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United States
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, 2005

Commission file number 001-6351

Eli Lilly and Company

An Indiana corporation I.R.S. employer identification no. 35-0470950
Lilly Corporate Center, Indianapolis, Indiana 46285
(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 (no par value)	New York Stock Exchange
Preferred Stock Purchase Rights	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
7-1/8% Notes Due June 1, 2025	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 if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes X No ___

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ___ No X

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. [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

[X] Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company as defined in Rule 12b-2 of the Act: Yes ___ No X

Aggregate market value of the common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the Registrant's most recently completed second fiscal quarter (Common Stock): approximately $54,624,800,000

Number of shares of common stock outstanding as of February 15, 2006: 1,129,982,580

Portions of the Registrant's Proxy Statement to be filed on or about March 13, 2006 have been incorporated by reference into Part III of this report.

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Part I

Item 1. Business

Eli Lilly and Company (the "Company" or "Registrant", which may be referred to as "we", "us", or "our") was incorporated in 1901 in Indiana to succeed to the drug manufacturing business founded in Indianapolis, Indiana, in 1876 by Colonel Eli Lilly. We discover, develop, manufacture, and sell products in one significant business segment — pharmaceutical products. We also have an animal health business segment, whose operations are not material to our financial statements. We manufacture and distribute our products through owned or leased facilities in the United States, Puerto Rico, and 26 other countries. Our products are sold in approximately 135 countries.

Most of the products we sell today were discovered or developed by our own scientists, and our success depends to a great extent on our ability to continue to discover and develop innovative new pharmaceutical products. We direct our research efforts primarily toward the search for products to prevent and treat human diseases. We also conduct research to find products to treat diseases in animals and to increase the efficiency of animal food production.

Products

Our principal products are:

Neuroscience products, our largest-selling product group, including:

- *Zyprexa*®, for the treatment of schizophrenia, bipolar mania and bipolar maintenance
- *Cymbalta*®, for the treatment of depression and diabetic peripheral neuropathic pain
- *Strattera*®, for the treatment of attention-deficit hyperactivity disorder in children, adolescents and adults
- *Prozac*®, for the treatment of depression and, in many countries, for bulimia and obsessive-compulsive disorder
- *Permax*®, for the treatment of Parkinson's disease
- *Sarafem*®, for the treatment of pre-menstrual dysphoric disorder
- *Symbyax*®, for the treatment of bipolar depression
- *Yentreve*®, for the treatment of stress urinary incontinence (approved in 2004 in the European Union and several other countries outside the United States).

Endocrine products, including:

- *Humalog*®, *Humalog Mix 75/25*®, and *Humalog Mix 50/50*™, injectable human insulin analogs for the treatment of diabetes
- *Humulin*®, injectable human insulin for the treatment of diabetes
- *Actos*®, an oral agent for the treatment of type 2 diabetes
- *Byetta*®, an injectable product for the treatment of type 2 diabetes
- *Evista*®, an oral agent for the prevention and treatment of osteoporosis in post-menopausal women

- *Humatrope*®, for the treatment of human growth hormone deficiency and idiopathic short stature
- *Forteo*®, an injectable treatment for severe osteoporosis in women and men.

Oncology products, including:

- *Gemzar*®, for the treatment of pancreatic cancer; in combination with other agents, for treatment of metastatic breast cancer and non-small cell lung cancer; and in the European Union for bladder and ovarian cancers
- *Alimta*®, for the treatment of malignant pleural mesothelioma and for second-line treatment of non- small cell lung cancer (approved in 2004 in the U.S. and several other countries).

Animal health products, including:

- *Tylan*®, an antibiotic used to control certain diseases in cattle, swine, and poultry
- *Rumensin*®, a cattle feed additive that improves feed efficiency and growth and also controls and prevents coccidiosis
- *Coban*®, *Monteban*® and *Maxiban*®, anticoccidial agents for use in poultry
- *Apralan*®, an antibiotic used to control enteric infections in calves and swine
- *Micotil*®, *Pulmotil*®, and *Pulmotil AC*®, antibiotics used to treat respiratory disease in cattle, swine, and poultry, respectively
- *Surmax*® (sold as *Maxus*® in some countries), a performance enhancer for swine and poultry
- *Paylean*® and *Optaflexx*®, leanness and performance enhancers for swine and cattle, respectively
- *Elector*®, a parasiticide for use on cattle and premises.

Cardiovascular agents, including:

- *ReoPro*®, a treatment for use as an adjunct to percutaneous coronary intervention (“PCI”), including patients undergoing angioplasty, atherectomy or stent placement
- *Xigris*®, for the treatment of adults with severe sepsis at high risk of death.

Anti-infectives, including:

- *Ceclor*®, for the treatment of a wide range of bacterial infections
- *Vancocin*® HCl, used primarily to treat staphylococcal infections.

Other pharmaceutical products, including:

- *Cialis*®, for the treatment of erectile dysfunction.

Marketing

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

Pharmaceuticals — United States

In the United States, we distribute pharmaceutical products principally through independent wholesale distributors. Our marketing policy is designed to assure that products and relevant medical information are immediately available to physicians, pharmacies, hospitals, public and private payers, and appropriate health care professionals throughout the country. Three wholesale distributors in the United States — AmerisourceBergen Corporation, Cardinal Health, Inc., and McKesson Corporation — each accounted for between 12 and 17 percent of our worldwide consolidated net sales in 2005. No other distributor accounted for more than 10 percent of consolidated net sales. We also sell pharmaceutical products directly to the United States government and other manufacturers, but those sales are not material.

We promote our major pharmaceutical products in the United States through sales representatives who call upon physicians, wholesalers, hospitals, managed-care organizations, retail pharmacists, and other health care professionals. We advertise in medical and drug journals, distribute literature and samples of certain products to physicians, and exhibit at medical meetings. In addition, we advertise certain products directly to consumers in the United States and we maintain web sites with information about all our major products. Divisions of our sales force are assigned to product lines or practice areas, such as primary care, neuroscience, acute care, endocrinology, and oncology.

Large purchasers of pharmaceuticals, such as managed-care groups, government agencies, and long-term care institutions, account for a significant portion of total pharmaceutical purchases in the United States. We have 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, we have entered into arrangements with a number of these organizations providing for discounts or rebates on one or more Lilly products or other cost-sharing arrangements.

Pharmaceuticals — Outside the United States

Outside the United States, we promote our pharmaceutical products primarily through 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 most countries, we maintain our own sales and distribution organizations. In some countries, however, we market our products through independent distributors.

Pharmaceutical Marketing Collaborations

Several of our significant products are marketed in collaboration with other pharmaceutical companies:

- Cymbalta is co-promoted in the United States by Quintiles Transnational Corp. and is co-promoted or co-marketed outside the U.S. (except Japan) by Boehringer Ingelheim GmbH.
- Cialis is sold in North America and most of Europe by a joint venture between Lilly and ICOS Corporation, and is sold by us alone in other territories.
- We co-promote Actos with a unit of Takeda Chemical Industries Ltd. in the United States and certain other countries and we sell it alone in other countries. Our U.S. marketing rights with respect to Actos expire in September 2006; however, we will receive residual royalties on U.S. Actos sales for three years thereafter.

- We co-promote Byetta with Amylin Pharmaceuticals, Inc. in the United States and Puerto Rico, and we have exclusive marketing rights in other territories.

We have also entered into licensing arrangements under which we have granted exclusive marketing rights to other companies in specified countries for certain older products manufactured by us, such as Permax, Sarafem, Vancocin, the anti-ulcer agent Axid®, the analgesic Darvon®, and the anti-infectives Ceclor, Keflex®, Keftab®, and Lorabid®.

Animal Health Products

Our Elanco Animal Health business unit employs field salespeople throughout the United States to market animal health products. Elanco also has an extensive sales force outside the United States. Elanco sells its products primarily to wholesale distributors.

Competition

Our pharmaceutical products compete with products manufactured by many other companies in highly competitive markets throughout the world. Our animal health products compete on a worldwide basis with products of animal health care companies as well as 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, marketing effectiveness, service, and research and development of new products and processes. If competitors introduce new products, delivery systems or processes with therapeutic or cost advantages, our products can be subject to progressive price reductions or decreased volume of sales, or both. Most new products that we introduce must compete with other products already on the market or products that are later developed by competitors. Manufacturers of generic pharmaceuticals typically invest far less in research and development than research-based pharmaceutical companies and therefore can price their products significantly lower than branded products. Accordingly, when a branded product loses its market exclusivity, it normally faces intense price competition from generic forms of the product. In many countries outside the United States, patent protection is weak or nonexistent and we must compete with generic or “knockoff” versions of our products. To successfully compete for business with managed care and pharmacy benefits management organizations, we must often demonstrate that our products offer not only medical benefits but also cost advantages as compared with other forms of care.

We believe our long-term competitive position depends upon our success in discovering and developing innovative, cost-effective products that serve unmet medical needs, together with our ability to continuously improve the productivity of our discovery, development, manufacturing, marketing and support operations in a highly competitive environment. There can be no assurance that our research and development efforts will result in commercially successful products or that our products or processes will not become uncompetitive from time to time as a result of products or processes developed by our competitors.

Patents, Trademarks, and Other Intellectual Property Rights

Overview

Intellectual property protection is, in the aggregate, material to our ability to successfully commercialize our life sciences innovations. We own, have applied for, or are licensed under, a large number of patents, both in the United States and in other countries, relating to products, product uses, formulations, and manufacturing processes. There is no assurance that the patents we

are seeking will be granted or that the patents we have been granted would be found valid and enforceable if challenged. Moreover, patents relating to particular products, uses, formulations, or processes do not preclude other manufacturers from employing alternative processes or from marketing alternative products or formulations that might successfully compete with our patented products. In addition, from time to time, competitors or other third parties assert claims that our activities infringe patents or other intellectual property rights held by them. While there can be no assurance, we do not believe that any such claims will have a material adverse effect on our results of operations, liquidity, or financial position.

Outside the United States, the adequacy and effectiveness of intellectual property protection for pharmaceuticals varies widely. Under the Trade-Related Aspects of Intellectual Property Agreement (TRIPs) administered by the World Trade Organization (WTO), over 140 countries have now agreed to provide non-discriminatory protection for most pharmaceutical inventions and to assure that adequate and effective rights are available to all patent owners. However, in many countries, this agreement will not become fully effective for many years. It is still too soon to assess when and how much, if at all, we will benefit commercially from these changes.

When a product patent expires, the patent holder often loses effective market exclusivity for the product. This can result in a severe and rapid decline in sales of the formerly patented product, particularly in the United States. However, in some cases the innovator company may achieve exclusivity beyond the expiry of the product patent through manufacturing trade secrets; later-expiring patents on methods of use or formulations; or data-based exclusivity that may be available under pharmaceutical regulatory laws.

Our Intellectual Property Portfolio

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

United States compound patent expirations include those claiming the respective active ingredients in Zyprexa, 2011, and Humalog, 2013. The Gemzar compound patent in the U.S. expires in 2010, and a method-of-use patent covering treatment of neoplasms with Gemzar is in force until 2012. We have also received an additional six months of marketing exclusivity for Gemzar from the FDA under the terms of the Food and Drug Administration Modernization Act of 1997, as a result of our conducting clinical studies of Gemzar in pediatric populations, which should provide us exclusivity until 2013. We hold a number of U.S. patents covering Evista and its approved uses in osteoporosis prevention and treatment that we believe should provide us exclusivity in the United States until 2014. For Strattera, a method-of-use patent in the U.S. for treating attention deficit-hyperactivity disorder should provide exclusivity until 2016. For Cymbalta, we expect the U.S. compound patent will expire in 2013. We also have a formulation patent for Cymbalta until 2014. We expect the U.S. compound patent for Alimta will expire in 2016. For Cialis, compound and method-of-use patent protection exists in the U.S. that should provide exclusivity until 2017. In the United States, the Actos compound patent extends beyond the duration of our co-promotion agreement, which is in force until September 2006. Xigris is a complex glycoprotein biologic product that is produced through recombinant DNA technology. Xigris is not subject to the Abbreviated New Drug Application process under the Hatch-Waxman law as described below. In addition, we hold patents on the DNA materials, certain uses, manufacturing process, and the glycoprotein itself. We believe the intellectual property protection for Xigris should provide us marketing exclusivity in the U.S. until 2015. Relevant patents covering Byetta are exclusively licensed or owned by our partner

Amylin Pharmaceuticals, Inc. A method of use patent focused on the treatment of type 2 diabetes is expected to expire in the U.S. in 2017. In addition, a patent covering the Byetta formulation will expire in the U.S. in 2020.

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

Patent Challenges Under the Hatch-Waxman Act

The Drug Price Competition and Patent Term Restoration Act of 1984, commonly known as "Hatch-Waxman," made a complex set of changes to both patent and new-drug-approval laws in the United States. Before Hatch-Waxman, no drug could be approved without providing the Food and Drug Administration (FDA) complete safety and efficacy studies, *i.e.*, a complete New Drug Application (NDA). Hatch-Waxman authorizes the FDA to approve generic versions of innovative medicines without such information by filing an Abbreviated New Drug Application (ANDA). In an ANDA, the generic manufacturer must demonstrate only "bioequivalence" between the generic version and the NDA-approved drug — not safety and efficacy.

Absent a successful patent challenge, the FDA cannot approve an ANDA until after the innovator's patents expire. However, after the innovator has marketed its product for four years, a generic manufacturer may file an ANDA alleging that one or more of the patents listed in the innovator's NDA are invalid or not infringed. This allegation is commonly known as a "Paragraph IV certification." The innovator must then file suit against the generic manufacturer to protect its patents. If one or more of the NDA-listed patents are successfully challenged, the first filer of a Paragraph IV certification may be entitled to a 180-day period of market exclusivity over all other generic manufacturers.

In recent years, generic manufacturers have used Paragraph IV certifications extensively to challenge patents on a wide array of innovative pharmaceuticals, and we expect this trend to continue. We are currently in litigation with numerous generic manufacturers arising from their Paragraph IV certifications on Zyprexa, Evista, and Gemzar. For more information on these, see Item 7, "Management's Discussion and Analysis — Legal and Regulatory Matters."

Government Regulation

Regulation of Our Operations

Our operations are regulated extensively by numerous national, state and local agencies. The lengthy process of laboratory and clinical testing, data analysis, manufacturing development, and regulatory review necessary for required governmental approvals is extremely costly and can significantly delay product introductions in a given market. Promotion, marketing, manufacturing, and distribution of pharmaceutical and animal health products are extensively regulated in all major world markets. We are required to conduct extensive post-marketing surveillance of the safety of the products we sell. In addition, our operations are subject to complex federal, state, local, and foreign environmental and occupational health and safety laws and regulations. The laws and 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.

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

Outside the United States, our products and operations are subject to similar regulatory requirements, notably by the European Medicines Agency (EMEA) in the European Union and the Ministry of Health, Labor and Welfare (MHLW) in Japan. Regulatory requirements vary from country to country.

The FDA extensively regulates all aspects of manufacturing quality under its current Good Manufacturing Practices (cGMP) regulations. In recent years, we have made, and we continue to make, substantial investments of capital and operating expenses to implement comprehensive, company-wide improvements in our manufacturing, product and process development, and quality operations to ensure sustained cGMP compliance. However, in the event we fail to adhere to cGMP requirements in the future, we could be subject to interruptions in production, fines and penalties, and delays in new product approvals.

The marketing, promotional, and pricing practices of pharmaceutical manufacturers, as well as the manner in which manufacturers interact with purchasers and prescribers, are subject to various other federal and state laws, including the federal anti-kickback statute and the False Claims Act and state laws governing kickbacks and false claims. These laws are administered by, among others, the Department of Justice, the Office of Inspector General of the Department of Health and Human Services, the Federal Trade Commission, the Office of Personnel Management and state attorneys general. Over the past several years, both the FDA and many of these other agencies have increased their enforcement activities with respect to pharmaceutical companies. Over this period, several cases brought by these agencies against other companies under these and other laws have resulted in corporate criminal sanctions and very substantial civil settlements. Several pharmaceutical companies, including Lilly, are currently subject to proceedings by one or more of these agencies regarding marketing and promotional practices. See Item 7, “Management’s Discussion and Analysis — Legal and Regulatory Matters,” for information about currently pending marketing and promotional practices investigations in which we are involved. It is possible that we could become subject to additional administrative and legal proceedings and actions, which could include claims for civil penalties (including treble damages under the False Claims Act), criminal sanctions, and administrative remedies, including exclusion from federal health care programs. It is possible that an adverse outcome in such an action could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

Regulations Affecting Pharmaceutical Pricing and Reimbursement

In the United States, we are required to provide rebates to state governments on their purchases of certain of our 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, we operate in an environment of government-mandated cost containment programs, which may include price controls, reference pricing, discounts and rebates, restrictions on physician prescription levels, restrictions on reimbursement, compulsory licenses, health economic assessments, and generic substitution.

In the U.S., implementation of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA), providing a prescription drug benefit under the Medicare program, took effect January 1, 2006. See Item 7, “Management’s Discussion and Analysis — Executive Overview — Legal and Governmental Matters” for a discussion of the anticipated impact of MMA and other federal and state healthcare cost containment measures.

International operations are also generally subject to extensive price and market regulations, and there are many proposals for additional cost-containment measures, including proposals that would directly or indirectly impose additional price controls or reduce the value of our intellectual property protection.

We cannot predict the extent to which our business may be affected by these or other potential future legislative or regulatory developments. However, we expect that pressures on pharmaceutical pricing will continue.

Research and Development

Our commitment to research and development dates back more than 100 years. Our research and development activities are responsible for the discovery and development of most of the products we offer today. We invest heavily in research and development because we believe it is critical to our long-term competitiveness. At the end of 2005, we employed approximately 8,400 people in pharmaceutical and animal health research and development activities, including a substantial number of physicians, scientists holding graduate or postgraduate degrees, and highly skilled technical personnel. Our research and development expenses were $2.35 billion in 2003, $2.69 billion in 2004, and $3.03 billion in 2005.

Our pharmaceutical research and development focuses on four therapeutic categories: central nervous system and related diseases; endocrine diseases, including diabetes, obesity and musculoskeletal disorders; cancer; and cardiovascular diseases. However, we remain opportunistic, selectively pursuing promising leads in other therapeutic areas. We are actively engaged in biotechnology research programs involving recombinant DNA, therapeutic proteins and antibodies as well as genomics (the development of therapeutics through identification of disease-causing genes and their cellular function), biomarkers, and targeted therapeutics. In addition to discovering and developing new chemical entities, we look for ways to expand the value of existing products through new uses and formulations that can provide additional benefits to patients. We also conduct research in animal health, including animal nutrition and physiology, control of parasites, and veterinary medicine.

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

Drug development is time-consuming, expensive, and risky. On average, only one out of many thousands of chemical compounds discovered by researchers proves to be both medically effective and safe enough to become an approved medicine. The process from discovery to regulatory approval typically takes 12 to 15 years or longer. Drug candidates can fail at any stage of the

process, and even late-stage drug candidates sometimes fail to receive regulatory approval. We believe our investments in research, both internally and in collaboration with others, have been rewarded by the number of new compounds and new indications for existing compounds that we have in all stages of development. Among our new investigational compounds in the later stages of development are potential therapies for diabetes and its complications, osteoporosis, cancer, and acute coronary syndromes. Further, we are studying many other drug candidates in the earlier stages of development, including compounds targeting cancers, thrombotic disorders, atherosclerosis, Alzheimer's disease, diabetes, obesity, and sleep disorders. We are also developing new uses and formulations for many of our currently marketed products, such as Zyprexa, Gemzar, Alimta, Cialis, Cymbalta, Evista, Forteo, and Byetta.

Raw Materials and Product Supply

Most of the principal materials we use in our manufacturing operations are available from more than one source. We obtain certain raw materials principally from only one source. In addition, four of our significant products are manufactured by others: Actos by Takeda; ReoPro by Centocor; Xigris by Lonza Biologics (bulk product) and DSM, N.V. (finished product); and Byetta by third-party suppliers to Amylin. If we were unable to obtain certain materials from present sources, we could experience an interruption in supply until we established new sources or, in some cases, implemented alternative processes.

Our primary bulk manufacturing occurs at three sites in Indiana as well as locations in Ireland, Puerto Rico, and the United Kingdom. Finishing operations, including labeling and packaging, take place at a number of sites throughout the world.

We seek to design and operate our manufacturing facilities and maintain inventory in a way that will allow us to meet all expected product demand while maintaining flexibility to reallocate manufacturing capacity to improve efficiency and respond to changes in supply and demand. However, pharmaceutical production processes are complex, highly regulated, and vary widely from product to product. Shifting or adding manufacturing capacity can be a very lengthy process requiring significant capital expenditures. Accordingly, if we were to experience extended plant shutdowns or extraordinary unplanned increases in demand, we could experience an interruption in supply of certain products or product shortages until production could be resumed or expanded.

Quality Assurance

Our success depends in great measure upon customer confidence in the quality of our products and in the integrity of the data that support their safety and effectiveness. Product quality arises from a total commitment to quality in all parts of our operations, including research and development, purchasing, facilities planning, manufacturing, and distribution. We have implemented quality-assurance procedures relating to the quality and integrity of scientific information and production processes.

Control of production processes involves rigid specifications for ingredients, equipment, facilities, manufacturing methods, packaging materials, and labeling. We perform tests at various stages of production processes and on the final product to assure that the product meets all regulatory requirements and our standards. These tests may involve chemical and physical chemical analyses, microbiological testing, testing in animals, or a combination. 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, and third-party suppliers.

Executive Officers of the Company

The following table sets forth certain information regarding our executive officers. All executive officers have been employed by the Company in executive positions during the last five years.

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 24, 2006, 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 and any other person pursuant to which the executive officer was selected.

Name	Age	Offices
Sidney Taurel	57	Chairman of the Board (since January 1999) and Chief Executive Officer (since June 1998) and a Director
John C. Lechleiter, Ph.D.	52	President and Chief Operating Officer (since October 2005) and a Director
Charles E. Golden	59	Executive Vice President and Chief Financial Officer (since March 1996) and a Director
Steven M. Paul, M.D.	55	Executive Vice President, Science and Technology (since July 2003)
Robert A. Armitage	57	Senior Vice President and General Counsel (since January 2003)
Scott A. Canute	45	President, Manufacturing Operations (since October 2004)
Anthony J. Murphy, Ph.D.	55	Senior Vice President, Human Resources (since June 2005)
Gino Santini	49	Senior Vice President, Corporate Strategy and Policy (since July 2004)
Deirdre P. Connelly	45	President, U.S. Operations (since June 2005)
Lorenzo Tallarigo, M.D.	55	President, International Operations (since January 2004)

Employees

At the end of 2005, we employed approximately 42,600 people, including approximately 20,000 employees outside the United States. A substantial number of our employees have long records of continuous service.

Financial Information Relating to Business Segments and Classes of Products

You can find financial information relating to our business segments and classes of products in Item 8 of this Form 10-K, “Segment Information.” That information is incorporated here by reference.

The relative contribution of any particular product to our consolidated net sales changes from year to year. This is due to several factors, including the introduction of new products by us and by other manufacturers and the introduction of generic pharmaceuticals upon patent expirations. In addition, margins vary for our different products due to various factors, including differences in the cost to manufacture and market the products, the value of the products to the marketplace, and government restrictions on pricing and reimbursement. Our major product sales are generally not seasonal.

Financial Information Relating to Foreign and Domestic Operations

You can find financial information relating to foreign and domestic operations in Item 8 of this Form 10-K, “Segment Information.” That information is incorporated here by reference.

To date, our overall operations abroad have not been significantly deterred by local restrictions on the transfer of funds from branches and subsidiaries located abroad, including the availability of dollar exchange. We cannot predict what effect these restrictions or the other risks inherent in foreign operations, including possible nationalization, might have on our future operations or what other restrictions may be imposed in the future. In addition, changing currency values can either favorably or unfavorably affect our financial position and results of operations. We actively manage foreign exchange risk through various hedging techniques including the use of foreign currency contracts.

Available Information on Our Web Site

We make available through our company web site, free of charge, our company filings with the Securities and Exchange Commission (SEC) as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. The reports we make available include our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, registration statements, and any amendments to those documents. The company web site link to our SEC filings is http://investor.lilly.com/edgar.cfm.

In addition, the Corporate Governance portion of our web site includes our corporate governance guidelines, board and committee information (including committee charters), and our articles of incorporation and by-laws. The link to our corporate governance information is http://investor.lilly.com/corp-gov.cfm.

We will provide paper copies of our SEC filings and corporate governance documents free of charge upon request to the company’s secretary at the address listed on the front of this Form 10-K.

Item 1A. Risk Factors

In addition to the other information contained in this Form 10-K, the following risk factors should be considered carefully in evaluating our company. It is possible that our business, financial condition, liquidity or results of operations could be materially adversely affected by any of these risks.

- *We face intense competition.* We compete with large number of multinational pharmaceutical companies, biotechnology companies and generic pharmaceutical companies. To compete successfully, we must continue to deliver to the market innovative, cost-effective products that meet important medical needs. Our product sales can be adversely affected by the introduction by competitors of branded products that are perceived as superior by the marketplace, by generic versions of our branded products, and by generic versions of other products in the same therapeutic class as our branded products. See Item 1, “Business — Competition,” for more details.

- *Our long-term success depends on intellectual property protection.* Our long-term success depends on our ability to continually discover, develop, and commercialize innovative new pharmaceutical products. Without strong intellectual property protection, we would be unable to generate the returns necessary to support the enormous investments in research and development, capital, and other expenditures required to bring new drugs to the market. We currently expect no major patent expirations in this decade, but several major products will lose intellectual property protection in the first half of the next decade.

  Intellectual property protection varies throughout the world and is subject to change over time. In the U.S., the Hatch-Waxman Act provides generic companies powerful incentives to seek to invalidate our patents; as a result, we expect that our U.S. patents on major products will be routinely challenged, and there can be no assurance that our patents will be upheld. See Item 1, “Business — Patents, Trademarks, and Other Intellectual Property Protection”, for more details. In addition, competitors or other third parties may claim that our activities infringe patents or other intellectual property rights held by them. If successful, such claims could result in our being unable to market a product in a particular territory or being required to pay damages for past infringement or royalties on future sales.

- *Our business is subject to increasing government price controls and other health care cost containment measures.* Government health care cost-containment measures can significantly affect our sales and profitability. In many countries outside the United States, government agencies strictly control, directly or indirectly, the prices at which our products are sold. In the United States, we are subject to substantial pricing pressures from state Medicaid programs and private insurance programs, including those operating under the new Medicare pharmaceutical benefit effective January 2006. We expect pricing pressures to increase. See Item I, “Business — Regulations Affecting Pharmaceutical Pricing and Reimbursement” for more details.

- *Pharmaceutical research and development is costly and uncertain.* There are many difficulties and uncertainties inherent in new product development and introduction of new products. 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, limited scope of approved uses, 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 can result in delays in product launches and lost market opportunity. In addition, it can be very difficult to predict sales growth rates of new products.

- *Pharmaceutical products can develop unexpected safety or efficacy concerns.* Unexpected safety or efficacy concerns can arise with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals, or declining sales, as well as product liability claims.

- *Zyprexa contributes a major portion of our sales and earnings.* Zyprexa, our largest-selling product, contributes a significant proportion of our total sales and income, and we believe Zyprexa will continue to be a major contributor to our sales and earnings for several years. An unexpected steep and extended decline in Zyprexa sales (resulting from, for example, an unexpected safety or efficacy concern, regulatory action, or premature loss of patent protection) could have a material adverse impact on our results of operations, financial condition and liquidity.
- *Regulatory compliance failures could be damaging to the company.* The marketing, promotional, and pricing practices of pharmaceutical manufacturers, as well as the manner in which manufacturers interact with purchasers and prescribers, are subject to extensive regulation. Many companies, including Lilly, have been subject to claims related to these practices asserted by federal and state governmental authorities and private payors and consumers. These claims could result in substantial expense to the company. In particular, See Item 7, "Management's Discussion and Analysis — Legal and Regulatory Matters", for the discussions of the U.S. sales and marketing practices investigations. In addition, regulatory issues concerning compliance with current Good Manufacturing Practice (cGMP) regulations for pharmaceutical products can lead to product recalls and seizures, interruption of production leading to product shortages, and delays in the approvals of new products pending resolution of the cGMP issues. See Item 1, "Business — Regulation of our Operations", for more details.
- *We face many product liability claims today, and future claims will be largely self-insured.* We are subject to a substantial number of product liability claims involving primarily Zyprexa, DES, and thimerosal, and because of the nature of pharmaceutical products, it is possible that we could become subject to large numbers of product liability claims for other products in the future. See Item 7, "Management's Discussion and Analysis — Legal and Regulatory Matters" and Item 3, "Legal Proceedings", for more information on our current product liability litigation. We have experienced difficulties in obtaining product liability insurance due to a very restrictive insurance market, and therefore will be largely self-insured for future product liability losses. In addition, there is no assurance that we will be able to fully collect from our insurance carriers on past claims.
- *Manufacturing difficulties could lead to product supply problems.* Pharmaceutical manufacturing is complex and highly regulated. Manufacturing difficulties can result in product shortages, leading to lost sales. See Item 1, "Business — Raw Materials and Product Supply," for more details.
- *We face other risks to our business and operating results.* Our business is subject to a number of other risks and uncertainties, including:
    - Economic factors over which we have no control, including changes in inflation, interest rates and foreign currency exchange rates, and overall economic conditions in volatile areas can affect our results of operations.
    - 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, can affect our net income.
    - Changes in accounting standards promulgated by the Financial Accounting Standards Board, the Securities and Exchange Commission, and the Emerging Issues Task Force can affect reported results.

- Our results can also be affected by internal factors, such as changes in business strategies and the impact of restructurings, asset impairments, technology acquisition and disposition transactions, and business combinations.

Cautionary Statement Regarding Forward-Looking Statements

We have made certain forward-looking statements in this Form 10-K, and company spokespeople may make such statements in the future based on then-current expectations of management. Where possible, we try to identify forward-looking statements by using such words as “expect,” “plan,” “will,” “estimate,” “forecast,” “project,” “believe,” “anticipate,” and similar expressions. Forward-looking statements do not relate strictly to historical or current facts. They are likely to address our growth strategy, sales of current and anticipated products, financial results, the results of our research and development programs, the status of product approvals, and the outcome of contingencies such as litigation and investigations. All forward-looking statements made by us are subject to risks and uncertainties, including those summarized above, that may cause actual results to differ materially from our expectations.

We undertake no duty to update forward-looking statements.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal domestic and international executive offices are located in Indianapolis. At December 31, 2005, we owned 13 production and distribution facilities in the United States and Puerto Rico. Together with the corporate administrative offices, these facilities contain an aggregate of approximately 12.2 million square feet of floor area dedicated to production, distribution, and administration. Major production sites include Indianapolis; Clinton and Lafayette, Indiana; and Carolina, Guayama, and Mayaguez, Puerto Rico. We are constructing a new production facility in Prince William County, Virginia.

We own production and distribution facilities in 13 countries outside the United States and Puerto Rico, containing an aggregate of approximately 4 million square feet of floor space. Major production sites include facilities in the United Kingdom, France, Ireland, Spain, Italy, Brazil, and Mexico. We lease production and warehouse facilities in Puerto Rico and several countries outside the United States.

Our research and development facilities in the United States consist of approximately 4.6 million square feet and are located primarily in Indianapolis and Greenfield, Indiana. Our major research and development facilities abroad are located in Belgium, United Kingdom, Germany, Canada, and Spain and contain an aggregate of approximately 700,000 square feet.

We believe that none of our 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. The buildings we own are of varying ages and in good condition.

Item 3. Legal Proceedings

We are a party to various currently pending legal actions, government investigations, and environmental proceedings, and we anticipate that such actions could be brought against us in the future. The most significant of these matters are described below or, as noted, in Item 7,

"Management's Discussion and Analysis — Legal and Regulatory Matters." While it is not possible to predict or determine the outcome of the legal actions, investigations and proceedings brought against us, we believe that, except as otherwise specifically noted in Item 7, the resolution of all such matters will not have a material adverse effect on our consolidated financial position or liquidity, but could possibly be material to our consolidated results of operations in any one accounting period.

Legal Proceedings Described in Management's Discussion and Analysis

See Item 7, "Management's Discussion and Analysis — Legal and Regulatory Matters," for information on various legal proceedings, including but not limited to:

- The U.S. patent litigation involving Zyprexa, Evista, and Gemzar
- The civil investigation by the U.S. Attorney for the Eastern District of Pennsylvania relating to our U.S. sales, marketing, and promotional practices
- The Zyprexa product liability and related litigation, including claims brought on behalf of healthcare payors
- The suits we have filed against several of our product liability insurance carriers with respect to our coverage for the Zyprexa product liability claims

That information is incorporated into this Item by reference.

Other Patent Litigation

During 2005, two generic pharmaceutical manufacturers, Apotex Inc. (Apotex) and Novopharm Ltd. (Novopharm) (a wholly-owned subsidiary of Teva), challenged the validity of our Zyprexa compound and method-of-use patent (expiring in 2011) in Canada. We currently anticipate a decision from the Canadian Federal Patent Court by January 2007 in the Apotex case and by September 2007 in the Novopharm case. The generic companies allege that our patent is invalid, obtained by fraud, or irrelevant. In May 2004, Egis-Gyogyszergyar, a generic pharmaceutical manufacturer, challenged the validity of our Zyprexa compound and method-of-use patent (expiring in 2011) in Germany. We currently anticipate a decision from the German Patent Court in 2006 or 2007. In addition to our patents, we have data package exclusivity in Germany through September 2006. We have received challenges to Zyprexa patents in a number of other countries as well, including Spain, China, Russia, and several Eastern European countries. We are vigorously contesting the various legal challenges to our Zyprexa patents. We cannot predict or determine the outcome of this litigation.

In October 2002, Pfizer Inc. filed a lawsuit in the United States District Court in Delaware against us, Lilly ICOS LLC, and ICOS Corporation alleging that the proposed marketing of Cialis for erectile dysfunction would infringe its newly issued method-of-use patent. In September 2003, the U.S. Patent and Trademark Office, on its own initiative, ordered that Pfizer's patent be reexamined. The Delaware suit has been stayed pending the outcome of the reexamination. In the European Union, the Technical Board of Appeal of the European Patent Office revoked Pfizer's method-of-use patent in its entirety in February 2005. The U.K. Court of Appeal has also held the U.K. counterpart to this patent invalid. Litigation relating to the corresponding patent is also pending in Australia, Brazil, Canada, Mexico, New Zealand, and South Africa. We intend to vigorously defend this litigation and expect to prevail. However, it is not possible to predict or determine the outcome of this litigation .

Other Product Liability Litigation

We are currently a defendant in a variety of product liability lawsuits in the United States involving primarily Zyprexa, diethylstilbestrol ("DES") and thimerosal.

In approximately 125 U.S. actions involving approximately 200 claimants, plaintiffs seek to recover damages on behalf of children or grandchildren of women who were prescribed DES during pregnancy.

We have been named as a defendant in approximately 340 actions in the U.S., involving approximately 1,020 claimants, brought in various state courts and federal district courts on behalf of children with autism or other neurological disorders who received childhood vaccines (manufactured by other companies) that contained thimerosal, a generic preservative used in certain vaccines in the U.S. beginning in the 1930s. We purchased patents and conducted research pertaining to thimerosal in the 1920s. We have been named in the suits even though we discontinued manufacturing the raw material in 1974 and discontinued selling it in the United States to vaccine manufacturers in 1992. The lawsuits typically name the vaccine manufacturers as well as Lilly and other distributors of thimerosal, and allege that the children's exposure to thimerosal-containing vaccines caused their autism or other neurological disorders. We strongly deny any liability in these cases. There is no credible scientific evidence establishing a causal relationship between thimerosal-containing vaccines and autism or other neurological disorders. In addition, we believe the majority of the cases should not be prosecuted in the courts in which they have been brought because the underlying claims are subject to the National Childhood Vaccine Injury Act of 1986. Implemented in 1988, the Act established a mandatory, federally administered no-fault claims process for individuals who allege that they were harmed by the administration of childhood vaccines. Under the Act, claims must first be brought before the U.S. Court of Claims for an award determination under the compensation guidelines established pursuant to the Act. Claimants who are unsatisfied with their awards under the Act may reject the award and seek traditional judicial remedies.

