Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Lilly's growth outlook is improving through cutting costs and launching several new blockbusters.

Updated Forecasts and Estimates from 10 Jun 2016

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The primary analyst covering this company does not own its stock.

Research as of 10 Jun 2016
Estimates as of 10 Jun 2016
Pricing data through 21 Jun 2016
Rating updated as of 21 Jun 2016

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 10 Jun 2016

Eli Lilly's innovative culture and strong financial commitment to developing the next generation of drugs set the company apart from its peers and fuel its long-term growth. Following a very steep patent cliff in 2014, Lilly's growth prospects are improving as the company is preparing to launch several new blockbusters and patent losses are fading.

Lilly's internal pipeline is well positioned to mitigate the patent losses during the next decade. The company tends to spend over 20% of its sales on financing the development efforts of new drugs, much higher than the midteens industry average. Its robust pipeline is a result of Lilly's strong commitment to research. We believe recently approved diabetes drugs Tradjenta and Jardiance hold the highest sales potential of Lilly's new drugs. Also, several of Lilly's late-stage cancer drugs, such as Cyramza and necitumumab, should develop into blockbusters if additional clinical data holds up. Further, Alzheimer's drug solanezumab, in phase 3 development, holds major blockbuster potential but also carries more risk of failure.

Lilly's strong entrenchment in insulin production should also help the company deal with patent losses. Unlike traditional drugs, Lilly's insulin drugs are very hard to copy by generics and create barriers to entry for noninsulin producers because of the large up-front investments needed to create scale efficiencies. Further, Lilly's longer-acting biosimilar insulin should help the company secure its market share.

The company is taking a hard look at its bottom line. Through a combination of cost savings and expected top-line growth, Lilly is targeting to reduce its research and development expenses and marketing costs as a percentage of sales to 18%-20% and 28%-30%, respectively, by 2018, which we believe is achievable if the pipeline is successful. Lilly expects to increase its gross margin through productivity initiatives and greater capacity utilization, which may prove challenging in 2017 as the patents expire on high-margin Cialis and Alimta in certain markets.

Vital Statistics

Market Cap (USD Mil)	80,105
52-Week High (USD)	92.85
52-Week Low (USD)	67.88
52-Week Total Return %	-9.7
YTD Total Return %	-12.7
Last Fiscal Year End	31 Dec 2015
5-Yr Forward Revenue CAGR %	8.1
5-Yr Forward EPS CAGR %	11.1
Price/Fair Value	0.77

Valuation Summary and Forecasts

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Price/Earnings	22.8	24.6	*20.3*	*17.8*
EV/EBITDA	15.3	18.7	*15.1*	*13.4*
EV/EBIT	20.9	25.7	*19.3*	*16.6*
Free Cash Flow Yield %	4.2	1.8	*4.0*	*4.3*
Dividend Yield %	2.7	2.3	*2.8*	*3.1*

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Revenue	19,616	19,959	*21,345*	*22,703*
Revenue YoY %	-15.1	1.8	*6.9*	*6.4*
EBIT	3,697	3,767	*4,407*	*5,140*
EBIT YoY %	-39.5	1.9	*17.0*	*16.6*
Net Income, Adjusted	3,258	3,656	*3,776*	*4,283*
Net Income YoY %	-27.7	12.2	*3.3*	*13.4*
Diluted EPS	3.03	3.43	*3.58*	*4.07*
Diluted EPS YoY %	-26.9	13.1	*4.3*	*13.7*
Free Cash Flow	-3,332	1,449	*3,179*	*3,422*
Free Cash Flow YoY %	-170.3	-143.5	*119.5*	*7.6*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Eli Lilly is a pharmaceutical company with a focus on neuroscience, endocrinology, oncology, and immunology. Lilly's key products include Alimta for cancer; Forteo for osteoporosis; Jardiance, Humalog, and Humulin for diabetes; and Cialis for erectile dysfunction. Also, Lilly holds a strong position in the animal healthcare market.

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Morningstar Analysis

Valuation, Growth and Profitability 10 Jun 2016

We are increasing our fair value estimate to $94 per share from $84 after increasing our projections for immunology drugs Taltz and baricitinib as recent clinical data supports the drugs in becoming leaders in psoriasis and rheumatoid arthritis, respectively. Outside immunology, we expect Jardiance and several other recently launched drugs, including diabetes drug Trulicity and cancer drug Cyramza, to become increasingly important drivers for cash flows. In particular, Jardiance looks poised to hit peak sales projections of over $7 billion based on strong cardiovascular data. Another important point driving our valuation is cost controls. We increasingly think Lilly will meet its estimate of reducing total operating costs as a percentage of sales to 50% by 2018. While the outcome of operating cost controls will depend on new revenue associated with the success of the pipeline, we expect Lilly will reach this goal. Regarding a key wild card in Lilly's valuation, solanezumab, we project sales reaching over $3 billion, but the range of outcomes is wide for this drug.

