg	Annual Bonus	—	—	$25,616	$1,024,643	$2,049,285					
	2017-2019 PA [3]	2/9/2017	12/12/2016				9,791	19,581	29,372		$2,160,000
	2017-2019 SVA [4]	2/9/2017	12/12/2016				16,537	33,073	49,610		$2,160,000
										0	
Mr. Harrington	Annual Bonus	—	—	$17,123	$684,904	$1,369,808					
	2017-2019 PA [3]	2/9/2017	12/12/2016				6,255	12,510	18,765		$1,380,000
	2017-2019 SVA [4]	2/9/2017	12/12/2016				10,565	21,130	31,695		$1,380,000
										0	

[1] These columns show the threshold, target, and maximum payouts for performance under the Bonus Plan. Bonus payouts range from 0 to 200 percent of target. The bonus payment for 2017 performance was 134 percent of target and is included in the Summary Compensation Table in the column titled “Non-Equity Incentive Plan Compensation.”

[2] To assure grant timing is not manipulated for employee gain, the annual grant date is established in advance by the Compensation Committee. Equity awards to new hires and other off-cycle grants are generally effective on the first trading day of the following month.

[3] This row shows the possible payouts for 2017-2019 performance award grants ranging from 0 to 150 percent of target. This performance award will pay out in January 2020. The grant-date fair value of the performance award reflects the probable payout outcome anticipated at the time of grant, which was greater than the target value.

[4] This row shows the range of payouts for 2017-2019 shareholder value award grants. This shareholder value award will pay out in January 2020, with payouts ranging from 0 to 150 percent of target. We measure the fair value of the shareholder value award on the grant date using a Monte Carlo simulation model.

[5] Mr. Conterno received a special retention grant in recognition of his leadership in delivering the company's strategy and providing continuity in a time of significant transition at the company. The award will vest on December 11, 2021, and it will be forfeited if Mr. Conterno resigns or retires from the company prior to that date.

Outstanding Equity Awards at December 31, 2017

The 2017 closing stock price used to calculate the values in the table below was $84.46.

	Stock Awards[1]				
Name	Award	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units, or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units, or Other Rights That Have Not Vested ($)
Mr. Ricks	2017-2019 SVA			140,561 [2]	$11,871,782
	2016-2018 SVA			57,797 [3]	$4,881,535
	2017-2019 PA			69,350 [4]	$5,857,301
	2016-2018 PA	12,222 [5]	$1,032,270		
	2015-2017 PA	21,326 [6]	$1,801,194		
Mr. Conterno	2017-2019 SVA			41,341 [2]	$3,491,661
	2016-2018 SVA			57,797 [3]	$4,881,535
	2017-2019 PA			20,397 [4]	$1,722,731
	2016-2018 PA	12,222 [5]	$1,032,270		
	2015-2017 PA	21,326 [6]	$1,801,194		
	2008 RSU Award	20,000 [7]	$1,689,200		
	2017 RSU Award	34,615 [8]	$2,923,583		
Mr. Rice (retired)	2017-2019 SVA			62,838 [2]	$5,307,297
	2016-2018 SVA			99,830 [3]	$8,431,642
	2017-2019 PA			31,004 [4]	$2,618,598
	2016-2018 PA	21,111 [5]	$1,783,035		
	2015-2017 PA	40,518 [6]	$3,422,150		
Dr. Lundberg	2017-2019 SVA			59,532 [2]	$5,028,073
	2016-2018 SVA			94,576 [3]	$7,987,889
	2017-2019 PA			29,372 [4]	$2,480,759
	2016-2018 PA	20,000 [5]	$1,689,200		
	2015-2017 PA	36,252 [6]	$3,061,844		
Mr. Harrington	2017-2019 SVA			38,034 [2]	$3,212,352
	2016-2018 SVA			60,423 [3]	$5,103,327
	2017-2019 PA			18,765 [4]	$1,584,892
	2016-2018 PA	12,778 [5]	$1,079,230		
	2015-2017 PA	24,524 [6]	$2,071,297		

[1] The chart no longer includes stock option awards because the company has not awarded stock options to employees since 2006 and there are no outstanding stock option awards.

[2] Shareholder value awards granted for the 2017-2019 performance period will vest on December 31, 2019. The number of shares reported reflects the maximum payout, which will be made if the average closing stock price in November and December 2018 is over $101.79. Actual payouts may vary from 0 to 180 percent of target. Net shares from any payout must be held by executive officers for a minimum of one year. Had the performance period ended December 31, 2017, the payout would have been at target.

[3] Shareholder value awards granted for the 2016-2018 performance period will vest on December 31, 2018. The number of shares reported reflects the maximum payout, which will be made if the average closing stock price in November and December 2018 is over $119.58. Actual payouts may vary from 0 to 180 percent of target. Net shares from any payout must be held by executive officers for a minimum of one year. Had the performance period ended December 31, 2017, the payout would have been 50 percent of target.

[4] This number represents the maximum value of performance award shares that could pay out for the 2017-2018 performance period, provided performance goals are met. Once the combined cumulative EPS result and associated payout level is determined at the end of the performance period, the associated number of shares are restricted stock units vesting in February 2020. Actual payouts may vary from 0 to 150 percent of target. The

number of shares recorded in the table reflects the payout if the combined cumulative EPS for 2017 and 2018 is at least $8.51.

[5] The performance period ending 2017 for the 2016-2018 performance award resulted in a restricted stock unit for 150 percent of target shares. The restricted stock units will vest in February 2019.

[6] Restricted stock units vested in February 2018 from the 2015-2017 performance award.

[7] This grant was made in 2008 before Mr. Conterno became an executive officer. This award was granted outside of the normal annual cycle and will vest on May 1, 2018.

[8] Mr. Conterno received a special retention grant in recognition of his leadership in delivering the company's strategy and providing continuity in a time of significant transition at the company. The award will vest on December 11, 2021, and it will be forfeited if Mr. Conterno resigns or retires from the company prior to that date.

Options Exercised and Stock Vested in 2017

Name	Option Awards[1]		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)[2]
Mr. Ricks	0	$0	10,244 [3]	$789,095
			22,507 [4]	$1,971,613
			5,496 [5]	$468,919
Mr. Conterno	0	$0	10,244 [3]	$789,095
			22,507 [4]	$1,971,613
Mr. Rice (retired)	0	$0	19,463 [3]	$1,499,235
			42,764 [4]	$3,746,126
Dr. Lundberg	0	$0	15,366 [3]	$1,183,643
			38,262 [4]	$3,351,751
Mr. Harrington	0	$0	9,732 [3]	$749,656
			25,883 [4]	$2,267,351

[1] The chart no longer includes stock option awards because the company has not awarded stock options to employees since 2006 and there are no outstanding stock option awards.

[2] Amounts reflect the market value of the stock on the day the stock vested.

[3] Restricted stock units resulting from the 2014-2016 performance award that vested in February 2017.

[4] Payout of the 2015-2017 shareholder value award at 100 percent of target.

[5] This grant was made in 2007 before Mr. Ricks became an executive officer. This award was granted outside of the normal annual cycle.

Retirement Benefits

We provide retirement income to eligible U.S. employees, including executive officers, through the following plans:

- The 401(k) Plan, a defined contribution plan qualified under Sections 401(a) and 401(k) of the Internal Revenue Code. Participants may elect to contribute a portion of their base salary to the plan, and the company provides matching contributions on employees' contributions up to 6 percent of base salary up to IRS limits. The employee contributions, company contributions, and earnings thereon are paid out in accordance with elections made by the participant. See the "All Other Compensation" column in the Summary Compensation Table for information about company contributions under the 401(k) Plan for the named executive officers.
- The Retirement Plan, a tax-qualified defined benefit plan that provides monthly benefits to retirees. See the Pension Benefits in 2017 table below for additional information about the value of these pension benefits.

Sections 401 and 415 of the Internal Revenue Code generally limit the amount of annual pension that can be paid from a tax-qualified plan ($270,000 in 2017 and $275,000 in 2018) as well as the amount of annual earnings that can be used to calculate a pension benefit. However, since 1975 the company has maintained a nonqualified pension plan that pays retirees the difference between the amount payable under the Retirement Plan and the amount they would have received without the Internal Revenue Code limits. The nonqualified pension plan is unfunded and subject to forfeiture in the event of bankruptcy. Likewise the company maintains a nonqualified savings plan that allows participants to contribute up to 6 percent of base salary exceeding the IRS limit. The company matches these contributions as described in the 401(k) Plan. For more information, see footnote 3 to the Nonqualified Deferred Compensation in 2017 table.

The following table shows benefits that the named executive officers have accrued under the Retirement Plan and the nonqualified pension plan.

Pension Benefits in 2017

Name	Plan	Number of Years of Credited Service	Present Value of Accumulated Benefit ($) [1]	Payments During Last Fiscal Year ($)
Mr. Ricks	retirement plan (pre-2010)	14	$570,749	
	retirement plan (post-2009)	8	$203,352	
	nonqualified plan (pre-2010)	14	$2,816,826	
	nonqualified plan (post-2009)	8	$980,129	
	total		$4,571,056	$0
Mr. Conterno	retirement plan (pre-2010)	17	$849,574	
	retirement plan (post-2009)	8	$211,141	
	nonqualified plan (pre-2010)	17	$4,074,998	
	nonqualified plan (post-2009)	8	$965,590	
	total		$6,101,303	$0
Mr. Rice (retired)[2]	retirement plan (pre-2010)	20	$990,838	
	retirement plan (post-2009)	8	$219,228	
	nonqualified plan (pre-2010)	20	$8,538,391	
	nonqualified plan (post-2009)	8	$1,775,668	
	total		$11,524,125	$0
Dr. Lundberg	retirement plan (post-2009)	8	$344,168	
	nonqualified plan (post-2009)	8	$2,660,445	
	total		$3,004,613	$0
Mr. Harrington	retirement plan (pre-2010)	18	$933,412	
	retirement plan (post-2009)	8	$236,344	
	nonqualified plan (pre-2010)	18	$4,530,371	
	nonqualified plan (post-2009)	8	$1,106,712	
	total		$6,806,839	$0

[1] The following standard actuarial assumptions were used to calculate the present value of each individual's accumulated pension benefit:

Discount rate:	3.83 percent for the qualified plan and 3.70 percent for non-qualified plan
Mortality (post-retirement decrement only):	RP2006 with generational projection using Scale MP2017
Pre-2010 joint and survivor benefit (% of pension):	50% until age 62; 25% thereafter
Post-2009 benefit payment form:	life annuity

[2] Mr. Rice retired with full retirement benefits under the old plan formula (pre-2010 benefits) and qualified for early retirement under the new plan formula (post-2009 benefits) as described below.

The Retirement Plan benefits shown in the table are net present values. The benefits are not payable as a lump sum; they are generally paid as a monthly annuity for the life of the retiree and, if elected, any qualifying survivor. The annual benefit under the retirement plan is calculated using years of service and the average of the annual earnings (salary plus bonus) for the highest 5 out of the last 10 calendar years of service (final average earnings).

Post-2009 Plan Information: Following amendment of our Retirement Plan formulas, employees hired on or after February 1, 2008, have accrued retirement benefits only under the new plan formula. Employees hired before that date have accrued benefits under both the old and new plan formulas. All eligible employees, including those hired on or after February 1, 2008, can retire at age 65 with at least five years of service and receive an unreduced benefit. The annual benefit under the new plan formula is equal to 1.2 percent of final average earnings multiplied by years of service. Early retirement benefits under this plan formula are reduced 6 percent for each year under age 65. Transition benefits were afforded to employees with 50 points (age plus service) or more as of December 31, 2009. These benefits were intended to ease the transition to the new retirement formula for those employees who were closer to retirement or had been with the company longer at the time the plan was changed. For the transition group, early retirement benefits are reduced 3 percent for each year from age 65 to age 60 and 6 percent for each year under age 60. All named executive officers except Dr. Lundberg are in this transition group.

Pre-2010 Plan Information: Employees hired prior to February 1, 2008, accrued benefits under both plan formulas. For these employees, benefits that accrued before January 1, 2010, were calculated under the old plan formula. The amount of the benefit is calculated using actual years of service through December 31, 2009, while total years of service is used to determine eligibility and early retirement reductions. The benefit amount is increased (but not decreased) proportionately, based on final average earnings at termination compared to final average earnings at December 31, 2009. Full retirement benefits are earned by employees with 90 or more points (the sum of his or her age plus years of service). Employees electing early retirement receive reduced benefits as described below:

- The benefit for employees with between 80 and 90 points is reduced by 3 percent for each year under 90 points or age 62.
- The benefit for employees who have fewer than 80 points, but who reached age 55 and have at least 10 years of service, is reduced as described above and is further reduced by 6 percent for each year under 80 points or age 65.

Nonqualified Deferred Compensation in 2017

Name	Plan	Executive Contributions in Last Fiscal Year ($)[1]	Registrant Contributions in Last Fiscal Year ($)[2]	Aggregate Earnings in Last Fiscal Year ($)	Aggregate Withdrawals/ Distributions in Last Fiscal Year ($)	Aggregate Balance at Last Fiscal Year End ($)[3]
Mr. Ricks	nonqualified savings	$67,800	$67,800	$79,349	$0	$621,637
	deferred compensation	$0		$0		$0
	total	$67,800	$67,800	$79,349	$0	$621,637
Mr. Conterno	nonqualified savings	$29,520	$29,520	$133,317	$0	$902,670
	deferred compensation	$100,000		$40,169		$1,290,943
	total	$129,520	$29,520	$173,486	$0	$2,193,613
Mr. Rice (retired)	nonqualified savings	$49,148	$49,148	$313,241	$0	$1,908,141
	deferred compensation	$0		$0		$0
	total	$49,148	$49,148	$313,241	$0	$1,908,141
Dr. Lundberg	nonqualified savings	$45,279	$45,279	$47,378	$0	$908,217
	deferred compensation	$0		$0		$0
	total	$45,279	$45,279	$47,378	$0	$908,217
Mr. Harrington	nonqualified savings	$35,168	$35,168	$66,068	$0	$519,523
	deferred compensation	$0		$5,704		$180,677
	total	$35,168	$35,168	$71,772	$0	$700,199

[1] The amounts in this column are also included in the Summary Compensation Table, in the “Salary” column (nonqualified savings) or the “Non-Equity Incentive Plan Compensation” column (deferred compensation).

[2] The amounts in this column are also included in the Summary Compensation Table, in the “All Other Compensation” column as a portion of the savings plan match.

[3] Of the totals in this column, the following amounts have previously been reported in the Summary Compensation Table for this year and for previous years:

Name	2017 ($)	Previous Years ($)	Total ($)
Mr. Ricks	$135,600	N/A	$135,600
Mr. Conterno	$159,040	$760,600	$919,640
Mr. Rice (retired)	$98,296	$895,298	$993,594
Dr. Lundberg	$90,557	$616,819	$707,376
Mr. Harrington	$70,336	$276,588	$346,924

The Nonqualified Deferred Compensation in 2017 table above shows information about two company programs: the nonqualified savings plan and the Deferred Compensation Plan. The nonqualified savings plan is designed to allow each employee to contribute up to 6 percent of his or her base salary and receive a company match, beyond the contribution limits prescribed by the IRS with regard to 401(k) plans. This plan is administered in the same manner as the 401(k) Plan, with the same participation and investment elections. Executive officers and other U.S. executives may also defer receipt of all or part of their cash compensation under the Deferred Compensation Plan. Amounts deferred by executives under this plan are credited with interest at 120 percent of the applicable federal long-term rate as established the preceding December by the U.S. Treasury Department under Section 1274(d) of the Internal Revenue Code with monthly compounding, which was 2.7 percent for 2017 and is 3.1 percent for 2018. Participants may elect to receive the funds in a lump sum or in up to 10 annual installments following termination of employment, but may not make withdrawals while employed by the company, except in the event of hardship as approved by the Compensation Committee. All deferral elections and associated distribution schedules are irrevocable. Both plans are unfunded and subject to forfeiture in the event of bankruptcy.

Payments Upon Termination or Change in Control (as of December 31, 2017)

The following table describes the potential payments and benefits under the company's compensation and benefit plans and arrangements to which the named executive officers would be entitled upon termination of employment. Except for certain terminations following a change in control of the company, as described below, there are no agreements, arrangements, or plans that entitle named executive officers to severance, perquisites, or other enhanced benefits upon termination of their employment. Any agreement to provide such payments or benefits to a terminating executive officer (other than following a change in control) would be at the discretion of the Compensation Committee.

	Cash Severance Payment [1]	Continuation of Medical / Welfare Benefits (present value) [2]	Value of Acceleration of Equity Awards	Total Termination Benefits
Mr. Ricks				
• Voluntary retirement	$0	$0	$0	$0
• Involuntary retirement or termination	$0	$0	$0	$0
• Involuntary or good reason termination after change in control	$7,000,000	$39,903	$6,206,019	$13,245,922
Mr. Conterno				
• Voluntary termination	$0	$0	$0	$0
• Involuntary retirement or termination	$0	$0	$0	$0
• Involuntary or good reason termination after change in control	$2,765,160	$296,844	$4,347,980	$7,409,984
Mr. Rice (retired)				
• Voluntary retirement	$0	$0	$0	$0
• Involuntary retirement or termination	$0	$0	$0	$0
• Involuntary or good reason termination after change in control	$4,370,800	$45,916	$4,159,289	$8,576,005
Dr. Lundberg				
• Voluntary retirement	$0	$0	$0	$0
• Involuntary retirement or termination	$0	$0	$0	$0
• Involuntary or good reason termination after change in control	$4,112,000	$63,472	$3,938,307	$8,113,779
Mr. Harrington				
• Voluntary termination	$0	$0	$0	$0
• Involuntary retirement or termination	$0	$0	$0	$0
• Involuntary or good reason termination after change in control	$3,097,080	$45,916	$2,517,449	$5,660,445

[1] See "Change-in-Control Severance Pay Plan—Cash Severance Payment" below.

[2] See "Accrued Pay and Regular Retirement Benefits" and "Change-in-Control Severance Pay Plan—Continuation of medical and welfare benefits" below.

Accrued Pay and Regular Retirement Benefits. The amounts shown in the table above do not include certain payments and benefits to the extent they are provided on a non-discriminatory basis to salaried employees generally upon termination of employment. These include:

- accrued salary and vacation pay.
- regular pension benefits under the Retirement Plan and the nonqualified pension plan. See "Retirement Benefits" above.
- welfare benefits provided to all U.S. retirees, including retiree medical and dental insurance. The amounts shown in the table above as "Continuation of Medical / Welfare Benefits" are explained below.
- distributions of plan balances under the 401(k) Plan, the nonqualified savings plan, and the Deferred Compensation Plan. See the narrative following the Nonqualified Deferred Compensation in 2017 table for information about these plans.

Deferred Compensation. The amounts shown in the table do not include distributions of plan balances under the deferred compensation plan. Those balances are shown in the Nonqualified Deferred Compensation in 2017 table.

Death and Disability. A termination of employment due to death or disability does not entitle named executive officers to any payments or benefits that are not available to U.S. salaried employees generally.

Termination for Cause. Executives terminated for cause receive no severance or enhanced benefits and forfeit any unvested equity grants.

Change-in-Control Severance Pay Plan. As described in the CD&A under "Severance Benefits," the company maintains a change-in-control severance pay plan for nearly all employees, including the named executive officers. The change-in-control plan defines a change in control very specifically, but generally the terms include the occurrence of one of the following: (i) acquisition of 20 percent or more of the company's stock; (ii) replacement by the shareholders of one half or more of the Board of Directors; (iii) consummation of a merger, share exchange, or consolidation of the company (other than a transaction that results in the Lilly shareholders prior to the transaction continuing to hold more than 60 percent of the voting stock of the combined entity); or (iv) liquidation of the company or sale or disposition of all or substantially all of its assets. The amounts shown in the table for "involuntary or good-reason termination after change in control" are based on the following assumptions and plan provisions:

- Covered terminations. The table assumes a termination of employment that is eligible for severance under the terms of the plan, based on the named executive officer's compensation, benefits, age, and service credit at December 31, 2017. Eligible terminations include an involuntary termination for reasons other than for cause or a voluntary termination by the executive for good reason, within two years following the change in control.
  - A termination of an executive officer by the company is for cause if it is for any of the following reasons: (i) the employee's willful and continued refusal to perform, without legal cause, his or her material duties, resulting in demonstrable economic harm to the company; (ii) any act of fraud, dishonesty, or gross misconduct resulting in significant economic harm or other significant harm to the business reputation of the company; or (iii) conviction of or the entering of a plea of guilty or *nolo contendere* to a felony.
  - A termination by the executive officer is for good reason if it results from: (i) a material diminution in the nature or status of the executive's position, title, reporting relationship, duties, responsibilities, or authority, or the assignment to him or her of additional responsibilities that materially increase his or her workload; (ii) any reduction in the executive's then-current base salary; (iii) a material reduction in the executive's opportunities to earn incentive bonuses below those in effect for the year prior to the change in control; (iv) a material reduction in the executive's employee benefits from the benefit levels in effect immediately prior to the change in control; (v) the failure to grant to the executive stock options, stock units, performance shares, or similar incentive rights during each 12-month period following the change in control on the basis of a number of shares or units and all other material terms at least as favorable to the executive as those rights granted to him or her on an annualized average basis for the three-year period immediately prior to the change in control; or (vi) relocation of the executive by more than 50 miles.

- Cash severance payment. The cash severance payment amounts to two times the executive officer's annual base salary plus two times the executive officer's bonus target for that year under the bonus plan.

- Continuation of medical and welfare benefits. This amount represents the present value of the change-in-control plan's provision, following a covered termination, of 18 months of continued coverage equivalent to the company's current active employee medical, dental, life, and long-term disability insurance. Similar actuarial assumptions to those used to calculate incremental pension benefits apply to the calculation for continuation of medical and welfare benefits, with the addition of actual COBRA rates based on current benefit elections.

- Acceleration of equity awards. Upon a covered termination, any unvested equity awards would convert into restricted stock units of the new company, with the number of shares earned under the awards based on accrued performance at the time of the transaction. The restricted stock units will continue to vest and pay out upon the earlier of the completion of the original award period; upon a covered termination; or if the successor entity does not assume, substitute, or otherwise replace the award. The amount in this column represents the value of the acceleration of unvested equity grants, had a qualifying termination occurred on December 31, 2017.

- Excise taxes. Upon a change in control, employees may be subject to certain excise taxes under Section 280G of the Internal Revenue Code. The company does not reimburse the affected employees for those excise taxes or any income taxes payable by the employee. To reduce the employee's exposure to excise taxes, the employee's change-in-control benefit may be decreased to maximize the after-tax benefit to the individual.