Other Marketing Practices Investigations

In 2002, 2003, and 2004, we received grand jury subpoenas from the Office of Consumer Litigation, Department of Justice, related to our marketing and promotional practices and physician communications with respect to Evista. In the fourth quarter of 2004 we recorded a provision for $36.0 million in connection with the matter. In December 2005, we reached a settlement of the matter with the government, which was subsequently approved by the U.S. District Court for the Southern District of Indiana in February 2006. As part of the settlement, we agreed to plead guilty to one misdemeanor violation of the Food, Drug, and Cosmetic Act. The plea is for the off-label promotion of Evista during 1998. The government did not charge the company with any unlawful intent, nor do we acknowledge any such intent. In connection with the overall settlement, we paid a total of $36.0 million. In addition, as part of the settlement, a civil consent decree requires us to continue to have a compliance program and to undertake a set of defined corporate integrity obligations related to Evista for five years.

In August 2003, we received notice that the staff of the SEC is conducting an investigation into the compliance by Polish subsidiaries of certain pharmaceutical companies, including Lilly, with the U.S. Foreign Corrupt Practices Act of 1977. The staff has issued subpoenas to us requesting production of documents related to the investigation. We are cooperating with the SEC in responding to the investigation.

Other Matters

In August 2005, we received a civil subpoena from office of the Attorney General of Connecticut for production of documents related to Healthcare Research & Development Institute LLC, an organization of executives of hospitals, healthcare systems, and other companies in the healthcare field, of which we are a corporate member. We are cooperating in responding to the subpoena.

In October 2005, we received a subpoena from the U.S. Attorney's office for the District of Massachusetts for the production of documents relating to our business relationship with a long-term care pharmacy organization concerning Actos, Humalog, Humulin, and Zyprexa. We are cooperating in responding to the subpoena.

Between 2003 and 2005, various counties in New York sued us and many other pharmaceutical manufacturers, claiming in general that as a result of alleged improprieties by the manufacturers in the calculation and reporting of average wholesale prices for purposes of Medicaid reimbursement, the counties overpaid their portion of the cost of pharmaceuticals. The suits seek monetary and other relief, including civil penalties and treble damages. The suits have been transferred to the U.S. District Court for the District of Massachusetts for pretrial proceedings. The suits are in the earliest stages. Similar suits were filed against us and many other manufacturers by the states of Alabama and Mississippi. In December 2005, Alabama voluntarily dismissed its case against us. The Mississippi case, pending in state court in Hinds County, is in the earliest stages.

During 2004 we, along with several other pharmaceutical companies, were named in one consolidated case in Minnesota federal court brought on behalf of consumers alleging that the conduct of pharmaceutical companies in preventing commercial importation of prescription drugs from outside the United States violated antitrust laws and one case in California state court brought by several pharmacies in which plaintiffs' claims are less specifically stated, but are substantially similar to the claims asserted in Minnesota. Both cases seek restitution for alleged overpayments for pharmaceuticals and an injunction against the allegedly violative conduct. The federal district court in the Minnesota case has dismissed the federal claims and ruled that the state claims must be brought in separate state court actions. Plaintiffs have appealed that decision to the Eighth Circuit Court of Appeals. The California case is currently in discovery.

Under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly known as Superfund, we have been designated as one of several potentially responsible parties with respect to the cleanup of fewer than 10 sites. Under Superfund, each responsible party may be jointly and severally liable for the entire amount of the cleanup.

We are also a defendant in other litigation and investigations, including product liability and patent suits, of a character we regard as normal to our business.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of 2005, no matters were submitted to a vote of security holders.

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

You can find information relating to the principal market for our common stock and related stockholder matters at Item 8 under "Selected Quarterly Data (unaudited)" and "Selected Financial Data (unaudited)." That information is incorporated here by reference.

The following table summarizes the activity related to repurchases of our equity securities during the fourth quarter ended December 31, 2005:

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share (b)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (c)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (d)
	(in thousands)		(in thousands)	(Dollars in millions)
October 2005	61	$51.86	—	$920.0
November 2005	—	—	—	920.0
December 2005	6,717	56.36	6,704	541.3
Total	6,778		6,704	

The amounts presented in columns (a) and (b) above include purchases of common stock related to our share repurchase program and employee stock option exercises. The amounts presented in columns (c) and (d) in the above table represent activity related only to our $3.0 billion share repurchase program announced in March 2000. As of December 31, 2005, we have purchased $2.46 billion related to this program.

Item 6. Selected Financial Data

You can find selected financial data for each of our five most recent fiscal years in Item 8 under "Selected Financial Data (unaudited)." That information is incorporated here by reference.

Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

Executive Overview

This section provides an overview of our financial results, product launches and late-stage product pipeline developments, and legal and governmental matters affecting our company and the pharmaceutical industry.

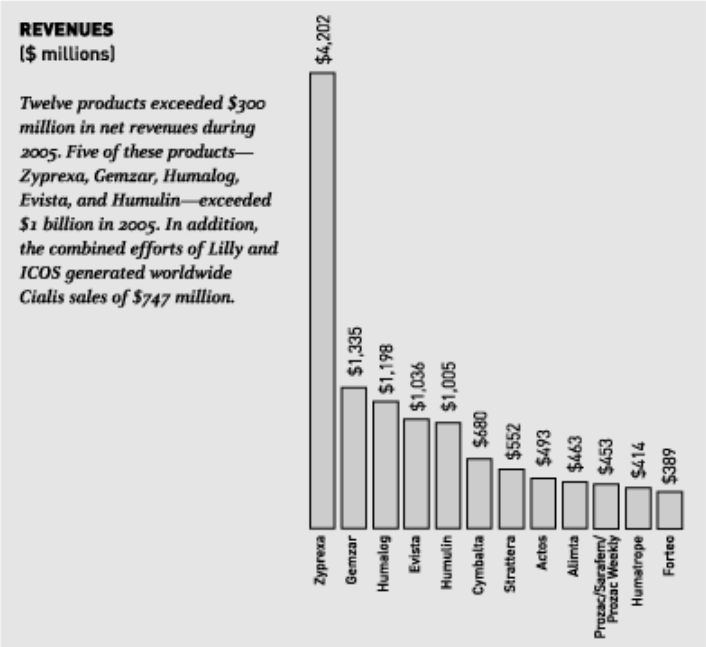
Financial Results

We achieved worldwide sales growth of 6 percent, due in part to the launch in 2004 of five new products as well as six new indications or formulations for expanded use of new and existing products in key markets. In addition, we launched one new product in the U.S. and several new products, new indications, or new formulations in key markets in 2005. We continued our substantial investments in our manufacturing operations and research and development activities, resulting in cost of products sold and research and development costs increasing at rates greater than sales. Despite product launch expenditures, our cost-containment and productivity measures

contributed to marketing and administrative expenses increasing at a rate less than sales. During 2005, we began to expense stock options, which had the effect of increasing our research and development and marketing and administrative expenses. We also benefited from an increase in net other income due primarily to increased profitability of the Lilly ICOS joint venture and a decrease in the tax rate in 2005. Net income was $1.98 billion, or $1.81 per share, in 2005 as compared with $1.81 billion, or $1.66 per share, in 2004, representing an increase in net income and earnings per share of 9 percent. Net income comparisons between 2005 and 2004 are also affected by the impact of the following significant items that are reflected in our financial results (see Notes 1, 2, 3, 4, 7, 11, and 13 to the consolidated financial statements for additional information):

2005

- We incurred a charge related to product liability litigation matters, primarily related to Zyprexa®, of $1.07 billion (pretax), which decreased earnings per share by $.90 in the second quarter of 2005 (Notes 4 and 13).
- In 2005, we began to expense stock options in accordance with SFAS 123(R). Had we expensed stock options in 2004, our 2004 net income would have been lower by $266.4 million, which would have decreased earnings per share by $.24 per share (Notes 1 and 7).
- We recognized asset impairment and other special charges of $171.9 million (pretax) in the fourth quarter, which decreased earnings per share by $.14 (Note 4).
- We adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143, in the fourth quarter of 2005. The adoption of FIN 47 resulted in an adjustment for the cumulative effect of a change in accounting principle of $22.0 million (after-tax), which decreased earnings per share by $.02 (Note 2).



2004

- We recognized asset impairment charges, streamlined our infrastructure, and provided for the anticipated resolution of the government investigation of Evista® marketing and promotional practices, resulting in charges of $108.9 million (pretax) in the second quarter and $494.1 million (pretax) in the fourth quarter, which decreased earnings per share by $.08 and $.30, respectively (Note 4).
- We incurred charges for acquired in-process research and development (IPR&D) of $362.3 million (no tax benefit) in the first quarter related to the acquisition of Applied Molecular Evolution, Inc. (AME), and $29.9 million (pretax) in the fourth quarter related to our acquisition of a Phase I compound currently under development as a potential treatment for insomnia, which decreased earnings per share by $.33 in the first quarter and $.02 in the fourth quarter (Note 3).
- As discussed further in Financial Condition, we recognized tax expenses of $465.0 million in the fourth quarter associated with the anticipated repatriation in 2005 of $8.00 billion of our earnings reinvested outside the U.S., as a result of the passage of the American Jobs Creation Act of 2004 (AJCA). This tax expense decreased earnings per share by $.43 in that quarter (Note 11).

Recent Product Launches and Late-Stage Product Pipeline Developments

Our long-term success depends, to a great extent, on our ability to continue to discover and develop innovative pharmaceutical products and acquire or collaborate on compounds currently in development by other biotechnology or pharmaceutical companies. We have achieved a number of successes with recent product launches and late-stage pipeline developments, including:

- We are in the process of rolling out the global launches of a number of new products, including Alimta®, Byetta®, Cialis®, Cymbalta®, Forteo®, Strattera®, Symbyax®, and Yentreve®. In addition, we recently launched new indications or formulations of Alimta, Cymbalta, Gemzar®, Humatrope®, and Zyprexa.
- We launched Cymbalta for the treatment of major depressive disorder in the U.S. in August 2004. In September 2004, Cymbalta received its second U.S. approval and became the first FDA-approved treatment for diabetic peripheral neuropathic pain (DPNP). Cymbalta was launched in the United Kingdom and Germany in the first quarter of 2005 for the treatment of major depressive episodes. Other launches in the European Union are expected to occur throughout 2006. The European Commission also granted marketing authorization of Cymbalta for the treatment of DPNP in adults in July 2005. Cymbalta has achieved $728.9 million in U.S. sales since its launch.
- In June 2005, Lilly and Amylin Pharmaceuticals, Inc., launched Byetta (exenatide), the first in a new class of medicines known as incretin mimetics, in the U.S. for the treatment of type 2 diabetes. In the fourth quarter of 2005, we submitted Byetta for the treatment of type 2 diabetes in Europe.
- We expect to advance our pipeline during 2006 with three significant submissions anticipated, including Arxxant™ for diabetic retinopathy, Cymbalta for generalized anxiety disorder, and Evista for breast cancer risk reduction in postmenopausal women.

Legal and Governmental Matters

Certain generic manufacturers have challenged our U.S. compound patent for Zyprexa and are seeking permission to market generic versions of Zyprexa prior to its patent expiration in 2011. On April 14, 2005, the U.S. District Court in Indianapolis ruled in our favor on all counts, upholding our patents. The decision has been appealed.

In 2005, we entered into an agreement with plaintiffs' attorneys involved in certain U.S. Zyprexa product liability litigation to settle a majority of the claims against us relating to the medication. We established a fund of $690 million for the claimants who agree to settle their claims. Additionally, we paid $10 million to cover administration of the settlement. As a result of our product liability exposures, the substantial majority of which were related to Zyprexa, we recorded a net pretax charge of $1.07 billion in the second quarter of 2005.

In March 2004, we were notified by the U.S. Attorney's office for the Eastern District of Pennsylvania that it has commenced a civil investigation relating to our U.S. sales, marketing, and promotional practices.

In the United States, implementation of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA), which provides a prescription drug benefit under the Medicare program, took effect January 1, 2006. While it is difficult to predict the business impact of this legislation, we currently anticipate a modest short-term increase in sales. However, in the long term there is additional risk of increased pricing pressures. While the MMA prohibits the Secretary of Health and Human Services (HHS) from directly negotiating prescription drug prices with manufacturers, we expect continued challenges to that prohibition over the next several years. Also, the MMA retains the authority of the Secretary of HHS to prohibit the importation of prescription drugs, but we expect Congress to consider several measures that could remove that authority and allow for the importation of products into the U.S. regardless of their safety or cost. If adopted, such legislation would likely have a negative effect on our U.S. sales. We believe there is some chance that the new and expanded prescription drug coverage for seniors under the MMA will alleviate the need for a federal importation scheme.

As a result of the passage of the MMA, aged and disabled patients jointly eligible for Medicare and Medicaid began receiving their prescription drug benefits through the Medicare program, instead of Medicaid, on January 1, 2006. This may relieve some state budget pressures but is unlikely to result in reduced pricing pressures at the state level. A majority of states have begun to implement supplemental rebates and restricted formularies in their Medicaid programs, and these programs are expected to continue in the post-MMA environment. Several states are also attempting to extend discounted Medicaid prices to non-Medicaid patients. Additionally, notwithstanding the federal law prohibiting drug importation, approximately a dozen states have implemented importation schemes for their citizens, usually involving a website that links patients to selected Canadian pharmacies. One state has such a program for its state employees. As a result, we expect pressures on pharmaceutical pricing to continue.

International operations are also generally subject to extensive price and market regulations, and there are many proposals for additional cost-containment measures, including proposals that would directly or indirectly impose additional price controls or reduce the value of our intellectual property protection.

Operating Results — 2005

Sales

Our worldwide sales for 2005 increased 6 percent, to $14.65 billion, driven primarily by sales growth of Cymbalta, Alimta, Forteo, and Gemzar. As a result of restructuring our arrangements with our U.S. wholesalers in early 2005, reductions occurred in wholesaler inventory levels for certain products (primarily Strattera, Prozac®, and Gemzar) that reduced our sales by approximately $170 million. Sales growth in 2005 was also affected by decreased U.S. demand for Zyprexa, Strattera, and Prozac. Despite this wholesaler destocking and decreased demand, sales in the U.S. increased 2 percent, to $7.80 billion, driven primarily by increased sales of Cymbalta and Alimta. Sales outside the U.S. increased 11 percent, to $6.85 billion, driven by growth of Zyprexa, Alimta, and Gemzar. Worldwide sales reflected a volume increase of 3 percent, with global selling prices contributing 1 percent and an increase due to favorable changes in exchange rates contributing 1 percent. (Numbers do not add due to rounding.)

The following table summarizes our net sales activity in 2005 compared with 2004:

	Year Ended December 31, 2005			Year Ended December 31, 2004	Percent Change
Product	U.S.(1)	Outside U.S.	Total	Total	from 2004
(Dollars in millions)					
Zyprexa	$ 2,034.9	$ 2,167.4	$ 4,202.3	$ 4,419.8	(5)
Gemzar	586.1	748.4	1,334.5	1,214.4	10
Humalog	739.6	458.1	1,197.7	1,101.6	9
Evista	652.9	383.2	1,036.1	1,012.7	2
Humulin	410.7	594.0	1,004.7	997.7	1
Animal health products	370.3	493.4	863.7	798.7	8
Cymbalta	636.2	43.5	679.7	93.9	NM
Strattera	498.7	53.4	552.1	666.7	(17)
Actos	355.7	137.3	493.0	452.9	9
Alimta	296.3	166.9	463.2	142.6	NM
Fluoxetine products	249.1	204.3	453.4	559.0	(19)
Anti-infectives	133.3	310.6	443.9	478.0	(7)
Humatrope	184.5	229.9	414.4	430.3	(4)
Forteo	264.7	124.6	389.3	238.6	63
ReoPro®	119.8	176.9	296.7	362.8	(18)
Xigris®	118.9	95.7	214.6	201.8	6
Cialis(2)	2.3	167.6	169.9	130.6	30
Symbyax	52.6	1.3	53.9	70.2	(23)
Other pharmaceutical products	91.5	290.7	382.2	485.6	(21)
Total net sales	$ 7,798.1	$ 6,847.2	$ 14,645.3	$ 13,857.9	6

NM — Not meaningful

(1) U.S. sales include sales in Puerto Rico.

(2) Cialis had worldwide 2005 sales of $746.6 million, representing an increase of 35 percent compared with 2004. The sales shown in the table above represent results only in the territories in which we market Cialis exclusively. The remaining sales relate to the joint-venture territories of Lilly ICOS LLC (North America, excluding Puerto Rico, and Europe). Our share of the joint-venture territory sales, net of expenses, is reported in net other income in our consolidated income statement.

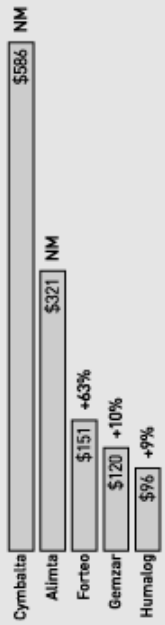
Zyprexa, our top-selling product, is a treatment for schizophrenia, bipolar mania, and bipolar maintenance. Zyprexa sales in the U.S. decreased 16 percent in 2005, resulting from a decline in underlying demand due to continuing competitive pressures. Sales outside the U.S. in 2005 increased 9 percent, driven by volume growth in a number of major markets and the favorable impact of exchange rates. Excluding the impact of exchange rates, sales of Zyprexa outside the U.S. increased by 6 percent. In September 2005, the National Institute of Mental Health released the results of its Clinical Antipsychotic Trial of Intervention Effectiveness (CATIE) study, which showed that Zyprexa was statistically superior on time to discontinuation in patients with schizophrenia as compared to other medications. Patients taking Zyprexa also experienced significantly fewer hospitalizations for schizophrenia than patients taking other medications. In addition, the study noted that Zyprexa patients experienced greater weight gain and increases in measures of glucose and lipid metabolism than patients using other antipsychotics.

Diabetes care products, composed primarily of Humalog®, our insulin analog; Humulin®, a biosynthetic human insulin; Actos®, an oral agent for the treatment of type 2 diabetes; and recently-launched Byetta, the first in a new class of medicines known as incretin mimetics for type 2 diabetes that we market with Amylin Pharmaceuticals, had aggregate worldwide revenues of $2.80 billion in 2005, an increase of 7 percent. Diabetes care revenues in the U.S. increased 7 percent, to $1.59 billion, primarily driven by higher prices, offset partially by a decline in underlying demand due to continued competitive pressures in the insulins market and reductions in wholesaler inventory levels of insulins. Diabetes care revenues outside the U.S. increased 8 percent, to $1.20 billion. Humalog sales increased 8 percent in the U.S. and 10 percent outside the U.S. Humulin sales in the U.S. decreased 3 percent, while Humulin sales outside the U.S. increased 3 percent. Actos revenues, the majority of which represent service revenues from a copromotion agreement in the U.S. with Takeda Pharmaceuticals North America (Takeda), increased 9 percent in 2005. Actos is manufactured by Takeda Chemical Industries, Ltd., and sold in the U.S. by Takeda. Our U.S. marketing rights with respect to Actos expire in September 2006; however, we will continue receiving royalties from Takeda. As a result, our revenues from Actos will decline each year from 2006 through 2009. Our arrangement in the U.S. ceases after October 2009. Sales of Byetta were $74.6 million following its June 2005 launch. We report as revenue our 50 percent share of Byetta’s gross margin and our sales of Byetta pen delivery devices to Amylin. This revenue totaled $39.6 million in 2005.

Sales of Gemzar, a product approved to fight various cancers, increased 4 percent in the U.S. Sales growth in the U.S. in 2005 was negatively affected by reductions in wholesaler inventory levels as a result of our restructured arrangements with our U.S. wholesalers. Gemzar sales increased 15 percent outside the U.S., driven by strong volume growth in a number of cancer indications.

KEY CONTRIBUTORS TO 2005 SALES GROWTH
($ in millions of growth; percentages represent changes from 2004)

Five of our products—Cymbalta, Alimta, Forteo, Gemzar, and Humalog—generated $4.1 billion in net sales during 2005, an increase of $1.3 billion over 2004. In addition, global sales of Cialis, promoted with our partner ICOS, increased $194 million to $747 million (a 35 percent increase from 2004).



Sales of Evista, a product for the prevention and treatment of osteoporosis, decreased 2 percent in the U.S. due to a decline in U.S. underlying demand resulting from continued competitive pressures and reductions in wholesaler inventory levels. This decline was partially offset by price increases. Outside the U.S., sales of Evista increased 11 percent, driven by volume growth in several markets and the early 2004 launch of the product in Japan.

Cymbalta was launched in the U.S. in late August 2004 for the treatment of major depressive disorder and in September 2004 for the treatment of diabetic peripheral neuropathic pain. Cymbalta launches began in Europe for the treatment of major depressive disorder during the first quarter of 2005, with additional launches expected through 2006. Cymbalta has been well accepted, generating $679.7 million in sales in 2005.

Sales of Strattera, the only nonstimulant medicine approved for the treatment of attention-deficit hyperactivity disorder in children, adolescents, and adults, declined 24 percent in the U.S. in 2005 due to wholesaler destocking resulting from restructured arrangements with our U.S. wholesalers and a decline in underlying demand. Sales outside the U.S. were $53.4 million in 2005, compared with $10.3 million in 2004, primarily reflecting recent launches in Australia, Canada, Germany, Mexico, and Spain. In the third quarter of 2005, we announced an important update to the Strattera label, communicating new information regarding uncommon reports of suicidal thoughts among children and adolescents. We have added a boxed warning to the label in the U.S. and are working with other regulatory agencies in countries where Strattera is approved to update the label information appropriately.

Alimta was launched in the U.S. in February 2004 for the treatment of malignant pleural mesothelioma and in August for second-line treatment of non-small-cell lung cancer (NSCLC). Alimta was launched in several European countries in the second half of 2004 and throughout 2005. Alimta generated sales of $463.2 million in 2005.

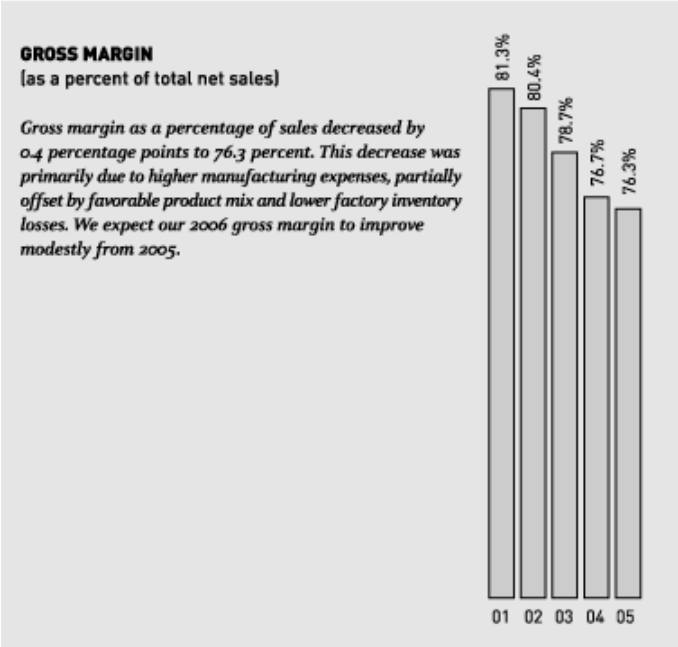
Forteo, a treatment for both men and postmenopausal women suffering from severe osteoporosis, increased 34 percent in the U.S. in 2005, driven by strong growth in underlying demand. Sales growth was offset, in part, by wholesaler destocking in the first half of 2005 related to our new arrangements with U.S. wholesalers.

Cialis, an erectile dysfunction treatment, is promoted in North America and Europe jointly by Lilly and ICOS Corporation, and by Lilly exclusively in the rest of the world. The $746.6 million of worldwide Cialis sales in 2005, an increase of 35 percent compared to 2004, comprises $169.9 million of sales in our territories, which are reported in our net sales, and $576.7 million of sales in the joint-venture territories. Within the joint-venture territories, U.S. sales of Cialis were $272.9 million for 2005, an increase of 32 percent, despite wholesaler destocking in the first half of the year as a result of our restructured arrangements with our U.S. wholesalers. Cialis continues to increase its market share in most major markets in this extremely competitive category.

Animal health product sales in the U.S. increased 9 percent, while sales outside the U.S. increased 7 percent, led by Rumensin and Paylean.

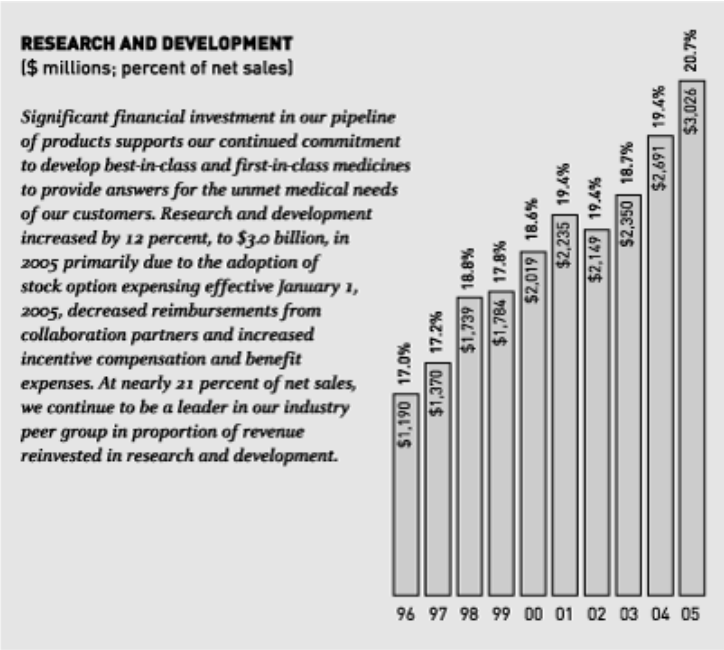
Gross Margin, Costs, and Expenses

The 2005 gross margin decreased to 76.3 percent of sales compared with 76.7 percent for 2004. The decrease was primarily due to higher manufacturing expenses, partially offset by favorable product mix and lower factory inventory losses.



Operating expenses (the aggregate of research and development and marketing and administrative expenses) increased 8 percent in 2005. Investment in research and development increased 12 percent, to $3.03 billion, in 2005, due to the adoption of stock option expensing in 2005, decreased reimbursements from collaboration partners, and increased incentive compensation and benefits expenses. We continued to be a leader in our industry peer group by investing

approximately 21 percent of our sales into research and development during 2005. Marketing and administrative expenses increased 5 percent in 2005, to $4.50 billion, due to the adoption of stock option expensing in 2005, and increased incentive compensation and benefits expenses. This comparison also benefited from a charitable contribution to the Lilly Foundation during the fourth quarter of 2004. Research and development expenses would have increased by 8 percent, and marketing and administrative expenses would have been flat for 2005, if 2004 had been restated as if stock options had been expensed.



Net other income for 2005 increased $89.4 million, to $419.4 million, primarily due to the Lilly ICOS LLC joint venture becoming profitable during 2005 and increased interest income, partially offset by less income related to the outlicense of legacy products and partnered products in development. We report our 50 percent share of the operating results of the Lilly ICOS joint venture in our net other income. For 2005, our net income from the joint venture was $11.1 million, compared with a net loss of $79.0 million in 2004. The joint venture became profitable for the first time in the third quarter of 2005.

Interest expense for 2005 increased $53.6 million, to $105.2 million, primarily due to an increase in interest rates.

The effective tax rate for 2005 was 26.3 percent, compared with 38.5 percent for 2004. The effective tax rate for 2005 was affected by the product liability charge of $1.07 billion. The tax benefit of this charge was less than our effective tax rate, as the tax benefit was calculated based upon existing tax laws in the countries in which we reasonably expect to deduct the charge. The effective tax rate for 2004 was affected by the tax provision related to the expected repatriation of $8.00 billion of earnings reinvested outside the U.S. pursuant to the AJCA and the charge for acquired IPR&D related to the AME acquisition, which is not deductible for tax purposes. See Note 11 to the consolidated financial statements for additional information.

Operating Results — 2004

Financial Results

We achieved worldwide sales growth of 10 percent, due in part to the launch during the year of five new products as well as six new indications or formulations for expanded use of new and existing products in key markets. We continued our substantial investments in our manufacturing operations and research and development activities, resulting in costs of products sold and research and development costs increasing at rates greater than sales. Despite significant product launch expenditures, our cost-containment and productivity measures resulted in marketing and administrative expenses increasing at a rate significantly less than sales. We also benefited from an increase in net other income in 2004. Net income was $1.81 billion, or $1.66 per share, in 2004, as compared with $2.56 billion, or $2.37 per share, in 2003, decreases of 29 and 30 percent, respectively.

Certain items, reflected in our operating results for 2004 and 2003, should be considered in comparing the two years. The significant items for 2004 are summarized in the Executive Overview. The 2003 items are summarized as follows (see Note 4 to the consolidated financial statements for additional information).

- We recognized asset impairments, primarily relating to manufacturing assets in the U.S., and streamlined our infrastructure, resulting in severance-related and other charges totaling $167.1 million (pretax) in the first quarter and $28.3 million (pretax) in the fourth quarter, which decreased earnings per share by approximately $.10 and $.02 in the first and fourth quarters of 2003, respectively (Note 4).
- Separately, we recognized asset impairments and other charges of $186.8 million (pretax) in the first quarter of 2003 related primarily to our common stock ownership and loan agreements with Isis Pharmaceuticals, Inc. (Isis), which decreased earnings per share by $.13 in that quarter (Note 4).
- In the fourth quarter of 2003, we recorded a gain of $65.0 million (pretax) related to the sale of patent rights to dapoxetine for development in the field of genitourinary disorders to PPD, Inc., which increased earnings per share by $.04 in that quarter.

Sales

Our worldwide sales for 2004 increased 10 percent, to $13.86 billion, due primarily to the increased global sales of Strattera, Gemzar, Forteo, Zyprexa, Evista, Humatrope, and Cialis, and sales related to the launches of Alimta and Cymbalta. Sales in the U.S. increased 6 percent, to $7.67 billion. Sales outside the U.S. increased 15 percent, to $6.19 billion. Worldwide sales reflected a volume increase of 5 percent, with global selling prices contributing 2 percent and an increase due to favorable changes in exchange rates contributing 3 percent.

The following table summarizes our net sales activity in 2004 compared with 2003:

Product	Year Ended December 31, 2004 U.S.(1)	Outside U.S.	Total	Year Ended December 31, 2003 Total	Percent Change from 2003
			(Dollars in millions)		
Zyprexa	$ 2,422.2	$ 1,997.6	$ 4,419.8	$ 4,276.9	3
Gemzar	565.1	649.3	1,214.4	1,021.7	19
Humalog	685.4	416.2	1,101.6	1,021.3	8
Evista	667.9	344.8	1,012.7	922.1	10
Humulin	422.7	575.0	997.7	1,060.4	(6)
Animal health products	338.9	459.8	798.7	726.6	10
Strattera	656.4	10.3	666.7	370.3	80
Fluoxetine products	327.3	231.7	559.0	645.1	(13)
Anti-infectives	110.2	367.8	478.0	489.9	(2)
Actos	340.4	112.5	452.9	431.2	5
Humatrope	204.8	225.5	430.3	370.9	16
ReoPro	175.4	187.4	362.8	364.4	0
Forteo	198.0	40.6	238.6	65.3	NM
Xigris	123.3	78.5	201.8	160.4	26
Alimta	121.8	20.8	142.6	—	NM
Cialis(2)	1.4	129.2	130.6	73.5	78
Cymbalta	92.7	1.2	93.9	—	NM
Symbyax	70.1	0.1	70.2	—	NM
Other pharmaceutical products	144.5	341.1	485.6	582.5	(17)
Total net sales	$ 7,668.5	$ 6,189.4	$ 13,857.9	$ 12,582.5	10

NM — Not meaningful

(1) U.S. sales include sales in Puerto Rico.

(2) Cialis had worldwide 2004 sales of $552.3 million, an increase of 172 percent compared with 2003. The sales shown in the tables above represent results in the territories in which we market Cialis exclusively. The remaining sales relate to the joint-venture territories of Lilly ICOS LLC (North America, excluding Puerto Rico, and Europe). Our share of the joint-venture territory sales, net of expenses, is reported in net other income in our consolidated income statement.

Zyprexa sales in the U.S. decreased 8 percent in 2004 due to a decline in underlying demand from continued competitive pressures. Zyprexa sales outside the U.S. increased 22 percent, driven by volume growth in a number of major markets outside the U.S. International Zyprexa sales growth also benefited from the impact of foreign exchange rates. Excluding the impact of exchange rates, sales of Zyprexa outside the U.S. increased 13 percent in 2004.

Diabetes care products had aggregate worldwide revenues of $2.61 billion in 2004, an increase of 2 percent. Diabetes care revenues in the U.S. decreased 6 percent, to $1.49 billion. Diabetes care revenues outside the U.S. increased 14 percent, to $1.12 billion. Humulin sales in the U.S. decreased 19 percent, driven primarily by volume declines due to competitive pressures. Humulin sales outside the U.S. increased 7 percent. Humalog sales in the U.S. increased 3 percent as increased prices offset slight volume declines. Humalog sales outside the U.S. increased 16 percent, to $416.2 million. Actos revenues increased 5 percent in 2004.

Sales of Gemzar increased 8 percent in the U.S. largely due to the May 2004 approval for the treatment of late-stage metastatic breast cancer. Gemzar sales increased 31 percent outside the U.S.,

driven by strong volume growth in a number of cancer indications as well as favorable foreign exchange rates.

Sales of Evista increased 1 percent in the U.S. due to continued competitive pressures. Outside the U.S., Evista maintained a strong growth rate of 32 percent, driven by volume growth in several markets and the early 2004 launch of the product in Japan.

In 2004, Strattera generated an 80 percent increase over 2003 sales despite a very competitive landscape. In December 2004, we added a bolded warning to the product label, which indicates that the medication should be discontinued in patients with jaundice (yellowing of the skin or whites of the eyes) or in the event of laboratory evidence of liver injury.

Forteo generated $238.6 million in sales in 2004, continuing the product's strong growth trajectory following its U.S. launch in December 2002 and European launches in late 2003 and during 2004.

The $552.3 million of worldwide Cialis sales in 2004, an increase of 172 percent compared to 2003, comprises $130.6 million of sales in our territories, which are reported in our net sales, and $421.7 million of sales in the joint-venture territories. Within the joint-venture territories, U.S. sales of Cialis were $206.6 million for 2004.

Animal health product sales in the U.S. increased 9 percent, while sales outside the U.S. increased 10 percent, led by Tylan®, Rumensin, and Paylean.

Gross Margin, Costs, and Expenses

The 2004 gross margin decreased to 76.7 percent of sales compared with 78.7 percent for 2003. The decrease was due primarily to continued investment in our manufacturing technical capabilities and capacity and the impact of foreign exchange rates, offset partially by favorable changes in product mix due to growth in sales of higher margin products.

Operating expenses increased 9 percent in 2004. Investment in research and development increased 15 percent, to $2.69 billion, due to increased clinical trial and development expenses and increased incentive compensation and benefits expenses, partially offset by reimbursements for research activities from our collaboration partners. We reinvested more than 19 percent of our sales into research and development. Marketing and administrative expenses increased 6 percent in 2004, to $4.28 billion, attributable primarily to increased selling expenses in support of the new and anticipated product launches, the impact of foreign exchange rates, increased incentive compensation and benefits expenses, increased charitable contributions to the Lilly Foundation, and increased product liability expenses, offset partially by ongoing marketing cost-containment measures and marketing expense reimbursement from collaboration partners. A majority of the reimbursements are ongoing.

