SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

Commission File Number 001-6351

ELI LILLY AND COMPANY

An Indiana Corporation I.R.S. Employer Number 35-0470950

Address: Lilly Corporate Center, Indianapolis, Indiana 46285

Telephone number, including area code: (317) 276-2000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title Of Each Class	Name Of Each Exchange On Which Registered
Common Stock	New York and Pacific Stock Exchanges
Preferred Stock Purchase Rights	New York and Pacific Stock Exchanges
8-1/8% Notes Due December 1, 2001	New York Stock Exchange
8-3/8% Notes Due December 1, 2006	New York Stock Exchange
6.57% Notes Due January 1, 2016	New York Stock Exchange
6.77% Notes Due January 1, 2036	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in the definitive proxy statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Aggregate market value of voting stock of the Registrant held by non-affiliates as of February 12, 1999 (Common Stock): $82,996,965,000.

Number of shares of common stock outstanding as of February 12, 1999: 1,101,256,334.

Portions of the following documents have been incorporated by reference into this report:

Document	Parts Into Which Incorporated
Registrant's Annual Report to Shareholders for fiscal year ended December 31, 1998	Parts I, II, and IV
Registrant's Proxy Statement dated March 4, 1999	Part III

PART I

Item 1. BUSINESS

Eli Lilly and Company was incorporated in 1901 under the laws of Indiana to succeed to the drug manufacturing business founded in Indianapolis, Indiana, in 1876 by Colonel Eli Lilly. The Company*, including its subsidiaries, discovers, develops, manufactures, and sells products in one significant business segment--pharmaceutical products. Products are manufactured or distributed through owned or leased facilities in the United States, Puerto Rico, and 27 other countries. Its products are sold in approximately 160 countries. Through its PCS Health Systems ("PCS") business, which was sold in January 1999, the Company provided health care management services in the United States. See "Health Care Management" at page 3.

Most of the Company's products were discovered or developed through the Company's research and development activities, and the success of the Company's business depends to a great extent on the continued introduction of new products resulting from these research and development activities. Research efforts are primarily directed toward discovering and developing products to diagnose and treat diseases in human beings and animals and to increase the efficiency of animal food production.

FINANCIAL INFORMATION RELATING TO BUSINESS SEGMENTS AND CLASSES OF PRODUCTS

Financial information relating to business segments and classes of products, set forth in the Company's 1998 Annual Report at page 43 under "Segment Information" (page 6 of Exhibit 13 to this Form 10-K), is incorporated herein by reference.

Due to several factors, including the introduction of new products by the Company and other manufacturers, the relative contribution of any particular Company product to consolidated net sales is not necessarily constant from year to year, and its contribution to net income is not necessarily the same as its contribution to consolidated net sales.

PRODUCTS AND SERVICES

Pharmaceutical Products

Pharmaceutical products include:

Neuroscience products, the Company's largest-selling product group, including Prozac(R), indicated for the treatment of depression and, in many countries, for bulimia and obsessive-compulsive disorder; Zyprexa(R), a product for the treatment of schizophrenia; the Darvon(R) line of analgesic products; and Permax(R), a treatment for Parkinson's disease;

* The terms "Company" and "Registrant" are used interchangeably herein to refer to Eli Lilly and Company or to Eli Lilly and Company and its consolidated subsidiaries, as the context requires.

Endocrine products, including Humulin(R), human insulin produced through recombinant DNA technology; Humalog(R), a rapid-acting injectable human insulin analog of recombinant DNA origin; Iletin(R), animal-source insulin in its various pharmaceutical forms; and Humatrope(R), human growth hormone produced by recombinant DNA technology;

Anti-infectives, including the oral cephalosporin antibiotics Ceclor(R) (cefaclor), Keflex(R), and Keftab(R), used in the treatment of a wide range of bacterial infections; the oral carbacephem antibiotic Lorabid(R), used to treat a variety of bacterial infections; Vancocin(R) HCl, an injectable antibiotic used primarily to treat staphylococcal infections; the oral macrolide antibiotic Dynabac(R); the injectable cephalosporin antibiotics Tazidime(R), Kefurox(R), and Kefzol(R), used to treat a wide range of bacterial infections in the hospital setting; and Nebcin(R), an injectable aminoglycoside antibiotic used in hospitals to treat various infections caused by staphylococci and Gram-negative bacteria;

Cardiovascular agents, including ReoPro(R), a monoclonal antibody product developed and manufactured by Centocor, Inc. and co-marketed by the Company and Centocor for use as an adjunct to percutaneous coronary intervention ("PCI"), including patients undergoing angioplasty, atherectomy or stent placement and patients with unstable angina who are not responding to conventional medical therapy when PCI is planned within 24 hours; Dobutrex(R), an inotropic agent; and Cynt(TM), marketed outside the United States for treatment of hypertension;

An antiulcer agent, Axid(R), an H2 antagonist, indicated for the treatment of active duodenal ulcer, for maintenance therapy for duodenal ulcer patients after healing of an active duodenal ulcer, for reflux esophagitis, and for benign gastric ulcer;

Oncology products, including Gemzar(R), indicated for treatment of advanced or metastatic pancreatic cancer and, in combination with other agents, for treatment of non-small-cell lung cancer; Oncovin(R), indicated for treatment of acute leukemia and, in combination with other oncolytic agents, for treatment of several different types of advanced cancers; Velban(R), used in a variety of malignant neoplastic conditions; and Eldisine(R), indicated for treatment of acute childhood leukemia resistant to other drugs; and

Evista(R), a selective estrogen receptor modulator, indicated for the prevention of osteoporosis in post-menopausal women, and in some countries outside the United States, for the treatment of osteoporosis in post-menopausal women.

Animal Health Products

Animal health products include Tylan(R), an antibiotic used to control certain diseases in cattle, swine, and poultry and to improve feed efficiency and growth; Rumensin(R), a cattle feed additive that improves feed efficiency and growth; Coban(R), Monteban(R) and Maxiban(R), anticoccidial agents for use in poultry; Apralan(R), an antibiotic used to control enteric infections in calves and swine; Micotil(R) and Pulmotil(R), antibiotics used to treat respiratory disease in cattle and swine, respectively; and Surmax(R) (sold as Maxus(R) in some countries), a growth promotant for swine and poultry.

Health Care Management Services

The Company's PCS business was sold to Rite Aid Corporation effective January 22, 1999. The Company received approximately $1.6 billion, including $1.5 billion in cash from Rite Aid and approximately $100 million in cash from PCS. As a result of the sale, the operating results of PCS are included in the Company's 1998 financial statements as discontinued operations. PCS provided computer-based prescription drug claims processing, pharmacy benefit administration and management services, mail order pharmacy services, data management and disease-management services to health plan sponsors, including insurance companies, third-party administrators, self-insured employers, health maintenance organizations, and Blue Cross/Blue Shield organizations that underwrite or administer prescription benefit plans.

MARKETING

Most of the Company's major products are marketed worldwide. Health care management services were marketed primarily in the United States.

Pharmaceuticals -- United States

In the United States, the Company distributes pharmaceutical products principally through approximately 200 independent wholesale distributing outlets. The Company's marketing policy is designed to assure that products are immediately available to physicians, pharmacies, hospitals, and appropriate health care professionals throughout the country. Four wholesale distributors in the United States accounted for approximately 17%, 15%, 13%, and 10%, respectively, of the Company's consolidated net sales in 1998. No other distributor accounted for more than 7% of consolidated net sales. The Company also sells pharmaceutical products directly to the United States government and other manufacturers, but those direct sales are not material to consolidated net sales.

The Company's major pharmaceutical products are promoted in the United States under the Lilly and Dista trade names by Company sales forces employing salaried sales representatives. These sales representatives, many of whom are registered pharmacists, call upon physicians, wholesalers, hospitals, managed-care organizations, retail pharmacists, and other health care professionals. Their efforts are supported by the Company through advertising in medical and drug journals, distribution of literature and samples of certain products to physicians, and exhibits for use at medical meetings. The Company also advertises certain of its products directly to consumers in the United States. The Company has created divisions of its sales force dedicated to product lines or practice areas, such as primary care, neuroscience, diabetes care, cardiovascular, endocrinology, and oncology. The Company has entered into licensing arrangements under which certain products manufactured by the Company, such as Ceclor CD, Dynabac, Keftab, and Permax, are marketed by other pharmaceutical companies.

Large purchasers of pharmaceuticals, such as managed-care groups and government and long-term care institutions, now account for a significant portion of total pharmaceutical purchases in the United States. The Company has created special sales groups to service managed-care organizations, government and long-term care institutions, hospital contract administrators, and certain retail pharmacies. In response to competitive pressures, the Company has entered into arrangements with a number of these organizations providing for discounts or rebates on one or more Company products or other cost-sharing arrangements.

Pharmaceuticals -- Outside the United States

Outside the United States, pharmaceutical products are promoted primarily by salaried sales representatives. While the products marketed vary from country to country, neuroscience products constitute the largest single group in total sales. Distribution patterns vary from country to country. In recent years, the Company has significantly expanded its marketing efforts in a number of overseas markets, including emerging markets in Central and Eastern Europe, Latin America, Asia and Africa.

Animal Health Products

Elanco Animal Health, a division of the Company, employs field salespeople throughout the United States to market animal health products. Sales are made to wholesale distributors, retailers, feed manufacturers, or producers in conformance with varying distribution patterns applicable to the various types of products. The Company also has an extensive sales force outside the United States to market its animal health products.

RAW MATERIALS

Most of the principal materials used by the Company in manufacturing operations are chemical, plant, and animal products that are available from more than one source. Certain raw materials are available or are purchased principally from only one source. Unavailability of certain materials from present sources could cause an interruption in production pending establishment of new sources or, in some cases, implementation of alternative processes.

Although the major portion of the Company's sales abroad are of products manufactured wholly or in part abroad, a principal source of active ingredients for these manufactured products continues to be the Company's facilities in the United States.

PATENTS AND OTHER INTELLECTUAL PROPERTY RIGHTS

Intellectual property protection is, in the aggregate, material to the Company's ability to successfully commercialize its life sciences innovations. The Company owns, has applications pending for, or is licensed under, a substantial number of patents, both in the United States and in other countries, relating to products, product uses, formulations, and manufacturing processes. There can be no assurance that patents will result from the Company's pending applications. Moreover, patents relating to particular products, uses, formulations, or processes do not preclude other manufacturers from employing alternative processes or from successfully marketing substitute products to compete with the patented products or uses.

The standard of intellectual property protection outside the United States for pharmaceutical inventions varies widely. While many countries have strong laws, many other countries provide little or no intellectual property protection. In recent years, the adoption of international agreements such as the new World Trade Agreement have resulted in a strengthening of intellectual property laws in some countries, and the Company believes further improvements are likely. The commercial significance of these changes to the Company is still uncertain.

The expiration of a product patent often results in a loss of market exclusivity and, particularly in the United States, can result in very substantial reductions in sales of the patented product. However, in some cases additional commercial benefits may be obtained from

manufacturing trade secrets, later-expiring patents on processes, uses, or formulations, or marketing exclusivity that may be provided by the pharmaceutical regulatory laws in the United States or other countries.

Patent protection for certain products, processes, and uses--particularly that relating to Prozac, Zyprexa, Axid, Humalog, ReoPro, Gemzar, and Evista--is considered to be important to the operations of the Company. The United States compound patent covering Prozac expires in February 2001 and a patent for the process by which Prozac works expires in December 2003. See "Legal Proceedings" at pages 10-11 for a discussion of certain litigation involving these two patents. In other countries, Prozac patents generally either have expired or will expire over the next several years. Other U.S. compound patent expirations include Axid, 2002; Zyprexa, 2011; Humalog, 2013; and ReoPro, 2015. The Gemzar compound patent in the U.S. expires in 2006, but a use patent covering treatment of neoplasms with Gemzar is in force until 2012. The Company holds a number of U.S. patents covering Evista that the Company believes will provide exclusivity in the United States until at least 2012.

Worldwide, all of the Company's major products are sold under trademarks that are considered in the aggregate to be important to the Company. Trademark protection varies widely 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.

The Company also grants licenses under patents and know-how developed by the Company and manufactures and sells products and uses technology and know-how under licenses from others. Royalties paid by the Company in relation to pharmaceuticals amounted to approximately $138 million in 1998 and royalties received were not material.

COMPETITION

The Company's pharmaceutical products compete with products manufactured by many other companies in highly competitive markets in the United States and throughout the world. The Company's animal health products compete on a worldwide basis with products of pharmaceutical, chemical, and other companies that operate animal health divisions or subsidiaries.

Important competitive factors include product efficacy, safety and ease of use, price and demonstrated cost-effectiveness, service, and research and development of new products and processes. The introduction by competitors of new products and processes with therapeutic or cost advantages can result in progressive price reductions or decreased volume of sales of the Company's products, or both. New products introduced with patent protection usually must compete with other products already on the market at the time of introduction or products developed by competitors after introduction. Manufacturers of generic products typically invest far less in research and development than research-based pharmaceutical companies and accordingly are able to price their products significantly lower than branded products. Therefore, upon expiration of market exclusivity, branded products often face intense price competition from generic forms of the product. In many countries outside the United States, patent protection is weak or nonexistent. The growth of managed care and pharmacy benefits management organizations has intensified price competition significantly and has magnified the importance of demonstrating not only medical benefits but also cost advantages as compared with other treatments.

The Company believes its long-term competitive position depends upon the success of its research and development endeavors in discovering and developing innovative products that are clinically- and cost-effective, together with increased productivity resulting from improved manufacturing methods and effective sales and marketing efforts. There can be no assurance that the Company's research and development efforts will result in commercially successful products or that products manufactured or processes used by the Company will not become outmoded from time to time as a result of products or processes developed by its competitors.

GOVERNMENTAL REGULATION

For many years the Company's operations have been regulated extensively by the federal government, to some extent by state governments, and in varying degrees by foreign governments. The Federal Food, Drug, and Cosmetic Act, other federal statutes and regulations, various state statutes and regulations, and laws and regulations of foreign governments govern to varying degrees the testing, approval, production, labeling, distribution, post-market surveillance, advertising, dissemination of information, and promotion of the Company's products. The lengthy process of laboratory testing, clinical testing, data analysis and regulatory review necessary for required governmental approvals is extremely costly and can significantly delay product introductions in a given market. Promotion, marketing and distribution of pharmaceutical products are extensively regulated in all major world markets. In addition, the Company's operations are subject to complex federal, state, local, and foreign environmental and occupational safety laws and regulations. The Company anticipates that compliance with regulations affecting the manufacture and sale of current products and the introduction of new products will continue to require substantial scientific and technical effort, time, and expense and significant capital investment.

In the United States, the Omnibus Budget Reconciliation Act of 1990 requires the Company to provide rebates to state governments on their purchases of certain Company products under state Medicaid programs. Other cost containment measures have been adopted or proposed by federal, state, and local government entities that provide or pay for health care. In most international markets, the Company operates in an environment of government-mandated cost containment programs, which may include price controls, discounts and rebates, restrictions on physician prescription levels, restrictions on reimbursement, compulsory licenses and generic substitution. The Company expects that governments inside and outside the United States will continue to propose and/or adopt a variety of measures to contain health care costs, including pharmaceutical costs, some of which could adversely affect the Company. As an example, there are a number of legislative proposals in the United States at both the state and federal levels intended to provide greater access to drugs for the elderly that effectively would impose controls on the prices at which the Company's products are sold for use by the elderly. The Company cannot predict whether such proposals will be adopted or the extent to which its business may be affected by these or other potential future legislative or regulatory developments.

RESEARCH AND DEVELOPMENT

The Company's research and development activities are responsible for the discovery or development of most of the products the Company offers today. Its commitment to research and development dates back more than 100 years. The Company invests heavily in research and development, which management believes is critical to the Company's long-term competitiveness. The growth in research and development expenditures and personnel over the past several years

demonstrates both the continued vitality of the Company's commitment and the increasing costs and complexity of bringing new products to the market. At the end of 1998, approximately 5,800 people, including a substantial number who are physicians or scientists holding graduate or postgraduate degrees or highly skilled technical personnel, were engaged in pharmaceutical and animal health research and development activities. The Company expended $1.19 billion on these research and development activities in 1996, $1.37 billion in 1997, and $1.74 billion in 1998.

The Company's research is concerned primarily with the effects of synthetic chemicals and natural products on biological systems. The results of that research are applied to develop products to treat diseases in humans and animals. The primary effort is devoted to human pharmaceutical products. The Company concentrates its pharmaceutical research and development efforts in five therapeutic categories: central nervous system and related diseases; endocrine diseases, including diabetes and osteoporosis; infectious diseases; cancer; and cardiovascular diseases. The Company also selectively pursues promising leads in other therapeutic areas. The Company is actively engaged in biotechnology research programs involving recombinant DNA, proteins, and genomics (the development of therapeutics through identification of disease-causing genes and their cellular function).

In addition to the research carried on in the Company's own laboratories, the Company sponsors and underwrites the cost of research and development by independent organizations, including educational institutions and research-based pharmaceutical and biotechnology companies, and contracts with others for the performance of research in their facilities. It utilizes the services of physicians, hospitals, medical schools, and other research organizations in the United States and many other countries to establish through clinical evidence the safety and effectiveness of new products. The Company actively seeks out opportunities to invest in external research and technologies that hold the promise to complement and strengthen the Company's own research efforts. These investments can take many forms, including licensing arrangements, co-development and co-marketing agreements, joint ventures and outright acquisitions.

Extensive work is also conducted in the animal sciences, including animal nutrition and physiology and veterinary medicine. Certain of the Company's research and development activities relating to pharmaceutical products may be applicable to animal health products. An example is the search for agents that will cure infectious disease.

QUALITY ASSURANCE

The Company's success depends in great measure upon customer confidence in the quality of the Company's products and in the integrity of the data that support their safety and effectiveness. The quality of the Company's products arises from the total commitment to quality in all parts of the Company, including research and development, purchasing, facilities planning, manufacturing, and distribution. Quality-assurance procedures have been developed relating to the quality and integrity of the Company's scientific information and production processes.

Control of production processes involves rigid specifications for ingredients, equipment, facilities, manufacturing methods, packaging materials, and labeling. Control tests are made at various stages of production processes and on the final product to assure that the product meets all regulatory requirements and the Company's standards. These tests may involve chemical and physical chemical analyses, microbiological testing, testing in animals, or a combination of these tests. Additional assurance of quality is provided by a corporate quality-assurance group that

monitors existing pharmaceutical and animal health manufacturing procedures and systems in the parent company, subsidiaries, and affiliates.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information regarding the executive officers of the Company. All but two of the executive officers have been employed by the Company in executive or managerial positions during the last five years. Charles E. Golden joined the Company as Executive Vice President and Chief Financial Officer and was elected to the Board of Directors in March 1996. He previously had held a number of executive positions with General Motors Corporation ("GM") including Vice President of GM and Chairman and Managing Director of Vauxhall Motors Limited, a GM subsidiary in the United Kingdom, from 1993 to 1996, Vice President and Treasurer from 1992 to 1993, and Treasurer from 1989 to 1992. Thomas Trainer joined the Company in January 1995. Since 1991 he had served as Vice President and Chief Information Officer of Reebok International Ltd.

Except as indicated in the following table, the term of office for each executive officer expires on the date of the annual meeting of the Board of Directors, to be held on April 19, 1999, or on the date his or her successor is chosen and qualified. No director or executive officer of the Company has a "family relationship" with any other director or executive officer of the Company, as that term is defined for purposes of this disclosure requirement. There is no understanding between any executive officer of the Company and any other person pursuant to which the executive officer was selected.

NAME	AGE	OFFICES
Randall L. Tobias	57	Former Chairman of the Board (retired as a director and employee December 31, 1998)
Sidney Taurel	50	Chairman of the Board (since January 1999), President and Chief Executive Officer (since June 1998) and a Director
Charles E. Golden	52	Executive Vice President and Chief Financial Officer (since March 1996) and a Director
August M. Watanabe, M.D.	57	Executive Vice President, Science and Technology (since February 1996) and a Director
Mitchell E. Daniels, Jr.	49	Senior Vice President, Corporate Strategy and Policy (since June 1998)
Rebecca O. Goss	51	Senior Vice President and General Counsel (since June 1998)
Pedro P. Granadillo	51	Senior Vice President, Human Resources and Manufacturing (since June 1998)

NAME	AGE	OFFICES
John C. Lechleiter	45	Senior Vice President, Pharmaceutical Products (since June 1998)
Bryce D. Carmine	47	President, SERM and Skeletal Products (since March 1999)*
Alan S. Clark	64	Former President, U.S. Operations and Global Marketing (since January 1997) (retiring April 1999)
Michael L. Eagle	51	Vice President, Manufacturing (since January 1994)*
Brendan P. Fox, D.V.M.	55	President, Elanco Animal Health (since January 1991)*
James A. Harper	51	President, Diabetes and Growth Disorders Products (since August 1994)*
Gerhard N. Mayr	52	President, Intercontinental Operations (since September 1997)*
Richard D. Pilnik	42	Vice President, Global Marketing (since January 1998)*
Robert N. Postlethwait	50	Former President, Neuroscience Products (since August 1994) (retiring May 1999)
William R. Ringo, Jr.	53	President, Internal Medicine Products (since January 1998)*
Gino Santini	42	President, U.S. Operations and Global Marketing (since March 1999)*
Gary Tollefson, M.D., Ph.D.	48	President, Neuroscience Products (since January 1999)*
Thomas Trainer	52	Former Vice President, Information Technology, and Chief Information Officer (since January 1995) (resigned March 1999)
Albertus Van den Bergh	45	President, European Operations (since September 1997)*

EMPLOYEES

At the end of 1998, the Company had approximately 29,800 employees (excluding PCS), including approximately 15,400 employees outside the United States. A substantial number of the Company's employees have long records of continuous service.

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* Serves in office until successor is appointed.

FINANCIAL INFORMATION RELATING TO FOREIGN AND DOMESTIC OPERATIONS

Financial information relating to foreign and domestic operations, set forth in the Company's 1998 Annual Report at page 43 under "Segment Information" (page 6 of Exhibit 13), is incorporated herein by reference.

Local restrictions on the transfer of funds from branches and subsidiaries located abroad (including the availability of dollar exchange) have not to date been a significant deterrent in the Company's overall operations abroad. The Company cannot predict what effect these restrictions or the other risks inherent in foreign operations, including possible nationalization, might have on its future operations or what other restrictions may be imposed in the future. In addition, changing currency values can either favorably or unfavorably affect the financial position and results of operations of the Company. The Company actively manages its foreign exchange risk through various hedging techniques including the use of foreign currency contracts.

Item 2. PROPERTIES

The Company's principal domestic and international executive offices are located in Indianapolis. At December 31, 1998, the Company owned 14 production and distribution facilities in the United States and Puerto Rico. Together with the corporate administrative offices, these facilities contain an aggregate of approximately 9.5 million square feet of floor area dedicated to production, distribution and administration. Major production sites include Indianapolis; Clinton and Lafayette, Indiana; and Carolina and Mayaguez, Puerto Rico. The Company also leases sales offices in a number of cities located in the United States and abroad.

The Company owns production and distribution facilities in 19 countries outside the United States and Puerto Rico, containing an aggregate of approximately 4.1 million square feet of floor space. Major production sites include facilities in the United Kingdom, France, Spain, Ireland, Brazil, Mexico, and Italy. Leased production and warehouse facilities are utilized in Puerto Rico and 18 countries outside the United States.

The Company's research and development facilities in the United States consist of approximately 3.8 million square feet and are located primarily in Indianapolis and Greenfield, Indiana. Its major research and development facilities abroad are located in Belgium, Germany, and the United Kingdom and contain approximately 387,000 square feet.

The Company believes that none of its properties is subject to any encumbrance, easement, or other restriction that would detract materially from its value or impair its use in the operation of the business of the Company. The buildings owned by the Company are of varying ages and in good condition.

Item 3. LEGAL PROCEEDINGS

Prozac Patent Litigation. In March 1996 the Company was informed by Barr Laboratories, Inc. ("Barr"), a generic pharmaceutical manufacturer, that it had submitted an abbreviated new drug application ("ANDA") to the U.S. FDA seeking to market a generic form of Prozac in the United States several years before the expiration of the Company's patents. Barr has alleged that

the Company's U.S. patents covering Prozac are invalid and unenforceable. The compound patent expires in February 2001 and a patent for the process by which Prozac operates expires in December 2003. These patents are material to the Company.

On April 11, 1996, the Company filed suit in the United States District Court for the Southern District of Indiana seeking a ruling that Barr's challenge to the Company's patents is without merit. In 1997, the Company was informed that Geneva Pharmaceuticals, Inc. ("Geneva"), another generic manufacturer, had submitted a similar ANDA and, like Barr, had asserted that the Company's U.S. Prozac patents are invalid and unenforceable. On June 23, 1997, the Company sued Geneva in the same court seeking a similar ruling as in the Barr suit. The two suits have been consolidated. On January 12, 1999, the trial court judge for the Southern District of Indiana granted partial summary judgment in favor of the Company, dismissing the claims of Barr and Geneva based on the patent doctrines of "best mode" and "double patenting." On January 25, 1999 (the day trial was to have begun), Barr and Geneva agreed to abandon their remaining two claims (based on the patent doctrines of "anticipation" and "inequitable conduct") in exchange for a payment of $4 million to be shared among Barr, Geneva, and a third defendant, Apotex, Inc. Barr and Geneva have appealed the trial court's January 12, 1999 rulings to the Court of Appeals for the Federal Circuit.

In late 1998, three additional generic manufacturers, Zenith Goldline Pharmaceuticals, Inc., Teva Pharmaceuticals USA, and Cheminor Drugs, Ltd. together with one of its subsidiaries filed ANDAs for generic forms of Prozac, asserting that the Company's December 2003 patent is invalid and unenforceable. Finally, in January 1999, Novex Pharma, a division of Apotex, Inc. filed an ANDA asserting that both the 2001 and 2003 patents are invalid and unenforceable. The Company has filed lawsuits in the United States District Court of the Southern District of Indiana seeking rulings that the four companies' challenges to the patent(s) are without merit. These suits are in the preliminary stages.

The Company believes that the claims of the six generic manufacturers are without merit and that the Company should be successful in this litigation. However, it is not possible to predict or determine the outcome of this litigation and accordingly there can be no assurance that the Company will prevail. An unfavorable outcome could have a material adverse effect on the Company's consolidated financial position, liquidity, or results of operations.

Product Liability Litigation. The Company is currently a defendant in a variety of product liability litigation matters involving primarily diethylstilbestrol ("DES") and Prozac. In approximately 100 actions, including several with multiple claimants, plaintiffs seek to recover damages on behalf of children or grandchildren of women who ingested DES during pregnancy. In another approximately 10 actions, plaintiffs seek to recover damages as a result of the ingestion of Prozac.