Payments Upon Change in Control Alone. In general, the change-in-control plan is a "double trigger" plan, meaning payments are made only if the employee suffers a covered termination of employment within two years following the change in control, or in the case of equity awards, if the successor entity does not assume, substitute, or otherwise replace the awards.

Compensation Committee Matters

Background

Role of the Independent Consultant in assessing Executive Compensation

The Compensation Committee has retained Cimi B. Silverberg of Frederic W. Cook & Co., Inc., as its independent compensation consultant. Ms. Silverberg reports directly to the committee. Neither she nor her firm is permitted to have any business or personal relationship with management or the members of the committee. The consultant's responsibilities are to:

- review the company's total compensation philosophy, peer group, and target competitive positioning for reasonableness and appropriateness
- review the company's executive compensation program and advise the committee of evolving best practices
- provide independent analyses and recommendations to the committee on the CEO's pay
- review draft CD&A and related tables for the proxy statement
- proactively advise the committee on best practices for board governance of executive compensation
- undertake special projects at the request of the committee chair.

Ms. Silverberg interacts directly with members of company management only on matters under the committee's oversight and with the knowledge and permission of the committee chair.

Role of Executive Officers and Management in assessing Executive Compensation

With the oversight of the CEO and the senior vice president of human resources and diversity, the company's global compensation group formulates recommendations on compensation philosophy, plan design, and compensation for executive officers (other than the CEO, as noted below). The CEO provides the committee with a performance assessment and compensation recommendation for each of the other executive officers. The committee considers those recommendations with the assistance of its consultant. The CEO and the senior vice president of human resources and diversity attend committee meetings; they are not present for executive sessions or any discussion of their own compensation. Only non-employee directors and the committee's consultant attend executive sessions.

The CEO does not participate in the formulation or discussion of his pay recommendations. He has no prior knowledge of the recommendations that the consultant makes to the committee.

Risk Assessment Process

As part of the company's overall enterprise risk management program, in 2017 the committee reviewed the company's compensation policies and practices and concluded that the programs and practices are not reasonably likely to have a material adverse effect on the company. The committee noted numerous policy and design features of the company's compensation programs and governance structure that reduce the likelihood of inappropriate risk-taking, including, but not limited to:

- The committee comprises of independent directors only
- The committee engages its own independent compensation consultant
- The committee has downward discretion to lower compensation plan payouts
- The committee approves all adjustments to financial results that affect compensation calculations
- Different measures and metrics are used across multiple incentive plans that appropriately balance cash/stock, fixed/variable pay, and short-term/long-term incentives

- Incentive plans have predetermined maximum payouts
- Performance objectives are challenging but achievable
- Programs with operational metrics have a continuum of payout multiples based upon achievement of performance milestones, rather than "cliffs" that might encourage suboptimal or improper behavior
- A compensation recovery policy is in place for all members of senior management; negative compensation consequences can be applied in cases of serious compliance violations
- Meaningful share ownership requirements are in place for all members of senior management and the board.

Compensation Committee Report

The Compensation Committee evaluates and establishes compensation for executive officers and oversees the deferred compensation plan, the company's management stock plans, and other management incentive and benefit programs. Management has the primary responsibility for the company's financial statements and reporting process, including the disclosure of executive compensation. With this in mind, the Compensation Committee has reviewed and discussed with management the CD&A above. The committee recommended to the Board of Directors that the CD&A be included in this proxy statement for filing with the SEC.

Compensation Committee

Ralph Alvarez, Chair
Michael L. Eskew
Ellen R. Marram
Kathi P. Seifert

CEO Pay Ratio

Lilly's compensation and benefits philosophy and the overall structure of our compensation and benefit programs are broadly similar across the organization to encourage and reward all employees who contribute to our success. We strive to ensure the pay of every Lilly employee reflects the level of their job impact and responsibilities and is competitive within our peer group. Compensation rates are benchmarked and set to be market-competitive in the country in which the jobs are performed. Lilly's ongoing commitment to pay equity is critical to our success in supporting a diverse workforce with opportunities for all employees to grow, develop, and contribute. Lilly is a global company that employs over 40,000 people with more than half of our workforce located outside of the U.S.

Under rules adopted pursuant to the Dodd-Frank Act of 2010, Lilly is required to calculate and disclose the total compensation paid to its median paid employee, as well as the ratio of the total compensation paid to the median employee as compared to the total compensation paid to Lilly's CEO. The paragraphs that follow describe our methodology and the resulting CEO Pay ratio.

Measurement Date

We identified the median employee using our employee population on November 1, 2017.

Consistently Applied Compensation Measure (CACM)

Under the relevant rules, we were required to identify the median employee by use of a "consistently applied compensation measure," or CACM. We chose a CACM that closely approximates the annual total direct compensation of our employees. Specifically, we identified the median employee by looking at annual base pay, bonus opportunity at target, and the grant date fair value for standard equity awards. We did not perform adjustments to the compensation paid to part-time employees to calculate what they would have been paid on a full-time basis.

De Minimis Exception

Lilly has employees in 86 countries. In identifying the median employee, we excluded workers in 10 countries totaling 639 workers (approximately 1.5 percent of our workforce). We excluded these employees because they are affiliated with joint ventures or third-party distributors and Lilly does not set their compensation philosophy.

We excluded the following number of workers from the following countries in the identification of the median employee:

Countries Excluded	Workers Excluded
Bahrain	2
Greece	270
Indonesia	30
Kuwait	17
Oman	2
Pakistan	33
Qatar	7
Saudi Arabia	145
United Arab Emirates	100
Vietnam	33
Total	639

Methodology and Pay Ratio
After applying our CACM methodology and excluding the employees listed above, we identified the median employee. Once the median employee was identified, we calculated the median employee's total annual compensation in accordance with the requirements of the Summary Compensation Table.

Our median employee compensation as calculated using Summary Compensation Table requirements was $134,003. Our CEO's compensation as reported in the Summary Compensation Table was $15,845,991. Therefore, our CEO to median employee pay ratio is 118:1. Our median employee's total compensation included the amount of a pension enhancement offered under our 2017 voluntary early retirement program. If we eliminated the change in pension value from our median employee and CEO's total compensation, our CEO to median employee pay ratio would have been 171:1.

This information is being provided for compliance purposes. Neither the Compensation Committee nor management of the company used the pay ratio measure in making compensation decisions.

Audit Matters

Item 3. Ratification of the Appointment of Principal Independent Auditor

Audit Committee Oversight of Independent Auditor

The Audit Committee is responsible for the appointment, compensation, retention, and oversight of the independent auditor, and oversees the process for selecting, reviewing, and evaluating the lead audit partner. Further information regarding the committee's oversight of the independent auditor can be found in the Audit Committee charter, available online at https://www.lilly.com/who-we-are/governance or upon request to the company's corporate secretary.

In connection with the decision regarding whether to reappoint the independent auditor each year (subject to shareholder ratification), the committee assesses the independent auditor's performance. This assessment examines three primary criteria: (1) the independent auditor's qualifications and experience; (2) the communication and interactions with the auditor over the course of the year; and (3) the auditor's independence, objectivity, and professional skepticism. These criteria are assessed against an internal and an external scorecard, and are discussed with management during a private session, as well as in executive session. The committee also periodically considers whether a rotation of the company's independent auditor is advisable.

Ernst & Young LLP (EY) has served as the principal independent auditor for the company since 1940. Based on this year's assessment of EY's performance, the Audit Committee believes that the continued retention of EY to serve as the company's principal independent auditor is in the best interests of the company and its shareholders, and has therefore reappointed the firm of EY as principal independent auditor for the company for 2018. In addition to

this year's favorable assessment of EY's performance, we recognize that there are several benefits of retaining a longer-tenured independent auditor. EY has gained institutional knowledge and expertise regarding the company's global operations, accounting policies and practices, and internal controls over financial reporting. Audit and other fees are also competitive with peer companies because of EY's familiarity with the company and its operations. In accordance with the bylaws, this appointment is being submitted to the shareholders for ratification.

Representatives of EY are expected to be present at the annual meeting and will be available to respond to questions. Those representatives will have the opportunity to make a statement if they wish to do so.

Board Recommendation on Item 3

The Board of Directors recommends that you vote FOR ratifying the appointment of Ernst & Young LLP as principal independent auditor for 2018.

Audit Committee Report

The Audit Committee reviews the company's financial reporting process on behalf of the Board. Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls and disclosure controls. In this context, the committee has met and held discussions with management and the independent auditor. Management represented to the committee that the company's consolidated financial statements were prepared in accordance with generally accepted accounting principles (GAAP), and the committee has reviewed and discussed the audited financial statements and related disclosures with management and the independent auditor, including a review of the significant management judgments underlying the financial statements and disclosures.

The independent auditor reports to the Audit Committee, which has sole authority to appoint and to replace the independent auditor (subject to shareholder ratification).

The committee has discussed with the independent auditor matters required to be discussed with the Audit Committee by the standards of the Public Company Accounting Oversight Board (PCAOB) and the NYSE, including the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of the disclosures in the financial statements. In addition, the committee has received the written disclosures and the letter from the independent auditor required by applicable requirements of the PCAOB regarding communications with the Audit Committee concerning independence, and has discussed with the independent auditor the auditor's independence from the company and its management. In concluding that the auditor is independent, the committee determined, among other things, that the nonaudit services provided by EY (as described below) were compatible with its independence. Consistent with the requirements of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act), the committee has adopted policies to ensure the independence of the independent auditor, such as prior committee approval of nonaudit services and required audit partner rotation.

The committee discussed with the company's internal and independent auditors the overall scope and plans for their respective audits, including internal control testing under Section 404 of the Sarbanes-Oxley Act. The committee periodically meets with the internal and independent auditors, with and without management present, and in private sessions with members of senior management (such as the chief financial officer and the chief accounting officer) to discuss the results of their examinations, their evaluations of the company's internal controls, and the overall quality of the company's financial reporting. The committee also periodically meets in executive session.

In reliance on the reviews and discussions referred to above, the committee recommended to the Board (and the Board subsequently approved the recommendation) that the audited financial statements be included in the company's annual report on Form 10-K for the year ended December 31, 2017, for filing with the SEC. The committee has also appointed the company's independent auditor, subject to shareholder ratification, for 2018.

Audit Committee
Michael L. Eskew, Chair
Katherine Baicker, Ph.D.
Jamere Jackson
Kathi P. Seifert
Jackson P. Tai

Services Performed by the Independent Auditor

The Audit Committee pre-approves all services performed by the independent auditor, in part to assess whether the provision of such services might impair the auditor's independence. The committee's policy and procedures are as follows:

- ***Audit services:*** The committee approves the annual audit services engagement and, if necessary, any changes in terms, conditions, and fees resulting from changes in audit scope, company structure, or other matters. Audit services include internal controls attestation work under Section 404 of the Sarbanes-Oxley Act. The committee may also preapprove other audit services, which are those services that only the independent auditor reasonably can provide.
- ***Audit-related services:*** Audit-related services are assurance and related services that are reasonably related to the performance of the audit or reviews of the financial statements, and that are traditionally performed by the independent auditor. The committee believes that the provision of these services does not impair the independence of the auditor.
- ***Tax services:*** The committee believes that, in appropriate cases, the independent auditor can provide tax compliance services, tax planning, and tax advice without impairing the auditor's independence.
- ***Other services:*** The committee may approve other services to be provided by the independent auditor if (i) the services are permissible under SEC and PCAOB rules, (ii) the committee believes the provision of the services would not impair the independence of the auditor, and (iii) management believes that the auditor is the best choice to provide the services.
- ***Approval process:*** At the beginning of each audit year, management requests prior committee approval of the annual audit, statutory audits, and quarterly reviews for the upcoming audit year as well as any other services known at that time. Management will also present at that time an estimate of all fees for the upcoming audit year. As specific engagements are identified thereafter, they are brought forward to the committee for approval. To the extent approvals are required between regularly scheduled committee meetings, preapproval authority is delegated to the committee chair.

For each engagement, management provides the committee with information about the services and fees, sufficiently detailed to allow the committee to make an informed judgment about the nature and scope of the services and the potential for the services to impair the independence of the auditor.

After the end of the audit year, management provides the committee with a summary of the actual fees incurred for the completed audit year.

Independent Auditor Fees

The following table shows the fees incurred for services rendered on a worldwide basis by Ernst & Young in 2017 and 2016. All such services were pre-approved by the committee in accordance with the pre-approval policy.

	2017 ($ millions)	2016 ($ millions)
Audit Fees Annual audit of consolidated and subsidiary financial statements, including Sarbanes-Oxley 404 attestation Reviews of quarterly financial statements Other services normally provided by the auditor in connection with statutory and regulatory filings	$14.8	$12.8
Audit-Related Fees Primarily related to assurance and related services reasonably related to the performance of the audit or reviews of the financial statements primarily related to employee benefit plan and other ancillary audits, and due diligence services on potential acquisitions	$0.5	$0.6
Tax Fees Tax compliance services, tax planning, tax advice Primarily related to consulting and compliance services	$4.8	$6.7
Total	$20.1	$20.2

*Numbers may not add due to rounding

Management Proposals

Item 4. Proposal to Amend the Company's Articles of Incorporation to Eliminate the Classified Board Structure

The company's articles of incorporation provide that the board of directors is divided into three classes, with each class elected every three years. On the recommendation of the Directors and Corporate Governance Committee, the board has approved, and recommends that the shareholders approve, amendments to provide for the declassification of the company's board. This proposal was brought before shareholders each year between 2007 and 2012, receiving the vote of a strong majority of the outstanding shares at each meeting; however, the proposal requires the vote of 80 percent of the outstanding shares to pass.

If approved, this proposal would become effective upon the filing of amended and restated articles of incorporation with the Secretary of State of Indiana, which the company would do promptly after shareholder approval is obtained. Directors elected prior to the effectiveness of the amendments would stand for election for one-year terms once their then-current terms expire. This means that directors whose terms expire at the 2019 and 2020 annual meetings of shareholders would be elected for one-year terms, and beginning with the 2021 annual meeting, all directors would be elected for one-year terms at each annual meeting. In the case of any vacancy on the board occurring after the 2018 annual meeting created by an increase in the number of directors, the vacancy would be filled through an interim election by the board with the new director to serve a term ending at the next annual meeting. Vacancies created by resignation, removal, or death would be filled by interim election of the board for a term until the end of the term of the director being replaced. This proposal would not change the present number of directors or the board's authority to change that number and to fill any vacancies or newly-created directorships.

Background of Proposal

As part of its ongoing review of corporate governance matters, the board, assisted by the Directors and Corporate Governance Committee, considered the advantages and disadvantages of maintaining the classified board structure and eliminating supermajority voting provisions of the articles of incorporation (see Item 5 below). The board considered the view of some shareholders who believe that classified boards have the effect of reducing the accountability of directors to shareholders because shareholders are unable to evaluate and elect all directors on an annual basis. The board gave considerable weight to the approval at the 2006 annual meeting of a shareholder proposal requesting that the board take all necessary steps to elect the directors annually, and to the favorable votes of a strong majority of the outstanding shares for management's proposals in each of the following six years.

The board also considered benefits of retaining the classified board structure, which has a long history in corporate law. A classified structure may provide continuity and stability in the management of the business and affairs of the company because a majority of directors always has prior experience as directors of the company. In some circumstances classified boards may enhance shareholder value by forcing an entity seeking control of the company to initiate discussions at arm's length with the board of the company, because the entity cannot replace the entire board in a single election. The board also considered that even without a classified board (and without the supermajority voting requirements, which the board also recommends eliminating), the company has defenses that work together to discourage a would-be acquirer from proceeding with a proposal that undervalues the company and to assist the board in responding to such proposals. These defenses include other provisions of the company's articles of incorporation and bylaws as well as certain provisions of Indiana corporation law.

The board believes it is important to maintain appropriate defenses to inadequate takeover bids, but also important to retain shareholder confidence by demonstrating that the board is accountable and responsive to shareholders. After balancing these interests, the board has decided to resubmit this proposal to eliminate the classified board structure.

Text of Amendments
Article 9(b) of the company's amended articles of incorporation contains the provisions that will be affected if this proposal is adopted. The amendments to the company's amended articles of incorporation, set forth in Appendix B to this proxy statement, shows the proposed changes with deletions indicated by strike-outs and additions indicated by underlining. The board has also adopted conforming amendments to the company's bylaws, to be effective immediately upon the effectiveness of the amendments to the amended articles of incorporation.

Vote Required
The affirmative vote of at least 80 percent of the outstanding common shares is needed to pass this proposal.

Board Recommendation on Item 4

The Board of Directors recommends that you vote FOR amending the company's articles of incorporation to eliminate the classified board structure.

Item 5. Proposal to Amend the Company's Articles of Incorporation to Eliminate Supermajority Voting Provisions

Under the company's articles of incorporation, nearly all matters submitted to a vote of shareholders can be adopted by a majority of the votes cast. However, our articles require a few fundamental corporate actions to be approved by the holders of 80 percent of the outstanding shares of common stock (a "supermajority vote"). Those actions are:

- amending certain provisions of the articles of incorporation that relate to the number and terms of office of directors:

  —the company's classified board structure (as described under Item 4, above)

  —a provision that the number of directors shall be specified solely by resolution of the board of directors
- removing directors prior to the end of their elected term
- entering into mergers, consolidations, recapitalizations, or certain other business combinations with a "related person"—a party who has acquired at least five percent of the company's stock (other than the Lilly Endowment or a company benefit plan) without the prior approval of the board of directors
- modifying or eliminating any of the above supermajority voting requirements.

Background of Proposal
This proposal is the result of the board's ongoing review of corporate governance matters. In 2007 through 2009, shareholder proposals requesting that the board take action to eliminate all supermajority voting provisions were supported by a majority of votes cast. In 2010 through 2012, the board responded by submitting proposals seeking shareholder approval to eliminate the provisions. In all three years, the proposal received the votes of a strong majority of the outstanding shares, but fell short of the required 80 percent.

Assisted by the Directors and Corporate Governance Committee, the board considered the advantages and disadvantages of maintaining the supermajority voting requirements. The board considered that under certain circumstances, supermajority voting provisions can provide benefits to the company. The provisions can make it more difficult for one or a few large shareholders to take over or restructure the company without negotiating with the board. In the event of an unsolicited bid to take over or restructure the company, supermajority voting provisions may encourage bidders to negotiate with the board and increase the board's negotiating leverage on behalf of the shareholders. They can also give the board time to consider alternatives that might provide greater value for all shareholders.

The board also considered the potential benefits of eliminating the supermajority voting provisions. While it is important to the company's long-term success for the board to maintain appropriate defenses against inadequate takeover bids, it is also important for the board to maintain shareholder confidence by demonstrating that it is responsive and accountable to shareholders and committed to strong corporate governance. This requires the board to carefully balance sometimes competing interests. In this regard, the board gave considerable weight to the fact that a substantial majority of shares voted have supported eliminating the supermajority voting provisions. Many shareholders believe that supermajority voting provisions impede accountability to shareholders and contribute to board and management entrenchment.

The board also considered that even without the supermajority vote (and without the classified board, which the board also recommends eliminating), the company has defenses that work together to discourage a would-be acquirer from proceeding with a proposal that undervalues the company and to assist the board in responding to such proposals. These defenses include other provisions of the company's articles of incorporation and bylaws as well as certain provisions of Indiana corporation law.

Therefore, the board believes the balance of interests is best served by recommending to shareholders that the articles of incorporation be amended to eliminate the supermajority voting provisions. By recommending these amendments, the board is demonstrating its accountability and willingness to take steps that address shareholder-expressed concerns.

Text of Amendments
Articles 9(c), 9(d), and 13 of the company's amended articles of incorporation contain the provisions that will be affected if this proposal is adopted. The amendments to the company's amended articles of incorporation set forth in Appendix B to this proxy statement show the proposed changes with deletions indicated by strike-outs and additions indicated by underlining.

Vote Required
The affirmative vote of at least 80 percent of the outstanding common shares is needed to pass this proposal.

Board Recommendation on Item 5

The Board of Directors recommends that you vote FOR amending the company's articles of incorporation to eliminate supermajority voting provisions.

Item 6. Proposal to Approve the Amended and Restated 2002 Lilly Stock Plan

Background of Proposal
As the 2002 Lilly Stock Plan (the "**2002 Plan**") nears its April 20, 2020 expiration date, we are asking our shareholders to approve an amendment and restatement of the 2002 Plan (the "Amended 2002 Plan"). The Amended 2002 Plan provides for a *decrease* – not an increase – in the number of shares of common stock available for issuance. Further, the Amended 2002 Plan eliminates certain provisions related to Section 162(m) of the Internal Revenue Code that are no longer applicable in light of tax legislation that was recently enacted while retaining a framework to continue to grant performance-based awards.

As of February 16, 2018, there were no options outstanding under the 2002 Plan, and 11,753,977 full value awards that were unvested and outstanding.

Material Changes to the 2002 Plan
The following summary highlights the proposed material changes to the 2002 Plan.

- 53,000,000 shares of common stock would be available for issuance pursuant to future awards granted on or following the effective date of the Amended 2002 Plan. This represents a *decrease* in the number of shares reserved for issuance under the plan:

	Immediately Prior to Shareholder Approval	After Shareholder Approval
Authorized Shares	119,000,000*	75,657,296*
Shares Available to Grant	96,342,704	53,000,000

*plus shares available for issuance from prior plans, as approved by shareholders at the inception of the 2002 Plan

- Amendments have been made to improve our corporate governance and to comply with some of the policies recommended by shareholder advisors, including:
  - Provisions to preclude the payment of dividends or dividend equivalents on unvested restricted stock, restricted stock units or other share-based awards that are full-value awards; and
  - Imposition of a minimum one-year vesting period for all awards other than a carve-out for up to 5% of the shares that are available for issuance as of the effective date of the Amended 2002 Plan.
- In light of the tax legislation that was recently enacted by Congress eliminating the performance-based exception from the deductibility limitations under Section 162(m) of the Internal Revenue Code, the requirements applicable to equity awards that were intended to constitute "qualified performance-based compensation" under Section 162(m) of the Internal Revenue Code have been eliminated. However, the Amended 2002 Plan retains a framework to grant performance-based awards that provides for requirements similar to those previously imposed on awards intended to constitute qualified performance-based compensation under Section 162(m).
- An annual limit has been imposed on the size of equity awards that may be granted to any non-employee director during a calendar year. The accounting value of equity awards, when aggregated with cash compensation, granted to a non-employee director in any calendar year may not exceed $800,000.
- A "clawback" provision has been added, permitting us to recover awards or payments from participants, including as may be required under the Dodd-Frank Act.

- To achieve consistency with our other change in control arrangements, the "Change in Control" definition has been revised to reflect a definition that is more consistent with the definition in the Eli Lilly and Company Change in Control Severance Pay Plan.

- The single-trigger change in control vesting acceleration provision applicable to time-based awards has been eliminated. The Amended 2002 Plan now provides that time-based awards will not vest in connection with a Change in Control unless they are not assumed, substituted or otherwise replaced.