Net other income for 2004 increased $126.9 million to $330.0 million. The increase for 2004 was primarily due to income related to the outlicensing of legacy products outside the United States, milestone payments from collaborations on the duloxetine molecule, income related to a previously assigned patent arrangement of $30.0 million, and other miscellaneous income. This was offset partially by an increase in the net loss of the Lilly ICOS LLC joint venture, due primarily to increased marketing costs of Cialis in joint-venture territories, and the 2003 sale of dapoxetine patent rights. For 2004, our net loss from the joint venture was $79.0 million, compared with $52.4 million in 2003.

The effective tax rate for 2004 was 38.5 percent, compared with 21.5 percent for 2003. The increase in the effective tax rate was caused by the tax provision related to the expected repatriation

of $8.00 billion of earnings reinvested outside the U.S. pursuant to the AJCA and the charge for acquired IPR&D related to the AME acquisition, which is not deductible for tax purposes. See Note 11 to the consolidated financial statements for additional information.

Financial Condition

As of December 31, 2005, cash, cash equivalents, and short-term investments totaled $5.04 billion compared with $7.46 billion at December 31, 2004. Cash flow from operations of $1.91 billion and net issuances of long-term debt of $2.00 billion were more than offset by net repayments of short-term debt of $1.99 billion, dividends paid of $1.65 billion, capital expenditures of $1.30 billion, net purchases of noncurrent investments of $638.0 million, and repurchases of common stock of $377.9 million.

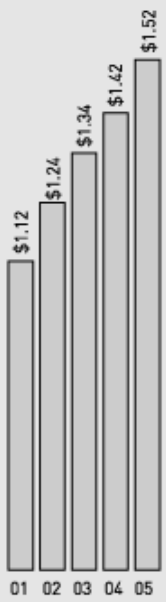
Capital expenditures of $1.30 billion during 2005 were $600.0 million less than in 2004, due primarily to the management of capital spending and completion of key projects. We expect near-term capital expenditures to remain approximately the same as 2005 levels while we continue to invest in the long-term growth of our diabetes care and other products, as well as research and development activities.

Total debt at December 31, 2005, was $6.50 billion, essentially unchanged compared to December 31, 2004. Our current debt ratings from Standard & Poor's and Moody's remain at AA and Aa3, respectively.

Dividends of $1.52 per share were paid in 2005, an increase of 7 percent from 2004. In the fourth quarter of 2005, effective for the first-quarter dividend in 2006, the quarterly dividend was increased to $.40 per share (a 5 percent increase), resulting in an indicated annual rate for 2006 of $1.60 per share. The year 2005 was the 121st consecutive year in which we made dividend payments and the 38th consecutive year in which dividends have been increased.

DIVIDENDS PAID PER SHARE
(dollars)

Dividends paid during 2005 increased to $1.52 per share. This constitutes the 38th consecutive increase in annual dividends. We continued this tradition into 2006 by declaring a first-quarter 2006 dividend of $.40 per share, a 5 percent increase over first-quarter 2005. This record clearly reflects our continued commitment to delivering outstanding shareholder value.



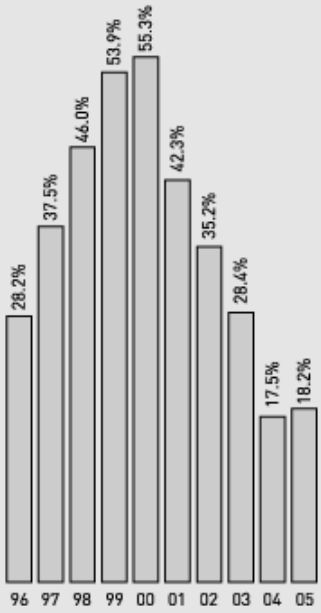
On October 22, 2004, President Bush signed into law the American Jobs Creation Act of 2004 (AJCA), which created a temporary incentive for U.S. corporations to repatriate undistributed income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. We planned to repatriate $8.00 billion in incentive dividends, as defined in the AJCA, during 2005 and accordingly, we recorded a related tax liability of $465.0 million as of December 31, 2004. During 2005, we repatriated all $8.00 billion of eligible incentive dividends. The proceeds from the incentive dividends have been or will be used for research and development activities, capital asset expenditures, and other permitted activities.

We believe that cash generated from operations, along with available cash and cash equivalents, will be sufficient to fund our operating needs, including debt service, capital expenditures, dividends, and taxes in 2006. We believe that amounts available through our existing commercial paper program should be adequate to fund maturities of short-term borrowings, if necessary. Our commercial paper program is also currently backed by $1.23 billion of unused committed bank credit facilities. We currently expect to repay approximately $1.5 billion of debt by the end of 2006, using available cash. Various risks and uncertainties, including those discussed in the Financial Expectations for 2006 section, may affect our operating results and cash generated from operations.

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

RETURN ON SHAREHOLDERS' EQUITY
(based on income from continuing operations divided by average shareholders' equity)

Return on shareholders' equity (ROE) increased in 2005 to 18.2 percent. ROE was negatively affected by charges associated with the Zyprexa settlement and restructuring charges in 2005, and additional tax expense associated with anticipated repatriation of earnings as the result of the American Jobs Creation Act, as well as charges related to acquired in-process research and development restructuring activities in 2004.



Our primary interest rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest rate exposures, we strive to achieve an acceptable balance between

fixed and floating rate debt positions and may enter into interest rate derivatives to help maintain that balance. Based on our overall interest rate exposure at December 31, 2005 and 2004, 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, 2005 and 2004, respectively, would have no material impact on earnings, cash flows, or fair values of interest rate risk-sensitive instruments over a one-year period.

Our foreign currency risk exposure results from fluctuating currency exchange rates, primarily the U.S. dollar against the euro and the Japanese yen. We face transactional currency exposures that arise when we enter into transactions, generally on an intercompany basis, denominated in currencies other than the local currency. We also face currency exposure that arises from translating the results of our global operations to the U.S. dollar at exchange rates that have fluctuated from the beginning of the period. We use forward contracts and purchased options to manage our foreign currency exposures. Our 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 our derivative financial instruments outstanding at December 31, 2005 and 2004, a hypothetical 10 percent change in exchange rates (primarily against the U.S. dollar) as of December 31, 2005 and 2004, respectively, would have no material impact on earnings, cash flows, or fair values of foreign currency rate risk-sensitive instruments over a one-year period. These calculations do not reflect the impact of the exchange gains or losses on the underlying positions that would be offset, in part, by the results of the derivative instruments.

Off-Balance Sheet Arrangements and Contractual Obligations

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

These arrangements are not material individually. However, if milestones for multiple products covered by these arrangements would happen to be reached in the same year, the aggregate charge to expense could be material to the results of operations in any one period. The inherent risk in pharmaceutical development makes it unlikely that this will occur, as the failure rate for products in development is very high. In addition, these arrangements often give us the discretion to unilaterally terminate development of the product, which would allow us to avoid making the contingent payments; however, we are unlikely to cease development if the compound successfully achieves clinical testing objectives. We also note that, from a business perspective, we view these payments as positive because they signify that the product is successfully moving through development and is now generating or is more likely to generate cash flows from sales of products.

Our current noncancelable contractual obligations that will require future cash payments are as follows (in millions):

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt, including interest payments(1)	$ 12,024.1	$ 983.3	$ 3,893.8	$ 187.6	$ 6,959.4
Capital lease obligations	177.1	21.0	36.5	31.4	88.2
Operating leases	335.5	86.5	130.2	84.5	34.3
Purchase obligations(2)	2,388.5	2,299.5	58.1	28.5	2.4
Other long-term liabilities reflected on our balance sheet(3)	599.7	—	90.6	90.6	418.5
Other(4)	73.1	73.1	—	—	—
Total	$ 15,598.0	$ 3,463.4	$ 4,209.2	$ 422.6	$ 7,502.8

(1) Our long-term debt obligations include both our expected principal and interest obligations and our interest rate swaps. We used the interest rate forward curve at December 31, 2005 to compute the amount of the contractual obligation for interest on the variable rate debt instruments and swaps.

(2) We have included the following:

- Purchase obligations, consisting primarily of all open purchase orders at our significant operating locations as of December 31, 2005. Some of these purchase orders may be cancelable; however, for purposes of this disclosure, we have not distinguished between cancelable and noncancelable purchase obligations.
- Contractual payment obligations with each of our significant vendors, which are noncancelable and are not contingent.

(3) We have included our long-term liabilities consisting primarily of our nonqualified supplemental pension funding requirements and deferred compensation liabilities.

(4) This category comprises primarily minimum pension funding requirements.

The contractual obligations table is current as of December 31, 2005. The amount of these obligations can be expected to change materially over time as new contracts are initiated and existing contracts are completed, terminated, or modified.

Application of Critical Accounting Policies

In preparing our financial statements in accordance with generally accepted accounting principles (GAAP), we must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures. Some of those judgments can be subjective and complex, and consequently actual results could differ from those estimates. For any given individual estimate or assumption we make, it is possible that other people applying reasonable judgment to the same facts and circumstances could develop different estimates. We believe that, given current facts and circumstances, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on our consolidated results of operations, financial position, or liquidity for the periods presented in this report. Our most critical accounting policies have been discussed with our audit committee and are described below.

Revenue Recognition and Sales Rebate and Discount Accruals

We recognize revenue from sales of products at the time title of goods passes to the buyer and the buyer assumes the risks and rewards of ownership. This is generally at the time products are shipped to the customer, typically a wholesale distributor or a major retail chain. Provisions for discounts and rebates to customers are established in the same period the related sales are recorded.

We regularly review the supply levels of our significant products sold to major wholesalers in the U.S. and in major markets outside the U.S., primarily by reviewing periodic inventory reports supplied by our major wholesalers and available prescription volume information for our products, or alternative approaches. We attempt to maintain wholesaler inventory levels at an average of approximately one month or less on a consistent basis across our product portfolio. We are generally able to determine when significant wholesaler stocking or destocking has occurred during a particular period, but we are not always able to accurately quantify the amount of stocking or destocking. Causes of unusual buying patterns include actual or anticipated product supply issues, weather patterns, anticipated changes in the transportation network, redundant holiday stocking, and changes in wholesaler business operations. An unusual buying pattern compared with underlying demand of our products outside the U.S. could also be the result of speculative buying by wholesalers in anticipation of price increases. When we believe wholesaler purchasing patterns have caused an unusual increase or decrease in the sales of a major product compared with underlying demand, we disclose this in our product sales discussion if the amount is believed to be material to the product sales trend.

As a result of restructuring our arrangements with our U.S. wholesalers in early 2005, reductions occurred in wholesaler inventory levels for certain products (primarily Strattera, Prozac, and Gemzar) that reduced our sales by approximately $170 million. The new structure eliminates the incentive for speculative wholesaler buying we have seen in the past and provides us improved data on inventory levels at our U.S. wholesalers. Wholesaler stocking and destocking activity historically has not caused any material changes in the rate of actual product returns, which have been approximately 1 percent or less of our net sales over the past three years and have not fluctuated significantly as a percent of sales.

We establish sales rebate and discount accruals in the same period as the related sales. The rebate/discount amounts are recorded as a deduction to arrive at our net sales. Sales rebates/discounts that require the use of judgment in the establishment of the accrual include Medicaid, managed care, chargebacks, long-term-care, hospital, discount card programs, and various other government programs. We base these accruals primarily upon our historical rebate/discount payments made to our customer segment groups and the provisions of current rebate/discount contracts. We calculate these rebates/discounts based upon a percentage of our sales for each of our products as defined by the statutory rates and the contracts with our various customer groups.

The largest of our sales rebate/discount amounts are rebates associated with sales covered by Medicaid. Although we accrue a liability for Medicaid rebates at the time we record the sale (when the product is shipped), the Medicaid rebate related to that sale is typically billed up to six months later. Due to the time lag, in any particular period our rebate adjustments may incorporate revisions of accruals for several periods. In determining the appropriate accrual amount, we consider our historical Medicaid rebate payments by product as a percentage of our historical sales as well as any significant changes in sales trends, an evaluation of the current Medicaid rebate laws and interpretations, the percentage of our products that are sold to Medicaid recipients, and our product pricing and current rebate/discount contracts.

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

We believe that our accruals for sales rebates and discounts are reasonable and appropriate based on current facts and circumstances. Federally mandated Medicaid rebate and state pharmaceutical assistance programs reduced sales by $626.6 million, $641.0 million, and $567.6 million in 2005, 2004, and 2003, respectively. A 5 percent change in the Medicaid rebate expense we recognized in 2005 would lead to an approximate $31 million effect on our income before income taxes and cumulative effect of change in accounting principle. As of December 31, 2005, our Medicaid rebate liability was $272.5 million.

Approximately 90 percent and 86 percent of our global rebate and discount liability results from sales of our products in the U.S. as of December 31, 2005 and 2004, respectively. The following represents a roll-forward of our most significant U.S. rebate and discount liability balances, including Medicaid (in millions):

	2005	2004
Rebate and discount liability, beginning of year	**$ 367.9**	$ 398.0
Reduction of net sales due to discounts and rebates(1)	**1,289.6**	1,157.0
Cash payments of discounts and rebates	**(1,288.6)**	(1,187.1)
Rebate and discount liability, end of year	**$ 368.9**	$ 367.9

(1) Adjustments of the estimates for these rebates and discounts to actual results were less than 0.3 percent of net sales for each of the years presented.

Product Litigation Liabilities and Other Contingencies

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

We also consider the insurance coverage we have to diminish the exposure. In assessing our insurance coverage, we consider the policy coverage limits and exclusions, the potential for denial of coverage by the insurance company, the financial position of the insurers, and the possibility of and the length of time for collection.

We believe that the accruals and related insurance recoveries we have established for product litigation liabilities and other contingencies are appropriate based on current facts and circumstances.

Pension and Retiree Medical Plan Assumptions

Pension benefit costs include assumptions for the discount rate, retirement age, and expected return on plan assets. Retiree medical plan costs include assumptions for the discount rate, retirement age, expected return on plan assets, and health-care-cost trend rates. These assumptions have a significant effect on the amounts reported. In addition to the analysis below, see Note 12 to the consolidated financial statements for additional information regarding our retirement benefits.

Periodically, we evaluate the discount rate and the expected return on plan assets in our defined benefit pension and retiree health benefit plans. In evaluating these assumptions, we consider many factors, including an evaluation of the discount rates, expected return on plan assets and the health-care-cost trend rates of other companies; our historical assumptions compared with actual results; an analysis of current market conditions and asset allocations (approximately 85 percent to 95 percent of which are growth investments); and the views of leading financial advisers and economists. We use an actuarially-determined, company-specific yield curve for purposes of determination of the discount rate. In evaluating our expected retirement age assumption, we consider the retirement ages of our past employees eligible for pension and medical benefits together with our expectations of future retirement ages.

We believe our pension and retiree medical plan assumptions are appropriate based upon the above factors. If the health-care-cost trend rates were to be increased by one percentage point each future year, the aggregate of the service cost and interest cost components of the 2005 annual expense would increase by approximately $26 million. A one-percentage-point decrease would decrease the aggregate of the 2005 service cost and interest cost by approximately $22 million. If the discount rate for 2005 were to be changed by a quarter percentage point, income before income taxes and cumulative effect of change in accounting principle would change by approximately $27 million. If the expected return on plan assets for 2005 were to be changed by a quarter percentage point, income before income taxes and cumulative effect of change in accounting principle would change by approximately $13 million. If our assumption regarding the expected age of future retirees for 2005 were adjusted by one year, our income before income taxes and cumulative effect of change in accounting principle would be affected by approximately $22 million.

Income Taxes

We prepare and file tax returns based on our interpretation of tax laws and regulations and record estimates based on these judgments and interpretations. In the normal course of business, our tax returns are subject to examination by various taxing authorities, which may result in future tax and interest assessments by these authorities. Inherent uncertainties exist in estimates of tax contingencies due to changes in tax law resulting from legislation, regulation and/or as concluded through the various jurisdictions' tax court systems. We record a liability for tax contingencies when we believe it is probable that we will be assessed and the amount of the contingency can be reasonably estimated. The tax contingency reserve is adjusted for changes in facts and circumstances, and additional uncertainties. For example, adjustments could result from significant amendments to existing tax law and the issuance of regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of an examination. We believe that our estimates for tax contingency reserves are appropriate and sufficient to pay assessments that may result from examinations of our tax returns.

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

We believe that our estimates for the valuation allowances reserved against the deferred tax assets are appropriate based on current facts and circumstances. A 5 percent change in the valuation allowance would result in a change in net income of approximately $23 million.

Financial Expectations for 2006

For the full year of 2006, we expect earnings per share to be in the range of $3.10 to $3.20. We expect sales to grow 7 to 9 percent and gross margins as a percent of sales to improve modestly compared with 2005. In addition, we expect operating expenses to grow in the mid-single digits in the aggregate, with marketing and administrative expenses accelerating while research and development expense growth moderates somewhat. However, we will continue to be among the industry leaders in terms of research and development investment as a percent of sales. We also expect other income, net of interest expense, to contribute approximately $175 million to $275 million; this ongoing net contribution is expected to be driven primarily by net interest income, Lilly ICOS joint venture after-tax profit, and partnering and out-licensing of molecules. We also anticipate the effective tax rate to be approximately 21 percent.

Actual results could differ materially and will depend on, among other things, the continuing growth of our currently marketed products; developments with competitive products; the timing and scope of regulatory approvals and the success of our new product launches; asset impairments, restructurings, and acquisitions of compounds under development resulting in acquired in-process research and development charges; foreign exchange rates; wholesaler inventory changes; other regulatory developments, litigation, and government investigations; the outcome of the Zyprexa patent appeal; and the impact of governmental actions regarding pricing, importation, and reimbursement for pharmaceuticals. We undertake no duty to update these forward-looking statements.

Legal and Regulatory Matters

Three generic pharmaceutical manufacturers, Zenith Goldline Pharmaceuticals, Inc. (Zenith), Dr. Reddy’s Laboratories, Ltd. (Reddy), and Teva Pharmaceuticals (Teva), submitted abbreviated new drug applications (ANDAs) seeking permission to market generic versions of Zyprexa in various dosage forms several years prior to the expiration of our U.S. patents for the product. The generic companies alleged that our patents are invalid, unenforceable, or not infringed. We filed suit against the three companies in the U.S. District Court for the Southern District of Indiana, seeking a ruling that the challenges to our compound patent (expiring in 2011) are without merit. The cases were consolidated, and on April 14, 2005, the district court upheld our 2011 U.S. patent on Zyprexa. In the case of Eli Lilly and Company v. Zenith Goldline Pharmaceuticals et al., the court ruled in our favor on all counts, including the patent doctrines of obviousness, double patenting, inequitable conduct, novelty, and public use. The decision has been appealed. We are confident, and the trial court confirmed, that the generic manufacturers’ claims are without merit, and we expect to prevail in this litigation. However, it is not possible to predict or determine the outcome of this litigation and, accordingly, we can provide no assurance that we will prevail on appeal. An unfavorable outcome would have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

In 2002, Barr Laboratories, Inc. (Barr), submitted an ANDA with the FDA seeking permission to market a generic version of Evista (raloxifene) several years prior to the expiration of our U.S. patents covering the product, alleging that the patents are invalid or not infringed. In November 2002, we filed suit against Barr in the U.S. District Court for the Southern District of Indiana, seeking a ruling that Barr’s challenges to our patents claiming the methods of use and pharmaceutical form (expiring from 2012 to 2017) are without merit. Barr has also asserted that the method of use patents are unenforceable. The U.S. Patent and Trademark Office issued to us two new patents (expiring in 2017) directed to pharmaceutical compositions containing raloxifene and a

method for preventing postmenopausal osteoporosis and a third (expiring in 2012) directed to methods of inhibiting postmenopausal bone loss by administering a single daily oral dose of raloxifene. These patents have been listed in the FDA's *Orange Book*. Barr has challenged these patents, alleging that each is invalid, unenforceable, or will not be infringed. These patents have been added to the pending suit. The suit is in discovery. No trial date has been set at this time. While we believe that Barr's claims are without merit and we expect to prevail, it is not possible to predict or determine the outcome of the litigation. Therefore, we can provide no assurance that we will prevail. An unfavorable outcome could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

In January 2006, we were notified that Sicor Pharmaceuticals, Inc. (Sicor), a subsidiary of Teva, submitted an ANDA with the FDA seeking permission to market a generic version of Gemzar several years prior to the expiration of two U.S. patents covering the product. Sicor alleged that both U.S. patents are invalid. In February, we filed suit against Sicor in the U.S. District Court for the Southern District of Indiana, seeking a ruling that Sicor's challenges to our patents claiming the compound (expiring in 2010) and the methods of use (expiring in 2012) are without merit. While we believe that Sicor's claims are without merit and we expect to prevail, it is not possible to predict or determine the outcome of the litigation. Therefore, we can provide no assurance that we will prevail. An unfavorable outcome could have a material adverse impact on our consolidated results of operations.

In July 2002, we received the first of several grand jury subpoenas for documents from the Office of Consumer Litigation, U.S. Department of Justice, related to our marketing and promotional practices and physician communications with respect to Evista. We reached a settlement with the U.S. Department of Justice in the fourth quarter of 2005, which was subsequently approved by the U.S. District Court for the Southern District of Indiana in February 2006. As part of the settlement, Lilly pleaded guilty to one misdemeanor violation of the Food, Drug, and Cosmetic Act. The plea is for the off-label promotion of Evista during 1998. The government did not, however, charge the company with any unlawful intent, nor do we acknowledge any such intent. In connection with the overall settlement, we agreed to pay a total of $36 million. As previously reported, Lilly took a charge in the fourth quarter of 2004 in connection with this investigation. The 2004 charge was sufficient to cover this settlement payment; consequently, no further charge will be necessary.

In March 2004, the office of the U.S. Attorney for the Eastern District of Pennsylvania advised us that it has commenced a civil investigation related to our U.S. marketing and promotional practices, including our communications with physicians and remuneration of physician consultants and advisors, with respect to Zyprexa, Prozac, and Prozac Weekly™. In October 2005, the U.S. Attorney's office advised that it is also conducting an inquiry regarding certain rebate agreements we entered into with a pharmacy benefit manager covering Axid, Evista, Humalog, Humulin, Prozac, and Zyprexa. The inquiry includes a review of Lilly's Medicaid best price reporting related to the product sales covered by the rebate agreements. We are cooperating with the U.S. Attorney in these investigations, including providing a broad range of documents and information relating to the investigations. In June 2005, we received a subpoena from the office of the Attorney General, Medicaid Fraud Control Unit, of the State of Florida, seeking production of documents relating to sales of Zyprexa and our marketing and promotional practices with respect to Zyprexa. It is possible that other Lilly products could become subject to investigation and that the outcome of these matters could include criminal charges and fines, penalties, or other monetary or nonmonetary remedies. We cannot predict or determine the outcome of these matters or reasonably estimate the amount or range of amounts of any fines or penalties that might result from an adverse outcome. It is possible, however, that an adverse outcome could have a material adverse impact on

our consolidated results of operations, liquidity, and financial position. We have implemented and continue to review and enhance a broadly based compliance program that includes comprehensive compliance-related activities designed to ensure that our marketing and promotional practices, physician communications, remuneration of health care professionals, managed care arrangements, and Medicaid best price reporting comply with applicable laws and regulations.

We have been named as a defendant in a large number of Zyprexa product liability lawsuits in the United States and have been notified of several thousand claims of individuals who have not filed suit. The lawsuits and unfiled claims (together the "claims") allege a variety of injuries from the use of Zyprexa, with the majority alleging that the product caused or contributed to diabetes or high blood-glucose levels. The claims seek substantial compensatory and punitive damages and typically accuse us of inadequately testing for and warning about side effects of Zyprexa. Many of the claims also allege that we improperly promoted the drug. Almost all of the federal lawsuits are part of a Multi-District Litigation (MDL) proceeding before The Honorable Jack Weinstein in the Federal District Court for the Eastern District of New York (MDL No. 1596). The MDL includes three lawsuits requesting certification of class actions on behalf of those who allegedly suffered injuries from the administration of Zyprexa. We have entered into agreements with various plaintiffs' counsel halting the running of the statutes of limitation (tolling agreements) with respect to a large number of claimants who do not have lawsuits on file.

In June 2005, we entered into an agreement in principle (followed by a definitive master settlement agreement in September 2005) with a group of plaintiffs' attorneys involved in U.S. Zyprexa product liability litigation to settle a majority of the claims. The agreement covers more than 8,000 claimants, including a large number of previously filed lawsuits (including the three purported class actions), tolled claims, and other informally asserted claims. We established a fund of $690 million for the claimants to settle their claims, and $10 million to cover administration of the settlement. The settlement fund is being overseen and distributed by claims administrators appointed by the court. The agreement and the distribution of funds to participating claimants are conditioned upon, among other things, our obtaining full releases from no fewer than 7,193 claimants.

Following this settlement, the remaining U.S. Zyprexa product liability claims include approximately 150 lawsuits in the U.S. covering 465 claimants, and approximately 825 tolled claims. In addition, we have been informally advised of a number of additional potential U.S. claims, but to date have received no substantiation of the claims. Also, in early 2005, we were served with five lawsuits seeking class action status in Canada on behalf of patients who took Zyprexa. The allegations in the Canadian actions are similar to those in the litigation pending in the United States. We are prepared to continue our vigorous defense of Zyprexa in all remaining cases.

In 2005, two lawsuits were filed in the Eastern District of New York purporting to be nationwide class actions on behalf of all consumers and third party payors, excluding governmental entities, which have made or will make payments on account of their members or insured patients being prescribed Zyprexa. These actions have now been consolidated into a single lawsuit, which is brought under certain state consumer protection statutes, the federal civil RICO statute, and common law theories, seeking a refund of the cost of Zyprexa, treble damages, punitive damages, and attorneys' fees. In addition, in 2006 a similar lawsuit was filed in the Eastern District of New York on similar grounds. As with the product liability suits, these lawsuits allege that we inadequately tested for and warned about side effects of Zyprexa and improperly promoted the drug.

In December 2004, we were served with two lawsuits brought in state court in Louisiana on behalf of the Louisiana Department of Health and Hospitals, alleging that Zyprexa caused or contributed

to diabetes or high blood-glucose levels, and that we improperly promoted the drug. These cases have been removed to federal court and are now part of the MDL proceedings in the Eastern District of New York. In these actions, the Department of Health and Hospitals seeks to recover the costs it paid for Zyprexa through Medicaid and other drug-benefit programs, as well as the costs the department alleges it has incurred and will incur to treat Zyprexa-related illnesses.

In connection with the Zyprexa product liability claims, certain of our insurance carriers have raised defenses to their liability under the policies and to date have failed to reimburse us for claim-related costs despite demand from the first-layer carriers for payment. However, in our opinion, the defenses identified to date appear to lack substance. In March 2005, we filed suit against several of the carriers in state court in Indiana to obtain reimbursement of costs related to the Zyprexa product liability litigation. The matter has been removed to the federal court in Indianapolis. Several carriers have asserted defenses to their liability, and some carriers are seeking rescission of the coverage. While we believe our position is meritorious, there can be no assurance that we will prevail.

In addition, we have been named as a defendant in numerous other product liability lawsuits involving primarily diethylstilbestrol (DES) and thimerosal.

With respect to the product liability claims currently asserted against us, we have accrued for our estimated exposures to the extent they are both probable and estimable based on the information available to us. In addition, we have accrued for certain product liability claims incurred but not filed to the extent we can formulate a reasonable estimate of their costs. We estimate these expenses based primarily on historical claims experience and data regarding product usage. Legal defense costs expected to be incurred in connection with significant product liability loss contingencies are accrued when probable and reasonably estimable. A portion of the costs associated with defending and disposing of these suits is covered by insurance. We record receivables for insurance-related recoveries when it is probable they will be realized. These receivables are classified as a reduction of the litigation charges on the statement of income. We estimate insurance recoverables based on existing deductibles, coverage limits, our assessment of any defenses to coverage that might be raised by the carriers, and the existing and projected future level of insolvencies among the insurance carriers.

In the second quarter of 2005, we recorded a net pre-tax charge of $1.07 billion for product liability matters, which includes the following:

- The $700 million Zyprexa settlement and administration fee;
- Reserves for product liability exposures and defense costs regarding currently known and expected claims to the extent we can formulate a reasonable estimate of the probable number and cost of the claims. A substantial majority of these exposures and costs relate to current and expected Zyprexa claims not included in the settlement. We have estimated these charges based primarily on historical claims experience, data regarding product usage, and our historical product liability defense cost experience.

The $1.07 billion net charge took into account our estimated recoveries from our insurance coverage related to these matters. The after-tax impact of this net charge was $.90 per share. The $700 million for the Zyprexa settlement was paid during 2005, while the cash related to the other reserves for product liability exposures and defense costs is expected to be paid out over the next several years. The timing of our insurance recoveries is uncertain.

We cannot predict with certainty the additional number of lawsuits and claims that may be asserted. In addition, although we believe it is probable, there can be no assurance that the Zyprexa

settlement described above will be concluded. The ultimate resolution of Zyprexa product liability and related litigation could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

We are subject to a substantial number of product liability claims, and because of the nature of pharmaceutical products, it is possible that we could become subject to large numbers of product liability claims for other products in the future. We have experienced difficulties in obtaining product liability insurance due to a very restrictive insurance market, and therefore will be largely self-insured for future product liability losses. In addition, there is no assurance that we will be able to fully collect from our insurance carriers on past claims.

While it is not possible to predict or determine the outcome of the patent, product liability, or other legal actions brought against us, we believe that, except as noted above, the resolution of all such matters will not have a material adverse effect on our consolidated financial position or liquidity but could possibly be material to the consolidated results of operations in any one accounting period.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

You can find quantitative and qualitative disclosures about market risk (*e.g.*, interest rate risk) in Item 7 at “Financial Condition” at pp. 31-32. That information is incorporated in this report by reference.

Item 8. Financial Statements and Supplementary Data

Consolidated Statements of Income

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions, except per-share data)	Year Ended December 31 2005	 2004	 2003
Net sales	**$ 14,645.3**	$ 13,857.9	$ 12,582.5
Cost of sales	**3,474.2**	3,223.9	2,675.1
Research and development	**3,025.5**	2,691.1	2,350.2
Marketing and administrative	**4,497.0**	4,284.2	4,055.4
Acquired in-process research and development (Note 3)	**—**	392.2	—
Asset impairments, restructuring, and other special charges (Note 4)	**1,245.3**	603.0	382.2
Interest expense	**105.2**	51.6	61.0
Other income — net	**(419.4)**	(330.0)	(203.1)
	11,927.8	10,916.0	9,320.8
Income before income taxes and cumulative effect of a change in accounting principle	**2,717.5**	2,941.9	3,261.7
Income taxes (Note 11)	**715.9**	1,131.8	700.9
Income before cumulative effect of a change in accounting principle	**2,001.6**	1,810.1	2,560.8
Cumulative effect of a change in accounting principle, net of tax (Note 2)	**(22.0)**	—	—
Net income	**$ 1,979.6**	$ 1,810.1	$ 2,560.8
Earnings per share — basic (Note 10)			
Income before cumulative effect of a change in accounting principle	**$ 1.84**	$ 1.67	$ 2.38
Cumulative effect of a change in accounting principle	**(0.02)**	—	—
Net income	**$ 1.82**	$ 1.67	$ 2.38
Earnings per share — diluted (Note 10)			
Income before cumulative effect of a change in accounting principle	**$ 1.83**	$ 1.66	$ 2.37
Cumulative effect of a change in accounting principle	**(0.02)**	—	—
Net income	**$ 1.81**	$ 1.66	$ 2.37

See notes to consolidated financial statements.

Consolidated Balance Sheets

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions)	December 31 2005	 2004
Assets		
Current Assets		
Cash and cash equivalents	**$ 3,006.7**	$ 5,365.3
Short-term investments	**2,031.0**	2,099.1
Accounts receivable, net of allowances of $66.3 (2005) and $66.1 (2004)	**2,313.3**	2,058.7
Other receivables	**448.4**	494.3
Inventories	**1,878.0**	2,291.6
Deferred income taxes (Note 11)	**756.4**	255.3
Prepaid expenses	**362.0**	271.5
Total current assets	**10,795.8**	12,835.8
Other Assets		
Prepaid pension (Note 12)	**2,419.6**	2,253.8
Investments (Note 5)	**1,296.6**	561.4
Sundry (Note 8)	**2,156.3**	1,665.1
	5,872.5	4,480.3
Property and Equipment, net	**7,912.5**	7,550.9
	$ 24,580.8	$ 24,867.0
Liabilities and Shareholders' Equity		
Current Liabilities		
Short-term borrowings and current maturities of long-term debt (Note 6)	**$ 734.7**	$ 2,020.6
Accounts payable	**781.3**	648.6
Employee compensation	**548.8**	471.6
Sales rebates and discounts	**491.2**	475.3
Dividends payable	**436.5**	414.4
Income taxes payable (Note 11)	**884.9**	1,703.9
Other current liabilities (Note 8)	**1,838.9**	1,859.3
Total current liabilities	**5,716.3**	7,593.7
Other Liabilities		
Long-term debt (Note 6)	**5,763.5**	4,491.9
Deferred income taxes (Note 11)	**695.1**	620.4
Other noncurrent liabilities (Note 8)	**1,614.0**	1,241.1
	8,072.6	6,353.4
Commitments and contingencies (Note 13)		
Shareholders' Equity (Notes 7 and 9)		
Common stock — no par value		
Authorized shares: 3,200,000,000		
Issued shares: 1,131,070,629 (2005) and 1,132,884,801 (2004)	**706.9**	708.0
Additional paid-in capital	**3,323.8**	3,119.4
Retained earnings	**10,027.2**	9,724.6
Employee benefit trust	**(2,635.0)**	(2,635.0)
Deferred costs — ESOP	**(106.3)**	(111.9)
Accumulated other comprehensive income (loss) (Note 14)	**(420.6)**	218.6
	10,896.0	11,023.7
Less cost of common stock in treasury		
2005 — 933,584 shares		
2004 — 942,677 shares	**104.1**	103.8
	10,791.9	10,919.9
	$ 24,580.8	$ 24,867.0

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions)	Year Ended December 31 2005	2004	2003
Cash Flows From Operating Activities			
Net income	**$ 1,979.6**	$ 1,810.1	$ 2,560.8
Adjustments To Reconcile Net Income To Cash Flows From Operating Activities			
Depreciation and amortization	**726.4**	597.5	548.5
Change in deferred taxes	**(347.5)**	772.4	130.9
Stock-based compensation expense	**403.5**	53.0	—
Acquired in-process research and development, net of tax	**—**	381.7	—
Asset impairments, restructuring, and other special charges, net of tax	**1,128.7**	374.3	261.7
Other, net	**(30.0)**	171.5	61.0
	3,860.7	4,160.5	3,562.9
Changes in operating assets and liabilities			
Receivables — increase	**(286.4)**	(240.8)	(195.1)
Inventories — (increase) decrease	**72.1**	(111.6)	(170.8)
Other assets — increase	**(269.4)**	(765.2)	(211.9)
Accounts payable and other liabilities — increase (decrease)	**(1,463.4)**	(173.4)	661.6
	(1,947.1)	(1,291.0)	83.8
Net Cash Provided by Operating Activities	**1,913.6**	2,869.5	3,646.7
Cash Flows From Investing Activities			
Purchase of property and equipment	**(1,298.1)**	(1,898.1)	(1,706.6)
Disposals of property and equipment	**11.1**	20.5	61.2
Net change in short-term investments	**62.7**	(1,119.0)	774.0
Proceeds from sales and maturities of noncurrent investments	**545.1**	14,849.3	6,762.4
Purchase of noncurrent investments	**(1,183.1)**	(11,967.7)	(7,005.3)
Purchase of in-process research and development	**—**	(29.9)	—
Cash paid for acquisition of Applied Molecular Evolution, net of cash acquired	**—**	(71.7)	—
Other, net	**(353.6)**	(468.2)	(217.2)
Net Cash Used in Investing Activities	**(2,215.9)**	(684.8)	(1,331.5)
Cash Flows From Financing Activities			
Dividends paid	**(1,654.9)**	(1,539.8)	(1,443.0)
Purchase of common stock	**(377.9)**	—	(276.8)
Issuances of common stock under stock plans	**105.9**	117.9	99.3
Net change in short-term borrowings	**(1,988.7)**	1,478.2	(247.3)
Proceeds from issuance of long-term debt	**3,000.0**	1,000.0	830.0
Repayments of long-term debt	**(1,004.7)**	(839.2)	(540.0)
Other, net	**39.8**	(13.4)	(.5)
Net Cash (Used for) Provided by Financing Activities	**(1,880.5)**	203.7	(1,578.3)
Effect of exchange rate changes on cash	**(175.8)**	220.6	73.5
Net (decrease) increase in cash and cash equivalents	**(2,358.6)**	2,609.0	810.4
Cash and cash equivalents at beginning of year	**5,365.3**	2,756.3	1,945.9
Cash and cash equivalents at end of year	**$ 3,006.7**	$ 5,365.3	$ 2,756.3

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income

ELI LILLY AND COMPANY AND SUBSIDIARIES (Dollars in millions)	Year Ended December 31 2005	 2004	 2003
Net income	**$ 1,979.6**	$ 1,810.1	$ 2,560.8
Other comprehensive income (loss)			
Foreign currency translation gains (losses)	**(533.4)**	441.7	473.0
Net unrealized gains (losses) on securities	**0.3**	(25.9)	72.0
Minimum pension liability adjustment	**(87.8)**	(4.4)	(9.8)
Effective portion of cash flow hedges	**(81.7)**	(53.7)	(2.1)
Other comprehensive income (loss) before income taxes	**(702.6)**	357.7	533.1
Provision for income taxes related to other comprehensive income (loss) items	**63.4**	21.0	(22.4)
Other comprehensive income (loss) (Note 14)	**(639.2)**	378.7	510.7
Comprehensive income	**$ 1,340.4**	$ 2,188.8	$ 3,071.5

See notes to consolidated financial statements.