Pricing Litigation. The Company has been named, together with numerous other U.S. prescription pharmaceutical manufacturers and in some cases wholesalers or distributors, as a defendant in a large number of related actions brought by retail pharmacies and consumers of prescription pharmaceuticals in the United States alleging violations of federal or state antitrust laws, or both, based on the practice of providing discounts or rebates to managed-care organizations and certain other purchasers. The federal cases have been consolidated or coordinated in the Northern District of Illinois as In re Brand Name Prescription Drugs Antitrust Litigation (MDL No. 997).

The federal suits include a certified class action on behalf of a majority of retail pharmacies in the United States (the "Federal Class Action"). The class plaintiffs allege an industrywide agreement in violation of the Sherman Act to deny favorable pricing on sales of brand-name prescription pharmaceuticals to certain retail pharmacies in the United States. The other federal suits (the "Federal Individual Actions"), brought as individual claims by several thousand pharmacies, allege price discrimination in violation of the Robinson-Patman Act as well as Sherman Act claims. The suits seek treble damages and injunctive relief against allegedly discriminatory pricing practices.

In 1995, the Company and several other manufacturers agreed with the plaintiffs to settle the Federal Class Action. In addition, in 1997 and again in 1998 the Company reached settlements with two large groups of retail pharmacy and supermarket chains that were plaintiffs in the Federal Individual Actions. As a result of the various settlements, the claims of the great majority of the U.S. retailers are now dismissed. With respect to the remaining Federal Individual Actions, the District Court has designated certain plaintiffs and defendants named in the individual suits (not including the Company) to participate in an initial trial or trials of the claims. No trial dates have been set. Robinson-Patman claims asserted in the Federal Individual Actions against nondesignated defendants, including the Company, are stayed.

In addition, a number of related state court cases were filed. The state court suits typically seek money damages and injunctive relief against allegedly discriminatory pricing practices. Cases were brought in Alabama, California, Minnesota, Mississippi, and Wisconsin by retail pharmacies alleging violations of various state antitrust and pricing laws, purporting to be class actions on behalf of all retail pharmacies in those states. Settlements have been approved in Minnesota and Wisconsin and the cases in those states are now dismissed. Cases were also brought in state courts in Alabama, Arizona, California, District of Columbia, Florida, Kansas, Maine, Michigan, Minnesota, New York, North Carolina, Tennessee, and Wisconsin that purport to be class actions on behalf of consumers of prescription pharmaceuticals, alleging violations of state antitrust, pricing or consumer protection laws. In all states except Alabama and Tennessee, settlements in those cases have been approved and the cases dismissed.

Other Matters. In March 1996, the Federal Trade Commission ("FTC") commenced a non-public investigation focusing on the pricing practices described under "Pricing Litigation" above. The Company has responded to two subpoenas from the FTC requesting production of certain documents and other discovery responses. The Company believes that all of its actions have been lawful and proper and is cooperating with the investigation.

The Company is also a defendant in other litigation, including product liability and patent suits, of a character regarded as normal to its business.

While it is not possible to predict or determine the outcome of the legal actions and investigations pending against the Company, the Company believes that except as noted above, the costs associated with all such matters will not have a material adverse effect on its consolidated financial position or liquidity but could possibly be material to the consolidated results of operations in any one accounting period.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of 1998, no matters were submitted to a vote of security holders.

PART II

Item 5. MARKET FOR THE COMPANY'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Information relating to the principal market for the Company's common stock and related stockholder matters, set forth in the Company's 1998 Annual Report under "Selected Quarterly Data (unaudited)," at page 44 (pages 7-8 of Exhibit 13), and "Selected Financial Data (unaudited)," at page 45 (page 9 of Exhibit 13), is incorporated herein by reference.

Item 6. SELECTED FINANCIAL DATA

Selected financial data for each of the Company's five most recent fiscal years, set forth in the Company's 1998 Annual Report under "Selected Financial Data (unaudited)," at page 45 (page 9 of Exhibit 13), are incorporated herein by reference.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

REVIEW OF OPERATIONS

Sale of PCS Health-Care-Management Business

In November 1998, the Company signed a definitive agreement to sell to Rite Aid Corporation the Company's PCS health-care-management subsidiary for $1.60 billion in cash. The sale, which was completed in January 1999, will allow the Company to further focus on pharmaceutical innovation and the realization of optimal demand for Company products in the marketplace. As a consequence of the divestiture, the operating results of PCS have been reflected as "discontinued operations" in the Company's financial statements for all periods and have been excluded from consolidated sales and expenses reflected therein. The net gain on disposal will be recognized in the first quarter of 1999. See Note 3 to the consolidated financial statements for further discussion.

Operating Results From Continuing Operations--1998

Income from continuing operations (before the 1998 extraordinary charge of $7.2 million, or $.01 per share) was $2.10 billion, or $1.87 per share, in 1998 and $2.02 billion, or $1.78 per share, in 1997. Comparisons between 1998 and 1997 are made difficult by the impact of several unusual transactions that are reflected in the Company's operating results for both years. Excluding these unusual items, which are discussed further below, income from continuing operations before extraordinary item for 1998 and 1997 would have been $2.17 billion, or $1.94

per share, and $1.83 billion, or $1.62 per share, respectively. This represents an increase in earnings and earnings per share of 19 percent and 20 percent, respectively. The 1998 increases are attributed to increased sales, improved gross margin, reduced interest expense and a lower effective tax rate, partially offset by increases in operating expenses.

During 1998, the Company announced a collaboration with ICOS Corporation to jointly develop and globally commercialize a phosphodiesterase type 5 (PDE5) inhibitor as an oral therapeutic agent for the treatment of both male and female sexual dysfunction. The compound is in the development phase (Phase II clinical trials) and no alternative future uses have been identified. As with many Phase II compounds, launch of the product, if successful, would not be expected in the near term. Accordingly, under current accounting rules, the Company's payments to acquire rights to this compound were required to be charged as a one-time expense of $127.5 million, which reduced earnings per share by approximately $.07 net of tax. The Company's reported tax rate was also affected by this item.

The Company's reported results from continuing operations for 1997 include the following unusual transactions: a pretax gain of $631.8 million from the sale of the Company's interest in the DowElanco joint venture, a $97.8 million noncash charge for an asset impairment as discussed further in the 1997 operating results section, a charge for the settlement of a significant portion of the Company's remaining retail pharmacy pricing litigation, and a $24.1 million charge for the discontinuance of the research collaboration with Somatogen, Inc. The Company's reported tax rate for 1997 was also affected by these transactions.

The Company's sales for 1998 increased 16 percent, to $9.24 billion. Sales in the U.S. were $5.84 billion, a 20 percent increase, while sales outside the U.S. were $3.40 billion, a 9 percent increase. Worldwide sales reflected volume growth of 15.3 percent and a 2.1 percent increase in selling prices, which were partially offset by an unfavorable exchange rate impact of 1.8 percent.

Worldwide pharmaceutical sales increased 17 percent, to $8.62 billion. Sales growth was led by four of the Company's newer products: Zyprexa, a treatment for schizophrenia and related psychoses; the cardiovascular agent ReoPro; the oncolytic product Gemzar; and the osteoporosis prevention agent Evista, which was launched in the first quarter of 1998; as well as the antidepressant Prozac. Revenue growth was partially offset by lower sales of anti-infective products and the antiulcer agent Axid due to continuing generic competition and other competitive pressures. Total U.S. pharmaceutical sales increased 20 percent, to $5.55 billion. Growth was driven primarily by increased volumes. International pharmaceutical sales increased 10 percent, to $3.07 billion. Strong volume growth drove the increase, offset by the effect of unfavorable exchange rates with selling prices remaining relatively stable. The adverse exchange rate impact in the Asia-Pacific region did not have a material impact on worldwide sales in 1998. The Company expects that the deterioration of the Brazilian economy will have a slight adverse impact on 1999 sales and net income due to a combination of the negative impact of the changing exchange rates and weakening local demand.

Worldwide sales of Prozac in 1998 were $2.81 billion, representing an increase of 10 percent. Prozac sales in the U.S. increased 13 percent, to $2.27 billion. Sales of Prozac outside the U.S. were substantially the same as 1997. Continued competitive pressures affected sales globally. In addition, during the first quarter of 1999 it became apparent that U.S. wholesaler stocking in late 1998 would have a greater negative impact on 1999 sales than had been anticipated. Based on the 1999 results to date, the Company now anticipates only slight growth in worldwide Prozac sales in 1999. The actual sales levels will depend upon the effectiveness of

the Company's marketing efforts in offsetting increased competition, the rate of growth of the antidepressant market, and U.S. wholesaler stocking patterns.

Zyprexa posted worldwide sales of $1.44 billion in 1998, representing an increase of 98 percent. U.S. sales of Zyprexa increased 91 percent, to $1.12 billion. Sales outside the U.S. increased 127 percent, to $317.9 million. Sales comparisons for Zyprexa benefited to some extent from U.S wholesaler stocking in the fourth quarter of 1998. The Company expects continued strong sales growth for Zyprexa in 1999 but at a lower percentage than in 1998.

Worldwide insulin sales, composed of Humulin, the Company's biosynthetic human insulin; Humalog, the Company's insulin analog; and the animal-source insulin Iletin, increased 8 percent, to $1.15 billion, in 1998. Insulin sales in the U.S. increased 4 percent, to $701.5 million. Insulin sales outside the U.S. increased 14 percent, to $453.4 million. Worldwide Humulin sales increased 3 percent. U.S. Humulin sales were flat compared with 1997 as they were affected by both increased sales of Humalog and competition from oral antidiabetic agents. Humulin sales outside the U.S. increased 8 percent. Worldwide Humalog sales were $129.6 million, representing an increase of 91 percent, or $61.9 million, over 1997. Iletin sales were essentially flat compared with 1997. The Company expects moderate growth in worldwide insulin sales in 1999.

Worldwide sales of anti-infectives decreased 9 percent, to $1.16 billion. U.S. and international anti-infectives sales declined 20 percent and 4 percent, respectively. These declines were due, in part, to continued generic competition in certain markets and the impact of unfavorable exchange rates. Cefaclor, Lorabid, and Vancocin accounted for the majority of the decline in anti-infectives sales with declines of 10 percent, 14 percent and 5 percent, respectively. The Company anticipates that 1999 worldwide sales of anti-infectives will be below 1998 levels largely due to continued pricing pressures as a result of generic competition.

Worldwide Axid sales decreased 20 percent, to $418.0 million, due to continuing competition from other branded and generic antiulcer agents. The Company expects a continued decline in Axid sales in 1999.

As mentioned above, the newer products ReoPro and Gemzar, along with Evista, which was launched in the first quarter of 1998, contributed significantly to worldwide sales growth. Worldwide ReoPro sales of $365.4 million reflected an increase of 44 percent. Worldwide Gemzar sales increased 76 percent, to $306.8 million. The Company expects the sales of both ReoPro and Gemzar to increase in 1999 but at a lower rate than in 1998. Evista had worldwide sales of $144.1 million and had been introduced in approximately 20 countries by the end of 1998. Sales of Evista benefited somewhat from U.S. wholesaler stocking in the fourth quarter of 1998. The Company anticipates strong growth in worldwide Evista sales for 1999.

Worldwide sales of animal health products increased 4 percent, to $614.4 million. Sales increased 7 percent in the U.S. and 2 percent outside the U.S. The worldwide sales growth was driven primarily by Micotil, an antibiotic for bovine respiratory disease; Tylan, an antibiotic for promoting feed efficiency and growth in swine and cattle; and Surmax, a feed additive performance enhancer for poultry. Weakness in the general economic condition of the Asia-Pacific region negatively affected sales of animal health products outside the U.S. These products have a greater sensitivity to adverse economic conditions in the Asia-Pacific region than pharmaceutical products.

The Company's payments under federally mandated Medicaid rebate programs reduced 1998 sales by approximately $278.6 million compared with approximately $199.1 million in 1997. The Company anticipates that Medicaid rebates will increase in 1999 due, in part, to the continuing growth in Zyprexa sales.

The gross margin improved to 78.2 percent of sales compared with 75.6 percent for 1997. This increase was primarily the result of favorable changes in product mix and productivity improvements. The Company anticipates that the gross margin percentage will continue to improve in 1999 due largely to favorable product mix and the expiration of a royalty obligation on Humulin and Humalog sales in August 1998.

Operating expenses (the aggregate of research and development and marketing and administrative expenses) for 1998, excluding the effect of the one-time expenses for acquired in-process technology related to the ICOS collaboration, increased 22 percent. The increase reflects a 27 percent growth rate in research and development, to $1.74 billion. This growth is the result of greater investments in both internal research efforts and external research collaborations. The Company expects research and development expenses in 1999 to increase at a significantly lower rate but still approximating that of sales growth. The actual 1999 increase will vary depending upon a number of factors, particularly the level of research collaboration activity. Marketing and administrative expenses increased 19 percent, to $2.66 billion. This increase was driven by increased expenditures to support continued new product launches around the world, including the U.S. launch of Evista and direct-to-consumer advertising campaigns in the U.S. In addition to the above, operating expenses were also affected by investments in the Company's global information technology capabilities, which include expenditures relating to the Company's Year 2000 computer initiatives and increased compensation accruals due to the Company's performance-based bonus programs. The Company expects marketing and administrative expenses to increase at a significantly lower rate in 1999, due in part to expense-management programs initiated in early 1999.

Interest expense in 1998 decreased $51.4 million, or 22 percent, due largely to declines in the Company's borrowings.

Net other income for 1998 was $149.3 million, a decrease of $12.1 million from 1997. Net other income in 1998 benefited from gains on the sale of certain investments and increased interest income. Also, in comparison with 1997, 1998 benefited from the inclusion in the 1997 amount of the charges associated with the discontinuance of a collaboration with Somatogen, Inc. These increases were more than offset by the absence of both DowElanco joint venture income and certain license fee income in 1998.

The Company's effective tax rate for 1998 was 21.3 percent compared with 30.5 percent for 1997. The Company's 1997 effective tax rate was distorted by the gain from the sale of DowElanco and the asset impairment charge. The Company's tax rate for 1997, excluding the impact of these items, was 24.1 percent. Excluding the ICOS transaction discussed previously, the Company's effective tax rate for 1998 was 22.2 percent. The lower 1998 rate is primarily the result of changes in the mix of earnings between jurisdictions with lower tax rates and those with higher rates. The Company expects that a tax rate in the range of 22 percent to 22.5 percent will be sustainable under present law for the near term. See Note 11 to the consolidated financial statements for additional information.

The Company refinanced an ESOP debenture during 1998. An extraordinary charge of $7.2 million, net of a $4.8 million income tax benefit, was recorded as a result of this refinancing.

Operating Results From Continuing Operations--1997

The Company's operating results from continuing operations for both 1997 and 1996 reflect the impact of several unusual transactions that make comparisons difficult. As noted above, the Company's reported results from continuing operations for 1997 include several unusual transactions. As a consequence of these transactions, 1997 income from continuing operations was $2.02 billion, or $1.78 per share. This compares with income from continuing operations in 1996 of $1.63 billion, or $1.45 per share.

Excluding the unusual items noted previously, income from continuing operations for 1997 would have been $1.83 billion, or $1.62 per share. After excluding the income from the sale of the U.S. marketing rights for Ceclor CD and Keftab to Dura Pharmaceuticals, Inc., from the 1996 amounts, 1997 income and earnings per share from continuing operations, without the unusual items, reflect increases from 1996 of 18 and 17 percent, respectively. The 1997 increases are attributed to increased sales, improved gross margin and reduced interest expense, partially offset by decreased other income.

The Company's sales for 1997 increased 14 percent, to $7.99 billion. Sales in the U.S. were $4.88 billion, a 25 percent increase, while sales outside the U.S. were $3.11 billion, a 1 percent increase. Worldwide sales volume growth of 16 percent and a 2 percent increase in global selling prices were partially offset by unfavorable exchange rates, which decreased sales by 4 percent.

Worldwide pharmaceutical sales increased 15 percent, to $7.39 billion. The sales growth was led by three of the Company's newer products, Zyprexa, ReoPro and Gemzar, as well as increased sales of Prozac and insulin products. The 1997 growth was achieved despite lower sales of anti-infective products. Total U.S. pharmaceutical sales increased 25 percent, to $4.61 billion, primarily as a result of increased volume. International pharmaceutical sales increased 1 percent, to $2.78 billion. Sales volume growth outside the U.S. of 12 percent was offset largely by unfavorable exchange rates (9 percent) and decreased selling prices (2 percent).

Worldwide sales of Prozac in 1997 were $2.56 billion, an increase of 8 percent. Prozac sales in the U.S. increased 17 percent, to $2.02 billion. International sales of Prozac experienced a decline of 14 percent due largely to the effects of unfavorable exchange rates, continuing generic competition in Canada and competitive pressures in France.

Three of the Company's newer products contributed significantly to the worldwide sales growth. Specifically, in 1997, Zyprexa, launched in the fourth quarter of 1996, contributed $729.9 million to worldwide sales and $589.7 million to U.S. sales, which represent increases of $643.0 million and $511.4 million, respectively. ReoPro, launched in 1995, reported worldwide sales of $254.4 million, reflecting an increase of $105.1 million. Worldwide sales of Gemzar, launched in the U.S. in May 1996, grew to $174.8 million, representing an increase over 1996 of $112.9 million.

Worldwide insulin sales in 1997 increased 9 percent, to $1.07 billion. Insulin sales in the U.S. increased 6 percent, to $673.8 million, and insulin sales outside the U.S. increased 14 percent, to $398.2 million. Worldwide sales of Humulin increased 6 percent, to $934.9 million, for 1997. U.S. Humulin sales increased 4 percent, to $585.7 million, with growth due to

wholesaler buying patterns being offset partially by the combined effect of competition from oral antidiabetic agents and increased sales of Humalog. International Humulin sales increased 9 percent.

Among other major products, worldwide sales of Axid decreased 1 percent, to $525.4 million. Axid sales declined 2 percent in the U.S. and increased 3 percent outside the U.S. Worldwide sales of the human growth hormone Humatrope declined 3 percent.

Compared with 1996, worldwide anti-infectives sales in 1997 decreased $193.1 million (13 percent). This decline was due primarily to continued generic competition in certain markets and the impact of unfavorable exchange rates. Sales of cefaclor decreased 18 percent, to $442.2 million, accounting for the majority of this decline. Both U.S. and international anti-infectives sales reflected declines.

Worldwide sales of animal health products increased 8 percent over 1996, driven by volume growth of 10 percent. Sales increased 15 percent in the U.S. and 2 percent outside the U.S. The worldwide sales increase was primarily due to increased sales of Micotil and Tylan.

The Company's payments under federally mandated Medicaid rebate programs reduced 1997 sales by approximately $199.1 million.

Gross margin improved to 75.6 percent of sales compared with 73.2 percent for 1996. This increase was primarily the result of favorable product mix, production efficiencies and procurement savings.

Research and development expenses in 1997 increased 15 percent. Expenses in support of global clinical trials, as well as an increase in external research collaborations relating to the discovery and development of new technologies, compounds and delivery systems, drove this increase.

Marketing and administrative expenses increased 18 percent over 1996. Overall, the increase was largely due to increased expenditures to support continued new product launches around the world, including the January 1998 launch of Evista, the Prozac direct-to-consumer advertising campaign, investments in the Company's global information technology capabilities and increased compensation accruals due to the Company's performance-based bonus programs. The charge for the settlement of a significant portion of the Company's remaining retail pharmacy pricing litigation also contributed to the 1997 increase.

The asset impairment represents a pretax noncash charge of $97.8 million, recorded in the second quarter of 1997, primarily to adjust to their fair value the carrying value of certain long-lived assets of a small portion of the Company's health-care-management business that was not sold. Fair value was determined based upon anticipated future cash flows, discounted at a rate commensurate with the risk involved. This business is now part of a joint venture, the results of which are immaterial to the consolidated financial statements.

On June 30, 1997, The Dow Chemical Company acquired the Company's 40 percent interest in the DowElanco joint venture. The cash purchase price was $1.2 billion, resulting in an after-tax gain of $303.5 million, or $.27 per share.

Interest expense in 1997 decreased $55.3 million (19 percent) due primarily to a decline in the Company's borrowings.

Net other income for 1997 amounted to $161.4 million, which was $213.6 million lower than in 1996. The decrease was primarily the result of several nonrecurring items reflected in the 1996 amount, including the sale of the U.S. marketing rights for Ceclor CD and Keftab ($91.8 million), income from codevelopment and comarketing contracts, the sale of marketing rights for ReoPro in Japan and Tapazole(R) in the U.S., and a higher level of sales of certain equity securities held by the Company. Net other income for 1997 benefited from income from outlicensing activity. These increases were partially offset by the charge for the discontinuance of the collaboration with Somatogen, Inc.

The Company's reported tax rates for 1997 reflect the effects of the unusual transactions that occurred during the year. The Company's 1997 tax rate, excluding the impact of these items, was 24.1 percent compared with the 1996 tax rate of 23.7 percent.

Discontinued Operations

Discontinued operations consists of the Company's PCS health-care-management business. As noted previously, in November 1998, the Company entered into an agreement to sell PCS for $1.6 billion in cash. The sale was closed in January 1999 and the resulting net gain on disposal will be recognized in the first quarter of 1999. See Note 3 to the consolidated financial statements for further information.

In the second quarter of 1997, the Company recognized an asset impairment (a noncash charge) of approximately $2.3 billion to adjust the carrying value of PCS's long-lived assets, primarily goodwill, to their fair value of approximately $1.5 billion. The Company determined that PCS's estimated future undiscounted cash flows were below the carrying value of PCS's long-lived assets. As a consequence, the carrying value was adjusted to estimated fair value based on anticipated future cash flows, discounted at a rate commensurate with the risk involved.

Financial Condition

As of December 31, 1998, cash, cash equivalents and short-term investments totaled approximately $1.60 billion compared with $2.02 billion at December 31, 1997. Total debt at December 31, 1998, was $2.37 billion, a decrease of $186.8 million. The decrease in cash was due primarily to stock repurchases and repayment of debt. The Company has completed its previously announced $2 billion share repurchase, acquiring approximately 28.3 million shares in 1998. The Company expects to repurchase shares costing approximately $1 billion in 1999. The Company believes that cash generated from operations, along with available cash and cash equivalents, will be sufficient to fund essentially all the Company's operating needs, including debt service, capital expenditures, share repurchases and dividends in 1999. The Company anticipates using the proceeds from the sale of PCS in 1999 for general corporate purposes.

The Company believes that amounts available through existing commercial paper programs should be adequate to fund maturities of short-term borrowings. The outstanding commercial paper is also backed by $2 billion of committed bank credit facilities.

In the normal course of business, operations of the Company are exposed to fluctuations in currency values and interest rates. These fluctuations can vary the costs of financing, investing

and operating. The Company addresses 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.

The Company's primary interest rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest rate exposures, the Company strives to achieve an acceptable balance between fixed and floating rate debt positions and may enter into interest rate swaps to help maintain that balance. Based on the Company's overall interest rate exposure at December 31, 1998, 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, 1998, would have no material impact on earnings, cash flows or fair values of interest rate risk sensitive instruments over a one-year period. Similarly, a hypothetical 10 percent change in interest rates from 1997 applied to the fair value of the instruments as of December 31, 1997, would have had no material impact on earnings, cash flows or fair values of interest rate risk sensitive instruments during 1998.

The Company's foreign currency risk exposure results from fluctuating currency exchange rates, primarily the strengthening of the U.S. dollar against the Japanese yen and European currencies. The Company faces transactional currency exposures that arise when its foreign subsidiaries (or the Company itself) enter into transactions, generally on an intercompany basis, denominated in currencies other than their local currency. The Company also faces currency exposure that arises from translating the results of its global operations to the U.S. dollar at exchange rates that have fluctuated from the beginning of the period. The Company uses forward contracts and purchased options to manage its foreign currency exposures. Company policy outlines the minimum and maximum hedge coverage of such exposures. Gains and losses on these derivative positions offset, in part, the impact of currency fluctuations on the existing assets, liabilities, commitments and anticipated revenues. Considering the Company's derivative financial instruments outstanding at December 31, 1998, a hypothetical 10 percent weakening in the exchange rates (primarily against the U.S. dollar) over a one-year period would decrease earnings by $26.1 million, while a 10 percent strengthening in the exchange rates would increase earnings by $45.9 million. Comparatively, considering the Company's derivative financial instruments outstanding at December 31, 1997, a hypothetical 10 percent weakening in the exchange rates (primarily against the U.S. dollar) over a one-year period would have decreased earnings by $51.0 million, while a 10 percent strengthening in the exchange rates would have increased earnings by $67.8 million. This calculation does not reflect the impact of exchange gains/losses on the underlying positions that would be offset, in part, by the results of the derivative instruments.

In connection with the sale of the Company's PCS subsidiary, PCS repurchased the Class B stock that had been sold to an institutional investor in 1997. See Note 9 to the consolidated financial statements for additional information.

Capital expenditures of $419.9 million during 1998 were $53.6 million more than in 1997 as the Company continued to invest in research and development initiatives and related infrastructure. The Company expects near-term capital expenditures to increase from 1998 levels but to remain well below the historical peaks of the early 1990s. Sufficient cash flows exist to meet these near-term requirements.

Dividends of $.80 per share were paid in 1998, an increase of approximately 8 percent from the $.74 per share paid in 1997. In the fourth quarter of 1998, effective for the first quarter dividend in 1999, the quarterly dividend was increased $.03 per share (15 percent), resulting in an indicated annual rate for 1999 of $.92 per share. The year 1998 was the 114th consecutive year in which the Company made dividend payments and the 31st consecutive year in which dividends have been increased.

Year 2000 Readiness Disclosure

Many of the Company's global information technology (IT) systems and non-IT systems, including laboratory and process automation devices, will require modification or replacement in order to render the systems ready for the year 2000 (Y2K). In late 1996, the Company initiated a comprehensive program to reduce the likelihood of a material impact on the business. The numerous activities that are intended to enable the Company to obtain Y2K readiness utilize both internal and external resources and are being centrally managed through a program office. Monthly reports are made to senior management and a business council comprising various management representatives. In addition, regular reports are made to the audit committee of the board of directors.

The Company's inventory of IT systems, including software applications, has been divided into various categories. Those most critical to the Company's global operations are generally being assessed and renovated, when necessary, first. The Company has instituted a process to monitor all critical and essential replacement and upgrade projects of existing systems to assist in managing them toward completion in a timely manner. The Company has completed renovation of approximately 95 percent of its critical applications. The Company anticipates that substantially all the remaining critical applications will be completed by March 31, 1999. Of applications deemed essential, the Company anticipates Y2K readiness of approximately 95 percent by June 30, 1999.

The most important non-IT systems are various laboratory and process automation devices. The Company has completed a global assessment of all devices. Based on this assessment, only a small percentage (10 percent to 13 percent) of all automation devices appear to require upgrade or replacement. The Company has begun the process of either remediating or replacing these devices and anticipates that this process will be substantially complete by mid-1999.

