

Registration number: 284385

Eli Lilly and Company Limited

Annual Report and Financial Statements

for the Year Ended 31 December 2018



Eli Lilly and Company Limited
Registration No: 284385

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Eli Lilly and Company Limited
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Company Information

Directors	H Bennett
	S Forda
	N Lemen
	K Alexander
	A Diaz-Granados
Company secretary	H Bennett
Registered office	Lilly House Priestley Road Basingstoke Hampshire RG24 9NL United Kingdom
Bankers	BNP Paribas 10 Harewood Avenue London NW1 6AA
Auditors	Ernst & Young City Quarter Lapps Quay Cork Ireland

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Strategic Report for the Year Ended 31 December 2018

The Directors present their strategic report for the year ended 31 December 2018.

Principal activity

The principal activity of the company during the year was the production and supply of pharmaceuticals and animal health products to fellow subsidiaries and third parties in the United Kingdom and certain selected areas of the world. The company is a wholly owned subsidiary of Eli Lilly and Company, its US parent company. The UK company manufactures, promotes and supplies products from the Eli Lilly global product portfolio, performs significant research and development in the UK as part of the global research and development programme and acts as a regional office for strategic management and certain other regional activities. These regional costs are billed out to other group companies. (Further details on the current global product portfolio and research pipeline can be obtained from the Eli Lilly and Company annual accounts at the following web address <http://investor.lilly.com/annuals.cfm>). During the year the company divested the Elanco Animal Health part of the business.

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Strategic Report for the Year Ended 31 December 2018 (continued)

Fair review of the business

The global nature of Eli Lilly and Company Limited's business and associated strategies results in significant intercompany trading, the level of which is driven by third party sales in different geographic markets. Eli Lilly and Company Limited manages its business with reference to UK and Ireland third party sales and control of operating expenditure.

On 24 July 2018, the group announced that after completing a strategic review of Elanco Animal Health, the company would separate the Animal Health business from the Pharma business. On 24 September 2018, Elanco Animal Health Incorporated completed its IPO which represents 19.8 percent of Elanco's outstanding shares. Elanco shares began trading on the New York Exchange under the symbol 'ELAN' in September 2018. On 11 March 2019, the final exchange offer was completed. The Elanco Group is now operating as a independent group from Eli Lilly and Company. Consequently the results of the Elanco Animal Health business no longer remain in Eli Lilly and Company Limited. The company is still forecast to remain profitable.

The company's turnover decreased by 8.8% in the year which was driven by decreased sales to group undertakings of 5.4% and decrease in rendering of services of 9.7%. The decrease in services was driven by a reduction of regional office activities performed in the UK and partially due to services related to the Animal Health part of the business that is now performed by Elanco UK AH Limited. Sales of pharmaceuticals and animal health products to third parties, principally in the UK and Republic of Ireland decreased by 11.7% due primarily to the divestment of the Elanco business, and were in line with local and global management expectations.

As the company's opportunities for growth in the next decade are becoming clear, the company implemented changes in the commercial business-unit structure and manufacturing site that will sharpen Eli Lilly and Company Limited's focus on the company's greatest opportunities, while improving productivity and contribute to the continued pursuit toward operational excellence.

Operating profit decreased by 36.5% and operating expenses also decreased by 6.3% as a result of decreased employee costs of 19.8%, decrease in other expenses of 10.1% (mainly driven by a decrease in regional services, legal and professional services, materials and travel) and an increase in changes in inventories of 154.0% offset by reduced depreciation costs of 27.1%. The change in inventory is driven by the one-off sale of Humatrope to another group entity. Variances in the year are largely driven by the divestment of the Elanco Animal Health business.

Equity shareholder's funds decreased by £182.6m as a result of a net actuarial gain on the defined benefit pension scheme, share based payment, profit for the year offset by dividends of £307.1m paid during the year.

The company's key financial indicators during the year were as follows:	2018 '000	2017 '000
Turnover	£879,813	£964,256
Operating Profit before exceptional items	£50,636	£79,686
Profit after tax	£33,677	£35,487
Equity shareholders funds	£463,005	£645,555

Eli Lilly and Company Limited
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Strategic Report for the Year Ended 31 December 2018 (continued)

Principal risks and uncertainties

The company faces risks in relation to successful patent challenges by generic manufacturers, failure to obtain approval for new products and license extensions from NICE (National Institute for Health and Clinical Excellence) and/or the Scottish Medicines Consortium (SMG). In Q4 2013, the Department of Health introduced a revised PPRS (Pharmaceutical Price Regulation Scheme) effective 1 January 2014. This scheme outlines proposed rebate percentages payable to the Department of Health over the next 5 years. However, these proposed rebate percentages beyond 2016 are subject to future variation according to the overall UK DoH medicines bill. The 2018 rebate percentage was agreed at 7.8%. During Q4 2018, the Department of Health introduced a revised Voluntary Scheme for Branded Medicines Pricing and Access effective 1 January 2019, running for a five year period, with a rebate percentage of 9.6% for 2019 and varying percentages thereafter.

The company does not hedge against foreign currency exposure; this risk is managed by the US parent company on a global basis.

Following the outcome of the UK referendum to leave the European Union ("EU"), uncertainty remains as to what extent, if any, this will affect Eli Lilly and Company Limited's operations. An internal working group was established in 2017 to review and manage all aspects of the company's operations through "Brexit" and this group continues to monitor the latest political developments. The company has made more than sufficient operational adjustments to be well prepared for the UK exiting the EU.

Approved by the Board on 25 September 2019 and signed on its behalf by:



.....
N Lemen
Director

Eli Lilly and Company Limited
Registration No: 284385

Directors' Report for the Year Ended 31 December 2018

The Directors present their report and the financial statements for the year ended 31 December 2018.

Directors of the Company

The directors who held office during the year were as follows:

P Troutt (resigned 30 November 2018)

G Hillier (resigned 30 June 2018)

J Haug (resigned 9 March 2018)

H Bennett - Company secretary and director

R Morison (resigned 1 December 2018)

S Forda

N Lemen (appointed 9 March 2018)

K Alexander

C Lewis (appointed 1 July 2018 and resigned 30 November 2018)

A Diaz-Granados (appointed 1 December 2018)

Dividends

The profit for the year, after taxation, amounted to £33,677,000.

Dividends of £307,130,000 were paid in the year (2017: Nil).

Employment of disabled persons

It is the policy of this company that disabled persons, whether registered disabled or not, should receive full and fair consideration for all job vacancies, company training and development programmes and promotion opportunities for which these persons are suitable and qualified applicants. Employees who become disabled during their working life with the company will be retrained in employment wherever practicable and will be given reasonable assistance with any necessary retraining.

Employee involvement

The company has continued to maintain and develop its policy of involving and communicating with its employees, as appropriate to the various components of its organisation, and has continued its policy of providing annually a detailed report to each employee of its performance and business progress.

Future developments

The company will continue to provide its customers with innovative medicines, information and exceptional customer service in order to enable people to live longer, healthier, and more active lives.

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Directors' Report for the Year Ended 31 December 2018 (continued)

Going concern

The UK operations are inextricably linked with global activities and therefore going concern should be considered as a wider global group; the financial condition of the group is discussed in Eli Lilly and Company's financial statements under 'Financial Condition' in the 'Financials' section. Eli Lilly and Company Limited (the UK company) will continue to promote and supply products from the Eli Lilly global product portfolio and performs significant research and development in the UK as part of the global research and development programme. The UK operations, in isolation, would not have a going concern exposure; if the UK activities were to become non-productive the facilities and entities would be properly shut down and dissolved with full support of the parent and wider group.