Segment Information

ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

We operate in one significant business segment — pharmaceutical products. Operations of the animal health business segment are not material and share many of the same economic and operating characteristics as pharmaceutical products. Therefore, they are included with pharmaceutical products for purposes of segment reporting.

	Year Ended December 31		
	2005	**2004**	**2003**
Net sales — to unaffiliated customers			
Neurosciences	**$ 6,080.0**	$ 6,052.5	$ 5,554.8
Endocrinology	**4,636.9**	4,290.9	3,926.7
Oncology	**1,801.0**	1,366.2	1,039.8
Animal health	**863.7**	798.7	726.6
Cardiovascular	**608.9**	658.7	669.3
Anti-infectives	**443.9**	478.0	489.9
Other pharmaceutical	**210.9**	212.9	175.4
Net sales	**$ 14,645.3**	$ 13,857.9	$ 12,582.5
Geographic Information			
Net sales — to unaffiliated customers(1)			
United States	**$ 7,798.1**	$ 7,668.5	$ 7,221.6
Europe, Middle East, and Africa	**4,184.0**	3,858.4	3,355.8
Other foreign countries	**2,663.2**	2,331.0	2,005.1
	$ 14,645.3	$ 13,857.9	$ 12,582.5
Long-lived assets			
United States	**$ 6,524.5**	$ 5,874.1	$ 5,296.0
Europe, Middle East, and Africa	**1,563.1**	1,627.9	1,299.9
Other foreign countries	**1,740.7**	1,556.1	1,188.4
	$ 9,828.3	$ 9,058.1	$ 7,784.3

(1) Net sales are attributed to the countries based on the location of the customer.

The largest category of products is the neurosciences group, which includes Zyprexa, Cymbalta, Strattera, Prozac, Permax®, Symbyax, and Yentreve. Endocrinology products consist primarily of Humalog, Humulin, Actos, Byetta, Evista, Forteo, and Humatrope. Oncology products consist primarily of Gemzar and Alimta. Animal health products include Tylan®, Rumensin®, Coban®, and other products for livestock and poultry. Cardiovascular products consist primarily of ReoPro and Xigris. Anti-infectives include primarily Ceclor® and Vancocin®. The other pharmaceutical product group includes Cialis, Axid, and other miscellaneous pharmaceutical products and services.

Most of the pharmaceutical products are distributed through wholesalers that serve pharmacies, physicians and other health care professionals, and hospitals. In 2005, our three largest wholesalers each accounted for between 12 percent and 17 percent of consolidated net sales. Further, they each accounted for between less than 1 percent and 13 percent of accounts receivable as of December 31, 2005. Animal health products are sold primarily to wholesale distributors.

Our business segments are distinguished by the ultimate end user of the product: humans or animals. Performance is evaluated based on profit or loss from operations before income taxes. The accounting policies of the individual segments are substantially the same as those described in the summary of significant accounting policies in Note 1 to the consolidated financial statements.

Income before income taxes and cumulative effect of a change in accounting principle for the animal health business was approximately $215 million, $223 million, and $204 million in 2005, 2004, and 2003, respectively.

The assets of the animal health business are intermixed with those of the pharmaceutical products business. Long-lived assets disclosed above consist of property and equipment and certain sundry assets.

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

Selected Quarterly Data (unaudited)

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

2005	Fourth	Third	Second	First
Net sales	$ 3,879.1	$ 3,601.1	$ 3,667.7	$ 3,497.4
Cost of sales	898.2	845.7	871.3	859.0
Operating expenses	1,999.5	1,821.9	1,908.5	1,792.6
Asset impairments, restructuring, and other special charges	171.9	—	1,073.4	—
Other — net	(85.2)	(85.0)	(45.4)	(98.6)
Income (loss) before income taxes and cumulative effect of a change in accounting principle	894.7	1,018.5	(140.1)	944.4
Net income (loss)	700.6(2)(4)	794.4	(252.0)(1)	736.6
Earnings (loss) per share — basic	.64	.73	(.23)	.68
Earnings (loss) per share — diluted	.64	.73	(.23)	.68
Dividends paid per share	.38	.38	.38	.38
Common stock closing prices				
High	57.81	57.26	60.44	57.78
Low	49.76	52.52	51.19	51.73

2004	Fourth	Third	Second	First
Net sales	$ 3,644.3	$ 3,280.4	$ 3,556.3	$ 3,376.9
Cost of sales	865.7	810.1	796.4	751.7
Operating expenses	1,803.7	1,606.7	1,854.4	1,710.5
Acquired in-process research and development	29.9	—	—	362.3
Asset impairments, restructuring, and other special charges	494.1	—	108.9	—
Other — net	(69.1)	(104.6)	(41.6)	(63.1)
Income before income taxes	520.0	968.2	838.2	615.5
Net income (loss)	(2.4)(3)	755.2	656.9	400.4
Earnings per share — basic	.00	.70	.61	.37
Earnings per share — diluted	.00	.69	.60	.37
Dividends paid per share	.355	.355	.355	.355
Common stock closing prices				
High	62.01	69.37	76.26	74.70
Low	50.44	60.05	67.60	65.00

Our common stock is listed on the New York, London, and other stock exchanges.

(1) In the second quarter of 2005, we incurred a tax expense of $111.9 million despite reporting a net loss before income taxes for the quarter. The product liability charge of $1.07 billion (Note 13) in the second quarter resulted in a tax benefit that was less than our effective tax rate, as the tax benefit was calculated based upon existing tax laws in the countries in which we reasonably expect to deduct the charge.

(2) A fourth-quarter 2005 analysis, which included the impact of a recently completed IRS examination for tax years 1998 to 2000, led us to conclude that our tax rate for 2005 should be 26.3 percent. As a result, the fourth-quarter tax rate declined to 19.2 percent.

(3) The net loss in the fourth quarter of 2004 included tax expenses of $465.0 million associated with the anticipated repatriation of $8.00 billion of our earnings reinvested outside the U.S. as a result of the American Jobs Creation Act (Note 11).

(4) Reflects the impact of a cumulative effect of a change in accounting principle in the fourth quarter of $22.0 million, net of income taxes of $11.8 million. The diluted earnings per share impact of this cumulative effect of a change in accounting principle was $.02. The net income per diluted share before the cumulative effect of a change in accounting principle was $.66. See Note 2 for additional information.

Selected Financial Data (unaudited)

ELI LILLY AND COMPANY AND SUBSIDIARIES

(Dollars in millions, except per-share data)	2005	2004	2003	2002	2001
Operations					
Net sales	**$ 14,645.3**	$ 13,857.9	$ 12,582.5	$ 11,077.5	$ 11,542.5
Cost of sales	**3,474.2**	3,223.9	2,675.1	2,176.5	2,160.2
Research and development	**3,025.5**	2,691.1	2,350.2	2,149.3	2,235.1
Marketing and administration	**4,497.0**	4,284.2	4,055.4	3,424.0	3,417.4
Other	**931.1**	716.8	240.1	(130.0)	222.9
Income before income taxes and cumulative effect of a change in accounting principle	**2,717.5**	2,941.9	3,261.7	3,457.7	3,506.9
Income taxes	**715.9**	1,131.8	700.9	749.8	726.9
Net income	**1,979.6** (1)	1,810.1	2,560.8	2,707.9	2,780.0
Net income as a percent of sales	**13.5%**	13.1%	20.4%	24.4%	24.1%
Net income per share — diluted	**1.81**	1.66	2.37	2.50	2.55
Dividends declared per share	**1.54**	1.45	1.36	1.27	1.15
Weighted-average number of shares outstanding — diluted (thousands)	**1,092,150**	1,088,936	1,082,230	1,085,088	1,090,793
Financial Position					
Current assets	**$ 10,795.8**	$ 12,835.8	$ 8,768.9	$ 7,804.1	$ 6,938.9
Current liabilities	**5,716.3**	7,593.7	5,560.8	5,063.5	5,203.0
Property and equipment — net	**7,912.5**	7,550.9	6,539.0	5,293.0	4,532.4
Total assets	**24,580.8**	24,867.0	21,688.3	19,042.0	16,434.1
Long-term debt	**5,763.5**	4,491.9	4,687.8	4,358.2	3,132.1
Shareholders' equity	**10,791.9**	10,919.9	9,764.8	8,273.6	7,104.0
Supplementary Data					
Return on shareholders' equity	**18.2%**	17.5%	28.4%	35.2%	42.3%
Return on assets	**8.2%**	7.8%	12.6%	15.2%	17.8%
Capital expenditures	**$ 1,298.1**	$ 1,898.1	$ 1,706.6	$ 1,130.9	$ 884.0
Depreciation and amortization	**726.4**	597.5	548.5	493.0	454.9
Effective tax rate	**26.3%**	38.5%	21.5%	21.7%	20.7%
Number of employees	**42,600**	44,500	45,000	42,900	40,500
Number of shareholders of record	**50,800**	52,400	54,600	56,200	57,700

(1) Reflects the impact of a cumulative effect of a change in accounting principle in 2005 of $22.0 million, net of income taxes of $11.8 million. The diluted earnings per share impact of this cumulative effect of a change in accounting principle was $.02. The net income per diluted share before the cumulative effect of a change in accounting principle was $1.83. See Note 2 for additional information.

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from those estimates.

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: We consider 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. If items meeting this definition are part of a larger investment pool, they are classified consistent with the classification of the pool.

Inventories: We state all inventories at the lower of cost or market. We use the last-in, first-out (LIFO) method for substantially all our inventories located in the continental United States, or approximately 49 percent of our total inventories. Other inventories are valued by the first-in, first-out (FIFO) method. FIFO cost approximates current replacement cost. Inventories at December 31 consisted of the following:

	2005	2004
Finished products	**$ 471.3**	$ 717.5
Work in process	**1,272.4**	1,356.3
Raw materials and supplies	**214.7**	305.7
	1,958.4	2,379.5
Reduction to LIFO cost	**(80.4)**	(87.9)
	$ 1,878.0	$ 2,291.6

Investments: Substantially all 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. Unrealized losses considered to be other-than-temporary are recognized in earnings. Factors we consider in making this evaluation include company-specific drivers of the decrease in stock price, status of projects in development, near-term prospects of the issuer, the length of time the value has been depressed, and the financial condition of the industry. We do not evaluate cost-method investments for impairment unless there is an indicator of impairment. We review these investments for indicators of impairment on a regular basis. Realized gains and losses on sales of available-for-sale securities are computed based upon specific identification of the initial cost adjusted for any other-than-temporary declines in fair value.

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

Derivative financial instruments: Our derivative activities 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, we designate the instruments individually as either a fair value hedge or a cash flow hedge. Management reviews the correlation and effectiveness of our derivatives on a quarterly basis.

For derivative contracts that are designated and qualify as fair value hedges, the derivative instrument is marked to market with gains and losses recognized currently in income to offset the respective losses and gains recognized on the underlying exposure. For derivative contracts that are designated and qualify as cash flow hedges, the effective portion of gains and losses on these contracts is reported as a component of other comprehensive income and reclassified into earnings in the same period the hedged transaction affects earnings. Hedge ineffectiveness is immediately recognized in earnings. Derivative contracts that are not designated as hedging instruments are recorded at fair value with the gain or loss recognized in current earnings during the period of change.

We enter into foreign currency forward and option contracts to reduce the effect of fluctuating currency exchange rates (principally the euro 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 subsidiary trade and loan payables and receivables denominated in foreign currency. These contracts are recorded at fair value with the gain or loss recognized in other income. The purchased option contracts are used to hedge anticipated foreign currency transactions, primarily intercompany inventory activities expected to occur within the next year. These contracts are designated as cash flow hedges of those future transactions and the impact on earnings is included in cost of sales. We may enter into foreign currency forward contracts and currency swaps as fair value hedges of firm commitments. Forward and option contracts generally have maturities not exceeding 12 months.

In the normal course of business, our operations are exposed to fluctuations in interest rates. These fluctuations can vary the costs of financing, investing, and operating. We address a portion of these risks through a controlled program of risk management that includes the use of derivative financial instruments. The objective of controlling these risks is to limit the impact of fluctuations in interest rates on earnings. Our primary interest rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest rate exposures, we strive to achieve an acceptable balance between fixed and floating rate debt and investment positions and may enter into interest rate swaps or collars to help maintain that balance. Interest rate swaps or collars that convert our fixed rate debt or investments to a floating rate are designated as fair value hedges of the underlying instruments. Interest rate swaps or collars that convert floating rate debt or investments to a fixed rate are designated as cash flow hedges. Interest expense on the debt is adjusted to include the payments made or received under the swap agreements.

Goodwill and other intangibles: Other intangibles with finite lives arising from acquisitions and research alliances are amortized over their estimated useful lives, ranging from 5 to 15 years, using the straight-line method. Goodwill is not amortized. Goodwill and other intangibles are reviewed to assess recoverability at least annually and when certain impairment indicators are present. Goodwill and net other intangibles with finite lives were $139.6 million and $110.3 million, respectively, at

December 31, 2005 and 2004, and were included in sundry assets in the consolidated balance sheets. We currently have no other intangible assets with indefinite lives. No material impairments occurred with respect to the carrying value of our goodwill or other intangible assets in 2005, 2004, or 2003.

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 (generally 12 to 50 years for buildings and 3 to 18 years for equipment). We review the carrying value of long-lived assets for potential impairment on a periodic basis, and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Impairment is determined by comparing projected undiscounted cash flows to be generated by the asset to its carrying value. If an impairment is identified, a loss is recorded equal to the excess of the asset's net book value over the asset's fair value, and the cost basis is adjusted.

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

	2005	2004
Land	**$ 166.8**	$ 147.0
Buildings	**4,584.5**	3,569.5
Equipment	**6,314.1**	5,627.2
Construction in progress	**2,070.6**	2,995.2
	13,136.0	12,338.9
Less allowances for depreciation	**5,223.5**	4,788.0
	$ 7,912.5	$ 7,550.9

Depreciation expense for 2005, 2004, and 2003 was $577.2 million, $495.9 million, and $469.3 million, respectively. Approximately $140.5 million, $111.3 million, and $61.0 million of interest costs were capitalized as part of property and equipment in 2005, 2004, and 2003, respectively. Total rental expense for all leases, including contingent rentals (not material), amounted to approximately $294.4 million, $286.8 million, and $268.5 million for 2005, 2004, and 2003, respectively. Capital leases included in property and equipment in the consolidated balance sheets, capital lease obligations entered into, and future minimum rental commitments are not material.

Revenue recognition: We recognize revenue from sales of products at the time title of goods passes to the buyer and the buyer assumes the risks and rewards of ownership. This is generally at the time products are shipped to the customer. Provisions for discounts and rebates to customers are established in the same period the related sales are recorded.

We also generate income as a result of collaboration agreements. Revenue from copromotion services (primarily Actos) is based upon net sales reported by our copromotion partner and, if applicable, the number of sales calls we perform. We immediately recognize the full amount of milestone payments due to us upon the achievement of the milestone event if the event is substantive, objectively determinable, and represents an important point in the development life cycle of the pharmaceutical product. Milestone payments earned by us are generally recorded in other income-net. Initial fees we receive from the partnering of our compounds under development are amortized through the expected product approval date. Initial fees received from out-licensing agreements that include both the sale of marketing rights to our commercialized products and a

related commitment to supply the products are generally recognized as net sales over the term of the supply agreement.

Research and development: We recognize as incurred the cost of directly acquiring assets to be used in the research and development process that have not yet received regulatory approval for marketing and for which no alternative future use has been identified. Once the product has obtained regulatory approval, we capitalize the milestones paid and amortize them over the period benefited. Milestones paid prior to regulatory approval of the product are generally expensed when the event requiring payment of the milestone occurs.

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. We record a liability for tax contingencies when we believe it is probable that we will be assessed and the amount of the contingency can be reasonably estimated. The tax contingency reserve is adjusted for changes in facts and circumstances, and additional uncertainties. See Note 11 regarding the 2004 tax expense associated with the now completed repatriation of earnings reinvested outside the U.S. pursuant to the American Job Creations Act.

Earnings per share: We calculate basic earnings per share based on the weighted-average number of outstanding common shares and incremental shares. We calculate diluted earnings per share based on the weighted-average number of outstanding common shares plus the effect of dilutive stock options and other incremental shares.

Stock-based compensation: As discussed more fully in Note 7, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective January 1, 2005. SFAS 123R requires the recognition of the fair value of stock-based compensation in net income. Stock-based compensation primarily consists of stock options and performance awards. Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant. Generally, options fully vest 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 our common stock. The number of performance award shares actually issued, if any, varies depending on the achievement of certain earnings-per-share targets. In general, performance awards fully vest at the end of the fiscal year of the grant. We recognize the stock-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. We provide newly issued shares and treasury stock to satisfy stock option exercises and for the issuance of performance awards.

Prior to January 1, 2005, we followed Accounting Principles Board (APB) Opinion 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for our stock options and performance awards. Under APB 25, because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense was recognized. However, SFAS 123R requires us to present pro forma information as if we had accounted for our employee stock options and performance awards 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 requisite service period, which generally is the vesting period.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation.

	2004	2003
Net income, as reported	**$ 1,810.1**	$ 2,560.8
Add: Compensation expense for stock-based performance awards included in reported net income, net of related tax effects	**34.5**	—
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	**(300.9)**	(210.8)
Pro forma net income	**$ 1,543.7**	$ 2,350.0
Earnings per share:		
Basic, as reported	**$ 1.67**	$ 2.38
Basic, pro forma	**$ 1.42**	$ 2.18
Diluted, as reported	**$ 1.66**	$ 2.37
Diluted, pro forma	**$ 1.42**	$ 2.17

Note 2: Implementation of New Financial Accounting Pronouncements

In 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 46, Consolidation of Variable Interest Entities. FIN 46 defines a variable interest entity (VIE) as a corporation, partnership, trust, or any other legal structure that does not have equity investors with a controlling financial interest or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires consolidation of a VIE by the primary beneficiary of the assets, liabilities, and results of activities. FIN 46 also requires certain disclosures by all holders of a significant variable interest in a VIE that are not the primary beneficiary. We do not have any material investments in variable interest entities; therefore, the adoption of this interpretation in the first quarter of 2004 had no material impact on our consolidated financial position or results of operations.

In 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143. FIN 47 requires us to record the fair value of a liability for conditional asset retirement obligations in the period in which it is incurred, which is adjusted to its present value each subsequent period. In addition, we are required to capitalize a corresponding amount by increasing the carrying amount of the related long-lived asset, which is depreciated over the useful life of the related long-lived asset. The adoption of FIN 47 on December 31, 2005 resulted in a cumulative effect of a change in accounting principle of $22.0 million, net of income taxes of $11.8 million.

As discussed previously, we adopted SFAS 123R effective January 1, 2005. The adoption of this standard required recognition of the fair value of stock-based compensation in net income.

Note 3: Acquisitions

Applied Molecular Evolution, Inc. Acquisition

On February 12, 2004, we acquired all the outstanding common stock of Applied Molecular Evolution, Inc. (AME) in a tax-free merger. Under the terms of the merger agreement, each outstanding share of AME common stock was exchanged for our common stock or a combination of cash and our stock valued at $18. The aggregate purchase price of approximately $442.8 million

consisted of issuance of 4.2 million shares of our common stock valued at $314.8 million, issuance of 0.7 million replacement options to purchase shares of our common stock in exchange for the remaining outstanding AME options valued at $37.6 million, cash of $85.4 million for AME common stock and options for certain AME employees, and transaction costs of $5.0 million. The fair value of our common stock was derived using a per-share value of $74.14, which was our average closing stock price for February 11 and 12, 2004. The fair value for the options granted was derived using a Black-Scholes valuation method using assumptions consistent with those we used in valuing employee options. Replacement options to purchase our common stock granted as part of this acquisition have terms equivalent to the AME options being replaced.

In addition to acquiring the rights to two compounds currently under development, we expected the acquisition of AME's protein optimization technology to create synergies that will accelerate our ability to discover and optimize biotherapeutic drugs for cancer, critical care, diabetes, and obesity, areas in which proteins are of great therapeutic benefit.

In accordance with SFAS 141, Business Combinations, the acquisition was accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed from AME at the date of acquisition were recorded at their respective fair values as of the acquisition date in our consolidated financial statements. The excess of the purchase price over the fair value of the acquired net assets was recorded as goodwill in the amount of $9.6 million. Goodwill resulting from this acquisition was fully allocated to the pharmaceutical products segment. No portion of this goodwill is expected to be deductible for tax purposes. AME's results of operations are included in our consolidated financial statements from the date of acquisition.

As of the date of acquisition, we determined the following estimated fair values for the assets purchased and liabilities assumed. The determination of estimated fair value requires management to make significant estimates and assumptions. We hired independent third parties to assist in the valuation of assets that were difficult to value.

Estimated Fair Value at February 12, 2004		
Cash and short-term investments	$	38.7
Acquired in-process research and development		362.3
Platform technology		17.9
Goodwill		9.6
Other assets and liabilities — net		14.3
Total estimated purchase price	$	442.8

The acquired in-process research and development (IPR&D) represents compounds currently under development that have not yet achieved regulatory approval for marketing. The estimated fair value of these intangible assets was derived using a valuation from an independent third party. AME's two lead compounds for the treatment of non-Hodgkin's lymphoma and rheumatoid arthritis represent approximately 80 percent of the estimated fair value of the IPR&D. In accordance with FIN 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, these IPR&D intangible assets were written off by a charge to income immediately subsequent to the acquisition because the compounds did not have any alternative future use. This charge was not deductible for tax purposes. The ongoing activity with respect to each of these compounds under development is not material to our research and development expenses.

There are several methods that can be used to determine the estimated fair value of the acquired IPR&D. We utilized the "income method," which applies a probability weighting to the estimated future net cash flows that are derived from projected sales revenues and estimated costs. These projections were based on factors such as relevant market size, patent protection, historical pricing of similar products, and expected industry trends. The estimated future net cash flows were then discounted to the present value using an appropriate discount rate. This analysis was performed for each project independently. The discount rate we used in valuing the acquired IPR&D projects was 18.75 percent.

Product Acquisition

In October 2004, we entered into an agreement with Merck KGaA (Merck) to acquire Merck's compound for a potential treatment for insomnia. At the inception of this agreement, this compound was in the development stage (Phase I clinical trials) and no alternative future uses were identified. As with many development phase compounds, launch of the product, if approved, was not expected in the near term. Our charge for acquired in-process research and development expense related to this arrangement was $29.9 million in the fourth quarter of 2004.

Note 4: Asset Impairments, Restructuring, and Other Special Charges

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

In December 2005, management approved, as part of our ongoing efforts to increase productivity and reduce our cost structure, decisions that resulted in non-cash charges of $154.6 million for the write-down of certain impaired assets, and other charges of $17.3 million, primarily related to contract termination payments. The impaired assets, which have no future use, include manufacturing buildings and equipment no longer needed to supply projected capacity requirements, as well as obsolete research and development equipment. The impairment charges are necessary to adjust the carrying value of the assets to fair value.

As discussed further in Note 13, in 2005 we entered into a master settlement agreement with plaintiffs' attorneys involved in the U.S. Zyprexa product liability litigation to settle a majority of the claims against us relating to the medication. According to the agreement, we established a fund of $690 million for the claimants who agreed to settle their claims. Additionally, $10 million was paid to cover administration of the settlement. In the second quarter of 2005, we recorded a net pre-tax charge of $1.07 billion for product liability matters, which included the following:

- The $700 million Zyprexa settlement and administration fee;
- Reserves for product liability exposures and defense costs regarding currently known and expected claims to the extent we can formulate a reasonable estimate of the probable number and cost of the claims. A substantial majority of these exposures and costs relate to current and expected Zyprexa claims not included in the settlement. We have estimated these charges based primarily on historical claims experience, data regarding product usage, and our historical product liability defense cost experience.

The $1.07 billion net charge takes into account our estimated recoveries from our insurance coverage related to these matters. The after-tax impact of this net charge is $.90 per share. The $700 million for the Zyprexa settlement was paid during 2005, while the other product liability exposures and defense costs are expected to be paid out over the next several years. The timing of our insurance recoveries is uncertain.

In the fourth quarter of 2004, management approved actions designed to increase productivity, to address current challenges in the marketplace, and to leverage prior investments in our product portfolio. These actions, which are described further below, affect primarily operations in the manufacturing, research and development, and sales and marketing components and resulted in asset impairments, severance and other related charges. These actions were substantially completed during 2005.

- We discontinued our plans to produce the bulk active ingredient for Xigris at our Indianapolis operations. Although we remain committed to this important lifesaving product, we have determined that our manufacturing partner, Lonza Biologics plc, has enough capacity to supply anticipated Xigris demand for the foreseeable future. In addition, we determined that a redesign of our Prince William County, Virginia, facility that is currently under construction was warranted. This decision rendered obsolete certain engineering and construction costs that have already been incurred. Also, the mission of our Clinton, Indiana, manufacturing site has been narrowed to make products solely for the Elanco Animal Health business. The portion of that site that produced human pharmaceutical products has ceased operation.
- We have focused our research efforts on the therapeutic areas of neuroscience, endocrine, oncology, and cardiovascular and have discontinued our efforts in inflammation. In addition to this narrowing of therapeutic focus, we have closed our RTP Laboratory site in Research Triangle Park, North Carolina. This site has historically been our center for high-throughput screening and combinatorial chemistry, but much of that technology has evolved such that these operations can be more efficiently performed in existing facilities in Indianapolis. The site has been written down to fair value less cost to sell and is currently held for sale.
- We closed all district and regional sales offices throughout the United States, and these operations are now managed from home-based offices. In addition, we reorganized our U.S. sales force to create an organization that better meets customer needs and maximizes sales potential. We also streamlined some sales and marketing support activities as well as our field-based operations that support our medical function.

As a result of these actions, we recognized asset impairment charges of $377.4 million in the fourth quarter of 2004. We have ceased using these assets, and have disposed of or destroyed substantially all of the assets. The impairment charges are necessary to adjust the carrying value of the assets to fair value. Other site charges, including lease termination payments, were $12.2 million.

In addition, nearly 1,400 positions globally were eliminated as a result of these actions. While a substantial number of the affected employees were successfully placed in other positions in the company, severance expenses were incurred in the fourth quarter of 2004 for those employees who elected a severance package. The restructuring and other special charges incurred in the fourth quarter of 2004 related to the elimination of positions totaled $68.5 million, including $35.1 million of severance charges related to restructuring activities in our overseas affiliates. The severance charges consisted primarily of voluntary severance expenses. All of this charge has been expended.

The other significant component of our fourth-quarter 2004 special charges was a provision for $36.0 million for the anticipated resolution of the previously reported Evista marketing and promotional practices investigation. See Note 13 for additional discussion.

In addition, in the second quarter of 2004, as part of our ongoing review of our manufacturing and research and development strategies to maximize performance and efficiencies, including the streamlining of manufacturing operations and research and development activities, we made decisions that resulted in the impairment of certain assets. This review did not result in any closure of facilities or layoffs, but certain assets located at various sites were affected. We have ceased using these assets, written down their carrying value to zero, and have disposed of or destroyed substantially all of the assets. The asset impairment charges incurred in the second quarter of 2004 aggregated $108.9 million.

Similar to 2004, during 2003, management approved global manufacturing strategies across our product portfolio to improve plant performance and efficiency, including the outsourcing of production of certain anti-infective products. These decisions resulted in the impairment of certain assets, primarily manufacturing assets in the U.S. This review did not result in any closure of facilities, but certain assets located at various manufacturing sites were affected. We have ceased using these assets, and substantially all of these assets have been disposed of or destroyed. The impairment charges were necessary to adjust the carrying value of these assets to zero. These asset impairment charges incurred totaled $142.9 million, of which $114.6 million was incurred in the first quarter of 2003 with the remaining $28.3 million incurred in the fourth quarter of 2003.

In December 2002, we initiated a plan of eliminating approximately 700 positions worldwide in order to streamline our infrastructure. While a substantial majority of affected employees were successfully placed in other positions in the company, severance expenses were incurred in the first quarter of 2003 for those employees who elected a severance package. The restructuring and other special charges incurred in the first quarter of 2003 were $52.5 million, consisting primarily of voluntary severance expenses. All of this charge has been expended.

In 2001, we licensed from Isis Pharmaceuticals, Inc. (Isis), Affinitak, a non-small-cell lung cancer drug candidate, and entered into an agreement regarding an ongoing research collaboration. In conjunction with this agreement, we purchased approximately 4.2 million shares of Isis common stock with a cost basis of approximately $68.0 million, and we committed to loan Isis $100 million over the four-year term of the research agreement. The Isis loan was repayable at the end of the research agreement term in cash or Isis stock, at Isis's option, using a conversion price of $40 per share. In addition, we committed to loan Isis $21.2 million for the building of a manufacturing suite for Affinitak. On March 17, 2003, we announced, along with Isis, the results of the Phase III trial that evaluated Affinitak when combined with chemotherapy in patients with advanced non-small-cell lung cancer. No difference was observed in the overall survival of the two groups. Due to this announcement and the decline in Isis's stock price that occurred in the previous 12 months, we concluded in the first quarter of 2003 that our investment in Isis common stock was other-than-temporarily impaired as defined by generally accepted accounting principles. For the same reasons, it was probable that the value of the consideration that we would be eligible to receive from Isis pursuant to the terms of the loan agreements would be less than the carrying amount of the loans. Therefore, in the first quarter of 2003, we recognized an impairment in our investment in Isis common stock of $55.0 million and a reserve related to the loans of $92.9 million. In addition, we recognized a charge of $38.9 million for contractual obligations related to Affinitak. The primary portion of this charge resulted from our supply agreement with Isis. The supply agreement obligated us to pay certain costs associated with work-in-process and raw materials and other costs that were triggered when we canceled our order of Affinitak. The remaining portion of the charge resulted from our contractual obligations related to the conduct of Affinitak clinical trials. All our contractual obligations have been fulfilled. The stock and loan impairments and other special charges incurred in the first quarter of 2003 related to this relationship totaled $186.8 million. In

the third quarter of 2005, Isis exercised its option to repay its loan obligation with 2.5 million shares of Isis common stock.

Note 5: Financial Instruments and Investments

Financial instruments that potentially subject us 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 mitigated by our ongoing credit review procedures. We place substantially all our interest-bearing investments with major financial institutions, in U.S. government securities, or with top-rated corporate issuers. At December 31, 2005, our investments in debt securities were comprised of 41 percent asset-backed securities, 34 percent corporate securities, and 25 percent U.S. government securities. In accordance with documented corporate policies, we limit the amount of credit exposure to any one financial institution or corporate issuer. We are exposed to credit-related losses in the event of nonperformance by counterparties to financial instruments but do not expect any counterparties to fail to meet their obligations given their high credit ratings.

Fair Value of Financial Instruments

A summary of our outstanding financial instruments and other investments at December 31 follows:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short-term investments				
Debt securities	**$ 2,031.0**	$ 2,031.0	$ 2,099.1	$ 2,099.1
Noncurrent investments				
Marketable equity	**$ 118.0**	$ 118.0	$ 80.4	$ 80.4
Debt securities	**1,076.2**	1,076.2	366.1	366.1
Equity method and other investments	**102.4**	N/A	114.9	N/A
	$ 1,296.6		$ 561.4	
Long-term debt, including current portion	**$ 6,484.8**	$ 6,484.2	$ 4,858.5	$ 4,868.6
Risk-management instruments — liabilities	**336.0**	336.0	213.4	213.4

We determine fair values based on quoted market values where available or discounted cash flow analyses (principally long-term debt). The fair value of equity method and other investments is not readily available and disclosure is not required. Approximately $2.6 billion of our investments in debt securities mature within five years.

A summary of the unrealized gains and losses (pretax) of our available-for-sale securities in other comprehensive income at December 31 follows:

	2005	2004
Unrealized gross gains	**$ 52.0**	$ 43.7
Unrealized gross losses	**15.9**	7.9

The net adjustment to unrealized gains and losses (net of tax) on available-for-sale securities increased (decreased) other comprehensive income by ($4.6) million, ($18.2) million, and

$45.4 million in 2005, 2004, and 2003, respectively. Activity related to our available-for-sale investment portfolio was as follows:

	2005	2004	2003
Proceeds from sales	$ **2,048.6**	$ 7,774.7	$ 5,303.7
Realized gross gains on sales	**25.6**	37.3	72.1
Realized gross losses on sales	**7.1**	17.6	26.4
Interest income	**212.1**	156.7	143.1

During the years ended December 31, 2005, 2004, and 2003, net losses related to ineffectiveness and net losses related to the portion of fair value and cash flow hedging instruments excluded from the assessment of effectiveness were not material.

We expect to reclassify an estimated $4.7 million of pretax net losses on cash flow hedges of anticipated foreign currency transactions and the variability in expected future interest payments on floating rate debt from accumulated other comprehensive loss to earnings during 2006. This assumes that short-term interest rates remain unchanged from the prevailing rates at December 31, 2005.