The representatives of the program office have visited numerous global sites to assess the progress being made toward site readiness. In addition, several global training programs have occurred to foster the consistent application of the chosen methodologies.

The Company has also mailed letters to thousands of vendors, service providers and customers to determine the extent to which they are prepared for the Year 2000 issue. These activities are being coordinated through a global network of regional site and functional coordinators. Many responses have been received and the Company is identifying the vendors, service providers and customers that are critical to Lilly through a business impact analysis. Follow-up interviews are more thoroughly assessing their readiness.

The Company has begun, but not yet completed, a comprehensive analysis of the operational problems and costs (including loss of revenues) that would be reasonably likely to result from the failure by the Company and certain third parties to complete efforts necessary to achieve Year 2000 compliance on a timely basis or from abnormal wholesaler or consumer buying patterns in

anticipation of the Year 2000. Contingency plans are beginning to be developed for the Company and its critical vendors, customers and suppliers to address the flow of products to the consumer. The contingency planning involves a multifaceted approach, which may include additional purchases of raw materials, manufacturing additional finished stock of critical products and/or locating inventories of products closer to the consumer. Business continuity plans will be developed to address the Company's approach for dealing with extended disruptions. In addition, "rapid response" teams will be established to respond to any issues that occur around the millennium. The Company currently plans to complete analysis and have contingency plans in place by September 30, 1999.

The costs of the Company's Year 2000 efforts are based upon management's best estimates, which are derived using numerous assumptions regarding future events, including the continued availability of certain resources, third-party remediation plans and other factors. There can be no assurance that these estimates will prove to be accurate, and actual results could differ materially from those currently anticipated. The Company currently estimates it will spend between $160 and $190 million over the life of the program and that approximately 55 percent to 60 percent of the anticipated costs were incurred by the end of 1998. Expenses associated with addressing the Year 2000 issues are being recognized as incurred.

The failure to correct a material Year 2000 problem could result in an interruption in, or a failure of, certain normal business activities or operations. Such failures could materially and adversely affect the Company's results of operations. Due to the uncertainty inherent in the Year 2000 problem, the Company is unable to determine, at this time, whether the consequences of Year 2000 failures will have a material impact on the Company's results of operations. The Year 2000 project is expected to significantly reduce the Company's level of uncertainty about the Year 2000 problem and, in particular, about the Year 2000 compliance and readiness of its vendors, service suppliers and customers. The Company believes that, with the completion of the project as scheduled, the possibility of a material interruption of normal operations should be reduced.

Euro Conversion

On January 1, 1999, 11 European nations adopted a common currency, the euro, and formed the European Economic and Monetary Union (EMU). For a three-year transition period, both the euro and individual participants' currencies will remain in circulation. After July 1, 2002, at the latest, the euro will be the sole legal tender for EMU countries. The adoption of the euro will affect a multitude of financial systems and business applications as the commerce of these nations will be transacted in the euro and the existing national currency.

The Company is currently addressing euro-related issues and their impact on information systems, currency exchange rate risk, taxation, contracts, competition and pricing. Action plans currently being implemented are expected to result in compliance with all laws and regulations; however, there can be no certainty that such plans will be successfully implemented or that external factors will not have an adverse effect on the Company's operations. Any costs of compliance associated with the adoption of the euro will be expensed as incurred and the Company does not expect these costs to be material to its results of operations, financial condition or liquidity.

Legal And Environmental Matters

Barr Laboratories, Inc. (Barr), and Geneva Pharmaceuticals, Inc. (Geneva), have each submitted an Abbreviated New Drug Application (ANDA) seeking FDA approval to market generic forms of Prozac before the expiration of the Company's patents. The ANDAs assert that two U.S. patents held by Lilly covering Prozac are invalid and unenforceable. The Company filed suit against Barr and Geneva in federal court in Indianapolis seeking a ruling that Barr's challenge to Lilly's patents is without merit. On January 12, 1999, the trial court granted summary judgment in favor of Lilly on two of the four claims raised by Barr and Geneva against Lilly's patents. Barr and Geneva have appealed that decision. On January 25, 1999, Barr and Geneva dismissed their other two claims in exchange for a $4 million payment, which Barr and Geneva will share with a third defendant. In late 1998, three other generic pharmaceutical companies, Zenith Goldline Pharmaceuticals, Inc., Teva Pharmaceuticals USA, and Cheminor Drugs, Ltd. together with one of its subsidiaries each filed ANDAs for generic forms of Prozac, asserting that the later of the two patents (expiring in December 2003) is invalid and unenforceable. Finally, in January 1999, Novex Pharma, a division of Apotex, Inc., filed an ANDA challenging both patents. Lilly has filed suits against the four companies in federal court in Indianapolis. The suits are in a very early stage. While the Company believes that the claims of the six generic companies are without merit, there can be no assurance that the Company will prevail. An unfavorable outcome of this litigation could have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations.

As with other industrial enterprises, the Company's operations are subject to complex and changing federal, state and local environmental laws and regulations, which will continue to require capital investment and operational expenses. The Company also has been designated a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, with respect to fewer than 10 sites with which the Company had varying degrees of involvement. Further, the Company continues remediation of certain of its own properties consistent with current environmental practices. The Company has accrued for estimated Superfund costs and remediation of its own properties, taking into account, as applicable, available information regarding site conditions, potential cleanup methods, estimated costs and the extent to which other parties can be expected to contribute to those costs. The Company reached a settlement with its primary liability insurance carrier providing for coverage for certain environmental liabilities and has instituted litigation seeking coverage from certain excess carriers. In addition, the Company has accrued for certain other environmental matters.

During 1998, the Company continued to be named as a defendant in a small number of product liability lawsuits involving Prozac. However, continuing a trend seen in recent years, the number of pending cases declined from levels of the previous year.

The Company continues to be a defendant, together with numerous other U.S. prescription drug manufacturers, in related suits brought under federal and state antitrust laws by many retail pharmacies and, in some cases, consumers. The Company has now resolved the great majority of the retailer claims and, subject in certain cases to court approval, has also settled the great majority of the consumer claims.

While it is not possible to predict or determine the outcome of the patent, product liability, antitrust or other legal actions brought against the Company or the ultimate cost of environmental matters, the Company believes that, except as noted above, the costs associated with all such

matters will not have a material adverse effect on its consolidated financial position or liquidity but could possibly be material to the consolidated results of operations in any one accounting period. For additional information on litigation and environmental matters, see Item 3 above and Note 13 to the consolidated financial statements.

Private Securities Litigation Reform Act Of 1995 --
A Caution Concerning Forward-Looking Statements

Under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions investors that any forward-looking statements or projections made by the Company, including those made in this document, are based on management's expectations at the time they are made, but they are subject to risks and uncertainties that may cause actual results to differ materially from those projected. Economic, competitive, governmental, technological and other factors that may affect the Company's operations and prospects are discussed in Exhibit 99 to the Company's most recent report on Forms 10-Q and 10-K filed with the Securities and Exchange Commission.

Additional Information

Additional financial information, presented as graphs in the Company's 1998 Annual Report to Shareholders, is found at pages 29-32 of Exhibit 13 and is incorporated herein by reference.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and qualitative disclosures about market risk (e.g., interest rate risk and foreign currency exchange risk) are set forth under Item 7 above at "Review of Operations -- Financial Condition" and are incorporated by reference herein.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements of the Company and its subsidiaries, listed in Item 14(a)1 and included in the Company's 1998 Annual Report at pages 32, 36-37, 41 and 42 (Consolidated Statements of Income, Consolidated Balance Sheets, Consolidated Statements of Cash Flows, and Consolidated Statements of Comprehensive Income), page 43 (Segment Information), and pages 46-59 (Notes to Consolidated Financial Statements) (together, pages 1-6 and 10-26 of Exhibit 13), and the Report of Independent Auditors set forth in the Company's 1998 Annual Report at page 61 (page 28 of Exhibit 13), are incorporated herein by reference.

Information on quarterly results of operations, set forth in the Company's 1998 Annual Report under "Selected Quarterly Data (unaudited)," at page 44 (pages 7-8 of Exhibit 13), is incorporated herein by reference.

Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information relating to the Company's directors, set forth in the Company's Proxy Statement dated March 4, 1999 (the "Proxy Statement"), under "Item 1. Election of Directors" at pages 3-6, is incorporated herein by reference. Information relating to the Company's executive officers is set forth at pages 8-9 of this Form 10-K under "Executive Officers of the Registrant." Information relating to certain filing obligations of directors and executive officers under the federal securities laws, set forth in the Proxy Statement under "Other Matters -- Section 16(a) Beneficial Ownership Reporting Compliance" at page 23, is also incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION

Information relating to executive compensation, set forth in the Proxy Statement under "Directors' Compensation", "Executive Compensation", "Compensation Committee Interlocks", "Retirement Plan", and "Change-in-Control Severance Pay Arrangements" at pages 9-18, is incorporated herein by reference, except that the Compensation Committee Report and Performance Graph are not so incorporated.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information relating to ownership of the Company's common stock by persons known by the Company to be the beneficial owners of more than 5 percent of the outstanding shares of common stock and by management, set forth in the Proxy Statement under "Common Stock Ownership by Directors and Executive Officers," at page 8, and "Principal Holders of Common Stock," at page 9, is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)1. Financial Statements

The following consolidated financial statements of the Company and its subsidiaries, included in the Company's 1998 Annual Report at the pages indicated in parentheses, are incorporated by reference in Item 8:

Consolidated Statements of Income--Years Ended December 31, 1998, 1997, and 1996 (page 32) (page 1 of Exhibit 13)

Consolidated Balance Sheets--December 31, 1998 and 1997 (pages 36-37) (pages 2-3 of Exhibit 13)

Consolidated Statements of Cash Flows--Years Ended December 31, 1998, 1997, and 1996 (page 41) (page 4 of Exhibit 13)

Consolidated Statements of Comprehensive Income--Years Ended December 31, 1998, 1997, and 1996 (page 42) (page 5 of Exhibit 13)

Segment Information (page 43) (page 6 of Exhibit 13)

Notes to Consolidated Financial Statements (pages 46-59) (pages 10-26 of Exhibit 13)

(a)2. Financial Statement Schedules

The consolidated financial statement schedules of the Company and its subsidiaries have been omitted because they are not required, are inapplicable, or are adequately explained in the financial statements.

Financial statements of interests of 50 percent or less, which are accounted for by the equity method, have been omitted because they do not, considered in the aggregate as a single subsidiary, constitute a significant subsidiary.

(a)3. Exhibits

3.1	Amended Articles of Incorporation
3.2	By-laws
4.1	Rights Agreement dated as of July 20, 1998, between Eli Lilly and Company and First Chicago Trust Company of New York, as Rights Agent
4.2	Form of Indenture with respect to Debt Securities dated as of February 1, 1991, between Eli Lilly and Company and Citibank, N.A., as Trustee

4.3 Form of Standard Multiple-Series Indenture Provisions dated, and filed with the Securities and Exchange Commission on, February 1, 1991

4.4 Form of Fiscal and Paying Agency Agreement dated February 7, 1995, between Eli Lilly and Company and Citibank, N.A., Fiscal and Paying Agent, including forms of Notes, relating to 8-1/8% Notes Due February 7, 2000(1)

4.8 Form of Fiscal and Paying Agency Agreement dated February 7, 1995, between Eli Lilly and Company and Citibank, N.A., Fiscal and Paying Agent, including forms of Notes, relating to 8-3/8% Notes Due February 7, 2005(1)

10.1 1989 Lilly Stock Plan, as amended(2)

10.2 1994 Lilly Stock Plan, as amended(2)

10.3 1998 Lilly Stock Plan(2)

10.4 The Lilly Deferred Compensation Plan, as amended(2)

10.5 The Lilly Directors' Deferral Plan, as amended(2)

10.6 The Eli Lilly and Company EVA(R)Bonus Plan, as amended(2),(3)

10.7 Eli Lilly and Company Change in Control Severance Pay Plan for Select Employees(2)

12. Computation of Ratio of Earnings to Fixed Charges

13. Annual Report to Shareholders for the Year Ended December 31, 1998 (portions incorporated by reference into this Form 10-K)

21. List of Subsidiaries

23. Consent of Independent Auditors

27. Financial Data Schedules for the periods indicated:

27.1 Year ended December 31, 1998

27.2 Restated for year ended December 31, 1996

27.3 Restated for quarter ended March 31, 1997

27.4 Restated for six months ended June 30, 1997

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(1) This exhibit is not filed with this Report. Copies will be furnished to the Securities and Exchange Commission upon request.

(2) Indicates management contract or compensatory plan.

(3) EVA(R) is a registered trademark of Stern Stewart & Co.

27.5 Restated for nine months ended September 30, 1997

27.6 Restated for year ended December 31, 1997

27.7 Restated for quarter ended March 31, 1998

27.8 Restated for six months ended June 30, 1998

27.9 Restated for nine months ended September 30, 1998

99. Cautionary Statement under Private Securities Litigation Reform Act of 1995 -- "Safe Harbor" for Forward-Looking Disclosures

(b) Reports on Form 8-K

The Company filed no reports on Form 8-K during the fourth quarter of 1998. During the third quarter, the Company filed a report on Form 8-K on July 23, 1998, in connection with the adoption of a new Shareholder Rights Plan to replace the Plan that expired on July 28, 1998.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ELI LILLY AND COMPANY

By /s/Sidney Taurel

Sidney Taurel, Chairman of the Board,
President and Chief Executive Officer

March 25, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 25, 1999 by the following persons on behalf of the Registrant and in the capacities indicated.

SIGNATURE	TITLE
/s/ Sidney Taurel (SIDNEY TAUREL)	Chairman of the Board, President, Chief Executive Officer, and a Director (principal executive officer)
/s/ Charles E. Golden (CHARLES E. GOLDEN)	Executive Vice President, Chief Financial Officer, and a Director (principal financial officer)
/s/ Arnold C. Hanish (ARNOLD C. HANISH)	Chief Accounting Officer (principal accounting officer)
/s/ Steven C. Beering, M.D. (STEVEN C. BEERING, M.D.)	Director
/s/ Karen N. Horn (KAREN N. HORN, Ph.D.)	Director

SIGNATURE	TITLE
/s/ Alfred G. Gilman, M.D., Ph.D. (ALFRED G. GILMAN, M.D., Ph.D.)	Director
/s/ Kenneth L. Lay, Ph.D. (KENNETH L. LAY, Ph.D.)	Director
/s/ Franklyn G. Prendergast, M.D., Ph.D. (FRANKLYN G. PRENDERGAST, M.D., Ph.D.)	Director
/s/ Kathi P. Seifert (KATHI P. SEIFERT)	Director
/s/ August M. Watanabe, M.D. (AUGUST M. WATANABE, M.D.)	Director
/s/ Alva O. Way (ALVA O. WAY)	Director

TRADEMARKS USED IN THIS REPORT

Trademarks or service marks owned by Eli Lilly and Company or its subsidiaries or affiliates, when first used in this Report, appear with an initial capital and are followed by the symbol (R) or (TM), as applicable. In subsequent uses of the marks in the Report, the symbols are omitted.

INDEX TO EXHIBITS

The following documents are filed as part of this report:

Exhibit		Location
3.1	Amended Articles of Incorporation	Incorporated by reference from Exhibit 3 to the Company's Report on Form 10-Q for the quarter ended September 30, 1998
3.2	By-laws	Incorporated by reference from Exhibit 3 to the Company's Report on Form 10-Q for the quarter ended June 30, 1998
4.1	Rights Agreement dated as of July 20, 1998, between Eli Lilly and Company and First Chicago Trust Company of New York, as Rights Agent	Incorporated by reference from Exhibit 1 to the Company's Report on Form 8-K filed July 23, 1998
4.2	Form of Indenture with respect to Debt Securities dated as of February 1, 1991, between Eli Lilly and Company and Citibank, N.A., as Trustee	Incorporated by reference from Exhibit 4.1 to the Company's Registration Statement on Form S-3, Registration No. 33-38347
4.3	Form of Standard Multiple-Series Indenture Provisions dated, and filed with the Securities and Exchange Commission on February 1, 1991	Incorporated by reference from Exhibit 4.2 to the Company's Registration Statement on Form S-3, Registration No. 33-38347

Exhibit		Location
4.6	Form of Fiscal and Paying Agency Agreement dated July 8, 1993, between Eli Lilly and Company and Citibank, N.A., Fiscal and Paying Agent, including forms of Notes, relating to 5-1/2% Notes Due 1998	*
4.7	Form of Fiscal and Paying Agency Agreement dated February 7, 1995, between Eli Lilly and Company and Citibank, N.A., Fiscal and Paying Agent, including forms of Notes, relating to 8-1/8% Notes Due February 7, 2000	*
4.8	Form of Fiscal and Paying Agency Agreement dated February 7, 1995, between Eli Lilly and Company and Citibank, N.A., Fiscal and Paying Agent, including forms of Notes, relating to 8-3/8% Notes Due February 7, 2005	*
10.1	1989 Lilly Stock Plan, as amended	Incorporated by reference from Exhibit 10.2 to the Company's Report on Form 10-K for the fiscal year ended December 31, 1993
10.2	1994 Lilly Stock Plan, as amended	Incorporated by reference from Exhibit 10 to the Company's Report on Form 10-Q for the quarter ended September 30, 1996
10.3	1998 Lilly Stock Plan	Incorporated by reference from Exhibit A to the Company's proxy statement dated March 4, 1998
10.4	The Lilly Deferred Compensation Plan, as amended	Incorporated by reference from Exhibit 10.4 to the Company's Report on Form 10-K for the fiscal year ended December 31, 1994

Exhibit		Location
10.5	The Lilly Directors' Deferral Plan, as amended	Attached
10.6	The Eli Lilly and Company EVA(R)Bonus Plan, as amended	Attached
10.7	Eli Lilly and Company Change in Control Severance Pay Plan for Select Employees	Attached
12.	Computation of Ratio of Earnings to Fixed Charges	Attached
13.	Annual Report to Shareholders for the Year Ended December 31, 1998 (portions incorporated by reference in this Form 10-K)	Attached
21.	List of Subsidiaries	Attached
23.	Consent of Independent Auditors	Attached
27.	Financial Data Schedules for the periods indicated:	
	27.1 Year ended December 31, 1998	
	27.2 Restated for year ended December 31, 1996	
	27.3 Restated for quarter ended March 31, 1997	
	27.4 Restated for six months ended June 30, 1997	
	27.5 Restated for nine months ended September 30, 1997	
	27.6 Restated for year ended December 31, 1997	

	27.7 Restated for quarter ended March 31, 1998	
	27.8 Restated for six months ended June 30, 1998	
	27.9 Restated for nine months ended September 30, 1998	
99.	Cautionary Statement Under Private Securities Litigation Reform Act of 1995 -- "Safe Harbor" for Forward-Looking Disclosures	Attached

Exhibit 10.5

THE LILLY DIRECTORS' DEFERRAL PLAN
(As amended and restated through December 21, 1998)

Section 1. Establishment of the Plan.

Effective January 1, 1996, there is hereby established a plan whereby certain Directors of the Company who are not current salaried employees of the Company may voluntarily defer compensation (the "Deferred Compensation" portion of the Plan), and certain Directors of the Company who are not current or former full-time salaried employees of the Company can share in the long-term growth of the Company by acquiring an ownership interest in the Company (the "Deferred Stock" portion of the Plan). Prior to January 1, 1996, the Company maintained the Deferred Compensation portion of the Plan and the Deferred Stock portion of the Plan as two separate plans, The Lilly Directors' Deferred Compensation Plan and The Lilly Non-Employee Directors' Deferred Stock Plan, respectively (the "Prior Plans"). The Plan is deemed to consist of the amounts held under the Prior Plans, and any election made by a Director under the Prior Plans, unless and until amended by the Director in accordance with this Plan, shall remain in effect under this Plan.

Section 2. Definitions.

When used in the Plan, the following terms shall have the definitions set forth in this Section 2:

2.1. Accrual Date. The term "Accrual Date" means the first day in December of each calendar year on which the common stock of the Company is traded, or such other annual date, not earlier than the third Monday in February, established by the Committee as the date as of which Shares are allocated to each Share Account.

2.2. Beneficiary. The term "Beneficiary" means the beneficiary or beneficiaries (including any contingent beneficiary or beneficiaries) designated pursuant to subsection 8.3 hereof.

2.3. Board of Directors. The term "Board of Directors" means the Board of Directors of the Company.

2.4. Committee. The term "Committee" refers to the Directors and Corporate Governance Committee of the Board of Directors.

2.5. Company. The term "Company" means Eli Lilly and Company.

2.6. Company Credit. The term "Company Credit" means an amount computed, and credited annually to a Participant's Deferred Compensation Account at a rate that is two percent (2%) above the rate that the Treasurer of the Company determines was the prime rate of interest charged by Chemical Bank, New York, New York or its successor bank (the "Bank"), on loans made on the immediately preceding December 15 or, if the Bank was closed on December 15, the last day preceding December 15 on which the Bank was open for business.

2.7. Compensation. The term "Compensation" means the retainer and the aggregate of all meeting fees to which a Director is entitled for services rendered to the Company as a Director.

2.8. Deferral Allocation Date. The term "Deferral Allocation Date" means the third Monday of any month, or if Shares are not traded on The New York Stock Exchange on such third Monday of the month, the last day before the third Monday of the month on which Shares are traded on The New York Stock Exchange, that follows the earlier of (a) the date on which an amount deferred under the Plan would have been paid in cash if a deferral election had not been made hereunder, or (b) in the case of an award of compensation which by its terms is subject to a deferred payment date, the date of award.

2.9. Deferred Amount. The term "Deferred Amount" means the amount of a Deferred Compensation Participant's Compensation that the Participant elects to defer in accordance with Section 4 hereof.

2.10. Deferred Compensation Participant. The term "Deferred Compensation Participant" means a Director who is not a salaried employee of the Company and who has elected to defer all or part of his Compensation pursuant to the Plan in accordance with Section 4 hereof.

2.11. Deferred Stock Participant. The term "Deferred Stock Participant" means a Director who is not a current or former full-time salaried employee of the Company and who becomes a Participant in the Plan in accordance with Section 3 hereof.

2.12. Director. The term "Director" means each member of the Board of Directors.

2.13. Dividend Allocation Date. The term "Dividend Allocation Date" means the first Monday that (a) follows a Dividend Payment Date and (b) is the third Monday of a Month.

2.14. Dividend Payment Date. The term "Dividend Payment Date" means the date as of which the Company pays a cash dividend on Shares.

2.15. Dividend Record Date. The term "Dividend Record Date" means, with respect to any Dividend Payment Date, the date established by the Board of Directors as the record date for determining shareholders entitled to receive payment of the dividend.

2.16. Individual Accounts. The term "Individual Accounts" or "Accounts" means the separate accounts (the Deferred Compensation Account and the Share Account), described in Section 7 hereof, one or both of which is established under the Plan for each Participant. When used in the singular, the term shall refer to one of these two accounts, as the context requires.

2.17. Participant. The term "Participant" means a Director who is a Deferred Stock Participant, a Deferred Compensation Participant, or both, as the case may be.

2.18. Plan. The term "Plan" means The Lilly Directors' Deferral Plan, as set forth herein and as it may be amended from time to time.

2.19. Share. The term "Share" means a share of common stock of the Company.

Section 3. Deferred Stock Participants.

Each Director who participated in The Lilly Non-Employee Directors' Deferred Stock Plan immediately before the effective date of this Plan shall continue as a Deferred Stock Participant on such effective date, and all elections in effect under The Lilly Non-Employee Directors' Deferred Stock Plan shall remain in effect under this Plan, unless and until amended in accordance with this Plan. Each person who is thereafter elected or appointed as a Director, and who is not and has never been a full-time salaried employee of the Company, shall become a Deferred Stock Participant beginning with the month in which such Director takes office. A Deferred Stock Participant shall cease to participate in the Plan when the Participant ceases to be a Director. For purposes of the Plan, a Deferred Stock Participant shall be deemed to cease to be a Director on the first day of the month next following the month in which he or she last serves as a Director.

Section 4. Deferred Compensation Participants.

Each Director who participated in The Lilly Directors' Deferred Compensation Plan immediately before the effective date of the Plan shall continue as a Deferred Compensation Participant on such effective date, and

all elections in effect under The Lilly Directors' Deferred Compensation Plan shall remain in effect under this Plan, unless and until amended in accordance with this Plan. Prior to the beginning of each calendar year, any Director who is not a salaried employee of the Company may defer the receipt of Compensation to be earned by the Director during such year by filing with the Company a written election that:

(i) defers payment of a designated amount (of one Thousand Dollars ($1,000) or more) or percentage of his Compensation for services attributable to the following calendar year or portion thereof (the "Deferred Amount");

(ii) specifies the payment option selected by the Participant pursuant to subsection 8.2 hereof for such Deferred Amount; and

(iii) specifies the option selected by the Participant pursuant to Section 5 hereof for such Deferred Amount.

The amount deferred may not exceed the Director's Compensation for the calendar year. Notwithstanding the foregoing, any individual who is newly elected or appointed to serve as a Director may, not later than thirty (30) days after his election or appointment becomes effective, elect in accordance with the preceding provisions of this Section 4, to defer the receipt of Compensation earned during the portion of the current calendar year that follows the filing of the election with the Company. Except as provided in subsections 8.2 and 8.4 hereof, any elections made pursuant to this Section 4 with respect to a calendar year shall be irrevocable when made. If a Participant fails to make an election under section 5 with respect to his or her Deferred Amount for a future calendar year, the Participant's previous election shall remain in effect, provided that the Participant may amend his or her election with regard to a future calendar year at any time.

Section 5. Form of Deferred Compensation Credits.

5.1. Deferred Compensation Account. Except with respect to the deferral of Compensation for a calendar year in which a Deferred Compensation Participant elects to have all or a percentage of the Deferred Amount credited in Shares in accordance with subsection 5.2 hereof, the Deferred Amount shall be denominated in U.S. dollars and credited to the Participant's Deferred Compensation Account pursuant to subsection 7.1 hereof.

5.2. Shares. Prior to the beginning of each calendar year, a Deferred Compensation Participant may elect to have all or a percentage of the Deferred Amount for the following calendar year credited in Shares and allocated to the Participant's Share Account pursuant to subsection 7.2 hereof.

5.3. Transfer of Deferred Compensation Account Balance to Share Account. Prior to the effective date of the Plan, a Deferred Compensation Participant may elect to have all or a portion of his or her final credited account balance in The Lilly Directors' Deferred Compensation Plan converted to Shares and credited to the Participant's Share Account. Such conversion shall take place as of January 1, 1996 based upon the combined average of the high and low prices of Shares on The New York Stock Exchange on each of the last five (5) days of 1995 on which Shares are traded on The New York Stock Exchange. Such conversion shall, however, be contingent upon receipt by the Company of (a) a no-action letter from the Securities and Exchange Commission ("SEC"), or (b) an opinion of counsel satisfactory to the Company, to the effect that such conversion shall not disqualify the Participant from being a "is interested person" within the meaning of prior SEC Rule 16b-3(d)(3) and new SEC Rule 16b-3(c)(2)(i) for purposes of administering the Company's employee stock incentive plans.

