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KBR, INC.

Form 10-Q

July 30, 2018

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kbr:HydrocarbonMember kbr:TechnologyMember kbr:OtherCountriesMember 2018-04-01 2018-06-30 0001357615

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country:AU 2018-04-01 2018-06-30 0001357615 kbr:HydrocarbonMember kbr:HydrocarbonServicesMember

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kbr:GovernmentServicesMember country:US 2018-01-01 2018-06-30 0001357615 kbr:HydrocarbonMember
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2018-01-01 2018-06-30 0001357615 kbr:AllDefenseContractAuditAgencyAuditIssuesMember 2018-06-30
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us-gaap:VariableInterestEntityPrimaryBeneficiaryMember 2017-12-31 0001357615
kbr:EscravosGasToLiquidsProjectMember us-gaap:VariableInterestEntityPrimaryBeneficiaryMember 2017-12-31
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

**ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2018**

**OR
.. Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition
period from to**

Commission File Number: 1-33146

KBR, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

20-4536774
(I.R.S. Employer Identification No.)

601 Jefferson Street, Suite 3400, Houston, Texas 77002
(Address of principal executive offices) (Zip Code)

(713) 753-3011
(Registrant's telephone number including area code)

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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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
	Emerging growth company <input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 12, 2018, there were 140,698,716 shares of KBR, Inc. Common Stock, par value \$0.001 per share, outstanding.

TABLE OF CONTENTS

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Information</u>	<u>6</u>
<u>Condensed Consolidated Statements of Operations</u>	<u>6</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>7</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>8</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>9</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>11</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>46</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>64</u>
<u>Item 4. Controls and Procedures</u>	<u>64</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>65</u>
<u>Item 1A. Risk Factors</u>	<u>65</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>
<u>Item 6. Exhibits</u>	<u>66</u>
<u>SIGNATURES</u>	<u>67</u>

Forward-Looking and Cautionary Statements

This Quarterly Report on Form 10-Q contains certain statements that are, or may be deemed to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act, as amended. The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward-looking information. Some of the statements contained in this Quarterly Report on Form 10-Q are forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "plan," "expect" and similar expressions are intended to identify forward-looking statements. Forward-looking statements include information concerning our possible or assumed future financial performance and results of operations.

We have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, factors that could cause actual future results to differ materially include the risks and uncertainties disclosed in our 2017 Annual Report on Form 10-K contained in Part I under "Risk Factors" and in this Quarterly Report on Form 10-Q in Part II under "Risk Factors."

Many of these factors are beyond our ability to control or predict. Any of these factors, or a combination of these factors, could materially and adversely affect our future financial condition or results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially and adversely from those projected in the forward-looking statements. We caution against putting undue reliance on forward-looking statements or projecting any future results based on such statements or on present or prior earnings levels. In addition, each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statement.

Glossary of Terms

The following frequently used abbreviations or acronyms are used in this Quarterly Report on Form 10-Q as defined below:

Acronym	Definition
Affinity	Affinity Flying Training Services Ltd.
AOCL	Accumulated other comprehensive loss
ASBCA	Armed Services Board of Contract Appeals
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BIE	Billings in excess of costs and estimated earnings on uncompleted contracts
CAS	Cost Accounting Standards
CIE	Costs and estimated earnings in excess of billings on uncompleted contracts
COFC	U.S. Court of Federal Claims
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DoD	Department of Defense
DOJ	U.S. Department of Justice
E&C	Engineering & Construction
EBIC	Egypt Basic Industries Corporation
EBITDA	Earnings before interest, taxes, depreciation and amortization
EPC	Engineering, procurement and construction
EPIC	EPIC Piping LLC
ESPP	Employee Stock Purchase Plan
Exchange Act	Securities Exchange Act of 1934
FAR	Federal Acquisition Regulation
FASB	Financial Accounting Standards Board
FCA	False Claims Act
FEED	Front end engineering and design
FKTC	First Kuwaiti Trading Company
FLNG	Floating liquefied natural gas
FPSO	Floating production, storage and offshore
FPU	Floating production units
FSRU	Floating storage and regasification unit
GS	Government Services
GTL	Gas to liquids
HETs	Heavy equipment transporters
HS	Hydrocarbons Services
HTSI	Honeywell Technology Solutions Inc.
ICC	International Chamber of Commerce
JKC	JKC Australia LNG, an Australian joint venture executing the Ichthys LNG Project
LIBOR	London interbank offered rate
LNG	Liquefied natural gas
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations (Part I, Item 2 of this Quarterly Report on Form 10-Q)
MFRs	Memorandums for Record
MoD	Ministry of Defense

Acronym	Definition
NCI	Noncontrolling interests
PEMEX	Petróleos Mexicanos
PEP	Pemex Exploration and Production
PFI	Privately financed initiatives and projects
PIC	Paid-in capital
PLOC	Performance Letter of Credit facility
PPE	Property, Plant and Equipment
PSC	Private Security Contractor
RIO	Restore Iraqi Oil
SEC	U.S. Securities and Exchange Commission
SFO	U.K. Serious Fraud Office
TSA	Transition Service Agreement
U.K.	United Kingdom
U.S.	United States
U.S. GAAP	Accounting principles generally accepted in the United States
UKMFTS	U.K. Military Flying Training System
VAT	Value-added tax
VIEs	Variable interest entities

PART I. FINANCIAL INFORMATION**Item 1. Financial Information****KBR, Inc.****Condensed Consolidated Statements of Operations****(In millions, except for per share data)****(Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenues	\$1,267	\$1,094	\$2,305	\$2,200
Cost of revenues	(1,137)	(986)	(2,094)	(2,010)
Gross profit	130	108	211	190
Equity in earnings of unconsolidated affiliates	10	32	33	41
General and administrative expenses	(41)	(38)	(76)	(70)
Acquisition and integration related costs	(1)	—	(4)	—
Gain on disposition of assets	—	1	—	5
Gain on consolidation of Aspire entities	—	—	115	—
Operating income	98	103	279	166
Interest expense	(17)	(5)	(23)	(10)
Other non-operating (loss) income	(1)	2	(3)	(5)
Income before income taxes and noncontrolling interests	80	100	253	151
Provision for income taxes	(18)	(21)	(52)	(34)
Net income	62	79	201	117
Net income attributable to noncontrolling interests	(20)	(2)	(21)	(3)
Net income attributable to KBR	\$42	\$77	\$180	\$114
Net income attributable to KBR per share:				
Basic	\$0.30	\$0.54	\$1.28	\$0.80
Diluted	\$0.30	\$0.54	\$1.27	\$0.80
Basic weighted average common shares outstanding	140	141	140	142
Diluted weighted average common shares outstanding	141	141	141	142
Cash dividends declared per share	\$0.08	\$0.08	\$0.16	\$0.16

See accompanying notes to condensed consolidated financial statements.

KBR, Inc.**Condensed Consolidated Statements of Comprehensive Income (Loss)****(In millions)****(Unaudited)**

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2018		2017	2018	2017
Net income	\$62		\$79	\$201	\$117
Other comprehensive income (loss), net of tax:					
<u>Foreign currency translation adjustments:</u>					
Foreign currency translation adjustments, net of tax	(26) (9) (28
Reclassification adjustment included in net income	—			—	5
Foreign currency translation adjustments, net of taxes of \$(2), \$1, \$(3) and \$5	(26) (9) (23
<u>Pension and post-retirement benefits, net of tax:</u>					
Actuarial losses, net of tax	—			—	—
Reclassification adjustment included in net income	7			7	13
Pension and post-retirement benefits, net of taxes of \$(1), \$(2), \$(2) and \$(3)	7		7		13
<u>Changes in fair value of derivatives:</u>					
Changes in fair value of derivatives, net of tax	(4) —) (4
Reclassification adjustment included in net income	—			—	—
Changes in fair value of derivatives, net of taxes of \$0, \$0, \$0 and \$0	(4) —) (4

² The incremental cost to the company is calculated by estimating the cost of computer hardware, software, and IT support, as well as part-time administrative support.

