LILLY ELI & CO
Form PRE 14A
February 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
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Check the appropriate box:

x Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
o Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

ELI LILLY AND COMPANY

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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Notice of 2008 Annual Meeting and Proxy Statement

March 10, 2008

Dear Shareholder:

You are cordially invited to attend our annual meeting of shareholders on Monday, April 21, 2008, at the Lilly Center Auditorium, Lilly Corporate Center, Indianapolis, Indiana, at 11:00 a.m. EDT.

The notice of meeting and proxy statement that follow describe the business we will consider at the meeting. Your vote is very important. I urge you to vote by mail, by telephone, or on the Internet in order to be certain your shares are represented at the meeting, even if you plan to attend.

Please note our procedures for admission to the meeting described on page 5.

I look forward to seeing you at the meeting.

Sidney Taurel

Chairman of the Board and Chief Executive Officer

Notice of Annual Meeting of Shareholders

April 21, 2008

The annual meeting of shareholders of Eli Lilly and Company will be held at the Lilly Center Auditorium, Lilly Corporate Center, Indianapolis, Indiana, on Monday, April 21, 2008, at 11:00 a.m. EDT for the following purposes:

- to elect four directors of the company to serve three-year terms
- to ratify the appointment by the audit committee of Ernst & Young LLP as principal independent auditors for the year 2008
- to approve amendments to the articles of incorporation to provide for the declassification of the board of directors
- to approve amendments to the articles of incorporation to provide for election of directors by majority vote
- to amend the company s 2002 Lilly Stock Plan
- to consider and vote on a shareholder proposal regarding the international outsourcing of animal research
- to consider and vote on a shareholder proposal requesting that the company amend its articles of incorporation to allow shareholders to amend the company s bylaws by majority vote
- to consider and vote on a shareholder proposal requesting that the board of directors adopt a simple majority vote standard for certain matters other than the election of directors
- to consider and vote on a shareholder proposal requesting that the company prepare a semi-annual report on its political contributions
- to consider and vote on a shareholder proposal adopting principles for comprehensive health care reform.

Shareholders of record at the close of business on February 15, 2008, will be entitled to vote at the meeting and at any adjournment of the meeting.

Attendance at the meeting will be limited to shareholders, those holding proxies from shareholders, and invited guests from the media and financial community. A page at the back of this proxy statement contains an admission ticket. If you plan to attend the meeting, please bring this ticket with you.

This combined proxy statement and annual report to shareholders and the proxy are being mailed on or about March 10, 2008.

By order of the board of directors,

James B. Lootens

Secretary

March 10, 2008

Indianapolis, Indiana

General Information

Why did I receive this proxy statement?

The board of directors of Eli Lilly and Company is soliciting proxies to be voted at the annual meeting of shareholders (the annual meeting) to be held on Monday, April 21, 2008, and at any adjournment of the annual meeting. When the company asks for your proxy, we must provide you with a proxy statement that contains certain information specified by law.

What will the shareholders vote on at the annual meeting?

Ten items:

- election of directors
- ratification of the appointment of principal independent auditors
- amending the company s articles of incorporation to provide for declassification of the board
- amending the company s articles of incorporation to provide for election of directors by majority vote
- amending the company s stock plan
- a shareholder proposal on international outsourcing of animal research
- a shareholder proposal on allowing shareholders to amend the company s bylaws
- a shareholder proposal on adopting a simple majority vote standard for matters other than election of directors
- a shareholder proposal requesting a semi-annual report on the company s political contributions
- a shareholder proposal on adopting principles for comprehensive health care reform.

Will there be any other items of business on the agenda?

We do not expect any other items of business because the deadline for shareholder proposals and nominations has already passed. Nonetheless, in case there is an unforeseen need, the accompanying proxy gives discretionary authority to the persons named on the proxy with respect to any other matters that might be brought before the meeting. Those persons intend to vote that proxy in accordance with their best judgment.

Who is entitled to vote?

Shareholders as of the close of business on February 15, 2008 (the record date) may vote at the annual meeting. You have one vote for each share of common stock you held on the record date, including shares:

- held directly in your name as the shareholder of record
- held for you in an account with a broker, bank, or other nominee
- attributed to your account in the Lilly Employee 401(k) Plan (the 401(k) plan).

What constitutes a quorum?

A majority of the outstanding shares, present or represented by proxy, constitutes a quorum for the annual meeting. As of the record date, ___ shares of company common stock were issued and outstanding.

How many votes are required for the approval of each item?

There are differing vote requirements for the various proposals.

- The four nominees for director receiving the most votes will be elected. Abstentions and instructions to withhold authority to vote for one or more of the nominees will result in those nominees receiving fewer votes but will not count as votes against a nominee.

The following items of business will be approved if the votes cast for the proposal exceed those cast against the proposal:

- the appointment of principal independent auditors
- the management proposal to amend the articles of incorporation to provide for election of directors by majority vote
- the management proposal to amend the company s stock plan
- the shareholder proposals.

Abstentions will not be counted either for or against these proposals.

The management proposal to amend the articles of incorporation to declassify the board requires the vote of 80 percent of the outstanding shares. For this item, abstentions and broker nonvotes have the same effect as a vote against the proposal.

Broker nonvotes. If your shares are held by a broker, the broker will ask you how you want your shares to be voted. If you give the broker instructions, your shares will be voted as you direct. If you do not give instructions, one of two things can happen, depending on the type of proposal. For the election of directors and the ratification of auditors, the broker may vote your shares in its discretion. For all other proposals, the broker may not vote your shares at all. When that happens, it is called a broker nonvote.

How do I vote by proxy?

If you are a shareholder of record, you may vote your proxy by any one of the following methods.

By mail. Sign and date each proxy card you receive and return it in the prepaid envelope. Sign your name exactly as it appears on the proxy. If you

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are signing in a representative capacity (for example, as an attorney-in-fact, executor, administrator, guardian, trustee, or the officer or agent of a corporation or partnership), please indicate your name and your title or capacity. If the stock is held in custody for a minor (for example, under the Uniform Transfers to Minors Act), the custodian should sign, not the minor. If the stock is held in joint ownership, one owner may sign on behalf of all owners. If you return your signed proxy but do not indicate your voting preferences, we will vote on your behalf for the election of the nominees for director listed below, for the ratification of the appointment of the independent auditors, for the management proposals on amending the articles of incorporation and amending the company s stock plan, and against the shareholder proposals.

Note that if you previously elected to receive these materials electronically, you did not receive a proxy card. If you wish to vote by mail, rather than by telephone or on the Internet as discussed below, you may request paper copies of these materials, including a proxy card, by calling 317-433-5112. Please make sure you give us the control number from the e-mail message that you received notifying you of the electronic availability of these materials, along with your name and mailing address.

By telephone. Shareholders in the United States, Puerto Rico, and Canada may vote by telephone by following the instructions on the enclosed proxy card or, if you received these materials electronically, by following the instructions in the e-mail message that notified you of their availability. Voting by telephone has the same effect as voting by mail. If you vote by telephone, do not return your proxy card. Telephone voting will be available until 11:59 p.m. EDT April 20, 2008.

On the Internet. You may vote online at www.proxyvote.com. Follow the instructions on the enclosed proxy card or, if you received these materials electronically, follow the instructions in the e-mail message that notified you of their availability. Voting on the Internet has the same effect as voting by mail. If you vote on the Internet, do not return your proxy card. Internet voting will be available until 11:59 p.m. EDT April 20, 2008.

You have the right to revoke your proxy at any time before the meeting by (1) notifying the company s secretary in writing or (2) delivering a later-dated proxy by telephone, on the Internet, or by mail. If you are a shareholder of record, you may also revoke your proxy by voting in person at the meeting.

How do I vote shares that are held by my broker?

If you have shares held by a broker or other nominee, you may instruct your broker or other nominee to vote your shares by following instructions that the broker or nominee provides for you. Most brokers offer voting by mail, telephone, and on the Internet.

How do I vote in person?

If you are a shareholder of record, you may vote your shares in person at the meeting. However, we encourage you to vote by mail, by telephone, or on the Internet even if you plan to attend the meeting.

How do I vote my shares in the 401(k) plan?

You may instruct the plan trustee on how to vote your shares in the 401(k) plan by mail, by telephone, or on the Internet as described above, except that, if you vote by mail, the card that you use will be a voting instruction card rather than a proxy card.

How many shares in the 401(k) plan can I vote?

You may vote all the shares allocated to your account on the record date. In addition, unless you decline, your vote will also apply to a proportionate number of other shares held in the 401(k) plan for which voting directions are not received. These undirected shares include:

shares credited to the accounts of participants who do not return their voting instructions (except for a small number of shares from a prior stock ownership plan, which can be voted only on the directions of the participants to whose accounts the shares are credited)

shares held in the plan that are not yet credited to individual participants accounts.

All participants are named fiduciaries under the terms of the 401(k) plan and under the Employee Retirement Income Security Act (ERISA) for the limited purpose of voting shares credited to their accounts and the portion of undirected shares to which their vote applies. Under ERISA, fiduciaries are required to act prudently in making voting decisions.

If you do not want to have your vote applied to the undirected shares, you should check the box marked I decline. Otherwise, the trustee will automatically apply your voting preferences to the undirected shares proportionally with all other participants who elected to have their votes applied in this manner.

What happens if I do not vote my 401(k) plan shares?

Your shares will be voted by other plan participants who have elected to have their voting preferences applied proportionally to all shares for which voting instructions are not otherwise received.

What does it mean if I receive more than one proxy card?

It means that you hold shares in more than one account. To ensure that all your shares are voted, sign and return each card. Alternatively, if you vote by telephone or on the Internet, you will need to vote once for each proxy card and voting instruction card you receive.

Who tabulates the votes?

The votes are tabulated by an independent inspector of election, IVS Associates, Inc.

What should I do if I want to attend the annual meeting?