Section 6. Allocations to Share Accounts.

6.1. Allocation of Shares. As of the Accrual Date of each calendar year, there shall be allocated to the Share Account of each Deferred Stock Participant, as part of the compensation to such Deferred Stock Participant for service on the Board of Directors, seven hundred (700) Shares (or such other number of Shares as may be specified from time to time by resolution of the Board of Directors), at the average of the high and low prices of Shares on The New York Stock Exchange on the Accrual Date. Shares allocated to each Deferred Stock Participant's Share Account shall be hypothetical and not issued or transferred by the Company until payment is made pursuant to Section 8 hereof.

6.2. Special Allocation. As of February 1, 1996, there shall be allocated to the Share Account of each Deferred Stock Participant the number of Shares having a market value (calculated as set forth below) equal to the present value as of December 31, 1995 of the accrued benefit of the Participant in The Lilly Non-Employee Directors' Retirement Plan, whether or not such Participant was vested in such benefit on that date. Such present value calculation shall be performed by the Company in its discretion and shall be converted to Shares based upon the combined average of the high and low prices of Shares on The New York Stock Exchange on each of the last five (5) days preceding February 1, 1996 on which Shares are traded on The

New York Stock Exchange. Such conversion shall, however, be contingent upon receipt by the Company of (a) a no-action letter from the Securities and Exchange Commission ("SEC"), or (b) an opinion of counsel satisfactory to the Company, to the effect that such conversion shall not disqualify the participant from being a "disinterested person" within the meaning of prior SEC Rule 16b-3(d)(3) and new SEC Rule 16b-3(c)(2)(i) for purposes of administering the Company's employee stock incentive plans.

Section 7. Individual Accounts.

The Company shall maintain Individual Accounts for Participants, as follows:

7.1. Deferred Compensation Account. The Company shall maintain a Deferred Compensation Account in the name of each Deferred Compensation Participant in respect of each calendar year the Deferred Compensation Participant elects to defer the receipt of Compensation pursuant to Section 4 hereof and does not elect to have the Deferred Amount for such calendar year credited in Shares pursuant to subsection 5.2 hereof. The opening balance of each Deferred Compensation Account on January 1, 1996 shall be equal to the closing balance on December 31, 1995 of the corresponding account maintained under The Lilly Directors' Deferred Compensation Plan, less any portion of such account converted to Shares and allocated to the Participant's Share Account pursuant to subsection 5.3 hereof. The Deferred Compensation Account shall be denominated in U.S. dollars, rounded to the nearest whole cent. A Deferred Amount allocated to a Deferred Compensation Account pursuant to subsection 5.1 hereof shall be credited to the Deferred Compensation Account as of the Deferral Allocation Date.

7.2. Share Account. The Company shall maintain a Share Account for each Deferred Stock Participant and for each Deferred Compensation Participant who elects to have a Deferred Amount credited in Shares pursuant to subsection 5.2 hereof, or who elects to convert all or a portion of his or her final account balance under The Lilly Directors' Deferred Compensation Plan to Shares pursuant to subsection 5.3 hereof. The opening balance of each Share Account on January 1, 1996, shall be equal to the closing balance on December 31, 1995, of the corresponding Share Account maintained under The Lilly Non-Employee Directors' Deferred Stock Plan. The Share Account shall be denominated in Shares, and shall be maintained in fractions rounded to three (3) decimal places.

Shares allocated to a Deferred Compensation Participant's Share Account in accordance with the Participant's election under subsection 5.2 hereof shall be credited to the Participant's Share Account as of the Deferral Allocation Date. Shares and, if necessary, fractional Shares, shall be

credited to a Participant's Share Account based upon the average of the high and low price of Shares on The New York Stock Exchange on the Deferral Allocation Date.

7.3. Former Interest Account. All balances in the Account known previously as the "Interest Account" under The Lilly Non-Employee Directors' Deferred Stock Plan shall be transferred to the Share Account effective on January 1, 1996, utilizing the same price of Shares set forth in subsection 5.3 hereof for purposes of the calculation.

7.4. Accrual of Company Credit. The Treasurer of the Company shall determine the annual rate of Company Credit on or before December 31 of each calendar year. This rate shall be effective for the following calendar year. The Company Credit shall accrue monthly, at one-twelfth of the applicable annual rate, on all amounts credited to a Participant's Deferred Compensation Account, including the Company Credits for prior years. The Company Credit shall not accrue on any amount distributed to a Participant (or to the Participant's Beneficiary) during the month for which the accrual is determined, except where an amount is distributed to a Beneficiary in the month of the Participant's death. The Company Credit for each year shall be credited to each Deferred Compensation Account as of December 31 of that year and shall be compounded monthly.

7.5. Cash Dividends. Cash dividends paid on Shares shall be deemed to have been paid on the Shares allocated to each Participant's Share Account as if the allocated Shares were actual Shares issued and outstanding on the Dividend Record Date. An amount equal to the amount of such dividends shall be credited in Shares to each Share Account as of each Dividend Allocation Date based upon the average of the high and low prices for Shares on The New York Stock Exchange on the Divided Allocation Date, or, if Shares are not traded on the Divided Allocation Date, the next day on which Shares are traded.

7.6. Capital Adjustments. The number of Shares referred to in Section 6 hereof and the number of Shares allocated to each Share Account shall be adjusted by the Committee, as it deems appropriate, to reflect stock dividends, stock splits, reclassifications, spinoffs, and other extraordinary distributions, as if those Shares were actual Shares.

7.7. Account Statements. Within a reasonable time following the end of each calendar year, the Company shall render an annual statement to each Participant. The annual statement for each Deferred Stock Participant shall report the number of Shares credited to the Participant's Share Account as of December 31 of that year. The annual statement for each Deferred Compensation Participant shall report the dollar amount credited to the

Participant's Deferred Compensation Account as of December 31 of that year, and, if the Deferred Compensation Participant elects to invest a Deferred Amount in Shares pursuant to subsection 5.2 hereof, or if the Deferred Compensation Participant elects to convert his final account balance under The Lilly Directors' Deferred Compensation Plan to Shares pursuant to subsection 5.3 hereof, the number of Shares credited to the Participant's Share Account as of December 31 of that year.

Section 8. Payment Provisions.

8.l. Method of Payment. All payments to a Participant (or to a Participant's Beneficiary) with respect to the Participant's Deferred Compensation Account shall be paid in cash. Except as provided in Section 8.5, all payments to a Participant (or to a Participant's Beneficiary) with respect to the Participant's Share Account shall be paid in Shares, at which time the Shares shall be issued or transferred on the books of the Company. All Shares to be transferred hereunder shall be transferred out of treasury shares to the extent available. Fractional Shares shall not be transferred to a Participant, provided that in the case of a final payment under the Plan with respect to a Participant, any fractions remaining in the Participant's Share Account shall be rounded up to the next whole Share and that number of whole Shares shall be transferred to the Participant (or, after the Participant's death, to the Participant's Beneficiary). If Shares are not traded on The New York Stock Exchange on any day on which a payment of Shares is to be made under the Plan, then that payment shall be made on the next day on which Shares are traded on The New York Stock Exchange.

8.2. Payment Options. Prior to each calendar year, or within 30 days after becoming a Participant, the Participant shall select a payment election with respect to the payment of any one or all of the Participant's Individual Accounts from the following payment elections:

(i) a lump sum in January of the calendar year immediately following the calendar year in which the Participant ceases to be a Director; or

(ii) annual (or, in the case of the Deferred Compensation Account only, monthly) installments over a period of two to ten years commencing in January of the calendar year following the calendar year during which the Participant ceases to be a Director.

If the payment option described in paragraph (i), above, has been elected, the amount of the lump sum with respect to the Participant's Deferred Compensation Account shall be equal to the amount credited to the Participant's Deferred Compensation Account as of the December 31 next

preceding the date of the payment, and the amount of the lump sum with respect to the Participant's Share Account shall be equal to the number of Shares credited to the Share Account as of the December 31 next preceding the date of payment. If the payment option described in paragraph (ii), above, has been elected, the amount of each installment with respect to the Participant's Deferred Compensation Account shall be equal to the amount credited to the Participant's Deferred Compensation Account as of the last day of the month next preceding the date of a monthly installment payment, or the December 31 next preceding the date of an annual installment payment, divided by the number of installment payments that have not yet been made. The amount of each installment with respect to the Participant's Share Account shall be equal to the number of Shares credited to the Participant's Share Account as of the December 31 next preceding the date of an annual installment payment, divided by the number of installment payments that have not yet been made.

A Participant may elect that his final payment election may control over all prior payment elections. If the Participant fails to elect a payment option, the amount credited to the Participant's Individual Account shall be distributed in a lump sum in accordance with the payment option described in paragraph (i), above. If the amount credited to a Participant's Deferred Compensation Account or the value of Shares credited to a Participant's Share Account is less than $25,000, the Committee, in its sole discretion, may pay out the amount credited to the Participant's Individual Account in a lump sum.

8.3. Payment Upon Death. Within a reasonable period of time following the death of a Participant, the amount credited to a Participant's Deferred Compensation Account and all of the Shares credited to the Participant's Share Account shall be paid by the Company in a lump sum to the Participant's Beneficiary. For purposes of this subsection 8.3, the amount credited to the Participant's Deferred Compensation Account and the number of Shares credited to the Participant's Share Account shall be determined as of the date of payment. A Participant may designate the Beneficiary, in writing, in a form acceptable to the Committee before the Participant's death. A Participant may, before the Participant's death, revoke a prior designation of Beneficiary and may also designate a new Beneficiary without the consent of the previously designated Beneficiary, provided that such revocation and new designation (if any) are in writing, in a form acceptable to the Committee, and filed with the Committee before the Participant's death. If the Participant does not designate a Beneficiary, or if no designated Beneficiary survives the Participant, any amount not distributed to the Participant during the Participant's life shall be paid to the Participant's estate in a lump sum in accordance with this subsection 8.3.

8.4. Payment on Unforeseeable Emergency. The Committee may, in its sole discretion, direct payment to a Participant of all or of any portion of the Participant's Individual Account balance, notwithstanding an election under subsection 8.2 above, at any time that it determines that such Participant has an unforeseeable emergency, and then only to the extent reasonably necessary to meet the emergency. For purposes of this section, "unforeseeable emergency" means severe financial hardship to the Participant resulting from a sudden and unexpected illness or accident of the Participant or of a dependent of the Participant, loss of the Participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. The circumstances that will constitute an unforeseeable emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that such hardship is, or may be, relieved --

(i) through reimbursement or compensation by insurance or otherwise,

(ii) by liquidation of the Participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or

(iii) by cessation of deferrals under the Plan.

Examples of what are not considered to be unforeseeable emergencies include the need to send a Participant's child to college or the desire to purchase a home.

8.5. Payment of Cash in Lieu of Shares. If at any time the Committee shall determine that payment of Shares to a Participant (or a Participant's Beneficiary) or the ownership or subsequent disposition of such Shares by such Participant or Beneficiary may violate or conflict with any applicable law or regulation, the Committee may, in its discretion, pay all or a portion of the Participant's Share Account in cash. In this case, the amount of cash shall be determined with reference to the average of the high and low trading price for Shares on the December 31 next preceding the date of payment, or if Shares are not traded on that day, the next preceding trading day.

Section 9. Ownership of Shares.

A Participant shall have no rights as a shareholder of the Company with respect to any Shares until the Shares are transferred to the Participant on the books of the Company.

Section 10. Prohibition Against Transfer.

The right of a Participant to receive payments of Shares and cash under the Plan may not be transferred except by will or applicable laws of descent and distribution. A Participant may not assign, sell, pledge, or otherwise transfer Shares or cash to which he is entitled hereunder prior to transfer or payment thereof to the Participant.

Section 11. General Provisions.

11.1. Director's Rights Unsecured. The Plan is unfunded. The right of any Participant to receive payments of cash or Shares under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

11.2. Administration. Except as otherwise provided in the Plan, the Plan shall be administered by the Committee, which shall have the authority to adopt rules and regulations for carrying out the Plan, and which shall interpret, construe, and implement the provisions of the Plan.

11.3. Legal Opinions. The Committee may consult with legal counsel, who may be counsel for the Company or other counsel, with respect to its obligations and duties under the Plan, or with respect to any action, proceeding, or any questions of law, and shall not be liable with respect to any action taken, or omitted, by it in good faith pursuant to the advice of such counsel.

11.4. Liability. Any decision made or action taken by the Board of Directors, the Committee, or any employee of the Company or any of its subsidiaries, arising out of or in connection with the construction, administration, interpretation, or effect of the Plan, shall be absolutely discretionary, and shall be conclusive and binding on all parties. Neither the Committee nor a member of the Board of Directors and no employee of the Company or any of its subsidiaries shall be liable for any act or action hereunder, whether of omission or commission, by any other member or employee or by any agent to whom duties in connection with the administration of the Plan have been delegated or, except in circumstances involving bad faith, for anything done or omitted to be done.

11.5. Withholding. The Company shall have the right to deduct from all payments hereunder any taxes required by law to be withheld from such payments. The recipients of such payments shall bear all taxes on amounts paid under the Plan to the extent that no taxes are withheld thereon, irrespective of whether withholding is required.

11.6. Incapacity. If the Committee determines that any person entitled to benefits under the Plan is unable to care for his or her affairs because of illness or accident, any payment due (unless a duly qualified guardian or other legal representative has been appointed) may be paid for the benefit of such person to such person's spouse, parent, brother, sister, or other party deemed by the Committee to have incurred expenses for such person.

11.7. Inability to Locate. If the Committee is unable to locate a person to whom a payment is due under the plan for a period of twelve (12) months, commencing with the first day of the month as of which the payment becomes payable, the total amount payable to such person shall be forfeited.

11.8. Legal Holidays. If any day on (or on or before) which action under the Plan must be taken falls on a Saturday, Sunday, or legal holiday, such action may be taken on (or on or before) the next succeeding day that is not a Saturday, Sunday, or legal holiday; provided, that this subsection 11.8 shall not permit any action that must be taken in one calendar year to be taken in any subsequent calendar year.

Section 12. Amendment, Suspension, and Termination.

The Board of Directors shall have the right at any time, and from time to time, to amend, suspend, or terminate the Plan, provided that no amendment or termination shall reduce the number of Shares or the cash balance in an Individual Account, and provided further that the number of Shares allocated annually pursuant to Section 6 hereof may not be changed more frequently than every calendar year.

Section 13. Applicable Law.

The Plan shall be governed by, and construed in accordance with, the laws of the State of Indiana, except to the extent that such laws are preempted by Federal law.

Section 14. Effective Date.

The effective date of this Plan is January 1, 1996. Nothing herein shall invalidate or adversely affect any previous election, designation, deferral, or accrual in accordance with the terms of The Lilly Directors' Deferred Compensation Plan or The Lilly Non-Employee Directors' Deferred Stock Plan that were in effect prior to the effective date of this Plan.

Exhibit 10.6

Eli Lilly and Company EVA Bonus Plan

(As amended and restated effective January 1, 1999)

ARTICLE I

Bonus Plan Statement of Purpose and Summary

1.1 The purpose of the Plan is to provide a system of bonus compensation for selected employees of Eli Lilly and Company and subsidiaries which will promote the maximization of shareholder value over the long term, by linking performance incentives to increases in shareholder value. The Plan ties bonus compensation to Economic Value Added ("EVA"), and thereby rewards employees for long-term, sustained improvement in shareholder value. The Plan is intended to satisfy the requirements for providing "performance-based" compensation under Section 162(m) of the Internal Revenue Code.

1.2 EVA will be used as the performance measure of value creation. EVA reflects the benefits and costs of capital employment. Employees create economic value when the operating profits from a business exceed the cost of the capital employed.

ARTICLE II

Definitions of Certain Terms

Unless the context requires a different meaning, the following terms shall have the following meanings:

2.1 "Company" means Eli Lilly and Company and its subsidiaries.

2.2 "Committee" means the Compensation and Management Development Committee, the members of which shall be selected by the Board of Directors from among its members. Each Committee member shall, at all times while serving, satisfy the requirements of an "outside director" within the meaning of Section 162(m).

2.3 "Participant" means any employee of the Company designated by the Committee as a participant in the Plan with respect to any Plan Year. In its discretion, the Committee may designate Participants either on an individual basis or by determining that all employees in specified job categories, classifications or levels shall be Participants.

2.4 "Plan" means this Eli Lilly and Company EVA Bonus Plan.

2.5 "Plan Year" means the applicable calendar year.

2.6 "Retirement" means the cessation of employment upon the attainment of at least eighty age and benefit years of service points, as determined by the provisions of The Lilly Retirement Plan as amended from time to time, assuming eligibility to participate in that plan.

2.7 "Disability" means the time at which a Participant becomes eligible for a payment under The Lilly Extended Disability Plan, assuming eligibility to participate in that plan.

2.8 "Section 162(m)" means Section 162(m) of the Internal Revenue Code of 1986, as amended.

2.9 "Section 162(m) Participant" means a Participant who, in the determination of the Committee, is or may in the future become a "covered employee" under Section 162(m).

ARTICLE III

Definition and Components of EVA

The following terms set forth the calculation of EVA and the components of calculating EVA. The calculation of EVA for a Plan Year is used in determining the bonuses earned by Participants under the Plan, as set forth in Article IV.

3.1 "Economic Value Added" or "EVA" means the excess NOPAT that remains after subtracting the Capital Charge.

3.2 "Net Operating Profit After Tax" or "NOPAT" means the after tax operating earnings of the Company for the Plan Year. NOPAT is determined by adding net sales plus other net income (excluding interest income from operating cash) and subtracting the following: cost of goods sold, selling, general and administrative expenses (excluding goodwill amortization and interest expense), amortization of research and development, taxes (excluding the tax benefit of interest expense) and amounts associated with discontinued operations.

3.3 "Capital Charge" means the deemed opportunity cost of employing Capital for the Company. The Capital Charge is calculated by multiplying Capital times Cost of Capital (C*).

3.4 "Capital" means the net investment employed in the operations of the Company produced by operations and financing activities. Capital is calculated by adding together current assets (excluding operating cash), net property, plant and equipment, gross goodwill, net intangibles, other assets, and capitalized research and development, and the present value of operating leases, and subtracting the following: non-interest bearing liabilities and capital associated with discontinued operations.

3.5 "Cost of Capital" or "C*" is the percentage calculated from the weighted average of Cost of Debt and Cost of Equity. Cost of Capital for each Plan Year is determined by reference to the percentage calculated at the end of October of the prior Plan Year.

3.6 "Cost of Debt" capital is the marginal long-term borrowing rate of the Company times (one minus the tax rate).

3.7 "Cost of Equity" capital is the risk-free rate plus (beta times the market risk premium). For this purpose, (i) "risk free rate" is the 30-year U.S. Treasury Bond rate, (ii) "beta" represents the 5 year historical average variation of the Company's earnings versus the S&P 500, and (iii) "market risk premium" represents the average risk of an equity return versus a bond return.

ARTICLE IV

Definition and Computation of the EVA Bonus

Bonuses earned under the Plan for a Plan Year are determined based on a comparison of actual EVA to the "Target EVA" for the year, which is established as described below to ensure improvement in EVA from year to year. The result of this comparison is adjusted by a "Leverage Factor" measuring the volatility of industry returns. The factor produced is referred to as the "Bonus Multiple," which is multiplied by the Participant's "Target Bonus" amount established for the year to produce the actual bonus earned. This amount, referred to as the "Declared Bonus," is credited to the Participant's "Bonus Bank" balance and paid out in the manner provided below.

4.1 Target Bonus. The Target Bonus Awards will be determined by the Committee on a basis that takes into consideration a Participant's salary grade level, job responsibilities as well as past and expected future job performance. Target Bonus Awards are expressed as a percentage of annual base salary as in effect on the first day of the Plan Year. If a Participant moves from any salary grade level to a G-6 or above salary grade level during a Plan Year, he/she will receive an award that is pro-rated according to time based on the Target Bonus percentage and base salary applicable to each such salary grade. The Target Bonus will be based on the currency in which the highest portion of base pay is regularly paid. The Committee shall determine the appropriate foreign exchange conversion methodology in its discretion.

4.2 Declared Bonus. A Declared Bonus is the Target Bonus times the Bonus Multiple.

4.3 Bonus Multiple. The Bonus Multiple is the difference (positive or negative) between Actual EVA and Target EVA, divided by the Leverage Factor, plus one.

4.4 Bonus Bank. All bonus payments are made from the Bonus Bank. Each Participant's beginning Bonus Bank balance in his/her first year of participation is zero. The Bonus Bank is increased or decreased for any plan year by the amount of Declared Bonus. If the available Bonus Bank balance is positive, the Participant will be paid from such balance up to the Target Bonus amount, plus one third of any such balance that remains after subtracting the Target Bonus from the available Bonus Bank balance. If the available Bonus Bank balance is negative, no payment will occur.

4.5 Target EVA. The Target EVA for each year will be calculated as follows:

Target EVA = Prior Year's Actual EVA + Expected Improvement

4.6 Expected Improvement. The Expected Improvement is the additional EVA amount determined by the Committee that is used to assure that a minimum level of improvement is achieved in order to earn target awards.

4.7 Leverage Factor. The Leverage Factor determines the rate of change in bonuses as EVA surpasses or falls short of Target EVA, determined by the Committee from an evaluation of the long term volatility of industry returns.

4.8 Section 162(m) Requirements, Bonus Maximum. In the case of Section 162(m) Participants, all determinations necessary for computing Declared Bonuses for a Plan Year, including establishment of all components of the EVA calculation and of the Target Bonus percentages, shall be made by the Committee not later than 90 days after the commencement of the Plan Year. As and to the extent required by Section 162(m), the terms of a Declared Bonus for a Section 162(m) Participant must state, in terms of an objective formula or standard, the method of computing the amount of compensation payable to the Section 162(m) Participant, and must preclude discretion to increase the amount of compensation payable that would otherwise be due under the terms of the award. Notwithstanding anything elsewhere in the Plan to the contrary, the maximum amount of the Declared Bonus that may be paid from the Bonus Bank to a Section 162(m) Participant during any one calendar year shall be $5 million.

ARTICLE V

Plan Administration

5.1 Time of Payment. Payment from the Bonus Bank will be made before March 1 of the year following the Plan Year.

5.2 Certification of Results. Before any amount is paid under the Plan, the Committee shall certify in writing the calculation of EVA for the Plan Year and the satisfaction of all other material terms of the calculation of the Declared Bonus.

5.3 New Hires, Promotions. New hires or individuals promoted who are first selected for participation by the Committee effective on a date other than January 1 will participate on a pro-rata basis in their first year of participation, based on the Declared Bonus determined for the Plan Year, pro-rated for that period of the year during which the Participant was selected for participation in the Plan. Any such Participant's Target Bonus Award will be determined based on his or her annual base salary as in effect on the date of hire or promotion, as applicable Notwithstanding the foregoing, in the case of any Section 162(m) Participant who first becomes eligible to participate in the Plan after January 1 of a Plan Year, such Participant's Declared Bonus may be determined, at the discretion of the Committee exercised at the time such participation begins, in a manner that complies with the requirements for "performance-based compensation" under Section 162(m).

5.4 Termination of Employment, Demotions. If a Participant ceases employment with the Company before the end of a Plan Year for reasons other than Retirement, Disability or death, or is demoted to a non-global job level with the Company during a Plan Year, the Participant shall receive no Declared Bonus for that Plan Year, and his/her Bank Balance

shall be forfeited. The Committee may make complete or partial exceptions to this rule, in its sole discretion, and, with respect to employees other than executive officers, may delegate to the vice president responsible for human resources the authority to make such exceptions. Notwithstanding the foregoing, with respect to the Declared Bonus for a Section 162(m) Participant, any such termination of employment or demotion shall result in payment of a bonus based on the Declared Bonus determined for the Plan Year but pro-rated for the period of the year prior to such event, subject to the Committee's discretion to forfeit all or any portion of such bonus.

5.5 Leave of Absence. If a Participant takes an approved leave of absence from employment during a Plan Year, the Participant will not be eligible for the Declared Bonus for the Plan Year. The Committee may make complete or partial exceptions to this rule, in whatever manner it deems appropriate, and, with respect to employees other than executive officers, may delegate to the vice president responsible for human resources the authority to make such exceptions. The Participant will retain his Bonus Bank balance if he returns to employment following the period of leave of absence. Notwithstanding the foregoing, with respect to the Declared Bonus for a Section 162(m) Participant, any such leave of absence shall result in payment of a bonus based on the Declared Bonus determined for the Plan Year but pro-rated for the period of the year that the Participant was actively employed by the Company, subject to the Committee's discretion to forfeit all or any portion of such bonus.

5.6 Retirement, Disability or Death. If a Participant ceases employment with the Company because of Retirement, Disability or death, the Participant or personal representative, as the case may be, shall receive full payment of his/her Bank Balance and a bonus based on the Declared Bonus determined for the Plan Year but pro-rated for that period of the Plan Year during which the Participant was an active employee of the Company.

5.7 Plan Participation. A Participant may not participate in this Plan for any portion of a Plan Year for which he/she is entitled to receive payment under the Eli Lilly and Company Contingent Compensation Plan, and shall be treated in accordance with 5.3.

5.8 Forfeiture Events. Notwithstanding any other provision of this Plan to the contrary, the Committee may, in its sole discretion, upon the occurrence of a Forfeiture Event (as defined below), forfeit all or any portion of a Participant's Declared Bonus and Bonus Bank balance and terminate such Participant's future participation in the Plan. For purposes hereof, a "Forfeiture Event" shall mean the occurrence of one or more of the following events with respect to a Participant: (i) the termination or forced resignation from employment of the Participant for "misconduct" (as defined in the Company's Employee Information Handbook), (ii) any violation by the Participant of the Guidelines of Company Policy (the "Redbook") that is detrimental to the Company, (iii) any breach of a noncompetition, nonsolicitation, nondisclosure or other restrictive covenant that may apply by written agreement between the Company and the Participant or (iv) Participant's having engaged in any other activity that, in the judgment of the Committee, is detrimental to the business, affairs or reputation of the Company (including, without limitation, engaging in any criminal activity). Except with respect to executive officers, the Committee may delegate the authority granted under this section to the vice president responsible for human resources.

ARTICLE VI

General Provisions

6.1 Withholding of Taxes. The Company shall have the right to withhold the amount of taxes which in the sole determination of the Company are required to be withheld under law with respect to any amount due or payable under the Plan.

6.2 Expenses. All expenses and costs in connection with the adoption and administration of the Plan shall be borne by the Company.