- The change in control treatment applicable to performance-based awards has been revised to provide that the vesting of performance-based awards upon a Change in Control will not occur at a rate that is greater than the actual level of attainment and/or provide for pro-rated vesting of the award based on any reduction to the performance period.

- An amendment to add the authority to grant other share-based awards, which would include other potential types of awards denominated or based on the stock of the Company that may not fall into the category of awards that currently may be granted.

- An amendment to eliminate the automatic expiration date. Instead, the Amended 2002 Plan provides that it will continue in effect until it is terminated by our Board of Directors.

Key Terms of the Amended 2002 Plan at a Glance

The following is a summary of the key provisions of the Amended 2002 Plan, as set forth and stated herein.

Plan Term:	The Amended 2002 Plan was adopted by the Board of Directors on February 20, 2018, subject to obtaining shareholder approval and will continue in effect until terminated by the Board of Directors. Shares available under the Amended 2002 Plan are expected to last at least five years.
Eligible Participants:	Employees and directors of the Company and its affiliates generally are eligible to receive non-qualified stock options, restricted stock, stock appreciation rights, restricted stock units and other share-based awards under the Amended 2002 Plan. Only employees of the Company or a subsidiary meeting the requirements of the Internal Revenue Code are eligible to receive "incentive stock options," within the meaning of Section 422 of the Internal Revenue Code (ISOs) under the Amended 2002 Plan.
Shares Available for Awards:	53,000,000 shares would be available for future awards granted on or following the effective date of the Amended 2002 Plan. The Amended 2002 Plan provides for a *decrease* in the number of shares of common stock reserved for issuance under the plan (including previously granted awards) to 75,657,296 shares plus shares available for issuance under prior plans immediately prior to the effective date of the 2002 Plan.
Award Types:	(1) Non-Qualified Stock Options and Incentive Stock Options (2) Restricted Stock (3) Stock Appreciation Rights (4) Restricted Stock Units (5) Dividend Equivalent Rights (6) Other Share-Based Awards (7) Performance-Based Awards

Award Terms (Exercisability Period):	Options, Stock Appreciation Rights (SARs), and Other Share-Based Awards have a term of no longer than 10 years. ISOs granted to ten percent owners will have a term of no longer than five years.
ISO Limits:	No more than 30,000,000 shares reserved for issuance may be issued upon the exercise of ISOs granted under the Amended 2002 Plan.
Minimum Vesting:	Vesting is generally determined by the Compensation Committee within limits set forth in the Amended 2002 Plan, except that no award may fully vest before the first anniversary of the grant date other than a carve-out for up to 5% of the number of shares that are reserved for issuance pursuant to future awards as of the effective date of the Amended 2002 Plan.
Not Permitted:	1) Repricing or reducing the exercise price of a share option or SAR below the per share exercise price as of the date of grant without shareholder approval. 2) Canceling, surrendering or substituting any outstanding option or SAR in exchange for (i) the grant of a new option or SAR with a lower exercise price, or (ii) other awards or a cash payment at a time when the exercise price of the option or SAR is greater than the fair market value of a share. 3) Adding shares back to the number of shares available for issuance when shares are repurchased on the open market with the proceeds of the exercise of an option. 4) Single-trigger change in control vesting acceleration. 5) Payment of dividend or dividend equivalent rights prior to the vesting of the underlying awards.

Summary of the Amended 2002 Plan
The following summary of certain material features of the Amended 2002 Plan is qualified in its entirety by reference to the Amended 2002 Plan, which is attached to this proxy statement as Appendix C.

Purpose of the Amended 2002 Plan
The purpose of the Amended 2002 Plan is to benefit the Company's shareholders by allowing the Company to attract, motivate and retain the best available employees and directors and by providing those employees and directors stock-based incentives to strengthen the alignment of interests between those persons and the Company's shareholders.

Shares Reserved for Issuance under Amended 2002 Plan
Shares Reserved. As proposed, the total number of shares of our common stock that are authorized and available for issuance pursuant to awards granted under the Amended 2002 Plan is 75,657,296 shares plus shares available for issuance under prior plans immediately prior to the effective date of the 2002 Plan, subject to adjustment in the event of certain changes in the capitalization of the Company. However, only 53,000,000 shares would be available for future awards as of the effective date of the Amended 2002 Plan. As of February 16, 2018, 96,342,704 shares of common stock were available for the grant of future awards under the 2002 Plan. The Amended 2002 Plan provides for a decrease – rather than an increase – in the number of shares of common stock reserved for issuance under the plan.

Shares Reissuable Under Amended 2002 Plan. The following shares are reissuable pursuant to new awards granted under the Amended 2002 Plan: shares that are not issued as a result of the termination, expiration or lapsing of an award for any reason; shares subject to a full value award that are not issued because the award is settled in cash; shares covered by an option surrendered in payment of the exercise or purchase price or in satisfaction of any tax-related items incident to the exercise of an option; or shares that are surrendered in satisfaction of obligations for tax-related items incident to the vesting or settlement of a full value award.

Shares Not Reissuable Under Amended 2002 Plan. Shares repurchased by the Company on the open market with the proceeds of the exercise price from options will be deducted from the aggregate number of shares available for future awards.

Shares Not Counted Against Share Reserve Pool Under Amended 2002 Plan. To the extent permitted by applicable law or any stock exchange rule, shares issued in assumption of, or in substitution for, any outstanding awards of any entity acquired in any form of combination by the Company or an affiliate will not be counted against shares available for grant pursuant to the Amended 2002 Plan. The payment of a dividend equivalent right in cash in conjunction with any outstanding awards will not be counted against the shares available for issuance under the Amended 2002 Plan.

Award Limits
In any calendar year, the maximum number of shares that may be granted to any one participant under the Amended 2002 Plan is 1,500,000 shares, subject to adjustment in the event of specified capitalization events of our company.

Awards
Under the Amended 2002 Plan, the following awards may be granted: stock options (including "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code), restricted stock, stock appreciation rights, restricted stock units, dividend equivalent rights, other share-based awards, and performance-based awards.

Eligibility
Incentive stock options may be granted only to our employees and to employees of any of our subsidiaries meeting the requirements of the Internal Revenue Code. Awards other than incentive stock options may be granted to our non-employee directors and to employees of the Company and any of its affiliates. As of February 16, 2018,13 non-employee directors and 31,531 employees were eligible to participate in the 2002 Plan.

Administration
The Amended 2002 Plan provides that it will be administered by our Board of Directors, unless the Board of Directors elects to delegate administration responsibilities to a committee. (In this Proxy Statement, we will refer to the Board of Directors or the committee to which administration of the Amended 2002 Plan has been delegated as the "Committee"). The Committee has the sole authority to grant awards, and sole and exclusive discretion to interpret and administer the Amended 2002 Plan. The Committee determines the eligible individuals who will receive grants and the precise terms of the grants (including accelerations or waivers of any restrictions, and the conditions under which such accelerated vesting or waivers occur, such as in connection with a participant's death). The Committee has the authority to amend or modify the terms of an outstanding award, except that an amendment that materially and adversely impacts the rights under an outstanding award will require prior written consent from the participant, unless the amendment is necessary or desirable to facilitate compliance with applicable law or to avoid adverse tax consequences under Section 409A of the Internal Revenue Code. The decisions of the Committee will be final and binding on all holders of awards. To the extent permitted by applicable law, our Board of Directors also may delegate to a committee of one or more members of our Board of Directors or one or more officers of our company the authority to grant or amend awards to participants other than employees who are subject to Section 16 of the Securities Exchange Act of 1934, as amended, or officers or directors of our company to whom authority to grant or amend awards has been delegated.

Stock Options
The Amended 2002 Plan authorizes the grant of incentive stock options, which are intended to satisfy the requirements of Section 422 of the Internal Revenue Code, and non-qualified stock options, which do not satisfy the requirements of Section 422 of the Code. The exercise price of stock options granted under the Amended 2002 Plan may not be less than 100% (or higher in the case of certain incentive stock options) of the fair market value of a share of our common stock on the date of grant. As of February 16, 2018, the fair market value of a share of our common stock was $78.97. Options granted under the Amended 2002 Plan will vest at the rate specified by the Committee. No stock option will be exercisable more than ten years after the date it is granted.

The Committee determines the methods by which the exercise price of options is paid, including the following: in cash or check, in shares, through a broker-dealer sale and remittance procedure pursuant to which the participant effects a same-day exercise of the option and sale of the purchased shares in order to cover the exercise price for the purchased shares and the applicable withholding taxes, a "net exercise" arrangement pursuant to which the number of shares issuable upon exercise of the option is reduced by a number of shares having a fair market value that would cover the exercise price and tax withholding. In addition, the Committee may provide financial assistance

to a participant who wishes to exercise his or her outstanding options, provided that the participant is not an executive officer or member of the Board of Directors, by allowing the participant to deliver an interest-bearing full recourse promissory note or through a third-party loan guaranteed by the Company in the amount of the exercise price and any associated withholding taxes.

Until the shares are issued, no right to vote or receive dividends or any other rights as a shareholder will exist with respect to the shares subject to an option, notwithstanding the exercise of the option. No adjustment will be made for a dividend or other right for which the record date is prior to the date the shares are issued, except in the case of a capitalization event of the Company as provided under the terms of the Amended 2002 Plan.

Restricted Stock Unit
A restricted stock unit represents the equivalent of one share and this type of award is typically awarded to participants without payment of consideration. Restricted stock units may be subject to vesting conditions based upon the passage of time or the attainment of performance-based conditions as determined in the discretion of the Committee. Except as otherwise determined by the Committee at the time of the grant of the award or thereafter, any restricted stock units that are not vested as of the date of the participant's termination of service will be forfeited. Unlike restricted stock, the stock underlying restricted stock units will not be issued until the restricted stock units have vested. In addition, recipients of restricted stock units generally have no voting or dividend rights until the vesting conditions are satisfied and the underlying shares are issued. Restricted stock units may be settled in shares, cash or a combination of both. The Committee may authorize dividend equivalents to be granted with respect to restricted stock units.

Restricted Stock Awards
An award of restricted stock is a direct grant of common stock, subject to such restrictions on transferability and other restrictions as the Committee may impose (including, without limitation, limitations on the right to vote the underlying shares or the right to receive dividends with respect to the underlying shares). These restrictions may lapse separately or in combination at such times, pursuant to such circumstances, in such installments, or otherwise, as the Committee determines at the time of the grant of the award or thereafter. Restrictions may be based on the passage of time or the attainment of performance-based conditions. Generally, any shares subject to restrictions are forfeited upon termination of employment. The price, if any, that participants are required to pay for each share of restricted stock will be set by the Committee and will be paid in a form approved by the Committee, which may be cash, services rendered or to be rendered to our company or an affiliate of our company, or in another form of payment.

Stock Appreciation Rights
Stock appreciation rights, or "SARs," typically provide for payments to the holder based upon increases in the price of our shares from the date the SAR was granted to the date that the right is exercised. The Committee will generally determine when the SAR will vest and become exercisable. The grant price of a SAR may not be less than the fair market value of a share on the date of grant of the SAR. The Committee determines the term of a SAR, but no SAR will be exercisable more than ten years after the date it is granted.

A SAR may be granted in connection with an option, either at the time of grant or at any time thereafter during the term of the option. Upon exercise, a SAR granted in connection with an option will entitle the holder to surrender the option or any portion thereof to the extent unexercised, with respect to the number of shares as to which such SAR is exercised. The option will, to the extent and when surrendered, cease to be exercisable. If a related option is exercised in whole or in part, then the SAR related to the shares purchased terminates as of the date of such exercise.

The Committee may elect to settle exercised SARs in cash, in shares, or in a combination of cash and shares. Until the shares are issued, no right to vote or receive dividends or any other rights as a shareholder will exist with respect to the shares subject to a SAR, notwithstanding the exercise of the SAR. No adjustment will be made for a dividend or other right for which the record date is prior to the date the shares are issued, except in the case of a capitalization event as provided under the terms of the Amended 2002 Plan.

Other Share-Based Awards
The Committee is authorized under the Amended 2002 Plan to make any other award that is not inconsistent with the provisions of the Amended 2002 Plan and that by its terms involves or might involve the issuance of shares, or of a right vesting based on the passage of time, the occurrence of one or more events, or the satisfaction of performance criteria or other conditions, or the issuance of any other security with the value derived from the value

of the shares. The Committee may elect to settle these awards in cash, in shares, or in a combination of cash and shares. The Committee may establish the exercise price, if any, of any other share-based awards granted under the Plan, except that the exercise price may not be less than the fair market value of a share on the date of grant for an award that is intended to be exempt from Section 409A of the Internal Revenue Code. The Committee may establish the term of other share-based awards, but it may not exceed ten years. The Committee may authorize dividend equivalents to be paid on other share-based awards.

Performance-Based Awards
The Committee may grant to eligible participants awards that are paid, vest or become exercisable upon the attainment of company performance goals which include, but are not limited to, one or more of the following performance criteria: cash flow (including, without limitation, operating cash flow and free cash flow), earnings per share, gross or net profit margin, net income (either before or after interest, taxes, amortization, and/or depreciation), operating income (either before or after restructuring and amortization charges), return on capital or return on invested capital, return on equity, return on operating assets or net assets, return on sales, sales or revenue, stock price goals or total shareholder return. The Committee intends to define objectively the manner of calculating the performance criteria it selects to use for any applicable performance period.

At the time of grant, the Committee may specify one or more objectively determinable adjustments to one or more of the performance goals. For all performance-based awards, the Committee intends that such determinations shall be made within the first twenty-five percent (25%) of the applicable performance period. No performance-based award may have a performance period with a duration that is less than twelve (12) months.

Notwithstanding the foregoing, while the Committee intends to grant performance-based awards subject to the conditions and procedures outlined above, the Committee may in its discretion grant awards that do not meet such conditions and procedures.

Transferability of Awards
Except as otherwise provided by the Committee, no award granted under the Amended 2002 Plan may be assigned, transferred, or otherwise disposed of by a participant other than by will or the laws of descent and distribution.

Minimum One-Year Vesting Requirement
No award may vest before the first anniversary of the date of grant with the exception of (i) up to five percent (5%) of the number of shares reserved under the Amended 2002 Plan for future awards as of the date the Amended 2002 Plan becomes effective, (ii) awards granted in connection with the assumption or substitution of awards as part of a transaction, and (iii) awards that may be settled only in cash.

Dividends/Dividend Equivalents
To the extent that any dividends or dividend equivalents are payable with respect to a full value award, the dividend or dividend equivalents, as applicable, will not be paid unless the underlying award vests.

Changes in Control
Provided that any applicable award agreement does not preclude the following from applying, in the event of a change in control of our company, each outstanding award that vests solely on the passage of time under the Amended 2002 Plan will immediately vest in the event the award is not converted, assumed, substituted or replaced by the successor corporation, and following the change in control, the awards will immediately terminate. Awards that vest based on the attainment of performance-based conditions shall be subject to the change in control provisions in the applicable award agreement, provided that the agreement does not permit vesting at a rate that is greater than the actual level of attainment and/or provide for pro-rated vesting based on any reduction to the performance period resulting from the change in control. Where awards are assumed, substituted or otherwise continued after a change in control of our company, the Committee may provide that one or more awards will automatically accelerate upon an involuntary termination of the participant's employment or service within a designated period in connection with the change of control. "Change in control" has a special meaning that is defined in the Amended 2002 Plan.

Adjustments upon Changes in Capitalization
In the event of any stock dividend, stock split, combination or exchange of shares, merger, consolidation, or other distribution (other than normal cash dividends) of assets to our shareholders or any other similar event or change in capitalization affecting our shares other than certain equity restructurings identified in the Amended 2002 Plan, the

Committee has discretion to make appropriate adjustments in the number and type of shares subject to the Amended 2002 Plan, the terms and conditions of any award outstanding under the Amended 2002 Plan, and the grant or exercise price of any such award. In the case of certain equity restructurings as specified in the Amended 2002 Plan, the number and type of securities subject to each outstanding award and the grant or exercise price, if applicable, will be equitably adjusted.

Amendment and Termination of Plan
With the approval of our Board of Directors, at any time and from time to time, the Committee may terminate, amend or modify the Amended 2002 Plan, except that the Board may not, without prior shareholder approval, amend the Amended 2002 Plan in any manner that would require shareholder approval to comply with any applicable laws, rules or regulations. Except as may be required to avoid adverse tax consequences under Section 409A of the Internal Revenue Code or as may be required or desirable to facilitate compliance with applicable law, no termination, amendment or modification of the Amended 2002 Plan may adversely affect in any material way any award granted under the Amended 2002 Plan without the consent of the participant.

Furthermore, absent approval of our shareholders and except as permitted under the provisions of the Amended 2002 Plan dealing with certain capitalization adjustments and change in control, no option or SAR may be amended to reduce the exercise price or grant price of the shares subject to such option or SAR and no option or SAR may be cancelled in exchange for the grant of an option or SAR having a lower per share exercise price or for a cash payment or another award at a time when the option or SAR has a per share exercise price that is higher than the fair market value of the shares.

Clawback/Recovery
Awards are subject to recoupment under any "clawback" policy that the Company adopts for the recovery of awards or payments thereunder in the event of fraud or as required by applicable law or governance considerations or in other similar circumstances.

Plan Term
The Amended 2002 Plan will continue in effect until terminated by our Board of Directors, but no incentive stock options may be granted under the Amended 2002 Plan after the tenth anniversary of the date the amendments to the Amended 2002 Plan were approved by our Board of Directors. Any awards that are outstanding at the time the Amended 2002 Plan terminates will remain in force according to the terms of the Amended 2002 Plan and the applicable agreement evidencing the award.

Federal Income Tax Consequences
The following is a summary of the U.S. federal income tax consequences applicable to equity awards under the Amended 2002 Plan based on current U.S. federal income tax laws. The Amended 2002 Plan is not qualified under Section 401(a) of the Internal Revenue Code. **The summary is general in nature and is not intended to cover all tax consequences that may apply to a particular employee, director or to our company. The provisions of the Internal Revenue Code and regulations thereunder relating to these matters are complicated, may change and their impact in any one case may depend upon the particular circumstances. Further, this summary does not discuss the tax consequences of a participant's death or the provisions of any income tax laws of any municipality, state or foreign country in which a participant may reside.**

Nonqualified Stock Options. With respect to nonqualified stock options: (i) no income is recognized by the participant at the time the nonqualified stock option is granted; (ii) generally, at exercise, ordinary income is recognized by the participant in an amount equal to the difference between the option exercise price paid for the shares and the fair market value of the shares on the date of exercise and we are entitled to a tax deduction in the same amount (subject to the restrictions on deductibility described under "Section 162(m) Limitation" below); and (iii) upon disposition of the shares, any gain or loss is treated as capital gain or loss. If the options are exercised and the shares acquired are sold on the same date, generally, the difference between the option exercise price paid for the shares and the sale price is recognized as ordinary income and no capital gain or loss is reported. If required, income tax must be withheld from the participant on the income recognized by the participant upon exercise of a nonqualified stock option.

Incentive Stock Options. The grant of an incentive stock option under the Amended 2002 Plan will not result in any federal income tax consequences to the participant or to our company. A participant recognizes no federal taxable income upon exercising an incentive stock option (subject to the alternative minimum tax rules discussed below), and we receive no deduction at the time of exercise. In the event of a disposition of common stock acquired upon

exercise of an incentive stock option, the tax consequences depend upon how long the participant has held the shares of common stock. If the participant does not dispose of the shares within two years after the incentive stock option was granted, nor within one year after the incentive stock option was exercised, the participant will recognize a long-term capital gain (or loss) equal to the difference between the sale price of the shares and the exercise price. We are not entitled to any deduction under these circumstances.

If the participant fails to satisfy either of these holding periods, he or she must recognize ordinary income in the year of the disposition (referred to as a "disqualifying disposition"). The amount of such ordinary income generally is the lesser of (A) the difference between the amount realized on the disposition and the exercise price or (B) the difference between the fair market value of the common stock on the exercise date and the exercise price. Any gain in excess of the amount taxed as ordinary income will be treated as a long- or short-term capital gain, depending on whether the common stock was held for more than one year. In the year of the disqualifying disposition, we are entitled to a deduction equal to the amount of ordinary income recognized by the participant, subject to possible limitations imposed by Section 162(m) of the Internal Revenue Code.

The "*spread*" under an incentive stock option (*i.e.*, the difference between the fair market value of the shares at exercise and the exercise price) is classified as an item of adjustment in the year of exercise for purposes of the alternative minimum tax. If a participant's alternative minimum tax liability exceeds such participant's regular income tax liability, the participant will owe the larger amount of taxes. The alternative minimum tax will not apply with respect to incentive stock options if the participant sells the shares within the same calendar year in which the incentive stock options are exercised. However, such a sale of shares within the same year of exercise will constitute a disqualifying disposition, as described above.

Stock Appreciation Rights. Upon exercise of a SAR, the participant will recognize ordinary income (treated as compensation) in an amount equal to the excess of the aggregate fair market value of the shares on the date the SAR is exercised over the aggregate exercise price of the SAR. We generally will be entitled to a business expense deduction in the same amount and at the same time as the participant recognizes ordinary compensation income (subject to the limits of Section 162(m) of the Internal Revenue Code). If required, income tax will be withheld from the participant on the income recognized by the participant upon exercise of a SAR.

Restricted Stock. In the absence of a Section 83(b) election (as described below), a participant who receives restricted stock will recognize no income at the time of grant. When the restrictions lapse, a participant will recognize ordinary income (treated as compensation) equal to the excess of the fair market value of the stock when the restrictions lapse over the amount paid (if any) for the stock. As the restrictions applicable to a grant of restricted stock lapse (for example, if the restrictions on 20% of a grant lapse on each anniversary of the grant date), the participant will include the applicable portion of the shares that vests as ordinary income (treated as compensation). The participant's basis in the common stock is equal to the amount included in income on the expiration of the restrictions and the amount paid (if any), and the holding period will begin when the restrictions end. Any disposition of the restricted stock will result in a long- or short-term capital gain or loss, depending on the time the common stock is held after the restrictions end. We generally will be entitled to a deduction equal to the fair market value of the common stock when it is included in the participant's income, and will also be entitled to a business expense deduction for dividends paid to the participant (if any) on common stock that remains subject to restrictions (in each case subject to the limits of Section 162(m) of the Internal Revenue Code).