All shareholders as of the record date may attend by presenting the admission ticket that appears at the end of this proxy statement. Please fill it out and bring it with you to the meeting. The meeting will be held at the Lilly Center Auditorium. Please use the Lilly Center entrance to the south of the fountain at the intersection of Delaware and McCarty streets. You will need to pass through security, including a metal detector. Present your ticket to the usher at the meeting.

Parking will be available on a first-come, first-served basis in the garage indicated on the map on page 62.

If you have questions about admittance or parking, you may call 317-433-5112.

How do I contact the board of directors?

You can send written communications to one or more members of the board, addressed to:

Presiding Director, Board of Directors
Eli Lilly and Company
c/o Corporate Secretary
Lilly Corporate Center
Indianapolis, Indiana 46285

All such communications will be forwarded to the relevant director(s), except for solicitations or other matters unrelated to the company.

How do I submit a shareholder proposal for the 2009 annual meeting?

The company s 2009 annual meeting is scheduled for April 20, 2009. If a shareholder wishes to have a proposal considered for inclusion in next year s proxy statement, he or she must submit the proposal in writing so that we receive it by November 10, 2008. Proposals should be addressed to the company s corporate secretary, Lilly Corporate Center, Indianapolis, Indiana 46285. In addition, the company s bylaws provide that any shareholder wishing to propose any other business at the annual meeting must give the company written notice by November 10, 2008. That notice must provide certain other information as described in the bylaws. Copies of the bylaws are available online at http://investor.lilly.com/bylaws.cfm.

Does the company offer an opportunity to receive future proxy materials electronically?

Yes. If you are a shareholder of record or a member of the 401(k) plan, you may, if you wish, receive future proxy statements and annual reports online. If you elect this feature, you will receive an e-mail message notifying you when the materials are available along with a web address for viewing the materials and instructions for voting by telephone or on the Internet. If you have more than one account, you may receive separate e-mail notifications for each account.

You may sign up for electronic delivery in two ways:

- If you vote online as described above, you may sign up for electronic delivery at that time.

- You may sign up at any time by visiting http://proxyonline.lilly.com.

If you received these materials electronically, you do not need to do anything to continue receiving materials electronically in the future.

If you hold your shares in a brokerage account, you may also have the opportunity to receive proxy materials electronically. Please follow the instructions of your broker.

What are the benefits of electronic delivery?

Electronic delivery reduces the company s printing and mailing costs. It is also a convenient way for you to receive your proxy materials and makes it easy to vote your shares online. If you have shares in more than one account, it is an easy way to avoid receiving duplicate copies of proxy materials.

What are the costs of electronic delivery?

The company charges nothing for electronic delivery. You may, of course, incur the usual expenses associated with Internet access, such as telephone charges or charges from your Internet service provider.

May I change my mind later?

Yes. You may discontinue electronic delivery at any time. For more information, call 317-433-5112.

What is householding ?

We have adopted householding, a procedure under which shareholders of record who have the same address and last name and do not receive proxy materials electronically will receive only one copy of our annual report and proxy statement unless one or more of these shareholders notifies us that they wish to continue receiving individual copies. This procedure saves printing and postage costs by reducing duplicative mailings.

Shareholders who participate in householding will continue to receive separate proxy cards. Householding will not affect dividend check mailings.

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Beneficial shareholders can request information about householding from their banks, brokers, or other holders of record.

What if I want to receive a separate copy of the annual report and proxy statement?

If you participate in householding and wish to receive a separate copy of the 2007 annual report and 2008 proxy statement, or if you wish to receive separate copies of future annual reports and proxy statements, please call 800-542-1061 or write to: Householding Department, 51 Mercedes Way, Edgewood, New York 11717. We will deliver the requested documents to you promptly upon your request.

Board of Directors

Directors Biographies

Class of 2008

The following four directors terms will expire at this year s annual meeting. Each of these directors has been nominated and is standing for election to serve another term that will expire in 2011. See page 41 of this proxy statement for more information.

George M.C. Fisher

Age 67

Director since 2000

Former Chairman of the Board and Chief Executive Officer, Motorola, Inc. and Eastman Kodak Company

Mr. Fisher served as chairman of the board of Eastman Kodak Company from 1993 to December 2000. He also served as chief executive officer from 1993 to January 2000 and as president from 1993 until 1996. Prior to joining Kodak, he was an executive officer of Motorola, Inc., serving as chairman and chief executive officer from 1990 to October 1993, and president and chief executive officer from 1988 to 1990. Mr. Fisher is a senior advisor for Kohlberg Kravis Roberts & Company, Presiding Director of General Motors Corporation, and a director of Visant Corporation. He is a former chairman of PanAmSat Corporation, and was chairman of the National Academy of Engineering from 2000 to 2004.

Alfred G. Gilman, M.D., Ph.D.

Age 66

Director since 1995

Executive Vice President for Academic Affairs and Provost, The University of Texas Southwestern Medical Center at Dallas; Dean, Southwestern Medical School; and Regental Professor of Pharmacology and Director of the Cecil and Ida Green Center for Molecular, Computational, and Systems Biology, The University of Texas Southwestern Medical Center

Dr. Gilman has served as executive vice president for academic affairs and provost of The University of Texas Southwestern Medical Center at Dallas and dean of The University of Texas Southwestern Medical School since 2005 and professor of pharmacology at The University of Texas Southwestern Medical Center since 1981. He holds the Raymond and Ellen Willie Distinguished Chair of Molecular Neuropharmacology, the Nadine and Tom Craddick Distinguished Chair in Medical Science, and the Atticus James Gill, M.D., Chair in Medical Science at the university and was named a regental professor in 1995. Dr. Gilman was on the faculty of the University of Virginia School of Medicine from 1971 to 1981 and was named a professor of pharmacology there in 1977. He is a director of Regeneron Pharmaceuticals, Inc. Dr. Gilman was a recipient of the Nobel Prize in Physiology or Medicine in 1994.

Karen N. Horn, Ph.D.

Age 64

Director since 1987

Retired President, Private Client Services, and Managing Director, Marsh, Inc.

Ms. Horn served as president of Private Client Services and managing director of Marsh, Inc., a subsidiary of MMC, from 1999 until her retirement in 2003. Prior to joining Marsh, she was senior managing director and head of international private banking, Bankers Trust Company; chair and chief executive officer of Bank One, Cleveland, N.A.; president of the Federal Reserve Bank of Cleveland; treasurer of Bell Telephone Company of Pennsylvania; and vice president of First National Bank of Boston. Ms. Horn serves as director of T. Rowe Price Mutual Funds; The U.S. Russia Investment Fund, a presidential appointment; Simon Property Group, Inc.; and Fannie Mae. Ms. Horn has been senior managing director of Brock Capital Group since 2004.

John C. Lechleiter, Ph.D.

Age 54

Director since 2005

President and Chief Operating Officer

Dr. Lechleiter was named president and chief operating officer of the company in 2005, and on April 1, 2008, he will become president and chief executive officer. He joined Lilly in 1979 as a senior organic chemist and has held management positions in England and the U.S. He was named vice president of pharmaceutical product development in 1993 and vice president of regulatory affairs in 1994. In 1996, he was named vice president for development and regulatory affairs. Dr. Lechleiter became senior vice president of pharmaceutical products in 1998, and executive vice president, pharmaceutical products and corporate development in 2001. He was named executive vice president, pharmaceutical operations, in 2004. He is a member of the American Chemical Society. In 2004, Dr. Lechleiter was appointed to the Visiting Committee of Harvard Business School and to the Health Policy and Management Executive Council of the Harvard School of Public Health. He also serves as a member of the Board of Trustees of Xavier University (Cincinnati, Ohio). In addition, he serves as a distinguished advisor to The Children s Museum of Indianapolis, a member of the board of directors and executive committee of Fairbanks Institute, and a member of the United Way of Central Indiana board of directors. He also serves on the board of Indianapolis Downtown, Inc.

Class of 2009

The following four directors will continue in office until 2009, except for Mr. Taurel, who will resign from the board effective December 31, 2008.

Martin S. Feldstein, Ph.D.

Age 68

Director since 2002

President and Chief Executive Officer, National Bureau of Economic Research and George F. Baker Professor of Economics, Harvard University

Dr. Feldstein is president and chief executive officer of the National Bureau of Economic Research and the George F. Baker Professor of Economics at Harvard University. He became an assistant professor at Harvard in 1967, an associate professor in 1968, and a professor in 1969. From 1982 through 1984, he served as chairman of the Council of Economic Advisers and President Ronald Reagan s chief economic adviser. He is a member of the American

Philosophical Society, a corresponding fellow of the British Academy, a fellow of the Econometric Society, and a fellow of the National Association for Business Economics. Dr. Feldstein is a member of the executive committee of the Trilateral Commission and a director of American International Group, Inc.; the Council on Foreign Relations; and Economic Studies, Inc. He is a member of the American Academy of Arts and Sciences and past president of the American Economic Association.

J. Erik Fyrwald

Age 48

Director since 2005

Group Vice President, DuPont Agriculture & Nutrition

Mr. Fyrwald has been group vice president of DuPont Agriculture & Nutrition since 2003. He was previously vice president and general manager of DuPont s nutrition and health businesses, which included The Solae Company, DuPont Qualicon, and Liqui-Box. Mr. Fyrwald joined DuPont in 1981 as a production engineer, and held a variety of sales and management positions in a number of areas. In 1990, he became the leader of the DuPont Engineering Polymers and DuPont Butacite businesses for the Asia Pacific region, a position he held until 1994. He was named leader of the DuPont Nylon Plastics business for the Americas until 1996, when he became head of global sales and marketing for Engineering Polymers. In 1998, he was appointed vice president of Corporate Plans and Business Development. Mr. Fyrwald serves on the boards of CropLife International President s Advisory Group; the Des Moines Art Center; and United Way of Iowa.