6.3 No Prior Right or Offer, No Right to Future Participation. Participation in the Plan for Plan Years is determined from year-to-year by the Committee in its sole discretion. Except and until expressly granted pursuant to the Plan, nothing in the Plan shall be deemed to give any employee any contractual or other right to participate in the benefits of the Plan. No award to any such Participant in any Plan Year shall be deemed to create a right to receive any award or to participate in the benefits of the Plan in any subsequent Plan Year.

6.4 Rights Personal to Employee. Any rights provided to an employee under the Plan shall be personal to such employee, shall not be transferable, except by will or pursuant to the laws of descent or distribution, and shall be exercisable during his/her lifetime, only by such employee, or a court-appointed guardian for the employee.

6.5 Non-Allocation of Award. In the event of a suspension of the Plan in any Plan Year, as described in Section 11.1, no awards under the Plan for the Plan Year during which such suspension occurs shall affect the calculation of awards for any subsequent period in which the Plan is continued.

ARTICLE VII

Limitations

7.1 No Continued Employment. Neither the establishment of the Plan nor the grant of an award thereunder shall be deemed to constitute an express or implied contract of employment of any Participant for any period of time or in any way abridge the rights of the Company to determine the terms and conditions of employment or to terminate the employment of any employee with or without notice or cause at any time.

7.2 No Vested Rights. Except as expressly provided herein, no employee or other person shall have any claim of right (legal, equitable, or otherwise) to any award, allocation, or distribution or any right, title, or vested interest in any amounts in his/her Bonus Bank and no officer or employee of the Company or any other person shall have any authority to make representations or agreements to the contrary. No interest conferred herein to a Participant shall be assignable or subject to claim by a Participant's creditors.

7.3 Non-alienation. Except as provided in Subsection 5.1, no Participant or other person shall have any right or power, by draft, assignment, or otherwise, to mortgage, pledge or

otherwise encumber in advance any payment under the Plan, and every attempted draft, assignment, or other disposition thereof shall be absolutely void.

ARTICLE VIII

Committee Authority

8.1 Authority to Interpret and Administer. Except as otherwise expressly provided herein, full power and authority to interpret and administer this Plan shall be vested in the Committee. The Committee may from time to time make such decisions and adopt such rules and regulations for implementing the Plan as it deems appropriate for any Participant under the Plan. Except as to Participants who are treated by the Company as executive officers of the Company for federal securities law reporting purposes (including any Section 162(m) Participant), the Committee may delegate in writing to officers or employees of the Company the power and authority granted by this Section 8.1 to interpret and administer this Plan. Any decision taken by the Committee or officer or employee to whom authority has been delegated, arising out of or in connection with the construction, administration, interpretation and effect of the Plan shall be final, conclusive and binding upon all Participants and any person claiming under or through Participants.

8.2 Adjustments for Significant Events. Prior to the beginning of a Plan Year, the Committee may specify with respect to Declared Bonuses for the Plan Year that EVA will be determined before the effects of acquisitions, divestitures, restructurings or changes in corporate capitalization, accounting changes, and/or events that are treated as extraordinary items for accounting purposes; provided that such adjustments shall be made only to the extent permitted by Section 162(m) in the case of Section 162(m) Participants.

8.3 Financial And Accounting Terms. Except as otherwise provided, financial and accounting terms, including terms defined herein, shall be determined by the Committee in accordance with generally accepted accounting principles and as derived from the audited consolidated financial statements of the Company, prepared in the ordinary course of business.

8.4 Section 162(m) Deferrals. To the extent that, notwithstanding the terms of the Plan, the Company's tax deduction for remuneration in respect of the payment of bonuses under the Plan to a Section 162(m) Participant would be disallowed under Section 162(m) by reason of the fact that such Participant's applicable employee remuneration, as defined in Section 162(m), either exceeds or, if such bonus were paid, would exceed the $1,000,000 limitation in Section 162(m), any such excess (as determined by the Committee in its sole discretion) shall be automatically deferred under the terms of The Lilly Deferred Compensation Plan. Payment of any deferred amounts shall be made to the Participant in the first year thereafter that the Company's tax deduction in respect of the payment would not be disallowed under Section 162(m).

ARTICLE IX

Notice

9.1 Any notice to be given to the Company or Committee pursuant to the provisions of the Plan shall be in writing and directed to Secretary, Eli Lilly and Company, Lilly Corporate Center, Indianapolis, IN 46285.

ARTICLE X

Effective Date

10.1 This Plan, as amended and restated herein, shall be effective for the Plan Year commencing January 1, 1999, subject to the approval of the Plan at the Company's 1998 annual meeting of stockholders. The terms of this restated plan shall apply to Declared Bonuses earned in 1999 and future years. All Declared Bonuses earned in years prior to 1999 shall be payable in accordance with the terms of the Plan as in effect for the year to which the Declared Bonus relates. The final Plan Year of this Plan, unless amended by the Board (or the Committee) and approved by the stockholders as provided in Article XI, shall be the 2002 Plan Year.

ARTICLE XI

Amendments and Termination

11.1 This Plan may be amended, suspended or terminated at any time at the discretion of the Board of Directors of Eli Lilly and Company, and may, except for this Section 11.1, be amended at any time by the Committee. Solely to the extent deemed necessary or advisable by the Board (or the Committee) for purposes of complying with Section 162(m), the Board (or the Committee) may seek the approval of any such amendment by the Company's stockholders. Any such approval shall be by the affirmative votes of the stockholders of the Company present, or represented, and entitled to vote at a meeting duly held in accordance with applicable state law and the Articles of Incorporation and By-Laws of the Company. The material terms of EVA must be disclosed to and reapproved by the stockholders of the Company no later than the Company's annual meeting of stockholders that occurs in the year 2003.

ARTICLE XII

Applicable Law

12.1 This Plan shall be governed by and construed in accordance with the provisions of the laws of the State of Indiana without regard to the conflicts-of-law principles of Indiana.

EXHIBIT 10.7

ELI LILLY AND COMPANY

CHANGE IN CONTROL SEVERANCE PAY PLAN
FOR SELECT EMPLOYEES

1. PURPOSE

This Eli Lilly and Company Change in Control Severance Pay Plan For Select Employees has been established by the Company to provide for the payment of severance pay and benefits to Eligible Employees whose employment with a Participating Employer terminates due to certain conditions created by a Change in Control of the Company. The purpose of the Plan is to assure a continuity in operations of the Company during a period of Change in Control by allowing employees to focus on their responsibilities to the Company knowing that they have certain financial security in the event of their termination of employment. The accomplishment of this purpose is in the best interests of the Company and its shareholders.

2. DEFINITIONS

The terms defined in this Section 2 shall have the meanings given below:

(a) "Annual Base Salary" means the amount of the Eligible Employee's Monthly Base Salary multiplied by twelve (12).

(b) "Board" means the Board of Directors of the Company.

(c) "Change in Control" has the meaning given in Section 3.

(d) "Code" means the Internal Revenue Code of 1986, as amended.

(e) "Committee" means the Compensation and Management Development Committee of the Board, or such other committee appointed by the Board to perform the functions of the Committee under the Plan, provided that at all times the Committee shall be constituted solely of directors who are Continuing Directors (as defined in Section 3) to the extent any such directors remain on the Board and are willing to serve in such capacity.

(f) "Covered Termination" has the meaning given in Section 6.

(g) "Company" means Eli Lilly and Company, an Indiana corporation.

(h) "Eligible Employee" means a Tier I Employee or a Tier II Employee.

(i) "ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

(j) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(k) "Monthly Base Salary" means an Eligible Employee's gross monthly base salary before any deductions, exclusions or any deferrals or contributions under any Participating Employer plan or

program, but excluding bonuses, incentive awards or compensation, employee benefits or any other non-salary form of compensation.

(l) "Participating Employer" has the meaning given in Section 4.

(m) "Plan" means this Eli Lilly and Company Change in Control Severance Pay Plan for Select Employees.

(n) "Severance Multiple" means the number of years represented by the Severance Period for the Eligible Employee.

(o) "Severance Period" means (i) in the case of Tier I Employees, the three (3) year period immediately following a Covered Termination and (ii) in the case of Tier II Employees, the two (2) year period immediately following a Covered Termination.

(p) "Tier I Employees" and "Tier II Employees" have the meanings given in Section 5.

3. CHANGE IN CONTROL

For purposes of the Plan, a "Change in Control" of the Company shall be deemed to have occurred upon:

(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 15% 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");

(b) the first day on which less than two-thirds of the total membership of the Board shall be Continuing Directors (as that term is defined in Article 13(f) of the Company's Articles of Incorporation);

(c) approval by the shareholders of the Company 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 50% of the Voting Stock of the Company or such surviving entity immediately after such Transaction;

(d) approval by the shareholders of the Company of 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;

(e) either (i) the Company shall have entered into a definitive agreement with any Person, which, if consummated, would result in a Change in Control as specified in paragraphs (a) through (d) of this Section 3 or (ii) any Person initiates a tender offer or exchange offer to acquire shares of the Voting Stock which, if consummated, would result in a Change in Control as specified in paragraphs (a) through (d) of this Section 3; provided, however, that if the Board shall make a final determination that such agreement, tender offer or exchange offer will not be consummated, the occurrence of any such event shall cease to constitute a

Change in Control and the termination of employment of an Eligible Employee after such determination shall not be treated as a Covered Termination on the basis of such event; or

(f) the Board adopts a resolution to the effect that any Person has taken actions which, if consummated, would result in its having acquired effective control of the business and affairs of the Company; provided, however, that if the Board shall make a final determination that such actions will not be consummated, the occurrence of any such event shall cease to constitute a Change in Control and the termination of employment of an Eligible Employee after such determination shall not be treated as a Covered Termination on the basis of such event.

For purposes of this Section 3 only, the term "subsidiary" means a corporation of which the Company owns directly or indirectly fifty (50) percent or more of the voting power.

4. PARTICIPATING EMPLOYERS

A. Designation of Participating Employers. The Company and each subsidiary corporation of which the Company owns directly or indirectly one-hundred (100) percent of the voting power at the time of the Change in Control shall be Participating Employers under the Plan. In addition, the Committee may designate other affiliates of the Company as Participating Employers under the Plan, from time to time and under such terms and conditions, as shall be specified by an action in writing by the Committee. Such terms and conditions may impose limitations on the extent to which any such affiliate participates in the Plan (including but not limited to the duration of any such participation), but shall not provide rights or benefits to Eligible Employees that are broader than those set forth in the Plan. Any entity that is a Participating Employer at the time of a Change in Control shall continue to be a Participating Employer following a Change in Control, and any person, firm or business that is a successor to the business or interests of a Participating Employer following a Change in Control shall be treated as a Participating Employer under the Plan.

B. Limitations in Foreign Jurisdictions. Notwithstanding the foregoing or anything elsewhere in the Plan to the contrary, the Committee shall have the discretionary authority, as specified below, to exclude from participation or limit the participation of any Participating Employer with respect to its Eligible Employees employed outside of the United States. The Committee shall exercise this authority only by an action in writing taken prior to a Change in Control on the basis of a good faith determination that, as a result of the specific effect of applicable local law or practice with respect to the Plan, it would be in the best interests of the Company to so exclude or limit such participation. In addition, to the extent specified by an action in writing prior to a Change in Control, the Committee may offset the benefits provided under the Plan to any such Eligible Employee by benefits under severance arrangements that exist by reason of applicable local law or practice.

5. ELIGIBLE EMPLOYEES

The following individuals shall be eligible to participate in the Plan and shall be considered an Eligible Employee for all purposes hereunder:

(i) "Tier I Employees" - the Chief Executive Officer of the Company immediately prior to the Change in Control, and all members of the Operations Committee (or a successor committee) of the Company appointed by the Chief Executive Officer, as constituted immediately prior to the Change in Control; and

(ii) "Tier II Employees" - all employees of the Participating Employers (other than Tier I Employees) who are classified by the Company as Executive Directors or above (or any successor classifications) immediately prior to the Change in Control.

Any person who is an Eligible Employee in accordance with the foregoing shall continue to be an Eligible Employee (and shall retain his/her status as a Tier I or Tier II Employee for purposes of the Plan) notwithstanding any change in his/her position or classification following a Change in Control. The Committee shall notify each Eligible Employee of his/her participation in the Plan and status as a Tier I or Tier II Employee at the time of the Change in Control.

6. COVERED TERMINATIONS

A. General. An Eligible Employee shall be treated as having suffered a "Covered Termination" hereunder under the following circumstances:

1. Tier I Employees. The termination of employment of a Tier I Employee shall be treated as a Covered Termination if his/her employment is terminated under one of the following circumstances:

(i) at anytime within two (2) years following the date of a Change in Control, termination of employment by a Participating Employer without "Cause" or by the Eligible Employee for "Good Reason"; or

(ii) beginning with the one (1) year anniversary of the date of a Change in Control and for a period of thirty (30) calendar days thereafter, termination of employment by a Participating Employer without "Cause" or by the Eligible Employee for any reason (whether or not for "Good Reason").

2. Tier II Employees. The termination of employment of a Tier II Employee shall be treated as a Covered Termination if his/her employment is terminated, within a period of two (2) years following the date of a Change in Control, by a Participating Employer other than for "Cause" or by the Eligible Employee for "Good Reason."

For purposes of the foregoing, the time periods specified above within which a termination of employment may be treated as a Covered Termination shall commence on the date the Change in Control becomes effective and, with respect to a Change in Control under paragraphs (e) and (f) of Section 3, shall recommence (for the full applicable period) on the date of consummation of the underlying actions; provided, however, that in the event of a Change in Control under paragraphs (e) and (f) of Section 3, the time period within which a Covered Termination under clause (ii) of paragraph 1 above may occur shall be measured only from the date of consummation of the underlying actions (and not from any earlier date).

An Eligible Employee shall not be treated as having suffered a Covered Termination in the event of his/her death, total disability (within the meaning of the Company's Extended Disability Plan), transfer of employment among Participating Employers (unless such transfer gives rise to a "Good Reason") or involuntary termination for "Cause."

B. Termination For Cause. For purposes hereof, the termination of an Eligible Employee's employment shall be deemed to be a termination for "Cause" if as a result of:

(i) the willful refusal of the Eligible Employee to perform, without legal cause, his/her material duties to the Participating Employer, resulting in demonstrable economic harm to any Participating Employer, which the Eligible Employee has failed to cure after thirty (30) calendar days' advance written notice from the Company; or

(ii) the conviction of the Eligible Employee by a court of competent jurisdiction of any crime (or enters a plea of guilty or nolo contendere to a charge of any crime) constituting a felony.

C. Termination for Good Reason. For purposes hereof, an Eligible Employee may terminate his/her employment for "Good Reason" as a result of:

(i) a material diminution in the nature or status of the Eligible Employee's position, title, reporting relationship, duties, responsibilities or authority, or the assignment to him/her of additional responsibilities that materially increase his/her workload;

(ii) any reduction in the Eligible Employee's then-current Monthly Base Salary;

(iii) a material reduction in the Eligible Employee's opportunities to earn incentive bonuses below those in effect for the year most recently completed before the date of the Change in Control, taking into account all material bonus factors such as targeted bonus amounts and corporate performance measures;

(iv) a material reduction in the Eligible Employee's employee benefits and coverages (including, without limitation, pension, profit sharing and all welfare and fringe benefits) that are provided to the Eligible Employee from the benefit levels in effect immediately prior to the Change in Control;

(v) the failure to grant to the Eligible Employee stock options, performance shares or similar equity incentive rights during each twelve (12) month period following the Change in Control on the basis of a number of shares or units and all other material terms (including vesting requirements) at least as favorable to the Eligible Employee as those rights granted to him/her on an annualized average basis for the three (3) year period immediately prior to the Change in Control; or

(vi) relocation of the Eligible Employee by more than fifty (50) miles from his/her regularly assigned workplace existing on the date of the Change in Control.

7. SEVERANCE PAYMENT

The amount of the severance payment to be received by an Eligible Employee whose employment is terminated under conditions constituting a Covered Termination shall equal the applicable Severance Multiple for the Eligible Employee multiplied by the sum of:

(i) the Eligible Employee's Annual Base Salary at the time of Covered Termination (calculated without regard to any reduction in Monthly Base Salary that results in a Good Reason termination) or, if greater, at the time of the Change in Control, plus

(ii) the greater of (a) the amount of the Eligible Employee's target incentive bonus for the year of Covered Termination or (b) the amount of the Eligible Employee's incentive bonus earned for the year immediately prior to the Change in Control.

The severance payment to be made hereunder shall be paid to the Eligible Employee in a single lump-sum cash payment, net of any required tax withholding, within fifteen (15) calendar days after the date of the Eligible Employee's Covered Termination. Any payment required under this Section 7 or any other provision of the Plan that is not made in a timely manner shall bear interest at a rate equal to one hundred twenty (120) percent of the monthly compounded applicable federal rate, as in effect under Section 1274(d) of the Code for the month in which the payment is required to be made.

8. OTHER SEVERANCE BENEFITS

In addition to the severance payment provided under Section 7, an Eligible Employee shall be entitled to the following benefits and other rights in the event of his/her Covered Termination:

A. Welfare Benefits. The Eligible Employee shall be entitled to continued coverage and benefits for the duration of the applicable Severance Period, at the Company's sole expense for coverage, under all employee welfare benefit plans (including, without limitation, medical, dental, group life, death benefit, dependent life, supplemental life, accidental death and dismemberment, short-term disability and long-term disability plans, health care reimbursement account and dependent day care reimbursement account) of a Participating Employer for which he/she was eligible at the time of Covered Termination or, if it would provide benefit coverages more favorable to the Eligible Employee, at the time of the Change in Control, as though his/her termination of employment had not occurred (the "Welfare Continuation Coverages"). All Welfare Continuation Coverages shall apply to the Eligible Employee and any of his/her dependents who would have been eligible for coverage if the Eligible Employee remained employed for the applicable Severance Period. The Company may provide the Eligible Employee with the Welfare Continuation Coverages under arrangements other than its generally applicable welfare benefit plans, provided that the benefit coverages so provided are at least as favorable to the Eligible Employee as coverage under the otherwise applicable Welfare Continuation Coverages, on a coverage by coverage basis, and taking into account all tax consequences to the Eligible Employee. At the expiration of the applicable Severance Period, the Eligible Employee shall be treated as a then terminating employee with respect to the right to elect continued medical and dental coverages in accordance with Section 4980B of the Code (or any successor provision thereto).

B. Pension Supplement. The Eligible Employee shall be entitled to the additional pension benefits that would be payable to him/her, under all defined benefit pension plans of a Participating Employer in which he/she is participating at the time of Covered Termination (including all such tax-qualified and supplemental plans), by taking into account under such plans (i) an additional number of years equal to the Severance Period applicable to the Eligible Employee for purposes of the age and service credit of the Eligible Employee under such plans and (ii) the amount of the severance payment to which the Eligible Employee is entitled under Section 7, expressed on an annualized basis for the number of years equal to the Severance Period applicable to the Eligible Employee, for purposes of the compensation credit of the Eligible Employee under such plans (but only to the extent such additional credit would produce a higher benefit for the Eligible Employee than if it were not taken into account). The additional pension benefits provided hereby shall be paid pursuant to a supplemental pension plan of the Company, at the same time and in the same form as pension benefits are otherwise payable to the Eligible Employee (subject to clause (iii) of Section 8.D).

C. Equity Incentives. Immediately upon a Covered Termination, (i) any stock options or similar equity-based incentive rights granted to the Eligible Employee under a stock incentive plan of a Participating Employer that are not then fully vested and exercisable shall become fully vested and immediately exercisable and the Eligible Employee shall be entitled to exercise any such rights until the expiration of their original full term (without regard to any earlier termination otherwise applicable in the event of termination of employment), and (ii) any performance shares or shares of restricted stock granted to the Eligible Employee under a stock incentive plan of a Participating Employer that remain subject to forfeiture, performance conditions or transfer restrictions at such time shall become fully and immediately vested and all such conditions and restrictions shall immediately lapse. In addition, as to any other types of equity-based incentive awards granted to the Eligible Employee under a stock incentive plan of a Participating Employer prior to the date of Covered Termination, any restrictions on exercise, payment or transfer shall immediately lapse, and the Eligible Employee shall have all rights associated with such awards as of the date of Covered Termination. Notwithstanding the foregoing, the rights provided by this Section 8.C shall not apply with respect to an Eligible Employee who is subject to Section 16 of the Exchange Act to the extent that any such rights could not be made available under the terms of a stock incentive plan of a Participating Employer, unless such plan could be amended to make such rights available without any requirement for shareholder approval for such plan to continue to meet the requirements for exemption of Rule 16b-3 under the Exchange Act. The provisions of this Section 8.C shall

apply equally to any awards or rights into which the equity incentive rights described herein are converted or for which such rights are substituted in connection with a Change in Control.

D. Accrued Rights. The Eligible Employee shall be entitled to the following payments and benefits in respect of accrued compensation rights at the time of a Covered Termination, in addition to all other rights provided under the Plan: (i) immediate payment of any accrued but unpaid Annual Base Salary through the date of Covered Termination; (ii) payment within fifteen (15) calendar days of Covered Termination of the accrued bonus for the year in effect on the date of the Covered Termination, determined on the basis of the bonus earned under terms of the applicable bonus plan through the date of termination or, if greater, the pro-rata amount of the target bonus for the period of such year through the date of termination; (iii) payment within fifteen (15) calendar days of Covered Termination of all non-tax-qualified deferred compensation rights, in lieu of payment in respect of such rights that would otherwise be made at a later date in accordance with the terms of such arrangements, except to the extent such rights are funded by amounts held under an irrevocable grantor trust or other irrevocable commitment of funds by the Company; and (iv) all benefits and rights accrued under the employee benefit plans, fringe benefit programs and payroll practices of a Participating Employer (other than those described in clause (iii) above) in accordance with their terms (including, without limitation, employee pension, employee welfare, incentive bonus and stock incentive plans).

E. Outplacement; Relocation. The Eligible Employee shall be provided, at the Company's sole expense, with professional outplacement services selected by the Eligible Employee consistent with his/her duties or profession and of a type and level customary for persons in his/her position; provided, however, that the Company shall not be required to pay fees in connection with the foregoing in an amount greater than fifteen (15) percent of the Eligible Employee's Annual Base Salary for purposes of clause (i) of Section 7. The Company shall honor any prior agreement or understanding with an Eligible Employee who has suffered a Covered Termination to reimburse his/her relocation expenses to the Indianapolis, Indiana metropolitan area or, if it does not result in a greater cost to the Company, to such other location selected by the Eligible Employee.

F. Indemnification. With respect to any Eligible Employee who is, immediately prior to a Change in Control or a Covered Termination, indemnified by the Company for his/her service as a director, officer or employee of a Participating Employer, the Company shall indemnify such Eligible Employee to the fullest extent permitted by applicable law, and the Company shall maintain in full force and effect, for the duration of all applicable statute of limitation periods, insurance policies at least as favorable to the Eligible Employee as those maintained by the Company for the benefit of its directors and officers at the time of Change in Control, with respect to all costs, charges and expenses whatsoever (including payment of expenses in advance of final disposition of a proceeding) incurred or sustained by the Eligible Employee in connection with any action, suit or proceeding to which he/she may be made a party by reason of being or having been a director, officer or employee of a Participating Employer or serving or having served any other enterprise as a director, officer or employee at the request of a Participating Employer.

9. EXCISE TAX REIMBURSEMENT

In the event it shall be determined that any payment or distribution by the Company or any other person or entity to or for the benefit of an Eligible Employee who suffers a Covered Termination is a "parachute payment" within the meaning of Section 280G of the Code, whether paid or payable or distributed or distributable pursuant to the terms of this Plan or otherwise, or whether prior to or following the Covered Termination, in connection with, or arising out of, his/her employment with a Participating Employer or a change in ownership or effective control of the Company or a substantial portion of its assets (a "Payment"), and would be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), concurrent with the making of such Payment, the Company shall pay to the Eligible Employee an additional payment (the "Gross-Up Payment") in an amount such that the net amount retained by the Eligible Employee, after deduction of any Excise Tax on such Payment and any federal, state or local income tax and Excise Tax on the Gross-Up Payment shall equal the amount of such Payment. In the event the Internal Revenue Service subsequently may assess or seek to assess from the Eligible Employee an amount of Excise Tax in excess of

that determined in accordance with the foregoing, the Company shall pay to the Eligible Employee an additional Gross-Up Payment, calculated as described above in respect of such excess Excise Tax, including a Gross-Up Payment in respect of any interest or penalties imposed by the Internal Revenue Service with respect to such excess Excise Tax.

10. NO MITIGATION OR OFFSET

The Eligible Employee shall be under no obligation to minimize or mitigate damages by seeking other employment, and the obtaining of any such other employment shall in no event effect any reduction of the Company's obligation to make the payments and provide the benefits required under the Plan. In addition, the Company's obligation to make the payments and provide the benefits required under the Plan shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other rights which a Participating Employer may have against the Eligible Employee.

11. UNFUNDED STATUS

The Plan is intended to constitute an employee pension benefit plan under ERISA which is unfunded and is maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, and shall be interpreted and administered accordingly. The payments and benefits provided hereunder shall be paid from the general assets of the Company. Nothing herein shall be construed to require the Company to maintain any fund or to segregate any amount for the benefit of any employee, and no employee or other person shall have any right against, right to, or security or other interest in any fund, account or asset of the Company from which the payment pursuant to the Plan may be made. Consistent with the foregoing, the Company may, in its sole discretion, deposit funds in a grantor trust or otherwise establish arrangements to pay amounts that become due under the Plan, and, notwithstanding anything elsewhere in the Plan to the contrary, the payments and benefits due under the Plan shall be reduced to reflect the amount of any payment made in respect of any Eligible Employee from a grantor trust or other arrangement established for this purpose.

12. ADMINISTRATION

The Committee shall be the named fiduciary of the Plan and the plan administrator for purposes of ERISA. The Committee shall be responsible for the overall operation of the Plan and shall have the fiduciary responsibility for the general operation of the Plan. The Committee may allocate to any one or more of the Company's employees any responsibility the Committee may have under the Plan and may designate any other person or persons to carry out any of the Committee's responsibilities under the Plan. As plan administrator, the Committee shall maintain records pursuant to the Plan's provisions and shall be responsible for the handling, processing and payment of any claims for benefits under the Plan.

13. CLAIMS AND DISPUTES

Within fifteen (15) calendar days of a Covered Termination, the Company shall notify each Eligible Employee whom the Company determines is entitled to payments and benefits under the Plan of his/her entitlement to such payments and benefits. An Eligible Employee who is not so notified may submit a claim for payments and benefits under the Plan in writing to the Company within ninety (90) calendar days after becoming entitled to such benefits as described in Section 6. All such claims shall be approved or denied in writing by the Company within fifteen (15) calendar days after submission.