Both the UK group of companies and the wider Lilly group have sufficient funding available through internal profit generation and external financing (through both institutions and financial markets). Globally Eli Lilly and Company is exposed to changes in government healthcare policies, reimbursement structures and patent expirations and challenges from generic manufacturers. The Group continues to benefit from the strength of its growth in the Far East and Emerging markets which helps to shelter the Group from the decline in Pharma sales in its Established markets.

The Eli Lilly and Company Limited directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the annual report and accounts.

The company participates in the group's centralised treasury arrangements and so shares banking arrangements with its parent and fellow subsidiaries.

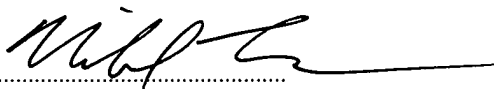
Disclosure of information to the auditors

Each Director has taken steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information. The Directors confirm that there is no relevant information that they know of and of which they know the auditors are unaware.

Re-appointment of auditors

In accordance with section 485 of the Companies Act 2006, a resolution is to be proposed at the Annual General Meeting for appointment of Ernst and Young as auditor of the Company.

Approved by the Board on 25 September 2019 and signed on its behalf by:



N Lemen
Director

Eli Lilly and Company Limited
Registration No: 284385


Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards has been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.



N Lemen
Director

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ELI LILLY AND COMPANY LIMITED

Opinion

We have audited the financial statements of Eli Lilly and Company Limited for the year ended 31 December 2018 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity and the related notes to the financial statements, including a summary of significant accounting policies set out in note 2. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 102 "The Financial Reporting Standard applicable in the UK and Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report below. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ELI LILLY AND COMPANY LIMITED (Continued)

Other information

The other information comprises the information included in the Annual Report and Accounts, other than the financial statements and our Auditor's Report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ELI LILLY AND COMPANY LIMITED (Continued)

Responsibilities of directors

As explained more fully in the Statements of Directors' Responsibilities set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

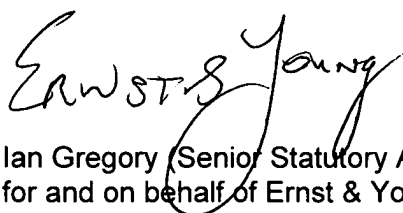
Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our Auditor's Report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an Auditor's Report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Ian Gregory (Senior Statutory Auditor)
for and on behalf of Ernst & Young, Statutory Auditor
Cork, Ireland

26 September 2019

Eli Lilly and Company Limited
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Income Statement for the Year Ended 31 December 2018

	Note	2018 Continuing operations £ 000	2018 Discontinued operations £ 000	2018 Total £ 000	2017 Continuing operations £ 000	2017 Discontinued operations £ 000	2017 Total £ 000
Turnover	3	£458,168	£421,645	£879,813	£475,966	488,290	964,256
Changes in stocks of finished goods and work in progress		-	(£98,371)	(£98,371)	-	(38,738)	(38,738)
Raw materials and consumables used		(£170,287)	(£250,565)	(£420,852)	(£169,053)	(311,363)	(480,416)
Employee benefits expense	8	(£89,512)	(£30,423)	(£119,935)	(£99,236)	(50,217)	(149,453)
Depreciation expense	12	(£11,067)	(£6,302)	(£17,369)	(£11,546)	(12,295)	(23,841)
Other expenses		(£163,733)	(£8,917)	(£172,650)	(£178,463)	(13,659)	(192,122)
		(£434,599)	(£394,578)	(£829,177)	(£458,298)	(426,272)	(884,570)
Operating profit before exceptional items	4	£23,569	£27,067	£50,636	£17,668	62,018	79,686
Exceptional items		(£12,001)	(£2,196)	(£14,197)	(£19,020)	(12,089)	(31,109)
Operating profit after exceptional items		£11,568	£24,871	£36,439	(£1,352)	49,929	48,577
Income from shares in group undertakings		£12,290	-	£12,290	£154	-	154
Interest payable and similar charges	7	(£5,681)	(£5,366)	(£11,047)	(£5,606)	(5,007)	(10,613)
		£6,609	(£5,366)	£1,243	(£5,452)	(5,007)	(10,459)
Profit/(loss) before tax		£18,177	£19,505	£37,682	(£6,804)	44,922	38,118
Taxation	10	£1,493	(£5,498)	(£4,005)	(£18)	(2,613)	(2,631)
Profit/(loss) for the year		£19,670	£14,007	£33,677	(£6,822)	42,309	35,487

The notes on pages 15 to 42 form an integral part of these financial statements.
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Statement of Comprehensive Income for the Year Ended 31 December 2018

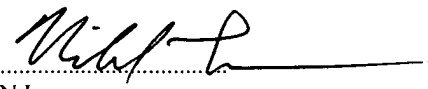
	Note	2018 '000	2017 '000
Profit for the year		<u>£33,677</u>	<u>£35,487</u>
Other Comprehensive Income:			
Actuarial gain recognised on retiree benefits	19	£10,812	£9,950
Deferred tax on retiree benefits	18	(£1,838)	(£1,692)
Actuarial gain recognised on pensions	19	£91,751	£83,668
Deferred tax on pensions	18	<u>(£15,598)</u>	<u>(£14,223)</u>
		<u>£85,127</u>	<u>£77,703</u>
Total comprehensive income for the year		<u><u>£118,804</u></u>	<u><u>£113,190</u></u>

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Statement of Financial Position as at 31 December 2018

	Note	2018 '000	2017 '000
Fixed assets			
Intangible assets	11	-	£132,914
Tangible assets	12	£84,473	£237,163
Investments	13	£22,527	£30,524
		<u>£107,000</u>	<u>£400,601</u>
Current assets			
Stocks	14	£168	£237,130
Debtors	15	£347,806	£542,571
Cash at bank and in hand		£139	£50
		<u>£348,113</u>	<u>£779,751</u>
Prepayments and accrued income	16	£37	£9,407
Creditors: Amounts falling due within one year	17	<u>(£60,097)</u>	<u>(£173,832)</u>
Net current assets		<u>£288,053</u>	<u>£615,326</u>
Total assets less current liabilities		£395,053	£1,015,927
Creditors: Amounts falling due after more than one year	17	(£3,726)	(£362,983)
Provisions for liabilities	18	<u>(£24,464)</u>	<u>(£24,250)</u>
Net assets excluding pension asset		£366,863	£628,694
Net pension and post retirement medical benefits asset/(liability)	19	<u>£96,142</u>	<u>£16,861</u>
Net assets		<u>£463,005</u>	<u>£645,555</u>
Capital and reserves			
Called up share capital	20	£9,452	£9,452
Contributed capital		£93,771	£93,771
Profit and loss account		<u>£359,782</u>	<u>£542,332</u>
Total equity		<u>£463,005</u>	<u>£645,555</u>

Approved and authorised by the Board on 25 Sep 2019 and signed on its behalf by:



 N Lemen
 Director

The notes on pages 15 to 42 form an integral part of these financial statements.

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Statement of Changes in Equity for the Year Ended 31 December 2018

	Share capital '000	Contributed Capital '000	Profit and loss account '000	Total '000
At 1 January 2018	£9,452	£93,771	£542,332	645,555
Profit for the year	-	-	£33,677	33,677
Other comprehensive income	-	-	£85,127	85,127
Total comprehensive income	-	-	£118,804	118,804
Dividends	-	-	(£307,130)	(307,130)
Share based payment transactions	-	-	£5,776	5,776
At 31 December 2018	£9,452	£93,771	£359,782	463,005

	Share capital '000	Contributed Capital '000	Profit and loss account '000	Total '000
At 1 January 2017	£8,202	£85,021	£423,071	516,294
Profit for the year	-	-	£35,487	£35,487
Other comprehensive income	-	-	£77,703	£77,703
Total comprehensive income	-	-	£113,190	113,190
New share capital subscribed	£1,250	£8,750	-	10,000
Share based payment transactions	-	-	£6,071	6,071
At 31 December 2017	£9,452	£93,771	£542,332	645,555

The notes on pages 15 to 42 form an integral part of these financial statements.