Ellen R. Marram

Age 61

Director since 2002

President, The Barnegat Group LLC

Ms. Marram is president of The Barnegat Group LLC, a firm that provides business advisory services. She was a managing director at North Castle Partners, LLC from 2000 to 2005 and is currently an advisor to the firm. Prior to joining North Castle, she served as the chief executive officer of a start-up B2B exchange for the food and beverage industry. From 1993 through 1998, Ms. Marram was president and chief executive officer of Tropicana and the Tropicana Beverage Group. From 1988 to 1993, she was president and chief executive officer of the Nabisco Biscuit Company, the largest operating unit of Nabisco, Inc.; from 1987 to 1988, she was president of Nabisco s Grocery Division; and from 1970 to 1986, she held a series of marketing positions at Nabisco/Standard Brands, Johnson & Johnson, and Lever Brothers. Ms. Marram is a member of the board of directors of Ford Motor Company, The New York Times Company, and Cadbury Schweppes plc as well as several private companies. She serves on the boards of The New York-Presbyterian Hospital, Lincoln Center Theater, Families and Work Institute, and Citymeals-on-Wheels.

Sidney Taurel

Age 59

Director since 1991

Chairman of the Board and Chief Executive Officer

Mr. Taurel has been the company s chief executive officer since July 1998, and will retire effective March 31, 2008. He has served as chairman of the board since January 1999, and will retire as chairman and member of the board effective December 31, 2008. He served as president and chief operating officer from February 1996 through September 2005. He joined the company in 1971 and has held management positions in the company s international operations based in São Paulo, Vienna, Paris, and London. Mr. Taurel served as president of Eli Lilly International Corporation from 1986 to 1991, executive vice president of the pharmaceutical division from 1991 to 1993, and executive vice president of the company from 1993 to 1996. He is a member of the boards of IBM Corporation and The McGraw-Hill Companies, Inc. He is also a member of the executive committee of the board of directors of Pharmaceutical Research and Manufacturers of America (PhRMA), a member of the board of overseers of the Columbia Business School, a trustee at the Indianapolis Museum of Art, a director of the Indianapolis Tennis Championships, and a member of The Business Council and The Business Roundtable. In 2007, he was appointed to the President s Advisory Committee for Trade Policy and Negotiations. He is an officer of the French Legion of

Honor.

Class of 2010

The following four directors will continue in office until 2010.

Sir Winfried Bischoff

Age 66

Director since 2000

Chairman, Citigroup Inc.

Sir Winfried Bischoff is chairman of Citigroup Inc. He served as chairman of Citi Europe from 2000 to 2007 and as interim chief executive officer of Citigroup for a portion of 2007. From 1995 to 2000, he was chairman of Schroders plc. He joined the Schroder Group in 1966 and held a number of positions there, including chairman of J. Henry Schroder & Co. and group chief executive of Schroders plc. He is a nonexecutive director of The McGraw-Hill Companies, Inc., Land Securities plc, and Prudential plc.

J. Michael Cook

Age 65

Director since 2005

Retired Chairman and Chief Executive Officer, Deloitte & Touche LLP

Mr. Cook served as chairman and chief executive officer of Deloitte & Touche LLP from 1989 until his retirement in 1999. He joined Deloitte, Haskins & Sells in 1964 and served as chairman and chief executive from 1986 through 1989. Mr. Cook is a member of the Advisory Council of the Public Company Accounting Oversight Board and is a trustee of The Scripps Research Institute. He serves on the boards of Comcast Corporation and International Flavors & Fragrances Inc. He is chairman of the Accountability Advisory Council to the Comptroller General of the United States. He was a member of the National Association of Corporate Directors Blue Ribbon Panel on Corporate Governance and was named the 62nd member of the Accounting Hall of Fame in 1999. He is past president of the Institute of Outstanding Directors.

Franklyn G. Prendergast, M.D., Ph.D.
Age 62
Director since 1995
Edmond and Marion Guggenheim Professor of Biochemistry and Molecular Biology and Professor of Molecular Pharmacology and Experimental Therapeutics, Mayo Medical School; Director, Mayo Clinic Center for Individualized Medicine; and Director Emeritus, Mayo Clinic Cancer Center
Dr. Prendergast is the Edmond and Marion Guggenheim Professor of Biochemistry and Molecular Biology and Professor of Molecular Pharmacology and Experimental Therapeutics at Mayo Medical School and the director of the Center for Individualized Medicine. He has held several other teaching positions at the Mayo Medical School since 1975. Dr. Prendergast serves on the board of trustees of the Mayo Foundation and the Mayo Clinic Board of Governors.

Kathi P. Seifert
Age 58
Director since 1995
Retired Executive Vice President, Kimberly-Clark Corporation
Ms. Seifert served as executive vice president for Kimberly-Clark Corporation until June 2004. She joined Kimberly-Clark in 1978 and served in several capacities in connection with both the domestic and international consumer products businesses. Prior to joining Kimberly-Clark, Ms. Seifert held management positions at Procter & Gamble, Beatrice Foods, and Fort Howard Paper Company. She is chairman of Pinnacle Perspectives, LLC. Ms. Seifert serves on the boards of Supervalu Inc.; Revlon Consumer Products Corporation; Lexmark International, Inc.; Appleton Papers Inc.; the U.S. Fund for UNICEF; ThedaCare; and the Fox Cities Performing Arts Center.

Highlights of the Company s Corporate Governance Guidelines

The board of directors has established guidelines that it follows in matters of corporate governance. The following summary provides highlights of those guidelines. A complete copy of the guidelines is available online at http://investor.lilly.com/guidelines.cfm or in paper form upon request to the company s corporate secretary.

I. Role of the Board

The directors are elected by the shareholders to oversee the actions and results of the company s management. Their responsibilities include:

- providing general oversight of the business
- approving corporate strategy
- approving major management initiatives
- providing oversight of legal and ethical conduct
- overseeing the company s management of significant business risks
- selecting, compensating, and evaluating directors
- evaluating board processes and performance
- selecting, compensating, evaluating, and, when necessary, replacing the chief executive officer, and compensating other executive officers
- ensuring that a succession plan is in place for all senior executives.

II. Composition of the Board

Mix of Independent Directors and Officer-Directors

There should always be a substantial majority (75 percent or more) of independent directors. The chief executive officer should be a board member. Other officers may, from time to time, be board members, but no officer other than the chief executive officer should expect to be elected to the board by virtue of his or her office.

Selection of Director Candidates

The board is responsible for selecting candidates for board membership and for establishing the criteria to be used in identifying potential candidates. The board delegates the screening process to the directors and corporate governance committee. For more information on the director nomination process, including the current selection criteria, see Directors and Corporate Governance Committee Matters on pages 17-18.

Independence Determinations

The board annually determines the independence of directors based on a review by the directors and corporate governance committee. No director is considered independent unless the board has determined that he or she has no material relationship with the company, either directly or as a partner, shareholder, or officer of an organization that has a material relationship with the company. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. To evaluate the materiality of any such relationship, the board has adopted categorical independence standards consistent with the New York Stock Exchange listing guidelines.

Specifically, a director is not considered independent if (i) the director or an immediate family member is a current partner of Lilly s independent auditor (currently Ernst & Young LLP); (ii) the director is a current employee of such firm; (iii) the director has an immediate family member who is a current employee of such firm and who participates in the firm s audit, assurance, or tax compliance (but not tax planning) practice; or (iv) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such firm and personally worked on the listed company s audit within that time.

In addition, a director is not considered independent if any of the following relationships existed within the previous three years:

- a director who is an employee of Lilly, or whose immediate family member is an executive officer of Lilly. Temporary service by an independent director as interim chairman or chief executive officer will not disqualify the director from being independent following completion of that service.

- a director who receives any direct compensation from Lilly other than the director s normal director compensation, or whose immediate family member receives more than $100,000 per year in direct compensation from Lilly other than for service as a nonexecutive employee.

- a director who is employed (or whose immediate family member is employed as an executive officer) by another company where any Lilly executive officer serves on the compensation committee of that company s board.

- a director who is employed by, who is a 10 percent shareholder of, or whose immediate family member is an executive officer of a company that makes payments to or receives payments from Lilly for property or services that exceed the greater of $1 million or 2 percent of that company s gross revenues in a single fiscal year.

- a director who is an executive officer of a nonprofit organization that receives grants or contributions from Lilly in a single fiscal year exceeding the greater of $1 million or 2 percent of that organization s gross revenues in a single fiscal year.

Members of the audit, compensation, and directors and corporate governance committees must meet all applicable independence tests of the

New York Stock Exchange, Securities and Exchange Commission, and Internal Revenue Service.

In February 2008, the directors and corporate governance committee reviewed directors responses to a questionnaire asking about their relationships with the company (and those of their immediate family members) and other potential conflicts of interest, as well as material provided by management related to transactions, relationships, or arrangements between the company and the directors or parties related to the directors. The committee determined that all 10 nonemployee directors listed below are independent, and that the members of the audit, compensation, and directors and corporate governance committees also meet the independence tests referenced above. The committee recommended this conclusion to the board and explained the basis for its decision, and this conclusion was adopted by the full board. The committee and the board determined that none of the 10 directors listed below has had during the last three years (i) any of the relationships listed above or (ii) any other material relationship with the company that would compromise his or her independence. The table below includes a description of categories or types of transactions, relationships, or arrangements considered by the board (in addition to those listed above) in reaching its determination that the directors are independent. All of these relationships and transactions were entered into at arm s length in the normal course of business and, to the extent they are commercial relationships, have standard commercial terms. None of these relationships or transactions exceeded the thresholds described above or otherwise compromise the independence of the named director.

Name	Independent	Transactions/Relationships/Arrangements
Sir Winfried Bischoff	Yes	
Mr. Cook	Yes	
Dr. Feldstein	Yes	
Mr. Fisher	Yes	
Mr. Fyrwald	Yes	
Dr. Gilman	Yes	
Ms. Horn	Yes	
Ms. Marram	Yes	
Dr. Prendergast	Yes	
Ms. Seifert	Yes	

Director Tenure

Subject to the company s charter documents, the governance guidelines establish the following expectations for director tenure:

A company officer-director, including the chief executive officer, will resign from the board at the time he or she retires or otherwise ceases to be an active employee of the company.