If a Section 83(b) election is made within 30 days of the grant of the award, the participant must recognize the fair market value of the restricted stock on the date of grant as ordinary income (treated as compensation) as of the date of grant, and the holding period would begin at the time the restricted stock is granted. We generally would be entitled to a corresponding business expense deduction for the grant, but dividends on the stock would not be deductible. Any subsequent disposition of the stock by the participant, other than by forfeiture, would result in capital gain or loss, which would be long- or short-term, depending on the length of the holding period. Upon a subsequent forfeiture of restricted stock with respect to which a Section 83(b) election has been made, no deduction will be allowed in respect of the amount included as income at the time the Section 83(b) election was made; however, the participant will generally be allowed a loss deduction equal to the amount (if any) the participant paid for the restricted stock over the amount (if any) we paid the participant for the restricted stock at the time it is forfeited.

If required, income tax will be withheld from the participant on the income recognized by the participant at the time the restrictions on the restricted stock lapse (or grant of the restricted stock, in the event the participant makes a Section 83(b) election).

Restricted Stock Units. A participant will not recognize any income at the time a restricted stock unit is granted, nor will we be entitled to a deduction at that time. When payment on a restricted stock unit is made, the participant will recognize ordinary income in an amount equal to the difference between the fair market value of the common stock received (or if the restricted stock unit is settled in cash, the cash amount) and the amount paid as consideration for the units, which will typically be nil. If required, income tax will be withheld on the income recognized by the participant. We will receive a deduction for federal income tax purposes equal to the ordinary income recognized by the participant, subject to the limits of Section 162(m) of the Code.

Performance-Based Awards. A participant will generally not recognize income at the time an award based on achievement of performance objectives is granted, nor will we be entitled to a deduction at that time. When payment on the performance award is made, the participant generally will recognize ordinary income in an amount equal to the fair market value of the common stock received (or if the award is settled in cash, the cash amount). If required, income tax must be withheld on the income recognized by the participant. We will receive a deduction for federal income tax purposes equal to the ordinary income recognized by the participant, subject to the limits of Section 162(m) of the Code.

Dividend Equivalents. A recipient of dividend equivalents generally will recognize ordinary income at the time the dividend equivalent is paid. If required, income tax will be withheld on the income recognized by the participant. We will receive a deduction for federal income tax purposes equal to the ordinary income recognized by the participant, subject to the limits of Section 162(m) of the Code.

Section 162(m) Limitation. Under Section 162(m) of the Internal Revenue Code, income tax deductions of publicly-held corporations are generally limited to the extent total compensation (including base salary, annual bonus, stock option exercises and non-qualified benefits paid) for specified executive officers exceeds $1 million (less the amount of any “excess parachute payments” as defined in Section 280G of the Internal Revenue Code) in any one year.

Section 409A. Section 409A of the Code imposes certain requirements on non-qualified deferred compensation arrangements. These include requirements on an individual’s election to defer compensation and the individual’s selection of the timing and form of distribution of the deferred compensation. If an award under the Amended 2002 Plan is subject to and fails to satisfy the requirements of Section 409A, the recipient of that award may recognize ordinary income on the amounts deferred under the award, to the extent vested, which may be prior to when the compensation is actually or constructively received. Also, if an award that is subject to Section 409A fails to comply with the requirements of Section 409A, Section 409A imposes an additional 20% federal penalty tax on compensation recognized as ordinary income, as well as interest on such deferred compensation.

Future Plan Benefits

Future awards to employees, officers, and directors under the Amended 2002 Plan are generally made at the discretion of the Committee. Therefore, the benefits and amounts that will be received or allocated under the Amended 2002 Plan, as amended, in the future are not determinable at this time.

Past Grants under the 2002 Plan

As of February 16, 2018, awards covering 44,257,285 shares of the common stock had been granted under the 2002 Plan. The following table shows information regarding the grants of those awards among the persons and groups identified below.

PRIOR GRANTS UNDER THE 2002 PLAN

	Options	Restricted Stock	RSUs	Performance RSUs	
	Number of Shares	Number of Shares	Number of Shares	Target Number of Shares	Maximum Number of Shares
David A. Ricks Chairman, President, and CEO	17,779	—	20,466	590,166	877,744
Enrique A. Conterno Senior VP and President, Lilly Diabetes and President, Lilly USA	35,429	11,000	76,837	524,315	783,226
Derica W. Rice (retired) Executive VP, Global Services and Chief Financial Officer	116,385	—	—	993,511	1,518,504
Jan M. Lundberg, Ph.D. Executive VP, Science and Technology and President, Lilly Research Laboratories	—	—	127,871	620,024	901,590
Michael Harrington Senior VP and General Counsel	17,746	5,000	22,778	313,188	466,151
Current Executive Officers, as a Group	392,978	30,000	443,736	4,053,170	6,045,121
Non-Employee Directors, as a Group	19,600	—	—	—	—
All current employees who are not executive officers, as a group	9,201,253	55,700	10,760,750	18,190,202	29,334,005

Vote Required
The affirmative vote of at least a majority of the outstanding common shares present in person or by proxy at the annual meeting is needed to pass this proposal.

Board Recommendation on Item 6

The Board of Directors recommends that you vote FOR approving the Amended and Restated 2002 Lilly Stock Plan.

Shareholder Proposals

Item 7. Shareholder Proposal Seeking Support for the Descheduling of Cannabis

Fred Pfenninger, 9247 N. Meridian Street, Suite 219, Indianapolis, Indiana, beneficial owner of 79 shares of common stock of Eli Lilly and Company, has submitted the following proposal:

Shareholder Proposal
The proponent requests that the Company announce its support for the descheduling of cannabis.

Supporting Statement
Eli Lilly, who was the Third President of Lilly from 1932 to 1948, graduated from the Philadelphia College of Pharmacy in 1907 and wrote his Doctoral Thesis on "The Comparative Physiological Effects of Several Varieties of Cannabis Sativa." Lilly was a world leader in cannabis based pharmaceutical products in the early 1900s. Lilly sold 23 different cannabis entries in its medical catalog in 1935 before the 1937 Marijuana Tax Act and Reefer Madness halted sales. Parke Davis worked with Lilly to create its own strain Cannabis Americana which Lilly grew in Greenfield, Indiana.

Federal prohibitions outlawing cannabis recreational, industrial and therapeutic use were first imposed by Congress under the Marijuana Tax Act of 1937 and later reaffirmed by federal lawmakers' decision to "temporarily" classify marijuana as well as the plant's organic compounds known as cannabinoids as a Schedule I substance under the Controlled Substances Act of 1970. This classification, which categorizes the plant by statute alongside heroin, defines cannabis and its cannabinoids as possessing a high potential for abuse, no currently accepted medical use and a lack of accepted safety for the use of the drug.

The Controlled Substances Act of 1970 called for the creation of a special federal commission appointed by Congress and President Nixon to study all aspects of cannabis and report their findings. After 2 years of scientific study the National Commission on Marijuana and Drug Abuse ("Schafer Commission") report "Marijuana: A Signal of Misunderstanding" reported that there was little proven danger of physical or psychological harm, it does not lead to physical dependence, it is not a gateway drug, and no one should go to jail for the private possession of cannabis.

Despite the US Government's nearly century long prohibition of the plant, cannabis is one of the most investigated therapeutically active substances in history. To date there are approximately 22,000 published studies or reviews in the scientific literature referencing the cannabis plant and its cannabinoids, nearly half of which were published within 10 years according to a key work search on the search engine PubMed Central.

The late 1980s discovery of the endogenous cannabinoid system, with specific receptors and ligands, has progressed our understanding of the therapeutic actions of cannabis. The cannabinoid system evolved with our species and is intricately involved in normal physiology -control of movement; pain, reproduction, memory, appetite.

Cannabis oil kills cancer, prevents and reverses dementia, prevents epileptic seizures, and extends longevity among other things. Cannabis is the most medicinal plant on the planet.

Statement in Opposition to the Shareholder Proposal Regarding Support for the Descheduling of Cannabis

The Public Policy and Compliance Committee has reviewed and recommends a vote against this proposal. We have finite resources for advocacy, which we must limit and focus to be effective, and descheduling of cannabis is not one of our core priorities. We focus our resources to support organizations that champion public policies that contribute to pharmaceutical innovation, healthy patients, and a healthy business climate. The company is also actively engaged in public policy discussions that relate to our current products and other important topics related to drug pricing.

Board Recommendation on Item 7

The Board of Directors recommends a vote AGAINST the proposal.

Item 8. Shareholder Proposal Requesting Report Regarding Direct and Indirect Political Contributions

The Comptroller of the State of New York, Thomas P. DiNapoli, trustee of the New York State Common Retirement Fund and the administrative head of the New York State and Local Retirement System, beneficial owner of 2,967,282 shares, has submitted the following proposal:

Shareholder Proposal
The proponent seeks a report from the company regarding its direct and indirect political contributions.

Supporting Statement
Whereas, we believe in full disclosure of Eli Lilly and Company's ("Lilly") direct and indirect lobbying activities and expenditures to assess whether Lilly's lobbying is consistent with its expressed goals and in the best interests of shareholders.

Resolved, the shareholders of Lilly request the preparation of a report, updated annually, disclosing:

1. Company policy and procedures governing lobbying, both direct and indirect, and grassroots lobbying communications.

2. Payments by Lilly used for (a) direct or indirect lobbying or (b) grassroots lobbying communications, in each case including the amount of the payment and the recipient.

3. Lilly's membership in and payments to any tax-exempt organization that writes and endorses model legislation.

4. Description of the decision making process and oversight by management and the Board for making payments described in section 2 and 3 above.

For purposes of this proposal, a "grassroots lobbying communication" is a communication directed to the general public that (a) refers to specific legislation or regulation, (b) reflects a view on the legislation or regulation and (c) encourages the recipient of the communication to take action with respect to the legislation or regulation. "Indirect lobbying" is lobbying engaged in by a trade association or other organization of which Lilly is a member.

Both "direct and indirect lobbying" and "grassroots lobbying communications" include efforts at the local, state and federal levels.

The report shall be presented to the Audit Committee or other relevant oversight committees and posted on Lilly's website.

Supporting Statement
We encourage transparency in the use of corporate funds to influence legislation and regulation, both directly and indirectly. Since 2010, Lilly has spent over $64 million on federal lobbying (opensecrets.org). This figure does not include lobbying expenditures to influence legislation in states, where Lilly also lobbies in 48 states ("Amid Federal Gridlock, Lobbying Rises in the States," *Center for Public Integrity,* February 11, 2016), but disclosure is uneven or absent.

Lilly is a member of the Pharmaceutical Research and Manufacturers of America (PhRMA), which spent over $100 million fighting a California drug pricing initiative ("Big Pharma Fights 'Tooth and Nail' against California Drug Vote," *Bloomberg,* October 25, 2016), and belongs to the Chamber of Commerce, which has spent over $1.3 billion on lobbying since 1998. Lilly does not disclose its payments to trade associations, or the amounts used for lobbying. We are concerned that Lilly's lack of trade association lobbying disclosure presents reputational risks. For example, Lilly believes in providing affordable medicines, yet helps fund PhRMA's opposition to lower drug price initiatives, and Lilly supports smoking cessation, yet the Chamber works to block global smoking laws.

And Lilly does not disclose its contributions to tax-exempt organizations that write and endorse model legislation, such as its membership in the American Legislative Exchange Council (ALEC). Lilly's ALEC membership has drawn media scrutiny ("Kendall: Businesses Should Cut Ties with Union-busting Lobbyists," *Indianapolis Star*, July 27, 2016). Over 100 companies have publicly left ALEC, including Allergan, Amgen, AstraZeneca, GlaxoSmithKline, Medtronic and Merck.

Statement in Opposition to the Shareholder Proposal Requesting Report Regarding Direct and Indirect Political Contributions

The Public Policy and Compliance Committee of the board has reviewed this proposal and recommends a vote against it, as we currently publish most of the information requested by the shareholder. The additional reporting requirements are unnecessary, as the information requested is publicly available and this reporting would place an undue administrative burden on the company.

Beginning in 2005, the company has published the following information on our website (www.lilly.com) for both direct company contributions and employee political action committee (PAC) contributions to support candidates for political office, political parties, officials, or committees in the U.S.:

- policies and procedures for company and PAC contributions
- contributions to candidates, including information about the candidate's office (for example, state, local, or federal; House or Senate), party affiliation, and state
- contributions to political organizations and Section 527 organizations reported by state.

This information is updated annually. In addition to the information available on our website, detailed corporate contributions, PAC contribution data, and the company's direct lobbying expenses are available to the public on the Federal Election Committee website (https://www.fec.gov/data/) and through individual state agencies. The company's direct lobbying expenses are also available to the public on the Lobbying Disclosure page of the U.S. House website (http://disclosures.house.gov/ld/ldsearch.aspx) and through individual state agencies.

In addition to direct political contributions, Lilly maintains memberships in certain 501(c)(6)s - trade associations that report lobbying activity to the U.S. government. We maintain memberships in trade associations and other tax-exempt organizations specific to business and pharmaceutical industry interests, such as PhRMA (Pharmaceutical Research and Manufacturers Association), BIO (Biotechnology Association), and the National Association of Manufacturers. We support organizations that champion public policies that contribute to pharmaceutical innovation, healthy patients, and a healthy business climate.

Information relating to Lilly's memberships in trade associations to which we contribute $50,000 per year or more, and any such organizations where Lilly has a board seat can be found at https://www.lilly.com/LillyPAC.

These tax exempt organizations are also required to disclose their lobbying expenditures under the Lobbying Act of 1995: they report their lobbying expenditures to the U.S. Senate.

As we do not control what portion of the organization's budget is spent on lobbying, it is the fact of company membership in and support for the trade association, and the trade association's total lobbying expenditure, that reveals the most about Lilly's political activities. As a result, the board of directors does not believe any value provided by the requested additional disclosures merits the resources required to produce such a report.

Board Recommendation on Item 8

The Board of Directors recommends a vote AGAINST the proposal.

Item 9. Shareholder Proposal Requesting Report on Policies and Practices Regarding Contract Animal Laboratories

People for the Ethical Treatment of Animals (PETA), 1536 16th Street N.W., Washington, D.C., beneficial owner of 56 shares of common stock of Eli Lilly and Company, has submitted the following proposal:

Establish Accountability for Animal Welfare
RESOLVED, in light of disturbing mistreatment of animals at external research organizations with which our Company has conducted business, the Board should strengthen our Company's policy and practices regarding contract animal laboratories and issue a report to shareholders.

Supporting Statement
In spite of its "commitment to the ethical treatment of animals," which extends to external laboratories, our Company has repeatedly conducted business with contract laboratories where substandard animal care practices have been documented by government agencies.

Our Company's animal care policy states that "animals used in research shall be treated humanely, with pain or distress eliminated or minimized." Additionally, our Company requires all contract research organizations "to adhere to [its animal welfare] policies and principles." Yet our Company has paid for services conducted at and purchased animals from at least three contract laboratories—Liberty Research, Inc. (Liberty), Professional Laboratory and Research Services (PLRS), and Covance—with serious violations of federal animal welfare laws.

A 2017 exposé of Liberty conducted by People for the Ethical Treatment of Animals (PETA) documented, including on video, living and dying conditions for dogs and cats marked by pain and misery. Workers failed to provide adequate anesthesia to dogs whose skulls were opened during invasive surgery and failed to administer humane euthanasia. Liberty used animals in multiple tests despite the long-term effects of experimental compounds and possible interactions with other medications. Cats were forced to live in severely crowded, barren, windowless pens where recently, some suffocated under litter pans; and dogs suffered severe injuries after being confined with incompatible cagemates.

Our company also contracts with Covance, which was cited and fined by the U.S. Department of Agriculture (USDA) in 2016 when negligence resulted in thirteen monkeys dying of hyperthermia.[1] According to recent federal inspections, beagles and monkeys at Covance were denied adequate veterinary care for numerous ailments: monkeys sustained limb fractures and beagles were not adequately treated for inflamed and painful skin. A rabbit was euthanized after she was found with a bell stuck in her mouth. Another rabbit was euthanized after she sustained a spinal injury.

Apparent carelessness in choosing outside laboratories is a long-standing issue for our Company. A 2010 PETA video exposé of PLRS documented repeated violations of federal laws. Workers yelled profanities at cowering, frightened dogs and cats. Employees kicked, threw, dropped, and dragged dogs, and violently threw cats into cages. Animals at PLRS were forced to live in their own feces and urine and suffered constantly from burns and sores-but received no veterinary care for their wounds. Following the release of the video, and inspection by the USDA, this laboratory was forced to close.

Shareholders cannot monitor what goes on inside animal testing laboratories, but our Company can and must review federal records and conduct frequent and extensive visits to contract laboratories. The Board must ensure that animal welfare measures are an integral part of our Company's corporate stewardship.

We urge shareholders to vote in favor of this socially and ethically important proposal.

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[1]http://www.mediapeta.com/peta/PDF/Covance_Research_Products.Stip.July2016.pdf

Statement in Opposition to the Shareholder Proposal Requesting Report on Policies and Practices Regarding Contract Animal Laboratories

We share the concerns raised in this shareholder proposal. We abhor mistreatment of animals and we are committed to the appropriate treatment of animals in research. However, for reasons stated below, the Public Policy and Compliance Committee of the board has reviewed this proposal and recommends a vote against it.

Of the violations cited by PETA in their proposal, Lilly has terminated relationships with one of the three laboratories. For the second laboratory, work has been curtailed and confined to a single site with additional oversight and remediation. The third laboratory self-reported the incidents and took immediate action to address the cited issues. We do not condone, in any form, the mistreatment of research animals, and we recognize our fundamental ethical and scientific obligation to ensure the appropriate treatment of animals used in research. We have processes and procedures in place to ensure humane treatment of animals, including programs for oversight by an internal corporate Animal Welfare Board, Institutional Animal Care and Use Committees, or an equivalent ethical review board, as well as veterinary oversight at every site—both ours and contract laboratories. We are committed to quality research-animal care and use, the responsible use of animals in medical research, and the use of alternative methods whenever possible and appropriate.

We adhere to standards set forth in the U.S. Animal Welfare Act. We have been accredited by the Association for Assessment and Accreditation of Laboratory Animal Care (AAALAC). AAALAC accreditation rules and standards can be found on the AAALAC website (www.aaalac.org). This accreditation is a voluntary process that includes a detailed, comprehensive review of our research-animal program including animal care and use policies and procedures, animal environment, housing and management, veterinary medical care, and physical plant operations. We consider our policies and practices to be very much in line with leading industry standards as evidenced by our engagement in industry consortia and professional societies focused on the use of animals in biomedical research (National Association of Biomedical Research, IQ Consortium, Foundation of Biomedical Research). We currently

publish information detailing our commitment to responsible animal research as well as an overview of our policies and procedures on our website (www.lilly.com).

For safe and effective medicines to be available to patients, U.S. and foreign regulatory agencies have mandated that a defined amount of research be performed in animals. Where animals must be used, we take every measure to assure that the lowest number of animals is used and that discomfort and distress are either eliminated or minimized.

As a global company, we develop contractual relationships with select laboratory-animal research and animal-supply companies inside and outside the U.S. We seek to do business only with those companies that share our commitment to animal welfare. We require these companies to maintain a quality animal care and use program. To ensure animal welfare, we assess third-party organization adherence to these expectations. If events suggest a laboratory has failed to meet our standards, we promptly investigate and act upon the allegations. These actions may include termination of a business relationship.

Board Recommendation on Item 9

The Board of Directors recommends a vote AGAINST the proposal.

Item 10. Shareholder Proposal Requesting Report on the Extent to Which Risks Related to Public Concern Over Drug Pricing Strategies are Integrated into Incentive Compensation Arrangements

Mercy Investment Services, Inc., 2039 North Geyer Road, St. Louis, Missouri, beneficial owner of 73 shares of common stock of Eli Lilly and Company, has submitted the following proposal:

RESOLVED, that shareholders of Eli Lilly and Company ("Eli Lilly") urge the Compensation Committee (the "Committee") to report annually to shareholders on the extent to which risks related to public concern over drug pricing strategies are integrated into Eli Lilly's incentive compensation policies, plans and programs (together, "arrangements") for senior executives. The report should include, but need not be limited to, discussion of whether incentive compensation arrangements reward, or not penalize, senior executives for (i) adopting pricing strategies, or making and honoring commitments about pricing, that incorporate public concern regarding the level or rate of increase in prescription drug prices; and (ii) considering risks related to drug pricing when allocating capital.

SUPPORTING STATEMENT
As long-term investors, we believe that senior executive incentive compensation arrangements should reward the creation of sustainable long-term value. To that end, it is important that those arrangements align with company strategy and encourage responsible risk management.

A key risk facing pharmaceutical companies is potential backlash against high drug prices. Public outrage over high prices and their impact on patient access may force price rollbacks and harm corporate reputation. Legislative or regulatory investigations regarding pricing of prescription medicines may bring about broader changes, with some favoring allowing Medicare to bargain over drug prices. (E.g., https://democrats-oversight.house.gov/news/press-releases/cummings-and-welch-launch-investigation-of-drug-companies-skyrocketing-prices; https://democrats-oversight.house.gov/news/press-releases/cummings-and-welch-propose-medicare-drug-negotiation-bill-in-meeting-with) An October 2017 report indicated that five states and federal prosecutors are investigating insulin makers, including Eli Lilly, for anticompetitive practices related to pricing. (https://medcitynews.com/2017/10/insulin-prices-soar/)

We applaud Eli Lilly for improving transparency on drug pricing and supporting alternative pricing approaches. We are concerned, however, that the incentive compensation arrangements applicable to Eli Lilly's senior executives may not encourage senior executives to take actions that result in lower short-term financial performance even when those actions may be in Eli Lilly's best long-term financial interests.

Eli Lilly uses revenue and earnings per share (EPS) as metrics for the annual bonus and EPS growth as the metric for performance awards. (2017 Proxy Statement, at 41-42) A recent Credit Suisse analyst report stated that "US drug price rises contributed 100% of industry EPS growth in 2016" and characterized that fact as "the most important issue for a Pharma investor today." The report identified Eli Lilly as a company where price increases accounted for at least 100% of EPS growth in 2016. (*Global Pharma and Biotech Sector Review: Exploring Future US Pricing Pressure*, Apr. 18, 2017, at 1)

In our view, excessive dependence on drug price increases is a risky and unsustainable strategy, especially when price hikes drive large senior executive payouts. For example, media coverage of the skyrocketing cost of Mylan's EpiPen noted that a 600% rise in Mylan's CEO's total compensation accompanied the 400% EpiPen price increase. (See, e.g., https://www.nbcnews.com/business/consumer/mylan-execs-gave-themselves-raises-they-hiked-epipen-prices-n636591; https://www.wsj.com/articles/epipen-maker-dispenses-outsize-pay-1473786288; https://www.marketwatch.com/story/mylan-top-executive-pay-was-second-highest-in-industry-just-as-company-raised-epipen-prices-2016-09-13)

The disclosure we request would allow shareholders to better assess the extent to which compensation arrangements encourage senior executives to responsibly manage risks relating to drug pricing and contribute to long-term value creation. We urge shareholders to vote for this Proposal.