Eli Lilly and Company Limited
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Notes to the Financial Statements for the Year Ended 31 December 2018

1 General information

The company is a private company limited by share capital incorporated in United Kingdom.

The address of its registered office is:

Lilly House
Priestley Road
Basingstoke
Hampshire
RG24 9NL
United Kingdom

2 Accounting policies

Summary of significant accounting policies and key accounting estimates

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Statement of compliance

The financial statements of Eli Lilly and Company Limited were approved for issue by the Board of Directors on the date shown on the statement of financial position.

These financial statements were prepared in accordance with Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

Basis of preparation

These financial statements have been prepared using the historical cost convention except that as disclosed in the accounting policies certain items are shown at fair value.

The financial statements are presented in sterling which is the functional currency of the company and rounded to the nearest £'000.

Summary of disclosure exemptions

The company satisfies the criteria of being a qualifying entity under FRS102. Its financial statements are consolidated into the financial statements of its ultimate parent, Eli Lilly and Company, which can be obtained from the address given in note 26. As such, advantage has been taken of the following exemptions under FRS102 for qualifying entities:

- No cash flow statement has been presented for the company.
- Disclosure in respect of financial instruments have not been presented.
- No disclosure has been given for the aggregate remuneration of key personnel.
- Exposure to and management of financial risks.
- Related party disclosure for all wholly owned subsidiaries of the Eli Lilly and Company group.

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Notes to the Financial Statements for the Year Ended 31 December 2018

2 Accounting policies (continued)

Exemption from preparing group accounts

The company is exempt from the obligation to prepare group financial statements by virtue of section 401 of the Companies Act 2006. Consequently these financial statements present the results of the company as an individual undertaking and not its group.

The results of the Company are included in the consolidated financial statements of Eli Lilly and Company, which is incorporated in the United States of America.

Revenue recognition

Revenue is recognised from sales of products at the time title of goods passes to the buyer and the buyer assumes the risks and rewards of ownership which is when the products are dispatched. Revenue for rendering services is recognised when the outcome of a transaction can be estimated reliably. Revenue is shown net of Valued Added Tax. Provisions for returns, discounts, and rebates are established in the same period the related sales are recognized. Rebates are based on the terms of arrangements with wholesalers, managed-care organizations and government purchasers and certain market conditions. Rebates accruals are included in total current liabilities.

Exceptional items

Eli Lilly and Company Limited disclose exceptional items separately on the income statement. Exceptional items are material items possessing a high degree of abnormality which arise from events or transactions that fall outside the ordinary activities of Eli Lilly and Company Limited and which do not recur. Exceptional items do not include prior period items merely because they relate to a prior period.

Foreign currency transactions and balances

Transactions in foreign currencies are recorded at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All differences are taken to the profit and loss account.

Tax

The tax expense for the period comprises current tax. Tax is recognised in profit or loss, except that a change attributable to an item of income or expense recognised as other comprehensive income is also recognised directly in other comprehensive income.

The current income tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the reporting date in the countries where the company operates and generates taxable income.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or right to pay less tax, with the following exceptions:

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

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Notes to the Financial Statements for the Year Ended 31 December 2018

2 Accounting policies (continued)

Tangible assets

Tangible assets are stated in the statement of financial position at cost, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The cost of tangible assets includes directly attributable incremental costs incurred in their acquisition and installation. We review the carrying value and remaining useful life of long-lived assets for potential impairment on a periodic basis and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Impairment is determined by comparing projected undiscounted cash flows to be generated by the asset to its carrying value. If an impairment is identified, a loss is recorded equal to the excess of the asset's net book value over its fair value, and the cost basis is adjusted.

Depreciation

Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the date of acquisition, of each asset evenly over its expected useful life, as follows:

Asset class	Depreciation method and rate
Freehold Buildings	over 40 to 50 years
Plant and equipment	over 3 to 20 years

Business combinations

Business combinations (except for group reconstructions that are accounted for using the merger accounting method) are accounted for using the purchase method. The consideration for each acquisition is measured at the aggregate of the fair values at acquisition date of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquired, plus any costs directly attributable to the business combination.

Under merger accounting, the carrying values of the assets and liabilities of the parties to the combination are not adjusted to fair value on consolidation. Merger expenses are charged to the statement of comprehensive Income as part of the profit or loss of the combined entity at the effective date of the group reconstruction.

Intangible assets

Intangible assets acquired separately from a business are capitalised at cost.

Subsequent to initial recognition, intangible assets are stated at cost less accumulated amortisation and accumulated impairment. Intangible assets are amortised on a straight line basis over the estimated useful lives. The carrying value of intangible assets is reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

The useful economic lives of intangible assets are as follows:

Customer relationships - 6-10 years
Licenses - 3-7 years
Other intangibles - 16 years

If there are indicators that the residual value or useful life of an intangible asset has changed since the most recent annual reporting period previous estimates shall be reviewed and, if current expectations differ the residual value, amortisation method or useful life should be amended. Changes in the expected useful life of the expected pattern of consumption of benefit shall be accounted for as a change in accounting estimate.

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Notes to the Financial Statements for the Year Ended 31 December 2018

2 Accounting policies (continued)

Investments

Investments in group companies are stated at cost unless, in the opinion of the Directors, a permanent diminution in the value of the investment has occurred. In these circumstances, the investment is stated at its written down value, which is calculated by discounting pre tax future cash flows at a pre-tax discount rate and the related impairment is charged to the income statement. An impairment review is performed annually.

Investments in equity shares which are not publicly traded and where fair value cannot be measured reliably are measured at cost less impairment.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand.

Trade debtors

Trade debtors are amounts due from customers for products sold or services performed in the ordinary course of business.

Trade debtors are recognised initially at the transaction price. They are subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for the impairment of trade debtors is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

Stocks

Stocks are stated at the lower of cost and estimated selling price less costs to complete and sell. Cost is determined using the first-in, first-out (FIFO) method.

The cost of finished goods and work in progress comprises direct materials and direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. At each reporting date, stocks are assessed for impairment. If stocks are impaired, the carrying amount is reduced to its selling price less costs to complete and sell; the impairment loss is recognised immediately in profit or loss.

Trade creditors

Trade creditors are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if the Company does not have an unconditional right, at the end of the reporting period, to defer settlement of the creditor for at least twelve months after the reporting date. If there is an unconditional right to defer settlement for at least twelve months after the reporting date, they are presented as non-current liabilities.

Borrowings

Interest-bearing borrowings are initially recorded at fair value, net of transaction costs. Interest-bearing borrowings are subsequently carried at amortised cost, with the difference between the proceeds, net of transaction costs, and the amount due on redemption being recognised as a charge to the Income Statement over the period of the relevant borrowing.

Interest expense is recognised on the basis of the effective interest method and is included in interest payable and similar charges.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

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Notes to the Financial Statements for the Year Ended 31 December 2018

2 Accounting policies (continued)

Provisions

A provision is recognised when the company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

Leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

Defined benefit pension obligation

Defined Benefit Pension Scheme

The company operates a defined benefit pension scheme for certain employees. The assets of the scheme are held separately from those of the company.

Pension scheme liabilities are measured on an actuarial basis using the projected unit credit method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Pension scheme assets are measured using market values at the balance sheet date.

Any pension scheme surplus is recognised, to the extent that it is recoverable, on the balance sheet. This surplus is presented gross of deferred tax in the Financial Statements and the deferred tax relating to a surplus is included with other deferred tax assets or liabilities.

Any pension scheme deficit is recognised in full on the balance sheet. The deferred tax relating to a benefit liability is included with other deferred tax assets or liabilities.