Note 6: Borrowings

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

	2005	2004
4.50 to 7.13 percent notes (due 2012-2036)	**$ 1,487.4**	$ 1,4874
2.90 to 8.38 percent notes (due 2006-2008)	**811.4**	811.4
Floating rate extendible notes (due 2007)	**1,500.0**	—
Floating rate bonds (due 2008-2037)	**1,939.2**	1,424.7
Private placement bonds (due 2007-2008)	**460.7**	652.6
8.38 percent eurodollar bonds (due 2005)	—	150.0
6.55 percent ESOP debentures (due 2017)	**92.6**	93.6
Other, including capitalized leases	**113.0**	122.8
SFAS 133 fair value adjustment	**80.5**	116.0
	6,484.8	4,858.5
Less current portion	**721.3**	366.6
	$ 5,763.5	$ 4,491.9

In September 2005, Eli Lilly Services, Inc. (ELSI), our indirect wholly-owned finance subsidiary, issued $1.5 billion of floating rate notes (4.53 percent at December 31, 2005). The notes mature in September 2008 and pay interest quarterly at LIBOR plus 5 basis points. The notes may be redeemed at our option beginning in September 2006. In August 2005, ELSI issued $1.5 billion of 13-month floating rate extendible notes. The maturity date of these notes is January 1, 2007, but holders of the notes may extend the maturity of the notes, in monthly increments, until September 1, 2010. These notes pay interest at essentially a rate equivalent to LIBOR (4.26 percent at December 31, 2005). The parent company fully and unconditionally guarantees the ELSI notes.

In August 2004, we issued $1.00 billion of floating rate notes due in 2007. We repaid these notes in August 2005. In March 2003, we issued $300.0 million of 2.9 percent 5-year notes and $200.0 million of 4.5 percent 15-year notes. In July 2002 and May 2001, we issued $150.0 million and $250.0 million, respectively, of floating rate bonds that mature in 2037. The variable interest

rate on these bonds is at LIBOR plus our six-month credit spread, adjusted semiannually (total of 4.64 percent at December 31, 2005). The interest accumulates over the life of the bonds and is payable upon maturity. We have an option to begin periodic interest payments at any time. At the time of option exercise, we would owe all previously accrued interest on the bonds. Additionally, in July 2003 and July 2002, respectively, we executed a $330.0 million and $542.8 million private placement note with a financial institution. Principal and interest are due semiannually over the five-year terms of each of these notes. In conjunction with these notes, we entered into interest rate swap agreements with the same financial institution, which converts the fixed rate into a variable rate of interest at essentially LIBOR over the term of the notes.

The 6.55 percent Employee Stock Ownership Plan (ESOP) debentures are obligations of the ESOP but are shown on the consolidated balance sheet because we guarantee them. The principal and interest on the debt are funded by contributions from us 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 aggregate amounts of maturities on long-term debt for the next five years are as follows: 2006, $721.3 million; 2007, $1.71 billion; 2008, $1.89 billion; 2009, $17.7 million; and 2010, $15.9 million.

At December 31, 2005 and 2004, short-term borrowings included $13.4 million and $1.65 billion, respectively, of notes payable to banks and commercial paper. At December 31, 2005, unused committed lines of credit totaled approximately $1.23 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.

We have converted substantially all fixed rate debt to floating rates through the use of interest rate swaps. The weighted-average effective borrowing rate based on debt obligations and interest rates at December 31, 2005 and 2004, including the effects of interest rate swaps for hedged debt obligations, were 4.75 percent and 2.7 percent, respectively.

In 2005 and 2003, cash payments of interest on borrowings totaled $32.0 million and $44.7 million, respectively, net of capitalized interest. In 2004, capitalized interest exceeded cash payments of interest on borrowings, due in large part to certain debt instruments requiring interest payments only at maturity, as previously noted.

In accordance with the requirements of SFAS 133, the portion of our fixed-rate debt obligations that is hedged is reflected in the consolidated balance sheet as an amount equal to the sum of the debt’s carrying value plus the fair value adjustment representing changes in fair value of the hedged debt attributable to movements in market interest rates subsequent to the inception of the hedge.

Note 7: Stock Plans

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective January 1, 2005. SFAS 123R requires the recognition of the fair value of stock-based compensation in net income. Stock-based compensation primarily consists of stock options and performance awards. Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant. Generally, options fully vest 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 our common stock. The number of performance award shares actually issued, if any, varies depending on the achievement of certain earnings-per-share targets. In general, performance awards fully vest at the end of the fiscal year of the grant.

We recognize the stock-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. We provide newly issued shares and treasury stock to satisfy stock option exercises and for the issuance of performance awards.

Prior to January 1, 2005, we followed Accounting Principles Board (APB) Opinion 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for our stock options and performance awards. Under APB 25, because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense was recognized. See Note 1 for a calculation of our net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation prior to January 1, 2005.

We have elected the modified prospective transition method for adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. In addition, the unrecognized expense of awards not yet vested at the date of adoption, determined under the original provisions of SFAS 123, shall be recognized in net income in the periods after the date of adoption. We recognized stock-based compensation cost in the amount of $403.5 million, $53.0 million, and $0 in 2005, 2004, and 2003, respectively, as well as related tax benefits of $122.9 million, $18.5 million, and $0, respectively. The amounts for 2004 relate only to expenses for performance awards because no expense was recognized for stock options under APB 25. In addition, after adopting SFAS 123R, we now classify tax benefits resulting from tax deductions in excess of the compensation cost recognized for exercised stock options as a financing cash flow in the consolidated statements of cash flows rather than an operating cash flow as under our previous disclosure.

As a result of the adoption of SFAS 123R and compensation plan structural changes effective January 1, 2005, the incremental impact on our stock compensation expense caused our income before income taxes and cumulative effect of a change in accounting principle and net income for the year ended December 31, 2005, to be $318.5 million and $225.4 million lower, respectively, than if we had continued to account for our equity compensation programs under APB 25. As a result, the reported basic and diluted earnings per share for the year ended December 31, 2005 are $.21 lower than they would have been had we not adopted SFAS 123R effective January 1, 2005.

In connection with the adoption of SFAS 123R, we reassessed the valuation methodology for stock options and the related input assumptions. As a result, beginning with the 2005 stock option grant, we utilized a lattice-based option valuation model for estimating the fair value of the stock options. The lattice model allows the use of a range of assumptions related to volatility, risk-free interest rate, and employee exercise behavior. Expected volatilities utilized in the lattice model are based on implied volatilities from traded options on our stock, historical volatility of our stock price, and other factors. Similarly, the dividend yield is based on historical experience and our estimate of future dividend yields. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. The model incorporates exercise and post-vesting forfeiture assumptions based on an analysis of historical data. The expected life of the 2005 grants is derived from the output of the lattice model.

Prior to 2005, we utilized a Black-Scholes option-pricing model to estimate the fair value of the options. This model did not allow for the input of a range of factors. Accordingly, volatility was derived from the historical volatility of our stock price and the risk-free interest rate was derived from the weighted-average yield of a treasury security with the same term as the expected life of the options. The expected life of the options was based on the weighted-average life of our historical option grants and the dividend yield was based on our historical dividends paid.

The weighted-average fair values of the individual options granted during 2005, 2004, and 2003 were $16.06, $26.19, and $20.59, respectively, determined using the following assumptions:

	2005	2004	2003
Dividend yield	2.0%	1.57%	1.50%
Weighted-average volatility	27.8%	35.20%	35.10%
Range of volatilities	27.6%-30.7%	—	—
Risk-free interest rate	2.5%-4.5%	3.43%	3.32%
Weighted-average expected life	7 years	7 years	7 years

The fair values of performance awards granted in 2005 and 2004 were $55.65 and $70.33, respectively. No performance awards were granted in 2003.

Stock option activity during 2005 is summarized below:

	Shares of Common Stock Attributable to Options (in thousands)	Weighted-Average Exercise Price of Options	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2005	93,658	$ 68.02		
Granted	5,084	55.65		
Exercised	(4,338)	24.42		
Forfeited or expired	(4,322)	69.82		
Outstanding at December 31, 2005	90,082	69.37	5.59	$ 57.3
Exercisable at December 31, 2005	57,543	71.64	4.27	52.7

A summary of the status of nonvested shares as of December 31, 2005, and changes during the year then ended, is presented below:

	Shares (in thousands)	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2005	39,342	$ 24.45
Granted	5,084	16.06
Vested	(10,220)	25.98
Forfeited	(1,667)	22.66
Nonvested at December 31, 2005	32,539	22.75

The intrinsic value of options exercised during 2005, 2004, and 2003 amounted to $131.9 million, $163.8 million, and $178.6 million, respectively. The total grant date fair value of options vested during 2005, 2004, and 2003, amounted to $265.5 million, $337.2 million, and $236.2 million, respectively. We received cash of $105.9 million, $117.9 million, and $99.3 million from exercises of stock options during 2005, 2004, and 2003, respectively, and recognized related tax benefits of $36.8 million, $36.8 million, and $44.3 million during those same years.

As of December 31, 2005, the total remaining unrecognized compensation cost related to nonvested stock options amounted to $216.2 million, which will be amortized over the weighted-average remaining requisite service period of 16 months. The number of shares ultimately issued for the performance award program is dependent upon the earnings achieved during the vesting period. Pursuant to this plan, no shares were issued in 2003 or 2004, and approximately 0.5 million shares were issued in 2005. Approximately 1.7 million shares are expected to be issued in 2006.

At December 31, 2005, additional options, performance awards, or restricted stock grants may be granted under the 2002 Lilly Stock Plan for not more than 49.1 million shares.

Note 8: Other Assets and Other Liabilities

Our sundry assets include our capitalized computer software, estimated insurance recoveries from our product litigation and environmental contingencies (Note 13), prepaid retiree health benefit (Note 12), goodwill and intangible assets (Note 1), and a variety of other items. The increase in sundry assets is primarily attributable to an increase in estimated insurance recoveries relating to litigation.

Our other current liabilities include the fair value of interest rate swaps and related accrued interest of $443.1 million associated with our borrowings, product litigation and environmental liabilities (Note 13), other taxes, and a variety of other items. The decrease in other current liabilities is caused primarily by a reduction in deferred income from our collaboration and out-licensing arrangements offset by an increase in product litigation liabilities and the interest rate swaps.

Our other noncurrent liabilities include the accrued liabilities from our pension and retiree health plans (Note 12), product litigation and environmental liabilities (Note 13), deferred income from our collaboration and out-licensing arrangements, and a variety of other items. The increase in other noncurrent liabilities is primarily attributable to an increase in product litigation and environmental liabilities.

None of the components of sundry assets exceeds 5 percent of total assets, and none of the components of other current liabilities (except for the interest rate swaps) or other noncurrent liabilities exceeds 5 percent of current or total liabilities, respectively.

Note 9: 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 (in thousands)	Amount
Balance at January 1, 2003	$ 2,610.0	$ 8,500.1	$ (123.3)	1,008	$ 109.5
Net income		2,560.8			
Cash dividends declared per share: $1.36		(1,465.4)			
Retirement of treasury shares	(289.1)			(3,180)	(291.2)
Purchase for treasury				2,976	276.8
Issuance of stock under employee stock plans	150.4			148	9.1
ESOP transactions	13.6		4.7		
Reclassification	125.1	(125.1)			
Balance at December 31, 2003	2,610.0	9,470.4	(118.6)	952	104.2
Net income		1,810.1			
Cash dividends declared per share: $1.45		(1,555.9)			
Retirement of treasury shares	(17.4)			(271)	(17.6)
Issuance of stock under employee stock plans	110.7			262	17.2
Stock-based compensation	53.0				
ESOP transactions	13.2		6.7		
Acquisition of AME	349.9				
Balance at December 31, 2004	3,119.4	9,724.6	(111.9)	943	103.8
Net income		1,979.6			
Cash dividends declared per share: $1.54		(1,677.0)			
Retirement of treasury shares	(381.7)			(6,874)	(386.0)
Purchase for treasury				6,704	377.9
Issuance of stock under employee stock plans	172.9			161	8.4
Stock-based compensation	403.5				
ESOP transactions	9.7		5.6		
Balance at December 31, 2005	$ 3,323.8	$ 10,027.2	$ 106.3	934	$ 104.1

As of December 31, 2005, we have purchased $2.46 billion of our announced $3.0 billion share repurchase program. We acquired approximately 6.7 million and 3.0 million shares in 2005 and 2003 under this program.

We have 5 million authorized shares of preferred stock. As of December 31, 2005 and 2004, no preferred stock has been issued.

We have funded an employee benefit trust with 40 million shares of Lilly common stock to provide a source of funds to assist us in meeting our obligations under various employee benefit plans. The funding had no net impact on shareholders' equity as we consolidated the employee benefit trust. The cost basis of the shares held in the trust was $2.64 billion and is shown as a reduction in shareholders' equity, which offsets the resulting increases of $2.61 billion in additional paid-in capital and $25 million in common stock. Any dividend transactions between us and the trust are eliminated. Stock held by the trust is not considered outstanding in the computation of earnings per

share. The assets of the trust were not used to fund any of our obligations under these employee benefit plans in 2005, 2004, or 2003.

We have an ESOP as a funding vehicle for the existing employee savings plan. The ESOP used the proceeds of a loan from us to purchase shares of common stock from the treasury. The ESOP issued $200 million of third-party debt, repayment of which was guaranteed by us (see Note 6). The proceeds were used to purchase shares of our 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 our savings plan contribution. The fair value of shares allocated each period is recognized as compensation expense.

Under a Shareholder Rights Plan adopted in 1998, all shareholders receive, along with 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 exercisable only after the Distribution Date, which is generally 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 our common stock. We may redeem the rights for $.005 per right, up to and including the Distribution Date. The rights will expire on July 28, 2008, unless we redeem them earlier.

The rights plan provides that, if an Acquiring Person acquires 15 percent or more of our outstanding common stock and our 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 our common stock that have a value of two times the exercise price.

Alternatively, if, in a transaction not approved by the board of directors, we are acquired in a business combination transaction or sell 50 percent or more of our 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 that 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 our outstanding common stock, the board of directors may exchange the rights (other than those owned by the Acquiring Person) for our 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 10: Earnings Per Share

The following is a reconciliation of the denominators used in computing earnings per share before cumulative effect of a change in accounting principle:

	2005	2004	2003
		(Shares in thousands)	
Income before cumulative effect of a change in accounting principle available to common shareholders	**$ 2,001.6**	$ 1,810.1	$ 2,560.8
Basic earnings per share			
Weighted-average number of common shares outstanding, including incremental shares	**1,088,754**	1,083,887	1,076,547
Basic earnings per share before cumulative effect of a change in accounting principle	**$ 1.84**	$ 1.67	$ 2.38
Diluted earnings per share			
Weighted-average number of common shares outstanding	**1,088,115**	1,083,677	1,076,547
Stock options and other incremental shares	**4,035**	5,259	5,683
Weighted-average number of common shares outstanding — diluted	**1,092,150**	1,088,936	1,082,230
Diluted earnings per share before cumulative effect of a change in accounting principle	**$ 1.83**	$ 1.66	$ 2.37

Note 11: Income Taxes

Following is the composition of income taxes attributable to income before cumulative effect of a change in accounting principle:

	2005	2004	2003
Current			
Federal	**$ 517.4**	$ 47.6	$ 391.2
Foreign	**649.8**	519.9	284.7
State	**11.6**	(10.6)	(6.2)
	1,178.8	556.9	669.7
Deferred			
Federal	**89.4**	175.2	(112.9)
Foreign	**(86.8)**	(74.0)	138.2
State	**(.5)**	8.7	5.9
Unremitted earnings to be repatriated due to change in tax law	**(465.0)**	465.0	—
	(462.9)	574.9	31.2
Income taxes	**$ 715.9**	$ 1,131.8	$ 700.9

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

	2005	2004
Deferred tax assets		
Inventory	**$ 637.8**	$ 538.4
Compensation and benefits	**396.6**	320.7
Other carryforwards	**391.5**	492.5
Sale of intangibles	**235.7**	411.5
Tax credit carryforwards and carrybacks	**218.7**	220.6
Financial instruments	**166.0**	117.1
Asset purchases	**92.4**	88.6
Asset disposals	**45.5**	165.3
Other	**414.8**	359.7
	2,599.0	2,714.4
Valuation allowances	**(455.7)**	(508.4)
Total deferred tax assets	**2,143.3**	2,206.0
Deferred tax liabilities		
Prepaid employee benefits	**(1,145.6)**	(952.8)
Property and equipment	**(702.6)**	(681.3)
Unremitted earnings to be repatriated due to change in tax law	**—**	(465.0)
Unremitted earnings	**—**	(327.4)
Other	**(236.8)**	(215.5)
Total deferred tax liabilities	**(2,085.0)**	(2,642.0)
Deferred tax assets (liabilities) — net	**$ 58.3**	$ (436.0)

At December 31, 2005, we had other carryforwards, primarily net operating loss carryforwards, for international and U.S. income tax purposes of $89.4 million: $54.6 million will expire within five years and $1.9 million thereafter; $32.9 million of the carryforwards will never expire. The primary component of the remaining portion of the deferred tax asset for other carryforwards is related to net operating losses for state income tax purposes that are fully reserved. We also have tax credit carryforwards and carrybacks of $218.7 million available to reduce future income taxes; $80.7 million will be carried back and $12.0 million of the tax credit carryforwards will never expire. The remaining portion of the tax credit carryforwards is related to state tax credits that are fully reserved.

Domestic and Puerto Rican companies contributed approximately 30 percent, 6 percent, and 22 percent in 2005, 2004, and 2003, respectively, to consolidated income before income taxes and cumulative effect of a change in accounting principle. We have a subsidiary operating in Puerto Rico under a tax incentive grant that begins to expire at the end of 2007.

The American Jobs Creation Act of 2004 (AJCA) created a temporary incentive for U.S. corporations to repatriate undistributed income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations in 2005. Although the deduction is subject to a number of limitations and uncertainty remained as to how to interpret certain provisions of the AJCA, we believed we had the information necessary to make an informed decision on the impact of the AJCA on our repatriation plans as of December 31, 2004. Based on that decision, we recorded a related tax liability of $465.0 million as of December 31,

2004, and subsequently repatriated $8.00 billion in incentive dividends, as defined in the AJCA, during 2005.

At December 31, 2005, we had an aggregate of $4.1 billion of 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. The amount of unremitted earnings for which no tax has been provided decreased substantially in 2004 due to the change in tax law described above, which caused us to change our previous plans to permanently reinvest a portion of those unremitted earnings.

Cash payments of income taxes totaled $1.78 billion, $487.0 million, and $614.0 million in 2005, 2004, and 2003, respectively. The higher cash payments of income taxes in 2005 are primarily attributable to the tax liability associated with the implementation of the AJCA and the resolution of an IRS examination for the years 1998 to 2000.

Following is a reconciliation of the effective income tax rate applicable to income before income taxes and cumulative effect of a change in accounting principle:

	2005	2004	2003
United States federal statutory tax rate	**35.0%**	35.0%	35.0%
Add (deduct)			
International operations, including Puerto Rico	**(9.5)**	(19.1)	(15.7)
Additional repatriation due to change in tax law	**—**	15.8	—
Non-deductible acquired in-process research and development	**—**	4.3	—
General business credits	**(1.5)**	(1.3)	(0.7)
Sundry	**2.3**	3.8	2.9
Effective income tax rate	**26.3%**	38.5%	21.5%

Note 12: Retirement Benefits

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

	Defined Benefit Pension Plans		Retiree Health Benefit Plans	
	2005	**2004**	**2005**	**2004**
Change in benefit obligation				
Benefit obligation at beginning of year	**$ 5,190.7**	$ 4,703.1	**$ 1,388.4**	$ 1,039.6
Service cost	**297.4**	238.8	**61.5**	47.6
Interest cost	**296.2**	286.4	**80.7**	62.5
Actuarial loss	**261.7**	39.7	**64.8**	161.2
Benefits paid	**(270.4)**	(259.4)	**(77.2)**	(71.5)
Reduction in discount rate, foreign currency exchange rate changes, and other adjustments	**(147.2)**	182.1	**155.4**	149.0
Benefit obligation at end of year	**5,628.4**	5,190.7	**1,673.6**	1,388.4
Change in plan assets				
Fair value of plan assets at beginning of year	**4,797.8**	3,721.9	**745.4**	553.9
Actual return on plan assets	**651.9**	494.6	**102.8**	58.7
Employer contribution	**375.0**	784.0	**194.7**	204.3
Benefits paid	**(268.4)**	(257.3)	**(77.2)**	(71.5)
Foreign currency exchange rate changes and other adjustments	**(73.9)**	54.6	**—**	—
Fair value of plan assets at end of year	**5,482.4**	4,797.8	**965.7**	745.4
Funded status	**(146.0)**	(392.9)	**(707.9)**	(643.0)
Unrecognized net actuarial loss	**2,237.9**	2,339.7	**1,089.1**	979.5
Unrecognized prior service cost (benefit)	**71.4**	66.0	**(101.3)**	(116.9)
Net amount recognized	**$ 2,163.3**	$ 2,012.8	**$ 279.9**	$ 219.6
Amounts recognized in the consolidated balance sheet consisted of				
Prepaid pension	**$ 2,419.6**	$ 2,253.8	**$ 377.2**	$ 310.4
Accrued benefit liability	**(567.5)**	(464.4)	**(97.3)**	(90.8)
Accumulated other comprehensive loss before income taxes	**311.2**	223.4	**—**	—
Net amount recognized	**$ 2,163.3**	$ 2,012.8	**$ 279.9**	$ 219.6

	Defined Benefit Pension Plans		Retiree Health Benefit Plans	
(Percents)	**2005**	**2004**	**2005**	**2004**
Weighted-average assumptions as of December 31				
Discount rate for benefit obligation	**5.8**	5.9	**6.0**	6.0
Discount rate for net benefit costs	**5.9**	6.2	**6.0**	6.2
Rate of compensation increase for benefit obligation	**4.7**	5.6	**—**	—
Rate of compensation increase for net benefit costs	**5.6**	5.3	**—**	—
Expected return on plan assets for net benefit costs	**9.0**	9.2	**9.0**	9.3

In evaluating the expected return on plan assets, we have considered our historical assumptions compared with actual results, an analysis of current market conditions, asset allocations, and the views of leading financial advisers and economists. Our plan assets in our U.S. defined benefit pension and retiree health plans comprise approximately 87 percent of our worldwide benefit plan assets. Including the investment losses due to overall market conditions in 2001 and 2002, our 10- and 20-year annualized rates of return on our U.S. defined benefit pension plans and retiree health benefit plan were approximately 9.3 percent and 11.3 percent, respectively, as of December 31, 2005. Health-care-cost trend rates were assumed to increase at an annual rate of 9 percent in 2006, decreasing 1 percent per year to 6 percent in 2009 and thereafter.

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

	Defined Benefit Pension Plans	Retiree Health Benefit Plans
2006	$ 271.7	$ 85.4
2007	278.2	92.3
2008	285.3	98.1
2009	293.1	104.3
2010	302.8	110.1
2011-2015	1,702.7	645.7

The total accumulated benefit obligation for our defined benefit pension plans was $4.88 billion and $4.55 billion at December 31, 2005 and 2004, respectively. The projected 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 $1.51 billion and $870.3 million, respectively, as of December 31, 2005, and $1.33 billion and $780.3 million, respectively, as of December 31, 2004.

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

	Defined Benefit Pension Plans			Retiree Health Benefit Plans		
	2005	**2004**	**2003**	**2005**	**2004**	**2003**
Components of net periodic benefit cost						
Service cost	**$ 297.4**	$ 238.8	$ 195.4	**$ 61.5**	$ 47.6	$ 38.2
Interest cost	**296.2**	286.4	267.2	**80.7**	62.5	60.4
Expected return on plan assets	**(445.9)**	(402.2)	(382.7)	**(75.6)**	(60.2)	(53.6)
Amortization of prior service cost	**7.6**	7.3	11.9	**(15.6)**	(15.6)	(15.6)
Recognized actuarial loss	**106.7**	99.7	52.4	**86.6**	57.8	50.6
Net periodic benefit cost	**$ 262.0**	$ 230.0	$ 144.2	**$ 137.6**	$ 92.1	$ 80.0

If the health-care-cost trend rates were to be increased by one percentage point each future year, the December 31, 2005, accumulated postretirement benefit obligation would increase by 14.0 percent and the aggregate of the service cost and interest cost components of the 2005 annual expense would increase by 18.4 percent. A one-percentage-point decrease in these rates would decrease the December 31, 2005, accumulated postretirement benefit obligation by 12.2 percent and the aggregate of the 2005 service cost and interest cost by 15.5 percent.

We have defined contribution savings plans that cover our 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 save. Our contributions to the plan

are based on employee contributions and the level of our match. Expenses under the plans totaled $96.1 million, $75.5 million, and $72.9 million for the years 2005, 2004, and 2003, respectively.

We provide certain other postemployment benefits primarily related to disability benefits and accrue for the related cost over the service lives of employees. Expenses associated with these benefit plans in 2005, 2004, and 2003 were not significant.

Our U.S. defined benefit pension and retiree health benefit plan investment allocation strategy currently comprises approximately 85 percent to 95 percent growth investments and 5 percent to 15 percent fixed-income investments. Within the growth investment classification, the plan asset strategy encompasses equity and equity-like instruments that are expected to represent approximately 75 percent of our plan asset portfolio of both public and private market investments. The largest component of these equity and equity-like instruments is public equity securities that are well diversified and invested in U.S. and international small-to-large companies. The remaining portion of the growth investment classification is represented by other alternative growth investments.

Our defined benefit pension plan and retiree health plan asset allocations as of December 31 are as follows:

	Percentage of Pension Plan Assets		Percentage of Retiree Health Plan Assets	
(Percents)	**2005**	**2004**	**2005**	**2004**
Asset Category				
Equity securities and equity-like instruments	**75**	74	**80**	78
Debt securities	**10**	9	**11**	10
Real estate	**1**	1	**0**	1
Other	**14**	16	**9**	11
Total	**100**	100	**100**	100

In 2006, we expect to contribute approximately $26 million to our defined benefit pension plans to satisfy minimum funding requirements for the year. In addition, we expect to contribute approximately $125 million of additional discretionary funding in 2006 to our defined benefit plans. We also expect to contribute approximately $120 million of discretionary funding to our postretirement health benefit plans during 2006.

Note 13: Contingencies

Three generic pharmaceutical manufacturers, Zenith Goldline Pharmaceuticals, Inc. (Zenith), Dr. Reddy's Laboratories, Ltd. (Reddy), and Teva Pharmaceuticals (Teva), submitted abbreviated new drug applications (ANDAs) seeking permission to market generic versions of Zyprexa in various dosage forms several years prior to the expiration of our U.S. patents for the product. The generic companies alleged that our patents are invalid, unenforceable, or not infringed. We filed suit against the three companies in the U.S. District Court for the Southern District of Indiana, seeking a ruling that the challenges to our compound patent (expiring in 2011) are without merit. The cases were consolidated, and on April 14, 2005, the district court upheld our 2011 U.S. patent on Zyprexa. In the case of Eli Lilly and Company v. Zenith Goldline Pharmaceuticals et al., the court ruled in our favor on all counts, including the patent doctrines of obviousness, double patenting, inequitable conduct, novelty, and public use. The decision has been appealed. We are confident, and the trial court confirmed, that the generic manufacturers' claims are without merit, and we expect

to prevail in this litigation. However, it is not possible to predict or determine the outcome of this litigation and, accordingly, we can provide no assurance that we will prevail on appeal. An unfavorable outcome would have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

In 2002, Barr Laboratories, Inc. (Barr), submitted an ANDA with the FDA seeking permission to market a generic version of Evista (raloxifene) several years prior to the expiration of our U.S. patents covering the product, alleging that the patents are invalid or not infringed. In November 2002, we filed suit against Barr in the U.S. District Court for the Southern District of Indiana, seeking a ruling that Barr's challenges to our patents claiming the methods of use and pharmaceutical form (expiring from 2012 to 2017) are without merit. Barr has also asserted that the method of use patents are unenforceable. The U.S. Patent and Trademark Office issued to us two new patents (expiring in 2017) directed to pharmaceutical compositions containing raloxifene and a method for preventing postmenopausal osteoporosis and a third (expiring in 2012) directed to methods of inhibiting postmenopausal bone loss by administering a single daily oral dose of raloxifene. These patents have been listed in the FDA's *Orange Book*. Barr has challenged these patents, alleging that each is invalid, unenforceable, or will not be infringed. These patents have been added to the pending suit. The suit is in discovery. No trial date has been set at this time. While we believe that Barr's claims are without merit and we expect to prevail, it is not possible to predict or determine the outcome of the litigation. Therefore, we can provide no assurance that we will prevail. An unfavorable outcome could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

In January 2006, we were notified that Sicor Pharmaceuticals, Inc. (Sicor), a subsidiary of Teva, submitted an ANDA with the FDA seeking permission to market a generic version of Gemzar several years prior to the expiration of two U.S. patents covering the product. Sicor alleged that both U.S. patents are invalid. In February, we filed suit against Sicor in the U.S. District Court for the Southern District of Indiana, seeking a ruling that Sicor's challenges to our patents claiming the compound (expiring in 2010) and the methods of use (expiring in 2012) are without merit. While we believe that Sicor's claims are without merit and we expect to prevail, it is not possible to predict or determine the outcome of the litigation. Therefore, we can provide no assurance that we will prevail. An unfavorable outcome could have a material adverse impact on our consolidated results of operations.

In July 2002, we received the first of several grand jury subpoenas for documents from the Office of Consumer Litigation, U.S. Department of Justice, related to our marketing and promotional practices and physician communications with respect to Evista. We reached a settlement with the U.S. Department of Justice in the fourth quarter of 2005, which was subsequently approved by the U.S. District Court for the Southern District of Indiana in February 2006. As part of the settlement, Lilly pleaded guilty to one misdemeanor violation of the Food, Drug, and Cosmetic Act. The plea is for the off-label promotion of Evista during 1998. The government did not, however, charge the company with any unlawful intent, nor do we acknowledge any such intent. In connection with the overall settlement, we agreed to pay a total of $36 million. As previously reported, Lilly took a charge in the fourth quarter of 2004 in connection with this investigation. The 2004 charge was sufficient to cover this settlement payment; consequently, no further charge will be necessary.

In March 2004, the office of the U.S. Attorney for the Eastern District of Pennsylvania advised us that it has commenced a civil investigation related to our U.S. marketing and promotional practices, including our communications with physicians and remuneration of physician consultants and advisors, with respect to Zyprexa, Prozac, and Prozac Weekly. In October 2005, the U.S. Attorney's

office advised that it is also conducting an inquiry regarding certain rebate agreements we entered into with a pharmacy benefit manager covering Axid, Evista, Humalog, Humulin, Prozac, and Zyprexa. The inquiry includes a review of Lilly's Medicaid best price reporting related to the product sales covered by the rebate agreements. We are cooperating with the U.S. Attorney in these investigations, including providing a broad range of documents and information relating to the investigations. In June 2005, we received a subpoena from the office of the Attorney General, Medicaid Fraud Control Unit, of the State of Florida, seeking production of documents relating to sales of Zyprexa and our marketing and promotional practices with respect to Zyprexa. It is possible that other Lilly products could become subject to investigation and that the outcome of these matters could include criminal charges and fines, penalties, or other monetary or nonmonetary remedies. We cannot predict or determine the outcome of these matters or reasonably estimate the amount or range of amounts of any fines or penalties that might result from an adverse outcome. It is possible, however, that an adverse outcome could have a material adverse impact on our consolidated results of operations, liquidity, and financial position. We have implemented and continue to review and enhance a broadly based compliance program that includes comprehensive compliance-related activities designed to ensure that our marketing and promotional practices, physician communications, remuneration of health care professionals, managed care arrangements, and Medicaid best price reporting comply with applicable laws and regulations.

We have been named as a defendant in a large number of Zyprexa product liability lawsuits in the United States and have been notified of several thousand claims of individuals who have not filed suit. The lawsuits and unfiled claims (together the "claims") allege a variety of injuries from the use of Zyprexa, with the majority alleging that the product caused or contributed to diabetes or high blood-glucose levels. The claims seek substantial compensatory and punitive damages and typically accuse us of inadequately testing for and warning about side effects of Zyprexa. Many of the claims also allege that we improperly promoted the drug. Almost all of the federal lawsuits are part of a Multi-District Litigation (MDL) proceeding before The Honorable Jack Weinstein in the Federal District Court for the Eastern District of New York (MDL No. 1596). The MDL includes three lawsuits requesting certification of class actions on behalf of those who allegedly suffered injuries from the administration of Zyprexa. We have entered into agreements with various plaintiffs' counsel halting the running of the statutes of limitation (tolling agreements) with respect to a large number of claimants who do not have lawsuits on file.

In June 2005, we entered into an agreement in principle (followed by a definitive master settlement agreement in September 2005) with a group of plaintiffs' attorneys involved in U.S. Zyprexa product liability litigation to settle a majority of the claims. The agreement covers more than 8,000 claimants, including a large number of previously filed lawsuits (including the three purported class actions), tolled claims, and other informally asserted claims. We established a fund of $690 million for the claimants to settle their claims, and $10 million to cover administration of the settlement. The settlement fund is being overseen and distributed by claims administrators appointed by the court. The agreement and the distribution of funds to participating claimants are conditioned upon, among other things, our obtaining full releases from no fewer than 7,193 claimants.

Following this settlement, the remaining U.S. Zyprexa product liability claims include approximately 150 lawsuits in the U.S. covering 465 claimants, and approximately 825 tolled claims. In addition, we have been informally advised of a number of additional potential U.S. claims, but to date have received no substantiation of the claims. Also, in early 2005, we were served with five lawsuits seeking class action status in Canada on behalf of patients who took Zyprexa. The allegations in the Canadian actions are similar to those in the litigation pending in the United States. We are prepared to continue our vigorous defense of Zyprexa in all remaining cases.

In 2005, two lawsuits were filed in the Eastern District of New York purporting to be nationwide class actions on behalf of all consumers and third party payors, excluding governmental entities, which have made or will make payments on account of their members or insured patients being prescribed Zyprexa. These actions have now been consolidated into a single lawsuit, which is brought under certain state consumer protection statutes, the federal civil RICO statute, and common law theories, seeking a refund of the cost of Zyprexa, treble damages, punitive damages, and attorneys' fees. In addition, in 2006 a similar lawsuit was filed in the Eastern District of New York on similar grounds. As with the product liability suits, these lawsuits allege that we inadequately tested for and warned about side effects of Zyprexa and improperly promoted the drug.

In December 2004, we were served with two lawsuits brought in state court in Louisiana on behalf of the Louisiana Department of Health and Hospitals, alleging that Zyprexa caused or contributed to diabetes or high blood-glucose levels, and that we improperly promoted the drug. These cases have been removed to federal court and are now part of the MDL proceedings in the Eastern District of New York. In these actions, the Department of Health and Hospitals seeks to recover the costs it paid for Zyprexa through Medicaid and other drug-benefit programs, as well as the costs the department alleges it has incurred and will incur to treat Zyprexa-related illnesses.

In connection with the Zyprexa product liability claims, certain of our insurance carriers have raised defenses to their liability under the policies and to date have failed to reimburse us for claim-related costs despite demand from the first-layer carriers for payment. However, in our opinion, the defenses identified to date appear to lack substance. In March 2005, we filed suit against several of the carriers in state court in Indiana to obtain reimbursement of costs related to the Zyprexa product liability litigation. The matter has been removed to the federal court in Indianapolis. Several carriers have asserted defenses to their liability, and some carriers are seeking rescission of the coverage. While we believe our position is meritorious, there can be no assurance that we will prevail.

In addition, we have been named as a defendant in numerous other product liability lawsuits involving primarily diethylstilbestrol (DES) and thimerosal.

With respect to the product liability claims currently asserted against us, we have accrued for our estimated exposures to the extent they are both probable and estimable based on the information available to us. In addition, we have accrued for certain product liability claims incurred but not filed to the extent we can formulate a reasonable estimate of their costs. We estimate these expenses based primarily on historical claims experience and data regarding product usage. Legal defense costs expected to be incurred in connection with significant product liability loss contingencies are accrued when probable and reasonably estimable. A portion of the costs associated with defending and disposing of these suits is covered by insurance. We record receivables for insurance-related recoveries when it is probable they will be realized. These receivables are classified as a reduction of the litigation charges on the statement of income. We estimate insurance recoverables based on existing deductibles, coverage limits, our assessment of any defenses to coverage that might be raised by the carriers, and the existing and projected future level of insolvencies among the insurance carriers.