Nonqualified Deferred Compensation in 2008

Executive Contributions in Last Fiscal Year	Registrant Contributions in Last Fiscal Year	Aggregate Earnings in Last Fiscal Year	Aggregate Withdrawals/ Distributions in Last Fiscal Year	Aggregate Balance at Last Fiscal Year End
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Name	Plan	(\$) ¹	(\$) ²	(\$)	(\$)	(\$) ³
Mr. Taurel	nonqualified					
	savings	\$ 51,019	\$51,019	-\$902,296		\$ 2,170,064
	deferred compensation			\$473,727		\$ 9,024,790
	total	\$ 51,019	\$51,019	-\$428,569	\$ 0	\$11,194,854
Dr. Lechleiter	nonqualified					
	savings	\$ 66,548	\$66,548	-\$282,414		\$ 729,866
	deferred compensation	\$1,080,138		\$210,586		\$ 4,207,892
	total	\$1,146,686	\$66,548	-\$ 71,828	\$ 0	\$ 4,937,758
Dr. Paul	nonqualified					
	savings			-\$213,476		\$ 485,199
	deferred compensation					
	total	\$ 0	\$ 0	-\$213,476	\$ 0	\$ 485,199
Mr. Carmine	nonqualified					
	savings	\$ 33,187	\$33,187	-\$ 84,211		\$ 215,816
	deferred compensation	\$ 344,422		\$ 47,278		\$ 963,203
	total	\$ 377,609	\$33,187	-\$ 36,933	\$ 0	\$ 1,179,019
Mr. Rice	nonqualified					
	savings	\$ 36,247	\$36,247	-\$ 62,423		\$ 198,920
	deferred compensation					
	total	\$ 36,247	\$36,247	-\$ 62,423	\$ 0	\$ 198,920
Mr. Armitage	nonqualified					
	savings	\$ 32,926	\$32,926	-\$136,712		\$ 304,756
	deferred compensation	\$1,020,457		\$179,099		\$ 3,597,219
	total	\$1,053,383	\$32,926	\$ 42,387	\$ 0	\$ 3,901,975

¹ The amounts in this column are also included in the Summary Compensation Table on page 39, in the Salary column (nonqualified savings) or the Non-Equity Incentive Plan Compensation

column
(deferred
compensation).

² The amounts in this column are also included in the Summary Compensation Table on page 39, in the All Other Compensation column as a portion of the savings plan match.

³ Of the totals in this column, the following amounts have previously been reported in the Summary Compensation Table for this year and for previous years:

Name	Previous Years		
	2008 (\$)	(\$)	Total (\$)
Mr. Taurel	\$ 102,038	\$ 3,520,965	\$3,623,003
Dr. Lechleiter	\$1,213,233	\$ 2,666,297	\$3,879,530
Dr. Paul	\$ 0	\$ 218,711	\$ 218,711
Mr. Carmine	\$ 410,795	\$ 0	\$ 410,795
Mr. Rice	\$ 72,494	\$ 110,110	\$ 182,604
Mr. Armitage	\$1,086,309	\$ 2,620,075	\$3,706,384

The Nonqualified Deferred Compensation in 2008 table above shows information about two company programs: a nonqualified savings plan and a deferred compensation plan. The nonqualified savings plan is designed to allow each executive to contribute up to six percent of his or her base salary, and receive a company match, beyond the contribution limits prescribed by the IRS with regard to 401(k) plans. This plan is administered in the same manner as the company 401(k) Plan, with the same participation and investment elections, and all employees are eligible to participate. Executive officers and other executives may also defer receipt of all or part of their cash compensation under the company's deferred compensation plan. Amounts deferred by executives under this program are credited with interest at 120 percent of the applicable federal long-term rate as established for the preceding December by the U.S. Treasury Department under Section 1274(d) of the Internal Revenue Code with monthly compounding, which was 5.5 percent for 2008 and is 5.2 percent for 2009. Participants may elect to receive the funds in a lump sum or in up to 10 annual installments following retirement, but may not make withdrawals during their employment, except in the event of hardship as approved by the compensation committee. All deferral elections and associated distribution schedules are irrevocable. Both plans are unfunded and subject to forfeiture in the event of bankruptcy.

Potential Payments Upon Termination or Change in Control

The following table describes the potential payments and benefits under the company's compensation and benefit plans

and arrangements to which the named executive officers would be entitled upon termination of employment. Except for (i) certain terminations following a change in control of the company, as described below, and (ii) certain pension arrangements as shown below and described under Retirement Benefits above, there are no agreements, arrangements, or plans that entitle named executive officers to severance, perquisites, or other enhanced benefits upon termination of their employment. Any agreement to provide such payments or benefits to a terminating executive officer (other than following a change in control) would be at the discretion of the compensation committee.

Potential Payments Upon Termination of Employment

	Cash Severance Payment	Incremental Pension Benefit (present value)	Continuation of Medical / Welfare Benefits (present value) ¹	Acceleration and Continuation of Equity Awards (unamortized expense as of 12/31/08)	Excise Tax Gross-Up	Total Termination Benefits
Mr. Taurel						
Voluntary retirement (12/31/08)	0	0	0	0	0	0
Dr. Lechleiter						
Voluntary retirement	0	0	0	0	0	0
Involuntary termination	0	0	0	0	0	0
Involuntary or good reason termination after change in control (CIC)	\$8,218,106	\$1,616,631	\$ 24,000	\$ 0	\$3,678,530	\$13,537,267
Dr. Paul						
Voluntary retirement	0	0	0	0	0	0
Involuntary termination	0	\$3,327,394 ²	\$ 90,076 ²	0	0	\$ 3,417,470
Involuntary or good reason termination after CIC	\$4,632,054	\$4,695,338 ²	\$ 114,076 ²	\$ 201,350	\$3,537,468	\$13,180,286
Mr. Carmine						
Voluntary retirement	0	0	0	0	0	0
Involuntary termination	0	0	0	0	0	0
Involuntary or good reason termination after CIC	\$3,772,270	\$ 289,618	\$ 24,000	\$ 249,352	\$ 0	\$ 4,335,240
Mr. Rice						
Voluntary termination	0	0	0	0	0	0
Involuntary termination	0	0	0	0	0	0
Involuntary or good reason termination after CIC	\$3,755,264	\$ 161,415	\$ 24,000	\$2,684,962	\$1,498,108	\$ 8,123,749
Mr. Armitage						
Voluntary retirement	0	0	0	0	0	0
Involuntary termination	0	0	0	0	0	0
Involuntary or good reason termination after CIC	\$3,488,882	\$ 498,064	\$ 24,000	\$2,278,154	\$1,572,805	\$ 7,861,906

¹ See Accrued Pay and Regular Retirement Benefits and Change-in-Control Severance Pay Program Continuation

of medical and welfare benefits on pages 49-51.

- 2 These amounts reflect an additional 10 years of service credit that would be credited to Dr. Paul upon an involuntary termination, other than for cause, should it occur before he reaches age 60 (see page 47 for more information about Dr. Paul's retirement benefits).

Accrued Pay and Regular Retirement Benefits. The amounts shown in the previous table do not include payments and benefits to the extent they are provided on a non-discriminatory basis to salaried employees generally upon termination of employment. These include:

Accrued salary and vacation pay.

Regular pension benefits under the Lilly Retirement Plan and the nonqualified retirement plan. See Retirement Benefits

on pages 45-47. The amounts shown in the table above as Incremental Pension Benefit are explained below. Welfare benefits provided to all U.S. retirees, including retiree medical and dental insurance. The amounts shown in the table above as Continuation of Medical / Welfare Benefits are explained below.

Distributions of plan balances under the Lilly 401(k) Plan and the nonqualified savings plan. See the narrative following the Nonqualified Deferred Compensation in 2008 table on page 48 for information about the 401(k) plan, the deferred compensation plan, and the nonqualified savings plan.

The value of accelerated vesting of certain unvested equity grants upon retirement. Under the company's stock plans, employees who terminate employment while retirement-eligible receive accelerated vesting of unvested stock options (except for options granted in the 12 months before retirement, which are forfeited), outstanding performance awards and shareholder value awards (which are paid on a reduced basis for time worked during the award period), and restricted stock awarded in payment of previous performance awards.

The value of option continuation upon retirement. When an employee terminates prior to retirement, his or her stock options are terminated 30 days thereafter. However,

when a retirement-eligible employee terminates, his or her options remain in force until the earlier of five years after retirement or the option's normal expiration date.

Deferred Compensation. The amounts shown in the table do not include distributions of plan balances under the Lilly deferred compensation plan. Those amounts are shown in the Nonqualified Deferred Compensation in 2008 table on page 47.

Death and Disability. A termination of employment due to death or disability does not entitle the named executive officers to any payments or benefits that are not available to salaried employees generally.