Any denial of a claim by the Company shall be in writing and shall include: (i) the reason or reasons for the denial; (ii) reference to the pertinent Plan provisions on which the denial is based; (iii) a description of any additional material or information necessary for the Eligible Employee to perfect the claim together with an explanation of why the material or information is necessary; and (iv) an explanation of the Plan's claim review procedure, described below.

An Eligible Employee shall have a reasonable opportunity to appeal a denied claim to the Company for a full and fair review. The Eligible Employee or authorized representative shall have sixty (60) calendar days after receipt of written notification of the denial of claim in which to request a review and to review pertinent documents of the Plan. The Company shall notify the Eligible Employee or his/her authorized representative of the time and place for the claim review. The Company shall issue a decision on the reviewed claim promptly, but no later than fifteen (15) calendar days after receipt of the request for review. The Company's decision shall be in writing and shall include: (i) the reasons for the decision, and (ii) references to the Plan provisions on which the decision is based.

If the Eligible Employee shall dispute the Company's final decision, the dispute shall be submitted to an arbitration proceeding, conducted before a panel of three arbitrators, in accordance with the rules of the Center for Public Resources (or such other organization selected by mutual agreement of the Company and the Eligible Employee). Such arbitration shall take place in the location most practicably proximate to the Eligible Employee's principal workplace. Judgment may be entered on the arbitrators' award in any court having jurisdiction. Notwithstanding the foregoing, if an Eligible Employee believes the claims procedure or dispute resolution mechanism provided under this Section 13 would be futile or would cause such Eligible Employee irreparable harm, the Eligible Employee may, in his/her sole discretion, elect to enforce his/her rights under the Plan pursuant to Section 502 of ERISA.

The Company shall bear the expense of any enforcement proceeding brought by an Eligible Employee under the Plan and shall reimburse the Eligible Employee for all of his/her reasonable costs and expenses relating to such enforcement proceeding, including, without limitation, reasonable attorneys' fees and expenses, provided that the Eligible Employee is the prevailing party in such proceeding. For purposes hereof, the trier of fact in such enforcement proceeding shall be requested to make a determination as to the reimbursement of the Eligible Employee's costs and expenses as a prevailing party hereunder. In no event shall the Eligible Employee be required to reimburse the Company for any of the costs or expenses relating to such enforcement proceeding.

14. TERM AND AMENDMENT

The Plan shall become effective on the date of its adoption by the Board (the "Effective Date") and shall continue to be effective until the "Expiration Date." The Expiration Date shall initially be the third anniversary of the Effective Date, but as of the first anniversary of the Effective Date and each anniversary date thereafter, the Expiration Date shall be extended by an additional one (1) year unless, not later than ninety (90) calendar days prior to the respective anniversary date of the Effective Date, the Board shall specify by resolution or other written action that the Expiration Date shall not be so extended. Notwithstanding the foregoing, in the event of a Change in Control, the Plan shall continue in effect, and the Expiration Date shall not occur, until the satisfaction of all severance payments and benefits to which Eligible Employees are or may become entitled to under the Plan. The Board shall have the right, by resolution or other written action, to amend the Plan; provided, however, that the Plan may only be amended prior to a Change in Control, and then only to the extent such amendment is of a technical or clarifying nature, or increases the rights or benefits of all affected Eligible Employees, and does not in any manner reduce the rights or benefits of any Eligible Employee, unless the Company has obtained the express written consent, in return for good and valuable consideration, of all affected Eligible Employees in respect of any such amendment.

15. SUCCESSORS AND ASSIGNS

The Plan shall be binding upon any person, firm or business that is a successor to the business or interests of the Company, whether as a result of a Change in Control of the Company or otherwise. All payments and benefits that become due to an Eligible Employee under the Plan shall inure to the benefit of his/her heirs, assigns, designees or legal representatives.

16. ENFORCEABILITY

The Company intends the Plan to constitute a legally enforceable obligation between it and each Eligible Employee, and that the Plan confer vested rights on each Eligible Employee in accordance with the terms of the Plan, with each Eligible Employee being a third-party beneficiary thereof. Nothing in the Plan, however, shall be construed to confer on any Eligible Employee any right to continue in the employ of a Participating Employer or affect the right of a Participating Employer to terminate the employment or change the terms and conditions of employment of an Eligible Employee, with or without notice or cause, prior to a Change in Control, or to take any such action following a Change in Control, subject to the consequences specified by the Plan.

The Plan shall be construed and enforced in accordance with ERISA and the laws of the State of Indiana to the extent not preempted by ERISA, regardless of the law that might otherwise govern under applicable principles or provisions of choice or conflict of law doctrines. To the extent any provision of the Plan shall be invalid or unenforceable under any applicable law, it shall be considered deleted herefrom and all other provisions of the Plan shall be unaffected and shall continue in full force and effect.

IN WITNESS WHEREOF, the Board has caused this Plan to be adopted and executed by its duly authorized representative as of March 1, 1995.

ELI LILLY AND COMPANY

By:

Title: Vice President of Human Resources

Attest:

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EXHIBIT 12. STATEMENT RE: COMPUTATION OF RATIO OF
EARNINGS FROM CONTINUING OPERATIONS TO FIXED CHARGES
(Dollars in Millions)

	Years Ended December 31,				
	1998	1997	1996	1995	1994
Consolidated Pretax Income from Continuing Operations before Extraordinary Item.....	$2,665.0	$2,901.1	$2,131.3	$1,866.6	$1,693.3
Interest from Continuing Operations and Other Fixed Charges.....	198.3	253.1	323.8	323.9	128.7
Less Interest Capitalized during the Period from Continuing Operations.....	(17.0)	(20.4)	(35.8)	(38.3)	(25.4)
Earnings.....	$2,846.3	$3,133.8	$2,419.3	$2,152.2	$1,796.6
Fixed Charges/(1)/.....	$ 200.5	$ 256.8	$ 328.5	$ 323.9	$ 128.7
Ratio of Earnings to Fixed Charges.....	14.2	12.2	7.4	6.6	14.0

/(1)/ Fixed charges include interest from continuing operations for all years presented and beginning in 1996, preferred stock dividends.

EXHIBIT 13. ANNUAL REPORT TO SHAREHOLDERS FOR THE YEAR
ENDED DECEMBER 31, 1998

Consolidated Statements of Income
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions, except per-share data)

Year Ended December 31	1998	1997	1996
Net sales	$9,236.8	$ 7,987.7	$6,998.3
Cost of sales	2,015.1	1,946.0	1,872.1
Research and development	1,738.9	1,370.2	1,189.5
Marketing and administrative	2,658.3	2,233.1	1,892.4
Acquired in-process technology (Note 4)	127.5	-	-
Asset impairment (Note 3)	-	97.8	-
Gain on sale of DowElanco (Note 4)	-	(631.8)	-
Interest expense	181.3	232.7	288.0
Other income--net	(149.3)	(161.4)	(375.0)
	6,571.8	5,086.6	4,867.0
Income from continuing operations before income taxes and extraordinary item	2,665.0	2,901.1	2,131.3
Income taxes (Note 11)	568.7	885.2	505.6
Income from continuing operations before extraordinary item	2,096.3	2,015.9	1,625.7
Income (loss) from discontinued operations, net of tax (Note 3)	8.8	(2,401.0)	(102.2)
Extraordinary item, net of tax (Note 6)	(7.2)	-	-
Net income (loss)	$2,097.9	$ (385.1)	$1,523.5
Earnings (loss) per share - basic (Note 10):			
Income from continuing operations before extraordinary item	$ 1.91	$ 1.83	$ 1.48
Income (loss) from discontinued operations	.01	(2.18)	(.09)
Extraordinary item	(.01)	-	-
Net income (loss)	$ 1.91	$ (.35)	$ 1.39
Earnings (loss) per share - diluted (Note 10):			
Income from continuing operations before extraordinary item	$ 1.87	$ 1.78	$ 1.45
Income (loss) from discontinued operations	.01	(2.12)	(.09)
Extraordinary item	(.01)	-	-
Net income (loss)	$ 1.87	$ (.34)	$ 1.36

See notes to consolidated financial statements.

Consolidated Balance Sheets
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

December 31	1998	1997
Assets		
Current Assets		
Cash and cash equivalents	$ 1,495.7	$ 1,947.5
Short-term investments	101.4	77.1
Accounts receivable, net of allowances of $64.3 (1998) and $53.3 (1997)	1,967.9	1,544.3
Other receivables	275.8	338.9
Inventories (Note 1)	999.9	900.7
Deferred income taxes (Note 11)	332.7	325.7
Prepaid expenses	233.4	186.5
Total current assets	5,406.8	5,320.7
Other Assets		
Prepaid retirement (Note 12)	612.3	579.1
Investments (Note 5)	204.0	465.6
Goodwill and other intangibles, net of allowances for amortization of $171.4 (1998) and $119.3 (1997)	1,517.9	1,550.5
Sundry	758.2	559.8
	3,092.4	3,155.0
Property and Equipment (Note 1)	4,096.3	4,101.7
	$12,595.5	$12,577.4

Consolidated Balance Sheets
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

December 31	1998	1997
Liabilities and Shareholders' Equity		
Current Liabilities		
Short-term borrowings (Note 6)	$ 181.4	$ 227.6
Accounts payable	1,186.0	985.5
Employee compensation	704.0	456.6
Dividends payable	252.9	221.7
Income taxes payable (Note 11)	1,290.2	1,188.0
Other liabilities	992.7	1,112.2
Total current liabilities	4,607.2	4,191.6
Other Liabilities		
Long-term debt (Note 6)	2,185.5	2,326.1
Deferred income taxes (Note 11)	247.9	215.5
Retiree medical benefit obligation (Note 12)	114.7	118.3
Other noncurrent liabilities	1,010.6	920.3
	3,558.7	3,580.2
Commitments and contingencies (Note 13)	-	-
Minority interest in subsidiary (Note 9)	-	160.0
Shareholders' Equity (Notes 7 and 8)		
Common stock--no par value Authorized shares: 3,200,000,000 Issued shares: 1,097,400,814 (1998) and 1,111,521,927 (1997)	686.5	694.7
Additional paid-in capital	-	-
Retained earnings	4,228.8	4,497.3
Deferred costs--ESOP	(146.9)	(155.7)
Accumulated other comprehensive income (Note 14)	(229.8)	(281.2)
	4,538.6	4,755.1
Less cost of common stock in treasury: 1998 -- 995,492 shares 1997 -- 1,000,000 shares	109.0	109.5
	4,429.6	4,645.6
	$12,595.5	$12,577.4

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

Year Ended December 31	1998	1997	1996
Cash Flows From Operating Activities			
Net income (loss)	$ 2,097.9	$ (385.1)	$ 1,523.5
Adjustments To Reconcile Net Income (Loss) to Cash Flows From Operating Activities			
Depreciation and amortization	490.4	509.8	543.5
Change in deferred taxes	25.4	(293.0)	207.3
Gain on sale of DowElanco, net of tax	-	(303.5)	-
Asset impairment, net of tax	-	2,429.6	-
Other noncash income--net	(93.0)	(37.8)	(97.8)
	2,520.7	1,920.0	2,176.5
Changes in operating assets and liabilities:			
Receivables--(increase) decrease	(403.6)	(4.7)	104.4
Inventories--(increase)	(55.6)	(65.8)	(42.2)
Other assets--(increase)	(81.1)	(22.2)	(51.7)
Accounts payable and other liabilities--increase (decrease)	649.4	573.1	(195.6)
	109.1	480.4	(185.1)
Net Cash From Operating Activities	2,629.8	2,400.4	1,991.4
Cash Flows From Investing Activities			
Acquisitions	-	-	(97.1)
Additions to property and equipment	(419.9)	(366.3)	(443.9)
Disposals of property and equipment	30.6	11.5	11.2
Additions to other assets	(120.1)	(34.2)	(40.8)
Reductions of investments	273.1	365.7	396.9
Additions to investments	(57.6)	(388.5)	(294.3)
Proceeds from sale of DowElanco	-	1,221.5	-
Net Cash From (Used for) Investing Activities	(293.9)	809.7	(468.0)
Cash Flows From Financing Activities			
Dividends paid	(877.7)	(818.0)	(753.2)
Purchases of common stock and other capital transactions	(1,999.8)	(351.3)	(314.5)
Issuances under stock plans	414.0	205.4	218.4
Issuance (redemption) of subsidiary stock	(172.8)	160.0	-
Decrease in short-term borrowings	(170.0)	(1,146.0)	(801.4)
Additions to long-term debt	23.8	2.8	-
Reductions of long-term debt	(30.2)	(7.5)	(10.4)
Net Cash Used for Financing Activities	(2,812.7)	(1,954.6)	(1,661.1)
Effect of exchange rate changes on cash	25.0	(121.7)	(48.1)
Net increase (decrease) in cash and cash equivalents	(451.8)	1,133.8	(185.8)
Cash and cash equivalents at beginning of year	1,947.5	813.7	999.5
Cash and cash equivalents at end of year	$ 1,495.7	$ 1,947.5	$ 813.7

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

Year Ended December 31	1998	1997	1996
Net income (loss)	$2,097.9	$(385.1)	$1,523.5
Other comprehensive income (loss):			
Foreign currency translation adjustments	69.2	(209.3)	(57.4)
Net unrealized losses on securities (Note 14)	(2.6)	(13.4)	(56.9)
Minimum pension liability adjustment	(30.8)	(16.8)	1.0
Other comprehensive income (loss), before income taxes	35.8	(239.5)	(113.3)
Provision for income taxes related to other comprehensive income items	15.6	5.4	18.2
Other comprehensive income (loss)	51.4	(234.1)	(95.1)
Comprehensive income (loss)	$2,149.3	$(619.2)	$1,428.4

See notes to consolidated financial statements.

Segment Information
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

The company operates in one significant business segment - pharmaceutical products. Operations of the animal health business are not material and are included with pharmaceutical products for purposes of segment reporting.

Year Ended December 31	1998	1997	1996
Net sales - to unaffiliated customers			
Neurosciences	$4,487.8	$3,515.3	$2,665.8
Endocrinology	1,482.5	1,381.8	1,286.6
Anti-infectives	1,160.9	1,272.5	1,465.6
Animal health	614.4	589.8	547.3
Cardiovascular	536.9	421.0	325.4
Gastrointestinal	418.0	525.4	532.2
Oncology	339.2	210.6	104.1
Other pharmaceutical	197.1	71.3	71.3
Net sales	$9,236.8	$7,987.7	$6,998.3
Geographic Information			
Net sales - to unaffiliated customers1:			
United States	$5,836.2	$4,881.8	$3,917.3
Western Europe	1,692.3	1,462.9	1,455.2
Other foreign countries	1,708.3	1,643.0	1,625.8
	$9,236.8	$7,987.7	$6,998.3
Long-lived assets:			
United States	$3,421.9	$3,333.4	$3,595.1
Western Europe	675.4	632.2	663.4
Other foreign countries	654.4	663.9	685.6
	$4,751.7	$4,629.5	$4,944.1

/1/Net sales are attributed to the countries based on the location of the subsidiary making the sale.

The largest category of products is the neurosciences group, which includes Prozac, Zyprexa, Darvon and Permax. Endocrinology products consist primarily of Humulin, Humatrope, Humalog and Iletin. Anti-infectives include primarily Ceclor, Keflex, Lorabid, Nebcin, Tazidime and Vancocin. Cardiovascular products consist primarily of ReoPro and Dobutrex. The gastrointestinal group is entirely composed of Axid. Oncology products consist primarily of Gemzar. Animal health products include Tylan; Micotil; Surmax; Rumensin, a nonhormonal cattle feed additive; anticoccidial agents for use in broilers and layer replacements, the largest of which is Coban; and other products for livestock and poultry. The other pharmaceutical product group includes Evista and other miscellaneous pharmaceutical products and services.

Most of the pharmaceutical products are distributed through wholesalers that serve physicians and other health care professionals, pharmacies and hospitals. In 1998, the company's four largest wholesalers each accounted for between 10 percent and 17 percent of consolidated net sales. Animal health products are sold to wholesale distributors, retailers, manufacturers and producers.

Total assets on the consolidated balance sheet include amounts from the discontinued operations of PCS (see Note 3). Total assets from continuing operations for 1998, 1997 and 1996 were $10.6 billion, $10.6 billion and $9.9 billion, respectively. Long-lived assets disclosed above consist of property and equipment, goodwill and certain sundry assets of the continuing operations.

The company is exposed to the risk of changes in social, political and economic conditions inherent in foreign operations, and the company's results of operations and the value of its foreign assets are affected by fluctuations in foreign currency exchange rates.

Selected Quarterly Data (unaudited)
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions, except per-share data)

1998/1/	Fourth	Third	Second	First/2/
Net sales	$2,635.4	$2,359.4	$2,155.0	$2,087.0
Cost of sales	583.5	495.7	478.6	457.3
Operating expenses	1,329.2	1,107.5	1,054.1	906.4
Acquired in-process technology	-	127.5	-	-
Other (income)/ expense-net	7.4	29.6	(25.0)	20.0
Income from continuing operations before income taxes and extraordinary item	715.3	599.1	647.3	703.3
Income (loss) from:				
Continuing operations before extraordinary item	561.6	512.2	490.9	531.6
Discontinued operations	5.7	6.0	0.4	(3.3)
Net income	567.3	518.2	491.3	521.1
Earnings per share - basic:				
Continuing operations before extraordinary item	.51	.47	.45	.48
Discontinued operations	.01	-	-	-
Net income	.52	.47	.45	.47
Earnings per share - diluted:				
Continuing operations before extraordinary item	.50	.46	.44	.47
Discontinued operations	.01	-	-	-
Net income	.51	.46	.44	.46
Dividends paid per share	.20	.20	.20	.20
Common stock prices:				
High	91.31	81.63	73.75	72.38
Low	68.00	62.56	57.88	57.69

1997/1/	Fourth	Third	Second	First
Net sales	$2,258.0	$2,029.0	$1,859.6	$1,841.1
Cost of sales	561.7	483.0	446.1	455.2
Operating expenses	1,060.5	908.3	876.6	757.9
Asset impairment	-	-	97.8	-
Gain on sale of DowElanco	-	13.6	618.2	-
Other (income)/expense - net	18.0	31.6	(15.0)	36.7
Income from continuing operations before income taxes	617.8	619.7	1,072.3	591.3
Income (loss) from:				
Continuing operations	465.1	464.1	636.0	450.7
Discontinued operations	(7.6)	(7.2)	(2,368.2)	(18.0)
Net income (loss)	457.5	456.9	(1,732.2)	432.7
Earnings (loss) per share - basic:				
Continuing operations	.42	.42	.58	.41
Discontinued operations	(.01)	(.01)	(2.15)	(.02)
Net income	.41	.41	(1.57)	.39
Earnings (loss) per share - diluted:				
Continuing operations	.41	.41	.56	.40
Discontinued operations	(.01)	(.01)	(2.10)	(.02)
Net income	.40	.40	(1.54)	.38
Dividends paid per share	.20	.18	.18	.18
Common stock prices:				
High	70.44	61.75	55.75	47.50
Low	60.00	50.41	38.69	35.56

/1/ Amounts for net sales, cost of sales, operating expenses and other income/expense for the first three quarters of 1998 and all 1997 differ from previously reported amounts since the results of the health-care-management business have been reflected as discontinued operations (see Note 3). This restatement also caused a change in 1997 earnings per share.

/2/ Reflects the impact of an extraordinary item (see Note 6).

The company's common stock is listed on the New York, London, Tokyo and other stock exchanges.

Selected Financial Data (unaudited)
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions, except per-share data)

	1998	1997	1996	1995	1994
Operations/1/					
Net sales	$9,236.8	$7,987.7	$6,998.3	$6,508.8	$5,686.5
Research and development	1,738.9	1,370.2	1,189.5	1,042.3	838.7
Other costs and expenses	4,832.9	4,348.2	3,677.5	3,599.9	3,154.5
Gain on sale of DowElanco	-	(631.8)	-	-	-
Income from continuing operations before taxes and extraordinary item	2,665.0	2,901.1	2,131.3	1,866.6	1,693.3
Income taxes	568.7	885.2	505.6	457.6	511.3
Income (loss)from:					
Continuing operations before extraordinary item	2,096.3	2,015.9	1,625.7	1,409.0	1,182.0
Discontinued operations	8.8	(2,401.0)	(102.2)	881.9	104.1
Net income (loss)	2,097.9/3/	(385.1)	1,523.5	2,290.9	1,286.1
Income from continuing operations before extraordinary item as a percent of sales	22.7%	25.2%	23.2%	21.6%	20.8%
Per-share data - diluted:					
Income (loss) from:					
Continuing operations before extraordinary item	$1.87	$1.78	$1.45	$1.22	$1.01
Discontinued operations	.01	(2.12)	(.09)	.77	.09
Net income (loss)	1.87/3/	(.34)	1.36	1.99	1.10
Dividends declared	.83	.76	.694	.665	.63
Weighted-average number of shares outstanding - diluted (thousands)	1,121,486	1,130,579	1,117,110	1,152,016	1,170,916
Financial Position					
Current assets	$5,406.8	$5,320.7	$3,891.3	$4,138.6	$3,962.3
Current liabilities	4,607.2	4,191.6	4,222.2	4,967.0	5,669.5
Property and equipment-net	4,096.3	4,101.7	4,307.0	4,239.3	4,411.5
Total assets	12,595.5	12,577.4	14,307.2	14,412.5	14,507.4
Long-term debt	2,185.5	2,326.1	2,516.5	2,592.9	2,125.8
Shareholders' equity	4,429.6	4,645.6	6,100.1	5,432.6	5,355.6
Supplementary Data/2/					
Return on shareholders' equity	46.2%	37.5%	28.2%	26.1%	23.8%
Return on assets	17.0%	15.4%	11.4%	9.6%	10.8%
Capital expenditures	$419.9	$366.3	$443.9	$551.3	$576.5
Depreciation and amortization	490.4	509.8	543.5	553.7	432.2
Effective tax rate	21.3%	30.5%/4/	23.7%	24.5%	30.2%
Number of employees	29,800	28,900	27,400	26,800	24,900
Number of shareholders of record	62,300	58,200	54,500	52,600	55,900

/1/ Amounts for net sales, research and development, other costs and expenses, and income taxes for 1997, 1996, 1995 and 1994 differ from previously reported amounts since the results of the health-care-management business have been reflected as discontinued operations (see Note 3). This restatement also caused a change in 1997 earnings per share and weighted-average number of shares outstanding.

/2/ All supplementary financial data have been computed using income from continuing operations except for capital expenditures and depreciation and amortization, which include amounts from discontinued operations. The number of employees reflects continuing operations, including controlled joint ventures.

/3/ Reflects the impact of an extraordinary item (see Note 6).

/4/ Excluding the impacts of the unusual transactions reflected in 1997, the effective tax rate would have been 24.1 percent.

Notes to Consolidated Financial Statements
ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions, except per-share data)

Note 1: Summary of Significant Accounting Policies

Basis of presentation: The accounts of all wholly owned and majority-owned subsidiaries are included in the consolidated financial statements. All intercompany balances and transactions have been eliminated. Certain 1997 and 1996 amounts, as previously reported, have been reclassified to conform to the 1998 presentation of discontinued operations (see Note 3).

The preparation of financial statements in conformity with generally accepted accounting principles 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.

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 and the effect of all potentially dilutive common shares (primarily unexercised stock options).

Cash equivalents: The company considers all highly liquid investments, generally with a maturity of three months or less, to be cash equivalents. The cost of these investments approximates fair value.

Inventories: The company states all its inventories at the lower of cost or market. The company uses the last-in, first-out (LIFO) method for substantially all its inventories located in the continental United States, or approximately 50 percent of its total inventories. Other inventories are valued by the first-in, first-out (FIFO) method. Inventories at December 31 consisted of the following:

	1998	1997
Finished products	$325.1	$262.0
Work in process	435.8	459.4
Raw materials and supplies	236.3	191.0
	997.2	912.4
Increase (decrease) to LIFO cost	2.7	(11.7)
	$999.9	$900.7

Investments: All short-term debt securities are classified as held-to-maturity because the company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost, adjusted for amortization of premiums and accretion of discounts to maturity. Substantially all long-term debt and marketable equity securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in other comprehensive income. The company owns no investments that are considered to be trading securities.

Derivative financial instruments: The company's derivative activities, all of which are for purposes other than trading, are initiated within the guidelines of documented corporate risk-management policies and do not create additional risk because gains and losses on derivative contracts offset losses and gains on the assets, liabilities and transactions being hedged. As derivative contracts are initiated, the company designates the instruments individually as hedges of underlying financial instruments or anticipated transactions (i.e., underlying exposures). Management reviews the correlation and effectiveness of its derivatives on a periodic basis. Derivative contracts that do not qualify for deferral hedge accounting are marked to market.

For terminations of derivatives receiving deferral accounting, gains and losses are deferred when the related underlying exposures remain outstanding

and are included in the measurement of the related transaction or balance. In addition, upon termination of the underlying exposures, the derivative is marked to market and the resulting gain or loss is included with the gain or loss on the related transaction. The company may redesignate the remaining derivative instruments as hedges of other underlying exposures.

The company enters into foreign currency forward and option contracts to reduce the effect of fluctuating currency exchange rates (principally European currencies and the Japanese yen). Generally, foreign currency derivatives used for hedging are put in place using the same or like currencies and duration as the underlying exposures. Forward contracts are principally used to manage exposures arising from affiliate foreign currency balances. These contracts are marked to market with gains and losses recognized currently in income to offset the respective losses and gains recognized on the underlying exposures. The company also enters into purchased option contracts to hedge anticipated foreign currency transactions, primarily intercompany inventory activities expected to occur within the next year, and foreign currency forward contracts and currency swaps to hedge firm commitments. The contracts are designated and effective as hedges of those future transactions. Gains and losses on these contracts that qualify as hedges are deferred and recognized as an adjustment of the subsequent transaction when it occurs. Forward and option contracts generally have maturities not exceeding 12 months.

The company may enter into interest rate swaps to manage interest rate exposures. The company designates the interest rate swaps as hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the swap agreements.

Intangible assets: Intangible assets arising from acquisitions and research alliances are amortized over their estimated useful lives, ranging from five to 25 years, using the straight-line method. Impairments are recognized in operating results if impairment indicators are present and the expected future operating cash flows of the related assets are less than their carrying amounts.

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

	1998	1997
Land	$ 141.1	$ 130.6
Buildings	2,178.5	2,057.1
Equipment	4,556.6	4,373.8
Construction in progress	398.3	473.4
	7,274.5	7,034.9
Less allowances for depreciation	3,178.2	2,933.2
	$4,096.3	$4,101.7

Depreciation expense related to continuing operations for 1998, 1997 and 1996 was $393.4 million, $382.3 million and $379.4 million, respectively. Approximately $17.0 million, $20.4 million and $35.8 million of interest costs were capitalized as part of property and equipment in 1998, 1997 and 1996, respectively. Total rental expense for all leases related to continuing operations, including contingent rentals (not material), amounted to approximately $134.8 million for 1998, $111.8 million for 1997 and $107.0 million for 1996. Capital leases included in property and equipment in the consolidated balance sheets and future minimum rental commitments are not material. However, the company entered into capital lease obligations aggregating $13.3 million in 1998 and $8.8 million in 1997.