The cost of the defined benefit plans are recognised as follows:

- any changes in the net defined benefit liability arising as a result of plan introductions or changes are recognised during the reporting period in profit and loss.
- net interest on the defined benefit liability is recognised during the reporting period in profit and loss
- the cost of plan introductions, benefit changes, curtailments and settlements recognised during the reporting period in profit and loss.
- re-measurement of the net defined benefit liability is recognised in other comprehensive income. Re-measurement comprises of any actuarial gain or loss and the return on plan assets, excluding amounts included in net interest on the net defined benefit liability.

Post Retirement Medical Benefits

The company provides healthcare benefits to certain retired employees. Payments are made to beneficiaries when claimed. The cost of the scheme and associated liabilities have been fully recognised on an actuarially determined basis. The Projected Unit Credit Cost Method is used to determine the present value of the Projected Benefit Obligation, the Accumulated Post retirement Benefit Obligation, and the related current service cost. Under this method, a "projected accrued benefit" is calculated by attributing benefits on a straight line basis over the period from the member's date of hire until the earliest date at which the member can retire (now age 55). The benefit obligations for the Healthcare Plan were measured as at the Company's 31 December 2017 measurement date and are based on the valuation of the Healthcare Plan as at 1 January 2017. The benefit obligations have been recalculated at the measurement date on the basis of an unchanged membership (subject to allowance for curtailment) and taking into account confirmation that the Plan premiums (Company subsidy) for the period 2018 will remain the same as 2017.

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Notes to the Financial Statements for the Year Ended 31 December 2018

2 Accounting policies (continued)

Defined contribution pension obligation

The company also operates a defined contribution pension scheme. Contributions are recognised in the profit and loss account in the period in which they become payable.

Share capital

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

Dividends

Dividend distribution to the company's shareholders is recognised as a liability in the financial statements in the reporting period in which the dividends are declared.

Share based payments

FRS 102 section 26 'Share based payment' requires the recognition of the fair value of share-based compensation within the company's operating expenses, and a corresponding entry is made through equity. Share based payments comprise performance awards, shareholder value awards and restricted stock units; all received in shares of the ultimate parent company Eli Lilly and Company. Grants are accounted for at the fair value (determined using an appropriate pricing model) at the date of grant and recognised evenly over the vesting period. Where employer national insurance liabilities arise on the issuance of share awards, this liability is accrued.

Performance Awards:

PA shares are accounted for at fair value based upon the closing stock price on the date of grant and fully vest at the end of the measurement period. The fair values of PAs granted for the years ended December 31, 2018, 2017, and 2016 were \$71.63, \$73.54, and \$72.00, respectively. The number of shares ultimately issued for the PA program is dependent upon the earnings achieved during the vesting period.

Shareholder Value Awards:

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

Restricted Stock Units:

RSUs are granted to certain employees and are payable in shares of our common stock. RSU shares are accounted for at fair value based upon the closing stock price on the date of grant. The corresponding expense is amortized over the vesting period, typically three years. The fair values of RSU awards granted during the years ended December 31, 2018, 2017, and 2016 were \$70.95, \$72.47, and \$71.46, respectively. The number of shares ultimately issued for the RSU program remains constant with the exception of forfeitures.

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Notes to the Financial Statements for the Year Ended 31 December 2018

3 Revenue

The analysis of the company's revenue for the year from continuing operations is as follows:

	2018 '000	2017 '000
Sale of goods	£653,874	£714,029
Rendering of services	<u>£225,939</u>	<u>£250,227</u>
	<u><u>£879,813</u></u>	<u><u>£964,256</u></u>

The analysis of the company's turnover for the year by destination is as follows:

	2018 '000	2017 '000
Third party sales to United Kingdom and Republic of Ireland	£307,647	£348,332
Sales to group undertakings	£346,227	£365,697
Rendering of services	<u>£225,939</u>	<u>£250,227</u>
	<u><u>£879,813</u></u>	<u><u>£964,256</u></u>

Turnover, which is stated net of value added tax, represents the revenue recognised in the period.

The turnover is attributable to the production and supply of pharmaceuticals and animal health products and service income from performing significant research and development activities in the UK and operating as a regional office.

The rendering of services is attributable to the performance of research and development in the UK as part of the global research and acting as a regional office for strategic management and certain other regional activities.

On 01 September 2018 the Elanco Animal Health business was transferred to Elanco UK AH Limited.

4 Operating profit

Arrived at after charging/(crediting)

	2018 '000	2017 '000
Auditors' remuneration (see note 9)	£271	£242
Depreciation expense	£17,369	£23,841
Amortisation expense	£9,261	£14,702
Research and development expenditure	£142,853	£141,181
Foreign exchange gains/(losses)	£1,283	(£1,167)
Operating lease expense - property	£277	£90
Loss on disposal of property, plant and equipment	<u>£429</u>	<u>£143</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

5 Exceptional Items

	2018 '000	2017 '000
Restructuring	-	24,217
Pension curtailment loss	5,000	200
Lilly House Impairment	7,001	6,692
Post-retirement benefit expense	2,196	-
Impairment of intangible assets	59,331	-
Gain on disposal of Animal Health business	(59,331)	-
	<u>14,197</u>	<u>31,109</u>

During the current period a net pension loss arose. The divestment of the Animal Health part of the business gave rise to a curtailment gain of £8,000,000. This was accounted for as a curtailment event using a single measurement date of 31 July 2018. This was offset by the recognition of an estimated liability of £13,000,000 for Gross Minimum pension equalisation following the High Court decision in the Lloyds case in October 2018. This was accounted for as a past service cost using a measurement date of 31 December 2018. The pension curtailment loss in 2017 is a result of the restructuring that took place during 2017. This has been accounted for as a curtailment event using a single measurement date of 31 December 2017.

Eli Lilly and Company Limited entered into a non-binding agreement to surrender the lease on the Basingstoke office, which no longer meets the needs of the company, during 2017 in preparation for moving to a new facility in approximately two years' time. Subsequently the asset was impaired in 2017. In November 2018 the lease was surrendered and consideration of £8,000,000 was paid to the landlord, of which £999,000 has been prepaid representing rent relating to the interim period.

The post-retirement benefit expense represents a provision made for payments for future retirees in lieu of receiving post retiree medical cover for Elanco employees.

A valuation of the intangibles held by the company and transferred to Elanco UK AH Limited in the period indicated the carrying value of the assets was impaired in the amount of £59,331,000. The impairment arose due to poor global sales performance for these products and product rationalisations following acquisition of the Novartis Animal Health business.

Share capital of £201,315,626 in Elanco UK AH Limited was acquired in exchange for the transfer of the trade and assets of the Elanco Animal Health business on 1 September 2018. The share capital issued exceeded the net book value of the assets transferred by £59,331,461, giving rise to a gain on disposal.

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Notes to the Financial Statements for the Year Ended 31 December 2018

6 Directors' remuneration

The directors' remuneration for the year was as follows:

	2018 '000	2017 '000
Aggregate remuneration in respect of qualifying services	<u>£3,410</u>	<u>£1,854</u>

During the year the number of directors who were receiving benefits and share incentives was as follows:

	2018 No.	2017 No.
Accruing benefits under defined benefit pension scheme	<u>2</u>	<u>2</u>

In respect of the highest paid director:

	2018 '000	2017 '000
Remuneration	£1,600	£394
Defined benefit accrued pension entitlement at the end of the period	<u>£119</u>	<u>-</u>

7 Interest payable and similar charges

	2018 '000	2017 '000
Interest expense on other finance liabilities	£4,579	£274
Interest payable on loans from group undertakings	<u>£6,468</u>	<u>£10,339</u>
	<u>£11,047</u>	<u>£10,613</u>

8 Staff costs

The aggregate payroll costs (including directors' remuneration) were as follows:

	2018 '000	2017 '000
Wages and salaries	£82,253	£100,330
Social security costs	£10,927	£12,714
Share-based payment expenses	£5,775	£6,071
Other pension costs	<u>£20,980</u>	<u>£30,338</u>
	<u>£119,935</u>	<u>£149,453</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

8 Staff costs (continued)

The average number of persons employed by the company (including directors) during the year, was as follows:

	2018 No.	2017 No.
Production	289	501
Other departments	850	1,012
	<u>1,139</u>	<u>1,513</u>

9 Auditors' remuneration

	2018 '000	2017 '000
Audit of the financial statements *	£247	£214
Other non-audit related fees to auditors	£24	£28
	<u>£271</u>	<u>£242</u>

* Included in these fees are the financial statement audits of Eli Lilly Group Limited.