Statement in Opposition to the Shareholder Proposal Requesting Report on the Extent to Which Risks Related to Public Concern Over Drug Pricing Strategies are Integrated into Incentive Compensation Arrangements

The Public Policy and Compliance Committee of the board has reviewed this proposal and recommends against it.

The company's annual proxy statement provides detailed information on the company's policies, plans, and practices relating to executive compensation. Each year, the CD&A section of this document describes our executive compensation philosophy, the Board of Director's Compensation Committee's process for setting executive compensation, the elements of our compensation program, the factors the committee considered when setting executive compensation for the previous year, and how the company's results affected incentive payouts for the previous year's performance.

The proxy statement includes a detailed summary of the Compensation Committee's review of individual named executive officers. These summaries provide all relevant information regarding the factors considered in those executive's compensation. These summaries include information regarding specific individualized performance inputs, including inputs relating to strategic efforts and decisions. This information is broadly available to shareholders and the general public.

Given that information relating to executive compensation programs, plans, and practices is already disclosed as part of the proxy statement, we believe an annual report is unnecessary.

Board Recommendation on Item 10

The Board of Directors recommends a vote AGAINST the proposal.

Other Information

Meeting and Voting Logistics

Additional Items of Business

We do not expect any items of business other than those above because the deadline for shareholder proposals and nominations has passed. Nonetheless, if necessary, the accompanying proxy gives discretionary authority to the persons named on the proxy with respect to any other matters that might be brought before the meeting. Those persons intend to vote that proxy in accordance with their best judgment.

Voting

Shareholders as of the close of business on March 12, 2018 (the record date) may vote at the annual meeting. You have one vote for each share of common stock you held on the record date, including shares:

- held directly in your name as the shareholder of record
- held for you in an account with a broker, bank, or other nominee
- attributed to your account in the company's 401(k) plan.

You may vote your shares in person at the meeting. However, we encourage you to vote by mail, by telephone, or online even if you plan to attend the meeting.

Required Vote

Below are the vote requirements for the various proposals:

- The five nominees for director will be elected if the votes cast for the nominee exceed the votes cast against the nominee. Abstentions will not count as votes cast either for or against a nominee.
- The following items of business will be approved if the votes cast for the proposal exceed those cast against the proposal:
    - advisory approval of executive compensation
    - ratification of the appointment of principal independent auditor
    - approve the amended and restated 2002 Lilly stock plan
    - four shareholder proposals.

  Abstentions will not be counted either for or against these proposals.
- The proposals to amend the articles of incorporation for declassification of the board and to eliminate supermajority voting provisions require the vote of 80 percent of the outstanding shares. For these items, abstentions and broker nonvotes have the same effect as a vote against the proposals.

Quorum

A majority of the outstanding shares, present or represented by proxy, constitutes a quorum for the annual meeting. As of February 28, 2018, 1,092,700,369 shares of company common stock were issued and outstanding.

Voting By Proxy

If you are a shareholder of record, you may vote your proxy by any one of the following methods:

Online. You may vote online at www.proxyvote.com. Follow the instructions on your proxy card or notice. If you received these materials electronically, follow the instructions in the e-mail message that notified you of their availability. Voting online has the same effect as voting by mail. If you vote online, do not return your proxy card.

By telephone. Shareholders in the U.S., Puerto Rico, and Canada may vote by telephone by following the instructions on your proxy card or notice. If you received these materials electronically, follow the instructions in the e-mail message that notified you of their availability. Voting by telephone has the same effect as voting by mail. If you vote by telephone, do not return your proxy card.

By mail. Sign and date each proxy card you receive and return it in the prepaid envelope. Sign your name exactly as it appears on the proxy. If you are signing in a representative capacity (for example, as an attorney-in-fact, executor, administrator, guardian, trustee, or the officer or agent of a corporation or partnership), please indicate your name and your title or capacity. If the stock is held in custody for a minor (for example, under the Uniform Transfers to Minors Act), the custodian should sign, not the minor. If the stock is held in joint ownership, one owner may sign on behalf of all owners. If you return your signed proxy but do not indicate your voting preferences, we will vote on your behalf with the board's recommendations.

You have the right to revoke your proxy at any time before the meeting by (i) notifying the company's secretary in writing, or (ii) delivering a later-dated proxy online, by mail, or by telephone. If you are a shareholder of record, you may also revoke your proxy by voting in person at the meeting.

Voting Shares Held By a Broker

If your shares are held by a broker, the broker will ask you how you want your shares to be voted. You may instruct your broker or other nominee to vote your shares by following instructions that the broker or nominee provides to

you. Most brokers offer voting by mail, by telephone, and online.

If you give the broker instructions, your shares will be voted as you direct. If you do not give instructions, one of two things can happen, depending on the type of proposal. For the ratification of the principal independent auditor, the broker may vote your shares in its discretion. For all other proposals, the broker may not vote your shares at all.

Voting Shares Held in the Company 401(k) Plan

You may instruct the plan trustee on how to vote your shares in the 401(k) plan online, by mail, or by telephone as described above, except that, if you vote by mail, the card that you use will be a voting instruction form rather than a proxy card.

In addition, unless you decline, your vote will apply to a proportionate number of other shares held by participants in the 401(k) plan for which voting directions are not received (except for a small number of shares from a prior stock ownership plan, which can be voted only on the directions of the participants to whose accounts the shares are credited).

All participants are named fiduciaries under the terms of the 401(k) plan and under the Employee Retirement Income Security Act (ERISA) for the limited purpose of voting shares credited to their accounts and the portion of undirected shares to which their vote applies. Under ERISA, fiduciaries are required to act prudently in making voting decisions.

If you do not want to have your vote applied to the undirected shares, you must so indicate when you vote. Otherwise, the trustee will automatically apply your voting preferences to the undirected shares proportionally with all other participants who elected to have their votes applied in this manner.

If you do not vote, your shares will be voted by other plan participants who have elected to have their voting preferences applied proportionally to all shares for which voting instructions are not otherwise received.

Proxy Cards and Notices

If you received more than one proxy card, notice, or e-mail related to proxy materials, you hold shares in more than one account. To ensure that all your shares are voted, sign and return each card. Alternatively, if you vote by telephone or online, you will need to vote once for each proxy card, notice, or e-mail you receive. If you do not receive a proxy card, you may have elected to receive your proxy statement electronically, in which case you should have received an e-mail with directions on how to access the proxy statement and how to vote your shares. If you wish to request a paper copy of these materials and a proxy card, please call 800-579-1639.

Vote Tabulation

Votes are tabulated by an independent inspector of election, Broadridge Financial Solutions, Inc.

Attending the Annual Meeting

Attendance at the meeting will be limited to shareholders of record, those holding proxies from shareholders of record, and invited guests from the media and financial community. All shareholders of record as of the record date may attend by presenting the admission ticket that appears at the end of this proxy statement. Please fill it out and bring it with you to the meeting. The meeting will be held at the Lilly Center Auditorium. Please use the Lilly Center entrance to the south of the fountain at the intersection of Delaware and McCarty streets. You will need to pass through security, including a metal detector. Present your ticket to an usher at the meeting.

Parking will be available on a first-come, first-served basis in the garage indicated on the map at the end of this report. If you have questions about admittance or parking, please call 855-731-6026 (toll free) or 317-433-5112 (prior to the annual meeting).

The 2019 Annual Meeting

The company's 2019 annual meeting is currently scheduled for May 6, 2019.

Other Matters

Householding

We have adopted a procedure approved by the SEC called "householding." Under the householding procedure, certain shareholders, whether they own registered shares or shares in street name, who have the same address will receive only one set of proxy materials, unless one or more of the shareholders at that address has previously notified us that they want to receive separate copies. Each 401(k) Plan participant will continue to receive a copy of all of the proxy materials. Regardless of how you own your shares, if you received a single set of proxy materials as a result of householding, and one or more shareholders at your address would like to have separate copies of these materials with respect to the 2018 annual meeting or in the future, please contact Broadridge Financial Solutions, Inc. at 866-540-7095.

Other information regarding the company's proxy solicitation

The board of directors is soliciting proxies for the 2018 annual meeting. We will pay all expenses in connection with our solicitation of proxies. We will pay brokers, nominees, fiduciaries, or other custodians their reasonable expenses for sending proxy material to and obtaining instructions from persons for whom they hold stock of the company. We expect to solicit proxies primarily by mail and email, but directors, officers, and other employees of the company may also solicit in person or by telephone, fax, or email. We have retained Georgeson LLC to assist in the distribution and solicitation of proxies. Georgeson may solicit proxies by personal interview, telephone, fax, mail, and email. We expect that the fee for those services will not exceed $17,500 plus reimbursement of customary out-of-pocket expenses.

Section 16(a) beneficial ownership reporting compliance

Under SEC rules, our directors and executive officers are required to file with the SEC reports of holdings and changes in beneficial ownership of company stock. We have reviewed copies of reports provided to the company, as well as other records and information. Based on that review, we concluded that all reports were timely filed, except that, due to administrative errors, Dr. Carolyn Bertozzi was late in filing Form 3, due to absence of SEC Edgar access codes; Christi Shaw was late in filing a Form 4 to report a restricted stock unit grant; and Maria Crowe was late in filing a Form 4 to report a 2016 charitable gift contribution. Each filing was made promptly after the issue was discovered.

By order of the Board of Directors,

Bronwen L. Mantlo
Secretary

March 19, 2018

Appendix A - Summary of Adjustments Related to the Annual Cash Bonus and Performance Award

Consistent with past practice, the Compensation Committee adjusted the reported financial results on which the 2017 annual cash bonus and the 2016-2018 performance awards were determined to eliminate the distorting effect of certain unusual items on incentive compensation performance measures. The adjustments are intended to:

- align award payments with the underlying performance of the core business
- avoid volatile, artificial inflation or deflation of awards due to unusual items in the award year, and, where relevant, the previous (comparator) year
- eliminate certain counterproductive short-term incentives—for example, incentives to refrain from acquiring new technologies, to defer disposing of underutilized assets, or to defer settling legacy legal proceedings to protect current bonus payments
- facilitate comparisons with peer companies.

To ensure the integrity of the adjustments, the Compensation Committee establishes adjustment guidelines in the first 90 days of the performance period. These guidelines are generally consistent with the company guidelines for reporting non-GAAP financial measures to the investment community, which are reviewed by the Audit Committee. The adjustments apply equally to income and expense items. The Compensation Committee reviews all adjustments and retains downward discretion, i.e., discretion to reduce compensation below the amounts that are yielded by the adjustment guidelines.

Adjustments for 2017 Bonus Plan

For 2017 bonus calculations, the Compensation Committee made the following adjustments to reported EPS consistent with our external reporting of non-GAAP financial measures:

- Eliminated the impact of the charge related to U.S. tax reform legislation
- Eliminated the impact of asset impairments, restructuring and other special charges
- Eliminated the impact of the charge recognized for acquired in-process research and development
- Eliminated the impact of amortization of certain intangible assets
- Eliminated the impact of inventory step-up costs associated with the acquisition of Boehringer Ingelheim Vetmedica's U.S. feline, canine, and rabies vaccine portfolio.

Reconciliations of these adjustments to our reported EPS are below:

	2017
EPS as reported	$(0.19)
Eliminate U.S. tax reform legislation charge	$1.81
Eliminate asset impairments, restructuring and other special charges	$1.23
Eliminate acquired in-process research and development charge	$0.97
Eliminate amortization of certain intangible assets	$0.44
Eliminate inventory step-up costs associated with the acquisition of Boehringer Ingelheim Vetmedica's U.S. feline, canine, and rabies vaccine portfolio	$0.03
Non-GAAP EPS	$4.28

*Numbers may not add due to rounding

Adjustments for 2016-2018 Performance Award

For the 2016-2018 performance award payout calculations, the Compensation Committee made the following adjustments to reported EPS consistent with our reporting of non-GAAP financial measures:

- 2017: Eliminated the impact of the charge related to U.S. tax reform legislation

- 2017: Eliminated the impact of inventory step-up costs associated with the acquisition of Boehringer Ingelheim Vetmedica's U.S. feline, canine, and rabies vaccine portfolio
- 2017, 2016 and 2015: Eliminated the impact of the charges recognized for acquired in-process research and development
- 2017, 2016 and 2015: Eliminated the impact of asset impairments, restructuring, and other special charges
- 2017, 2016 and 2015: Eliminated the impact of amortization of certain intangible assets.
- 2016: Eliminated the impact of the Venezuelan financial crisis
- 2015: Eliminated the impact of the debt extinguishment loss
- 2015: Eliminated the impact of inventory step-up for Novartis Animal Health.

In addition to the adjustments consistent with our reporting of non-GAAP financial measures, the Compensation Committee made the following other adjustments:

- When the Compensation Committee set 2016-2018 performance award targets, the EPS goals were set assuming the transfer of the commercialization rights for Erbitux® in North America to Lilly (which occurred in October 2015). To make effective comparisons, the committee adjusted the base year 2015 results to include the impact of the transfer of the commercialization rights of Erbitux as if the transfer had occurred as of January 1, 2015.

Reconciliations of these adjustments to our reported EPS are below.

	2017	2016	% Growth 2017 vs. 2016	2015	% Growth 2016 vs. 2015
EPS as reported	$(0.19)	$2.58	NM	$2.26	14.2%
Eliminate impact of U.S. tax reform legislation	$1.81	—		—	
Eliminate inventory step-up for Vetmedica	$0.03	—		—	
Eliminate impact of the Venezuelan financial crisis	—	$0.19		—	
Eliminate acquired in-process research and development charges	$0.97	$0.02		$0.33	
Eliminate asset impairments, restructuring and other special charges	$1.23	$0.29		$0.25	
Eliminate amortization of certain intangible assets	$0.44	$0.44		$0.39	
Eliminate debt extinguishment loss	—	—		$0.09	
Eliminate inventory step-up for Novartis Animal Health	—	—		$0.10	
Non-GAAP EPS	$4.28	$3.52	21.6%	$3.43	2.6%
Transfer of Erbitux commercialization rights adjustment	—	—		$0.09	
Adjusted Non-GAAP EPS	$4.28	$3.52	26.6%	$3.52	—

*Numbers may not add due to rounding

Appendix B - Proposed Amendments to the Company's Articles of Incorporation

Proposed changes to the company's articles of incorporation are shown below related to Items 4 and 5, "Items of Business To Be Acted Upon at the Meeting." The changes shown to Article 9(b) will be effective if Item 4, "Proposal to Amend the Company's Articles of Incorporation to Eliminate the Classified Board Structure," receives the vote of at least 80 percent of the outstanding shares. The changes to Articles 9(c), 9(d), and 13 will be effective if Item 5, "Proposal to Amend the Company's Articles of Incorporation to Eliminate Supermajority Voting Provisions," receives the vote of at least 80 percent of the outstanding shares. Additions are indicated by underlining and deletions are indicated by strike-outs. The full text of the company's Articles of Incorporation can be found on our website at: https://www.lilly.com/who-we-are/governance.

. . . . .

9. The following provisions are inserted for the management of the business and for the conduct of the affairs of the Corporation, and it is expressly provided that the same are intended to be in furtherance and not in limitation or exclusion of the powers conferred by statute:

(a) The number of directors of the Corporation, exclusive of directors who may be elected by the holders of any one or more series of Preferred Stock pursuant to Article 7(b) (the "Preferred Stock Directors"), shall not be less than nine, the exact number to be fixed from time to time solely by resolution of the Board of Directors, acting by not less than a majority of the directors then in office.

(b) Prior to the 2019 annual meeting of directors, the Board of Directors (exclusive of Preferred Stock Directors) shall be divided into three classes, with the term of office of one class expiring each year. ~~At the annual meeting of shareholders in 1985, five directors of the first class shall be elected to hold office for a term expiring at the 1986 annual meeting, five directors of the second class shall be elected to hold office for a term expiring at the 1987 annual meeting, and six directors of the third class shall be elected to hold office for a term expiring at the 1988 annual meeting.~~ Commencing with the annual meeting of shareholders in ~~1986~~ 2019, each class of directors whose term shall then expire shall be elected to hold office for a ~~three~~ one-year term~~.~~ expiring at the next annual meeting of shareholders. In the case of any vacancy on the Board ~~of Directors, including a vacancy created by an increase in the number~~ of Directors, the vacancy shall be filled by election of the Board of Directors with the director so elected to serve for the remainder of the term of the director being replaced or, in the case of an additional director, ~~for the remainder of the term of the class to which the director has been assigned.~~ until the next annual meeting of shareholders. All directors shall continue in office until the election and qualification of their respective successors in office. ~~When the number of directors is changed, any newly created directorships or any decrease in directorships shall be so assigned among the classes by a majority of the directors then in office, though less than a quorum, as to make all classes as nearly equal in number as possible.~~ No decrease in the number of directors shall have the effect of shortening the term of any incumbent director. Election of directors need not be by written ballot unless the By-laws so provide.

(c) Any director or directors (exclusive of Preferred Stock Directors) may be removed from office at any time, but only for cause and only by the affirmative vote of ~~at least 80%~~a majority of ~~the~~ votes ~~entitled to be~~ cast by the holders ~~of all the outstanding shares~~ of Voting Stock (as defined in Article 13 hereof), voting together as a single class.

~~(d) Notwithstanding any other provision of these Amended Articles of Incorporation or of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class of Voting Stock required by law or these Amended Articles of Incorporation, the affirmative vote of at least 80% of the votes entitled to be cast by holders of all the outstanding shares of Voting Stock, voting together as a single class, shall be required to alter, amend or repeal this Article 9.~~

13. In addition to all other requirements imposed by law and these Amended Articles ~~and except as otherwise expressly provided in paragraph (c) of this Article 13~~, none of the actions or transactions listed in paragraph (a) below shall be effected by the Corporation, or approved by the Corporation as a shareholder of any majority-owned subsidiary of the Corporation if, as of the record date for the determination of the shareholders entitled to vote thereon, any Related Person (as hereinafter defined) exists, unless the applicable requirements of paragraphs (b),

(c), (d), ~~(e),~~ and (~~f~~e) of this Article 13 are satisfied.

(a) The actions or transactions within the scope of this Article 13 are as follows:

(i) any merger or consolidation of the Corporation or any of its subsidiaries into or with such Related Person;

(ii) any sale, lease, exchange, or other disposition of all or any substantial part of the assets of the Corporation or any of its majority-owned subsidiaries to or with such Related Person;

(iii) the issuance or delivery of any Voting Stock (as hereinafter defined) or of voting securities of any of the Corporation's majority-owned subsidiaries to such Related Person in exchange for cash, other assets or securities, or a combination thereof;

(iv) any voluntary dissolution or liquidation of the Corporation;

(v) any reclassification of securities (including any reverse stock split), or recapitalization of the Corporation, or any merger or consolidation of the Corporation with any of its subsidiaries, or any other transaction (whether or not with or otherwise involving a Related Person) that has the effect, directly or indirectly, of increasing the proportionate share of any class or series of capital stock of the Corporation, or any securities convertible into capital stock of the Corporation or into equity securities of any subsidiary, that is beneficially owned by any Related Person; or

(vi) any agreement, contract, or other arrangement providing for any one or more of the actions specified in the foregoing clauses (i) through (v).

(b) The actions and transactions described in paragraph (a) of this Article 13 shall have been authorized by the affirmative vote of ~~at least 80% of all~~ a majority of the votes entitled to be cast by holders of all the outstanding shares of Voting Stock, voting together as a single class.

~~(c) Notwithstanding paragraph (b) of this Article 13, the 80% voting requirement shall not be applicable if any action or transaction specified in paragraph (a) is approved by the Corporation's Board of Directors and by a majority of the Continuing Directors (as hereinafter defined).~~

(~~d~~ c) Unless approved by a majority of the Continuing Directors, after becoming a Related Person and prior to consummation of such action or transaction~~.~~:

(i) the Related Person shall not have acquired from the Corporation or any of its subsidiaries any newly issued or treasury shares of capital stock or any newly issued securities convertible into capital stock of the Corporation or any of its majority-owned subsidiaries, directly or indirectly (except upon conversion of convertible securities acquired by it prior to becoming a Related Person or as a result of a pro rata stock dividend or stock split or other distribution of stock to all shareholders pro rata);

(ii) such Related Person shall not have received the benefit directly or indirectly (except proportionately as a shareholder) of any loans, advances, guarantees, pledges, or other financial assistance or tax credits provided by the Corporation or any of its majority-owned subsidiaries, or made any major changes in the Corporation's or any of its majority-owned subsidiaries' businesses or capital structures or reduced the current rate of dividends payable on the Corporation's capital stock below the rate in effect immediately prior to the time such Related Person became a Related Person; and

(iii) such Related Person shall have taken all required actions within its power to ensure that the Corporation's Board of Directors included representation by Continuing Directors at least proportionate to the voting power of the shareholdings of Voting Stock of the Corporation's Remaining Public Shareholders (as hereinafter defined), with a Continuing Director to occupy an additional Board position if a fractional right to a director results and, in any event, with at least one Continuing Director to serve on the Board so long as there are any Remaining Public Shareholders.

(~~e~~d) A proxy statement responsive to the requirements of the Securities Exchange Act of 1934, as amended, whether or not the Corporation is then subject to such requirements, shall be mailed to the

shareholders of the Corporation for the purpose of soliciting shareholder approval of such action or transaction and shall contain at the front thereof, in a prominent place, any recommendations as to the advisability or inadvisability of the action or transaction which the Continuing Directors may choose to state and, if deemed advisable by a majority of the Continuing Directors, the opinion of an investment banking firm selected by a majority of the Continuing Directors as to the fairness (or not) of the terms of the action or transaction from a financial point of view to the Remaining Public Shareholders, such investment banking firm to be paid a reasonable fee for its services by the Corporation. The requirements of this paragraph (~~e~~d) shall not apply to any such action or transaction which is approved by a majority of the Continuing Directors.