Revenue recognition: Revenue from sales of products is recognized at the time products are shipped to the customer.

Income taxes: 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. Federal income taxes are provided on the portion of the income of foreign subsidiaries that is expected to be remitted to the United States and be taxable.

Earnings (loss) per share: Basic earnings (loss) per share are calculated based on the weighted-average number of outstanding common shares and incremental shares. Diluted earnings (loss) per share are calculated based on the weighted-average number of outstanding common shares plus the effect of dilutive stock options and other incremental shares.

Note 2: Implementation of New Financial Accounting Pronouncements

Accounting Changes

Effective January 1, 1998, the company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." Under provisions of this statement, the company has included a financial statement presentation of comprehensive income to conform to these new requirements. Statement 130 requires unrealized gains or losses on the company's available-for-sale securities, minimum pension liability adjustments and foreign currency translation adjustments, which, prior to adoption of the statement, were reported separately in shareholders' equity, to be included in other comprehensive income. As a consequence of this change, certain balance sheet reclassifications were necessary for previously reported amounts to achieve the required presentation of comprehensive income. See Note 14.

Effective December 31, 1998, the company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Statement 131 requires public business enterprises to report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. Statement 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. See the segment information.

Effective January 1, 1998, the company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits." Statement 132 revises the disclosure requirements for employers' pensions and other retiree benefits. See Note 12.

In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued. Statement 133 is required to be adopted in years beginning after June 15, 1999. The statement permits early adoption as of the beginning of any fiscal quarter after its issuance. The statement will require the company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. Hedge ineffectiveness, the amount by which the change in the value of a hedge does not exactly offset the change in the value of the hedged item, will be immediately recognized in earnings. The company has not yet determined what the effect of Statement 133 will be on the earnings and financial position of the company or when the statement will be adopted.

Effective January 1, 1998, the company adopted the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The SOP requires capitalization of certain costs incurred in the development of internal-use software, including external direct material and service costs, employee payroll and payroll-related costs, and capitalized interest. Prior to adoption of SOP 98-1, the company expensed certain of these costs as incurred. The effect of this change in accounting principle on consolidated earnings during the current period is immaterial.

In April 1998, the AICPA issued SOP 98-5, "Reporting the Costs of Start-up Activities." The SOP is effective beginning January 1, 1999, and requires that start-up costs capitalized prior to January 1, 1999, be written off and any future start-up costs be expensed as incurred. The unamortized balance of start-up costs will be written off as of January 1, 1999. The company estimates the impact of adopting this SOP will not result in a material reduction of 1999 earnings.

Note 3: Discontinued Operations and Asset Impairment

In November 1998, the company signed a definitive agreement for Rite Aid Corporation to acquire PCS, the company's health-care-management subsidiary for $1.6 billion in cash. The transaction closed on January 22, 1999, and will generate a gain of approximately $165 million to $185 million ($.15 to $.17 per share) in the first quarter of 1999. There will not be a significant tax effect on the gain.

Because of the planned disposition of PCS, the results of operations of PCS have been classified as discontinued operations in the consolidated statements of income and prior periods have been restated. Selected income statement information for PCS follows:

	1998	1997	1996
Revenues	$814.5	$ 529.9	$ 348.3
Income tax expense	32.2	10.1	2.2
Income (loss) from discontinued operations	8.8	(2,401.0)	(102.2)

In the second quarter of 1997, concurrent with PCS' annual planning process, the company determined that PCS' estimated future undiscounted cash flows were below the carrying value of PCS' long-lived assets. Accordingly, during the second quarter of 1997, the company adjusted the carrying value of PCS' long-lived assets, primarily goodwill, to their estimated fair value of approximately $1.5 billion, resulting in a noncash impairment loss of approximately $2.3 billion ($2.07 per share), which is included in discontinued operations. The estimated fair value was based on anticipated future cash flows discounted at a rate commensurate with the risk involved.

The consolidated balance sheet and consolidated statements of cash flows include PCS. Selected balances, excluding intercompany amounts, as of December 31 were as follows:

	1998	1997
Current assets	$ 528.7	$ 408.9
Goodwill	1,397.4	1,436.3
Total assets	2,026.5	1,945.7
Current liabilities	886.3	714.7

An asset impairment charge related to continuing operations was also identified in the second quarter of 1997, concurrent with the annual planning process. The primary component of the $97.8 million ($.09 per share) noncash asset impairment charge was an adjustment to the carrying value of certain long-lived assets of a small portion of the company's health-care-management business that was not sold. Similar to the impairment of PCS' long-lived assets discussed above, the company determined that the estimated future undiscounted cash flows were below the carrying value of the related long-lived assets. Accordingly, the carrying value was adjusted to estimated fair value based on anticipated future cash flows, discounted at a rate commensurate with the risk involved. This business is now part of a joint venture, the results of which are immaterial to the consolidated financial statements.

Note 4: Collaboration and Other Divestiture

During 1998, the company announced a collaboration with ICOS Corporation to jointly develop and globally commercialize a phosphodiesterase type 5 (PDE5) inhibitor as an oral therapeutic agent for the treatment of both male and female sexual dysfunction. The compound is in the development phase (Phase II clinical trials) and no alternative future uses have been identified. As with many Phase

II compounds, launch of the product, if successful, would not be expected in the near term. Accordingly, under current accounting rules, the company's payments to acquire rights to this compound were required to be charged as a one-time expense of $127.5 million, which reduced earnings per share by approximately $.07 net of tax.

On June 30, 1997, The Dow Chemical Company acquired the company's 40 percent interest in the DowElanco joint venture. The cash purchase price was $1.2 billion, resulting in a gain of $631.8 million ($303.5 million after-tax, or $.27 per share).

Note 5: Financial Instruments

Risk-Management Instruments and Off-Balance-Sheet Risk

In the normal course of business, operations of the company are exposed to fluctuations in currency values and interest rates. These fluctuations can vary the costs of financing, investing and operating. The company addresses a portion of these risks through a controlled program of risk management that includes the use of derivative financial instruments.

The notional amounts of derivatives summarized in the following paragraphs do not represent amounts exchanged by the parties and thus are not a measure of the exposure of the company through its use of derivatives. The company is exposed to credit-related losses in the event of nonperformance by counterparties to financial instruments, but it does not expect any counterparties to fail to meet their obligations given their high credit ratings.

At December 31, the stated, or notional, amounts of the company's outstanding derivative financial instruments were as follows:

	1998	1997
Forward exchange contracts	$448.3	$593.9
Foreign currency options - purchased	606.0	504.5
Interest rate swaps	-	30.0

Financial instruments that potentially subject the company to credit risk consist principally of trade receivables and interest-bearing investments. Wholesale distributors of life-sciences products and managed care organizations account for a substantial portion of trade receivables; collateral is generally not required. The risk associated with this concentration is limited due to the company's ongoing credit review procedures. The company places substantially all its interest-bearing investments with major financial institutions, in U.S. Government securities or with top-rated corporate issuers. In accordance with documented corporate policies, the company limits the amount of credit exposure to any one financial institution.

Fair Value of Financial Instruments

A summary of the company's outstanding financial instruments at December 31 follows. As summarized, "cost" relates to investments while "carrying amount" relates to long-term debt.

	1998		1997	
	Cost/Carrying Amount	Fair Value	Cost/Carrying Amount	Fair Value
Short-term investments:				
Debt securities	$ 101.4	$ 102.7	$ 77.1	$ 76.9
Noncurrent investments:				
Marketable equity	66.5	70.4	77.7	86.0
Debt securities	38.6	38.6	93.0	94.3
Nonmarketable equity	26.1	26.1	33.7	33.7
Long-term debt, including current portion	2,337.7	2,629.7	2,524.4	2,684.7

The company determines fair values based on quoted market values where available or discounted cash flow analyses (principally long-term debt). The fair values of nonmarketable equity securities, which represent either equity investments in start-up technology companies or partnerships that invest in start-up technology companies, are estimated based on the fair value information provided by these ventures. The fair value and carrying amount of risk-management instruments were not material at December 31, 1998 or 1997.

At December 31, 1998 and 1997, the gross unrealized holding gains on available-for-sale securities were $22.7 million and $20.0 million, respectively, and the gross unrealized holding losses were $ 20.6 million and $15.3 million, respectively. Substantially all these gains and losses are associated with the marketable equity securities. The proceeds from sales of available-for-sale securities totaled $36.3 million, $39.7 million and $102.1 million in 1998, 1997 and 1996, respectively. Realized gains on sales of available-for-sale securities were $20.6 and $6.6 million in 1998 and 1997, respectively. Realized losses on sales of available-for-sale securities were $2.5 and $25.3 million in 1998 and 1997, respectively. Realized gains and losses were not significant in 1996. The net adjustment to unrealized gains and losses on available-for-sale securities reduced shareholders' equity by $1.7 million and $7.7 million in 1998 and 1997, respectively.

The company is a limited partner in certain affordable housing investments that generate benefits in the form of tax credits. The determination of fair value of these investments is not practicable. The carrying value of such investments was $68.9 million and $251.6 million as of December 31, 1998 and 1997, respectively. The reduction in carrying value was a result of sales of these investments during 1998.

Note 6: Borrowings

Long-term debt at December 31 consisted of the following:

	1998	1997
6.57 to 7.13 percent notes (due 2016-2036).....	$1,000.0	$1,000.0
6.25 to 8.38 percent notes (due 1999-2006).....	750.0	750.0
8.13 to 8.38 percent eurodollar bonds (due 2000-2005).....	350.0	500.0
7.10 percent medium-term notes (due 1999).....	36.5	36.5
6.55 percent ESOP debentures (due 2017).....	99.6	-
8.18 percent ESOP debentures.....	-	100.6
Other, including capitalized leases.....	101.6	137.3
	2,337.7	2,524.4
Less current portion.....	152.2	198.3
	$2,185.5	$2,326.1

The 6.55 percent Employee Stock Ownership Plan (ESOP) debentures are obligations of the ESOP but are shown on the consolidated balance sheet because they are guaranteed by the company. The principal and interest on the debt will be funded by contributions from the company and by dividends received on certain shares held by the ESOP. Because of the amortizing feature of the ESOP debt, bondholders will receive both interest and principal payments each quarter.

The 6.55 percent ESOP debentures replaced the 8.18 percent ESOP debentures pursuant to a refinancing in March 1998. An extraordinary charge of $12.0 million, net of a $4.8 million income tax benefit, was recorded as a result of this refinancing.

The aggregate amounts of maturities on long-term debt for the next five years are as follows: 1999, $152.2 million; 2000, $213.7 million; 2001, $162.9 million; 2002, $12.0 million; and 2003, $211.0 million.

At December 31, 1998 and 1997, short-term borrowings included $29.2 million and $29.3 million, respectively, of notes payable to banks. At December 31, 1998, unused committed lines of credit totaled approximately $2.2 billion. 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.

Cash payments of interest on borrowings totaled $188.2 million, $243.9 million and $292.9 million in 1998, 1997 and 1996, respectively.

Note 7: Stock Plans

Stock options are granted to employees at exercise prices equal to the fair market value of the company's stock at the dates of grant. Generally, options vest 100 percent three years from the grant date and have a term of 10 years. Performance awards are granted to officers and key employees and are payable in shares of the company's common stock. The number of performance award shares actually issued varies depending upon the achievement of certain earnings targets. In general, performance awards vest 100 percent at the end of the second fiscal year following the grant date.

The company has elected to follow Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its stock options and performance awards. Under APB No. 25, because the exercise price of the company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Total compensation expense for stock-based performance awards reflected in income on a pretax basis was $257.8 million, $242.1 million and $164.2 million in 1998, 1997 and 1996, respectively. However, SFAS No. 123, "Accounting for Stock-Based Compensation," requires presentation of pro forma information as if the company had accounted for its employee stock options and performance awards granted subsequent to December 31, 1994, under the fair value method of that statement. For purposes of pro forma disclosure, the estimated fair value of the options and performance awards at the date of the grant is amortized to expense over the vesting period. Under the fair value method, the company's net income (loss) and earnings (loss) per share would have been as follows:

	1998	1997	1996
Net income (loss)	$2,120.9	$(339.5)	$1,508.3
Earnings (loss) per share - diluted	1.89	(.30)	1.35

Because SFAS No. 123 is applicable only to options and performance awards granted subsequent to December 31, 1994, and the options and performance awards have three-year and two-year vesting periods, respectively, the pro forma effect was not fully reflected until 1998.

The weighted-average per-share fair value of the individual options and performance awards granted during 1998, 1997 and 1996 were as follows on the date of grant:

	1998	1997	1996
Employee stock options	$16.64	$15.55	$ 8.25
Performance awards	88.88	69.63	36.50

The fair values of the options were determined using a Black-Scholes option-pricing model with the following assumptions:

	1998	1997	1996
Dividend yield	2.96%	3.14%	3.24%
Volatility	23.5%	21.5%	21.0%
Risk-free interest rate	4.29%	6.18%	6.36%
Forfeiture rate	0	0	0
Expected life	7 years	7 years	7 years

Stock option activity during 1996-1998 is summarized below:

	Shares of Common Stock Attributable to Options	Weighted-Average Exercise Price of Options
Unexercised at January 1, 1996.....	75,233,590	$16.51
Granted.....	6,340,874	33.55
Exercised.....	(14,583,420)	12.94
Forfeited.....	(1,081,168)	20.93
Unexercised at December 31, 1996.....	65,909,876	18.86
Granted.....	5,854,408	64.73
Exercised.....	(10,072,728)	13.88
Forfeited.....	(797,912)	22.30
Unexercised at December 31, 1997.....	60,893,644	24.05
Granted.....	6,803,350	74.18
Exercised.....	(13,696,906)	16.88
Forfeited.....	(1,047,023)	24.29
Unexercised at December 31, 1998.....	52,953,065	32.35

The following table summarizes information concerning outstanding and exercisable options at December 31, 1998 (shares in millions, contractual life in years):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$10 - $20	17.70	4.57	$13.90	17.70	$13.90
$20 - $30	16.90	6.37	$23.14	16.90	$23.14
$30 - $75	18.35	8.85	$58.63	1.22	$52.36

Shares exercisable at December 31, 1998, were 35.8 million (1997 - 29.6 million shares, 1996 - 30.6 million shares).

As noted above, the number of shares ultimately issued pursuant to the performance award program is dependent upon the earnings achieved during the vesting period. Pursuant to this plan, 1,543,047 shares, 1,119,487 shares and 1,064,899 shares were issued in 1998, 1997 and 1996, respectively. At December 31, 1998, plan participants had the right to receive up to 7,719,450 additional shares (reduced to the extent necessary to satisfy payroll tax withholdings), contingent upon earnings achieved.

At December 31, 1998, additional options, performance awards or restricted stock grants may be granted under the 1998 Lilly Stock Plan for not more than 45.8 million shares (1.3 million shares and 6.6 million shares in 1997 and 1996, respectively, under the 1994 Lilly Stock Plan).

Note 8: Shareholders' Equity

Changes in certain components of shareholders' equity were as follows:

	Additional Paid-in Capital	Retained Earnings	Deferred Costs - ESOP	Common Stock in Treasury Shares	Common Stock in Treasury Amount
Balance at January 1, 1996	$ 418.3	$ 6,435.7	$(199.5)	18,149,494	$ 1,625.5
Net income		1,523.5			
Cash dividends declared per share: $.695		(762.9)			
Purchase for treasury				5,315,000	318.5
Issuance of stock under employee stock plans	(368.4)			(7,384,672)	(648.0)
ESOP transactions	17.5		22.6		
Other		0.7		(499)	(0.1)
Balance at December 31, 1996	67.4	7,197.0	(176.9)	16,079,323	1,295.9
Net loss		(385.1)			
Cash dividends declared per share: $.76		(840.9)			
Stock dividend declared		(346.5)			
Retirement of treasury shares	(1,134.5)			(14,223,272)	(1,143.4)
Purchase for treasury				3,400,000	355.3
Issuance of stock under employee stock plans	(99.7)			(4,247,216)	(397.4)
ESOP transactions	39.6		21.2		
Other	(0.3)	0.3		(8,835)	(0.9)
Reclassification	1,127.5	(1,127.5)			
Balance at December 31,1997	-	4,497.3	(155.7)	1,000,000	109.5
Net income		2,097.9			
Cash dividends declared per share: $.83		(908.9)			
Retirement of treasury shares	(2,035.2)			(29,009,799)	(2,053.3)
Purchase for treasury				28,349,900	2,005.8
Issuance of stock under employee stock plans	558.7			659,899	47.5
ESOP transactions	23.6		8.8		
Other	5.4	(10.0)		(4,508)	(0.5)
Reclassification	1,447.5	(1,447.5)			
Balance at December 31, 1998	$ -	$ 4,228.8	$(146.9)	995,492	$ 109.0

As shown above, the company has completed its previously announced $2 billion share repurchase, acquiring approximately 28.3 million shares in 1998. The company expects to repurchase shares costing approximately $1 billion in 1999.

The company has an Employee Stock Ownership Plan (ESOP) as a funding vehicle for the existing employee savings plan. The ESOP used the proceeds of a loan from the company to purchase shares of common stock from the treasury. In 1991, the ESOP issued $200 million of third-party debt, repayment of which was guaranteed by the company (see Note 6). The proceeds were used to purchase shares of the company's common stock on the open market. Shares of common stock held by the ESOP will be allocated to participating employees annually through 2017 as part of the company's savings plan contribution. The fair value of shares allocated each period is recognized as compensation expense.

On October 15, 1997, the company effected a two-for-one stock split in the form of a 100 percent stock dividend payable to shareholders of record on September 24, 1997. The outstanding and weighted-average number of shares of common stock and per-share data in these financial statements have been adjusted to reflect the impact of the stock split for all periods presented. Treasury shares held by the company were not split.

A new Shareholder Rights Plan was adopted by the company's board of directors to replace the existing plan, which expired on July 28, 1998. Under the terms of the new plan, all shareholders of record as of July 28, 1998, received for each common share owned a preferred stock purchase right entitling them to purchase from the company one one-thousandth of a share of Series B Junior Participating Preferred Stock (the "Preferred Stock") at a price of $325. The rights are not exercisable until after the "Distribution Date," which is generally defined as the 10th business day after the date of a public announcement that a person (the "Acquiring Person") has acquired ownership of 15 percent or more of the company's common stock. The company may redeem the rights for $.005 per right up to and including the Distribution Date. The rights will expire on July 28, 2008, unless redeemed earlier by the company.

The plan provides that, if an Acquiring Person acquires 15 percent or more of the outstanding common stock of the company and the company's redemption right has expired, generally each holder of a right (other than the Acquiring Person) will have the right to purchase at the exercise price the number of shares of common stock of the company as have a value of two times the exercise price.

Alternatively, if, in a transaction not approved by the board of directors, the company is acquired in a business combination transaction or sells 50 percent or more of its assets or earning power after a Distribution Date, generally each holder of a right (other than the Acquiring Person) will have the right to purchase at the exercise price the number of shares of common stock of the acquiring company as have a value of two times the exercise price.

At any time after an Acquiring Person has acquired 15 percent or more but less than 50 percent of the company's outstanding common stock, the board of directors may exchange the rights (other than those owned by the Acquiring Person) for company common stock or Preferred Stock at an exchange ratio of one common share (or one one-thousandth of a share of Preferred Stock) per right.

Note 9: Minority Interest in Subsidiary

In November 1998, in connection with the sale of the company's PCS subsidiary (see Note 3), PCS repurchased its convertible Class B shares. The Class B shares were initially issued and sold to an institutional investor in October 1997 for $160 million. Prior to their repurchase, the Class B shares paid dividends on a quarterly basis at 25 basis points above the three-month LIBOR rate.

Note 10: Earnings per Share

The following is a reconciliation of the numerators and denominators used in computing earnings per share from continuing operations before extraordinary item:

	1998	1997	1996
	(Shares in thousands)		
Income from continuing operations before extraordinary item available to common shareholders:			
Income from continuing operations before extraordinary item	$ 2,096.3	$ 2,015.9	$ 1,625.7
Preferred stock dividends	(1.7)	(2.6)	(3.6)
Income from continuing operations before extraordinary item available to common shareholders	$ 2,094.6	$ 2,013.3	$ 1,622.1
Basic earnings per share:			
Weighted-average number of common shares outstanding, including incremental shares	1,095,834	1,101,513	1,093,920
Basic earnings per share from continuing operations before extraordinary item	$ 1.91	$ 1.83	$ 1.48
Diluted earnings per share:			
Weighted-average number of common shares outstanding	1,095,537	1,101,099	1,093,654
Stock options and other incremental shares	25,949	29,480	23,456
Weighted-average number of common shares outstanding - diluted	1,121,486	1,130,579	1,117,110
Diluted earnings per share from continuing operations before extraordinary item	$ 1.87	$ 1.78	$ 1.45

Note 11: Income Taxes

Following is the composition of income taxes attributable to continuing operations before extraordinary item:

	1998	1997	1996
Current:			
Federal	$322.1	$ 766.1	$309.5
Foreign	238.9	392.3	143.1
State	(8.9)	51.5	6.2
	552.1	1,209.9	458.8
Deferred:			
Federal	(2.4)	(284.5)	22.9
Foreign	9.4	9.6	7.8
State	9.6	(49.8)	16.1
	16.6	(324.7)	46.8
Income taxes	$568.7	$ 885.2	$505.6

Significant components of the company's deferred tax assets and liabilities as of December 31 are as follows:

	1998	1997
Deferred tax assets:		
Tax credit carryforwards and carrybacks	$ 589.9	$ 289.4
Other carryforwards	223.2	53.7
Capital loss carryforward	703.7	108.6
Inventory	251.0	248.7
Compensation and benefits	183.1	173.1
Contingent liabilities	78.1	117.5
Other	244.6	263.4
	2,273.6	1,254.4
Valuation allowances	(810.0)	(110.2)
Total deferred tax assets	1,463.6	1,144.2
Deferred tax liabilities:		
Property and equipment	(540.4)	(555.9)
Unremitted earnings	(512.8)	(152.0)
Prepaid employee benefits	(238.3)	(229.6)
Other	(54.7)	(61.3)
Total deferred tax liabilities	(1,346.2)	(998.8)
Deferred tax assets - net	$ 117.4	$ 145.4

At December 31, 1998, the company had operating and capital loss carryforwards for income tax purposes of $270.3 million: $148.1 million will expire within five years and $85.7 million thereafter; $36.5 million of the carryforwards will never expire. The company also has tax credit carryforwards of $548.6 million available to reduce future income taxes: $443.6 million will expire within five years and $73.0 million thereafter; $32.0 million of the tax credit carryforwards will never expire.

As discussed in Note 3, the company signed a definitive agreement to sell its PCS health-care-management subsidiary in November 1998, and the sale closed in January 1999. As a consequence of the agreement, the company recorded a deferred tax asset of $655.3 million for the tax capital loss that resulted from this transaction. This loss can be carried forward five years. A valuation allowance was established for this asset due to the uncertain realization of the benefit.

Domestic and Puerto Rican companies contributed approximately 60 percent, 73 percent and 74 percent in 1998, 1997 and 1996, respectively, to consolidated income from continuing operations before income taxes and extraordinary item. Unremitted earnings of foreign subsidiaries that have been, or are intended to be, permanently reinvested for continued use in foreign operations and that,

if distributed, would result in taxes at approximately the U.S. statutory rate, aggregated $1.01 billion at December 31, 1998 ($115 million at December 31, 1997). Cash payments of income taxes totaled $273 million, $542 million and $289 million in 1998, 1997 and 1996, respectively.

Following is a reconciliation of the effective income tax rate applicable to income from continuing operations:

	1998	1997	1996
United States federal statutory tax	35.0%	35.0%	35.0%
Add (deduct):			
International operations, including Puerto Rico	(10.5)	(1.3)	(8.9)
General business credits	(2.4)	(2.2)	(1.6)
Valuation allowance reversal	(1.5)	-	-
Sale of investments	-	(1.7)	-
Sundry	0.7	0.7	(0.8)
Effective income tax	21.3%	30.5%	23.7%

Excluding the impact of the gain on the sale of DowElanco and asset impairment, the effective income tax rate applicable to continuing operations for 1997 would have been 24.1 percent.

Note 12: Retirement Benefits

The change in benefit obligation, change in plan assets, funded status and amounts recognized in the consolidated balance sheets at December 31 for the company's defined benefit pension and retiree health benefit plans were as follows:

	Defined Benefit Pension Plans		Retiree Health Benefits	
	1998	1997	1998	1997
Change in benefit obligation:				
Benefit obligation at beginning of year	$2,550.9	$2,303.5	$ 477.5	$ 412.1
Service cost	115.5	89.2	13.3	11.2
Interest cost	185.8	179.0	34.5	31.6
Actuarial loss	229.8	176.8	139.2	60.7
Benefits paid	(170.3)	(165.8)	(43.3)	(37.6)
Foreign currency exchange rate changes and other adjustments	(12.9)	(31.8)	0.3	(0.5)
Benefit obligation at end of year	2,898.8	2,550.9	621.5	477.5
Change in plan assets:				
Fair value of plan assets at beginning of year	2,923.2	2,629.2	228.1	200.1
Actual return on plan assets	286.4	407.7	33.8	30.1
Employer contribution	28.1	65.7	33.9	35.5
Benefits paid	(170.3)	(165.8)	(43.3)	(37.6)
Foreign currency exchange rate changes and other adjustments	2.2	(13.6)	-	-
Fair value of plan assets at end of year	3,069.6	2,923.2	252.5	228.1
Funded status	170.8	372.3	(369.0)	(249.4)
Unrecognized net actuarial (gain) loss	202.7	(13.8)	254.9	134.2
Unrecognized prior service cost (benefit)	130.5	118.0	(0.6)	(3.1)
Unrecognized net obligation at January 1, 1986	2.6	3.0	-	-
Net amount recognized	$ 506.6	$ 479.5	$(114.7)	$(118.3)
Amounts recognized in the consolidated balance sheet consisted of:				
Prepaid benefit cost	$ 612.3	$ 579.1	$ -	$ -
Accrued benefit liability	(192.3)	(131.6)	(114.7)	(118.3)
Intangible asset	37.9	14.1	-	-
Accumulated other comprehensive income before income taxes	48.7	17.9	-	-
Net amount recognized	$ 506.6	$ 479.5	$(114.7)	$(118.3)

	Defined Benefit Pension Plans		Retiree Health Benefits	
	1998	1997	1998	1997
(Percents)				
Weighted-average assumptions as of December 31:				
Discount rate	6.9	7.5	7.0	7.5
Expected return on plan assets	10.5	10.5	10.5	10.5
Rate of compensation increase	4.0-8.0	4.0-8.0	-	-

Health-care-cost trend rates were assumed to increase at an annual rate of 6.5 percent in 1999 for participants under age 65, decreasing one-half percent per year to 5.0 percent in 2002 and thereafter. For participants over age 65, the rate was assumed to increase 5.0 percent in 1999 and thereafter. The discount rate decrease at December 31, 1998, increased the projected benefit obligation for the defined benefit plans and the retiree health benefits plans by approximately $227.4 million and $61.2 million, respectively.