Change-in-Control Severance Pay Program. As described in the Compensation Discussion and Analysis under Severance Benefits on pages 36-37, the company maintains a change-in-control severance pay program for nearly all employees, including the named executive officers (the CIC Program). The CIC Program defines a change in control very specifically, but generally the term includes the occurrence of, or entry into, an agreement to do one of the following: (a) acquisition of 15 percent (20 percent beginning October 20, 2010) or more of the company's stock; (b) replacement by the shareholders of one third (one half beginning October 20, 2010) or more of the board of directors; (c) consummation of a merger, share exchange, or consolidation of the company; or (d) liquidation of the company or sale or disposition of all or substantially all of its assets. The amounts shown in the table for involuntary or good reason termination following a change in control are based on the following assumptions and plan provisions:

Covered terminations. The table assumes a termination of employment that is eligible for severance under the terms of the current plan, based on the named executive's compensation, benefits, age, and service credit at December 31, 2008. Eligible terminations include an involuntary termination for reasons other than cause, or a voluntary termination by the executive for good reason, within two years following the change in control.

A termination of an executive officer by the company is for cause if it is for any of the following reasons: (i) the employee's willful and continued refusal to perform, without legal cause, his or her material duties, resulting in demonstrable economic harm to the company; (ii) any act of fraud, dishonesty, or gross misconduct resulting in significant economic harm or other significant harm to the business reputation of the company; or (iii) conviction of or the entering of a plea of guilty or nolo contendere to a felony.

A termination by the executive officer is for good reason if it results from (i) a material diminution in the nature or status of the executive's position, title, reporting relationship, duties, responsibilities or authority, or the assignment to him or her of additional responsibilities that materially increase his or her workload; (ii) any reduction in the executive's then-current base salary; (iii) a material reduction in the executive's opportunities to earn incentive bonuses below those in effect for the year prior to the change in control; (iv) a material reduction in the executive's employee benefits from the benefit levels in effect immediately prior to the change in control; (v) the failure to grant to the executive stock options, stock units, performance shares, or similar incentive rights during each twelve (12) month period following the change in control on the basis of a number of shares or units and all other material terms at least as favorable to the executive as those rights granted to him or her on an annualized average basis for the three (3) year period immediately prior to the change in control; or (vi) relocation of the executive by more than fifty (50) miles.

Cash severance payment. Represents the CIC Program benefit of two times the 2008 annual base salary plus two times cash bonus for 2008 under the Eli Lilly and Company Bonus Plan.

Incremental pension benefit. Represents the present value of an incremental nonqualified pension benefit of two years of age credit and two years of service credit that is provided under the CIC Program. The incremental pension benefit will be discontinued effective October 20, 2010. The following standard actuarial assumptions were used to calculate each individual's incremental pension benefit:

Discount rate:	6.9 percent
Mortality (post-retirement only):	RP 2000CH
Joint & survivor benefit:	25% of pension

For Dr. Paul, the amounts in the table above reflect the 10 years of additional service credit described on page 47.

Continuation of medical and welfare benefits. Represents the present value of the CIC Plan's guarantee for two years following a covered termination of continued coverage equivalent to the company's current active employee medical, dental, life, and long-term disability insurance. Effective October 20, 2010, the coverage period will be reduced to 18 months. For Dr. Paul, the amount in the table reflects the 10 years of additional service credit described on page 47, which makes him eligible for an enhanced retiree medical benefit. The same actuarial assumptions were used to calculate continuation of medical and welfare benefits as were used to calculate incremental pension benefits, with the addition of an assumed COBRA rate of \$12,000 per year.

Acceleration and continuation of equity awards. Under the CIC Plan, upon a covered termination, any unvested stock options, restricted stock, or other equity awards would vest, and options would be exercisable for up to three years following termination. Payment of the Shareholder Value Award is accelerated in the case of a change in control in which Lilly is not the surviving entity. For the four retirement-eligible employees, Dr. Lechleiter, Dr. Paul, Mr. Carmine, and Mr. Armitage, the only other equity award receiving accelerated vesting and term extension because of the CIC Plan would be 5,000 shares of restricted stock held by Dr. Paul; all other unvested equity awards (with the exception of the SVA) automatically vest upon retirement regardless of reason. The amounts in this column represent the previously unamortized expense that would be recognized in connection with the acceleration of unvested equity grants. In addition, the named executive officer who is not retirement-eligible, Mr. Rice, would receive the benefit under the CIC Plan of continuation of his outstanding stock options for up to three years following termination of employment. There would be no incremental expense to the company for this continuation because the option would already have been fully expensed.

Excise tax reimbursement. Upon a change in control, employees may be subject to certain excise taxes under Section 280G of the Internal Revenue Code. The company has agreed to reimburse the affected employees for those excise taxes as well as any income and excise taxes payable by the executive as a result of the reimbursement. The amounts in the table are based on a 280G excise tax rate of 20 percent and a 40 percent federal, state, and local income tax rate.

Payments Upon Change in Control Alone. In general, the CIC Program is a "double trigger" program, meaning payments are made only if the employee suffers a covered termination of employment within two years following the change in control. Employees do not receive payments upon a change in control alone, except that upon consummation of a change in control a partial payment of outstanding performance awards would be made, reduced to reflect only the portion of the year worked prior to the change in control. For example, if a change in control occurred on June 30, the employee would receive one-half of the value of the performance award, calculated based on the company's then-current financial forecast for the year. Likewise, in the case of a change in control in which Lilly is not the surviving entity, the SVA will pay out based on the change-in-control stock price and prorated for the portion of the three-year performance period elapsed.

Related-Person Transaction

As noted above, for security reasons the company aircraft was made available to Mr. Taurel in 2008 for all travel. The company entered into a time-share arrangement (now ended) with Mr. Taurel in connection with his personal use of company aircraft. Under the time-share agreement, Mr. Taurel leased the company aircraft, including crew and flight services, for personal flights. He paid a time-share fee based on the company's cost of the flight but capped at the greater of (i) an amount equivalent to first-class airfare for the relevant flight (if commercially available) or (ii) the Standard Industry Fare Levels as established by the Internal Revenue Service for purposes of determining taxable fringe benefits.

Ownership of Company Stock**Common Stock Ownership by Directors and Executive Officers**

The following table sets forth the number of shares of company common stock beneficially owned by the directors, the named executive officers, and all directors and executive officers as a group, as of February 3, 2009.

The table shows shares held by named executives in the Lilly Employee 401(k) Plan, shares credited to the accounts of outside directors in the Lilly Directors' Deferral Plan, and total shares beneficially owned by each individual, including the shares in the respective plans. In addition, the table shows shares that may be purchased pursuant to stock options that are exercisable within 60 days of February 3, 2009.

Name	401(k) Plan Shares	Directors Deferral Plan Shares ¹	Total Shares Owned Beneficially ²	Stock Options Exercisable Within
				60 Days of February 3, 2009
Robert A. Armitage	1,932		63,424	335,371
Sir Winfried Bischoff		16,237	18,237	11,200
Bryce D. Carmine	4,717		44,348	361,855
J. Michael Cook		15,683	17,483	
Michael L. Eskew		4,513	4,513	
Martin S. Feldstein, Ph.D.		14,529	15,529	8,400
J. Erik Fyrwald		16,673	16,786	
Alfred G. Gilman, M.D., Ph.D.		22,424	22,424	14,000
Karen N. Horn, Ph.D.		35,769	35,769	14,000
John C. Lechleiter, Ph.D.	14,163		229,400 ³	958,775
Ellen R. Marram		14,529	15,529	5,600
Douglas R. Oberhelman		0	0	
Steven M. Paul, M.D.	552		43,538	568,396
Franklyn G. Prendergast, M.D., Ph.D.		28,317	28,317	14,000
Derica W. Rice	5,559		59,689	123,385
Kathi P. Seifert		24,176	27,709	14,000
Sidney Taurel	18,061		1,064,059 ⁴	2,447,488
All directors and executive officers as a group (21 people):			1,902,333	

¹ See description of the Lilly Directors Deferral Plan, page 19.

2 Unless otherwise indicated in a footnote, each person listed in the table possesses sole voting and sole investment power with respect to the shares shown in the table to be owned by that person. No person listed in the table owns more than 0.09 percent of the outstanding common stock of the company. All directors and executive officers as a group own 0.17 percent of the outstanding common stock of the company. 1,800 of Mr. Cook's shares were on deposit in a margin account as of February 3, 2009.

3 The shares shown for Dr. Lechleiter include 13,470 shares that are owned by a family foundation for which he is a director. Dr. Lechleiter

has shared
voting power
and shared
investment
power over the
shares held by
the foundation.

4 The shares shown for Mr. Taurel are presented as of his retirement, December 31, 2008, and include 17,304 shares that are owned by a family foundation for which he is a director. Mr. Taurel has shared voting power and shared investment power over the shares held by the foundation.