In the second quarter of 2005, we recorded a net pre-tax charge of $1.07 billion for product liability matters, which includes the following:

- The $700 million Zyprexa settlement and administration fee;
- Reserves for product liability exposures and defense costs regarding currently known and expected claims to the extent we can formulate a reasonable estimate of the probable number and cost of the claims. A substantial majority of these exposures and costs relate to current and expected Zyprexa claims not included in the settlement. We have estimated these charges based primarily on historical claims experience, data regarding product usage, and our historical product liability defense cost experience.

The $1.07 billion net charge took into account our estimated recoveries from our insurance coverage related to these matters. The after-tax impact of this net charge was $.90 per share. The $700 million for the Zyprexa settlement was paid during 2005, while the cash related to the other reserves for product liability exposures and defense costs is expected to be paid out over the next several years. The timing of our insurance recoveries is uncertain.

We cannot predict with certainty the additional number of lawsuits and claims that may be asserted. In addition, although we believe it is probable, there can be no assurance that the Zyprexa settlement described above will be concluded. The ultimate resolution of Zyprexa product liability and related litigation could have a material adverse impact on our consolidated results of operations, liquidity, and financial position.

We are subject to a substantial number of product liability claims, and because of the nature of pharmaceutical products, it is possible that we could become subject to large numbers of product liability claims for other products in the future. We have experienced difficulties in obtaining product liability insurance due to a very restrictive insurance market, and therefore will be largely self-insured for future product liability losses. In addition, there is no assurance that we will be able to fully collect from our insurance carriers on past claims.

Also, under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly known as Superfund, we have been designated as one of several potentially responsible parties with respect to fewer than 10 sites. Under Superfund, each responsible party may be jointly and severally liable for the entire amount of the cleanup. We also continue remediation of certain of our own sites. We have accrued for estimated Superfund cleanup costs, remediation, and certain other environmental matters. This takes 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. We have reached a settlement with our liability insurance carriers providing for coverage for certain environmental liabilities.

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

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

Note 14: Other Comprehensive Income (Loss)

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

	Foreign Currency Translation Gains (Losses)	Unrealized Gains (Losses) on Securities	Minimum Pension Liability Adjustment	Effective Portion of Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Beginning balance at January 1, 2005	$ 551.4	$ 24.3	$ (147.0)	$ (210.1)	$ 218.6
Other comprehensive loss	(533.4)	(4.6)	(55.9)	(45.3)	(639.2)
Balance at December 31, 2005	$ 18.0	$ 19.7	$ (202.9)	$ (255.4)	$ (420.6)

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 reclassification adjustments of $9.1 million, $9.8 million, and $37.4 million, net of tax, in 2005, 2004, and 2003, respectively, for net realized gains on sales of securities included in net income. The effective portion of cash flow hedges is net of reclassification adjustments of $3.8 million, $23.1 million, and $27.2 million, net of tax, in 2005, 2004, and 2003, respectively, for realized losses on foreign currency options and $21.4 million, $15.6 million, and $14.2 million, net of tax, in 2005, 2004, and 2003, respectively, for interest expense on interest rate swaps designated as cash flow hedges.

Generally, the assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rate. For those operations, changes in exchange rates generally do not affect cash flows; therefore, resulting translation adjustments are made in shareholders' equity rather than in income.

Management's Reports

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

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

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

The financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm. Their responsibility is to examine our consolidated financial statements in accordance with generally accepted auditing standards of the Public Company Accounting Oversight Board (United States). Ernst & Young's opinion with respect to the fairness of the presentation of the statements (see opinion on page 80) is included in our annual report. Ernst & Young reports directly to the audit committee of the board of directors.

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

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

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

Management of Eli Lilly and Company and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and

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

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under this framework, we concluded that our internal controls over financial reporting were effective as of December 31, 2005.

The internal control over financial reporting has been assessed by Ernst & Young LLP. Their responsibility is to evaluate management's assessment and evidence about whether internal control over financial reporting was designed and operating effectively. Ernst & Young's report with respect to the effectiveness of internal control over financial reporting is included on page 81 of our annual report.

Sidney Taurel *Chairman of the Board and Chief Executive Officer*	John C. Lechleiter, Ph.D. *President and Chief Operating Officer*	Charles E. Golden *Executive Vice President and Chief Financial Officer*

February 13, 2006

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Eli Lilly and Company

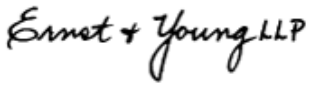
We have audited the accompanying consolidated balance sheets of Eli Lilly and Company and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, cash flows, and comprehensive income for each of the three years in the period ended December 31, 2005. These financial 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 the standards of the Public Company Accounting Oversight Board (United States). 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, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Eli Lilly and Company and subsidiaries' internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 13, 2006 expressed an unqualified opinion thereon.

As discussed in Notes 2 and 7 to the financial statements, in 2005 Eli Lilly and Company adopted new accounting pronouncements for asset retirement obligations and stock-based compensation.



Indianapolis, Indiana
February 13, 2006

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Eli Lilly and Company

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Eli Lilly and Company and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Eli Lilly and Company and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

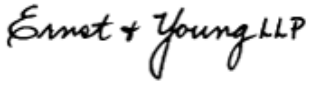
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, management's assessment that Eli Lilly and Company and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Eli Lilly and Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2005 consolidated financial statements of Eli Lilly and Company and subsidiaries and our report dated February 13, 2006 expressed an unqualified opinion thereon.



Indianapolis, Indiana
February 13, 2006

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

Under applicable SEC regulations, management of a reporting company, with the participation of the principal executive officer and principal financial officer, must periodically evaluate the company's "disclosure controls and procedures," which are defined generally as controls and other procedures of a reporting company designed to ensure that information required to be disclosed by the reporting company in its periodic reports filed with the commission (such as this Form 10-K) is recorded, processed, summarized, and reported on a timely basis.

Our management, with the participation of Sidney Taurel, chairman and chief executive officer, and Charles E. Golden, executive vice president and chief financial officer, evaluated our disclosure controls and procedures as of December 31, 2005, and concluded that they are effective.

Internal Control over Financial Reporting

Messrs. Taurel and Golden and Dr. Lechleiter provided a report on behalf of management on our internal control over financial reporting, in which management concluded that the company's internal control over financial reporting is effective at December 31, 2005. In addition, Ernst & Young LLP, the company's independent auditor, provided an attestation report on management's assessment of internal control over financial reporting. You can find the full text of management's report and Ernst & Young's attestation report in Item 8, and both reports are incorporated by reference in this Item.

Changes in Internal Controls

During the fourth quarter of 2005, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

Not applicable.

Part III

Item 10. Directors and Executive Officers of the Registrant

Information relating to our Board of Directors is found in our Proxy Statement to be dated on or about March 13, 2006 (the "Proxy Statement") under "Board of Directors" at pages 64-66, and is incorporated in this report by reference.

The Board has appointed an audit committee consisting entirely of independent directors in accordance with applicable SEC and New York Stock Exchange rules. The members of the

committee are Sir Winfried Bischoff (chairman), Mr. J. Michael Cook, Dr. Martin Feldstein, Dr. Franklyn G. Prendergast, and Ms. Kathi P. Seifert. The Board has determined that Sir Winfried Bischoff and Mr. J. Michael Cook are audit committee financial experts as defined in the SEC rules.

Information relating to our executive officers is found at Part I, Item 1 of this Form 10-K under "Executive Officers of the Company." In addition, information relating to certain filing obligations of directors and executive officers under the federal securities laws is found in the Proxy Statement under "Other Matters — Section 16(a) Beneficial Ownership Reporting Compliance," at page 93. That information is incorporated in this report by reference.

We have adopted a code of ethics that complies with the applicable SEC and New York Stock Exchange requirements. The code is set forth in:

- *The Red Book*, a comprehensive code of ethical and legal business conduct applicable to all employees worldwide and to our Board of Directors; and
- *Code of Ethical Conduct for Lilly Financial Management*, a supplemental code for our chief executive officer, chief operating officer, and all members of financial management that focuses on accounting, financial reporting, internal controls, and financial stewardship.

Both documents are online on our web site at http://investor.lilly.com/code_business_conduct.cfm. In the event of any amendments to, or waivers from, a provision of the code affecting the chief executive officer, chief financial officer, chief accounting officer, controller, or persons performing similar functions, we intend to post on the above web site within four business days after the event a description of the amendment or waiver as required under applicable SEC rules. We will maintain that information on our web site for at least 12 months. Paper copies of these documents are available free of charge upon request to the company's secretary at the address on the front of this Form 10-K.

Item 11. Executive Compensation

Information on executive compensation and director compensation is found in the Proxy Statement under "Directors' Compensation" at page 72 and "Executive Compensation" at pages 76-82. That information is incorporated in this report by reference, except that the Compensation Committee Report is not incorporated in this report.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security Ownership of Certain Beneficial Owners and Management

Information relating to ownership of the Company's common stock by management and by persons known by the Company to be the beneficial owners of more than five percent of the outstanding shares of common stock is found in the Proxy Statement under "Ownership of Company Stock," at page 84. That information is incorporated in this report by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table presents information as of December 31, 2005, regarding our compensation plans under which shares of Lilly common stock have been authorized for issuance.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(b) Weighted-average exercise price of outstanding options, warrants, and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	79,741,504	$68.55	49,127,003
Equity compensation plan not approved by security holders(1)	10,340,400	75.73	320,555
Total	90,081,904	69.37	49,447,558

(1) Represents shares in the Lilly GlobalShares Stock Plan, which permits the company to grant stock options to nonmanagement employees worldwide. The plan is administered by the senior vice president responsible for human resources. The stock options are nonqualified for U.S. tax purposes. The option price cannot be less than the fair market value at the time of grant. The options shall not exceed 11 years in duration and shall be subject to vesting schedules established by the plan administrator. There are provisions for early vesting and early termination of the options in the event of retirement, disability, and death. In the event of stock splits or other recapitalizations, the administrator may adjust the number of shares available for grant, the number of shares subject to outstanding grants, and the exercise price of outstanding grants.

Item 13. Certain Relationships and Related Transactions

Information related to a time-share arrangement between the company and Mr. Sidney Taurel, chairman and chief executive officer, relating to his board-mandated personal use of the corporate aircraft, can be found in the Proxy Statement under “Related Transaction” at page 82. That information is incorporated in this report by reference.

Item 14. Principal Accountant Fees and Services

Information related to the fees and services of our independent auditor, Ernst & Young LLP, can be found in the Proxy Statement under “Services Performed by the Independent Auditor” and “Independent Auditor Fees” at pages 74-75. That information is incorporated in this report by reference.

Item 15. Exhibits and Financial Statement Schedules

(a)1. Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are found at Item 8:

- Consolidated Statements of Income — Years Ended December 31, 2005, 2004, and 2003
- Consolidated Balance Sheets — December 31, 2005 and 2004
- Consolidated Statements of Cash Flows — Years Ended December 31, 2005, 2004, and 2003
- Consolidated Statements of Comprehensive Income — Years Ended December 31, 2005, 2004, and 2003

- Segment Information
- Notes to Consolidated Financial Statements

(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 Norwest Bank Minnesota, N.A., as successor Rights Agent
4.2	Amendment No. 1 to Rights Agreement dated as of May 27, 2003, between Eli Lilly and Company and Wells Fargo Bank Minnesota, N.A., as successor Rights Agent
4.3	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
4.4	Form of Standard Multiple-Series Indenture Provisions dated, and filed with the Securities and Exchange Commission on, February 1, 1991
4.5	Form of Indenture dated March 10, 1998, among The Lilly Savings Plan Master Trust Fund C, as issuer; Eli Lilly and Company, as guarantor; and The Chase Manhattan Bank, as Trustee, relating to ESOP Amortizing Debentures due 2017[1]
4.6	Form of Fiscal Agency Agreement dated May 30, 2001, between Eli Lilly and Company and Citibank, N.A., Fiscal Agent, relating to Resetable Floating Rate Debt Security due May 15, 2037[1]
4.7	Form of Resetable Floating Rate Debt Security due May 15, 2037[1]
4.8	Form of Indenture, dated as of August 9, 2005, by and among Eli Lilly and Company, Eli Lilly Services, Inc., and Citibank, N.A., as trustee[1]
4.9	Form of Floating Rate Note of Eli Lilly Services, Inc. due September 12, 2008[1]

[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.

10.1	1994 Lilly Stock Plan, as amended[2]
10.2	1998 Lilly Stock Plan, as amended[2]
10.3	2002 Lilly Stock Plan, as amended[2]
10.4	Lilly GlobalShares Stock Plan, as amended[2]
10.5	The Lilly Deferred Compensation Plan, as amended[2]
10.6	The Lilly Directors' Deferral Plan, as amended[2]
10.7	The Eli Lilly and Company Bonus Plan, as amended[2]
10.8	Eli Lilly and Company Change in Control Severance Pay Plan for Select Employees, as amended[2]
10.9	2007 Change in Control Severance Pay Plan for Select Employees[2]
10.10	Summary of 2006 Compensation for Non-employee Directors[2]
10.11	Summary of 2006 Compensation for Named Executive Officers[2]
10.12	Letter agreement between the company and Charles E. Golden concerning retirement benefits[2]
10.13	Letter agreement between the company and Steven M. Paul, M.D. concerning retirement benefits[2]
10.14	Arrangement regarding retirement benefits for Robert A. Armitage[2]
10.15	Time Sharing Agreement between the company and Sidney Taurel for use of corporate aircraft
10.16	Master Settlement Agreement regarding Zyprexa product liability claims
12.	Computation of Ratio of Earnings from Continuing Operations to Fixed Charges
21.	List of Subsidiaries
23.	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a-14(a) Certification of Sidney Taurel, Chairman of the Board and Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Charles E. Golden, Executive Vice President and Chief Financial Officer
32.	Section 1350 Certification

[2]Indicates management contract or compensatory plan.

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 and Chief Executive Officer

February 28, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 28, 2006 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, 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/ Sir Winfried Bischoff SIR WINFRIED BISCHOFF	Director
/s/ J. Michael Cook J. MICHAEL COOK	Director
/s/ Martin S. Feldstein, PH.D MARTIN S. FELDSTEIN, PH.D	Director
/s/ J. Erik Fyrwald J. ERIK FYRWALD	Director
/s/ George M. C. Fisher GEORGE M. C. FISHER	Director
/s/ Karen N. Horn, PH.D KAREN N. HORN, PH.D	Director
/s/ Alfred G. Gilman, M.D.,PH.D ALFRED G. GILMAN, M.D.,PH.D	Director
/s/ John C. Lechleiter, PH.D JOHN C. LECHLEITER, PH.D	Director

Signature	Title
/s/ Ellen R. Marram ELLEN R. MARRAM	Director
/s/ Franklyn G. Prendergast, M.D.,PH.D FRANKLYN G. PRENDERGAST, M.D.,PH.D	
/s/ Kathi P. Seifert KATHI P. SEIFERT	Director

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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 ® or ™, 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 3.1 to the Company's Report on Form 10-K for the year ended December 31, 2003
3.2	By-laws, as amended	Attached
4.1	Rights Agreement dated as of July 20, 1998, between Eli Lilly and Company and Wells Fargo Bank Minnesota, N.A., as successor Rights Agent	Incorporated by reference from Exhibit 4.1 to the Company's Report on Form 10-K for the year ended December 31, 2003
4.2	Amendment No. 1 to Rights Agreement dated as of May 27, 2003, between Eli Lilly and Company and Wells Fargo Bank Minnesota, N.A., as successor Rights Agent	Incorporated by reference from Exhibit 4.2 to the Company's Form 8-A/A, Amendment No. 1, dated May 29, 2003
4.3	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, Amendment No. 1, Registration No. 333-106478
4.4	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, Amendment No. 1, Registration No. 333-106478
4.5	Form of Indenture dated March 10, 1998, among The Lilly Savings Plan Master Trust Fund C, as issuer; Eli Lilly and Company, as guarantor; and The Chase Manhattan Bank, as Trustee, relating to ESOP Amortizing Debentures due 2017	*
4.6	Form of Fiscal Agency Agreement dated May 30, 2001, between Eli Lilly and Company and Citibank, N.A., Fiscal Agent, relating to Resettable Floating Rate Debt Security due May 15, 2037	*
4.7	Form of Resettable Floating Rate Debt Security due May 15, 2037	*
4.8	Form of Indenture dated as of August 9, 2005, by and among Eli Lilly and Company, Eli Lilly Services, Inc., and Citibank, N.A. as trustee	*
4.9	Form of Floating Rate Note of Eli Lilly Services, Inc. due September 12, 2008	*
10.1	1994 Lilly Stock Plan, as amended	Incorporated by reference from Exhibit 10.1 to the Company's Report on Form 10-Q for the quarter ended September 30, 2001

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Exhibit		Location
10.2	1998 Lilly Stock Plan, as amended	Incorporated by reference from Exhibit 10.2 to the Company's Report on Form 10-Q for the quarter ended September 30, 2001
10.3	2002 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, 2004
10.4	The Lilly GlobalShares Stock Plan, as amended	Incorporated by reference from Exhibit 10.5 to the Company's Report of Form 10-K for the year ended December 31, 2003
10.5	The Lilly Deferred Compensation Plan, as amended	Incorporated by reference from Exhibit 10.1 to the Company's Report on Form 10-Q for the quarter ended June 30, 2004
10.6	The Lilly Directors' Deferral Plan, as amended	Incorporated by reference from Exhibit 10.7 to the Company's Report on Form 10-K for the year ended December 31, 2003
10.7	The Eli Lilly and Company Bonus Plan, as amended	Attached
10.8	Eli Lilly and Company Change in Control Severance Pay Plan for Select Employees, as amended	Incorporated by reference from Exhibit 10.2 to the Company's Report on Form 10-Q for the quarter ended June 30, 2004
10.9	2007 Change in Control Severance Pay Plan for Select Employees	Incorporated by reference from Exhibit 10.3 to the Company's Report on Form 10-Q for the quarter ended June 30, 2004
10.10	Summary of 2006 Compensation for Non- employee Directors	Attached
10.11	Summary of 2006 Compensation for Named Executive Officers	Attached
10.12	Letter agreement between the Company and Charles E. Golden concerning retirement benefits	Incorporated by reference from Exhibit 10.13 to the Company's Report on Form 10-K for the year ended December 31, 2004
10.13	Letter agreement between the Company and Steven M. Paul, M.D. concerning retirement benefits	Incorporated by reference from Exhibit 10.14 to the Company's Report on Form 10-K for the year ended December 31, 2004
10.14	Arrangement regarding retirement benefits for Robert A. Armitage	Incorporated by reference from Exhibit 10.15 to the Company's Report on Form 10-K for the year ended December 31, 2004

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Exhibit		Location
10.15	Time Sharing Agreement between the Company and Sidney Taurel for use of corporate aircraft	Incorporated by reference from Exhibit 10.16 to the Company's Report on Form 10-K for the year ended December 31, 2004
10.16	Master Settlement Agreement regarding Zyprexa product liability claims	Incorporated by reference from Exhibit 10.2 to the Company's Report on Form 10-Q for the quarter ended September 30, 2005
12.	Statement regarding Computation of Ratio of Earnings from Continuing Operations to Fixed Charges	Attached
21.	List of Subsidiaries	Attached
23.	Consent of Independent Registered Public Accounting Firm	Attached
31.1	Rule 13a-14(a) Certification of Sidney Taurel, Chairman of the Board and Chief Executive Officer	Attached
31.2	Rule 13a-14(a) Certification of Charles E. Golden, Executive Vice President and Chief Financial Officer	Attached
32	Section 1350 Certification	Attached

*Not filed with this report. Copies will be furnished to the Securities and Exchange Commission upon request.

Exhibit 3.2

ELI LILLY AND COMPANY

BY-LAWS

As Amended through

February 20, 2006

ELI LILLY AND COMPANY

BY-LAWS

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Board of Directors

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Indemnification

ARTICLE VII

Miscellaneous

BY-LAWS
of
ELI LILLY AND COMPANY
(An Indiana Corporation)

ARTICLE I

The Shareholders

SECTION 1.0. *Annual Meetings*. The annual meeting of the shareholders of the Corporation for the election of directors and for the transaction of such other business as properly may come before the meeting shall be held on the third Monday in April in each year; provided, however, that for a particular year the Board of Directors may designate another date not later than June 30 of that year by resolution adopted by not less than a majority of the directors then in office. Failure to hold an annual meeting of the shareholders at such designated time shall not affect otherwise valid corporate acts or work a forfeiture or dissolution of the Corporation.

SECTION 1.1. *Special Meetings*. Special meetings of the shareholders may be called at any time by the Board of Directors or the Chairman of the Board of Directors..

SECTION 1.2. *Time, Place, and Conduct of Meetings*. Each meeting of the shareholders shall be held at such time of day and place, either within or without the State of Indiana, as shall be determined by the Board of Directors. Each adjourned meeting of the shareholders shall be held at such time and place as may be provided in the motion for adjournment. The chairman of each meeting shall have sole authority to decide questions relating to the conduct of that meeting.

SECTION 1.3. *Notice of Meetings*. The Secretary shall cause a written or printed notice of the place, day and hour and the purpose or purposes of each meeting of the shareholders to be delivered or mailed (which may include by facsimile or other form of electronic communication) at least ten (10) but not more than sixty (60) days prior to the meeting, to each shareholder of record entitled to vote at the meeting, at the shareholder's address as the same appears on the records maintained by the Corporation. Notice of any such shareholders meeting may be waived by any shareholder by delivering a written waiver to the Secretary before or after such meeting. Attendance at any meeting in person or by proxy when the instrument of proxy sets forth in reasonable detail the purpose or purposes for which the meeting is called, shall constitute a waiver of notice thereof. Notice of any adjourned meeting of the shareholders of the Corporation shall not be required to be given unless otherwise required by statute.

SECTION 1.4. *Quorum*. At any meeting of the shareholders a majority of the outstanding shares entitled to vote on a matter at such meeting, represented in person or by proxy, shall constitute a quorum for action on that matter. In the absence of a quorum, the chairman of the meeting or the holders of a majority of the shares entitled to vote present in person or by proxy, or, if no shareholder entitled to vote is present in person or by proxy, any

officer entitled to preside at or act as Secretary of such meeting, may adjourn such meeting from time to time, until a quorum shall be present. At any such adjourned meeting at which a quorum may be present any business may be transacted which might have been transacted at the meeting as originally called.

SECTION 1.5. *Voting*. Except as otherwise provided by statute or by the Articles of Incorporation, at each meeting of the shareholders each holder of shares entitled to vote shall have the right to one vote for each share standing in the shareholder's name on the books of the Corporation on the record date fixed for the meeting under Section 1.7. Each shareholder entitled to vote shall be entitled to vote in person or by proxy executed in writing (which shall include facsimile) or transmitted by electronic submission by the shareholder or a duly authorized attorney in fact. The vote of shareholders approving any matter to which the provisions of Article 9(c) or 9(d) or Article 13 of the Articles of Incorporation or of a statute are applicable shall require the percentage of affirmative vote therein specified. All other matters, except the election of directors, shall require that the votes cast in favor of the matter exceed the votes cast opposing the matter at a meeting at which a quorum is present. In the event that more than one group of shares is entitled to vote as a separate voting group, the vote of each group shall be considered and decided separately.

SECTION 1.6. *Voting Lists*. The Secretary shall make or cause to be made, after a record date for a meeting of shareholders has been fixed under Section 1.7 and at least five (5) days before such meeting, a complete list of the shareholders entitled to vote at such meeting, arranged in alphabetical order, with the address of each such shareholder and the number of shares so entitled to vote held by each which list shall be on file at the principal office of the Corporation and subject to inspection by any shareholder entitled to vote at the meeting. Such list shall be produced and kept open at the time and place of the meeting and subject to the inspection of any such shareholder during the holding of such meeting or any adjournment. Except as otherwise required by law, such list shall be the only evidence as to who are the shareholders entitled to vote at any meeting of the shareholders. In the event that more than one group of shares is entitled to vote as a separate voting group at the meeting, there shall be a separate listing of the shareholders of each group.

SECTION 1.7. *Fixing of Record Date.* For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors shall fix in advance a date as the record date for any such determination of shareholders, not more than seventy (70) days prior to the date on which the particular action requiring this determination of shareholders is to be taken. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, the determination shall, to the extent permitted by law, apply to any adjournment thereof.

SECTION 1.8. *Notice of Shareholder Business*. At an annual meeting of the shareholders, only such business shall be conducted as shall have been properly brought before

the meeting. To be properly brought before an annual meeting, business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (c) otherwise properly brought before the meeting by a shareholder. For business to be properly brought before an annual meeting by a shareholder, the shareholder must have the legal right and authority to make the proposal for consideration at the meeting and the shareholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a shareholder's notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than one hundred twenty (120) calendar days in advance of the date of the Corporation's proxy statement released to shareholders in connection with the previous year's annual meeting of shareholders; provided, however, that in the event that no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) days from the date contemplated at the time of the previous year's proxy statement, notice by the shareholder to be timely must be so received not later than the close of business on the later of one hundred twenty (120) calendar days in advance of such annual meeting or ten (10) calendar days following the date on which public announcement of the date of the meeting is first made.

A shareholder's notice to the Secretary shall set forth as to each matter the shareholder proposes to bring before the annual meeting (a) a brief description of the business described to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (b) the name and record address of the shareholder(s) proposing such business, (c) the class and number of the Corporation's shares which are beneficially owned by such shareholder(s), and (d) any material interest of such shareholder(s) in such business. Notwithstanding anything in these By-laws to the contrary, no business shall be conducted at an annual meeting except in accordance with the procedures set forth in this Section 1.8. The chairman of an annual meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting and in accordance with the provisions of this Section 1.8, and if the chairman should so determine, he or she shall so declare to the meeting any such business not properly brought before the meeting shall not be transacted. At any special meeting of the shareholders, only such business shall be conducted as shall have been brought before the meeting by or at the direction of the Board of Directors.

SECTION 1.9. *Notice of Shareholder Nominees*. Only persons who are nominated in accordance with the procedures set forth in this Section 1.9 shall be eligible for election as Directors. Nominations of persons for election to the Board of Directors may be made at or prior to a meeting of shareholders by or at the direction of the Board of Directors or by any nominating committee or person appointed by or at the direction of the Board of Directors, and at a meeting of shareholders by any shareholder entitled to vote for the election of Directors at the meeting who complies with the notice procedures set forth in this Section 1.9. Such nominations, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the Corporation. To be timely, a shareholder's notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than one hundred twenty (120) calendar days in advance of the date of the Corporation's proxy statement released to shareholders in connection with the previous year's annual meeting of shareholders; provided, however, that in the event that no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) days

from the date contemplated at the time of the previous year's proxy statement, notice by the shareholder to be timely must be so received not later than the close of business on the later of one hundred twenty (120) calendar days in advance of such annual meeting or ten (10) calendar days following the date on which public announcement of the date of the meeting is first made.

Such shareholder's notice shall set forth (a) as to each person whom the shareholder proposes to nominate for election or re-election as a director, (i) the name, age, business address and residence address of such person; (ii) the principal occupation or employment of such person; (iii) the class and number of the Corporation's shares which are beneficially owned by such person; and (iv) to the extent reasonably available to the shareholder, any other information relating to such person that is required to be disclosed in solicitations of proxies for election of Directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including without limitation such person's written consent to being named in the proxy statement as a nominee and to serving as a Director if elected); and (b) as to the shareholder giving the notice (i) the name and record address of such shareholder and (ii) the class and number of the Corporation's shares which are beneficially owned by such shareholder. No person shall be eligible for election as a director of the Corporation unless nominated in accordance with the procedures set forth in this Section 1.9. The chairman of the meeting may, if the facts warrant, determine and declare to the meeting that a nomination was not so declared in accordance with the procedures prescribed by these By-laws, and if the chairman should so determine, he or she shall so declare to the meeting and the defective nomination shall be disregarded.

ARTICLE II

Board of Directors

SECTION 2.0. *General Powers.* The property, affairs and business of the Corporation shall be managed under the direction of the Board of Directors.

SECTION 2.1. *Number and Qualifications.* The number of directors which shall constitute the whole Board of Directors shall be sixteen (16), which number may be either increased or diminished by resolution adopted by not less than a majority of the directors then in office; provided that the number may not be diminished below nine (9) and no reduction in number shall have the effect of shortening the term of any incumbent director. In the event that the holders of shares of preferred stock become entitled to elect two directors, the number of directors and the minimum number of directors shall be increased by two. Neither ownership of stock of the Corporation nor residence in the State of Indiana shall be required as a qualification for a director.

SECTION 2.2. *Classes of Directors and Terms*. The directors shall be divided into three classes as nearly equal in number as possible. Except as provided in Article 9 of the Articles of Incorporation fixing one, two, and three year terms for the initial classified board, each class of directors shall be elected for a term of three (3) years. In the event of vacancy, either by death, resignation, or removal of a director, or by reason of an increase in the number of directors, each

replacement or new director shall serve for the balance of the term of the class of the director he or she succeeds or, in the event of an increase in the number of directors, of the class to which he or she is assigned. All directors elected for a term shall continue in office until the election and qualification of their respective successors, their death, their resignation in accordance with Section 2.6, their removal in accordance with Section 2.7, or if there has been a reduction in the number of directors and no successor is to be elected, until the end of the term.

SECTION 2.3. *Election of Directors.* At each annual meeting of shareholders, the class of directors to be elected at the meeting shall be chosen by a plurality of the votes cast by the holders of shares entitled to vote in the election at the meeting, provided a quorum is present. The election of directors by the shareholders shall be by written ballot if directed by the chairman of the meeting or if the number of nominees exceeds the number of directors to be elected.

Any vacancy on the Board of Directors shall be filled by the affirmative vote of a majority of the remaining directors.

If the holders of preferred stock are entitled to elect any directors voting separately as a class, those directors shall be elected by a plurality of the votes cast by the holders of shares of preferred stock entitled to vote in the election at the meeting, provided a quorum of the holders of shares of preferred stock is present.

SECTION 2.4. *Meetings of Directors*.

a. Annual Meeting. Unless otherwise provided by resolution of the Board of Directors, the annual meeting of the Board of Directors shall be held at the place of and immediately following the annual meeting of shareholders, for the purpose of organization, the election of officers and the transaction of such other business as properly may come before the meeting. No notice of the meeting need be given, except in the case an amendment to the By-laws is to be considered.

b. Regular Meetings. The Board of Directors by resolution may provide for the holding of regular meetings and may fix the times and places (within or outside the State of Indiana) at which those meetings shall be held. Notice of regular meetings need not be given except when an amendment to the By-laws is to be considered. Whenever the time or place of regular meetings shall be fixed or changed, notice of this action shall be mailed promptly to each director not present when the action was taken, addressed to the director at his or her residence or usual place of business.

c. Special Meetings. Special meetings of the Board of Directors may be called by the Chairman of the Board and shall be called by the Secretary at the request of any three (3) directors. Except as otherwise required by statute, notice of each special meeting shall be mailed to each director at his or her residence or usual place of business at least three (3) days before the day on which the meeting is to be held, or shall be sent to the director at such place by facsimile transmission or other form of electronic communication or personally delivered, not later than the day before the day on which the meeting is to be held. The notice shall state the time and place (which may be within or outside the State of Indiana) of the meeting but, unless otherwise

required by statute, the Articles of Incorporation or the By-laws, need not state the purposes thereof.

Notice of any meeting need not be given to any director, however, who shall attend the meeting, or who shall waive notice thereof, before, at the time of, or after the meeting, in a writing signed by the director and delivered to the Corporation. No notice need be given of any meeting at which every member of the Board of Directors shall be present.

SECTION 2.5. *Quorum and Manner of Acting.* A majority of the actual number of directors established pursuant to Section 2.1, from time to time, shall be necessary to constitute a quorum for the transaction of any business except the filling of vacancies on the Board of Directors under Section 2.3 or voting on a conflict of interest transaction under Section 2.12. The act of a majority of the directors present at a meeting at which a quorum is present, shall be the act of the Board of Directors, unless the act of a greater number is required by statute, by the Articles of Incorporation, or by the By-laws. Under the provisions of Article 13 of the Articles of Incorporation, certain actions by the Board of Directors therein specified require not only approval by the Board of Directors, but also approval by a majority of the Continuing Directors, as therein defined. Any or all directors may participate in a meeting of the Board of Directors by means of a conference telephone or similar communications equipment by which all persons participating in the meeting may simultaneously hear each other, and participation in this manner shall constitute presence in person at the meeting. In the absence of a quorum, a majority of the directors present may adjourn the meeting from time to time until a quorum shall be present. No notice of any adjourned meeting need be given.

SECTION 2.6. *Resignations*. Any director may resign at any time by giving written notice of resignation to the Board of Directors, the Chairman of the Board, the Chief Executive Officer, or the Secretary. Unless otherwise specified in the written notice, the resignation shall take effect upon receipt thereof and unless otherwise specified in it, the acceptance of the resignation shall not be necessary to make it effective.

SECTION 2.7. *Removal of Directors*. Any director, other than a director elected by holders of preferred stock voting as a class, may be removed from office at any time but only for cause and only upon the affirmative vote of at least 80 percent of the votes entitled to be cast by holders of all of the outstanding shares of Voting Stock (as defined in Article 13 of the Articles of Incorporation), voting together as a single class.

SECTION 2.8. *Action without a Meeting*. Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if taken by all members of the Board of Directors or such committee, as the case may be, evidenced by a written consent signed by all such members and effective on the date, either prior or subsequent to the date of the consent, specified in the written consent, or if no effective date is specified in the written consent, the date on which the consent is filed with the minutes of proceedings of the Board of Directors or committee.

SECTION 2.9. *Attendance and Failure to Object*. A director, who is present at a meeting of the Board of Directors, at which action on any corporate matter is taken, shall be presumed to have assented to the action taken, unless (a) the director's dissent shall be entered in the minutes of the meeting, (b) the director shall file a written dissent to such action with the Secretary of the meeting before adjournment thereof, or (c) the director shall forward such dissent by registered mail to the Secretary immediately after adjournment of the meeting. The right of dissent provided for by the preceding sentence shall not be available, in respect of any matter acted upon at any meeting, to a director who voted in favor of such action.

SECTION 2.10. *Special Standing Committees*. The Board of Directors, by resolution adopted by a majority of the actual number of directors elected and qualified, may designate from among its members one or more committees. Such committees shall have those powers of the Board of Directors which may by law be delegated to such committees and are specified by resolution of the Board of Directors or by committee charters approved by the Board of Directors.

SECTION 2.11. *Appointment of Auditors*. The Board of Directors or the Audit Committee of the Board of Directors, prior to each annual meeting of shareholders, shall appoint a firm of independent public accountants as auditors of the Corporation. Such appointment shall be submitted to the shareholders for ratification at the annual meeting next following such appointment. Should the shareholders fail to ratify the appointment of any firm as auditors of the Corporation, or should the Board of Directors or Audit Committee for any reason determine that any such appointment be terminated, the Board of Directors or Audit Committee shall appoint another firm of independent public accountants to act as auditors of the Corporation and such appointment shall be submitted to the shareholders for ratification at the annual or special shareholders meeting next following such appointment.

SECTION 2.12. *Transactions with Corporation*. No transactions with the Corporation in which one or more of its directors has a direct or indirect interest shall be either void or voidable solely because of such interest if any one of the following is true:

(a) the material facts of the transaction and the director's interest are disclosed or known to the Board of Directors or committee which authorizes, approves, or ratifies the transaction by the affirmative vote or consent of a majority of the directors (or committee members) who have no direct or indirect interest in the transaction and, in any event, of at least two directors (or committee members);

(b) the material facts of the transaction and the director's interest are disclosed or known to the shareholders entitled to vote and they authorize, approve or ratify such transaction by vote; or

(c) the transaction is fair to the Corporation.

If a majority of the directors or committee members who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for purposes of taking action under subsection (a) of this section. The presence of, or a vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any actions taken under subsection (a) of this section.