Nonemployee directors will retire from the board not later than the annual meeting of shareholders that follows their seventy-second birthday.

Directors may stand for reelection even though the board s retirement policy would prevent them from completing a full three-year term.

A nonemployee director who retires or changes principal job responsibilities will offer to resign from the board. The directors and corporate governance committee will assess the situation and recommend to the board whether to accept the resignation.

Voting for Directors

In an uncontested election, any nominee for director who receives a greater number of votes withheld from his or her election than votes for such election (a majority withheld vote) shall promptly tender his or her resignation following certification of the shareholder vote. The directors and corporate governance committee will consider the resignation offer and recommend to the board whether to accept it. The board will act on the committee s recommendation within 90 days following certification of the shareholder vote. Board action on the matter will require the approval of a majority of the independent directors.

The company will disclose the board s decision on a Form 8-K furnished to the Securities and Exchange Commission within four business days after the decision, including a full explanation of the process by which the decision was reached and, if applicable, the reasons why the board rejected the director s resignation. If the resignation is accepted, the directors and corporate governance committee will recommend to the board whether to fill the vacancy or reduce the size of the board.

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Any director who tenders his or her resignation under this provision will not participate in the committee or board deliberations regarding whether to accept the resignation offer. If each member of the directors and corporate governance committee receives a majority withheld vote at the same election, then the independent directors who did not receive a majority withheld vote will appoint a committee amongst themselves to consider the resignation offers and recommend to the board whether to accept them.

See Item 4 for management s proposal to provide for the election of directors by a true majority vote.

III. Director Compensation and Equity Ownership

The directors and corporate governance committee annually reviews board compensation. Any recommendations for changes are made to the full board by the committee.

Directors should hold meaningful equity ownership positions in the company; accordingly, a significant portion of overall director compensation is in the form of company equity. Directors are required to hold Lilly stock valued at a minimum of five times their annual cash retainer; new directors are allowed five years to reach this ownership level.

IV. Key Responsibilities of the Board

Selection of Chairman and Chief Executive Officer; Succession Planning

The board customarily combines the roles of chairman and chief executive officer, believing this generally provides the most efficient and effective leadership model for the company. The board anticipates that, in certain circumstances, and particularly during relatively short periods of leadership transition, these roles may be assigned to two different persons. The presiding director recommends to the board an appropriate process by which a new chairman and chief executive officer will be selected.

The independent directors are responsible for overseeing succession and management development programs for senior leadership. The chief executive officer develops and maintains a process for advising the board on succession planning for the chief executive officer and other key leadership positions. He or she reviews this plan with the independent directors at least annually.

Evaluation of Chief Executive Officer

The presiding director leads the independent directors annually in assessing the performance of the chief executive officer. The results of this review are discussed with the chief executive officer and considered by the compensation committee in establishing his or her compensation for the next year.

Corporate Strategy

Once each year, the board devotes an extended meeting to an update from management regarding the strategic issues and opportunities facing the company, allowing the board an opportunity to provide direction for the corporate strategic plan. Throughout the year, significant corporate strategy decisions are brought to the board for approval.

Code of Ethics

The board approved the company s code of ethics, which complies with the requirements of the New York Stock Exchange and the Securities and Exchange Commission. This code is set out in:

- *The Red Book*, a comprehensive code of ethical and legal business conduct applicable to all employees worldwide and to our board of directors

- the company s 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 recognizes the unique responsibilities of those individuals in assuring proper accounting, financial reporting, internal controls, and financial stewardship.

Both documents are available online at http://investor.lilly.com/code_business_conduct.cfm or in paper form upon request to the company s corporate secretary.

The audit committee and public policy and compliance committee assist in the board s oversight of compliance programs with respect to matters covered in the code of ethics.

V. Functioning of the Board

Executive Session of Directors

The independent directors meet alone in executive session at every regularly scheduled board meeting. In addition, at least twice a year, the independent directors meet in executive session with the chief executive officer.

Presiding Director

The board appoints a presiding director from among the independent directors (currently Ms. Horn). The presiding director:

- leads the board s process for selecting and evaluating the chief executive officer;
- presides at all meetings of the board at which the chairman is not present, including executive sessions of the independent directors unless the directors decide that, due to the subject matter of the session, another independent director should preside;
- serves as a liaison between the chairman and the independent directors;
- approves meeting agendas and schedules and generally approves information sent to the board; and

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has the authority to call meetings of the independent directors.

Conflicts of Interest

Occasionally a director s business or personal relationships may give rise to an interest that conflicts, or appears to conflict, with the interests of the company. Directors must disclose to the company all relationships that create a conflict or an appearance of a conflict. The board, after consultation with counsel, takes appropriate steps to ensure that all directors voting on an issue are disinterested. In appropriate cases, the affected director will be excused from discussions on the issue.

To avoid any conflict or appearance of a conflict, board decisions on certain matters of corporate governance are made solely by the independent directors. These include executive compensation and the selection, evaluation, and removal of the chief executive officer.

Review and Approval of Transactions with Related Persons

The board has adopted a written policy and written procedures for review, approval, and monitoring of transactions involving the company and related persons (directors and executive officers, their immediate family members, or shareholders owning five percent or greater of the company s outstanding stock). The policy covers any related person transaction that meets the minimum threshold for disclosure in the proxy statement under the relevant SEC rules (generally, transactions involving amounts exceeding $120,000 in which a related person has a direct or indirect material interest).

Policy

Related person transactions must be approved by the board or by a committee of the board consisting solely of independent directors, who will approve the transaction only if they determine that it is in the best interests of the company. In considering the transaction, the board or committee will consider all relevant factors, including as applicable (i) the company s business rationale for entering into the transaction; (ii) the alternatives to entering into a related person transaction; (iii) whether the transaction is on terms comparable to those available to third parties, or in the case of employment relationships, to employees generally; (iv) the potential for the transaction to lead to an actual or apparent conflict of interest and any safeguards imposed to prevent such actual or apparent conflicts; and (v) the overall fairness of the transaction to the company.

The board or relevant committee will periodically monitor the transaction to ensure that there are no changed circumstances that would render it advisable for the company to amend or terminate the transaction.

Procedures

Management or the affected director or executive officer will bring the matter to the attention of the chairman, the presiding director, the chair of the directors and corporate governance committee, or the secretary.

The chairman and the presiding director shall jointly determine (or if either is involved in the transaction, the other shall determine in consultation with the chair of the directors and corporate governance committee) whether the matter should be considered by the board or by one of its existing committees consisting only of independent directors.

If a director is involved in the transaction, he or she will be recused from all discussions and decisions about the transaction.

The transaction must be approved in advance whenever practicable, and if not practicable, must be ratified as promptly as practicable.

The board or relevant committee will review the transaction annually to determine whether it continues to be in the company s best interests.

Currently the only related person transaction is the time-share arrangement for Mr. Taurel s personal use of the corporate aircraft, as described on pages 39-40. The compensation committee approved and continues to monitor this arrangement consistent with the above policy.

Orientation and Continuing Education

A comprehensive orientation process is in place for new directors. In addition, directors receive ongoing continuing education through educational sessions at meetings, the annual strategy retreat, and periodic mailings between meetings. We hold periodic mandatory training sessions for the audit committee, to which other directors and executive officers are invited. We also afford directors the opportunity to attend external director education programs.

Director Access to Management and Independent Advisers

Independent directors have direct access to members of management whenever they deem it necessary. The independent directors and the committees are also free to retain their own independent advisers, at company expense, whenever they feel it would be desirable to do so. In accordance with New York Stock Exchange listing standards, the audit, compensation, and directors and corporate governance committees have sole authority to retain independent advisers to their respective committees.

Assessment of Board Processes and Performance

The directors and corporate governance committee annually assesses the performance of the board, its committees, and board processes based on inputs from all directors. The committee also considers the contributions of individual directors at least every three years when considering whether to recommend nominating the director to a new three-year term.

VI. Board Committees

Number, Structure, and Independence

The duties and membership of the six board-appointed committees are described below. Only independent directors may serve on the audit, compensation, directors and corporate governance, and public policy and compliance committees. Only independent directors may chair any committee.

Committee membership and selection of committee chairs are recommended to the board by the directors and corporate governance committee after consulting the chairman of the board and after considering the desires of the board members.

Functioning of Committees

Each committee reviews and approves its own charter annually, and the directors and corporate governance committee reviews and approves all committee charters annually. The board may form new committees or disband a current committee (except the audit, compensation, and directors and corporate governance committees) as it deems appropriate. The chair of each committee determines the frequency and agenda of committee meetings. In addition, the audit and compensation committees meet alone in executive session on a regular basis; all other committees meet in executive session as needed.

All six committee charters are available online at http://investor.lilly.com/board-committees.cfm or in paper form upon request to the company s corporate secretary.

Committees of the Board of Directors

Audit Committee

The duties of the audit committee are described in the audit committee report found on pages 18-19.

Directors and Corporate Governance Committee

The duties of the directors and corporate governance committee are described on pages 17-18.

Compensation Committee

The duties of the compensation committee are described on pages 21-22, and the compensation committee report is shown on page 30.

Public Policy and Compliance Committee

- oversees the processes by which the company conducts its business so that the company will do so in a manner that complies with laws and regulations and reflects the highest standards of integrity
- reviews and makes recommendations regarding policies, practices, and procedures of the company that relate to public policy and social, political, and economic issues that may affect the company.

Finance Committee

- reviews and makes recommendations regarding capital structure and strategies, including dividends, stock repurchases, capital expenditures, financings and borrowings, and significant business development projects.