Principal Holders of Stock

To the best of the company's knowledge, the only beneficial owners of more than five percent of the outstanding shares of the company's common stock are the shareholders listed below:

Name and Address	Number of Shares Beneficially Owned	Percent of Class
Lilly Endowment, Inc. (the Endowment) 2801 North Meridian Street Indianapolis, Indiana 46208	_____ (as of __/__/__)	_____
Capital World Investors 333 South Hope Street Los Angeles, California 90071	_____ (as of __/__/__)	_____
Wellington Management Company, LLP 75 State Street Boston, Massachusetts 02109	_____ (as of __/__/__)	_____
PRIMECAP Management Company 225 South Lake Ave., #400 Pasadena, California 91101	_____ (as of __/__/__)	_____

The Endowment has sole voting and sole investment power with respect to its shares. The board of directors of the Endowment is composed of Mr. Thomas M. Lofton, chairman; Mr. N. Clay Robbins, president; Mrs. Mary K. Lisher; Drs. Otis R. Bowen and William G. Enright; and Messrs. Daniel P. Carmichael, Eli Lilly II, and Eugene F. Ratliff (emeritus director). Each of the directors is, either directly or indirectly, a shareholder of the company.

Capital World Investors is a division of Capital Research and Management Company. It has sole voting power with respect to _____ shares (approximately ___ percent of shares outstanding) and sole investment power with respect to all of its shares.

Wellington Management Company, LLP acts as investment advisor to various clients. It has shared voting power with respect to _____ shares (approximately ___ percent of shares outstanding) and shared investment power with respect to all of its shares.

PRIMECAP Management Company acts as investment advisor to various clients. It has sole voting power with respect to _____ shares (approximately ___ percent of shares outstanding) and sole investment power with respect to all of its shares.

Items of Business to Be Acted Upon at the Meeting

Item 1. Election of Directors

Under the company's articles of incorporation, the board is divided into three classes with approximately one-third of the directors standing for election each year. The term for directors elected this year will expire at the annual meeting of shareholders held in 2012. Each of the nominees listed below has agreed to serve that term. If any director is unable to stand for election, the board may, by resolution, provide for a lesser number of directors or designate a substitute. In the latter event, shares represented by proxies may be voted for a substitute director.

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

Martin S. Feldstein, Ph. D.
J. Erik Fyrwald
Ellen R. Marram
Douglas R. Oberhelman

Biographical information about these nominees may be found on pages 8-9 of this proxy statement. Information about certain legal matters may be found on page 64.

Item 2. Proposal to Ratify the Appointment of Principal Independent Auditor

The audit committee has appointed the firm of Ernst & Young LLP as principal independent auditor for the company for the year 2009. In accordance with the bylaws, this appointment is being submitted to the shareholders for ratification. Ernst & Young served as the principal independent auditor for the company in 2008. Representatives of Ernst & Young are expected to be present at the annual meeting and will be available to respond to questions. Those representatives will have the opportunity to make a statement if they wish to do so.

The board recommends that you vote FOR ratifying the appointment of Ernst & Young LLP as principal independent auditor for 2009.

Item 3. Proposal to Amend the Company's Articles of Incorporation to Provide for Annual Election of Directors

The company's amended articles of incorporation currently provide that the board of directors is divided into three classes, with each class elected every three years. On the recommendation of the directors and corporate governance committee, the board has approved, and recommends to the shareholders for approval, amendments to provide for the annual election of directors. This proposal was brought before shareholders in April 2007 and again in April 2008, and received the vote of more than 75 percent of the outstanding shares at each meeting; however, the proposal requires the vote of 80 percent of the outstanding shares to pass.

If approved, this proposal will become effective upon the filing of amended and restated articles of incorporation containing these amendments with the Secretary of State of Indiana, which the company intends to do promptly after shareholder approval is obtained. Directors elected prior to the effectiveness of the amendments will stand for election for one-year terms once their then-current terms expire. This means that directors whose terms expire at the 2010 and 2011 annual meetings of shareholders would be elected for one-year terms, and beginning with the 2012 annual meeting, all directors would be elected for one-year terms at each annual meeting. In addition, in the case of any vacancy on the board occurring after the 2009 annual meeting, including a vacancy created by an increase in the number of directors, the vacancy would be filled by interim election of the board, with the new director to serve a term ending at the next annual meeting. At all times, directors are elected to serve for their respective terms and until their successors have been elected and qualified. This proposal would not change the present number of directors, and it would not change the board's authority to change that number and to fill any vacancies or newly created directorships.

Article 9(b) of the company's amended articles of incorporation contains the provisions that will be affected if this proposal is adopted. This article, set forth in Appendix A to this proxy statement, shows the proposed changes with deletions indicated by strike-outs and additions indicated by underlining. The board has also adopted conforming amendments to the company's bylaws, to be effective immediately upon the effectiveness of the amendments to the amended articles of incorporation.

Background of Proposal

The proposal is a result of ongoing review of corporate governance matters by the board. The board, assisted by the directors and corporate governance committee, considered the advantages and disadvantages of maintaining the classified board structure. The board considered the view of some shareholders who believe that classified boards have the effect of reducing the accountability of directors to shareholders because classified boards limit the ability of shareholders to evaluate and elect all directors on an annual basis. The election of directors is the primary means for shareholders to influence corporate governance policies. The board gave considerable weight to the approval at the 2006 annual meeting of a shareholder proposal requesting that the board take all necessary steps to elect the directors annually, and to the 77 percent favorable vote for management's proposal in 2008 (75 percent in 2007).

The board also considered benefits of retaining the classified board structure, which has a long history in corporate law. Proponents of a classified structure believe it provides continuity and stability in the management of the business and affairs of a company because a majority of directors always have prior experience as directors of the company. Proponents also assert that classified boards may enhance shareholder value by forcing an entity seeking control of a target company to initiate arms-length discussions with the board of that company, because the entity cannot replace the entire board in a single election. While the board recognizes those potential benefits, it also notes that even without a classified board, the company has other means to compel a takeover bidder to negotiate with the board, including certain supermajority vote requirements in its amended articles of incorporation (as described in the company's response to Item 5 on pages 58-59), other provisions of its articles and bylaws, and certain provisions of Indiana law.

On the recommendation of the directors and corporate governance committee, the board approved the amendments, and now recommends that the shareholders approve them. Although this proposal did not pass in 2008, the board continues to support this change and believes that by taking this action, it can provide shareholders further assurance that the directors are accountable to shareholders while maintaining appropriate defenses to respond to inadequate takeover bids.

Vote Required

The affirmative vote of at least 80 percent of the outstanding common shares is needed to pass this proposal.

The board recommends that you vote FOR amending the company's articles of incorporation to provide for annual election of directors.

Item 4. Reapproval of Material Terms of Performance Goals for the Eli Lilly and Company Bonus Plan

Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), limits the amount of compensation expense that the company can deduct for income tax purposes. In general, a public corporation cannot deduct compensation in excess of \$1 million paid to any of the named executive officers in the proxy statement. However, compensation that qualifies as performance-based is not subject to this deduction limitation.

The Eli Lilly and Company Bonus Plan (the plan) allows the grant of cash bonuses that qualify as performance-based compensation under Section 162(m) of the Code. One of the conditions to qualify as performance-based is that the material terms of the performance goals must be approved by the shareholders at least every five years. The last such approval for the plan was when the plan itself was approved in 2004. To preserve the tax status of company bonuses as performance-based, and thereby to allow the company to continue to fully deduct the compensation expense related to the awards, we are now asking the shareholders to reapprove the performance goals. We are not amending or altering the plan. If this proposal is not adopted, the committee will continue to grant cash bonuses under the plan, but certain executive officer bonuses would no longer be fully tax deductible by the company.

Purpose of the Plan

The purpose of the plan is to motivate superior performance and teamwork by employees at all levels of the company by linking annual cash bonuses to important corporate performance measures. Bonus payments are linked directly to both individual and corporate performance. Exceptional performance by individuals and the company will lead to increases in bonuses, and shortfalls in performance will lead to bonus reductions.

Principal Features of the Plan

The following is a summary of the material features of the plan:

Administration. The plan is administered by the compensation committee of the board, which is composed entirely of independent directors. The committee has authority to delegate plan administration with respect to employees other than the executive officers.

Eligibility. Plan participants include all executive officers, all management employees worldwide, most U.S. and Puerto Rico nonmanagement employees, and selected employees outside the United States. The committee may include other employees at its discretion. For 2008, approximately 17,500 employees were eligible to participate.