(~~f~~e) For the purpose of this Article 13

(i) the term "Related Person" shall mean any other corporation, person, or entity which beneficially owns or controls, directly or indirectly, 5% or more of the outstanding shares of Voting Stock, and any Affiliate or Associate (as those terms are defined in the General Rules and Regulations under the Securities Exchange Act of 1934) of a Related Person; *provided, however,* that the term Related Person shall not include (a) the Corporation or any of its subsidiaries, (b) any profit-sharing, employee stock ownership or other employee benefit plan of the Corporation or any subsidiary of the Corporation or any trustee of or fiduciary with respect to any such plan when acting in such capacity, or (c) Lilly Endowment, Inc.; and *further provided,* that no corporation, person, or entity shall be deemed to be a Related Person solely by reason of being an Affiliate or Associate of Lilly Endowment, Inc.;

(ii) a Related Person shall be deemed to own or control, directly or indirectly, any outstanding shares of Voting Stock owned by it or any Affiliate or Associate of record or beneficially, including without limitation shares

a. which it has the right to acquire pursuant to any agreement, or upon exercise of conversion rights, warrants, or options, or otherwise or

b. which are beneficially owned, directly or indirectly (including shares deemed owned through application of clause a. above), by any other corporation, person, or other entity with which it or its Affiliate or Associate has any agreement, arrangement, or understanding for the purpose of acquiring, holding, voting, or disposing of Voting Stock, or which is its Affiliate (other than the Corporation) or Associate (other than the Corporation);

(iii) the term "Voting Stock" shall mean all shares of any class of capital stock of the Corporation which are entitled to vote generally in the election of directors;

(iv) the term "Continuing Director" shall mean a director who is not an Affiliate or Associate or representative of a Related Person and who was a member of the Board of Directors of the Corporation immediately prior to the time that any Related Person involved in the proposed action or transaction became a Related Person or a director who is not an Affiliate or Associate or representative of a Related Person and who was nominated by a majority of the remaining Continuing Directors; and
(v) the term "Remaining Public Shareholders" shall mean the holders of the Corporation's capital stock other than the Related Person.

(~~g~~f) A majority of the Continuing Directors of the Corporation shall have the power and duty to determine for the purposes of this Article 13, on the basis of information then known to the Continuing Directors, whether (i) any Related Person exists or is an Affiliate or an Associate of another and (ii) any proposed sale, lease, exchange, or other disposition of part of the assets of the Corporation or any majority-owned subsidiary involves a substantial part of the assets of the Corporation or any of its subsidiaries. Any such determination by the Continuing Directors shall be conclusive and binding for all purposes.

(~~h~~g) Nothing contained in this Article 13 shall be construed to relieve any Related Person or any Affiliate or Associate of any Related Person from any fiduciary obligation imposed by law.

(~~i~~h) The fact that any action or transaction complies with the provisions of this Article 13 shall not be construed to waive or satisfy any other requirement of law or these Amended Articles of Incorporation or to impose any fiduciary duty, obligation, or responsibility on the Board of Directors or any member thereof, to

approve such action or transaction or recommend its adoption or approval to the shareholders of the Corporation, nor shall such compliance limit, prohibit, or otherwise restrict in any manner the Board of Directors, or any member thereof, with respect to evaluations of or actions and responses taken with respect to such action or transaction. The Board of Directors of the Corporation, when evaluating any actions or transactions described in paragraph (a) of this Article 13, shall, in connection with the exercise of its judgment in determining what is in the best interests of the Corporation and its shareholders, give due consideration to all relevant factors, including without limitation the social and economic effects on the employees, customers, suppliers, and other constituents of the Corporation and its subsidiaries and on the communities in which the Corporation and its subsidiaries operate or are located.

~~(j) Notwithstanding any other provision of these Amended Articles of Incorporation or of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class of Voting Stock required by law or these Amended Articles of Incorporation, the affirmative vote of the holders of at least 80% of the votes entitled to be cast by holders of all the outstanding shares of Voting Stock, voting together as a single class, shall be required to alter, amend, or repeal this Article 13.~~

Appendix C - Proposed Amended and Restated 2002 Lilly Stock Plan

AMENDED AND RESTATED
2002 LILLY
STOCK PLAN
(Effective May 07, 2018)

ARTICLE 1. PURPOSES OF THE PLAN

The Company believes that this Amended and Restated 2002 Lilly Stock Plan, as amended from time to time (the "Plan"), will benefit the Company's shareholders by allowing the Company to attract, motivate and retain the best available Employees and Directors and by providing those Employees and Directors stock-based incentives to strengthen the alignment of interests between those persons and the Company's shareholders.

ARTICLE 2. DEFINITIONS

Wherever the following terms are used in the Plan, they shall have the meanings specified below, unless the context clearly indicates otherwise. The singular pronoun shall include the plural where the context so indicates.

2.1 "Affiliate" shall have the meaning given to such term in Rule 12b-2 promulgated under the Exchange Act. The Board shall have the authority to determine the time or times at which "Affiliate" status is determined within the foregoing definition.

2.2 "Applicable Laws" means the requirements relating to the administration of equity-based and cash-based awards, as applicable, and the related issuance of Shares under U.S. state corporate laws, U.S. federal and state and non-U.S. securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any non-U.S. country or jurisdiction where Awards are, or will be, granted under the Plan.

2.3 "Award" means an Option, Restricted Stock Units, Restricted Stock, a Stock Appreciation Right, Dividend Equivalent Rights, an Other Share-Based Award or a Performance-Based Award granted to a Participant pursuant to the Plan.

2.4 "Award Agreement" means any written agreement, contract, or other instrument or document evidencing the terms and conditions of an Award, including through electronic medium.

2.5 "Board" means the board of directors of the Company.

2.6 "Change in Control" means and includes each of the following:

(a) the acquisition by any "person," as that term is used in Sections 13(d) and 14(d) of the Exchange Act (other than (i) the Company, (ii) any subsidiary of the Company, (iii) any employee benefit plan or employee stock plan of the Company or a subsidiary of the Company or any trustee or fiduciary with respect to any such plan when acting in that capacity, or (iv) Lilly Endowment, Inc.) of "beneficial ownership," as defined in Rule 13d-3 under the Exchange Act, directly or indirectly, of twenty percent (20%) or more of the shares of the Company's capital stock the holders of which have general voting power under ordinary circumstances to elect at least a majority of the Board (or which would have such voting power but for the application of the Indiana Control Shares Statute) ("Voting Stock"); provided, however, that an acquisition of Voting Stock directly from the Company shall not constitute a Change in Control under this Section 2.6(a);

(b) the first day on which less than one-half of the total membership of the Board shall be Continuing Directors (as that term is defined in Section 13(f) of the Company's Articles of Incorporation);

(c) consummation of a merger, share exchange, or consolidation of the Company (a "Transaction"), other than a Transaction which would result in the Voting Stock of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting

securities of the surviving entity) more than sixty percent (60%) of the Voting Stock of the Company or such surviving entity immediately after such Transaction;

(d) a complete liquidation of the Company or a sale or disposition of all or substantially all the assets of the Company, other than a sale or disposition of assets to any subsidiary of the Company.

For purposes of this Section 2.6(a) only, the term "subsidiary" means a corporation or limited liability company of which the Company owns directly or indirectly fifty percent (50%) or more of the voting power.

2.7 "Code" means the U.S. Internal Revenue Code of 1986, as amended. All references herein to specific sections of the Code shall include any successor provisions of the Code or corresponding sections of any future U.S. federal tax code.

2.8 "Committee" means the committee of the Board appointed or described in Article 3 to administer the Plan.

2.9 "Common Stock" means the common stock of the Company, no par value, and such other securities of the Company that may be substituted for the Common Stock pursuant to Article 13.

2.10 "Company" means Eli Lilly and Company, an Indiana corporation, and any successor corporation thereto.

2.11 "Director" means a member of the Board.

2.12 "Disability" means, unless otherwise provided in an Award Agreement, that the Participant would qualify to receive benefit payments under the long-term disability plan or policy, as it may be amended from time to time, of the Company or the Affiliate to which the Participant provides Service regardless of whether the Participant is covered by such policy. If the Company or the Affiliate to which the Participant provides Service does not have a long-term disability policy, "Disability" means that a Participant is unable to carry out the responsibilities and functions of the position held by the Participant by reason of any medically determined physical or mental impairment for a period of not less than ninety (90) consecutive days. A Participant shall not be considered to have incurred a Disability unless he or she furnishes proof of such impairment sufficient to satisfy the Committee in its discretion. Notwithstanding the foregoing, (a) for purposes of Incentive Stock Options granted under the Plan, "Disability" means that the Participant is disabled within the meaning of Section 22(e)(3) of the Code, and (b) with respect to an Award that is subject to Section 409A of the Code where the payment or settlement of the Award will accelerate as a result of the Participant's Disability, solely for purposes of determining the timing of payment, no such event will constitute a Disability for purposes of the Plan or any Award Agreement unless such event also constitutes a "disability" as defined under Section 409A of the Code.

2.13 "Dividend Equivalent Right" means a right to receive the equivalent value of dividends paid on the Shares with respect to Shares underlying Restricted Stock Units or an Other Share-Based Award that is a Full Value Award prior to vesting of the Award in accordance with the provision of Section 12.4.

2.14 "Effective Date" means the date that the shareholders approved the amendment and restatement of the Plan.

2.15 "Eligible Individual" means any natural person who is an Employee or a Director determined by the Committee as eligible to participate in the Plan.

2.16 "Employee" means an individual, including an officer or Director, who is treated as an employee in the personnel records of the Company or an Affiliate and providing Service to the Company or the Affiliate. Neither services as a Director nor payment of a director's fee by the Company or an Affiliate shall be sufficient to constitute "employment" by the Company or an Affiliate.

2.17 "Equity Restructuring" shall mean a nonreciprocal transaction between the Company and its shareholders, such as a stock dividend, stock split, spin-off, rights offering or recapitalization through a large, nonrecurring cash dividend, that affects the Shares (or other securities of the Company) or the price of Shares (or other securities) and causes a change in the per-share value of the Shares underlying outstanding Awards.

2.18 "Exchange Act" means the U.S. Securities Exchange Act of 1934, as amended.

2.19 "Fair Market Value" means, as of any given date, (a) if Shares are traded on any established stock exchange, the closing price of a Share as quoted on the principal exchange on which the Shares are listed, as reported in *The Wall Street Journal* (or such other source as the Company may deem reliable for such purposes) for such date, or if no sale occurred on such date, the first trading date immediately prior to such date during which a sale occurred; or (b) if Shares are not traded on an exchange but are regularly quoted on a national market or other quotation system, the closing sales price on such date as quoted on such market or system, or if no sales occurred on such date, then on the date immediately prior to such date on which sales prices are reported; or (c) in the absence of an established market for the Shares of the type described in (a) or (b) of this Section 2.19, the fair market value established by the Committee acting in good faith, under a reasonable methodology and reasonable application in compliance with Section 409A of the Code to the extent such determination is necessary for Awards under the Plan to comply with, or be exempt from, Section 409A of the Code.

Notwithstanding the foregoing, for income tax reporting purposes under U.S. federal, state, local or non-US law and for such other purposes as the Committee deems appropriate, including, without limitation, where Fair Market Value is used in reference to exercise, vesting, settlement or payout of an Award, the Fair Market Value shall be determined by the Company in accordance with uniform and nondiscriminatory standards adopted by it from time to time.

2.20 "Full Value Award" means any Award other than an (i) Option, (ii) Stock Appreciation Right or (iii) other Award for which the Participant pays (or the value or amount payable under the Award is reduced by) an amount equal to or exceeding the Fair Market Value of the Shares, determined as of the date of grant.

2.21 "Incentive Stock Option" means an Option that is intended to meet the requirements of Section 422 of the Code.

2.22 "Non-Employee Director" means a Director of the Company who is not an Employee.

2.23 "Non-Qualified Stock Option" means an Option that is not intended to be an Incentive Stock Option.

2.24 "Option" means a right granted to a Participant pursuant to Article 6 to purchase a specified number of Shares at a specified price during specified time periods. An Option may be either an Incentive Stock Option or a Non-Qualified Stock Option.

2.25 "Other Share-Based Award" shall mean an Award granted pursuant to Article 10.

2.26 "Outstanding Qualified Performance-Based Awards" shall mean any Awards granted prior to November 3, 2017 and that are outstanding as of the Effective Date and that are intended to constitute "qualified performance-based compensation" as described in Section 162(m)(4)(C) of the Code. For the avoidance of any doubt, all provisions of the Plan governing Outstanding Qualified Performance Awards that were in effect prior to the Effective Date shall continue in effect with respect to Outstanding Qualified Performance-Based Awards, notwithstanding the elimination of such provisions from the Plan as of the Effective Date.

2.27 "Participant" means any Eligible Individual who, as an Employee or Director, has been granted an Award pursuant to the Plan.

2.28 "Performance-Based Award" means an Award that are subject, in whole or in part, to Performance Goals and are granted pursuant to Article 10.

2.29 "Performance Criteria" means the criteria that the Committee selects for purposes of establishing the Performance Goal or Performance Goals for a Participant for a Performance Period. The Performance Criteria that will be used to establish Performance Goals include, but are not limited to, the following: cash flow (including, without limitation, operating cash flow and free cash flow), earnings per share, gross or net profit margin, net income (either before or after interest, taxes, amortization, and/or depreciation), operating income (either before or after restructuring and amortization charges), return on capital or return on invested capital, return on equity, return on operating assets or net assets, return on sales, sales or revenue, stock price goals, total shareholder return. The Committee shall define objectively the manner of calculating the Performance Criteria it selects to use for such Performance Period for such Participant.

2.30 "Performance Goals" means, for a Performance Period, the goals established in writing by the Committee for the Performance Period based upon the Performance Criteria that the Committee, in its sole discretion, selects. The Committee, in its sole discretion, may provide that one or more objectively determinable adjustments shall be made to one or more of the Performance Goals.

2.31 "Performance Period" means the one or more periods of time, which may be of varying and overlapping durations, as the Committee may select, over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant's right to, and the payment of, a Performance-Based Award, provided that the duration of any Performance Period shall not be less than twelve (12) months.

2.32 "Plan" means this Amended and Restated 2002 Lilly Stock Plan, as it may be amended from time to time.

2.33 "Prior Plans" means the 1989, 1994 and 1998 Lilly Stock Plans, as amended from time to time.

2.34 "Restricted Stock" means Shares awarded to a Participant pursuant to Article 8 that are subject to certain restrictions and may be subject to risk of forfeiture.

2.35 "Restricted Stock Unit" means an Award granted pursuant to Article 7 that shall be evidenced by a bookkeeping entry representing the equivalent of one Share.

2.36 "Securities Act" means the U.S. Securities Act of 1933, as amended.

2.37 "Service" means service as an Employee or Non-Employee Director. Except as otherwise determined by the Committee in its sole discretion, a Participant's Service terminates when the Participant ceases to actively provide services to the Company or an Affiliate and shall not be extended by any notice period mandated under applicable employment laws or the terms of the Participant's employment or service contract, if any. The Committee shall determine which leaves shall count toward Service and when Service terminates for all purposes under the Plan. Further, unless otherwise determined by the Committee, a Participant's Service shall not be deemed to have terminated merely because of a change in the capacity in which the Participant provides Service to the Company or an Affiliate, or a transfer between entities (*i.e.*, the Company or any Affiliates), *provided* that there is no interruption or other termination of Service in connection with the Participant's change in capacity or transfer between entities (except as may be required to effect the change in capacity or transfer between entities). For purposes of determining whether an Option is entitled to Incentive Stock Option status, an Employee's Service shall be treated as terminated ninety (90) days after such Employee goes on leave, unless such Employee's right to return to active work is guaranteed by law or by a contract.

2.38 "Share" means a share of Common Stock.

2.39 "Stock Appreciation Right" or "SAR" means a right granted pursuant to Article 9 to receive a payment equal to the excess of the Fair Market Value of a specified number of Shares on the date the SAR is exercised over the exercise price of the SAR, as set forth in the applicable Award Agreement.

2.40 "Tax-Related Items" means any U.S. federal, state, and/or local taxes and any taxes imposed by a jurisdiction outside of the U.S. (including, without limitation, income tax, social insurance and similar contributions, payroll tax, fringe benefits tax, payment on account, employment tax, stamp tax and any other taxes related to participation in the Plan and legally applicable to a Participant, including any employer liability for which the Participant is liable pursuant to Applicable Laws or the applicable Award Agreement).

ARTICLE 3. ADMINISTRATION

3.1 Committee. The Board, at its discretion or as otherwise necessary to comply with the requirements of Section 162(m) of the Code (with respect to Outstanding Qualified Performance-Based Awards), Rule 16b-3 promulgated under the Exchange Act or to the extent required by any other Applicable Law or regulation, may delegate administration of the Plan to a Committee consisting of two or more members of the Board. Unless otherwise determined by the Board, the Committee shall consist solely of two or more Non-Employee Directors, each of whom is an "outside director," within the meaning of Section 162(m) of the Code (with respect to Outstanding Qualified Performance-Based Awards), a "non-employee director" within the meaning of Rule 16b-3(b)(3) under the Exchange Act, or any successor rule, and an "independent director" under the applicable New York Stock Exchange rules (or other principal securities

market on which Shares are traded). Notwithstanding the foregoing: (a) the full Board, acting by a majority of its members in office, shall conduct the general administration of the Plan with respect to all Awards granted to Non-Employee Directors and for purposes of such Awards the term "Committee" as used in this Plan shall be deemed to refer to the Board and (b) the Committee may delegate its authority hereunder to the extent permitted by Section 3.5 hereof. Unless and until the Board delegates administration of the Plan to a Committee as set forth below, the Plan shall be administered by the full Board, and for such purposes the term "Committee" as used in this Plan shall be deemed to refer to the Board. In its sole discretion, the Board may at any time and from time to time exercise any and all rights and duties of the Committee under the Plan, except with respect to matters which under Rule 16b-3 under the Exchange Act or Section 162(m) of the Code (with respect to Outstanding Qualified Performance-Based Awards), or any regulations or rules issued thereunder, are required to be determined in the sole discretion of the Committee.

3.2 Action by the Committee. Unless otherwise established by the Board or in any charter of the Committee, a majority of the Committee shall constitute a quorum and the acts of a majority of the members present at any meeting at which a quorum is present, and acts approved in writing by a majority of the Committee in lieu of a meeting, shall be deemed the acts of the Committee. Each member of the Committee is entitled to, in good faith, rely or act upon any report or other information furnished to that member by any officer or other employee of the Company or any Affiliate, the Company's independent certified public accountants, or any executive compensation consultant or other professional retained by the Company to assist in the administration of the Plan.

3.3 Authority of Committee. Subject to any specific designation in the Plan, the Committee has the exclusive power, authority and discretion to:

(a) designate Participants to receive Awards;

(b) determine the type or types of Awards to be granted to each Participant;

(c) determine the number of Awards to be granted and the number of Shares to which an Award will relate;

(d) determine the terms and conditions of any Award granted pursuant to the Plan, including, without limitation, the exercise price, grant price, or purchase price, any restrictions or limitations on the Award, any schedule for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers thereof, any provisions related to recoupment of gain on an Award, based in each case on such considerations as the Committee in its sole discretion determines;

(e) determine whether, to what extent, and pursuant to what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Shares, other Awards, or other property, or an Award may be cancelled, forfeited, or surrendered;

(f) prescribe the form of each Award Agreement, which need not be identical for each Participant and may vary for Participants within and outside of the U.S.;

(g) decide all other matters that must be determined in connection with an Award;

(h) establish, adopt or revise any rules and regulations, including adopting sub-plans to the Plan, for the purposes of facilitating compliance with foreign laws, easing the administration of the Plan and/or taking advantage of tax-favorable treatment for Awards granted to Participants outside the U.S., in each case as it may deem necessary or advisable;

(i) suspend or terminate the Plan at any time, subject to Article 15;

(j) amend or modify the terms of an Award, including, without limitation, accelerate the vesting and/or exercisability of any Award for any reason, including, without limitation, the Participant's retirement or other termination; *provided*, *however*, that no amendment or modification of an outstanding Award other than the following types of amendments or modifications shall affect adversely, in any material way, any Award previously granted pursuant to the Plan without the prior written consent of the Participant: (i) an amendment or modification that may cause an Incentive Stock Option to become a Non-Qualified Stock Option; (ii) an amendment made or other action taken pursuant to Section 16.14 of the Plan; (iii) any amendment or other action that may be required or desirable to facilitate compliance with Applicable Laws, as determined in the sole discretion of the Committee .

(k) interpret the terms of, and any matter arising pursuant to, the Plan or any Award Agreement; and

(l) make all other decisions and determinations that may be required pursuant to the Plan or that the Committee deems necessary or advisable to administer the Plan.

3.4 Decisions Binding. The Committee's interpretation of the Plan, any Awards granted pursuant to the Plan, and any Award Agreement and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties.

3.5 Delegation of Authority. To the extent permitted by Applicable Laws, the Board, from time to time, may delegate to a Committee of one or more members of the Board (pursuant to delegation that does not meet the requirement of Section 3.1 hereof) or to one or more officers of the Company the authority to grant Awards to Participants other than (a) Employees who are subject to Section 16 of the Exchange Act, or (b) officers of the Company (or Directors) to whom authority to grant or amend Awards has been delegated hereunder. Furthermore, if the authority to grant or amend Awards has been delegated to the Committee pursuant and subject to the preceding sentence, such authority may be further delegated by the Committee to one or more officers of the Company. For the avoidance of doubt, provided it meets the limitations of this Section 3.5, any delegation hereunder shall include the right to modify Awards as necessary to accommodate changes in Applicable Laws or regulations, including in jurisdictions outside the U.S. Furthermore, any delegation hereunder shall be subject to the restrictions and limitations that the Board (or, as applicable, the Committee) specifies at the time of such delegation, and the Board (or, as applicable, the Committee) may rescind at any time the authority so delegated and/or appoint a new delegatee. At all times, the delegatee appointed under this Section 3.5 shall serve in such capacity at the pleasure of the Board (or, as applicable, the Committee).

ARTICLE 4. SHARES SUBJECT TO THE PLAN

4.1 Number of Shares. Subject to Article 13 hereof, the aggregate number of Shares that may be issued or transferred pursuant to Awards under the Plan shall be the sum of (i) 75,657,296 Shares, plus (ii) the number of Shares available for issuance under the Prior Plans (including Shares subject to awards granted under the Prior Plans that otherwise subsequently became available for issuance under the Prior Plans upon forfeiture, cancellation, or termination of the awards or any other reason under the terms of the Prior Plans); provided, however, that only 53,000,000 Shares may be issued or transferred pursuant to new Awards granted on or following the Effective Date. Subject to Article 13, the aggregate number of Shares that may be issued or transferred pursuant to the exercise of Incentive Stock Options shall be 30,000,000.

(a) Shares Reissuable under Plan. The following Shares shall again be available for the grant of an Award pursuant to the Plan: (i) Shares that are not issued as a result of the termination, expiration or lapsing of any Award for any reason; (ii) Shares subject to a Full Value Award that are not issued because the Award is settled in cash; (iii) Shares covered by an Option which are surrendered in payment of the Option exercise or purchase price or in satisfaction of obligations for Tax-Related Items incident to the exercise of an Option; (iv) Shares covered by an Award which are surrendered in satisfaction of obligations for Tax-Related Items incident to the vesting or settlement of a Full Value Award. Notwithstanding the provisions of this Section 4.1, no Shares may again be optioned, granted or awarded if such action would cause an Incentive Stock Option to fail to qualify as an Incentive Stock Option.