Science and Technology Committee

- reviews and makes recommendations regarding the company s strategic research goals and objectives
- reviews new developments, technologies, and trends in pharmaceutical research and development.

Membership and Meetings of the Board and Its Committees

In 2007, each director attended more than 88 percent of the total number of meetings of the board and the committees on which he or she serves. In addition, all board members are expected to attend the annual meeting of shareholders, and all attended in 2007. Current committee membership and the number of meetings of the full board and each committee in 2007 are shown in the table below.

Name	Board	Audit	Compensation	Directors and Corporate Governance	Finance	Public Policy and Compliance	Science and Technology
Sir Winfried Bischoff	Member			Member	Chair		
Mr. Cook	Member	Chair			Member		
Dr. Feldstein	Member	Member			Member	Chair	
Mr. Fisher	Member		Member	Member			
Mr. Fyrwald	Member		Member				Member
Dr. Gilman	Member					Member	Chair
Ms. Horn	Member		Chair	Member			
Dr. Lechleiter	Member						Member
Ms. Marram	Member		Member	Chair			
Dr. Prendergast	Member	Member				Member	Member
Ms. Seifert	Member	Member			Member	Member	
Mr. Taurel	Chair						
Number of 2007 Meetings	7	8	6	4	5	5	5

Directors Compensation

Directors who are employees receive no additional compensation for serving on the board or its committees. In 2007, we provided the following annual compensation to directors who are not employees:

Name	**Fees Earned or Paid in Cash ($) (1)**	**Stock Awards ($) (2)**	**Stock Option Awards ($) (3)**	**All Other Compensation ($) (4)**	**Total ($) (5)**
Sir Winfried Bischoff	$ 95,000	$ 145,000	$ 4,074	$ 3,067	$ 247,141
Mr. Cook	$ 120,000	$ 145,000	0	$ 29,124	$ 294,124
Dr. Feldstein	$ 110,000	$ 145,000	$ 4,074	$ 29,000	$ 288,074
Mr. Fisher	$ 93,000	$ 145,000	$ 4,074	$ 30,610	$ 272,684
Mr. Fyrwald	$ 103,000	$ 145,000	0	$ 1,185	$ 249,185
Dr. Gilman	$ 100,000	$ 145,000	$ 4,074	$ 32,374	$ 281,448
Ms. Horn	$ 122,000	$ 145,000	$ 4,074	$ 4,202	$ 275,276
Ms. Marram	$ 95,000	$ 145,000	$ 4,074	$ 34,878	$ 278,952
Dr. Prendergast	$ 98,000	$ 145,000	$ 4,074	$ 555	$ 247,629
Ms. Seifert	$ 100,000	$ 145,000	$ 4,074	$ 75,000	$ 324,074

(1) The following directors deferred 2007 cash compensation into their deferred share account under the Lilly

Directors Deferral Plan (further described below):

Name	2007 Cash Deferred	Shares
Mr. Fisher	$ 46,500	839
Mr. Fyrwald	$ 103,000	1,854

(2) Each nonemployee director received an award of stock with a grant date fair value of $145,000 (2,840 shares). This stock award and all prior stock awards are fully vested in that they are not subject to forfeiture; however, the shares are not issued until the director ends his or her service on the board, as further described below under Lilly Directors Deferral Plan. The table shows the expense recognized by the company for each director s stock award.

(3) No stock options were granted in 2007, as the stock option program

for directors was discontinued in 2005. The amounts in this column reflect the expenses related to options granted in 2004 recognized in our 2007 financial statements. A discussion of the assumption used in calculating these values may be found in Note 7 to our 2007 audited financial statements on pages XX XX of our annual report. Aggregate total numbers of stock option awards outstanding are shown below in the Directors Outstanding Stock Options table. All outstanding options were vested as of February 17, 2007. Stock option grants were established using the same procedure for timing and price as is used for employees.

(4) This column also includes amounts donated by the Eli Lilly and Company Foundation, Inc. under its matching gift program, which is generally available to U.S. employees as well as the outside directors. Under this program, the foundation matches 100 percent of charitable donations over $25 made to eligible charities, up to a maximum of $90,000 per year for each individual. For all directors, the amounts in this column also include tax reimbursements for income imputed to him or her for use of the corporate aircraft, or for commercial flights, by his or her spouse to attend board functions that included spouse participation. For Mr. Fyrwald, this amount includes

tax reimbursement for income imputed to him for child care during a board function that included spouse participation.

The foundation matched the following donations of more than $10,000 for outside directors in 2007 via payments made directly to the recipient charity:

Name	Amount of Matching Donation
Mr. Cook	$ 27,000
Dr. Feldstein	$ 29,000
Mr. Fisher	$ 30,000
Dr. Gilman	$ 31,500
Ms. Marram	$ 34,500
Ms. Seifert	$ 75,000

(5) Directors do not participate in a Lilly pension plan or non-equity incentive plan.

Directors Outstanding Stock Options

Name	Grant Date	Expiration Date	Exercise Price	Outstanding Stock Options (Exercisable)
Sir Winfried Bischoff	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800

Mr. Cook				0
Dr. Feldstein	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800
Mr. Fisher	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800
Mr. Fyrwald				0
Dr. Gilman	4/20/2000	4/19/2010	$ 75.94	2,800
	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800
Ms. Horn	4/20/2000	4/19/2010	$ 75.94	2,800
	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800
Ms. Marram	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800

Name	Grant Date	Expiration Date	Exercise Price	Outstanding Stock Options (Exercisable)
Dr. Prendergast	4/20/2000	4/19/2010	$ 75.94	2,800
	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800
Ms. Seifert	4/20/2000	4/19/2010	$ 75.94	2,800
	2/20/2001	2/18/2011	$ 73.98	2,800
	2/19/2002	2/17/2012	$ 75.92	2,800
	2/18/2003	2/18/2013	$ 57.85	2,800
	2/17/2004	2/17/2014	$ 73.11	2,800

Cash Compensation

The company provides directors the following cash compensation:

retainer of $80,000 per year (payable monthly)

$1,000 for each committee meeting attended

$2,000 to the committee chairpersons for each committee meeting conducted as compensation for the chairperson s preparation time

retainer of $20,000 per year to the presiding director

reimbursement for customary and usual travel expenses.

Stock Compensation

Stock compensation for directors consists of:

Shares of Lilly stock equaling $145,000, deposited annually in a deferred stock account in the Lilly Directors Deferral Plan (as described below), payable after service on the board has ended.

Lilly Directors Deferral Plan

This plan allows directors to defer receipt of all or part of their retainer and meeting fees until after their service on the board has ended. Each director can choose to invest the funds in either of two accounts:

Deferred Share Account. This account allows the director, in effect, to invest his or her deferred cash compensation in Lilly stock. In addition, the annual award of shares to each director noted above (2,840 shares in 2007) is credited to this account on a pre-set annual date. Funds in this account are credited as hypothetical shares of Lilly stock based on the market price of the stock at the time the compensation would otherwise have been earned. Hypothetical dividends are reinvested in additional shares based on the market price of the stock on the date dividends are paid. All shares in the deferred share accounts are hypothetical and are not issued or transferred until the director ends his or her service on the board.

Deferred Compensation Account. Funds in this account earn interest each year at a rate of 120 percent of the applicable federal long-term rate, compounded monthly, as established the preceding December by the U.S. Treasury Department under Section 1274(d) of the Internal

Revenue Code. The rate for 2008 is 5.5 percent. The aggregate amount of interest that accrued in 2007 for the participating directors was $188,706, at a rate of 5.7 percent.

Both accounts may be paid in a lump sum or in annual installments for up to 10 years. Amounts in the deferred share account are paid in shares of Lilly stock.

Directors and Corporate Governance Committee Matters

Overview

The directors and corporate governance committee recommends candidates for membership on the board and board committees. The committee also oversees matters of corporate governance, director independence, director compensation, and board performance. The committee s charter is available online at http://investor.lilly.com/board-committees.cfm or in paper form upon request to the company s corporate secretary.

All committee members are independent as defined in the New York Stock Exchange listing requirements.

Director Nomination Process

The board seeks independent directors who represent a mix of backgrounds and experiences that will enhance the quality of the board s deliberations and decisions. Candidates shall have substantial experience with one or more publicly traded national or multinational companies or shall have achieved a high level of distinction in their chosen fields.

Board membership should reflect diversity in its broadest sense, including persons diverse in geography, gender, and ethnicity. The board is particularly interested in maintaining a mix that includes the following backgrounds:

- active or retired chief executive officers and senior executives, particularly those with experience in operations, finance or banking, and marketing or sales
- international business
- medicine and science
- government and public policy
- health care environment
- information technology.

The board delegates the screening process to the directors and corporate governance committee, which receives direct input from other board members. Potential candidates are identified by recommendations from several sources, including:

- incumbent directors
- management
- shareholders
- an independent executive search firm retained by the committee to assist in locating candidates meeting the board s selection criteria.

The committee employs the same process for evaluating all candidates, including those submitted by shareholders. The committee initially evaluates the candidate based on publicly available information and any additional information supplied by the party recommending the candidate. If the candidate appears to satisfy the selection criteria and the committee s initial evaluation is favorable, the committee, assisted by management, gathers additional data on the candidate s qualifications, availability, probable level of interest, and any potential conflicts of interest. If the committee s subsequent evaluation continues to be favorable, the candidate is contacted by the chairman of the board and one or more of the independent directors for direct discussions to determine the mutual levels of interest in pursuing the candidacy. If these discussions are favorable, the committee makes a final recommendation to the board to nominate the candidate for election by the shareholders (or to select the candidate to fill a vacancy, as applicable).

Process for Submitting Recommendations and Nominations

A shareholder who wishes to recommend a director candidate for evaluation by the committee pursuant to this process should forward the candidate s name and information about the candidate s qualifications to the chairman of the directors and corporate governance committee, in care of the corporate secretary, at Lilly Corporate Center, Indianapolis, Indiana 46285. The candidate must meet the selection criteria described above and must be willing and expressly interested in serving on the board.