Performance Measures and Bonus Calculation. Prior to the beginning of each year, the committee establishes the following elements necessary for the bonus calculation:

Bonus targets are established for participants based on a schedule that associates job responsibilities with a bonus target amount expressed as a percentage of regular earnings for the year.

Company performance measures are established for the year. The committee may select one or more from among the following measures: growth in net income or earnings per share; growth in sales; return on assets; return on equity; total shareholder return; economic value added (EVA); market value added (MVA); or any of the foregoing before the effect of acquisitions, divestitures, accounting changes, changes in corporate capitalization, restructurings, and special charges or gains (determined according to objective criteria established by the committee not later than 90 days after the beginning of the year). Unless the committee chooses otherwise, the company performance measures are based 75 percent on earnings-per-share growth and 25 percent on sales growth. Bonuses for 2009 will be based on this measure.

A **bonus multiple** is used to adjust the bonus target to account for company performance. The committee establishes performance benchmarks for sales and earnings growth after considering expected peer group performance. If the benchmarks are met exactly, the bonus multiple would be 100 percent of the bonus target. Actual bonus multiples will vary depending on company performance relative to the benchmarks. The maximum bonus multiple is 200 percent of the bonus target and the threshold multiple is 25 percent of the bonus target (zero for executive officers), except that the committee has discretion to reduce the bonus multiple to a lower percentage or to zero. The committee does not have discretion to increase the multiple.

Individual Performance Adjustments. For employees other than executive officers, the committee will establish performance multipliers which correspond to individual performance ratings on an annual basis. Executive officers' awards may not be adjusted upward.

Payment. Payment will be made following certification by the committee of the company's actual performance results for the year. No executive officer's bonus payment may exceed \$7 million in any one year. Participants must remain employed until the end of the year to receive a bonus, except in the case of retirement, death, disability, and certain leaves of absence.

Amendment. The plan may be amended at any time by the board or the committee. Shareholder approval of amendments may be sought to the extent the company deems it necessary or advisable to preserve tax-deductibility under Section 162(m) of the Code.

It is not possible to predict with certainty the bonuses that would be payable to the executive officers with respect to 2009 performance. However, if the company were to meet the target performance benchmarks for earnings-per-share growth and sales growth, and assuming no change in the regular earnings of the executive officers for the year, the following bonuses would be paid for 2009 (before taxes):

Mr. Taurel no longer eligible

Dr. Lechleiter \$2,100,000

Dr. Paul \$933,210

Mr. Carmine \$831,600

Mr. Rice \$720,800

Mr. Armitage \$653,120

All executive officers as a group (10 officers): \$7,382,020

It is not possible to estimate the aggregate 2009 bonuses that would be payable to all eligible employees as a group.

Equity Compensation Plan Information

The following table presents information as of December 31, 2008, about our other compensation plans under which shares of Lilly stock have been authorized for issuance.

Plan category	(a) Number of securities to be	(b)	(c) Number of securities remaining available for future issuance under
	issued upon exercise of outstanding options, warrants, and rights	Weighted-average exercise price of outstanding options, warrants, and rights	equity compensation plans (excluding securities reflected in (a))
Equity compensation plans approved by security holders	63,429,738	68.48	87,996,763
Equity compensation plans not approved by security holders ¹	8,594,960	75.76	0 ₂
Total	72,024,698	69.35	87,996,763

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.

2 The Lilly GlobalShares Stock Plan was terminated in

February 2009.
No more grants
can be made
under this plan.

The board recommends that you vote FOR reapproving the material terms of performance goals for the Eli Lilly and Company Bonus Plan.

Item 5. Shareholder Proposal on Eliminating Supermajority Voting Provisions from the Company's Articles of Incorporation and Bylaws

Dana Chatfield Jones, 1354 Campus Drive, Berkeley, California 94708, beneficial owner of approximately 100 shares, has submitted the following proposal:

57

RESOLVED, Shareholders request that our board take the steps necessary so that each shareholder voting requirement in our charter and bylaws, that calls for a greater than simple majority vote, be changed to a majority of the votes cast for and against related proposals in compliance with applicable laws. This proposal applies to each 80% provision in our charter and bylaws.

Supporting Statement: This proposal is submitted in part to support our Board and management in securing the necessary vote to adopt the management proposals for annual election of each director, also known as declassifying the board.

In 2007 and 2008 our management recommended that we vote in favor of management proposals for annual election of each director. But although we responded and management won strong support of 75% and 77% of shares outstanding it still fell disappointingly short of our 80% threshold.

This Simple Majority Vote proposal will reduce the threshold from 80% to 50% and one vote to adopt annual election of each director. I believe this proposal will enable our management to secure the vote necessary to adopt annual election of each director after these two disappointments.

Additionally this proposal topic to adopt simple majority voting received 63% of our yes and no votes at our 2008 annual meeting as a shareholder proposal. This proposal topic also won up to 89% support at the following companies in 2008:

Whirlpool (WHR)	79%
Lear Corp. (LEA)	88%
Liz Claiborne (LIZ)	89%

The Council of Institutional Investors recommends adoption of simple majority voting. The Council also recommends timely adoption of shareholder proposals upon receiving their first 51% or higher vote.

Please encourage our board to respond positively to this proposal and take the steps necessary to adopt a simple majority voting standard.

Statement in Opposition to the Proposal on Eliminating Supermajority Voting Provisions from the Company's Articles of Incorporation and Bylaws

The board of directors believes that this proposal is not in the best long-term interests of the shareholders and recommends that you vote against it.

The supermajority vote requirements were approved by shareholders and are very limited.

Nearly all proposals submitted to a vote of shareholders can already be adopted by a simple majority vote. However, in 1985 the company's shareholders voted to increase the approval requirement established in the articles of incorporation for a few fundamental corporate actions. These actions, which require the approval of at least 80 percent of the outstanding shares, relate to:

- terms of office of directors (i.e., the classified board structure)
- removal of directors prior to the end of their elected term
- the amendment of the articles of incorporation's provisions relating to the terms of office and removal of directors
- merger, consolidation, recapitalization, or certain other business combinations that are not approved by the board of directors
- the amendment of the articles of incorporation's provisions relating to such mergers and business combinations.

Under Item 3 of this proxy statement the board is recommending a vote to provide for annual election of directors. If Item 3 is successful, the only significant matters that would require an 80 percent vote would be (i) removal of directors other than through the annual election process and (ii) approval of

mergers and business combinations that are opposed by the board. These are rare and dramatic corporate actions that should not be undertaken without the approval of a very large majority of shareholders.

The vote requirements help the board preserve long-term value for shareholders in the face of short-term opportunistic threats.

The board believes that in adopting these supermajority voting provisions, the shareholders intended to preserve and maximize the value of Lilly stock for all shareholders by protecting against short-term, self-interested actions by one or a few large shareholders who would seek to make fundamental changes to the company without the involvement of the board of directors.

The board has a fiduciary duty under the law to act in a manner it believes to be in the best interests of the company and its shareholders. In the event of an unsolicited bid to take over or restructure the company, these supermajority voting provisions encourage bidders to negotiate with the board and give the board substantial bargaining leverage. The provisions also give the board valuable time to consider alternative proposals that might provide greater value for all shareholders.

The board believes that these supermajority voting provisions protect all shareholders by making it more difficult for one or a few large shareholders to restructure the company to further a special interest, or to take control of the company, without negotiating with the board to assure that the best results are achieved for all shareholders.

In today's troubled markets, takeover defenses are especially important.

In our analysis, the evidence does not support the view that large-scale pharmaceutical mergers have produced sustained operating performance, competitive advantage, or superior returns for shareholders. Thus, under any circumstances—and especially during a period of depressed stock prices—it is important that a board be able to respond to opportunistic takeover bids from a position of strength, ensuring that the outcome is in the best interests of the company and all shareholders.

The board recommends that you vote AGAINST this proposal.

Item 6. Shareholder Proposal on Allowing Shareholders to Amend the Company's Bylaws

California Public Employees Retirement System (CalPERS), P.O. Box 942707, Sacramento, California 94229-2707, beneficial owner of approximately 3,488,440 shares, has submitted the following proposal:

RESOLVED, that the shareowners of Eli Lilly & Company (Company) urge the Company to take all steps necessary, in compliance with applicable law, to allow its shareowners to amend the Company's bylaws by a simple majority vote.

Supporting Statement: The most important shareowner power is the power to vote. In most cases, in addition to having the power to vote to elect directors, shareowners are able to vote to amend a company's bylaws. Approximately 95% of companies in the S&P 500 and the Russell 1000 allow shareowners to amend the bylaws. The Company is one of the very few companies in the S&P 500 that does not give shareowners this power.