10 Taxation

Tax charged/(credited) in the income statement

	2018 '000	2017 '000
Current taxation		
UK corporation tax	£2,517	£14,592
UK corporation tax adjustment to prior periods	£3,484	(£2,082)
Foreign withholding tax	-	£6
	<u>£6,001</u>	<u>£12,516</u>
Deferred taxation		
Arising from origination and reversal of timing differences	(£1,996)	(£9,885)
Tax expense in the income statement	<u>£4,005</u>	<u>£2,631</u>

Other Comprehensive Income deferred taxation:

Actuarial gain on post employment benefits	<u>£17,436</u>	<u>£15,915</u>
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Notes to the Financial Statements for the Year Ended 31 December 2018

10 Taxation (continued)

The tax on profit before tax for the year is higher than the standard rate of corporation tax in the UK (2017 - lower than the standard rate of corporation tax in the UK) of 19% (2017 - 19.25%). The Finance Act 2016 which was substantively enacted in September 2016 included provisions to reduce the rate of corporation tax in the financial year 2020 from 18% to 17%. Accordingly deferred tax balances not expected to reverse until 2020 have been accounted at the lower rate of 17%.

The 2018 UK corporation tax adjustment to prior periods resulted from a £711,000 difference in the 2017 statutory tax calculation versus final 2017 tax filing, a (£3,539,000) difference in the 2016 statutory tax calculation versus final 2016 tax filing and a (£656,000) difference in the 2013 statutory tax calculation versus final tax liability.

The 2017 UK corporation tax adjustment to prior period resulted from a £2,405,000 difference in the 2016 Statutory tax calculation versus final 2016 tax filing, a £2,063,000 difference in the 2015 statutory tax calculation versus final 2015 tax filing and a (£2,386,000) difference in the 2014 statutory tax calculation versus final tax liability.

The differences are reconciled below:

	2018 '000	2017 '000
Profit before tax	<u>37,682</u>	<u>38,118</u>
Corporation tax at standard rate	7,160	7,338
Effect of revenues exempt from taxation	(£13,426)	-
Effect of expense not deductible in determining taxable profit/(tax loss)	£6,510	£2,850
Increase/(decrease) in UK and foreign current tax from unrecognised temporary difference from a prior period	-	£6
Increase/(decrease) in UK and foreign current tax from adjustment for prior periods	£3,484	(£2,082)
Tax increase (decrease) from effect of unrelieved tax losses carried forward	-	£1,690
Tax increase (decrease) arising from group relief	-	(£503)
Tax increase/(decrease) from changes in pension fund	<u>£277</u>	<u>(£6,668)</u>
Total tax charge	<u>£4,005</u>	<u>£2,631</u>

The rate of corporation tax was reduced to 19% commencing 1 April 2017 and is expected to reduce to 17% on 1 April 2020.

Included in the 2018 'Effect of expense not deductible in determining taxable profit (and loss)' are the following expenses: capital assets, share based payments, non-deductible amortisation, investment write-off, capital impairment, post retirement benefit expenses and entertainment costs.

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Notes to the Financial Statements for the Year Ended 31 December 2018

11 Intangible assets

Intangible Assets	Licenses '000	Relationships '000	Other '000	Total '000
Balance at the 1 January 2017	751	28,166	117,253	146,171
Additions	-	-	1,446	1,446
Amortisation	(563)	(5,140)	(8,999)	(14,702)
Carrying amount at the 31 December 2017	<u>188</u>	<u>23,026</u>	<u>109,700</u>	<u>132,914</u>

Intangible Assets	Licenses '000	Relationships '000	Other '000	Total '000
Balance at the 1 January 2018	188	23,026	109,700	132,914
Amortisation	(188)	(3,427)	(5,646)	(9,261)
Impairment	-	(7,868)	(51,464)	(59,331)
Disposals	-	(11,731)	(52,590)	(64,322)
Carrying amount at the 31 December 2018	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

Elanco Animal Health Ireland Ltd acquired the animal health business of Janssen Pharmaceutical NV (Atlantic), a Johnson & Johnson company in July 2011. Janssen Animal Health specialised in the development and marketing of pharmaceutical products for the treatment of companion and feed animals. Following the 2011 transaction, Elanco Animal Health Ireland Ltd retained ownership of the subject assets, that were acquired from Janssen; and on January 01, 2015 ownership of the subject assets were transferred from Elanco Animal Health Ireland Ltd to Eli Lilly and Company Limited. An independent analysis with respect to certain intangible assets of the Janssen Animal Health business (Atlantic Assets) was carried out in support of the planned transfer of the subject assets to establish an "arms length" value. The final purchase price was £168,079,590.

Intangible assets acquired as part of this transaction were being amortised as follows:

- Customer relationships are amortised evenly over their useful lives of 6 years.
- Licenses are amortised evenly over their useful lives of 3 years.
- Other intangibles are amortised evenly over their useful lives of 16 years.

During 2015 Eli Lilly and Company Limited entered into a License and Distribution agreement with Prevtec Microbia International, a Barbados corporation. Under this agreement Eli Lilly and Company Limited was granted an exclusive license to use the Licensed Trademark and Patents in association with the product Coliprotec - F4 vaccine. Eli Lilly and Company Limited paid £655,890 for this intangible asset and will be amortized over the life of this license and distribution agreement of 7 years.

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Notes to the Financial Statements for the Year Ended 31 December 2018

11 Intangible assets (continued)

The Eli Lilly Group completed a global acquisition of the Novartis Animal Health business on 1 January 2015. This included three UK companies: Novartis Animal Health (UK) Limited, Vericore Limited and Novartis Animal Vaccines Limited. These three entities were originally acquired by Elanco Netherlands Holding B.V. They were subsequently purchased intra-group by Eli Lilly and Company Limited, on 14 December 2015, for £20,049,000 via a share purchase of Novartis Animal Health (UK) Limited which in turn owned Vericore & Novartis Animal Vaccines Limited. On 10 February 2016 Eli Lilly and Company Limited acquired the trade and assets of Novartis Animal Health (UK) Limited and Novartis Animal Vaccines Limited. The total identifiable net assets transferred resulted in UK identifiable intangibles relating to customer relationships of £10,987,000 (amortised evenly over their useful lives of 10 years) and £683,810 goodwill (amortised evenly over their useful lives of 5 years).

On the 16 April 2018, Eli Lilly and Company Limited sold two intangible assets; Vulketan and Imaverol. All remaining intangible assets at 01 September 2018 relate to the Animal Health business and were disposed of to Elanco UK AH Limited.

A valuation of the intangibles held by the company and transferred to Elanco UK AH Limited in the period indicated the carrying value of the assets was impaired in the amount of £59,331,000. The impairment arose due to poor global sales performance for these products and product rationalisations following acquisition of the Novartis Animal Health business.

12 Tangible assets

Included within the net book value of land and buildings below is £49,856,058 (2017: £108,398,935) in respect of freehold land and buildings.