SECTION 2.13. *Compensation of Directors*. The Board of Directors is empowered and authorized to fix and determine the compensation of directors and additional compensation for such additional services any of such directors may perform for the Corporation.

ARTICLE III

Officers

SECTION 3.0. *Officers, General Authority and Duties*. The officers of the Corporation shall be a Chairman of the Board, Chief Executive Officer, a President, two (2) or more Vice Presidents, a Secretary, a Chief Financial Officer, a Treasurer, a Chief Accounting Officer, and such other officers as may be elected or appointed in accordance with the provisions of Section 3.2. One or more of the Vice Presidents may be designated by the Board to serve as Executive Vice Presidents, Senior Vice Presidents, or Group Vice Presidents. Any two (2) or more offices may be held by the same person. All officers and agents of the Corporation, as between themselves and the Corporation, shall have such authority and perform such duties in the management of the Corporation as may be provided in the By-laws or as may be determined by resolution of the Board of Directors not inconsistent with the By-laws.

SECTION 3.1. *Election, Term of Office, Qualifications*. Each officer (except such officers as may be appointed in accordance with the provisions of Section 3.2. of this Article III) shall be elected by the Board of Directors at each annual meeting. Each such officer (whether elected at an annual meeting of the Board of Directors or to fill a vacancy or otherwise) shall hold office until the officer's successor is chosen and qualified, or until death, or until the officer shall resign in the manner provided in Section 3.3. or be removed in the manner provided in Section 3.4. The Chairman of the Board and the Chief Executive Officer shall be members of the Board of Directors. Any other officer may but need not be a director of the Corporation. Election or appointment of an officer or agent shall not of itself create contract rights.

SECTION 3.2. *Other Officers, Election or Appointment*. The Board of Directors from time to time may elect such other officers or agents (including one or more Assistant Vice Presidents, one or more Assistant Secretaries, one or more Assistant Treasurers, a Controller, and one or more Assistant Controllers) as it may deem necessary or advisable. The Board of Directors may delegate to any officer the power to appoint any such officers or agents and to prescribe their respective terms of office, powers and duties.

SECTION 3.3. *Resignation*. Any officer may resign at any time by giving written notice of such resignation to the Board of Directors, the Chairman of the Board, the Chief Executive Officer or the Secretary of the Corporation. Unless otherwise specified in such written notice, such resignation shall take effect upon receipt thereof and unless otherwise specified in it, the acceptance of the resignation shall not be necessary to make it effective.

SECTION 3.4. *Removal*. The officers specifically designated in Section 3.0. may be removed, either for or without cause, at any meeting of the Board of Directors called for the purpose, by the vote of a majority of the actual number of directors elected and qualified. The officers and agents elected or appointed in accordance with the provisions of Section 3.2. may be removed, either for or without cause, at any meeting of the Board of Directors at which a quorum be present, by the vote of a majority of the directors present at such meeting, by any superior officer upon whom such power of removal shall have been conferred by the Board of Directors, or by any officer to whom the power to appoint such officer has been delegated by the Board of Directors pursuant to Section 3.2. Any removal shall be without prejudice to the contract rights, if any, of the person so removed.

SECTION 3.5. *Vacancies*. A vacancy in any office by reason of death, resignation, removal, disqualification or any other cause, may be filled by the Board of Directors or by an officer authorized under Section 3.2. to appoint to such office.

SECTION 3.6. *Chairman of the Board of Directors*. The Chairman of the Board shall preside at all meetings of the shareholders and of the Board of Directors if present and shall have such powers and perform such duties as are assigned to him or her by the By-laws and by the Board of Directors. At any time in which neither the Chairman nor the Chief Executive Officer is able to perform the duties and exercise the powers of the Chairman, then the Board's presiding or lead director (if one shall have have been previously selected) shall perform such duties and exercise such powers.

SECTION 3.7. *Chief Executive Officer*. The Chief Executive Officer shall, subject to the control of the Board of Directors, have general supervision over the management and direction of the business of the Corporation. He or she shall see that all orders and resolutions of the Board of Directors are carried into effect. The Chief Executive Officer shall have such other powers and perform such other duties as are assigned to him or her by the By-laws or the Board of Directors. The Chief Executive Officer shall perform the duties and exercise the powers of the Chairman of the Board at any time that the Chairman of the Board is unable to do so, and shall also perform the duties and exercise the powers of the President at any time that the President is unable to do so.

SECTION 3.8. *President.* The President shall have such powers and perform such duties as are assigned to him or her by the Chief Executive Officer, the By-laws or the Board of Directors. The President shall perform the duties and exercise the powers of the Chief Executive Officer at any time that the Chief Executive Officer is unable to do so. If the President is also a director, he or she shall perform the duties and exercise the powers of the Chairman of the Board

at any time that none of the Chairman of the Board, the Chief Executive Officer, or the presiding or lead director is able to do so.

SECTION 3.9. *Executive Vice Presidents*. Each Executive Vice President shall have such powers and perform such duties as may be assigned to him or her by the President or the Board of Directors. The Executive Vice Presidents, in order of their seniority in office as Executive Vice Presidents (and, between two or more of equal seniority in office as Executive Vice Presidents, in order of their seniority in office as Vice Presidents), shall perform the duties and exercise the powers of the Chief Executive Officer and the President at any time that both the Chief Executive Officer and the President are unable to do so.

SECTION 3.10. *Senior Vice Presidents and Group Vice Presidents*. Each Senior Vice President and each Group Vice President shall perform such duties and have such powers as may be assigned to him or her by the Chief Executive Officer, the President or the Board of Directors. The Senior Vice Presidents, in order of their seniority in office as Senior Vice Presidents (and between two or more of equal seniority in office as Senior Vice Presidents, in order of their seniority in office as Vice Presidents), shall perform the duties and exercise the powers of the Chief Executive Officer and the President at any time that the Chief Executive Officer, the President, and all the Executive Vice Presidents are unable to do so.

SECTION 3.11. *Vice Presidents*. Each Vice President shall perform such duties and have such powers as may be assigned to him or her by the Chief Executive Officer, the President or the Board of Directors.

SECTION 3.12. *Secretary*. The Secretary shall:

(a) record all the proceedings of the meetings of the shareholders and Board of Directors in books to be kept for such purposes;

(b) cause all notices to be duly given in accordance with the provisions of these By-laws and as required by statute;

(c) be custodian of the Seal of the Corporation, and cause such Seal to be affixed to all certificates representing shares of the Corporation prior to the issuance thereof (subject, however, to the provisions of Section 5.0) and to all instruments the execution of which on behalf of the Corporation under its Seal shall have been duly authorized in accordance with these By-laws;

(d) subject to the provisions of Section 5.0, sign certificates representing shares of the Corporation the issuance of which shall have been authorized by the Board of Directors; and

(e) in general, perform all duties incident to the office of Secretary and such other duties as are given to the Secretary by these By-laws or as may be assigned to him or her by the Chairman of the Board, the Chief Executive Officer, the President or the Board of Directors.

SECTION 3.13. *Assistant Secretaries*. Each Assistant Secretary shall assist the Secretary in his or her duties, and shall perform such other duties as the Board of Directors may from time to time prescribe or the Chief Executive Officer, the President or the Secretary may from time to time delegate. At the request of the Secretary, any Assistant Secretary may temporarily act in the Secretary's place in the performing of part or all of the duties of the Secretary. In the case of the death of the Secretary, or in the case of the Secretary's absence or inability to act without having designated an Assistant Secretary to act temporarily in his or her place, the Assistant Secretary who is to perform the duties of the Secretary shall be designated by the Chief Executive Officer or the Board of Directors.

SECTION 3.14. *Chief Financial Officer*. The Chief Financial Officer shall:

(a) have supervision over and be responsible for the funds, securities, receipts, and disbursements of the Corporation;

(b) cause to be kept at the principal business office of the Corporation and preserved for review as required by law or regulation records of financial transactions and correct books of account using appropriate accounting principles;

(c) be responsible for the establishment of adequate internal control over the transactions and books of account of the Corporation;

(d) be responsible for rendering to the proper officers and the Board of Directors upon request, and to the shareholders and other parties as required by law or regulation, financial statements of the Corporation; and

(e) in general perform all duties incident to the office and such other duties as are given by the By-laws or as may be assigned by the Chief Executive Officer, the President or the Board of Directors.

SECTION 3.15. *Treasurer*. The Treasurer shall:

(a) have charge of the funds, securities, receipts and disbursements of the Corporation;

(b) cause the moneys and other valuable effects of the Corporation to be deposited or invested in the name and to the credit of the Corporation in such banks or trust companies or with such bankers or other depositories or investments as shall be selected in accordance with resolutions adopted by the Board of Directors;

(c) cause the funds of the Corporation to be disbursed from the authorized depositories of the Corporation, and cause to be taken and preserved proper records of all moneys disbursed; and

(d) in general, perform all duties incident to the office of Treasurer and such other duties as are given to the Treasurer by the By-laws or as may be assigned to him or her by the Chief Executive Officer, the President, the Chief Financial Officer, or the Board of Directors.

SECTION 3.16. *Assistant Treasurers*. Each Assistant Treasurer shall assist the Treasurer in his or her duties, and shall perform such other duties as the Board of Directors may from time to time prescribe or the President or the Chief Financial Officer may from time to time delegate. At the request of the Treasurer, any Assistant Treasurer may temporarily act in the Treasurer's place in performing part or all of the duties of the Treasurer. In the case of the death of the Treasurer, or in the case of the Treasurer's absence or inability to act without having designated an Assistant Treasurer to act in his or her place, the Assistant Treasurer who is to perform the duties of the Treasurer shall be designated by the Chief Executive Officer, the President, the Chief Financial Officer or the Board of Directors.

SECTION 3.17. *Chief Accounting Officer*. The Chief Accounting Officer shall:

(a) keep full and accurate accounts of all assets, liabilities, commitments, revenues, costs and expenses, and other financial transactions of the Corporation in books belonging to the Corporation, and conform them to sound accounting principles with adequate internal control;

(b) cause regular audits of these books and records to be made;

(c) see that all expenditures are made in accordance with procedures duly established, from time to time, by the Corporation;

(d) render financial statements upon the request of the Board of Directors, and a full financial report prior to the annual meeting of shareholders, as well as such other financial statements as are required by law or regulation; and

(e) in general, perform all the duties ordinarily connected with the office of Chief Accounting Officer and such other duties as may be assigned to him or her by the Chief Executive Officer, the President, the Chief Financial Officer, or the Board of Directors.

SECTION 3.18. *General Counsel*. The Board of Directors may appoint a general counsel who shall have general control of all matters of legal import concerning the Corporation.

SECTION 3.19. *Other Officers or Agents*. Any other officers or agents elected or appointed pursuant to Section 3.2 shall have such duties and responsibilities as may be fixed from time to time by the By-laws or as may be assigned to them by the Chief Executive Officer, the President or the Board of Directors.

SECTION 3.20. *Chairman Emeritus.* In recognition of distinguished service to the Corporation, the Board of Directors may designate a person who has served as Chairman of the Board and who is no longer an employee, officer, or director as Chairman Emeritus. The Chairman Emeritus may serve to represent the Corporation at the request of the Chairman of the Board.

SECTION 3.21. *Compensation*. The compensation of executive officers of the Corporation shall be fixed from time to time by the Compensation Committee (or successor committee) established pursuant to Section 2.10. Unless the Board of Directors by resolution shall direct otherwise, the compensation of employees who are not executive officers of the Corporation shall be fixed by the management of the Company. No employee shall be prevented from receiving compensation by reason of being a director of the Corporation.

SECTION 3.22. *Surety Bonds*. In case the Board of Directors shall so require, any officer or agent of the Corporation shall execute to the Corporation a bond in such sum and with such surety or sureties as the Board of Directors may direct, conditioned upon the faithful performance of his or her duties to the Corporation, including responsibility for negligence and for the accounting of all property, funds or securities of the Corporation which the officer or agent may handle.

ARTICLE IV

Execution of Instruments and Deposit of Corporate Funds

SECTION 4.0. *Execution of Instruments Generally*. All deeds, contracts, and other instruments requiring execution by the Corporation may be signed by the Chairman of the Board, the Chief Executive Officer, the President or any Vice President. Authority to sign any deed, contract, or other instrument requiring execution by the Corporation may be conferred by the Board of Directors upon any person or persons whether or not such person or persons be officers of the Corporation. Such person or persons may delegate, from time to time, by instrument in writing, all or any part of such authority to any other person or persons if authorized so to do by the Board of Directors.

SECTION 4.1. *Notes, Checks, Other Instruments*. All notes, drafts, acceptances, checks, endorsements, and all evidences of indebtedness of the Corporation whatsoever, shall be signed by such officer or officers or such agent or agents of the Corporation and in such manner as the Board of Directors from time to time may determine. Endorsements for deposit to the credit of the Corporation in any of its duly authorized depositories shall be made in such manner as the Board of Directors from time to time may determine.

SECTION 4.2. *Proxies*. Proxies, powers of attorney, or consents to vote with respect to shares or units of other corporations or other entities owned by or standing in the name of the Corporation may be executed and delivered from time to time on behalf of the Corporation by the Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary or by any other person or persons thereunto authorized by the Board of Directors. Persons with authority to execute proxies, powers of attorney, or consents under this Section 4.2 may delegate that authority unless prohibited by the Board of Directors.

ARTICLE V

Shares

SECTION 5.0. *Certificates for Shares*. Shares in the corporation may be issued in book-entry form or evidenced by certificates. However, every holder of shares in the Corporation shall be entitled upon request to have a certificate evidencing the shares owned by the shareholder, signed in the name of the Corporation by the Chairman of the Board, the Chief Executive Officer, President or a Vice President and the Secretary or an Assistant Secretary, certifying the number of shares owned by the shareholder in the Corporation. The signatures of such officers, the signature of the transfer agent and registrar, and the Seal of the Corporation may be facsimiles. In case any officer or employee who shall have signed, or whose facsimile signature or signatures shall have been used on, any certificate shall cease to be an officer or employee of the Corporation before the certificate shall have been issued and delivered by the Corporation, the certificate may nevertheless be adopted by the Corporation and be issued and delivered as though the person or persons who signed the certificate or whose facsimile signature or signatures shall have been used thereon had not ceased to be such officer or employee of the Corporation; and the issuance and delivery by the Corporation of any such certificate shall constitute an adoption thereof. Every certificate shall state on its face (or in the case of book-entry shares, the statements evidencing ownership of such shares shall state) the name of the Corporation and that it is organized under the laws of the State of Indiana, the name of the person to whom it is issued, and the number and class of shares and the designation of the series, if any, the certificate represents, and shall state conspicuously on its front or back that the Corporation will furnish the shareholder, upon written request and without charge, a summary of the designations, relative rights, preferences and limitations applicable to each class and the variations in rights, preferences and limitations determined for each series (and the authority of the Board of Directors to determine variations for future series). Every certificate (or book-entry statement) shall state whether such shares have been fully paid and are non-assessable. If any such shares are not fully paid, the certificate (or book-entry statement) shall be legibly stamped to indicate the percentum which has been paid up, and as further payments are made thereon, the certificate shall be stamped (or book-entry statement updated) accordingly. Subject to the foregoing provisions, certificates representing shares in the Corporation shall be in such form as shall be approved by the Board of Directors. There shall be entered upon the stock books of the Corporation at the time of the issuance or transfer of each share the number of the certificates representing such share (if any), the name of the person owning the shares represented thereby, the class of such share and the date of the issuance or transfer thereof.

SECTION 5.1. *Transfer of Shares*. Transfer of shares of the Corporation shall be made on the books of the Corporation by the holder of record thereof, or by the shareholder’s attorney thereunto duly authorized in writing and filed with the Secretary of the Corporation or any of its transfer agents, and on surrender of the certificate or certificates (if any) representing such shares. The Corporation and its transfer agents and registrars, shall be entitled to treat the holder of record of any share or shares the absolute owner thereof for all purposes, and accordingly shall not be bound to recognize any legal, equitable or other claim to or interest in such share or shares on the part of any other person whether or not it or they shall have express or other notice thereof, except as otherwise expressly provided by the statutes of the State of Indiana.

Shareholders shall notify the Corporation in writing of any changes in their addresses from time to time.

SECTION 5.2. *Regulations*. Subject to the provisions of this Article V, the Board of Directors may make such rules and regulations as it may deem expedient concerning the issuance, transfer and regulation of certificates for shares or book-entry shares of the Corporation.

SECTION 5.3. *Transfer Agents and Registrars*. The Board of Directors may appoint one or more transfer agents, one or more registrars, and one or more agents to act in the dual capacity of transfer agent and registrar with respect to the certificates representing shares and the book-entry shares of the Corporation.

SECTION 5.4. *Lost or Destroyed Certificates*. The holders of any shares of the Corporation shall immediately notify the Corporation or one of its transfer agents and registrars of any loss or destruction of the certificate representing the same. The Corporation may issue a new certificate in the place of any certificate theretofore issued by it alleged to have been lost or destroyed upon such terms and under such regulations as may be adopted by the Board of Directors or the Secretary, and the Board of Directors or Secretary may require the owner of the lost or destroyed certificate or the owner's legal representatives to give the Corporation a bond in such form and for such amount as the Board of Directors or Secretary may direct, and with such surety or sureties as may be satisfactory to the Board of Directors or the Secretary to indemnify the Corporation and its transfer agents and registrars against any claim that may be made against it or any such transfer agent or registrar on account of the alleged loss or destruction of any such certificate or the issuance of such new certificate. A new certificate may be issued without requiring any bond when, in the judgment of the Board of Directors or the Secretary, it is proper so to do.

SECTION 5.5. *Redemption of Shares Acquired in Control Share Acquisitions*. Any or all control shares acquired in a control share acquisition shall be subject to redemption by the Corporation, if either:

(a) No acquiring person statement has been filed with the Corporation with respect to the control share acquisition; or

(b) The control shares are not accorded full voting rights by the Corporation's shareholders as provided in IC 23-1-42-9.

A redemption pursuant to Section 5.5(a) may be made at any time during the period ending sixty (60) days after the date of the last acquisition of control shares by the acquiring person. A redemption pursuant to Section 5.5(b) may be made at any time during the period ending two (2) years after the date of the shareholder vote with respect to the voting rights of the control shares in question. Any redemption pursuant to this Section 5.5 shall be made at the fair

value of the control shares and pursuant to such procedures for the redemption as may be set forth in these By-laws or adopted by resolution of the Board of Directors.

As used in this Section 5.5, the terms “control shares,” “control share acquisition,” “acquiring person statement” and “acquiring person” shall have the meanings ascribed to them in IC 23-1-42.

ARTICLE VI

Indemnification

SECTION 6.0. *Right to Indemnification*. The Corporation shall, to the fullest extent permitted by applicable law now or hereafter in effect, indemnify any person who is or was a director, officer or employee of the Corporation (“Eligible Person”) and who is or was involved in any manner (including, without limitation, as a party or a witness) or is threatened to be made so involved in any threatened, pending or completed investigation, claim, action, suit or proceeding, whether civil, criminal, administrative or investigative (including, without limitation, any action, suit or proceeding by or in the right of the Corporation to procure a judgment in its favor) (a “Proceeding”) by reason of the fact that such Eligible Person is or was a director, officer or employee of the Corporation or is or was serving at the request of the Corporation as a director, officer, partner, member, manager, trustee, employee, fiduciary or agent of another corporation, partnership, joint venture, limited liability company, trust or other enterprise (including, without limitation, any employee benefit plan) (a “Covered Entity”), against all expenses (including attorneys’ fees), judgments, fines or penalties against (including excise taxes assessed with respect to an employee benefit plan) and amounts paid in settlement actually and reasonably incurred by such Eligible Person in connection with such Proceeding; provided, however, that the foregoing shall not apply to a Proceeding commenced by a current or former director, officer or employee of the Corporation except for such a Proceeding commenced following a Change in Control (as hereafter defined) with respect to actions or failure to act prior to such Change in Control. Any right of an Eligible Person to indemnification shall be a contract right and shall include the right to receive, prior to the conclusion of any Proceeding, advancement of any expenses incurred by the Eligible Person in connection with such Proceeding in accordance with Section 6.3.

SECTION 6.1. *Insurance, Contracts and Funding*. The Corporation may purchase and maintain insurance to protect itself and any Eligible Person against any expense, judgments, fines and amounts paid in settlement as specified in Section 6.0 of this Article or incurred by any Eligible Person in connection with any Proceeding referred to in such section, to the fullest extent permitted by applicable law now or hereafter in effect. The Corporation may enter into agreements with any director, officer, employee or agent of the Corporation or any director, officer, employee, fiduciary or agent of any Covered Entity supplemental to or in furtherance of the provisions of this Article and may create a trust fund or use other means (including, without limitation, a letter of credit) to ensure the payment of such amounts as may be necessary to effect indemnification and advancement of expenses as provided in this Article.

SECTION 6.2. *Non-Exclusive Rights; Applicability to Certain Proceedings*. The rights provided in this Article shall not be exclusive of any other rights to which any Eligible Person may otherwise be entitled, and the provisions of this Article shall inure to the benefit of the heirs and legal representatives of any Eligible Person and shall be applicable to Proceedings commenced or continuing after the adoption of this Article, whether arising from acts or omissions occurring before or after such adoption.

SECTION 6.3. *Advancement of Expenses*. All reasonable expenses incurred by or on behalf of an Eligible Person in connection with any Proceeding shall be advanced to the Eligible Person by the Corporation within sixty (60) days after the receipt by the Corporation of a statement or statements from the Eligible Person requesting such advance or advances from time to time, whether prior to or after final disposition of such Proceeding unless a determination has been made pursuant to Section 6.4 that such Eligible Person is not entitled to indemnification. Any such statement or statements shall reasonably evidence the expenses incurred by the Eligible Person and shall include any written affirmation or undertaking to repay advances if it is ultimately determined that the Eligible Person is not entitled to indemnification under this Article.

SECTION 6.4. *Procedures; Presumptions and Effect of Certain Proceedings; Remedies*. In furtherance, but not in limitation, of the foregoing provisions, the following procedures, presumptions and remedies shall apply with respect to and the right to indemnification and advancement of expenses under this Article.

(a) To obtain indemnification under this Article, an Eligible Person shall submit to the Secretary of the Corporation a written request, including such documentation and information as is reasonably available to the Eligible Person and reasonably necessary to determine whether and to what extent the Eligible Person is entitled to indemnification (the "Supporting Documentation"). The determination of the Eligible Person's entitlement to indemnification shall be made not later than sixty (60) days after receipt by the Corporation of the written request together with the Supporting Documentation. The Secretary of the Corporation shall, promptly upon receipt of such request, advise the Board in writing of the Eligible Person's request.

(b) An Eligible Person's entitlement to indemnification under this Article shall be determined in one of the following methods, such method to be selected by the Board of Directors, regardless of whether there are any Disinterested Directors (as hereinafter defined): (i) by a majority vote of the Disinterested Directors, if they constitute a quorum of the Board; (ii) by a written opinion of Special Counsel (as hereinafter defined) if (A) a Change in Control shall have occurred and the Eligible Person so requests or (B) a quorum of the Board consisting of Disinterested Directors is not obtainable or, even if obtainable, a majority of such Disinterested Directors so directs; (iii) by the shareholders of the Corporation (but only if a majority of the Disinterested Directors, if they constitute a quorum of the Board, presents the issue of entitlement to the shareholders for their determination); or (iv) as provided in subsection (d).

(c) In the event of the determination of entitlement is to be made by Special Counsel, a majority of the Disinterested Directors shall select the Special Counsel, but only Special Counsel to which the Eligible Person does not reasonably object; provided, however, that if a Change in

Control shall have occurred, the Eligible Person shall select such Special Counsel, but only Special Counsel to which a majority of the Disinterested Directors does not reasonably object.

(d) Except as otherwise expressly provided in this Article, if a Change in Control shall have occurred, the Eligible Person shall be presumed to be entitled to indemnification (with respect to actions or failures to act occurring prior to such Change in Control) upon submission of a request for indemnification together with the Supporting Documentation in accordance with subsection (a), and thereafter the Corporation shall have the burden of proof to overcome that presumption in reaching a contrary determination. In any event, if the person or persons empowered under subsection (c) to determine entitlement shall not have been appointed or shall not have made a determination within sixty (60) days after receipt by the Corporation of the request therefor together with the Supporting Documentation, the Eligible Person shall be deemed to be, and shall be, entitled to indemnification and advancement of expenses unless (i) the Eligible Person misrepresented or failed to disclose a material fact in making the request for indemnification or in the Supporting Documentation or (ii) such indemnification is prohibited by law. The termination of any Proceeding or of any claim, issue or matter therein, by judgment, order, settlement or conviction, or upon a plea of *nolo contendere* or its equivalent, shall not, of itself, adversely affect the right of an Eligible Person to indemnification or create a presumption that the Eligible Person did not act in good faith and in a manner which the Eligible Person reasonably believed to be in or not opposed to the best interests of the Corporation and, with respect to any criminal proceeding, that the Eligible Person had reasonable cause to believe that his or her conduct was unlawful.

(e) In the event that a determination is made that the Eligible Person is not entitled to indemnification (i) the Eligible Person shall be entitled to seek an adjudication of his or her entitlement to such indemnification either, at the Eligible Person's sole option, in (A) an appropriate court of the state of Indiana or any other court of competent jurisdiction or (B) an arbitration to be conducted in Indianapolis, Indiana, by a single arbitrator pursuant to the rules of the American Arbitration Association; (ii) in any such judicial proceeding or arbitration the Eligible Person shall not be prejudiced by reason of the prior determination pursuant to this Section 6.4; and (iii) if a Change in Control shall have occurred, in any such judicial proceeding or arbitration the Corporation shall have the burden of proving that the Eligible Person is not entitled to indemnification but only with respect to actions or failures to act occurring prior to such Change in Control.

(f) If a determination shall have been made or deemed to have been made that the Eligible Person is entitled to indemnification, the Corporation shall be obligated to pay the amounts incurred by the Eligible Person within ten (10) days after such determination has been made or deemed to have been made and shall be conclusively bound by such determination unless (i) the Eligible Person misrepresented or failed to disclose a material fact in making the request for indemnification or in the Supporting Documentation or (ii) such indemnification is prohibited by law. In the event that (A) any advancement of expenses is not timely made pursuant to Section 6.3 or (B) payment of indemnification is not made within ten (10) days after a determination of entitlement to indemnification has been made, the Eligible Person shall be entitled to seek judicial enforcement of the Corporation's obligation, to pay to the Eligible Person such advancement of expenses or indemnification. Notwithstanding the foregoing, the Corporation may bring an action, in an appropriate court in the State of Indiana or any other court of competent jurisdiction, contesting the right of the Eligible Person to receive indemnification

hereunder due to the occurrence of an event described in clause (i) or (ii) of this subsection (f) (a "Disqualifying Event"); provided, however, that in any such action the Corporation shall have the burden of proving the occurrence of such Disqualifying Event.

(g) The Corporation shall be precluded from asserting in any judicial proceeding or arbitration commenced pursuant to this Section 6.4 that the procedures and presumptions of this Article are not valid, binding and enforceable and shall stipulate in any such court or before any such arbitrator that the Corporation is bound by the provisions of this Article.

(h) In the event that the Eligible Person seeks a judicial adjudication of or an award in arbitration to enforce his or her rights under, or to recover damages for breach of this Article, the Eligible Person shall be entitled to recover from the Corporation, and shall be indemnified by the Corporation, against, any expenses actually and reasonably incurred by the Eligible Person if the Eligible Person prevails in such judicial adjudication or arbitration. If it shall be determined in such judicial adjudication or arbitration that the Eligible Person is entitled to receive part but not all of the indemnification or advancement of expenses sought, the expenses incurred by the Eligible Person in connection with such judicial adjudication or arbitration shall be prorated accordingly.

SECTION 6.5. *Certain Definitions*. For purposes of this Article:

(a) "Change in Control" means any of the following events: (i) the acquisition by any "person," as that term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), other than (A) the Corporation, (B) any subsidiary of the Corporation, (C) any employee benefit plan or employee stock plan of the Corporation or a subsidiary of the Corporation or any trustee or fiduciary with respect to any such plan when acting in that capacity, or (D) Lilly Endowment, Inc., of "beneficial ownership" as defined in Rule 13d-3 under the 1934 Act, directly or indirectly, of 15 percent or more of the shares of the Corporation'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 IC 23-1-42-1 through IC 23-1-42-11) ("Voting Stock"); (ii) the first day on which less than two-thirds of the total membership of the Board shall be Continuing Directors (as such term is defined in Article 13.(f) of the Articles of Incorporation); (iii) consummation of a merger, share exchange, or consolidation of the Corporation (a "Transaction"), other than a Transaction which would result in the Voting Stock of the Corporation 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 percent of the Voting Stock of the Corporation or such surviving entity immediately after such Transaction; or (iv) approval by the shareholders of the Corporation of a complete liquidation of the Corporation or a sale of disposition of all or substantially all the assets of the Corporation.

(b) "Disinterested Director" means a Director who is not or was not a party to the Proceeding in respect of which indemnification is sought by the Eligible Person.

(c) "Special Counsel" means a law firm or a member of a law firm that neither presently is, nor in the past five years has been, retained to represent any other party to the Proceeding giving rise to a claim for indemnification under this Article. In addition, any person who, under

applicable standards of professional conduct, would have a conflict of interest in representing either the Corporation or the Eligible Person in an action to determine the Eligible Person's rights under this Article may not act as Special Counsel.

SECTION 6.6. *Indemnification of Agents*. Notwithstanding any other provisions of this Article, the Corporation may, consistent with the provisions of applicable law, indemnify any person other than a director, officer or employee of the Corporation who is or was an agent of the Corporation and who is or was involved in any manner (including, without limitation, as party or a witness) or is threatened to be made so involved in any threatened, pending or completed Proceeding by reasons of the fact that such person is or was an agent of the Corporation or, at the request of the Corporation, a director, officer, partner, member, manager, employee, fiduciary or agent of a Covered Entity against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such Proceeding. The Corporation may also advance expenses incurred by such person in connection with any such Proceeding, consistent with the provisions of applicable law.

SECTION 6.7. *Effect of Amendment or Repeal*. Neither the amendment or repeal of, nor the adoption of a provision inconsistent with, any provision of this Article shall adversely affect the rights of any Eligible Person under this Article (i) with respect to any Proceeding commenced or threatened prior to such amendment, repeal or adoption of an inconsistent provision or (ii) after the occurrence of a Change in Control, with respect to any Proceeding arising out of any action or omission occurring prior to such amendment, repeal or adoption of an inconsistent provision, in either case without the written consent of such Eligible Person.

SECTION 6.8. *Severability*. If any of this Article shall be held to be invalid, illegal or unenforceable for any reason whatsoever: (a) the validity, legality and enforceability of the remaining provisions of this Article (including, without limitation, all portions of any Section of this Article containing any such provision held to be invalid, illegal or unenforceable, that are not themselves invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby; and (b) to the fullest extent possible, the provisions of this Article (including, without limitation, all portions of any Section of this Article containing any such provision held to be invalid, illegal or unenforceable, that are not themselves invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal or unenforceable.

ARTICLE VII

Miscellaneous

SECTION 7.0. *Corporate Seal*. The Seal of the Corporation shall consist of a circular disk around the circumference of which shall appear the words:

"ELI LILLY AND COMPANY, INDIANAPOLIS, INDIANA"

and across the center thereof the words:

"Established 1876 Incorporated 1901".

SECTION 7.1. *Fiscal Year*. The fiscal year of the Corporation shall begin on the first day of January in each year and shall end on the thirty-first day of the following December.

SECTION 7.2. *Amendment of By-laws*. These By-laws may be amended or repealed and new By-laws may be adopted by the affirmative vote of at least a majority of the actual number of directors elected and qualified at any regular or special meeting of the Board of Directors, provided that: (a) the notice or waiver of notice of such meeting states in effect that consideration is to be given at such meeting to the amendment or repeal of the By-laws or the adoption of new By-laws; (b) no provision of these By-laws incorporating a provision of Articles 9, 13 or 14 of the Articles of Incorporation may be amended except in a manner consistent with those Articles as they may be amended in compliance with the requirements stated therein; and (c) any amendment to Articles I and VI of these By-laws shall require the affirmative vote of a majority of (i) the actual number of directors elected and qualified, and (ii) the Continuing Directors, as defined in Article 13.(f) of the Articles of Incorporation.

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Exhibit 10.7

The Eli Lilly and Company Bonus Plan
(as amended January 1, 2006)

SECTION 1. PURPOSE

The purpose of The Eli Lilly and Company Bonus Plan is to encourage and promote eligible employees to create and deliver innovative pharmaceutical-based health care solutions that enable people to live longer, healthier and more active lives, to outgrow our competitors through a constant stream of pharmaceutical innovation, and to materially increase shareholder value. The Plan is designed to accomplish the following key objectives:

a. motivate superior employee performance through the implementation of a performance-based bonus system for all eligible management employees, United States employees (including those in Puerto Rico) and other employees as may be designated from time to time;

b. encourage eligible employees to take greater ownership of the company and provide "Answers that Matter" daily by creating a direct relationship between key company measurements and individual bonus payouts; and

c. enable the Company to attract and retain employees that will be instrumental in driving sustained growth and performance of Eli Lilly and Company by providing a competitive bonus program that rewards outstanding performance consistent with the Company's mission, values and increased shareholder value.

The Plan is intended to satisfy the requirements for providing "performance-based" compensation under Section 162(m) of the Internal Revenue Code.

SECTION 2. DEFINITIONS

The following words and phrases as used in this Plan will have the following meanings unless a different meaning is clearly required by the context. Masculine pronouns will refer both to males and to females:

2.1 Applicable Year means the calendar year immediately preceding the year in which payment of the Company Bonus is payable pursuant to Section 6. For example, the Applicable Year for 2005 payout is January 1, 2004 through December 31, 2004.

2.2 Bonus Target means the percentage of Participant Earnings for each Participant as described in Section 5.6(a) below.

2.3 Committee means (i) with respect to the Executive Officers of Lilly, the Compensation Committee, the members of which will be selected by the Board of Directors of Lilly, from among its members; and (ii) with respect to all other Eligible Employees, the

Compensation Committee of the Board of Directors or its designee. Each member of the Compensation Committee will, to the extent deemed necessary or appropriate by the Board of Directors, satisfy the requirements of an "outside director" within the meaning of Section 162(m) of the Internal Revenue Code.

2.4 Company means Eli Lilly and Company and its subsidiaries.

2.5 Company Bonus means the amount of bonus compensation payable to a Participant as described in Section 5 below. Notwithstanding the foregoing, however, the Committee may determine, in its sole discretion, to reduce the amount of a Participant's Company Bonus if such Participant becomes eligible to participate in such other bonus program of the Company as may be specifically designated by the Committee. Such reduction may be by a stated percentage up to and including 100% of the Company Bonus.

2.6 Company Performance Bonus Multiple means the amount as calculated in Sections 5.3 and 5.4 below.

2.7 Disabled means a Participant who (i) has become eligible for a payment under The Lilly Extended Disability Plan, assuming eligibility to participate in that plan, or (ii) for those employees ineligible to participate in The Lilly Extended Disability Plan, has become otherwise "disabled" under the applicable disability benefit plan or program for the Participant, or, in the event that there is no such disability benefit plan or program, has become disabled under applicable local law.

2.8 Earnings Per Share (EPS) means the diluted earnings per share of the Company as reported in the Company's "Consolidated Statements of Income" in accordance with generally accepted accounting principles and Section 3.4 below.

2.9 Earnings Per Share Growth (EPS Growth) means the percentage increase in EPS in the Applicable Year compared to the prior year.