Bylaws typically contain corporate governance provisions of the utmost importance to shareowners, e.g., the ability to call a special meeting, the ability to remove directors, anti-takeover provisions, director election rules, among other provisions. Without a formal mechanism to impact a company's governance through bylaw amendments, the shareowners of a company are disenfranchised. In fact, limiting shareowner ability to amend the bylaws has been found to be one of six entrenching mechanisms that are negatively correlated with company performance. See *What Matters in Corporate Governance?* Lucian Bebchuk, Alma Cohen & Allen Ferrell, Harvard Law School, Discussion Paper No. 491 (09/2004, revised 03/2005).

This proposal asks for a simple majority vote standard to amend the bylaws of the Company since a supermajority vote can be almost impossible to obtain in light of abstentions and broker non-votes. For example, a proposal to declassify the board of directors filed at Goodyear Tire &

Rubber Company failed to pass by a majority of shares outstanding even though approximately 90 percent of votes cast were in favor of the proposal. While it is often stated by corporations that the purpose of supermajority requirements is to provide corporations the ability to protect minority shareowners, supermajority requirements are most often used, in CalPERS' opinion, to block initiatives opposed by management and the board of directors but supported by most shareowners. At the Sara Lee Corporation, approximately 81% of shareowners agreed when it passed a proposal identical to this proposal.

This is why CalPERS is sponsoring this proposal that, if passed and implemented, would make the Company more accountable to shareowners by allowing shareowners to amend the bylaws by majority vote. As a trust fund with more than 1.5 million participants, and as the owner of approximately 3.4 million shares of the Company's common stock, CalPERS believes that corporate governance procedures and practices, and the level of accountability they impose, are closely related to financial performance. CalPERS also believes that shareowners are willing to pay a premium for shares of corporations that have excellent corporate governance. If the Company were to take steps to implement this proposal, it would be a strong statement that this Company is committed to good corporate governance and its long-term financial performance.

Please vote FOR this proposal.

Statement in Opposition to the Proposal on Allowing Shareholders to Amend the Company's Bylaws

The board of directors believes that this proposal is not in the best long-term interests of the shareholders and recommends that you vote against it.

The current rules prevent the bylaws from being abused by special interest shareholder groups.

The company's bylaws establish a number of fundamental corporate governance operating principles, including rules for meetings of directors and shareholders, election and duties of directors and officers, authority to approve transactions, and procedures for stock issuance. Under Indiana law, the bylaws can contain any provision regulating the operation of the business not prohibited by law or the articles of incorporation. Like many other Indiana corporations, Lilly has adopted the default provision under Indiana law, which states that unless the articles of incorporation provide otherwise, the bylaws may be amended only by the directors.

The board of directors has fiduciary obligations to the company and all its shareholders, including large institutions, small institutions, and individual investors. The board believes that allowing the bylaws to be amended by a majority shareholder vote would expose shareholders to the risk that a relatively small number of large shareholders who wish to advance their own special interests and who have no duties to the other shareholders could adopt changes in these operating principles that would be detrimental to minority shareholders. Under the majority vote standard endorsed by the proponent (requiring only a majority of shares voted at the meeting), shareholders holding significantly less than half of the outstanding shares could adopt bylaw amendments to further their own special interests. The board, on the other hand, has fiduciary duties to consider and balance the interests of all shareholders when considering bylaw provisions, and is better positioned to ensure that any bylaw amendments are prudent and are designed to protect and maximize long-term value for all shareholders.

This proposal is not necessary to foster good governance or create growth in shareholder value.

The proponent suggests this proposal is necessary to foster good governance principles and make the directors more accountable to the shareholders. On the contrary, the board has been for many years, and intends to remain, a leader in corporate governance. The company has adopted comprehensive corporate governance principles, consistent with best practices, that ensure the company remains fully transparent and accountable to shareholders. Further, the board has taken significant steps to demonstrate its continuing commitment to good corporate governance and accountability to shareholders:

In this proxy statement, the board is seeking shareholder approval to provide for annual election of directors (see Item 3).

The board adopted a majority voting standard for uncontested director elections beginning this year.

The board allowed the company's shareholder rights plan to expire in 2008.

The proponent also suggests that adopting this proposal will enhance company performance. We certainly agree that strong corporate governance practices benefit shareholders, but we do not believe that this proposal will improve the company's corporate governance or lead to better performance. In fact, a 2004 study by Lawrence D. Brown and Marcus L. Caylor of Georgia State University¹ found that companies that permit shareholders to amend the bylaws performed no better or worse than those which reserve that power to the directors. This is consistent with our view that adopting this proposal would not enhance our already strong corporate governance practices and instead would expose minority shareholders to actions detrimental to their best interests.

The board recommends that you vote AGAINST this proposal.

Item 7. Shareholder Proposal on Shareholder Ratification of Executive Compensation

Gretchen Parrish, 2820 Senour Road, Indianapolis, Indiana 46239, beneficial owner of approximately 120 shares, has submitted the following proposal:

RESOLVED, that shareholders of Eli Lilly and Company request the board of directors to adopt a policy that provides shareholders the opportunity at each annual shareholder meeting to vote on an advisory resolution, proposed by management, to ratify the compensation of the named executive officers (NEOs) set forth in the proxy statement's Summary Compensation Table (the SCT) and the accompanying narrative disclosure of material factors provided to understand the SCT (but not the Compensation Discussion and Analysis). The proposal submitted to shareholders should make clear that the vote is non-binding and would not affect any compensation paid or awarded to any NEO.

Supporting Statement: Investors are increasingly concerned about mushrooming executive compensation especially when insufficiently linked to performance. In 2008, shareholders filed close to 100 Say on Pay resolutions. Votes on these resolutions have averaged 43% in favor, with ten votes over 50%, demonstrating strong shareholder support for this reform.

An Advisory Vote establishes an annual referendum process for shareholders about senior executive compensation. We believe the results of this vote would provide the board and management useful information about shareholder views on the company's senior executive compensation.

In its 2008 proxy Aflac submitted an Advisory Vote resulting in a 93% vote in favor, indicating strong investor support for good disclosure and a reasonable compensation package. Daniel Amos, Chairman and CEO said, "An advisory vote on our compensation report is a helpful avenue for our shareholders to provide feedback on our pay-for-performance compensation philosophy and pay package."

To date eight other companies have also agreed to an Advisory Vote, including Verizon, MBIA, H&R Block, Ingersoll Rand, Blockbuster, and Tech Data. TIAA-CREF, the country's largest pension fund, has successfully utilized the Advisory Vote twice.

Influential proxy voting service RiskMetrics Group, recommends votes in favor, noting: "RiskMetrics encourages companies to allow shareholders to express their opinions of executive compensation practices by establishing an annual referendum process. An advisory vote on executive compensation is another step forward in enhancing board accountability."

¹ Brown, L.D.
and M.L.
Caylor. 2004.
The Correlation
between
Corporate
Governance and
Company
Performance.
*Institutional
Shareholder
Services White*

Paper.

The Council of Institutional Investors endorsed advisory votes and a bill to allow annual advisory votes passed the House of Representatives by a 2-to-1 margin. We believe the statement like approach for company leaders is to adopt an Advisory Vote voluntarily before required by law.

We believe that existing U.S. Securities and Exchange Commission rules and stock exchange listing standards do not provide shareholders with sufficient mechanisms for providing input to boards on senior executive compensation. In contrast, in the United Kingdom, public companies allow shareholders to cast a vote on the directors remuneration report, which discloses executive compensation. Such a vote isn't binding, but gives shareholders a clear voice that could help shape senior executive compensation.

We believe that a company that has a clearly explained compensation philosophy and metrics, reasonably links pay to performance, and communicates effectively to investors would find a management sponsored Advisory Vote a helpful tool.

We urge our board to allow shareholders to express their opinion about senior executive compensation through an Advisory Vote.

Statement in Opposition to the Proposal on Shareholder Ratification of Executive Compensation

The board of directors believes that this proposal is not in the best long-term interests of the shareholders and recommends that you vote against it.

An advisory vote is not a substitute for the informed judgment of independent directors.

The compensation committee, composed of independent directors and assisted by an independent consultant, takes very seriously its fiduciary duties to oversee executive compensation programs that are designed to promote long-term value for the company and its shareholders. The committee's work is complex and time-consuming; it involves analysis of both public and confidential information, including competitively sensitive strategic and operational information. Any votes by shareholders would necessarily be based on less information and analysis and therefore could not be a substitute for the fully informed judgment of the independent directors.