Under Section 1.9 of the company s bylaws, a shareholder who wishes to directly nominate a director candidate at the 2009 annual meeting (i.e., to propose a candidate for election who is not otherwise nominated by the board through the recommendation process described above) must give the company written notice by November 10, 2008. The notice should be addressed to the corporate secretary at Lilly Corporate Center, Indianapolis, Indiana 46285. The notice must contain prescribed information about the candidate and about the shareholder proposing the candidate as described in more detail in Section 1.9 of the bylaws. A copy of the bylaws is available online at http://investor.lilly.com/bylaws.cfm. The bylaws will also be provided by mail without charge upon request to the corporate secretary.

Audit Committee Matters

Audit Committee Membership

All members of the audit committee are independent as defined in the New York Stock Exchange listing standards applicable to audit committee members. The board of directors has determined that Mr. J. Michael Cook is an audit committee financial expert as defined in the rules of the Securities and Exchange Commission.

Audit Committee Report

The audit committee (we or the committee) reviews the company s financial reporting process on behalf of the board. Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls and disclosure controls. In this context, we have met and held discussions with management and the independent auditors. Management represented to us that the company s consolidated financial statements were prepared in accordance with generally accepted accounting principles, and we have reviewed and discussed the audited financial statements and related disclosures with management and the independent auditors, including a review of the significant management judgments underlying the financial statements and disclosures.

The independent auditors report to us. We have sole authority to appoint (subject to shareholder ratification) and to terminate the engagement of the independent auditors.

We have discussed with the independent auditors matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees), including the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of the disclosures in the financial statements. In addition, we have received the written disclosures and the letter from the independent auditors required by the Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and have discussed with the independent auditors the auditors independence from the company and its management. In concluding that the auditors are independent, we determined, among other things, that the nonaudit services provided by Ernst & Young LLP (as described below) were compatible with their independence. Consistent with the requirements of the Sarbanes-Oxley Act of 2002, we have adopted policies to avoid compromising the independence of the independent auditors, such as prior committee approval of nonaudit services and required audit partner rotation.

We discussed with the company s internal and independent auditors the overall scope and plans for their respective audits including internal control testing under Section 404 of the Sarbanes-Oxley Act. We periodically meet with the internal and independent auditors, with and without management present, and in private sessions with members of senior management (such as the chief financial officer, the chief accounting officer, and the general auditor) to discuss the results of their examinations, their evaluations of the company s internal controls, and the overall quality of the company s financial reporting. We also periodically meet in executive session.

In reliance on the reviews and discussions referred to above, we recommended to the board (and the board subsequently approved the recommendation) that the audited financial statements be included in the company s annual report on Form 10-K for the year ended December 31, 2007, for filing with the Securities and Exchange Commission. We have also appointed the company s independent auditors, subject to shareholder ratification, for 2008.

Audit Committee

J. Michael Cook, Chair
Martin S. Feldstein, Ph.D.
Franklyn G. Prendergast, M.D., Ph.D.
Kathi P. Seifert

Services Performed by the Independent Auditor

The audit committee preapproves all services performed by the independent auditor, in part to assess whether the provision of such services might impair the auditor s independence. The committee s policy and procedures are as follows:

> The committee approves the annual **audit services** engagement and, if necessary, any changes in terms, conditions, and fees resulting from changes in audit scope, company structure, or other matters. The committee may also preapprove other audit services, which are those services that only the independent auditor reasonably can provide. Since 2004, audit services have included internal controls attestation work under Section 404 of the Sarbanes-Oxley Act.
>
> **Audit-related services** are assurance and related services that are reasonably related to the performance of the audit, and that are traditionally performed by the independent auditor. The committee believes that the provision of these services does not impair the independence of the auditor.
>
> **Tax services.** The committee believes that, in appropriate cases, the independent auditor can provide tax compliance services, tax planning, and tax advice without impairing the auditor s independence.
>
> The committee may approve **other services** to be provided by the independent auditor if (i) the services are permissible under SEC and Public Company Accounting Oversight Board rules, (ii) the committee believes the provision of the services would not impair the independence of the auditor, and (iii) management believes that the auditor is the best choice to provide the services.
>
> **Process.** At the beginning of each audit year, management requests prior committee approval of the annual audit, statutory audits, and quarterly reviews for the upcoming audit year as well as any other engagements known at that time. Management will also present at that time an estimate of all fees for the upcoming audit year. As specific engagements are identified thereafter, they are brought forward to the committee for approval. To the extent approvals are required between regularly scheduled committee meetings, preapproval authority is delegated to the committee chair.

For each engagement, management provides the committee with information about the services and fees sufficiently detailed to allow the committee to make an informed judgment about the nature and scope of the services and the potential for the services to impair the independence of the auditor.

After the end of the audit year, management provides the committee with a summary of the actual fees incurred for the completed audit year.

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Independent Auditor Fees

The following table shows the fees incurred for services rendered on a worldwide basis by Ernst & Young LLP, the company s independent auditor, in 2007 and 2006. All such services were preapproved by the committee in accordance with the preapproval policy.

	2007 (millions)	2006 (millions)
Audit Fees		
Annual audit of consolidated and subsidiary financial statements, including Sarbanes-Oxley 404 attestation Reviews of quarterly financial statements Other services normally provided by the auditor in connection with statutory and regulatory filings	$7.0	$ 6.0
Audit-Related Fees		
Assurance and related services reasonably related to the performance of the audit or reviews of the financial statements 2007 and 2006: primarily related to employee benefit plan and other ancillary audits, and due diligence consulting on a possible acquisition in 2007.	$0.4	$ 0.4
Tax Fees		
2007 and 2006: primarily related to compliance services outside the U.S.	$1.4	$ 1.5
All Other Fees		
2007 and 2006: primarily related to compliance services outside the U.S.	$0.1	$ 0.1
Total	$8.9	$ 8.0

Compensation Committee Matters

Scope of Authority

The compensation committee oversees the company s global compensation philosophy and establishes the compensation of executive officers. The committee also acts as the oversight committee with respect to the company s deferred compensation plans, management stock plans, and bonus plans covering executives. In overseeing those plans, the committee may delegate authority to company officers for day-to-day plan administration and interpretation, including selecting participants, determining award levels within plan parameters, and approving award documents. However, the committee may not delegate any authority for matters affecting the executive officers.

The Committee s Processes and Procedures

The committee s primary processes for establishing and overseeing executive compensation can be found in the Compensation Discussion and Analysis section under The Committee s Processes on pages 21-22. Additional processes and procedures include:

Meetings. The committee meets several times each year (6 times in 2007). Committee agendas are established in consultation with the committee chair and the committee s independent compensation consultant. The committee meets in executive session after each meeting.

Role of Independent Consultant. The committee has retained Frederic W. Cook and his firm, Frederic W. Cook & Co., as its independent compensation consultant to assist the committee in evaluating executive compensation programs and in setting executive officers compensation. Mr. Cook reports directly to the committee, and neither he nor his firm is permitted to perform any services for management. The consultant s duties include the following:

- Review committee agendas and supporting materials in advance of each meeting and raise questions with the company s global compensation group and the committee chair as appropriate
- Review the company s total compensation philosophy, peer group, and target competitive positioning for reasonableness and appropriateness
- Review the company s total executive compensation program and advise the committee of plans or practices that might be changed to better reflect evolving best practices
- Provide independent analyses and recommendations to the committee on the CEO s pay
- Review draft Compensation Discussion and Analysis report and related tables for proxy statement
- Proactively advise committee on best practices ideas for board governance of executive compensation
- Undertake special projects at the request of the committee chair

The consultant interacts directly with members of Lilly management only on matters under the committee s oversight and with the knowledge and permission of the committee chairperson.

Role of Executive Officers and Management. With the oversight of the CEO, chief operating officer, and the senior vice president of human resources, the company s global compensation group formulates recommendations on matters of compensation philosophy, plan design, and the specific compensation recommendations for executive officers (other than the CEO as noted below). The CEO gives the committee a performance assessment and compensation recommendation for each of the other named executive officers. Those recommendations are then considered by the committee with the assistance of its compensation consultant. The CEO, the senior vice president of human resources, and, less frequently, the COO attend committee meetings but are not present for the executive sessions or for any discussion of their own compensation. (Only nonemployee directors and the committee s consultant attend executive sessions.)

The CEO does not participate in the formulation or discussion of his pay recommendations and has no prior knowledge of the recommendations that the consultant makes to the committee.

Compensation Committee Interlocks and Insider Participation

None of the compensation committee members:

- has ever been an officer or employee of the company
- is or was a participant in a related person transaction in 2007 (see page 13 for a description of our policy on related person transactions)
- is an executive officer of another entity, at which one of our executive officers serves on the board of directors.

Executive Compensation

Compensation Discussion and Analysis

2007 Summary

Executive compensation for 2007 aligned well with the objectives of our compensation philosophy and with our performance, driven by these factors:

- *Strong operating results yield strong incentive compensation payouts.* In 2007, Lilly performed in the top tier of its peer group in sales growth and adjusted earnings per share growth; this strong top- and bottom-line growth led to cash and equity incentive compensation payouts substantially above target.
- *Equity design changes improve cost-effectiveness.* We lowered the overall cost of our equity program in 2007 while maintaining its competitiveness and motivational impact by eliminating stock options in favor of shareholder value awards and by lowering total equity grant values for most positions.
- *Balanced program fosters employee achievement, retention, and engagement.* We delivered a balance of salary, performance-based cash and equity incentives, and a strong employee benefit program. Together, these elements reinforced pay-for-performance incentives and encouraged employee retention and engagement.

For more detail, please see the remainder of this Compensation Discussion and Analysis and the compensation tables.