	Land & Buildings Freehold '000	Plant & Machinery '000	CIP '000	Total '000
Cost				
As at 1 January 2017	183,213	347,677	34,326	565,216
Additions	-	-	19,853	19,853
Transfer	11,831	25,480	(37,311)	-
Disposal	(757)	(7,924)	-	(8,681)
At 31 December 2017	<u>194,287</u>	<u>365,233</u>	<u>16,868</u>	<u>576,388</u>
Depreciation				
As at 1 January 2017	62,642	253,931	-	316,573
Provided during the year	6,869	16,972	-	23,841
Disposal	(7)	(7,876)	-	(7,883)
Impairment	6,694	-	-	6,694
At 31 December 2017	<u>76,198</u>	<u>263,027</u>	<u>-</u>	<u>339,225</u>
Net Book Value				
NBV 1 January 2017	<u>120,571</u>	<u>93,746</u>	<u>34,326</u>	<u>248,643</u>
NBV 31 December 2017	<u>118,089</u>	<u>102,206</u>	<u>16,868</u>	<u>237,163</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

12 Tangible assets (continued)

	Land & Buildings Freehold '000	Plant & Machinery '000	CIP '000	Total '000
Cost				
As at 1 January 2018	194,287	365,233	16,868	576,388
Additions	-	581	13,077	13,658
Transfer	5,892	7,698	(13,590)	-
Disposal	(99,215)	(292,937)	(13,731)	(405,883)
At 31 December 2018	<u>100,964</u>	<u>80,575</u>	<u>2,624</u>	<u>184,163</u>
Depreciation				
As at 1 January 2018	76,198	263,027	-	339,225
Provided during the year	5,271	12,098	-	17,369
Disposal	(40,049)	(216,855)	-	(256,904)
At 31 December 2018	<u>41,420</u>	<u>58,270</u>	<u>-</u>	<u>99,690</u>
Net Book Value				
NBV 1 January 2018	<u>118,089</u>	<u>102,206</u>	<u>16,868</u>	<u>237,163</u>
NBV 31 December 2018	<u>59,544</u>	<u>22,305</u>	<u>2,624</u>	<u>84,473</u>

Assets relating to the Animal Health business were divested to Elanco UK AH Limited at their book value of £148,817,000 on 01 September 2018.

13 Investments in subsidiaries, joint ventures and associates

	Venture Capital '000	Subsidiary Undertakings '000	Total '000
1 January 2017	7,578	8,228	15,806
Investments made during the year	<u>4,718</u>	<u>10,000</u>	<u>14,718</u>
31 December 2017	<u>12,296</u>	<u>18,228</u>	<u>30,524</u>
1 January 2018	12,296	18,228	30,524
Investments made during the year	2,003	-	2,003
Write down of investment in Vericore Limited	<u>-</u>	<u>(10,000)</u>	<u>(10,000)</u>
31 December 2018	<u>14,299</u>	<u>8,228</u>	<u>22,527</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

13 Investments in subsidiaries, joint ventures and associates (continued)

Venture Capital Funds

Eli Lilly & Company Limited further invested in Dementia Discover LP during the year, a venture capital fund which invests in the research and treatment for dementia. The company also holds an investment in Epidarex Capital II LP, a venture capital fund which invests in early stage life science companies. The investments are held at cost and Lilly have agreed a cap regarding future commitments. There were no cost adjustments or distributions relating to venture capital during 2018 or 2017.

Subsidiary Undertakings

On 14 March 2017, 1,250,000 ordinary shares were issued of £1 nominal value each in the capital of Vericore Limited for an aggregate subscription price of £10,000,000.

On 30 August 2018, Vericore limited distributed residual cash held in the company of £11,330,455 to Eli Lilly and Company Limited and the investment held in Vericore Limited was written down to £1.

Details of undertakings

Details of the investments in which the company holds 20% or more of the nominal value of any class of share capital are as follows:

Undertaking	Country of incorporation	Holding	Proportion of voting rights and shares held	
			2018	2017
Subsidiary undertakings				
Lilly Industries Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Eli Lilly (Basingstoke) Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Eli Lilly Leasing Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Eli Lilly Property Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Eli Lilly Resources Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Greenfield Pharmaceuticals Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Lilly Property Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Lilly Research Centre Limited *	United Kingdom	Ordinary Share Capital	100%	100%
Lilly Resources Limited *	United Kingdom	Ordinary Share Capital	100%	100%

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13 Investments in subsidiaries, joint ventures and associates (continued)

Dista Products Limited *	United Kingdom	Ordinary Share Capital	0%	100%
Elanco Europe Limited *	United Kingdom	Ordinary Share Capital	0%	100%
Vericore Limited *	United Kingdom	Ordinary Share Capital	0%	100%
Elanco Animal Health UK Limited *	United Kingdom	Ordinary Share Capital	0%	100%
Elanco Animal Vaccines Limited *	United Kingdom	Ordinary Share Capital	0%	100%

* The subsidiaries have no trading activities. Apart from the amounts loaned, without any terms specified, to Eli Lilly & Company Limited, the subsidiaries have no other assets and liabilities. The Animal Health subsidiaries; Dista Products Limited, Elanco Europe Limited, Vericore Limited, Elanco Animal Health UK Limited and Elanco Animal Vaccines Limited were divested to Elanco UK AH Limited on 1 September 2018, which was also divested in the year as a distribution.

14 Stocks

	2018 '000	2017 '000
Raw materials and consumables	-	£10,282
Work in progress	-	£189,945
Finished goods and goods for resale	-	£32,175
Other inventories	£168	£4,728
	<u>£168</u>	<u>£237,130</u>

The difference between purchase price or production cost of stocks and their replacement cost is not material. Stocks provided for in the period were £6,526,731 (2017 - £7,620,708).

The stock held relating to the Animal Health business was disposed of to Elanco UK AH Limited on 01 September 2018.

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15 Debtors

	Note	2018 '000	2017 '000
Trade debtors		£55,599	£83,640
Other debtors		£7,562	£6,403
Prepayments		£3,179	£3,810
Other Assets		£507	£536
Income tax asset	10	£10,173	£4,516
Amounts owed by group undertakings - Trade		£44,202	£86,860
Amounts owed by group undertakings - Non Trade		<u>£226,584</u>	<u>£356,806</u>
Total current trade and other debtors		<u>£347,806</u>	<u>£542,571</u>

Included within "Amounts owed by group undertakings - Non Trade" is £194,992,342 (2016 - £356,720,829) receivable balance from GEMS pooling agreement which bears interest of LIBOR +12 basis points.

16 Prepayments and accrued income

	2018 '000	2017 '000
Long Term Prepaid Assets - Net of Amortisation	<u>£37</u>	<u>£9,407</u>

17 Creditors

	Note	2018 '000	2017 '000
Due within one year			
Trade creditors		£1,691	£32,099
Social security and other taxes		£3,813	£3,508
Other payables		£9,912	£10,103
Accrued expenses		£30,407	£52,922
Amounts owed to group undertakings - Trade		£407	£59,113
Amounts owed to group undertakings - Non Trade		<u>£13,867</u>	<u>£16,087</u>
		<u>£60,097</u>	<u>£173,832</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

17 Creditors (continued)

	Note	2018 '000	2017 '000
Due after one year			
Deferred income		-	£3,122
Liabilities under disability scheme		£1,614	£1,770
Loans and borrowings		£2,112	£358,091
		<u>£3,726</u>	<u>£362,983</u>

During 2018 Eli Lilly and Company Limited repaid an intercompany loan from Kinsale Financial Services of £188,000,000. A further loan of £168,000,000 from Kinsale Financial Services was included in the divestment of the Animal Health business of Elanco to Elanco UK Animal Health Limited.

Deferred income in 2017 related to a government grant connected to the Speke manufacturing site. This was transferred to Elanco UK AH Limited as part of the divestment of the Animal Health business.