(b) Shares Not Reissuable under Plan. Notwithstanding the foregoing, Shares that are repurchased on the open market with the proceeds of the exercise of an Option shall be counted against the maximum number of Shares available for issuance pursuant to Section 4.1 hereof and shall not be returned to the Plan.

(c) Shares Not Counted Against Share Pool Reserve. To the extent permitted by Applicable Laws, Shares issued in assumption of, or in substitution for, any outstanding awards of any entity acquired in any form of combination by the Company or an Affiliate shall not be counted against Shares available for grant pursuant to this Plan. Additionally, to the extent permitted by Applicable Laws, in the event that a company acquired by (or combined with) the Company or an Affiliate has shares available under a pre-existing plan approved by its shareholders and not adopted in contemplation of such acquisition or combination, the shares available for grant pursuant to the terms of such pre-existing plan (as adjusted, to the extent appropriate, using the exchange ratio or other adjustment or valuation ratio or formula used in such acquisition or combination to determine the consideration payable to the shareholders of the entities party to such acquisition or combination) may, at the discretion of the Committee, be used for Awards under the Plan in lieu of awards under the applicable pre-existing plan of the other company and

shall not reduce the Shares authorized for grant under the Plan; *provided* that Awards using such available shares shall not be made after the date awards or grants could have been made under the terms of the pre-existing plan absent the acquisition or combination, and shall only be made to individuals who were not employees or directors of the Company or any Affiliate in existence prior to such acquisition or combination by the Company or an Affiliate. The payment of Dividend Equivalent Rights in cash in conjunction with any outstanding Awards shall not be counted against the Shares available for issuance under the Plan.

4.2 Shares Distributed. Any Shares distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Shares, treasury Shares or Shares purchased on the open market, subject to Section 4.1(b)(ii) hereof.

4.3 Limitation on Number of Shares Subject to Awards. Notwithstanding any provision in the Plan to the contrary, and subject to Article 13, the maximum number of Shares subject to all Awards that may be granted to any one Participant during any calendar year shall be 1,500,000 Shares.

4.4 Non-Employee Director Award Limit. Notwithstanding any provision to the contrary in the Plan or in any policy of the Company regarding compensation payable to a Non-Employee Director, the sum of the grant date fair value (determined as of the grant date in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, or any successor thereto) of all Awards payable in Common Stock to an individual as compensation for services as a Non-Employee Director, together with cash compensation earned by the Non-Employee Director during any calendar year, shall not exceed $800,000 in any calendar year.

ARTICLE 5. ELIGIBILITY AND PARTICIPATION

5.1 Eligibility. Each Eligible Individual shall be eligible to be granted one or more Awards pursuant to the Plan. An Eligible Individual who is subject to taxation in the U.S. and who is providing Services to an Affiliate may be granted Options or SARs under this Plan only if the Affiliate qualifies as an "eligible issuer of service recipient stock" within the meaning of the U.S. Department of Treasury regulations promulgated under Section 409A of the Code.

5.2 Participation. Subject to the provisions of the Plan, the Committee, from time to time, may select from among all Eligible Individuals those to whom Awards shall be granted, and shall determine the nature and amount of each Award. No Eligible Individual shall have any right to be granted an Award pursuant to this Plan and the grant of an Award to an Eligible Individual shall not imply any entitlement to receive future Awards.

ARTICLE 6. STOCK OPTIONS

6.1 General. The Committee is authorized to grant Options to Eligible Individuals on the following terms and conditions, and the Committee may specify such additional terms and conditions as:

(a) Exercise Price. The exercise price per Share subject to an Option shall be determined by the Committee and set forth in the Award Agreement; *provided* that, subject to Section 6.2(c) hereof, the per-Share exercise price for any Option shall not be less than 100% of the Fair Market Value of a Share on the date of grant.

(b) Time and Conditions of Exercise. The Committee shall determine the time or times at which an Option may be exercised in whole or in part; *provided* that the term of any Option granted under the Plan shall not exceed ten (10) years. Subject to Section 12.3, the Committee also shall specify the vesting conditions, if any, as it deems appropriate that must be satisfied before all or part of an Option may be exercised. The vesting conditions, if any, may be based on, among other conditions, a Participant's continued Service, the attainment of performance conditions, or a combination of both.

(c) Payment. The Committee shall determine the methods by which the exercise price of an Option may be paid, including the following methods: (i) cash or check; (ii) surrender of Shares or delivery of a properly executed form of attestation of ownership of Shares as the Committee may require (including withholding of Shares otherwise deliverable upon exercise of the Option) which have a Fair Market Value on the date or surrender of attestation equal to the aggregate exercise price of the Shares as to which the Option is to be exercised; (iii) promissory note from a Participant to the Company or a third-party loan guaranteed by the Company (in either case, with such loan bearing interest at no less than such rate as shall then preclude the imputation of interest under the Code); (iv) through the delivery of a notice that the Participant has placed a market sell order with a broker with respect to Shares then issuable upon exercise of the Option, and that the broker has been directed to pay a sufficient

portion of the net proceeds of the sale to the Company in satisfaction of the Option exercise price, *provided* that payment of such proceeds is then made to the Company upon settlement of such sale; (v) by a "net exercise" arrangement pursuant to which the number of Shares issuable upon exercise of the Option shall be reduced by the largest whole number of Shares having an aggregate fair market value that does not exceed the aggregate exercise price (plus withholding taxes, if applicable) and any remaining balance of the aggregate exercise price (and/or applicable withholding taxes) not satisfied by such reduction in the number of whole Shares to be issued shall be paid by Participant in cash or other form of payment approved by the Committee; (vi) other property acceptable to the Committee; or (vii) any combination of the foregoing methods of payment. The Award Agreement will specify the methods of paying the exercise price available to each Participant. The Committee also shall determine the methods by which Shares shall be delivered or deemed to be delivered to Participants. Notwithstanding any other provision of the Plan to the contrary, no Participant who is a Director or an "executive officer" of the Company within the meaning of Section 13(k) of the Exchange Act shall be permitted to pay the exercise price of an Option, or continue any extension of credit with respect to the exercise price of an Option, with a loan from the Company or a loan arranged by the Company in violation of Section 13(k) of the Exchange Act.

(d) Exercise of Option.

(i) Procedure for Exercise; Rights as a Shareholder. An Option may not be exercised for a fraction of a Share. An Option shall be deemed exercised when the Company receives: (A) a notice of exercise (in such form as the Committee may specify from time to time) from the person entitled to exercise the Option, and (B) full payment for the Shares with respect to which the Option is exercised (together with applicable withholding taxes). Full payment may consist of any consideration and method of payment authorized by the Committee and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Participant. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no dividends or Dividend Equivalent Right shall be paid, and no right to vote or receive dividends or Dividend Equivalent Rights or any other rights as a shareholder shall exist with respect to the Shares subject to an Option, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 13.1 of the Plan.

(ii) Termination of Participant's Service. If a Participant ceases to provide Service, including as a result of the Participant's death or Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). Unless otherwise provided by the Committee, if on the date of termination of Service the Participant is not vested as to his or her entire Option, the unvested portion of the Option shall be forfeited and the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination of Service, the Participant does not exercise his or her Option within the time specified by the Committee, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan. To the extent the Option is exercisable following a Participant's death, the Option may be exercised by such persons as may be specified in the Award Agreement, which may include any of the following: (i) the Participant's designated beneficiary, *provided* that such designation is permitted under Applicable Laws and that such beneficiary has been designated before the Participant's death in a form acceptable to the Company; (ii) the Participant's legal representative or representatives; (iii) the person or persons entitled to do so pursuant to the Participant's last will and testament; or (iv) if the Participant fails to make testamentary disposition of the Option or dies intestate, by the person or persons entitled to receive the Option pursuant to the applicable laws of descent and distribution.

6.2 Incentive Stock Options. Incentive Stock Options shall be granted only to Employees of the Company or any "subsidiary corporation," as defined in Section 424(f) of the Code and any applicable U.S. Department of Treasury regulations promulgated thereunder, of the Company, and the terms of any Incentive Stock Options granted pursuant to the Plan, in addition to the requirements of Section 6.1 hereof, must comply with the provisions of this Section 6.2.

(a) Expiration. Subject to Section 6.2(c) hereof, an Incentive Stock Option shall expire and may not be exercised to any extent by anyone after the first to occur of the following events:

(i) Ten (10) years from the date of grant, unless an earlier time is set in the Award Agreement;

(ii) Three (3) months after the date of the Participant's termination of Service on account of any reason other than death or Disability (within the meaning of Section 22(e)(3) of the Code); and

(iii) One (1) year after the date of the Participant's termination of Service on account of death or Disability (within the meaning of Section 22(e)(3) of the Code).

(b) Dollar Limitation. The aggregate Fair Market Value (determined as of the time the Option is granted) of all Shares with respect to which Incentive Stock Options are first exercisable by a Participant in any calendar year may not exceed US$100,000 or such other limitation as imposed by Section 422(d) of the Code, or any successor provision. To the extent that Incentive Stock Options are first exercisable by a Participant in excess of such limitation, the excess shall be considered Non-Qualified Stock Options.

(c) Ten Percent Owners. An Incentive Stock Option shall be granted to any individual who, at the date of grant, owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of Shares of the Company only if such Option is granted at a price that is not less than 110% of Fair Market Value on the date of grant and the Option is exercisable for no more than five (5) years from the date of grant.

(d) Notice of Disposition. The Participant shall give the Company prompt notice of any disposition of Shares acquired by exercise of an Incentive Stock Option within (i) two (2) years from the date of grant of such Incentive Stock Option or (ii) one (1) year after the transfer of such Shares to the Participant.

(e) Right to Exercise. During a Participant's lifetime, only the Participant may exercise an Incentive Stock Option.

(f) Failure to Meet Requirements. Any Option (or portion thereof) purported to be an Incentive Stock Option, which, for any reason, fails to meet the requirements of Section 422 of the Code shall be considered a Non-Qualified Stock Option.

ARTICLE 7. RESTRICTED STOCK UNITS

7.1 Restricted Stock Units. The Committee is authorized to grant Restricted Stock Units to Eligible Individuals in such amounts and subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose.

7.2 Vesting Conditions. Subject to Section 12.3, the Committee shall specify the date or dates on which the Restricted Stock Units shall become fully vested and nonforfeitable, and may specify such conditions to vesting, if any, as it deems appropriate. The vesting conditions, if any, may be based on among other conditions, a Participant's continued Service, the attainment of performance conditions, or a combination of both.

7.3 Form and Timing of Payment. The Committee shall specify the settlement date applicable to each grant of Restricted Stock Units, which date shall not be earlier than the date or dates on which the Restricted Stock Units shall become fully vested and nonforfeitable, or such settlement date may be deferred to any later date, subject to compliance with Section 409A of the Code, as applicable. On the settlement date, the Company shall, subject to Section 12.6(a) hereof and satisfaction of applicable Tax-Related Items (as further set forth in Section 16.3 hereof), transfer to the Participant one Share for each Restricted Stock Unit scheduled to be paid out on such date and not previously forfeited. Alternatively, settlement of a Restricted Stock Unit may be made in cash (in an amount reflecting the Fair Market Value of the Shares that otherwise would have been issued) or any combination of cash and Shares, as determined by the Committee, in its sole discretion, in either case, less applicable Tax-Related Items (as further set forth in Section 16.3 hereof). Until a Restricted Stock Unit is settled, the number of Restricted Stock Units shall be subject to adjustment pursuant to Article 13 hereof.

7.4 Forfeiture. Except as otherwise determined by the Committee at the time of the grant of the Award or thereafter, any Restricted Stock Units that are not vested as of the date of the Participant's termination of Service shall be forfeited.

7.5 General Creditors. A Participant who has been granted Restricted Stock Units shall have no rights other than those of a general creditor of the Company. Restricted Stock Units represent an unfunded and unsecured obligation of the Company, subject to the terms and conditions of the applicable Award Agreement evidencing the grant of the Restricted Stock Units.

ARTICLE 8. RESTRICTED STOCK AWARDS

8.1 Grant of Restricted Stock. The Committee is authorized to grant Restricted Stock to Eligible Individuals selected by the Committee in such amounts and subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose.

8.2 Purchase Price. At the time of the grant of Restricted Stock, the Committee shall determine the price, if any, to be paid by the Participant for each Share subject to the Award. The purchase price of Shares acquired pursuant to the Award shall be paid either: (i) in cash at the time of purchase; (ii) at the sole discretion of the Committee, by Service rendered or to be rendered to the Company or an Affiliate; or (iii) in any other form of legal consideration that may be acceptable to the Committee in its sole discretion and in compliance with Applicable Laws.

8.3 Issuance and Restrictions. Subject to Section 12.3 hereof, Restricted Stock shall be subject to such restrictions, if any, on transferability and other restrictions as the Committee may impose (including, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock). The restrictions, if any, may be based on, among other conditions, a Participant's continued Service, the attainment of performance conditions, or a combination of both. These restrictions, if any, may lapse separately or in combination at such times, pursuant to such circumstances, in such installments, or otherwise, as the Committee determines at the time of the grant of the Award or thereafter.

8.4 Dividends. Any dividends that are distributed with respect to Shares of Restricted Stock shall be paid in accordance with the applicable Award Agreement, subject to the provisions of Section 12.4(b).

8.5 Forfeiture. Except as otherwise determined by the Committee at the time of the grant of the Award or thereafter, upon termination of Service during the applicable restriction period, Restricted Stock that is at that time subject to restrictions shall be forfeited.

8.6 Certificates for Restricted Stock. Restricted Stock granted pursuant to the Plan may be evidenced in such manner as the Committee shall determine. If certificates representing shares of Restricted Stock are registered in the name of the Participant, certificates shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock, and the Company may, at its discretion, retain physical possession of the certificate until such time as all applicable restrictions lapse.

ARTICLE 9. STOCK APPRECIATION RIGHTS

9.1 Grant of Stock Appreciation Rights. The Committee is authorized to grant SARs to Eligible Individuals on the following terms and conditions, and the Committee may specify such additional terms and conditions as:

(a) Exercise Price. The exercise price per Share subject to a SAR shall be determined by the Committee and set forth in the Award Agreement; *provided* that the exercise price per Share for any SAR shall not be less than 100% of the Fair Market Value of a Share on the date of grant.

(b) Time and Conditions of Exercise. The Committee shall determine the time or times at which a SAR may be exercised in whole or in part; *provided* that the term of any SAR granted under the Plan shall not exceed ten (10) years. Subject to Section 12.3, the Committee also shall specify the vesting conditions, if any, as it deems appropriate that must be satisfied before all or part of a SAR may be exercised. The vesting conditions, if any, may be based on, among other conditions, a Participant's continued Service, the attainment of performance conditions, or a combination of both.

(c) A SAR may not be exercised for a fraction of a Share. A SAR shall be deemed exercised when the Company receives a notice of exercise (in such form as the Committee may specify from time to time) from the person entitled to exercise the SAR.

9.2 Tandem Stock Appreciation Rights. A SAR may be granted in connection with an Option, either at the time of grant or at any time thereafter during the term of the Option. A SAR granted in connection with an Option will entitle the holder, upon exercise, to surrender the Option or any portion thereof to the extent unexercised, with respect to the number of Shares as to which such SAR is exercised, and to receive payment of an amount computed as described in Section 9.3. The Option shall, to the extent and when surrendered, cease to be exercisable. A SAR granted in connection with an Option hereunder will have an exercise price per share equal to the per share exercise price of the Option, will be exercisable at such time or times, and only to the extent, that the related Option is exercisable, and will expire no later than the related Option expires. If a related Option is exercised in whole or in part, then the SAR related to the Shares purchased terminates as of the date of such exercise.

9.3 Payment and Limitations on Exercise.

(a) A SAR shall entitle the Participant (or other person entitled to exercise the SAR pursuant to the Plan) to exercise all or a specified portion of the SAR (to the extent then exercisable pursuant to its terms) and to receive from the Company an amount equal to the excess of the aggregate Fair Market Value of the Shares on the date the SAR is exercised over the aggregate exercise price of the SAR, less applicable Tax-Related Items (as further set forth in Section 16.3 hereof), subject to any limitations the Committee may impose.

(b) Payment of the amounts determined under Section 9.3(a) hereof shall be in cash, in Shares (based on the Fair Market Value of the Shares as of the date the SAR is exercised) or a combination of both, as determined by the Committee in the Award Agreement. To the extent Shares are issued upon exercise of a SAR, the Shares shall be issued in the name of the Participant. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no dividends or Dividend Equivalent Right shall be paid, and no right to vote or receive dividends or Dividend Equivalent Rights or any other rights as a shareholder shall exist with respect to the Shares subject to a SAR, notwithstanding the exercise of the SAR. The Company shall issue (or cause to be issued) such Shares promptly after the SAR is exercised. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 13.1 of the Plan. The provisions of Section 6.1(d)(ii) regarding the treatment of a termination of the Participant's Service shall also apply to SARs.

ARTICLE 10. OTHER SHARE-BASED AWARDS

10.1 Grants of Other Share-Based Awards. Subject to limitation under Applicable Laws, the Committee is authorized under the Plan to grant Awards (other than Options, Restricted Stock Units, Restricted Stock and SARs) to Eligible Individuals subject to the terms and conditions set forth in this Article 10 and such other terms and conditions as may be specified by the Committee that are not inconsistent with the provisions of the Plan and that, by their terms, involve or might involve the issuance of, consist of, or are denominated in, payable in, valued in whole or in part by reference to, or otherwise relate to, Shares. The Committee may also grant Shares as a bonus, or may grant other Awards in lieu of obligations of the Company or an Affiliate to pay cash or other property under the Plan or other plans or compensatory arrangements. The terms and conditions applicable to such other Awards shall be determined from time to time by the Committee and set forth in an applicable Award Agreement. The Committee may establish one or more separate programs under the Plan for the purpose of issuing particular forms of Awards to one or more classes of Participants on such terms and conditions as determined by the Committee from time to time.

10.2 Exercise Price. The Committee may establish the exercise price, if any, of any Other Share-Based Award granted pursuant to this Article 10; *provided* that such exercise price shall not be less than the Fair Market Value of a Share on the date of grant for an Award that is intended to be exempt from Section 409A of the Code.

10.3 Form of Payment. Payments with respect to any Awards granted under Section 10.1 shall be made in cash or cash equivalent, in Shares or any combination of the foregoing, as determined by the Committee.

10.4 Vesting Conditions. Subject to Section 12.3, the Committee shall specify the date or dates on which the Awards granted pursuant to this Article 10 shall become fully vested and nonforfeitable, and may specify such conditions to vesting as it deems appropriate. The vesting conditions may be based on, among other vesting conditions, a Participant's continued Service, the attainment of performance conditions, or a combination of both.

10.5 Term. Except as otherwise provided herein, the Committee shall set, in its discretion, the term of any Award granted pursuant to this Article 10; *provided* that the term of any Award granted pursuant to this Article 10 shall not exceed ten (10) years.

ARTICLE 11. PERFORMANCE-BASED AWARDS

11.1 Purpose. If the Committee, in its discretion, decides to grant a Performance-Based Award to an Eligible Individual, the provisions of this Article 11 shall control over any contrary provision contained in Articles 6 through 10; *provided* that the Committee may in its discretion grant Awards to Eligible Individuals that are based on Performance Criteria or other performance conditions but that do not satisfy the requirements of this Article 11.

11.2 Applicability. This Article 11 shall apply only to those Eligible Individuals selected by the Committee to receive Performance-Based Awards. The designation of an Eligible Individual as a Participant for a Performance Period shall not entitle the Participant, in any manner, to receive an Award for the period. Moreover, the designation of an Eligible Individual as a Participant for a particular Performance Period shall not require designation of such Eligible Individual as a Participant in any subsequent Performance Period and designation of one Eligible Individual as a Participant shall not require designation of any other Eligible Individuals as a Participant in such period or in any other Performance Period.

11.3 Procedures with Respect to Performance-Based Awards. With respect to any Performance-Based Awards, which may be granted to one or more Eligible Individuals, within the first twenty-five percent (25%) of the Performance Period in question or period of Service, the Committee, in writing (a) shall designate one or more Eligible Individuals as eligible for an Award, (b) shall designate the Performance Period over which the Performance Goals shall be measured; (c) shall select the Performance Criteria applicable to the Performance Period, (d) shall establish the Performance Goals, and amounts of such Awards, as applicable, which may be earned for such Performance Period, and (e) shall specify the relationship between Performance Criteria and the Performance Goals and the amounts of such Awards, as applicable, to be earned by each Eligible Individuals for such Performance Period. Following the completion of each Performance Period, the Committee shall certify in writing whether the applicable Performance Goals have been achieved for such Performance Period. In determining the amount earned by an Eligible Individual, the Committee shall have the right to adjust or eliminate the amount payable at a given level of performance to take into account additional factors that the Committee may deem relevant to the assessment of individual or corporate performance for the Performance Period.

11.4 Payment of Performance-Based Awards. Unless otherwise provided in the applicable Award Agreement, a Participant must be providing Service on the day a Performance-Based Award for the appropriate Performance Period is paid to the Participant. Furthermore, unless otherwise provided in the applicable Award Agreement, a Participant shall be eligible to receive payment pursuant to a Performance-Based Award for a Performance Period only if the Performance Goals for such period are achieved.

ARTICLE 12. PROVISIONS APPLICABLE TO AWARDS

12.1 Stand-Alone and Tandem Awards. Awards granted pursuant to the Plan may, in the discretion of the Committee, be granted either alone, in addition to, or in tandem with, any other Award granted pursuant to the Plan. Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

12.2 Award Agreement. Awards under the Plan shall be evidenced by Award Agreements that set forth the terms, conditions and limitations for each Award, not inconsistent with the Plan, which may include, without limitation, the term of an Award, the provisions applicable in the event the Participant's Service terminates, and the Company's authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind an Award.

12.3 Minimum Vesting Requirements. Notwithstanding any other provision of the Plan, except in connection with Awards granted in connection with assumption or substitution of awards as part of a transaction as contemplated under Section 4.1(c) or Awards that may be settled only in cash, no portion of an Award granted on or after the Effective Date may vest before the first anniversary of the date of grant, subject to accelerated vesting as contemplated under Section 3.3(j) and ARTICLE 13; provided, however, that the Company may grant Awards with respect to up to five percent (5%) of the number of Shares reserved under Section 4.1 as of the Effective Date without regard to the minimum vesting period set forth in this Section 12.3.

12.4 Dividends and Dividend Equivalent Rights.

(a) Any Participant selected by the Committee may be granted Dividend Equivalent Rights based on the dividends declared on the Shares that are subject to any Restricted Stock Unit or an Other Share-

Based Award that is a Full Value Award, to be credited as of dividend payment dates, during the period between the date the Award is granted and the date the Award vests or is settled, as determined by the Committee and set forth in the applicable Award Agreement. Such Dividend Equivalent Rights shall be converted to cash or additional Shares by such formula and at such time and subject to such limitations as may be determined by the Committee.