Executive Compensation Philosophy

Our success depends on our ability to discover, develop, and market a stream of innovative medicines that address important medical needs. In addition, we must continually improve productivity in all that we do. To achieve these goals, we seek to attract, engage, and retain highly talented individuals who are committed to the company s core values of excellence, integrity, and respect for people. Our compensation and benefit programs are based on these objectives:

- *Compensation should reflect individual and company performance.* We link all employees pay to individual and company performance.
  - As employees assume greater responsibilities, more of their pay is linked to company performance and shareholder returns.
  - We seek to deliver top-tier compensation given top-tier individual and company performance, but lower-tier compensation where individual performance falls short of expectations and/or company performance lags the industry.
  - We design our programs to be simple and clear, so that employees can easily understand how their efforts affect their pay.
  - We balance the objectives of pay-for-performance and employee retention. Even during downturns in company performance, the programs should continue to motivate and engage successful, high-achieving employees.
- *Compensation should foster a long-term focus.* A long-term focus is critical to success in our industry. As employees progress to higher levels of the organization, a greater portion of compensation is tied to our

longer-term performance.

Compensation should be based on the level of job responsibility. We seek internal pay relativity, meaning that pay differences among jobs should be commensurate with differences in the levels of responsibility and impact of the jobs.

Compensation should reflect the marketplace for talent. We aim to remain competitive with the pay of other premier employers with whom we compete for talent.

Compensation and benefit programs should attract employees who are interested in a career at Lilly. Our employee benefit programs provide a competitive advantage by helping us attract and retain highly talented employees who are looking for the opportunity to build careers.

Compensation should be efficient. To deliver superior long-term shareholder returns, we must deliver value to employees in a cost-effective manner.

Compensation and benefit programs should be egalitarian. While compensation will always reflect differences in job responsibilities, geographies, and marketplace considerations, the overall structure of compensation and benefit programs should be broadly similar across the organization.

The Committee s Processes and Analyses

The compensation committee uses several tools to help it structure compensation programs that meet company objectives. Among those are:

Assessment of Company Performance. The committee uses company performance measures in two ways:

- In establishing total compensation ranges, the committee compares the performance of Lilly and its peer group with respect to sales, earnings per share, return on assets, return on equity, and total shareholder return. The committee uses this data as a reference point rather than applying a formula.

- The committee establishes specific company performance measures that determine payouts under the company s cash and equity formula-based incentive programs.

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Assessment of Individual Performance. Individual performance has a strong impact on compensation. The independent directors, under the direction of the presiding director, meet with the CEO in executive session at the beginning of the year to agree upon the CEO s performance objectives for the year. At the end of the year, the independent directors again meet in executive session to review the performance of the CEO based on his or her achievement of the agreed-upon objectives, contribution to the company s performance, and other leadership accomplishments. This evaluation is shared with the CEO by the presiding director and is provided to the compensation committee for its consideration in setting the CEO s compensation.

For the other named executive officers, the committee receives a performance assessment and compensation recommendation from the CEO and also exercises its judgment based on the board s interactions with the executive officer. As with the CEO, the executive s performance evaluation is based on the executive s achievement of objectives established between the executive and his or her supervisor, the executive s contribution to the company s performance, and other leadership accomplishments.

Peer Group Analysis. The committee compares the company s programs with a peer group of global pharmaceutical companies. Pharmaceutical companies needs for scientific and sales/marketing talent are unique to the industry and as such, Lilly must compete with these companies for talent: Abbott Laboratories; Amgen; Bristol-Myers Squibb Company; GlaxoSmithKline; Johnson & Johnson; Merck & Co.; Pfizer, Inc.; Schering-Plough Corporation; and Wyeth Laboratories. The committee uses the peer group data two ways:

Overall competitiveness. The committee uses aggregated data as a reference point to ensure that the executive compensation program as a whole is competitive, meaning within the broad middle range of comparative pay of the peer group companies when the company achieves the targeted performance levels. The committee does not target a specific position within the range.

Individual competitiveness. The committee compares the overall pay of individual executives, if the jobs are sufficiently similar to make the comparison meaningful. The individual s pay is driven primarily by individual and company performance and internal relativity rather than the peer group data; the peer group data is used as a market check to ensure that individual pay remains within the broad middle range of peer group pay. Again, the committee does not target a specific position within the range.

CEO Compensation. To provide further assurance of independence, the compensation recommendation for the CEO is developed by the independent consultant without the input or knowledge of the CEO and with limited support from company staff. The Cook firm prepares analyses showing the median CEO compensation among the peer group in terms of base salary, target annual incentive award, most recent equity grant value, and resulting total direct compensation. Mr. Cook develops a range of recommendations for any change in the CEO s base salary, annual incentive target, and equity grant value and mix. Mr. Cook s recommendations for target CEO pay take into account the peer competitive pay analysis and, importantly, the position of the CEO in relation to other senior company executives and proposed pay actions for all key employees of the company. The range allows for the committee to exercise its discretion based on the CEO s individual performance. The CEO has no prior knowledge of the recommendations and takes no part in the recommendations, committee discussions, or decisions.

Executive Compensation for 2007

Overview Establishment of Overall Pay

In making its pay decisions for 2007, the committee reviewed 2006 company performance data and peer group data as discussed above, and also considered expected competitive trends in executive pay. That review showed:

Company performance. In 2006, Lilly performed in the upper tier of the peer group in adjusted earnings per share growth, return on assets, and return on equity; in the middle tier in sales growth; and in the lower tier in total shareholder return.

Pay relative to peer group. For the one- and three-year periods ended 2006, Lilly s total pay to executive officers was in the broad middle range.

The committee determined as follows:

Program elements. The 2007 program consisted of base salary, a cash incentive bonus award, and two forms of performance-based equity grants performance awards and shareholder value awards (SVAs). Executives also received the company employee benefit package. This program balances the mix of cash and equity compensation, the mix of current and longer-term compensation, and the security of foundational benefits in a way that furthers the compensation objectives discussed above.

Pay ranges and mix of pay elements. To manage the overall costs of the program while remaining competitive with expected peer group compensation, 2007 target pay ranges were reduced in the aggregate across the management and executive ranks and the mix of pay was shifted. This was accomplished by:

- eliminating stock options in favor of SVAs, which provide greater retention and motivation value to employees at a lower cost to the shareholders

- reducing the target values for equity awards for most positions by up to 15 percent

- increasing base salaries modestly, consistent with the corporate merit budget

- maintaining cash bonus targets at 2006 levels.

The committee believes that these changes resulted in a more cost-effective program that:

- reduces overall costs to the company
- strengthens the incentives for retention and employee engagement by delivering a competitive cash component and the new SVA program
- maintains a strong link to company performance and shareholder returns through a balanced equity incentive program
- maintains appropriate internal pay relativity
- provides opportunity for total pay within the broad middle range of expected peer group pay given company performance comparable to that of our peers.

Base Salary

In setting base salaries for 2007, the committee considered the following:

- *The corporate merit budget,* the company s overall budget for base salary increases. The corporate merit budget was established based on company performance for 2006, planned performance for 2007, and a reference to general merit trends. The objective of the merit budget is to allow salary increases to retain, motivate, and reward successful performers while maintaining affordability within the company s business plan. Individual pay increases can be more or less than the budget amount depending on individual performance but aggregate increases must stay within the budget. The aggregate increases for all executive officers were within the corporate merit budget.
- *Individual performance.* As described above under The Committee s Processes and Analyses, base salary increases were driven largely by individual performance assessments.
  - The independent directors assessed Mr. Taurel s 2006 performance. They considered the company s and Mr. Taurel s accomplishment of objectives that had been established at the beginning of the year and its own subjective assessment of his performance. They noted that under Mr. Taurel s leadership, in 2006 the company exceeded its earnings targets through sales growth and productivity improvements, drove progress in refining and implementing the long-term strategy, met aggressive Six Sigma goals, strengthened its diversity programs, and enhanced its brand image and reputation. In recognition of his continued strong leadership in 2006, the committee increased Mr. Taurel s annual salary by 4 percent, which was within the range recommended by the committee s consultant.
  - The committee reviewed similar considerations for each of the other named executives. In addition, with regard to Dr. Lechleiter s performance, the committee considered his leadership in increasing employee productivity and implementation of strategic initiatives. The committee increased Dr. Lechleiter s annual salary by 4 percent.
  - With regard to Dr. Paul, the committee gave particular weight to his leadership of the company s research and development efforts, noting that Lilly Research Laboratories improved productivity in several phases of discovery and development, increased the percentage of pipeline molecules currently in clinical trials, and forged stronger links between research and the sales and marketing organizations. The committee increased Dr. Paul s annual salary by 5 percent.
  - In establishing Mr. Armitage s annual salary (a 5 percent increase), the committee noted his leadership in implementing successful litigation strategies, leading the company s efforts to influence the legal and regulatory environment to support innovation, and improving productivity within the law division.

Mr. Rice s annual salary was increased 6 percent in recognition of strong internal controls and an improved financial planning process, as well as his strong leadership of, and development of talent within, the financial component and his outstanding contributions to the management of the company.

Internal relativity, meaning the relative pay differences for different job levels.

Peer group data specific to certain positions where the jobs were viewed as comparable in content and importance to the company. We used the peer group data not to target a specific position in range, but instead as a market check for reasonableness and competitiveness. The salaries as determined by the other factors were within the broad middle range of expected competitive pay and, therefore, no further adjustments were necessary for competitiveness.

Cash Incentive Bonuses

The company s annual cash bonus programs align employees goals with the company s sales and earnings growth objectives for the current year. Cash incentive bonuses for all management employees worldwide, as well as most nonmanagement employees in the U.S., are determined under the Eli Lilly and Company Bonus Plan. Under the plan, the company sets target bonus amounts (a percentage of base salary) for all participants at the beginning of each year. Bonus payouts range from zero to 200 percent of target depending on the company s financial results relative to predetermined performance measures. At the end of the performance period, the committee has discretion to adjust an award payout downward, but not upward, from the amount yielded by the formula.