18 Deferred tax and other provisions

	2018 '000	2017 '000
Provision for liabilities and charges		
Provision for deferred taxation	24,464	24,250
The movements in deferred taxation during the current year are as follows:		
At 1 January	24,250	18,220
Charge for the year	(1,996)	(9,885)
Transfer	(15,226)	-
Amounts credited to other comprehensive income	17,436	15,915
At 31 December	<u>24,464</u>	<u>24,250</u>
Full provision has been made for deferred taxation at ('16:19%/'17:17%/'18:17%) as follows:		
Capital allowances in advance of depreciation	8,910	20,632
Intrinsic value of share based payments	(790)	(807)
Other short term timing differences	(6,545)	(6,703)
Pension	22,889	11,128
Total provisions for liabilities and charges	<u>24,464</u>	<u>24,250</u>

Assets and liabilities relating to the Animal Health business were divested to Elanco UK AH Limited at their book value on 01 September 2018. Accordingly deferred tax balances relating to these assets and liabilities were transferred.

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes

Defined contribution pension scheme

The company operates a defined contribution pension scheme. The pension cost charge for the year represents contributions payable by the company to the scheme and amounted to £3,730,000 (2017 - £4,887,000).

Defined benefit pension schemes

Eli Lilly and Company Limited operates two pension schemes - A) Eli Lilly Group Pension Plan (main plan) and B) Supplementary Pension Plan (top-up scheme).

In the following note the details for both schemes are displayed separately but in the Statement of Comprehensive Income and Statement of Financial Position both schemes are combined for presentational purposes.

A) Eli Lilly Group Pension Plan

The company operates a defined benefit pension scheme for certain employees. The assets of the scheme are held separately from those of the company.

Pension scheme liabilities are measured on an actuarial basis using the projected unit credit method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Pension scheme assets are measured using market values at the balance sheet date.

Asset allocations are intended to achieve a total asset return target over the long term. Expected rates of return detailed below are based on historical data and future long-term expectations. The assumed rate of return on pension scheme assets is consistent with the scheme's long-term investment return objective.

The date of the most recent comprehensive actuarial valuation was 01 January 2017. The membership data used for this valuation, updated to reflect the impact of the recent curtailments, has also been used to calculate the 31 December 2018 benefit obligations for the Plan set out in this report

The total cost relating to defined benefit schemes for the year recognised in profit or loss as an expense was £22,779,000 (2017 - £24,475,000).

Reconciliation of scheme assets and liabilities to assets and liabilities recognised

The amounts recognised in the statement of financial position are as follows:

	2018	2017
	'000	'000
Fair value of scheme assets	£1,498,741	£1,505,161
Present value of scheme liabilities	<u>(£1,352,000)</u>	<u>(£1,428,000)</u>
Defined benefit pension scheme surplus	<u>£146,741</u>	<u>£77,161</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes (continued)

Defined benefit obligation

Changes in the defined benefit obligation are as follows:

<i>Defined Benefit Obligation</i>	2018 '000	2017 '000
Changes in the defined benefit obligation are as follows:		
Present value at start of year	1,428,000	1,397,000
Current service cost	18,200	24,200
Interest cost	34,181	35,731
Benefits paid	(44,000)	(40,000)
Remeasurement of DBO	(89,381)	12,069
Curtailment loss / (gain)	5,000	(1,000)
Present value at end of year	<u>1,352,000</u>	<u>1,428,000</u>

Fair value of scheme assets

Changes in the fair value of scheme assets are as follows:

	2018 '000	2017 '000
Fair value at start of year	1,505,160	1,414,154
Interest income	35,602	35,556
Return on plan assets, excluding amounts included in interest income	2,229	95,800
Employer contributions	750	750
Benefits paid	(44,000)	(40,000)
Administrative costs paid	(1,000)	(1,100)
Fair value at end of year	<u>1,498,741</u>	<u>1,505,160</u>

Analysis of assets

The major categories of scheme assets are as follows:

	2018 %	2017 %
Equity instruments	26%	33%
Bonds	37%	36%
Other	37%	31%
	<u>100%</u>	<u>100%</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes (continued)

Return on scheme assets

	2018 '000	2017 '000
Return on scheme assets	<u>£37,831</u>	<u>£131,356</u>

The pension scheme has not invested in any of the company's own financial instruments or in properties or other assets used by the company.

Recognised in the Income Statement

	2018 '000	2017 '000
Current service cost	18,200	24,200
Net interest on net defined benefit liability / (asset)	(1,421)	175
Curtailment loss / (gain)	5,000	(1,000)
Defined benefit cost recognised in the Income Statement	<u>21,779</u>	<u>23,375</u>
Administration costs	1,000	1,100
Cost recognised in the Income Statement	<u>22,779</u>	<u>24,475</u>

Recognised in Other Comprehensive Income

	2018 '000	2017 '000
Actuarial loss arising during period	(89,381)	12,069
Return on plan assets	(2,229)	(95,800)
Remeasurement effects recognised in OCI	<u>(91,610)</u>	<u>(83,731)</u>

Principal actuarial assumptions

The principal actuarial assumptions at the statement of financial position date are as follows:

	2018 %	2017 %
Discount rate	2.70	2.40
Future salary increases	3.20	3.20
Price Inflation (RPI)	3.20	3.20
Price Inflation (CPI)	2.20	2.20
Pension increases for in-payment benefits - RPI capped at 5%	2.95	3.00
Pension increases for deferred benefits - CPI capped at 5%	<u>2.20</u>	<u>2.20</u>

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19 Pension and other schemes (continued)

Post retirement mortality assumptions

100% of S2PMA_L and 90% of S2PFA_L mortality tables for males and females respectively for pre-retirement and post-retirement.

B) Supplementary Scheme

This is a top-up pension scheme for certain employees and is managed separately to the main pension plan. The supplementary scheme is based on the same assumptions as those used for the main pension plan.

Reconciliation of scheme assets and liabilities to assets and liabilities recognised

The amounts recognised in the statement of financial position are as follows:

	2018 '000	2017 '000
Present value of defined benefit obligation	<u>(£12,100)</u>	<u>(£11,700)</u>

Recognised in the Income Statement

	2018 '000	2017 '000
Current Service Cost	440	820
Net interest on net defined benefit liability	269	242
Curtailment loss	-	1,500
Defined benefit cost recognised in the Income Statement	<u>709</u>	<u>2,562</u>
Administration costs	<u>270</u>	<u>259</u>
Cost recognised in the Income Statement	<u>979</u>	<u>2,821</u>

Recognised in Other Comprehensive Income

	2018 '000	2017 '000
Actuarial loss/(gain) arising during period	129	322
Loss amortized during the period	<u>(270)</u>	<u>(259)</u>
Remeasurement effects recognised in OCI	<u>(141)</u>	<u>63</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes (continued)

Defined benefit obligation

Changes in the defined benefit obligation are as follows:

<i>Defined Benefit Obligation</i>	2018 '000	2017 '000
Changes in the defined benefit obligation are as follows:		
Present value at start of year	11,700	9,500
Current service cost	440	820
Interest cost	269	242
Actuarial (gain)/loss	129	322
Benefits paid	(438)	(684)
Curtailment loss	-	1,500
Present value at end of year	<u>12,100</u>	<u>11,700</u>

Principal actuarial assumptions

The principal actuarial assumptions are the same as for the main plan detailed above.

Post Retirement Medical Benefits

Employees and former employees who joined before 1 January 1997 are provided with post retirement benefits in the form of cover for medical costs. The net present value of the liability was assessed with the advice of independent qualified actuaries at 1 January 2013 and updated using the following main assumptions.

During the year Elanco employees left the scheme as a result of the divestment of the Elanco Animal Health business giving rise to a gain on plan amendment of £5,300,000 at 31 July 2018.