2.10 Effective Date means January 1, 2004, as amended from time to time.

2.11 Eligible Employee means:

a. with respect to employees of Lilly or its Puerto Rican subsidiaries, a person (1) who is employed as an employee by the Company on a scheduled basis of twenty (20) or more hours per week and is scheduled to work at least five (5) months per year; and (2) who is receiving compensation, including temporary illness pay under Lilly's Illness Pay Program or similar short-term disability program, from the Company for services rendered as an employee. Notwithstanding anything herein to the contrary, the term "Eligible Employee" will not include:

(1) a person who has reached Retirement with the Company;

(2) a person who is Disabled;

(3) a person who is a "leased employee" within the meaning of Section 414(n) of the Internal Revenue Code of 1986, as amended, or whose basic compensation for services on behalf of the Company is not paid directly by the Company;

(4) a person who is classified as a "Fixed Duration Employee", as that term is used by Lilly;

(5) a person who is classified as a special status employee because his employment status is temporary, seasonal, or otherwise inconsistent with regular employment status;

(6) a person who is eligible to participate in the Eli Lilly and Company Prem1er Rewards Plan or such other Company bonus or incentive program as may be specifically designated by the Committee or its designee; or

(7) a person who submits to the Committee in writing a request that he not be considered eligible for participation in the Plan or is a member of the Board of Directors of Lilly unless he or she is also an Eligible Employee.

(8) any other category of employees designated by the Committee in its discretion with respect to any Applicable Year.

b. with respect to those employees who are employed by the Company, but not by Lilly or a Puerto Rican subsidiary, an employee of the Company designated by the Committee as a Participant in the Plan with respect to any Applicable 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, levels, subsidiaries or other appropriate classification will be Participants.

c. Notwithstanding anything herein to the contrary, the term Eligible Employee will not include any person who is not so recorded on the payroll records of the Company, including any such person who is subsequently reclassified by a court of law or regulatory body as a common law employee of the Company. Consistent with the foregoing, and for purposes of clarification only, the term employee or Eligible Employee does not include any individual who performs services for the Company as an independent contractor or under any other non-employee classification.

2.12 Lilly means Eli Lilly and Company.

2.13 Lilly Executive Officer or Section 162(m) Participant means a Participant who has been designated by the Board of Directors of Lilly as an executive officer pursuant to Rule 3b-7 under the Securities Exchange Act of 1934, as amended. For purposes of this Plan, a Lilly Executive Officer will be considered a Section 162(m) Participant whether or not he is a "covered employee" under Section 162(m).

2.14 Participant means an Eligible Employee who is participating in the Plan.

2.15 Participant Earnings means (A) those amounts described below that are earned during the portion of the Applicable Year during which the employee is a Participant in the Plan:

(i) regular compensation (including applicable deferred compensation amounts), overtime, shift premiums and other forms of additional compensation determined by and paid currently pursuant to an established formula or procedure;

(ii) salary reduction contributions to The Lilly Employee Savings Plan or elective contributions under any similar tax-qualified plan that is intended to meet the requirements of Section 401(k) of the Internal Revenue Code or similar Company savings program;

(iii) elective contributions to any cafeteria plan that is intended to meet the requirements of Section 125 of the Internal Revenue Code or other pre-tax contributions to a similar Company benefit plan;

(iv) payments made under the terms of Lilly's Illness Pay Program or other similar Company or government-required leave program during an Applicable Year to a Participant who is on approved leave of absence and is receiving one hundred percent (100%) of his base pay; and

(v) other legally-mandated or otherwise required pre-tax deductions from a Participant's base salary.

(B) The term "Participant Earnings" does not include:

(i) compensation paid in lieu of earned vacation;

(ii) amounts contributed to the Retirement Plan or any other qualified plan, except as provided in clause (A)(ii), above;

(iii) payments made under the terms of Lilly's Illness Pay Program or other similar Company or government-required leave program during an Applicable Year to a Participant who is on approved leave of absence and is receiving less than the full amount of his base pay;

(iv) amounts paid under this Plan or other bonus or incentive program of the Company;

(v) payments made under The Lilly Severance Pay Plan or any other severance-type benefit (whether company-sponsored or mandated by law) arising out of or relating to a Participant's termination of employment;

(vi) payments based upon the discretion of the Company;

(vii) in the case of a person employed by a Lilly subsidiary, foreign service, cost of living, or other allowances that would not be paid were the person employed by Lilly;

(viii) amounts paid as commissions, sales bonuses, or Market Premiums (as defined under the Retirement Plan); or

(ix) earnings with respect to the exercise of stock options or vesting of restricted stock.

2.16 Performance Benchmarks mean the amounts as calculated in Section 5.3 below. The Performance Benchmarks will be established after considering expected pharmaceutical peer group performance and based on performance measures as described in Section 5.2.

2.17 Plan means The Eli Lilly and Company Bonus Plan as set forth herein and as hereafter modified or amended from time to time. The Plan is an incentive compensation program and is not subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), pursuant to Department of Labor Regulation Section 2510.3.

2.18 Plant Closing means the closing of a plant site or other Company location that directly results in termination of employment.

2.19 Reduction in Workforce means the elimination of a work group, functional or business unit or other broadly applicable reduction in job positions that directly results in termination of employment.

2.20 Retirement means the cessation of employment upon the attainment of age fifty-five with ten years of service (55 and 10) or at least eighty (80) points, as determined by the provisions of the Retirement Plan as amended from time to time, assuming eligibility to participate in that plan. For persons who are not participants in the Retirement Plan, Retirement means the cessation of employment as a retired employee under the applicable retirement benefit plan or program as provided by the Company or applicable law.

2.21 Retirement Plan means The Lilly Retirement Plan.

2.22 Sales means, for any Applicable Year, the consolidated net sales of the Company as set forth in the "Consolidated Statements of Income" as reported by the Company in accordance with generally accepted accounting principles and Section 3.4 below.

2.23 Sales Growth means the percentage increase in Sales in the Applicable Year compared to the prior year.

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

2.25 Service means the aggregate time of employment of an Eligible Employee by the Company.

SECTION 3. ADMINISTRATION

3.1 Committee. The Plan will be administered by the Compensation Committee of the Board of Directors of Eli Lilly and Company or, if the name of the Compensation Committee is changed, the Plan will be administered by such successor committee. For all Eligible Employees other than Lilly Executive Officers, the Compensation Committee may delegate all or a portion of its responsibilities within its sole discretion by resolution. Any reference in this Plan to the Committee or its authority will be deemed to include such designees (other than with respect to Lilly Executive Officers or a member of the Board of Directors or for purposes of Section 9).

3.2 Powers of the Committee. The Committee will have the right to interpret the terms and provisions of the Plan and to determine any and all questions arising under the Plan, including, without limitation, the right to remedy possible ambiguities, inconsistencies, or omissions by a general rule or particular decision. The Committee will have authority to adopt, amend and rescind rules consistent with the Plan, to make exceptions in particular cases to the rules of eligibility for participation in the Plan (except with respect to Lilly Executive Officers), and to delegate authority for approval of participation of any Eligible Employee except for Lilly Executive Officers or a member of the Board of Directors. The Committee will take all necessary action to establish annual Performance Benchmarks and approve the timing of payments, as necessary.

3.3 Certification of Results. Before any amount is paid under the Plan, the Committee will certify in writing the calculation of EPS, EPS Growth, Sales and Sales Growth (or other applicable performance measures) for the Applicable Year and the satisfaction of all other material terms of the calculation of the Company Performance Bonus Multiple and Company Bonus.

3.4 Adjustments for Significant Events. Not later than 90 days after the beginning of an Applicable Year, the Committee may specify with respect to Company Bonuses for the Applicable Year that the performance measures described in Section 5.2 will be determined before the effects of acquisitions, divestitures, restructurings or special charges or gains, 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 Lilly Executive Officers.

3.5 Finality of Committee Determinations. Any determination by the Committee of Sales, Sales Growth, EPS, EPS Growth, any other performance measure, Performance Benchmarks and the level and entitlement to Company Bonus, and any interpretation, rule, or decision adopted by the Committee under the Plan or in carrying out or administering the Plan, will be final and binding for all purposes and upon all interested persons, their heirs, and personal representatives. The Committee may rely conclusively on determinations made by Lilly and its auditors to determine Sales, Sales Growth, EPS,

EPS Growth and related information for administration of the Plan, whether such information is determined by the Company, auditors or a third-party vendor engaged specifically to provide such information to the Company. This subsection is not intended to limit the Committee's power, to the extent it deems proper in its discretion, to take any action permitted under the Plan.

SECTION 4. PARTICIPATION IN THE PLAN

4.1 General Rule. Only Eligible Employees may participate in and receive payments under the Plan.

4.2 Commencement of Participation. An Eligible Employee will become a Participant in the Plan as follows: (i) in the case of Eligible Employees under Section 2.11(a), on the date on which the individual completes at least one hour of employment as an Eligible Employee within the United States or Puerto Rico, and (ii) in the case of Eligible Employees under Section 2.11(b), on the date as of which the Committee has designated the individual to become a Participant in the Plan.

4.3 Termination of Participation. An Eligible Employee will cease to be a Participant upon termination of employment with the Company for any reason, or at the time he otherwise ceases to be an Eligible Employee under the Plan.

SECTION 5. DEFINITION AND COMPUTATION OF COMPANY BONUS

5.1 Computation for Eligible Employees. Company Bonus amounts will depend significantly on Company performance as well as Participants' individual performance for certain Eligible Employees. As more specifically described below, a Participant's Company Bonus is calculated by multiplying the Participant's Bonus Target by his Participant Earnings and the Company Performance Bonus Multiple. For eligible management and Lilly employees and those Participants designated by the Committee, individual performance will also impact the Company Bonus calculation, as described in Section 5.6(c) below. Company Bonuses are paid out to eligible Participants in the manner provided below.

5.2 Establishment of Performance Measures. Not later than 90 days after the beginning of each Applicable Year, the Committee will, in its sole discretion, determine appropriate performance measures for use in calculating Company Bonus amounts. These performance measures may include Sales Growth, EPS Growth, growth in net income, return on assets, return on equity, total shareholder return, EVA, MVA or any of the foregoing before the effect of acquisitions, divestitures, accounting changes, restructurings and special charges or gains (determined according to objective criteria established by the Committee not later than ninety (90) days after the beginning of the

Applicable Year). Unless otherwise specified in a written resolution adopted by the Committee for the Applicable Year, the Committee will use EPS Growth and Sales Growth, in each case before the effect of acquisitions, divestitures, accounting changes, restructurings and special charges or gains (determined as described above) as performance measures.

5.3 Establishment of Performance Benchmarks. Not later than 90 days after the beginning of each Applicable Year, the Committee will establish Performance Benchmarks for the Company based on the performance measures described in Section 5.2 above. Unless otherwise specified in a written resolution adopted by the Committee for the Applicable Year, the Performance Benchmarks will correspond with EPS Growth and Sales Growth amounts for the Applicable Year, established after considering expected pharmaceutical peer group performance. The Performance Benchmarks will correspond to EPS Growth and Sales Growth multiples equal to 1.0. The Committee will also adopt a formula that will determine the extent to which the performance measure multiples will vary as the Company's actual results vary from the Performance Benchmarks.

5.4 Company Performance Bonus Multiple. Unless otherwise specified in a written resolution adopted by the Committee not later than 90 days after the beginning of the Applicable Year, the Company Performance Bonus Multiple is equal to the product of the EPS Growth multiple and 0.75 plus the product of the Sales Growth multiple and 0.25 (i.e., Company Performance Bonus Multiple = (EPS Growth multiple * 0.75) + (Sales Growth multiple * 0.25)).

5.5 Company Performance Bonus Multiple Threshold and Ceiling: Notwithstanding Sections 5.3 and 5.4, the Company Performance Bonus Multiple will not be less than 0.25 or greater than 2.0 in an Applicable Year. If the calculations described in Sections 5.3 and 5.4 above result in a number that is less than 0.25, the Company Performance Bonus Multiple will equal 0.25 for the Applicable Year. If the calculations described in Sections 5.3 and 5.4 above result in a multiple greater than 2.0, the Company Performance Bonus Multiple will equal 2.0 for the Applicable Year. Notwithstanding the foregoing, the Committee may reduce the Company Performance Bonus Multiple (including but not limited to a reduction to below 0.25) for some or all Eligible Employees, in its discretion.

5.6 Participant Company Bonus.

a. Bonus Target. Not later than 90 days after the beginning of the Applicable Year, the Bonus Target for each Participant will be determined by the Committee on a basis that takes into consideration a Participant's pay grade level and job responsibilities. The Bonus Target for each Participant for the Applicable Year will be expressed as a percentage of Participant Earnings as of December 31 of the Applicable Year. Early in the Applicable Year, each Participant will receive information regarding the Participant's Bonus Target. In the event that a Participant's pay grade level changes during the Applicable Year (e.g., because of promotion, demotion or otherwise), the

Participant's Bonus Target will be prorated based on the Bonus Target applicable to each pay grade level (with related job responsibilities) and the percentage of time that the Participant is employed at each pay grade level during the Applicable Year.

b. Company Bonus Calculation. Except as described in Section 5.6(c) below, a Participant's Company Bonus will equal the product of the Company Performance Bonus Multiple and the Participant's Bonus Target and the Participant's Earnings.

c. Adjustment for Performance Multiplier, if Applicable. Notwithstanding anything herein to the contrary, all eligible management employees (except Lilly Executive Officers), United States employees and other employees as may be designated from time to time by the Committee are subject to individual performance multipliers. For all such Participants subject to an individual performance multiplier, the amount calculated in Section 5.5(b) above will be adjusted based on the Participant's performance rating at the end of the Applicable Year as described below. For each such Participant, the performance rating will be determined by the Participant's supervision.

    1. Exemplary Performance. If the Participant receives an exemplary or equivalent performance rating (using the applicable performance rating system then in effect for the Participant), the amount calculated in Section 5.6(b) will be multiplied by an amount determined by the Committee, not to exceed 1.5, to obtain the Participant's actual Company Bonus.

    2. Satisfactory Performance. If the Participant receives a satisfactory or equivalent performance rating (using the applicable performance rating system then in effect for the Participant), the amount calculated in Section 5.6(b) will be multiplied by 1.0 so that the Participant's actual Company Bonus will equal the amount calculated in Section 5.6(b) above.

    3. Unsatisfactory Performance. If the Participant receives a year-end unsatisfactory or equivalent performance rating (using the applicable performance rating system then in effect for the Participant), the amount calculated in Section 5.6(b) will be multiplied by 0.0 so that the Participant's actual Company Bonus will equal $0.00.

In the event that a Participant does not receive a year-end performance rating, but is eligible for a Company Bonus, the amount calculated in Section 5.6(b) will be multiplied by 1.0 so that the Participant's actual Company Bonus will be the amount calculated in Section 5.6(b) above.

5.7 Conditions on Company Bonus. Payment of any Company Bonus is neither guaranteed nor automatic. A Participant's Company Bonus is not considered to be any form of compensation, wages, or benefits, unless and until paid.

5.8 Required Employment. Except as provided below in this Section 5.8 or as otherwise designated by the Committee, if a Participant is not employed by the Company on the last day of the Applicable Year, or is otherwise not an Eligible Employee on that date, the Participant is not entitled to any Company Bonus payment under this Plan for that Applicable Year.

a. Leaves of Absence. A Participant who, on the last day of the Applicable Year, is on approved leave of absence under the Family and Medical Leave Act of 1993, military leave under the Uniformed Services Employment and Reemployment Rights Act, or such other approved leave of absence will be considered to be an Eligible Employee on that date for purposes of this Plan.

b. Transfer. An employee who is a Participant in this Plan for a portion of the Applicable Year and then transfers to a position within the Company in which he is ineligible to participate in this Plan, but who remains employed by the Company on the last day of the Applicable Year, will be treated as satisfying the last-day-of-Applicable Year requirement for purposes of this Plan. In that event, his Company Bonus will be based on his Participant Earnings for the portion of the Applicable Year in which the employee was a Participant in the Plan.

c. Retirement, Disability or Death. A Participant who was an Eligible Employee for some portion of the Applicable Year and then takes Retirement, becomes and remains Disabled through the end of the Applicable Year, or dies during the Applicable Year will be considered to satisfy the last-day-of-Applicable-Year requirement described in this Section 5.8 for purposes of this Plan.

d. Reallocation, Medical Reassignment, Plant Closing or Reduction in Workforce. A Participant who was an Eligible Employee for some portion of the Applicable Year and whose employment is terminated as a result of his failure to locate a position following his reallocation or medical reassignment in the United States, or a Plant Closing or Reduction in Workforce will be considered to satisfy the last-day-of-Applicable Year requirement described in this Section 5.8 for purposes of this Plan. The Committee or its designee's determination regarding whether a Participant's termination is a direct result of either a Plant Closing or a Reduction in Workforce will be final and binding.

e. Notice of Resignation. In addition, a Participant who submits a notice of resignation from employment with the Company prior to the end of the

Applicable Year and whose effective date of resignation is two (2) weeks or less from the date of notice of resignation will be considered employed by the Company for purposes of this Plan until the end of his specified notice period.

5.9 New Participants. If an Eligible Employee began participation in the Plan during an Applicable Year and is eligible for a Company Bonus, his Company Bonus will be based on Participant Earnings earned after the employee became a Participant. An Eligible Employee who became assigned to a position eligible for a Company Bonus at any time other than the first of the month will become a Participant the first of the following month.

5.10 Section 162(m) Requirements, Bonus Maximum. In the case of Lilly Executive Officers, all determinations necessary for computing a Company Bonus for the Applicable Year, including establishment of all components of EPS, EPS Growth, Sales, Sales Growth, Company Performance Bonus Multiple and Bonus Target percentages, shall be made by the Committee not later than 90 days after the commencement of the Applicable Year. As and to the extent required by Section 162(m), the terms of a Company Bonus for a Lilly Executive Officer must state, in terms of an objective formula or standard, the method of computing the amount of compensation payable to the Lilly Executive Officer, 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 Company Bonus that may be payable to a Lilly Executive Officer in respect of any Applicable Year will be $7 million.

SECTION 6. TIME OF PAYMENT

6.1 General Rule. Payment under the Plan will be made prior to April 1 of the year following the Applicable Year.

6.2 Terminated Employee. Except as provided in Section 5.8 above, in the event an Eligible Employee's employment with the Company ends for any reason prior to the last day of the Applicable Year, he will not receive any Company Bonus for the Applicable Year.

6.3 Deceased Eligible Employee. In the event an Eligible Employee dies before payment under the Plan is made, the Committee may, in its sole discretion, authorize the Company to pay to his personal representative or beneficiary an amount not to exceed the amount established by the Committee to reflect the payment accrued at the date of death.

SECTION 7. ADMINISTRATIVE GUIDELINES

7.1 Establishment and Amendment by the Committee. The Committee may establish objective and nondiscriminatory written guidelines for administering those provisions of

the Plan that expressly provide for the determination of eligibility, Company Bonus or benefits on the basis of rules established by the Committee. The Committee may, from time to time, amend or supplement the administrative guidelines established in accordance with this subsection 7.1. The administrative guidelines established or amended in accordance with this subsection 7.1 will not be effective to the extent that they materially increase the Plan's liability, or to the extent that they are inconsistent with, or purport to amend, any provision of the Plan set forth in a document other than such administrative guidelines.

7.2. Amendment by Board of Directors. Any administrative guidelines established by the Committee pursuant to subsection 7.1 may be amended or revoked by the Board of Directors, either prospectively or retroactively, in accordance with the general amendment procedures set forth in section 9 below.

SECTION 8. MISCELLANEOUS

8.1 No Vested Right. No employee, participant, beneficiary, or other individual will have a vested right to a Company Bonus or any part thereof until payment is made to him under Section 6.

8.2 No Employment Rights. No provision of the Plan or any action taken by the Company, the Board of Directors of the Company, or the Committee will give any person any right to be retained in the employ of the Company. The right and power of the Company to dismiss or discharge any Participant for any reason or no reason, with or without notice, is specifically reserved.

8.3 No Adjustments. After the certification of the calculation of EPS, EPS Growth, Sales, Sales Growth and any other material terms of the calculation of the Company Performance Bonus Multiple and Company Bonus for the Applicable Year as described in Section 3.3 above, no adjustments will be made to reflect any subsequent change in accounting, the effect of federal, state, or municipal taxes later assessed or determined, or otherwise.

8.4 Other Representations. Nothing contained in this Plan, and no action taken pursuant to its provisions, will create or be construed to create a trust of any kind, or a fiduciary relationship between the Company and any employee, participant, beneficiary, legal representative, or any other person. Although Participants generally have no right to any payment from this Plan, to the extent that any Participant acquires a right to receive payments from the Company under the Plan, such right will be no greater than the right of an unsecured general creditor of the Company. All payments to be made hereunder will be paid from the general funds of the Company and no special or separate fund will be established, and no segregation of assets will be made, to assure payment of such amount.

8.5 Tax Withholding. The Company will make such provisions and take such steps as it may deem necessary or appropriate for the withholding of all federal, state, local, and other taxes required by law to be withheld with respect to Company Bonus payments under the Plan, including, but not limited to, deducting the amount required to be withheld from the amount of cash otherwise payable under the Plan, or from salary or any other amount then or thereafter payable to an employee, Participant, beneficiary, or legal representative.

8.6 Currency. The Company Bonus will be based on the currency in which the highest portion of base pay is regularly paid. The Committee will determine the appropriate foreign exchange conversion methodology in its discretion.

8.7 Effect of Plan on other Company plans. Nothing contained in this Plan is intended to amend, modify, terminate, or rescind other benefit or compensation plans established or maintained by the Company. Whether and to what extent a Participant’s Company Bonus

is taken into account under any other plan will be determined solely in accordance with the terms of such plan.

8.8 Construction. This Plan and all the rights thereunder will be governed by, and construed in accordance with, the laws of the state of Indiana, without reference to the principles of conflicts of law thereof.

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

SECTION 9. AMENDMENT, SUSPENSION, OR TERMINATION

The Board of Directors of the Company will have the right to amend, modify, suspend, revoke, or terminate the Plan, in whole or in part, at any time and without notice, by written resolution of the Board of Directors. The Committee also will have the right to amend the Plan, except that the Committee may not amend this Section 9. 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 by the Company's stockholders of the Plan or any amendments to the Plan or any aspect of the Plan or Plan amendments. Any such approval shall be obtained in a separate vote of stockholders, with approval by a majority of the votes cast on the issue, including abstentions to the extent abstentions are counted as voting under applicable state law and the Articles of Incorporation and By-laws of the Company. To the extent deemed necessary or advisable by the Board of Directors to comply with Section 162(m), the material terms of the performance measures used in calculating Company Bonus amounts will be disclosed to and reapproved by the stockholders of the Company no later than the Company's 2009 annual meeting.

Exhibit 10.10

Summary of 2006 Compensation for Non-employee Directors

Cash Compensation

- Annual retainer of $80,000
- Additional annual retainer of $20,000 for the presiding director
- $1,000 for each committee meeting attended
- $2,000 to the committee chairpersons for each committee meeting chaired as compensation for the chairperson's preparation time
- Reimbursement for customary and usual travel expenses

Stock Compensation

- $145,000 of Lilly stock (subject to a maximum of 3,000 shares) in a deferred stock account in the Lilly Directors' Deferral Plan, payable after service on the board has ended. The number of shares contributed to the account will be based on the market value of Lilly stock at the time of the contribution.

Exhibit 10.11

Summary of 2006 Compensation for Named Executive Officers

Executive Officer	Salary (1) ($)	Bonus (2) ($)	Stock Options (3) Value at grant ($)	Performance Award (4) Value at grant ($)
Sidney Taurel Chairman and Chief Executive Officer	$1,650,333	$2,062,917	$ 3,600,000	$ 3,600,000
John C. Lechleiter, Ph.D. President and Chief Operating Officer	$1,112,000	$1,112,000	$ 2,340,000	$ 2,340,000
Steven M. Paul, M.D. Executive Vice President, Science and Technology	$ 916,167	$ 778,742	$ 1,200,000	$ 1,200,000
Charles E. Golden Executive Vice President and Chief Financial Officer	$ 857,700	$ 729,045	$ 1,100,000	$ 1,100,000
Robert A. Armitage Senior Vice President and General Counsel	$ 701,657	$ 526,243	$ 900,000	$ 900,000

(1) Expected base salary for the full year 2006 assuming individual is employed for the full year. However, it is noted that Charles E. Golden has announced his intent to retire as of April 30, 2006, in which event his salary, bonus and performance award would be reduced accordingly and his 2006 stock option would terminate without vesting.

(2) Target bonus under the Eli Lilly and Company Bonus Plan for 2006 assuming individual is employed for the full year. Actual bonuses earned may vary from zero to 200 percent of the target amount, depending on the company's 2006 results relative to predetermined corporate performance measures that are based 25 percent on sales growth and 75 percent on earnings-per-share growth (adjusted for unusual items in accordance with predetermined criteria).

(3) The options will vest three years from the grant date and expire ten years from the grant date. The exercise price is the market value of Lilly stock on the grant date. The number of shares granted will be determined as of the grant date based on the values listed above, the share price on the grant date, and the company's lattice valuation method for stock options.

(4) Target payout under the performance award program for 2006. Actual payouts earned for 2006 may vary from zero to 200 percent of the target amount, depending on the growth in the company's 2006 earnings per share (adjusted for unusual items in accordance with predetermined criteria). The present values listed above will be converted to shares based on 100 percent of the market value of Lilly stock on the grant date. The shares will be paid in the form of restricted stock vesting in 2008.

EXHIBIT 12. STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

ELI LILLY AND COMPANY AND SUBSIDIARIES
(Dollars in millions)

	Years Ended December 31,				
	2005	2004	2003	2002	2001
Consolidated pretax income before cumulative effect of a change in accounting principle	$ 2,717.5	$ 2,941.9	$ 3,261.7	$ 3,457.7	$ 3,506.9
Interest	245.7	162.9	121.9	140.0	253.3
Less interest capitalized during the period	(140.5)	(111.3)	(60.9)	(60.3)	(61.5)
Earnings	$ 2,822.7	$ 2,993.5	$ 3,322.7	$ 3,537.4	$ 3,698.7
Fixed charges	$ 245.7	$ 162.9	$ 121.9	$ 140.0	$ 253.3
Ratio of earnings to fixed charges	11.5	18.4	27.3	25.3	14.6

Exhibit 21 — List of Subsidiaries & Affiliates

The following are the subsidiaries and affiliated corporations of the Company at December 31, 2005
Certain subsidiaries have been omitted as they are not significant in the aggregate.

	State or Jurisdiction of Incorporation or Organization
ELI LILLY AND COMPANY	Indiana
Eli Lilly International Corporation	Indiana
Lilly HK Finance I Limited	Hong Kong
Lilly HK Finance II Limited	Hong Kong
Eli Lilly Funding Partnership	Hong Kong
Eli Lilly Funding II Partnership	Hong Kong
Eli Lilly Holdings Ltd.	United Kingdom
Eli Lilly Group Limited	United Kingdom
Eli Lilly Group Pension Trustees Limited	United Kingdom
Eli Lilly and Company Limited	United Kingdom
Eli Lilly and Company (Ireland) Trustees Limited	Ireland
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
Lilly GmbH	Germany
Eli Lilly and Company (Ireland) Limited	Ireland
ELCO Insurance Company Limited	Bermuda
Lilly Ilac Ticaret Limited Sirketi	Turkey
Eli Lilly Interamerica, Inc.	Indiana
Eli Lilly do Brasil Limitada	Brazil
Elanco Quimica Limitada	Brazil
Darilor Sociedad Anonima	Uruguay
Beirmirco Sociedad Anonima	Uruguay
Eli Lilly Interamerica Inc., y Compania Limitada	Chile
ELCO International Sales Corporation	U.S. Virgin Islands
Control Diabetes Services, Inc.	Indiana
STC Pharmaceuticals, Inc.	Indiana
Integrated Medical Systems, Inc.	Colorado
Lilly ICOS LLC	Delaware

ELI LILLY AND COMPANY (continued)	State or Jurisdiction of Incorporation or Organization
Eli Lilly Finance, S.A.	Switzerland
Lilly Del Mar, Inc.	British Virgin Islands
Scienteur Corporation	Indiana
ELIIC Holdings, Inc.	Delaware
InnoCentive Innovations, Inc.	Delaware
Lilly Global Services, Inc.	Indiana
Applied Molecular Evolution, Inc.	Delaware
Novasite Pharmaceuticals, Inc.	Delaware
AME Torreview LLC	Delaware
Eli Lilly Funding Ltd.	Hong Kong
Dista, Inc.	Indiana
Eli Lilly Holding Company Ltd.	United Kingdom
Eli Lilly Holding GmbH	Germany
Eli Lilly Spain Holding ETVE, S.L.	Spain
Eli Lilly Nederland Holding B.V.	Netherlands
Eli Lilly and Company (Tawian), Inc.	Taiwan
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 Virgin Islands
Lilly del Caribe, Inc.	Cayman Islands
ELCO Dominicana, S.A.	Dominican Republic
Eli Lilly Asia, Inc.	Delaware
Eli Lilly Australia Pty. Limited	Australia
Eli Lilly Australia Custodian Pty. Limited	Australia
Eli Lilly and Company (N.Z.) Limited	New Zealand
Eli Lilly (NZ) Staff Benefits Custodian Limited	New Zealand

ELI LILLY AND COMPANY (continued)	State or Jurisdiction of Incorporation or Organization
Eli Lilly de Mexico, S.A. de C.V.	Mexico
Lilly Systems Biology Pte. Ltd.	Singapore
ELCO Management, Inc.	Delaware
E L Management LLC	Delaware / Canada
Eli Lilly Canada Inc.	Canada
Eli Lilly Denmark Holding ApS	Denmark
Lilly Holdings, LLC	Delaware
Lilly Holdings GmbH	Austria
Eli Lilly S.A.	Switzerland
Eli Lilly Export S.A.	Switzerland
Eli Lilly (Suisse) S.A.	Switzerland
Eli Lilly Vostok S.A., Geneva	Switzerland
Oldfields Financial Management S.A.	Switzerland
Lilly Cayman Holdings	Cayman Islands
Eli Lilly Trading (Shanghai) Co. Ltd.	China
GEMS Services S.A.	Belgium
Eli Lilly Suzhou Pharmaceutical Co. Ltd.	China
Eli Lilly Nederland B.V.	Netherlands
Lilly France S.A.S.	France
ELSA France, S.A.	France
LICO sarl	France
Eli Lilly Benelux, S.A.	Belgium
Eli Lilly Italia S.p.A.	Italy
Dista-Produtos Quimicos & Farmaceuticos, LDA	Portugal
Lilly-Farma, Produtos Farmaceuticos, Lda.	Portugal
Vital Pharma Productos Farmaceuticos	Portugal
Greenfield-Produtos Farmaceuticos, Lda.	Portugal
Elanco-Valquimica, S.A.	Spain
Dista, S.A.	Spain
Spaly Bioquimica, S.A.	Spain
Irisfarma S.A.	Spain
Lilly S.A.	Spain
Eli Lilly Nigeria Ltd.	Nigeria
Lilly Development Centre, S.A.	Belgium
Lilly Services, S.A.	Belgium
Lilly Clinical Operations S.A.	Belgium
Eli Lilly CR s.r.o.	Czech Republic
Eli Lilly Egypt	Egypt
ELCO Foreign Trade and Marketing SAE	Egypt
Pharmaserve-Lilly S.A.C.I.	Greece
Pharmabrand, S.A.C.I.	Greece
PRAXICO Ltd.	Hungary
Lilly Hungaria KFT	Hungary
PaRxner B.V.	Netherlands

	State or Jurisdiction of Incorporation or Organization
ELI LILLY AND COMPANY (continued)	
ELCO Management, Inc. (continued)	
Lilly Holdings, LLC (continued)	
Lilly Holdings GmbH (continued)	
Eli Lilly S.A. (continued)	
Eli Lilly Nederland B.V. (continued)	
Eli Lilly (Philippines), Incorporated	Philippines
Eli Lilly and Company (India) Pvt. Ltd.	India
Eli Lilly Israel Ltd.	Israel
Dista Italia S.r.L.	Italy
Eli Lilly Japan K.K.	Japan
Lilly Korea Ltd.	Korea
Elanco Animal Health, Korea, Ltd.	Korea
Eli Lilly Malaysia Sdn. Bhd.	Malaysia
Eli Lilly Maroc, S.a.r.l.	Morocco
TDM B.V.	Netherlands
Eli Lilly Pakistan (Pvt.) Ltd.	Pakistan
Eli Lilly Polska Sp.z.o.o. (Ltd.)	Poland
Vitalia Pharma Sp.Z.o.o.	Poland
Eli Lilly Singapore Pte. Ltd.	Singapore
Lilly-NUS Centre for Clinical Pharmacology	Singapore
Eli Lilly (S.A.) (Proprietary) Limited	South Africa
Eli Lilly y Compania de Venezuela, S.A.	Venezuela
Dista Products & Compania Venezuela S.A.	Venezuela
Eli Lilly Regional Operations GmbH	Austria
Andean Technical Operations Center	Peru
Eli Lilly Asian Operations, Limited	Hong Kong
Dista Ilac Ticaret Ltd. Sti.	Turkey
Eli Lilly Slovakia s.r.o.	Slovakia
Eli Lilly Romania SRL	Romania
Eli Lilly Lithuania UAB	Lithuania
Eli Lilly Hrvatska d.o.o.	Croatia
Lilly Pharma Ltd.	Russia
Elanco Trustees Limited	Ireland
Kinsale Financial Services, Ltd.	Ireland
ELGO Insurance Company Limited	Bermuda
Eli Lilly Services, Inc.	British Virgin Islands
Eli Lilly Danmark A/S	Denmark
OY Eli Lilly Finland AB	Finland
Eli Lilly Norge A.S.	Norway
Eli Lilly Sweden AB	Sweden

Exhibit 23

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the following Registration Statements:

Registration Statement No.	Type of Statement	Date
33-37341	S-8	October 17, 1990
33-58466	S-3	February 17, 1993
33-50783	S-8	October 27, 1993
33-56141	S-8	October 24, 1994
333-02021	S-8	March 28, 1996
333-62015	S-8	August 21, 1998
333-66113	S-8	October 26, 1998
333-90397	S-8	November 5, 1999
333-35248	S-3	April 20, 2000
333-70308	S-8	September 27, 2001
333-104057	S-8	March 27, 2003
333-106478	S-3/A	September 16, 2003;

of our reports dated February 13, 2006, with respect to the consolidated financial statements of Eli Lilly and Company and subsidiaries and Eli Lilly and Company and subsidiaries management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of Eli Lilly and Company and subsidiaries included in this Annual Report (10-K) for the year ended December 31, 2005.

/s/ Ernst & Young LLP

Indianapolis, Indiana
February 28, 2006

EXHIBIT 31.1 Rule 13a-14(a) Certification of Sidney Taurel, Chairman of the Board and Chief Executive Officer

CERTIFICATIONS

I, Sidney Taurel, chairman of the board and chief executive officer, certify that:

1. I have reviewed this report on Form 10-K of Eli Lilly and Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2006

By: /s/ Sidney Taurel
Sidney Taurel
Chairman of the Board and
Chief Executive Officer

EXHIBIT 31.2 Rule 13a-14(a) Certification of Charles E. Golden, Executive Vice President and Chief Financial Officer

CERTIFICATIONS

I, Charles E. Golden, executive vice president and chief financial officer, certify that:

1. I have reviewed this report on Form 10-K of Eli Lilly and Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2006

By: /s/ Charles E. Golden
Charles E. Golden
Executive Vice President
and Chief Financial Officer

Exhibit 32 Section 1350 Certification

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Eli Lilly and Company, an Indiana corporation (the "Company"), does hereby certify that, to the best of their knowledge:

The Annual Report on Form 10-K for the year ended December 31, 2005 (the "Form 10-K") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date February 24, 2006

/s/ Sidney Taurel
Sidney Taurel
Chairman of the Board and Chief Executive Officer

Date February 24, 2006

/s/ Charles E. Golden
Charles E. Golden
Executive Vice President and Chief Financial Officer