(b) To the extent Shares subject to an Award (other than Restricted Stock) are subject to vesting conditions, any Dividend Equivalent Rights relating to such Shares shall either (i) not be paid or credited or (ii) be accumulated and subject to restrictions and risk of forfeiture to the same extent as the underlying Award with respect to which such cash, stock or other property has been distributed. For Shares of Restricted Stock that are subject to vesting, dividends shall be accumulated and subject to any restrictions and risk of forfeiture to which the underlying Restricted Stock is subject.

12.5 Limits on Transfer. No right or interest of a Participant in any Award may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or an Affiliate, or shall be subject to any lien, obligation, or liability of such Participant to any other party other than the Company or an Affiliate. Except as otherwise provided by the Committee, no Award shall be assigned, transferred, or otherwise disposed of by a Participant other than by will or the laws of descent and distribution.

12.6 Stock Certificates; Book Entry Procedures.

(a) Notwithstanding anything herein to the contrary, the Company shall not be required to issue or deliver any certificates evidencing Shares pursuant to the exercise or vesting, as applicable, of any Award, unless and until the Board has determined, with advice of counsel, that the issuance and delivery of such certificates is in compliance with all Applicable Laws, regulations of governmental authorities and, if applicable, the requirements of any exchange on which the Shares are listed or traded. All certificates evidencing Shares delivered pursuant to the Plan are subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal, state, or local securities or other laws, including laws of jurisdictions outside of the U.S., rules and regulations and the rules of any national securities exchange or automated quotation system on which the Shares are listed, quoted, or traded. The Committee may place legends on any certificate evidencing Shares to reference restrictions applicable to the Shares. In addition to the terms and conditions provided herein, the Board may require that a Participant make such reasonable covenants, agreements, and representations as the Board, in its discretion, deems advisable in order to comply with any such laws, regulations, or requirements. The Committee shall have the right to require any Participant to comply with any timing or other restrictions with respect to the settlement or exercise of any Award, including, without limitation, a window-period limitation, as may be imposed in the discretion of the Committee.

(b) Notwithstanding any other provision of the Plan, unless otherwise determined by the Committee or required by any Applicable Laws, rule or regulation, the Company shall not deliver to any Participant certificates evidencing Shares issued in connection with any Award and instead such Shares shall be recorded in the books of the Company (or, as applicable, its transfer agent or stock plan administrator).

12.7 Paperless Administration. In the event that the Company establishes, for itself or using the services of a third party, an automated system for the documentation, granting or exercise of Awards, such as a system using an internet website, intranet or interactive voice response, then the paperless documentation, granting or exercise of Awards by a Participant may be permitted through the use of such an automated system.

ARTICLE 13. CHANGES IN CAPITAL STRUCTURE

13.1 Adjustments.

(a) In the event of any stock dividend, stock split, combination or exchange of shares, merger, consolidation or other distribution (other than normal cash dividends) of Company assets to shareholders, or any other similar event or other change related to a corporate event affecting the Shares or the price of the Shares other than an Equity Restructuring, the Committee shall make such adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such change with respect to (a) the aggregate number and kind of shares that may be issued under the Plan (including, without limitation, adjustments of the limitations in Sections 4.1 and 4.3 hereof); (b) the terms and conditions of any outstanding Awards (including, without limitation, the number and kind of shares that may be issued, or any applicable performance goals or criteria with respect thereto); and (c) the grant or exercise price per Share for any outstanding Awards under the Plan.

(b) In the event of any transaction or event described in Section 13.1(a) hereof or any unusual or infrequently occurring items or nonrecurring transactions or events affecting the Company, any affiliate of the Company, or the financial statements of the Company or any affiliate, or of changes in Applicable Laws, regulations or accounting principles, the Committee, in its sole and absolute discretion, and on such terms and conditions as it deems appropriate, either by the terms of the Award or by action taken prior to the occurrence of such transaction or event and either automatically or upon the Participant's request, is hereby authorized to take any one or more of the following actions whenever the Committee determines that such action is appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan or with respect to any Award under the Plan, to facilitate such transactions or events or to give effect to such changes in laws, regulations or principles:

(i) to provide for either (A) termination of any such Award in exchange for an amount of cash, if any, equal to the amount that would have been attained upon the exercise of such Award or realization of the Participant's rights (and, for the avoidance of doubt, if as of the date of the occurrence of the transaction or event described in this Section 13.1 the Committee determines in good faith that no amount would have been attained upon the exercise of such Award or realization of the Participant's rights, then such Award may be terminated by the Company without payment) or (B) the replacement of such Award with other rights or property selected by the Committee in its sole discretion;

(ii) to provide that such Award be assumed by the successor or survivor corporation, or a parent or subsidiary thereof, or shall be substituted for by similar options, rights or awards covering the stock of the successor or survivor corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices;

(iii) to make adjustments in the number and type of Shares (or other securities or property) subject to outstanding Awards, and/or in the terms and conditions of (including the grant or exercise price), and the criteria included in, outstanding options, rights and awards;

(iv) to provide that such Award shall be exercisable or payable or fully vested with respect to all Shares covered thereby, notwithstanding anything to the contrary in the Plan or the applicable Award Agreement; and

(v) to provide that the Award cannot vest, be exercised or become payable after such event.

(c) In connection with the occurrence of any Equity Restructuring, and notwithstanding anything to the contrary in Sections 13.1(a) and 13.1(b) hereof:

(i) the number and type of securities subject to each outstanding Award and the exercise price or grant price thereof, if applicable, shall be equitably adjusted. The adjustments provided under this Section 13.1(c)(i) shall be final and binding on the affected Participant and the Company.

(ii) the Committee shall make such equitable adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such Equity Restructuring with respect to the aggregate number and kind of shares that may be issued under the Plan (including, without limitation, adjustments of the limitations in Sections 4.1 and 4.3 hereof).

13.2 Change in Control.

(a) Notwithstanding Section 13.1 hereof, and provided that any applicable Award Agreement does not expressly preclude the following from applying, if a Change in Control occurs and Awards that vest solely on the Participant's continued Service are not converted, assumed, substituted or replaced by a successor or survivor corporation, or a parent or subsidiary thereof, then immediately prior to the Change in Control such Awards shall become fully exercisable and all forfeiture restrictions on such Awards shall lapse and, immediately following the consummation of such Change in Control, all such Awards shall terminate and cease to be outstanding.

(b) Notwithstanding Section 13.1 hereof, Awards that vest based on the attainment of performance-based conditions shall be subject to the provisions of the Award Agreement governing the impact of a Change in Control, provided that any such provisions in the Award Agreement shall (i) not permit the vesting of

Awards at a rate that is greater than the actual level of attainment and/or (ii) provide for pro-rated vesting of the Award based on any reduction to the performance period resulting from the Change in Control.

(c) Where Awards are assumed or continued after a Change in Control, the Committee may provide that the vesting of one or more Awards will automatically accelerate upon an involuntary termination of the Participant's employment or service within a designated period following the effective date of such Change in Control. Any such Award shall accordingly, upon an involuntary termination of the Participant's employment or service in connection with a Change in Control, become fully exercisable and all forfeiture restrictions on such Award shall lapse.

(d) The portion of any Incentive Stock Option accelerated in connection with a Change in Control shall remain exercisable as an Incentive Stock Option only to the extent the applicable $100,000 limitation is not exceeded. To the extent such U.S. dollar limitation is exceeded, the accelerated portion of such Option shall be exercisable as a Non-Statutory Option under the U.S. federal tax laws.

13.3 No Other Rights. Except as expressly provided in the Plan, no Participant shall have any rights by reason of any subdivision or consolidation of Shares of any class, the payment of any dividend, any increase or decrease in the number of Shares of any class or any dissolution, liquidation, merger, or consolidation of the Company or any other corporation. Except as expressly provided in the Plan or pursuant to action of the Committee under the Plan, no issuance by the Company of Shares of any class, or securities convertible into Shares of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number of Shares subject to an Award or the grant or the exercise price of any Award.

ARTICLE 14. EFFECTIVE AND EXPIRATION DATE

14.1 Plan Effective Date. The Plan was approved by the Board on February 20, 2018 and shall become effective upon approval of the shareholders of the Company.

14.2 Expiration Date. The Plan will continue in effect until it is terminated by the Board pursuant to Section 15.1 hereof, except that no Incentive Stock Options may be granted under the Plan after February 20, 2028. Any Awards that are outstanding on the date the Plan terminates shall remain in force according to the terms of the Plan and the applicable Award Agreement.

ARTICLE 15. AMENDMENT, MODIFICATION, AND TERMINATION

15.1 Amendment, Modification, and Termination. Subject to Section 16.14 hereof, with the approval of the Board, at any time and from time to time, the Committee may terminate, amend or modify the Plan; *provided, however*, that to the extent necessary and desirable to comply with any Applicable Laws, the Company shall obtain shareholder approval of any Plan amendment in such a manner and to such a degree as required. Notwithstanding any provision in this Plan to the contrary, absent approval of the shareholders of the Company, and except as permitted by Article 13, no Option or SAR may be amended to reduce the per-Share exercise price of the Shares subject to such Option or SAR below the per-Share exercise price as of the date the Option or SAR is granted and (a) no Option or SAR may be granted in exchange for, or in connection with, the cancellation, surrender or substitution of an Option or SAR having a higher per-Share exercise price and (b) no Option or SAR may be cancelled in exchange for, or in connection with, the payment of a cash amount or another Award at a time when the Option or SAR has a per-Share exercise price that is higher than the Fair Market Value of a Share.

15.2 Awards Previously Granted. Except with respect to amendments made or other actions taken pursuant to Section 16.14 hereof or any amendment or other action with respect to an outstanding Award that may be required or desirable to facilitate compliance with Applicable Laws, as determined by the Committee in its sole discretion, no termination, amendment, or modification of the Plan shall affect adversely, in any material way, any Award previously granted pursuant to the Plan without the prior written consent of the Participant; *provided*, *however*, that an amendment or modification that may cause an Incentive Stock Option to become a Non-Qualified Stock Option shall not be treated as adversely affecting the rights of the Participant.

ARTICLE 16. GENERAL PROVISIONS

16.1 No Rights to Awards. No Eligible Individual or other person shall have any claim to be granted any Award pursuant to the Plan, and neither the Company nor the Committee is obligated to treat Eligible Individuals, Participants or any other persons uniformly.

16.2 No Shareholders Rights. Except as otherwise provided herein, a Participant shall have none of the rights of a shareholder with respect to Shares covered by any Award, including the right to vote or receive dividends, until the Participant becomes the record owner of such Shares, notwithstanding the exercise of an Option or SAR or vesting of another Award.

16.3 Tax-Related Items. The Company or any Affiliate, as applicable, shall have the authority to require a Participant to remit to the Company or an Affiliate, an amount sufficient to satisfy the withholding obligations for Tax-Related Items or to take such other action as may be necessary or appropriate in the opinion of the Company or an Affiliate, as applicable, to satisfy withholding obligations for Tax-Related Items, including one or a combination of the following: (a) withholding from the Participant's wages or other cash compensation payable to the Participant by the Company or an Affiliate; (b) withholding from the proceeds of the sale of Shares acquired pursuant to an Award, either through a voluntary sale or a mandatory sale arranged by the Company on the Participant's behalf, without need of further authorization; or (c) in the Committee's sole discretion, by withholding Shares otherwise issuable under an Award (or allowing the return of Shares) sufficient, as determined by the Committee in its sole discretion, to satisfy such Tax-Related Items. No Shares shall be delivered pursuant to an Award to any Participant or other person until the Participant or such other person has made arrangements acceptable to the Committee to satisfy the withholding obligations for Tax-Related Items.

16.4 No Right to Employment or Services. Nothing in the Plan or any Award Agreement shall interfere with or limit in any way the right of the Company or any Affiliate to terminate any Participant's Service at any time, nor confer upon any Participant any right to continue in the Service of the Company or any Affiliate.

16.5 Unfunded Status of Awards. The Plan is intended to be an "unfunded" plan for incentive compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Agreement shall give the Participant any rights that are greater than those of a general creditor of the Company or any Affiliate.

16.6 Indemnification. To the extent allowable pursuant to Applicable Laws, each member of the Committee and the Board shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such member in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action or failure to act pursuant to the Plan and against and from any and all amounts paid by him or her in satisfaction of judgment in such action, suit, or proceeding against him or her; *provided* he or she gives the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled pursuant to the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

16.7 Relationship to other Benefits. No payment pursuant to the Plan shall be taken into account in determining any benefits pursuant to any pension, retirement, savings, profit sharing, group insurance, termination programs and/or indemnities or severance payments, welfare or other benefit plan of the Company or any Affiliate, except to the extent otherwise expressly provided in writing in such other plan or an agreement thereunder.

16.8 Expenses. The expenses of administering the Plan shall be borne by the Company and/or its Affiliates.

16.9 Titles and Headings. The titles and headings of the sections in the Plan are for convenience of reference only and, in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

16.10 Fractional Shares. No fractional Shares shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional shares or whether such fractional shares shall be eliminated by rounding up or down as appropriate.

16.11 Limitations Applicable to Section 16 Persons. Notwithstanding any other provision of the Plan, the Plan, and any Award granted or awarded to any Participant who is then subject to Section 16 of the Exchange Act, shall be subject to any additional limitations set forth in any applicable exemptive rule under Section 16 of the Exchange Act (including any amendment to Rule 16b-3 under the Exchange Act) that are requirements for the application of such exemptive rule. To the extent permitted by Applicable Laws, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such applicable exemptive rule.

16.12 Government and Other Regulations. The obligation of the Company to make payment of awards in Shares or otherwise shall be subject to all Applicable Laws, and to such approvals by government agencies, including government agencies in jurisdictions outside of the U.S., in each case as may be required or as the Company deems necessary or advisable. Without limiting the foregoing, the Company shall have no obligation to issue or deliver evidence of title for Shares subject to Awards granted hereunder prior to: (i) obtaining any approvals from governmental agencies that the Company determines are necessary or advisable, and (ii) completion of any registration or other qualification with respect to the Shares under any Applicable Laws in the U.S. or in a jurisdiction outside of the U.S. or ruling of any governmental body that the Company determines to be necessary or advisable or at a time when any such registration or qualification is not current, has been suspended or otherwise has ceased to be effective. The inability or impracticability of the Company to obtain or maintain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained and shall constitute circumstances in which the Committee may determine to amend or cancel Awards pertaining to such Shares, with or without consideration to the affected Participant. The Company shall be under no obligation to register, pursuant to the Securities Act or otherwise, any offering of Shares issuable under the Plan. If, in certain circumstances, the Shares paid pursuant to the Plan may be exempt from registration pursuant to the Securities Act, the Company may restrict the transfer of such Shares in such manner as it deems advisable to ensure the availability of any such exemption.

16.13 Governing Law. The Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of Indiana.

16.14 Section 409A. Except as provided in Section 16.15 hereof, to the extent that the Committee determines that any Award granted under the Plan is subject to Section 409A of the Code, the Award Agreement evidencing such Award shall incorporate the terms and conditions required by Section 409A of the Code. To the extent applicable, the Plan and Award Agreements shall be interpreted in accordance with Section 409A of the Code and U.S. Department of Treasury regulations and other interpretive guidance issued thereunder, including without limitation any such regulations or other guidance that may be issued after the Effective Date. Notwithstanding any provision of the Plan to the contrary, in the event that following the date an Award is granted the Committee determines that the Award may be subject to Section 409A of the Code and related U.S. Department of Treasury guidance (including such guidance as may be issued after the Effective Date), the Committee may adopt such amendments to the Plan and the applicable Award Agreement or adopt other policies and procedures (including amendments, policies and procedures with retroactive effect), or take any other actions, including amendments or actions that would result in a reduction to the benefits payable under an Award, in each case, without the consent of the Participant, that the Committee determines are necessary or appropriate to (a) exempt the Award from Section 409A of the Code and/or preserve the intended tax treatment of the benefits provided with respect to the Award, or (b) comply with the requirements of Section 409A of the Code and related U.S. Department of Treasury guidance and thereby avoid the application of any penalty taxes under such Section or mitigate any additional tax, interest and/or penalties or other adverse tax consequences that may apply under Section 409A of the Code if compliance is not practical.

16.15 No Representations or Covenants with respect to Tax Qualification. Although the Company may endeavor to (a) qualify an Award for favorable or specific tax treatment under the laws of the U.S. (*e.g.*, Incentive Stock Options under Section 422 of the Code) or jurisdictions outside of the U.S. or (b) avoid adverse tax treatment (*e.g.*, under Section 409A of the Code), the Company makes no representation to that effect and expressly disavows any covenant to maintain favorable or avoid unfavorable tax treatment, notwithstanding anything to the contrary in this Plan, including Section 16.14 hereof. The Company shall be unconstrained in its corporate activities without regard to the potential negative tax impact on Participants under the Plan. Nothing in this Plan or in an Award Agreement shall provide a basis for any person to take any action against the Company or any Affiliate based on matters covered by Section 409A of the Code, including the tax treatment of any Awards, and neither the Company nor any Affiliate will have any liability under any circumstances to the Participant or any other party if the Award that is intended to be exempt from, or compliant with, Section 409A of the Code, is not so exempt or compliant or for any action taken by the Committee with respect thereto.

16.16 Clawback/Recovery. All Awards granted under the Plan will be subject to recoupment in accordance with any clawback policy adopted by the Company providing for the recovery of Awards, shares, proceeds, or payments to Participants in the event of fraud or as required by Applicable Laws or governance considerations or in other similar circumstances.

16.17 Severability. If any provision of the Plan or the application of any provision hereof to any person or circumstance is held to be invalid or unenforceable, the remainder of the Plan and the application of such provision to any other person or circumstance shall not be affected, and the provisions so held to be unenforceable shall be reformed to the extent (and only to the extent) necessary to make it enforceable and valid.

* * * *

Annual Meeting Admission Ticket

Eli Lilly and Company 2018 Annual Meeting of Shareholders
Monday, May 7, 2018
11:00 a.m. EDT

Lilly Center Auditorium
Lilly Corporate Center
Indianapolis, Indiana 46285

The top portion of this page will be required for admission to the meeting.

Please write your name and address in the space provided below and present this ticket when you enter the Lilly Center.

Doors open at 10:15 a.m.

Name

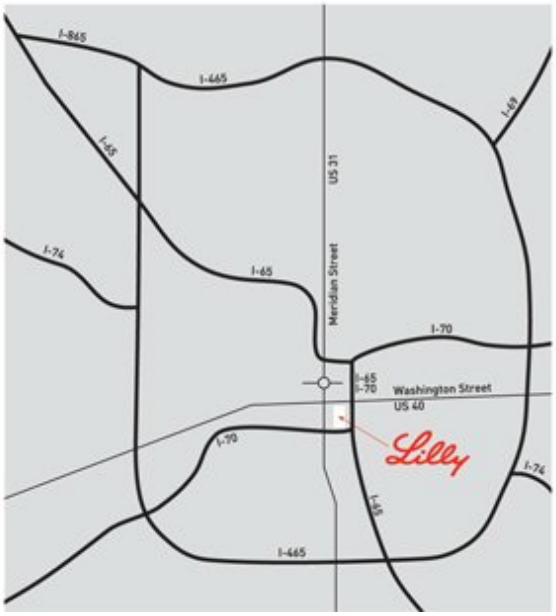
Address

City, State, and Zip Code

Parking Pass

Detach here

Detach here



Directions and Parking

From I-70 take Exit 79B; follow signs to McCarty Street. Turn right (east) on McCarty Street; go straight into Lilly Corporate Center. You will be directed to parking. **Be sure to take the admission ticket (the top portion of this page) with you to the meeting and leave this parking pass on your dashboard.**

Take the top portion of this page with you to the meeting.

Detach here

Detach here

Eli Lilly and Company
Annual Meeting of Shareholders
May 7, 2018

Please place this identifier on the dashboard of your car as you enter Lilly Corporate Center so it can be clearly seen by security and parking personnel.

CORPORATE INFORMATION

ANNUAL MEETING

The annual meeting of shareholders will be held at the **Lilly Center Auditorium, Lilly Corporate Center, Indianapolis, Indiana, on Monday, May 7, 2018, at 11:00 a.m. EDT.** For more information, see the proxy statement section of this report.

10-K AND 10-Q REPORTS

Paper copies of the company's annual report to the Securities and Exchange Commission on Form 10-K and quarterly reports on Form 10-Q are available upon written request to:

ELI LILLY AND COMPANY
c/o Corporate Secretary
Lilly Corporate Center
Indianapolis, Indiana 46285

To access these reports more quickly, you can find all of our SEC filings online at: **https://investor.lilly.com/sec.cfm.**

STOCK LISTINGS

Eli Lilly and Company common stock is listed on the New York Stock Exchange, NYSE Euronext, and SIX Swiss Exchange. NYSE ticker symbol: LLY. Most newspapers list the stock as "Lilly (Eli) and Co."

CEO AND CFO CERTIFICATES

The company's chief executive officer and chief financial officer have provided all certifications required under Securities and Exchange Commission regulations with respect to the financial information and disclosures in this report. The certifications are available as exhibits to the company's Form 10-K and 10-Q reports.

In addition, the company's chief executive officer has filed with the New York Stock Exchange a certification to the effect that, to the best of his knowledge, the company is in compliance with all corporate governance listing standards of the Exchange.

TRANSFER AGENT AND REGISTRAR

EQ SHAREOWNER SERVICES

Mailing Address:

EQ SHAREOWNER SERVICES
P.O. Box 64854
St. Paul, Minnesota 55164-0854

Overnight Address:

EQ SHAREOWNER SERVICES
1110 Centre Pointe Curve, Suite 101
Mendota Heights, Minnesota 55120-4100

Telephone: 1-800-833-8699
E-mail: stocktransfer@eq-us.com
Internet: www.shareowneronline.com

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

EQ Shareowner Services administers the Shareowner Service Plus Plan, which allows registered shareholders to purchase additional shares of Lilly common stock through the automatic investment of dividends. The plan also allows registered shareholders and new investors to purchase shares with cash payments, either by check or by automatic deductions from checking or savings accounts. The minimum initial investment for new investors is $1,000. Subsequent investments must be at least $50. The maximum cash investment during any calendar year is $150,000. Please direct inquiries concerning the Shareowner Service Plus Plan to:

EQ SHAREOWNER SERVICES
P.O. Box 64856
St. Paul, Minnesota 55164-0856
Telephone: 1-800-833-8699

ONLINE DELIVERY OF PROXY MATERIALS

Shareholders may elect to receive annual reports and proxy materials online. This reduces paper mailed to the shareholder's home and saves the company printing and mailing costs. To enroll, go to **https://investor.lilly.com/services.cfm** and follow the directions provided.

ELI LILLY AND COMPANY

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