The total cost relating to defined benefit schemes for the year recognised in profit or loss as an expense was £1,075,000 (2017 - £3,773,000), which includes current service cost, interest cost and net loss/(gain) amortisation during the period.

Reconciliation of scheme assets and liabilities to assets and liabilities recognised

The amounts recognised in the statement of financial position are as follows:

	2018 '000	2017 '000
Present value of scheme liabilities	<u>(£38,500)</u>	<u>(£48,600)</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes (continued)

Defined benefit obligation

Changes in the defined benefit obligation are as follows:

	2018 '000	2017 '000
Present value at start of year	(£48,600)	(55,500)
Current service cost	(£317)	(583)
Interest cost	(£1,040)	(1,308)
Actuarial (gain)/loss	£5,794	7,768
Benefits paid	£363	723
Curtailment gain	-	300
Plan amendment	£5,300	-
Present value at end of year	<u>(£38,500)</u>	<u>(48,600)</u>

Recognised in the Income Statement

	2018 '000	2017 '000
Current service cost	317	583
Net interest on net defined benefit liability	1,040	1,308
Curtailment gain	-	(300)
Defined benefit cost recognised in the Income Statement	<u>1,357</u>	<u>1,591</u>
Administration costs	<u>(282)</u>	<u>2,182</u>
Cost recognised in the Income Statement	<u>1,075</u>	<u>3,773</u>

Recognised in Other Comprehensive Income

	2018 '000	2017 '000
Net (gain) amortisation during the period	(158)	(2,182)
Actuarial (gain)/loss arising during the period	(5,794)	(7,768)
Net prior service cost/(credit) amortisation during the period	440	-
Plan amendment	<u>(5,300)</u>	<u>-</u>
Remeasurement effects recognised in OCI	<u>(10,812)</u>	<u>(9,950)</u>

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Notes to the Financial Statements for the Year Ended 31 December 2018

19 Pension and other schemes (continued)

Principal actuarial assumptions

The principal actuarial assumptions at the statement of financial position date are as follows:

	2018	2017
	%	%
Discount rate for ABPO	2.70	2.40
Rate of increase in healthcare costs	<u>5.80</u>	<u>5.80</u>

20 Share capital

Authorised, allotted, called up and fully paid shares

	2018		2017
	No. 000	£ 000	No. 000
			£ 000
Ordinary shares of £1 each	<u>9,452</u>	<u>9,452</u>	<u>9,452</u>

21 Obligations under leases and hire purchase contracts

Operating leases

The total of future minimum lease payments is as follows:

	2018	2017
	'000	'000
Later than one year and not later than five years	£2,670	£2,670
Later than five years	<u>£148</u>	<u>£444</u>
	<u>£2,818</u>	<u>£3,114</u>

The amount of non-cancellable operating lease payments recognised as an expense during the year was £Nil (2017 - £Nil).

22 Share-based payments

FRS 102 section 26 'Share based payment' requires the recognition of the fair value of share-based compensation within the company's operating expenses. Share based payments comprise performance awards, shareholder value awards and restricted stock units and are all received in shares of the ultimate parent company Eli Lilly and Company.

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Notes to the Financial Statements for the Year Ended 31 December 2018

22 Share-based payments (continued)

Performance Awards

Performance awards are granted to directors and key employees and are payable in shares of the ultimate parent company; these vest at the end of the financial year following the year of grant. The number of shares actually issued, if any, varies depending on the achievement of certain pre-established earnings-per-share targets over a 2 year period. Performance awards are accounted for at fair value based upon the closing stock price on the date of grant and are spread equally across the vesting period. The fair values of performance awards granted during the year ended 31 December 2018 was \$71.63 (2017: \$73.54). Approximately 35,000 performance awards were granted in 2018 (2017: 45,000).

Shareholder Value Awards

Shareholder values awards are granted to directors and key employees and are payable in shares of the ultimate parent company; these vest across a three year period from the date of grant. The number of shares actually issued, if any, varies depending on the share price at the end of the three year vesting period compared to pre-established target share prices. The corresponding expense for shareholder value awards is accounted for at fair value and spread evenly over the vesting period. We measure the fair value of the shareholder value awards on the grant date using a Monte Carlo simulation model. The Monte Carlo Simulation model uses multiple input variables that determine the probability of satisfying the market condition stipulated in the award grant and calculates the fair value of the award. Expected volatilities utilized in the model are based on implied volatilities from traded options on our stock, historical volatility of our stock price, and other factors. Similarly, the dividend yield is based on historical experience and our estimate of future dividend yields. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. The weighted-average fair values of the shareholder value awards granted during the year ended 31 December 2018 was \$48.51 (2017: \$66.25). The following assumptions were used to calculate the fair values:

	2018	2017
	'000	'000
Expected dividend yield	2.50%	2.50%
Risk-free interest rate	2.31	1.38
Volatility	22.26	22.91

Approximately 27,000 shareholder value awards were granted in 2018 (2017: 31,000)

Restricted Stock Units

Restricted stock units are granted to certain employees and are payable in shares of the ultimate parent company. Restricted stock units are accounted for at fair value based upon the closing stock price on the date of grant. The corresponding expense is spread evenly over the vesting period, typically 3 years. The fair values of restricted stock units granted during the year ended 31 December 2018 was \$70.95 (2017: \$72.47). Approximately 43,000 restricted stock units were granted in 2018 (2017: 40,000)

The total expense recognised in the income statement for the year ended 31 December 2018 is £5,776,000 (2017: £6,071,000).

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Notes to the Financial Statements for the Year Ended 31 December 2018

23 Commitments

Capital commitments

The total amount contracted for but not provided in the financial statements was £1,296 (2017 - £7,707,972).

24 Contingent liabilities

The company has an uncommitted £1,000,000 Bilateral bank Guarantee facility dated 01 October 2014 for issuance of bonds, guarantees and indemnity umbrella limit to allow Eli Lilly and Company Limited to add Customs Duty Deferment Guarantee. To date the company has issued £600,000.

25 Related party transactions

Summary of transactions with other related parties

On 24 September 2018, Elanco Animal Health Incorporated completed its IPO which represents 19.8 percent of Elanco's outstanding shares. Consequently the related party disclosure exemption for wholly owned subsidiaries of the Eli Lilly and Company group is no longer satisfied for transactions between Elanco and Eli Lilly entities. All Elanco UK AH Limited liabilities and collections were settled or collected by Eli Lilly and Company Limited on behalf of Elanco UK AH Limited during the period 24 September 2018 to 31 December 2018. All amounts relating to the Elanco business are reflected in Elanco UK AH Limited's statutory accounts for the period 24 September 2018 to 31 December 2018.

Income and receivables from related parties

2018

Receipt of services

Amounts receivable from related party

**Other related
parties
£ 000**

£385

£29,492

26 Ultimate Parent Undertaking and Related Party Transactions

The company's immediate parent is Eli Lilly Group Limited, incorporated in United Kingdom.

The ultimate parent is Eli Lilly and Company , incorporated in United States of America.

The consolidated financial statements of Eli Lilly and Company are those of the smallest and largest group of which the company is a member and for which consolidated financial statement are prepared. The consolidated financial statements can be obtained from Eli Lilly and Company, Lilly Corporate Centre, Indianapolis, Indiana, USA.

The company has utilised the exemption under Section 33 of Financial Reporting Standard 102 whereby a subsidiary undertaking does not have to disclose transactions with other entities that are wholly owned subsidiaries of the Eli Lilly & Company Group.

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Notes to the Financial Statements for the Year Ended 31 December 2018

27 Non adjusting events after the financial period

On 11 March 2019, the final exchange offer regarding the Animal Health part of the business was completed and Elanco Animal Health Incorporated became the ultimate parent company of Elanco UK AH Limited. The Elanco Group is now operating as a fully independent group from Eli Lilly and Company.