An advisory vote is an ineffective way to communicate shareholder opinions regarding our executive compensation.

The compensation committee welcomes shareholder input on executive compensation; however, a simple up or down advisory vote would give the committee no insight into what aspects of the company's programs should be addressed or how to address them. Further, voting results could be misconstrued. For example, a heavily positive vote could lead the committee to discount legitimate concerns raised by a small minority of shareholders. Likewise, a heavily negative vote could be a reaction to events unrelated to the company's executive compensation programs and could pressure the committee to make compensation changes that are not in the best long-term interests of the shareholders.

Shareholders already have an efficient and effective way to express their opinions.

The company has established an avenue for shareholders to communicate directly with the board or its committees. See "How do I contact the board of directors?" on pages 5-6 for instructions on how shareholders can communicate with the compensation committee or board. In addition, company representatives periodically meet with large shareholders and shareholder representatives to discuss governance issues and executive compensation. Finally, the committee's independent consultant routinely consults with shareholder groups and advises the committee of evolving shareholder views on executive compensation best practices.

These communications yield results. In recent years, the committee has made a number of changes to our executive compensation programs that were influenced at least in part by shareholder views expressed to us directly:

eliminated stock options in favor of performance-based shareholder value awards

extended the performance period for performance awards from one to two years and added additional stock retention periods for executive officers
substantially reduced benefits under the change-in-control severance pay program for executives
implemented a claw-back provision to recoup performance-based compensation from executives in the case of restatement of results attributable to misconduct
enhanced the transparency and clarity of our disclosures on executive compensation.

The committee takes seriously its responsibilities to provide competitively justifiable and defensible pay levels and programs that reflect evolving best practices. Enacting this resolution would be a distraction and not helpful to a process that is already working well.

We should not adopt advisory voting ahead of proposed U.S. legislation that would apply to all companies.

In the U.K., advisory votes are mandated by law. In the U.S., legislation is expected to be introduced in Congress that would mandate advisory votes, but the nature and scope of the advisory vote is not at all clear at this time. We should not adopt advisory voting until the rules are clear and apply to all companies equally.

The board recommends that you vote AGAINST this proposal.

Other Matters

Section 16(a) Beneficial Ownership Reporting Compliance

Under Securities and Exchange Commission rules, our directors and executive officers are required to file with the Securities and Exchange Commission reports of holdings and changes in beneficial ownership of company stock. We have reviewed copies of reports provided to the company, as well as other records and information. Based on that review, we concluded that all reports were timely filed.

Certain Legal Matters

In 2007, the company received two demands from shareholders that the board of directors cause the company to take legal action against current and former directors and others for allegedly causing damage to the company through improper marketing of Evista, Prozac, and Zyprexa. In accordance with procedures established under the Indiana Business Corporation Law (Ind. Code § 23-1-32), the board has appointed a committee of independent persons to consider the demands and determine what action, if any, the company should take in response. Since January 2008, we have been served with seven shareholder derivative lawsuits: *Lambrecht, et al. v. Taurel, et al.*, filed January 17, 2008, in the United States District Court for the Southern District of Indiana; *Staehr et al. v. Eli Lilly and Company et al.*, filed March 27, 2008, in Marion County Superior Court in Indianapolis, Indiana; *Waldman et al., v. Eli Lilly and Company et al.*, filed February 11, 2008, in the United States District Court for the Eastern District of New York; *Solomon v. Eli Lilly and Company et al.*, filed March 27, 2008, in Marion County Superior Court in Indianapolis, Indiana; *Robbins v. Taurel, et al.*, filed April 9, 2008, in the United States District Court for the Eastern District of New York; *City of Taylor General Employees Retirement System v. Taurel, et al.*, filed April 15, 2008, in the United States District Court for the Eastern District of New York; and *Zemprelli v. Taurel, et al.*, filed June 24, 2008, in the United States District Court for the Southern District of Indiana. Two of these lawsuits were filed by the shareholders who served the demands described above. All seven lawsuits are nominally filed on behalf of the company, against various current and former directors and officers and allege that the named officers and directors harmed the company through the improper marketing of Zyprexa, and in certain suits, Evista and Prozac. The Zemprelli suit also claims that certain defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Each of the current directors, other than Mr. Eskew and Mr. Oberhelman, are named in the suits. We believe these suits are without merit and are prepared to defend against them vigorously.

Other Information Regarding the Company's Proxy Solicitation

We will pay all expenses in connection with our solicitation of proxies. We will pay brokers, nominees, fiduciaries, or other custodians their reasonable expenses for sending proxy material to and obtaining instructions from persons for whom they hold stock of the company. We expect to solicit proxies primarily by mail, but directors, officers, and other employees of the company may also solicit in person or by telephone, fax, or electronic mail. We have retained Georgeson Shareholder Communications Inc. to assist in the distribution and solicitation of proxies. Georgeson may solicit proxies by personal interview, telephone, fax, mail, and electronic mail. We expect that the fee for those services will not exceed \$17,500 plus reimbursement of customary out-of-pocket expenses.

By order of the board of directors,

James B. Lootens

Secretary

March 9, 2009

Appendix A

Proposed Amendments to the Company's Articles of Incorporation

The changes to the company's articles of incorporation proposed in Item 3, *Items of Business to Be Acted Upon at the Meeting*, are shown below. Additions are indicated by underlining and deletions are indicated by strike-outs.

.....

9. The following provisions are inserted for the management of the business and for the conduct of the affairs of the Corporation, and it is expressly provided that the same are intended to be in furtherance and not in limitation or exclusion of the powers conferred by statute:

(a) The number of directors of the Corporation, exclusive of directors who may be elected by the holders of any one or more series of Preferred Stock pursuant to Article 7(b) (the Preferred Stock Directors), shall not be less than nine, the exact number to be fixed from time to time solely by resolution of the Board of Directors, acting by not less than a majority of the directors then in office.

(b) ~~The~~ Prior to the 2010 annual meeting of shareholders, the Board of Directors (exclusive of Preferred Stock Directors) shall be divided into three classes, with the term of office of one class expiring each year. ~~At the annual meeting of shareholders in 1985, five directors of the first class shall be elected to hold office for a term expiring at the 1986 annual meeting, five directors of the second class shall be elected to hold office for a term expiring at the 1987 annual meeting, and six directors of the third class shall be elected to hold office for a term expiring at the 1988 annual meeting.~~ Commencing with the annual meeting of shareholders in ~~1986~~2010, each class of directors whose term shall then expire shall be elected to hold office for a ~~three~~ one-year term expiring at the next annual meeting of shareholders. In the case of any vacancy on the Board of Directors occurring after the 2009 annual meeting of shareholders, including a vacancy created by an increase in the number of directors, the vacancy shall be filled by election of the Board of Directors with the director so elected to serve ~~for the remainder of the term of the director being replaced or, in the case of an additional director, for the remainder of the term of the class to which the director has been assigned.~~ until the next annual meeting of shareholders. All directors shall continue in office until the election and qualification of their respective successors in office. ~~When the number of directors is changed, any newly created directorships or any decrease in directorships shall be so assigned among the classes by a majority of the directors then in office, though less than a quorum, as to make all classes as nearly equal in number as possible.~~ No decrease in the number of directors shall have the effect of shortening the term of any incumbent director. Election of directors need not be by written ballot unless the By-laws so provide.

(c) Any director or directors (exclusive of Preferred Stock Directors) may be removed from office at any time, but only for cause and only by the affirmative vote of at least 80% of the votes entitled to be cast by holders of all the outstanding shares of Voting Stock (as defined in Article 13 hereof), voting together as a single class.

(d) Notwithstanding any other provision of these Amended Articles of Incorporation or of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class of Voting Stock required by law or these Amended Articles of Incorporation, the affirmative vote of at least 80% of the votes entitled to be cast by holders of all the outstanding shares of Voting Stock, voting together as a single class, shall be required to alter, amend or repeal this Article 9.

.....

Annual Meeting Admission Ticket

Eli Lilly and Company 2009 Annual Meeting of Shareholders

Monday, April 20, 2009

11 a.m. EDT

Lilly Center Auditorium

Lilly Corporate Center

Indianapolis, Indiana 46285

The top portion of this page will be required for admission to the meeting.

Please write your name and address in the space provided below and present this ticket when you enter the Lilly Center.

A reception (beverages only) will be held from 10:00 a.m. to 10:45 a.m. in the Lilly Center.