The committee considered the following when establishing the 2007 awards:

Target Bonus Sizes. Bonus targets (expressed as a percentage of base salary) were based on job responsibilities, internal relativity, and peer group data. Consistent with our compensation objectives, as executives assume greater responsibilities, more of their pay is linked to company performance. For 2007, the committee maintained the same bonus targets as 2006. The committee determined that these targets appropriately reflected internal relativity. In addition, the peer group data suggested that the 2006 targets would maintain cash compensation within the broad middle range of expected competitive pay given median peer performance, so no adjustments were necessary. The 2007 targets were:

Mr. Taurel 125 percent

Dr. Lechleiter 100 percent

Dr. Paul 85 percent

Messrs. Rice and Armitage 75 percent.

Company performance measures. The committee established 2007 company performance measures with a 25 percent weighting on sales growth and a 75 percent weighting on growth in adjusted EPS (reported earnings per share adjusted as described below under Adjustments for Certain Items). This mix of performance measures focuses employees appropriately on improving both top-line sales and bottom-line earnings, with special emphasis on earnings in order to tie rewards directly to productivity improvements. The measures are also effective motivators because they are easy for employees to track and understand.

In establishing the 2007 target growth rates, the committee considered the expected 2007 performance of our peer group, based on published investment analyst estimates. The target growth rates of 5 percent for sales and 8 percent for adjusted EPS represented approximately the median expected growth rates for our peer group. These targets are consistent with our compensation objectives because they result in above-target payouts if Lilly outperforms the peer group and below-target payouts if Lilly performance lags the peer group. Payouts were determined by this formula:

(0.25 x sales multiple) + (0.75 x adjusted EPS multiple) = bonus multiple

Bonus multiple X target bonus X base salary earnings = payout

2007 sales and adjusted EPS multiples are illustrated by these charts:

2007 pro forma sales growth of 13.6 percent resulted in a sales multiple of 1.861.

2007 pro forma adjusted EPS growth of 16.8 percent resulted in an adjusted EPS multiple of 1.883.

Together the sales multiple and the adjusted EPS multiple yielded a bonus multiple of 1.88:

(0.25 x 1.861) + (0.75 x 1.883) = 1.88 bonus multiple

See page 27 for a reconciliation of 2007 reported and pro forma sales and reported and pro forma adjusted EPS.

Equity Incentives Total Equity Program

In 2007, we employed two forms of equity incentives granted under the 2002 Lilly Stock Plan: performance awards and shareholder value awards. These incentives ensure that our leaders are properly focused on long-term shareholder value.

Target Grant Values. For 2007, the committee reduced aggregate grant values for management and executives overall in order to manage overall compensation costs. The committee did not make up for the equity reductions by significantly increasing other elements of compensation. The specific reductions at different job levels were determined by internal relativity. Consistent with the company s compensation objectives, individuals at higher levels received a greater proportion of total pay in the form of equity. The committee determined that a 50/50 split for executives between performance awards and shareholder value awards appropriately balances the shorter- and longer-term incentives of the two programs. This is consistent with the 2006 grants, which were split 50/50 between performance awards and stock options.

The target values for 2007 equity grants for the named executives were as follows:

Name	Performance Awards	Shareholder Value Awards
Mr. Taurel	$ 3,060,000	$ 3,060,000
Dr. Lechleiter	$ 1,989,000	$ 1,989,000
Dr. Paul	$ 1,200,000	$ 1,200,000
Mr. Armitage	$ 855,000	$ 855,000
Mr. Rice	$ 855,000	$ 855,000

Two named executive officers did not receive reductions in their target equity values. Dr. Paul s 2007 value remained the same as 2006 to preserve competitiveness within peer company pay and to recognize the strategic importance of the chief scientific officer role. Mr. Rice s 2007 value increased due to his promotion in May 2006.

Equity Incentives Performance Awards

Performance awards provide employees with shares of Lilly stock if certain company performance goals are achieved, aligning employees with shareholder interests and providing an ownership stake in the company. The awards are structured as a schedule of shares of Lilly stock based on the company s achievement of specific adjusted earnings-per-share (adjusted EPS) levels over specified time periods of one or more years. Possible payouts range from zero to 200 percent of the target amount, depending on adjusted EPS growth over the period. No dividends are paid on the awards during the performance period. At the end of the performance period, the committee has discretion to adjust an award payout downward, but not upward, from the amount yielded by the formula. For the 2007 grants, the committee took into consideration the following:

Target grant values. As described above, the committee reduced target grant values for most job levels and established a 50/50 split for executives between performance awards and SVAs.

Company performance measure. The committee established the performance measure as adjusted EPS growth (reported EPS adjusted as described below under Adjustments for Certain Items) over a one-year period, with a one-year holding period, thus creating a two-year award. The committee believes adjusted EPS growth is an effective motivator because it is closely linked to shareholder value, is broadly communicated to the public, and is easily understood by employees. In setting the target growth percentage of 8 percent, the committee considered the expected earnings performance of companies in our peer group over a one-year period, based on published investment analyst estimates. Eight percent represented approximately the median expected growth for our peer group; accordingly, consistent with our compensation objectives, Lilly performance exceeding the peer group median would result in above-target payouts and Lilly performance lagging the peer group median would result in below-target payouts. Payouts were determined according to this schedule:

Adjusted 2007 EPS	Up to 2.99%	3.00 4.99%	5.00 6.99%	7.00 8.99%	9.00 10.99%	11.00 12.99%	13.00 15.99%	16.00% +

Growth Percent of Target	-0-	50%	75%	100%	125%	150%	175%	200%

Pro forma adjusted EPS growth of 16.8 percent resulted in a 2007 performance award payout at 200 percent of target. See page 27 for a reconciliation of 2007 reported and pro forma adjusted EPS.

Equity Incentives Shareholder Value Awards

Beginning in 2007, the company implemented a new equity program, the shareholder value award (SVA), which replaced our stock option program. The SVA pays out shares of Lilly stock based on the performance of the company s stock over a three-year period. No dividends are paid on the awards during the performance period. Payouts range from zero to 140 percent of the target amount, depending on stock price performance over the period. The SVA program delivers equity compensation that is strongly linked to longer-term shareholder returns. It is more cost-effective than the stock option program it replaces, because the SVA program delivers, at a lower cost to the company, an equity incentive that is equally or more effective in aligning employee interests with long-term shareholder return. For the 2007 grants, the committee considered the following:

Target grant size. As described above, the committee reduced target grant sizes for most job levels and established a 50/50 split between performance awards and SVAs.

Company performance measure. The SVA is designed to pay above target if Lilly s stock price outperforms an expected compounded annual rate of return for large-cap companies and below target if Lilly stock underperforms that rate of return. The expected rate of return used in this calculation was determined considering the total return that a reasonable investor would consider appropriate for investing in the stock of a large-cap U.S. company, based on input from external money managers, less Lilly s current dividend yield. Executive officers receive no payout if the stock price (less 3 years of dividends at the current rate) does not grow over the three-year performance period in other words, if total shareholder return for the three-year period is zero or negative.

The starting price for the 2007 SVAs was $54.01 per share, representing the average of the closing prices of Lilly stock for all trading days in November and December 2006. The ending price to determine payouts will be the average of the closing prices of Lilly stock for all trading days in November and December 2009.

Payouts will be determined by this grid:

Ending Stock Price	Up to $48.72	$48.72 $53.85	$53.86 $58.99	$59.00 - $62.99	$63.00 $66.99	$67.00 - $70.99	$71.00 +
Percent of Target	-0-	40%	60%	80%	100%	120%	140%

Adjustments for Certain Items

Consistent with past practice, the committee adjusted the results on which 2007 bonuses and performance awards were determined to eliminate the effect of certain unusual income or expense items. The adjustments are intended to:

align award payments with the underlying growth of the core business

avoid volatile, artificial inflation or deflation of awards due to the unusual items either in the award year or the previous (comparator) year

eliminate certain counterproductive short-term incentives for example, incentives to refrain from acquiring new technologies or to defer disposing of underutilized assets or settling legacy litigation in order to protect current bonus payments.

To assure the integrity of the adjustments, the committee establishes adjustment guidelines at the beginning of the year. These guidelines are consistent with the company guidelines for reporting adjusted earnings to the investment community, which are reviewed by the audit committee of the board. The adjustments apply equally to income and expense items and must exceed a materiality threshold. The committee reviews all adjustments and retains downward discretion i.e., discretion to reduce compensation below the amounts that are yielded by the adjustment guidelines.

For the 2007 awards calculation, the committee adjusted EPS to eliminate the effect in 2007 of accounting charges for the acquisition of in-process research and development (IPR&D), and in both 2006 and 2007 of major product liability charges, major asset impairments, restructuring, and other special charges. In addition, to eliminate the distorting effect of the acquisition of ICOS Corporation (which was completed in January 2007) on year-over-year growth rates, the committee adjusted sales and EPS for both 2006 and 2007 on a pro forma basis as if the acquisition had been completed at the beginning of 2006.

The adjustments were intended to align award payments more closely to underlying business growth trends and eliminate volatile swings (up or down) caused by the unusual items. This is demonstrated by the 2006 and 2007 adjustments:

Reconciliations of the adjustments to our reported sales and earnings per share are below. The shaded numbers were used for calculating growth percentages for the compensation programs.

	2007	2006	% Growth 2007 vs. 2006	2005	% Growth 2006 vs. 2005
Sales as Reported ($ millions)	$18,633.5	$15,691.0	19%	$14,645.3	**7%**
Pro Forma ICOS Adjustment	$ 72.7	$ 755.2		N/A	
Sales Pro Forma Adjusted	$18,706.2	$16,446.2	**14%**	N/A	N/A
EPS as Reported	$ 2.71	$ 2.45	11%	$ 1.81	35%
Eliminate IPR&D charges for acquisitions and in-licensing transactions	$ .63				