The projected benefit obligation, accumulated benefit obligation and fair value of the plan assets for the defined benefit pension plans with projected benefit obligations in excess of plan assets were $586.6 million, $502.3 million and $349.7 million, respectively, as of December 31, 1998, and $478.0 million, $386.9 million and $318.3 million, respectively, as of December 31, 1997.

Net pension and retiree health benefit expense included the following components related to continuing operations:

	Defined Benefit Pension Plans			Retiree Health Benefits		
	1998	1997	1996	1998	1997	1996
Components of net periodic benefit cost:						
Service cost	$ 112.9	$ 86.3	$ 81.9	$ 12.8	$ 10.9	$ 11.4
Interest cost	184.2	178.0	166.3	34.3	31.5	28.7
Expected return on plan assets	(277.1)	(252.2)	(235.1)	(23.0)	(21.1)	(19.0)
Amortization of prior service cost (benefit)	9.7	9.2	8.8	(3.3)	(7.9)	(8.6)
Recognized actuarial loss	3.4	0.3	1.0	7.3	4.0	3.9
Net periodic benefit cost	$ 33.1	$ 21.6	$ 22.9	$ 28.1	$ 17.4	$ 16.4

The assumed health-care-cost trend rates have a significant effect on the amounts reported. If these trend rates were to be increased by one percentage point each future year, the December 31, 1998, accumulated postretirement benefit obligation would increase by 10 percent and the aggregate of the service cost and interest cost components of 1998 annual expense would increase by 15 percent. A one-percentage-point decrease in these rates would decrease the December 31, 1998, accumulated postretirement benefit obligation by 9 percent and the aggregate of the 1998 service cost and interest cost by 13 percent.

The company has defined contribution savings plans that cover its eligible employees worldwide. The purpose of these defined contribution plans is generally to provide additional financial security during retirement by providing employees with an incentive to make regular savings. Company contributions to the plan are based on employee contributions and the level of company match. Expenses under the plans related to continuing operations totaled $50.3 million, $43.5 million and $39.6 million for the years 1998, 1997 and 1996, respectively.

The company provides certain other postemployment benefits, primarily related to disability benefits, and accrues for the related cost over the service lives of

the employees. Expenses associated with these benefit plans in 1998, 1997 and 1996 were not significant.

Note 13: Contingencies

Barr Laboratories, Inc. (Barr), and Geneva Pharmaceuticals, Inc. (Geneva), have each submitted an Abbreviated New Drug Application (ANDA) seeking FDA approval to market generic forms of Prozac before the expiration of the company's patents. The ANDAs assert that two U.S. patents held by Lilly covering Prozac are invalid and unenforceable. The company filed suit against Barr and Geneva in federal court in Indianapolis seeking a ruling that Barr's challenge to Lilly's patents is without merit. On January 12, 1999, the trial court granted summary judgment in favor of Lilly on two of the four claims raised by Barr and Geneva against Lilly's patents. The company expects that the decision will be appealed. On January 25, 1999, Barr and Geneva dismissed their other two claims in exchange for a $4 million payment, which Barr and Geneva will share with a third defendant. In late 1998, three other generic pharmaceutical companies, Zenith Goldline Pharmaceuticals, Teva Pharmaceuticals USA and Reddy-Cheminor, Inc., each filed ANDAs for generic forms of Prozac, asserting that the later of the two patents (expiring in December 2003) is invalid and unenforceable. Finally, in January 1999, Novex Pharma division of Apotex, Inc., filed an ANDA challenging both patents. Lilly has filed suits against the four companies in federal court in Indianapolis. The suits are in a very early stage. While the company believes that the claims of the six generic companies are without merit, there can be no assurance that the company will prevail. An unfavorable outcome of this litigation could have a material adverse effect on the company's consolidated financial position, liquidity and results of operations.

The company has been named as a defendant in numerous product liability lawsuits involving primarily two products, diethylstilbestrol and Prozac. The company has accrued for its estimated exposure, including costs of litigation, with respect to all current product liability claims. In addition, the company has accrued for certain future anticipated product liability claims to the extent the company can formulate a reasonable estimate of their costs. The company's estimates of these expenses are based primarily on historical claims experience and data regarding product usage. The company expects the cash amounts related to the accruals to be paid out over the next several years. The majority of costs associated with defending and disposing of these suits are covered by insurance. The company's estimate of insurance recoverables is based on existing deductibles, coverage limits, and the existing and projected future level of insolvencies among its insurance carriers.

Under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly known as Superfund, the company has been designated as one of several potentially responsible parties with respect to certain sites. Under Superfund, each responsible party may be jointly and severally liable for the entire amount of the cleanup. The company also continues remediation of certain of its own sites. The company has accrued for estimated Superfund cleanup costs, remediation and certain other environmental matters, taking into account, as applicable, available information regarding site conditions, potential cleanup methods, estimated costs and the extent to which other parties can be expected to contribute to payment of those costs. The company has reached a settlement with its primary liability insurance carrier providing for coverage for certain environmental liabilities and has instituted litigation seeking coverage from certain excess carriers.

The company continues to be a defendant, together with numerous other U.S. prescription drug manufacturers, in related suits brought under federal and state antitrust laws by many retail pharmacies and, in some cases, consumers. The company has now resolved the great majority of the retailer claims, and, subject in certain cases to court approval, has also settled the great majority of the consumer claims.

The environmental liabilities and litigation accruals have been reflected in the company's consolidated balance sheet at the gross amount of approximately $300.7 million at December 31, 1998. Estimated insurance recoverables of approximately

$240.9 million at December 31, 1998, have been reflected as assets in the consolidated balance sheet.

While it is not possible to predict or determine the outcome of the patent, product liability, antitrust, or other legal actions brought against the company or the ultimate cost of environmental matters, the company believes that, except as noted above, the costs associated with all such matters will not have a material adverse effect on its consolidated financial position or liquidity but could possibly be material to the consolidated results of operations in any one accounting period.

Note 14: Other Comprehensive Income

The accumulated balances related to each component of other comprehensive income were as follows:

	Foreign Currency Translation	Unrealized Gains (Losses) on Securities	Minimum Pension Liability Adjustment	Accumulated Other Comprehensive Income
Beginning balance at January 1, 1998	$ (267.0)	$ 3.2	$ (17.4)	$ (281.2)
Other comprehensive income (loss)	69.2	(1.7)	(16.1)	51.4
Balance at December 31, 1998	$ (197.8)	$ 1.5	$ (33.5)	$ (229.8)

The amounts above are net of income taxes. The income taxes related to other comprehensive income were not significant as income taxes were generally not provided for foreign currency translation.

The unrealized gains (losses) on securities is net of a reclassification adjustment of $4.8 million, net of tax, in 1998 for realized gains and losses on sales of securities included in net income.

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 to shareholders' equity rather than to income.

Responsibility for Financial Statements

Eli Lilly and Company and Subsidiaries

The consolidated financial statements and related notes have been prepared by management, who are responsible for their integrity and objectivity. The statements have been prepared in accordance with generally accepted accounting principles and include amounts based on judgments and estimates by management. The other financial information in this annual report is consistent with that in the financial statements.

The company maintains internal accounting control systems that 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. The design, monitoring and revision of internal accounting control systems involve, among other things, management's judgments with respect to the relative cost and expected benefits of specific control measures. A staff of internal auditors regularly monitors, on a worldwide basis, the adequacy and effectiveness of internal accounting controls.

In addition to the system of internal accounting controls, the company maintains guidelines of company policy emphasizing proper overall business conduct, possible conflicts of interest, compliance with laws and confidentiality of proprietary information. The guidelines are reviewed on a periodic basis with employees worldwide.

The financial statements have been audited by Ernst & Young LLP, independent auditors. Their responsibility is to examine the company's financial statements in accordance with generally accepted auditing standards and to express their opinion with respect to the fairness of presentation of the statements.

The members of the audit committee of the board of directors, none of whom are employees of the company, recommend independent auditors for appointment by the board of directors, review the services performed by the independent auditors, and receive and review the reports submitted by them. The audit committee meets several times during the year with management, the internal auditors and the independent auditors to discuss audit activities, internal controls and financial reporting matters. The internal auditors and the independent auditors have full and free access to the committee.

Sidney Taurel
Chairman of the Board,
President and Chief Executive Officer

Charles E. Golden
Executive Vice President and
Chief Financial Officer

January 30, 1999

Report of Independent Auditors

Board of Directors and Shareholders
Eli Lilly and Company

We have audited the accompanying consolidated balance sheets of Eli Lilly and Company and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, cash flows and comprehensive income for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eli Lilly and Company and subsidiaries at December 31, 1998 and 1997, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Indianapolis, Indiana

January 30, 1999

Appendix to Exhibit 13

Graphs in Annual Report to Shareholders
for the Year Ended December 31, 1998

Set forth below, converted to tabular format, are the graphs contained in the paper format of the portions of the Company's Annual Report to Shareholders that are contained in this Exhibit 13.

Graph #1--Net Sales

($ millions)

Year	Amount
1989	$3,391.0
1990	4,178.3
1991	4,533.4
1992	4,963.1
1993	5,198.5
1994	5,686.5
1995	6,508.8
1996	6,998.3
1997	7,987.7
1998	9,236.8

Net sales increased 16 percent as strong worldwide volume growth of 15 percent and a slight increase in global selling prices were partially offset by unfavorable exchange rates.

Graph #2--Sales Growth

($ millions; percentages represent changes from 1997)

Class	Amount	Percent Change from 1997
Zyprexa	$713.0	98%
Prozac	257.0	10%
Evista	144.0	N/M
Gemzar	132.0	76%
ReoPro	111.0	44%
Humalog	62.0	91%

Five of the company's newer products - Zyprexa, Evista, Gemzar, ReoPro and Humalog - generated $2.4 billion in sales in 1998 and 93 percent of the growth in sales. Prozac also continues to contribute to Lilly's sales growth.

Appendix to Exhibit 13 Continued

Graph #3--Net Sales

($ millions; percentages represent changes from 1997)

Class	Amount	Percent Change from 1997
Prozac	$2,811.5	10%
Zyprexa	1,442.7	98%
Anti-Infectives	1,160.9	(9)%
Insulins	1,154.9	8%
Animal Health	614.4	4%
Axid	418.0	(20)%
ReoPro	365.4	44%
Gemzar	306.8	76%
Humatrope	268.0	3%
Evista	144.1	N/M

In 1998, sales of four of the company's newer products, Zyprexa, Evista, Gemzar, and ReoPro, and continued growth in sales of Prozac accounted for essentially all the 16 percent increase in net sales. In total, 16 products, spanning all therapeutic classes, had annual sales in excess of $100 million.

Graph #4--Sales Outside the U.S.

($ millions)

Year	Amount
1989	$1,335.7
1990	1,636.9
1991	1,807.0
1992	1,996.2
1993	2,097.5
1994	2,430.2
1995	2,950.9
1996	3,081.0
1997	3,105.9
1998	3,400.6

After 3 years of essentially flat international sales, the recent launches of Humalog, Zyprexa and Gemzar in many countries contributed to sales growth of 9 percent. Volume growth of 13 percent and price increases of 1 percent were somewhat offset by an adverse exchange rate impact of 5 percent.

Graph #5--Research and Development

($ millions)

Year	Amount
1994	$ 838.7
1995	1,042.3
1996	1,189.5
1997	1,370.2
1998	1,738.9

Worldwide research and development expenditures increased 27 percent in 1998, a greater rate than sales, in support of the company's strong pipeline, which includes 25 compounds in Phase II or Phase III clinical trials.

Appendix to Exhibit 13 Continued

Graph #6--Return on Shareholders' Equity (Based on Income from Continuing Operations before Extraordinary Item)

(percentage)

Year	Percent
1994	23.8%
1995	26.1%
1996	28.2%
1997	37.5%
1998	46.2%

Earnings growth, combined with measures to enhance shareholder value, such as the special share repurchase program, resulted in a significant increase in return on shareholders' equity.

Graph #7--Economic Value Added

($ millions)

Year	Amount
1995	$ 333
1996	460
1997	751
1998	1,429

In 1998, Lilly's Economic Valued Added (EVA) was $1.4 billion, an increase of 90 percent, reflecting the company's commitment to delivering exceptional shareholder value.

Graph #8--Capital Expenditures

($ millions)

Year	Amount
1994	$576.5
1995	551.3
1996	443.9
1997	366.3
1998	419.9

Capital expenditures increased 15 percent from the 1997 level primarily due to the increased support of various research initiatives and related infrastructure. The company expects near-term capital expenditures to increase from 1998 levels due to continuing investment in research and manufacturing capabilities.

Graph #9--Dividends Paid per Share

(dollars)

Year	Amount
1994	$.625
1995	.655
1996	.685
1997	.740
1998	.800

Dividends paid during 1998 increased 8 percent over 1997. Nineteen ninety-eight was the 31st consecutive year in which dividends were increased. The continued earnings growth in 1998 enabled the company to declare a first-quarter 1999 dividend of $.23 per share, a 15 percent increase over 1998. The increase reflects the company's continued commitment to delivering shareholder value.

Exhibit 21-List of Subsidiaries and Affiliates

The following are the subsidiaries and affiliated corporations of the Company at December 31, 1998. Certain subsidiaries have been omitted since they are not significant in the aggregate.

	State or Jurisdiction of Incorporation or Organization
ELI LILLY AND COMPANY (1)	Indiana
Eli Lilly International Corporation	Indiana
Eli Lilly Iran, S.A.	Iran
ELCO Insurance Company, Ltd.	Bermuda
Eli Lilly Interamerica, Inc.	Indiana
Eli Lilly do Brasil Limitada	Brazil
Elanco Quimica Limitada	Brazil
Darilor Sociedad Anonima	Uruguay
Beimirco Sociedad Anonima	Uruguay
Eli Lilly Interamerica Inc., y Compania Limitada	Chile
STC Pharmaceuticals, Inc.	Indiana
Idacorp Acquistion LLC	Idaho
Dista, Inc.	Indiana
Eli Lilly de Centro America, S.A.	Guatemala
Eli Lilly de Centro America, Sociedad Anonima	Costa Rica
Eli Lilly y Compania de Mexico, S.A. de C.V.	Mexico
Dista Mexicana, S.A. de C.V.	Mexico
Eli Lilly Industries, Inc.	Delaware
del Sol Financial Services, Inc.	British V.I.
Lilly del Caribe, Inc.	Cayman Isls.
Eli Lilly and Company (Taiwan), Inc.	Taiwan
Control Diabetes Services, Inc.	Indiana
PCS Holding Corporation	Delaware
Clinical Pharmaceuticals, Inc.	Delaware
Convenience Office Prescriptions	California
PCS Health Systems, Inc.	Delaware
PCS of New York, Inc.	New York
PCS Services, Inc.	Delaware
PCS Mail Services, Inc.	Delaware
Integrated Medical Systems, Inc.	Colorado
ELCO Dominicana, S.A.	Dominican Rep.
ELCO International Sales Corporation	Virgin Is.-US

Exhibit 21-List of Subsidiaries and Affiliates

The following are the subsidiaries and affiliated corporations of the Company at December 31, 1998. Certain subsidiaries have been omitted since they are not significant in the aggregate.

	State or Jurisdiction of Incorporation or Organization
ELI LILLY AND COMPANY (1) (Cont'd)	Indiana
Eli Lilly Group Limited	England
Eli Lilly & Co. LTD.	England
Dista Products Limited	England
Eli Lilly & Co (Ireland) Trustee Limited	Ireland
Lilly Industries	England
Lilly Research Centre Limited	England
Elanco Products Limited	England
Creative Packaging Limited	England
Greenfield Pharmaceuticals Limited	England
Lilly Medical Instruments Limited	England
Eli Lilly (Basingstoke) Limited	England
Eli Lilly UK Limited	England
Eli Lilly Group Pension Trustees Limited	England
Lilly Pharma Holding GmbH	Germany
Lilly Deutschland GmbH	Germany
Lilly Pharma Fertigung & Distribution GmbH	Germany
Lilly Pharma Produktion GmbH & Co. KG	Germany
Lilly Forschung GmbH	Germany
Eli Lilly Ges.m.b.H.	Austria
Eli Lilly & Co. (Ireland) Limited	Ireland
Eli Lilly Asia, Inc.	Delaware
Eli Lilly Australia Pty. Limited	Australia
Eli Lilly Australia Custodian Pty. Limited	Bermuda
Eli Lilly and Company (N.Z.) Limited	New Zealand
Eli Lilly (NZ)Staff Benefits Custodian Limited	New Zealand
Integrated Disease Management (NZ) Limited	New Zealand
E L Management Incorporated	Delaware/Nova Scotia
Eli Lilly Canada Inc.	Canada
Eli Lilly S.A.	Switzerland
Eli Lilly Export S.A.	Switzerland
GEMS Services, S.A.	Belgium
T. P. Eli Lilly and Elanco D.O.O.	Yugoslavia
Elanco Trustees Limited	Ireland
Kinsale Financial Services, Ltd.	Ireland

Exhibit 21-List of Subsidiaries and Affiliates

The following are the subsidiaries and affiliated corporations of the Company at December 31, 1998. Certain subsidiaries have been omitted since they are not significant in the aggregate.

	State or Jurisdiction of Incorporation or Organization
ELI LILLY S.A.	Switzerland
Eli Lilly (Suisse) S.A.	Switzerland
Eli Lilly Vostok SA, Geneva	Switzerland
Eli Lilly MHC S.A.R.L.	Switzerland
Eli Lilly Mauritius	Mauritius
Oldfields Financial Management S.A.	Switzerland
Eli Lilly Suzhou Pharmaceutical Company Limited	China
Eli Lilly Nederland B.V.	Netherlands
Eli Lilly Regional GmbH	Austria
Lilly Development Centre S.A.	Belgium
Lilly Services S.A.	Belgium
Lilly Clinical Operations S.A.	Belgium
Eli Lilly CR s.r.o.	Czech Repub.
Eli Lilly Danmark A/S	Denmark
Eli Lilly Egypt	Egypt
OY Eli Lilly Finland Ab	Finland
Elco Participation, sarl	France
Lilly France S.A.	France
Elsa France, S.A.	France
ILCO sarl	France
Eli Lilly Italia S.p.A.	Italy
Dista Italia S.r.l.	Italy
Eli Lilly Benelux, S.A.	Belgium
Dista-Produtos Quimicos & Farmaceuticos,LDA	Portugal
Lilly-Farma, Produtos Farmaceuticos, Lda.	Portugal
Vitalfarma	Portugal
Pharmaserve - Lilly S.A.C.I.	Greece
Pharmabrand, S.A.C.I.	Greece
PRAXICO Ltd.	Hungary
Lilly Hungaria KFT	Hungary
Eli Lilly (Philippines), Incorporated	Philippines
Eli Lilly Ranbaxy Limited	India
Eli Lilly Israel Ltd.	Israel
Eli Lilly Japan K.K.	Japan
Lilly Korea LTD.	Korea
Elanco Animal Health, Korea, Ltd.	Korea
Eli Lilly Malaysia Sdn Bhd.	Malaysia
Damsen Trading Limited	Malta
Eli Lilly Maroc S.a.r.l.	Morocco
ELCO Production Services B.V.	Netherlands
Eli Lilly Norge A.S.	Norway
Eli Lilly Pakistan (Pvt.) Ltd.	Pakistan
Eli Lilly Polska Sp. z.o.o. (Ltd.)	Poland
Lilly Grodzisk Sp. z.o.o.	Poland
Vitalia Pharma Sp. Z.o.o.	Poland
Eli Lilly Asia Pacific Pte. Ltd.	Singapore
Lilly-NUS Centre for Clinical Pharmacology Pte. Ltd.	Singapore
Eli Lilly (S.A.) (Proprietary) Limited	South Africa
The Medikredit Joint Venture Partnership	South Africa
Medikredit Pty. Ltd.	South Africa
Elanco-Valquimica, S.A.	Spain
Dista, S.A.	Spain
Lilly, S.A.	Spain
Spaly Bioquimica, S.A.	Spain
Eli Lilly Sweden AB	Sweden
Lilly Ilac Ticaret A.S.	Turkey
Eli Lilly y Compania de Venezuela, S.A.	Venezuela
Dista Products & Compania Venezuela S.A.	Venezuela

EXHIBIT 23. CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Eli Lilly and Company of our report dated January 30, 1999, included in the 1998 Annual Report to Shareholders of Eli Lilly and Company.

We also consent to the incorporation by reference in Registration Statement Number 33-29482 on Form S-8 dated June 23, 1989, in Registration Statement Number 33-37341 on Form S-8 dated October 17, 1990, in Registration Statement Number 33-58466 on Form S-3 dated February 17, 1993, in Registration Statement Number 33-50783 on Form S-8 dated October 27, 1993, in Registration Statement Number 33-56141 on Form S-8 dated October 24, 1994, in Registration Statement Number 333-02021 on Form S-8 dated March 28, 1996, in Registration Statement Number 333-62015 on Form S-8 dated August 21, 1998 and in Registration Statement Number 333-66113 on Form S-8 dated October 26, 1998 of our report dated January 30, 1999 with respect to the consolidated financial statements incorporated herein by reference in the Annual Report (Form 10-K) of Eli Lilly and Company.

Ernst & Young LLP

Indianapolis, Indiana
March 26, 1999

YEAR	
	DEC-31-1998
	JAN-01-1998
	DEC-31-1998
	1,495,741
	101,385
	2,032,138
	64,263
	999,894
	5,406,760
	7,274,449
	3,178,183
	12,595,494
	4,607,243
	2,185,501
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	0
	686,497
	3,743,071
	12,595,494
	8,807,831
	9,236,755
	1,601,436
	2,015,040
	4,524,712
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	181,278
	2,664,991
	568,657
	2,096,334
	8,770
	(7,249)
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	2,097,855
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	1.87

YEAR	
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	JAN-01-1996
	DEC-31-1996
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	4,222,193
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	0
	355,564
	5,744,576
	14,307,170
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	6,998,295
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	1,872,071
	3,081,901
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	288,062
	2,131,272
	505,622
	1,625,650
	(102,180)
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	0
	1,523,470
	1.39
	1.36

5

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JAN-01-1997	
MAR-31-1997	
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876,264	
4,275,747	
7,002,555	
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14,513,618	
4,061,749	
2,509,649	
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0	
355,564	
6,213,909	
14,513,618	
1,833,779	
1,841,089	
449,151	
455,271	
757,833	
0	
60,375	
591,274	
140,635	
450,639	
(18,023)	
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0	
432,616	
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.38	

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6-MOS
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JUN-30-1997
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355,564
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889,356
901,320
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122,499
1,663,625
576,927
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0
(1,299,480)
(1.18)
(1.15)

5

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9-MOS
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SEP-30-1997
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179,467
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0
(842,563)
(.77)
(.75)

5

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YEAR	
	DEC-31-1997
	JAN-01-1997
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	4,191,617
	2,326,110
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	694,701
	3,950,911
	12,577,436
	7,962,218
	7,987,683
	1,922,783
	1,946,023
	3,701,126
	0
	232,736
	2,901,115
	885,251
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	0
	0
	(385,130)
	(.35)
	(.34)

5

1,000

3-MOS
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692,037
4,101,326
12,046,750
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2,087,032
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457,278
906,426
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47,924
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171,754
531,675
(3,338)
(7,249)
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521,088
.47
.46

5

1,000

6-MOS
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2,307,491
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688,887
3,952,711
11,868,651
4,242,066
4,242,066
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935,874
1,960,504
0
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(2,870)
(7,249)
0
1,021,432
.92
.90

5

1,000

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4,007,853	
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0	
0	
686,242	
3,822,757	
12,581,264	
6,601,465	
6,601,465	
1,431,659	
1,431,659	
3,195,519	
0	
135,976	
1,949,655	
414,938	
1,534,717	
3,061	
(7,249)	
0	
1,530,529	
1.39	
1.36	

EXHIBIT 99. CAUTIONARY STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 - "SAFE HARBOR" FOR FORWARD LOOKING DISCLOSURES

Certain forward-looking statements are included in this Form 10-K and may be made by Company spokespersons based on current expectations of management. All forward-looking statements made by the Company are subject to risks and uncertainties. Certain factors, including but not limited to those listed below, may cause actual results to differ materially from current expectations and historical results.

- Competitive factors, including generic competition as patents on key products, such as Prozac, expire; pricing pressures, both in the U.S. and abroad, primarily from managed care groups and government agencies; and new patented products or expanded indications for existing products introduced by competitors, which can lead to declining demand for the Company's products.

- Changes in inventory levels maintained by pharmaceutical wholesalers as a result of wholesaler buying patterns, which can cause reported sales for a particular period to differ significantly from underlying prescriber demand.

- Economic factors over which the Company has no control, including changes in inflation, interest rates and foreign currency exchange rates, and overall economic conditions in volatile areas such as Latin America.

- Governmental factors, including laws and regulations and judicial decisions at the state and federal level related to Medicare, Medicaid and health care reform that could adversely affect pricing and reimbursement of the Company's products; and laws and regulations affecting international operations.

- The difficulties and uncertainties inherent in new product development. 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, difficulty or excessive costs to manufacture, or infringement of the patents or intellectual property rights of others.

- Delays and uncertainties in the FDA approval process and the approval processes in other countries, resulting in lost market opportunity.

- Unexpected safety or efficacy concerns arising with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals or declining sales.

- Legal factors including unanticipated litigation of product liability or other liability claims; antitrust litigation; environmental matters; and patent disputes with competitors which could preclude commercialization of products or negatively affect the profitability of existing products. In particular, while the Company believes that its U.S. patents on Prozac are valid

and enforceable, there can be no assurance that the Company will prevail in the various legal challenges to those patents.

- Future difficulties obtaining or the inability to obtain existing levels of product liability insurance.

- Changes in tax laws, including laws related to the remittance of foreign earnings or investments in foreign countries with favorable tax rates, and settlements of federal, state, and foreign tax audits.

- Changes in accounting standards promulgated by the Financial Accounting Standards Board, the Securities and Exchange Commission, and the American Institute of Certified Public Accountants which are adverse to the Company.

- Internal factors such as changes in business strategies and the impact of restructurings and business combinations.

- The Company's statement that it expects to complete the Year 2000 modifications before December 31, 1999, is based on management's best estimate, which was derived utilizing numerous assumptions of future events, including the continued availability of certain resources, third party modification plans and other factors. However, there can be no guarantee that timely completion will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and the successful completion by key third parties of their own Year 2000 modifications.