Name

Address

City, State, and Zip Code

Detach here

Directions and Parking

From I-70 take Exit 79B; follow signs to McCarty Street. Turn right (east) on McCarty Street; go straight into Lilly Corporate Center. You will be directed to parking. **Be sure to take the admission ticket (the top portion of this page) with you to the meeting and leave this parking pass on your dashboard.**

Take the top portion of this page with you to the meeting. Eli Lilly and Company Annual Meeting of Shareholders April 21, 2008 Please place this Identifier on the dashboard of your car as you enter Lilly Corporate Center so it can be clearly seen by security and parking personnel.

67

Important notice regarding the availability of proxy material for the shareholder meeting to be held April 20, 2009: the annual report and proxy statement are available at http://www.lilly.com/investor/annual_report/lillyar2008.pdf The undersigned hereby appoints Messrs. R. A. Armitage, J. C. Lechleiter, and D. W. Rice, and each of them, as proxies, each with full power to act without the others and with full power of substitution, to vote as indicated on the back of this card all the shares of common stock of ELI LILLY AND COMPANY in this account held in the name of the undersigned at the close of business on February 13, 2009, at the annual meeting of shareholders to be held on April 20, 2009, at 11:00 a.m. EDT, and at any adjournment thereof, with all the powers the undersigned would have if personally present. If this card is properly executed and returned, the shares represented thereby will be voted. If a choice is specified by the shareholder, the shares will be voted accordingly. **If not otherwise specified, the shares represented by this card will be voted for items 1 through 4 against items 5 through 7, and, in the discretion of the proxy holders, upon such other matters as may properly come before the meeting. This proxy is solicited on behalf of the board of directors.** PLEASE MARK YOUR VOTES AND SIGN ON THE REVERSE SIDE OF THIS CARD.

LI LILLY AND COMPANY VOTE BY INTERNET www.proxyvote.com C/O IVS, P.O. Box 17149 Use the Internet to transmit your voting instructions until Wilmington, DE 19850 11:59 p.m. EDT on Sunday, April 19, 2009. Have your proxy card in hand when you access the web site and follow the instructions.

VOTE BY PHONE (1-800-690-6903) Use any touch-tone telephone to transmit your voting instructions until 11:59 p.m. EDT on Sunday, April 19, 2009. Have your proxy card in hand when you call and follow the instructions.

VOTE BY MAIL Mark, sign, and date your proxy card and return it in the postage-paid envelope we have provided or return to Eli Lilly and Company, c/o IVS Associates, Inc., P.O. Box 17149, Wilmington, DE 19885.

Important notice regarding the availability of proxy material for the shareholder meeting to be held April 20, 2009: The annual report and proxy statement are available at

http://www.lilly.com/investor/annual_report/lillyar2008.pdf. THANK YOU FOR VOTING TO

VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK; FOLD ALONG THIS LINE AND

RETURN IN ACOMPANYING RETURN ENVELOPE.

THISPROXYCARDISVALIDONLYWHENSIGNEDANDDATED**ELI LILLY AND COMPANY**The board of directors recon

he following items (1, 2, 3, and 4): Election of directors, each for a three-year term. To withhold authority to vote for any individual nominee(s) mark (01) M.S. Feldstein For All Except and write the number(s) of the nominee(s) on the (02)

J.E. Fyrwald FOR Withhold For All line below. (03) E.R. Marram All All Except (04) D.R. Oberhelman **q q q**

FOR AGAINST ABSTAIN FOR AGAINST ABSTAIN Ratification of the appointment by the audit (4) Reapprove the material terms of performance goals committee of the board of the directors of Ernst for the Eli Lilly and Company Bonus Plan **q q**

q & Young LLP as principal independent auditors for for 2009 **q q q**

(3) Approve amendment to the articles of incorporation to provide for an annual election of all directors The board of di

rectors recommends a vote **AGAINST** the following items (5, 6, and 7): **FOR AGAINST ABSTAIN FOR AGAINST ABSTAIN** (5) Pro

al by shareholders requesting that the board (7) Proposal by shareholders requesting that the eliminate all supermajority voting provisions from board of directors adopt a policy of asking the company articles of incorporation and bylaws **q q q**

shareholder to ratify the compensation of named executive officers at the annual meeting (6) Proposal by shareholders requesting that the company of shareholders **q q q**

amend its articles of incorporation to allow shareholders to amend the company s bylaws by majority vote **q q q**

Please sign exactly as name appears hereon. One joint owner may sign on behalf of the others. When signing in a representative capacity, please clearly state your capacity. Signature (PLEASE SIGN WITHIN BOX) Date Signature Date

Important notice regarding the availability of proxy material for the shareholder meeting to be held April 20, 2009: the annual report and proxy statement are available at http://www.lilly.com/investor/annual_report/lillyar2008.pdf -**ESOP Lilly Employee 401(K) Plan Confidential Voting Instructions To National City Bank, Indiana, Trustee** By signing on the reverse side or by voting by phone or Internet, you direct the Trustee to vote (in person or in proxy) as indicated on the front of this card, the number of shares of Eli Lilly and Company Common Stock credited to your account under The Lilly Employee Savings Plan or an affiliated plan at the Annual Meeting of Shareholders to be held on April 20, 2009 at 11:00 a.m EDT, and at any adjournment thereof. Also, unless you decline by checking the box below, you direct the Trustee to apply this voting instruction *pro rata* (along with all other participants who provide voting instructions and do not decline as provided below) to all shares of Common Stock held in the plans for which the Trustee receives no voting instructions (the undirected shares), except that shares formerly held in The Lilly Employee Stock Ownership Plan (PAYSOP) may only be voted upon the express instruction of the participants to whose accounts the shares are credited. For more information on the voting of the undirected shares, see the Proxy Statement. **Check here only if you decline** to have your vote applied *pro rata* to the undirected shares. **q** These confidential voting instructions will be seen only by authorized representatives of the Trustee. PLEASE MARK YOUR VOTES AND SIGN ON THE REVERSE SIDE OF THIS CARD.

National City Bank, Indiana, Trustee VOTE BY INTERNET www.proxyvote.com C/O IVS, P.O. Box 17149 Use the Internet to transmit your voting instructions until Wilmington, DE 19850 11:59 p.m. EDT on Sunday, April 19, 2009. Have your proxy card in hand when you access the web site and follow the instructions. VOTE BY PHONE (1-800-690-6903) Use any touch-tone telephone to transmit your voting instructions until 11:59 p.m. EDT on Sunday, April 19, 2009. Have your proxy card in hand when you call and then follow the instructions. VOTE BY MAIL Mark, sign, and date this card and return it in the postage-paid envelope we have provided or return to IVS Associates, Inc., P.O. Box 17149, Wilmington, DE 19885. **Important notice regarding the availability of proxy material for the shareholder meeting to be held April 20, 2009: The annual report and proxy statement are available at http://www.lilly.com/investor/annual_report/lillyar2008.pdf.** THANK YOU FOR VOTING TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK; FOLD ALONG THIS LINE AND RETURN IN ACOMPANYING RETURN ENVELOPE. **ESOP THIS VOTING INSTRUCTION CARD IS VALID ONLY WHEN SIGNED AND DATED. ELI LILLY AND COMPANY The board of directors recommends a vote FOR the following items (1, 2, 3, and 4):** Election of directors, each for a three-year term. To withhold authority to vote for any individual nominee(s) mark (01) M. S. Feldstein For All Except and write the number(s) of the nominees on the (02) J. E. Fyrwald For Withhold For All line below. (03) E. R. Marram All All Except (04) D. R. Oberhelman **q q q ___ For Against Abstain For Against Abstain** Ratification of the appointment by the audit (4) Reapprove the material terms of performance goals committee of the board of the directors of Ernst for the Eli Lilly and Company Bonus Plan **q q q** & Young LLP as principal independent auditors for for 2009 **q q q** (3) Approve amendments to the articles of incorporation to provide for annual election of all directors **q q q** The board of directors recommends a vote AGAINST the following items (5, 6, and 7): **For Against Abstain For Against Abstain** (5) Proposal by shareholders requesting that the board (7) Proposal by shareholders requesting that the eliminate all supermajority voting provisions from board of directors adopt a policy of asking the company s articles of incorporation and bylaws **q q q** shareholders to ratify the compensation of named executive officers at the annual meeting (6) Proposal by shareholders requesting that the company of shareholders **q q q** amend its articles of incorporation to allow shareholders to amend the company s bylaws by majority vote **q q q** Please sign exactly as name appears hereon. One joint owner may sign on behalf of the others. When signing in a representative capacity, please clearly state your capacity. Signature (PLEASE SIGN WITHIN BOX) Date Signature Date