Overall, we project annual sales increases of 7% during the next decade as a result of new drug launches offsetting patent losses. However, we expect a high degree of volatility in sales growth during the next 10 years, as patent losses will create several setbacks to the top line. Also, we expect operating margins to improve, as the company gains leverage from new product launches, which we expect will be partly offset by gross margin headwinds because of patent expirations on high-margin drugs. Additionally, we estimate a weighted cost of capital for Lilly at 7%, in line with the company's peer group.

Scenario Analysis

Largely based on the low volatility of cash flows from a diverse and inelastic product portfolio, we rate Lilly's uncertainty as medium, which is a bit higher than its Big Pharma peer group partly due to the high product concentration risk surrounding the company's pipeline that represents more than one fourth of sales by the end of the next 10 years. Our scenario analysis assumes a base-case fair value estimate of $94 and a bull case of $113 (25% probability), while our bear case (25% probability) projects a $70 fair value estimate. Relative to our base case, the scenario analysis shows moderate variances, hence our medium uncertainty rating. Key factors affecting the scenario analysis include the degree of success of the branded drug pipeline and the magnitude of market pressures for currently marketed drugs. With a large amount of valuation driven by the pipeline, the success of new drug launches and clinical trials has an amplified impact on Lilly's valuation.

Economic Moat

Patents, economies of scale, and a powerful distribution network support Eli Lilly's wide moat. Lilly's patent-protected drugs carry strong pricing power, which enables the firm to generate returns on invested capital in excess of its cost of capital. Further, the patents give the company time to develop the next generation of drugs before generic competition arises. Additionally, Lilly's diversified product portfolio means the company's top drugs represent only a moderate amount of total sales, with the largest drug, Alimta, representing 13% of total sales, which sets up manageable cash flow declines as new products mitigate the generic competition. Also, Lilly's operating structure allows for cost-cutting after patent losses to reduce the margin pressure from lost high-margin drug sales. Overall, Lilly's established product line creates the enormous cash flows needed to fund the average $800 million in development costs per new drug. In addition, the company's powerful distribution network sets up the company as a strong partner for smaller drug companies that lack Lilly's resources. Lilly's entrenched insulin franchise creates an added layer of competitive advantage, as interchangeable insulin competition seems many years away due to the complexity of gaining generic approval for insulin and the high cost to build the needed economy of scale for insulin

Price/Fair Value Morningstar data as of Jun 21, 2016

production.

Moat Trend

Given decelerating patent losses and a strong pipeline, we believe Eli Lilly's moat trend is stable. Over the next three years, the company's key patent losses include erectile dysfunction drug Cialis, cardiovascular drug Effient, and potentially cancer drug Alimta. While patent losses over the next three years will affect over 20% of total sales, the company's strong pipeline combined with stable currently marketed drugs should lead to over 7% annual revenue growth over the same period. On the pipeline side, we expect over $1 billion in peak annual sales from psoriasis drug ixekizumab and rheumatoid arthritis drug baricitinib. Also, strong cardiovascular data for Lilly's diabetes drug Jardiance (approved in 2014) should drive this drug's peak annual sales to over $7 billion.

Turning to the macro environment, Lilly has several headwinds, but it is making solid strategic moves to address the challenges. On the negative side, the risk-sensitive U.S. Food and Drug Administration is generally approving only very safe drugs or drugs in high-need areas such as cancer. Also, managed-care organizations and pharmacy benefit managers have consolidated over the past decade and are now using their growing size to demand lower drug prices and reduced coverage for less innovative drugs, forcing drug firms to push for true innovation, and reducing the power of Lilly's distribution networks. Further, the U.S. government is evaluating comparative effectiveness programs and more aggressive price negotiations, raising the bar for future innovation. While Lilly faces several headwinds, its pipeline holds several biologic drugs that hold much stronger competitive advantages than traditional small molecules. Further, the company's pipeline is focused on more innovative treatments in areas of unmet medical need where payer coverage and pricing power remain strong. Outside the pipeline, the company's strong insulin franchise (20% of sales) carries some of the extra protections awarded to biologics and the economies of scale needed to produce the relatively lower-priced drugs. Also, the company's well-entrenched animal health business (17% of sales) operates in a mature and stable business that is not experiencing any significant changes.

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Bulls Say/Bears Say

Bulls Say

- Alzheimer's drug solanezumab could become a major blockbuster drug if a follow-up phase 3 trial supports previous clinical data.
- Buoyed by several recent acquisitions, Lilly's animal health business should post stable growth over the next decade.
- Lilly is increasing its focus on developing drugs for unmet medical indications in neurology and oncology. The strategy should improve the success rate at the Food and Drug Administration, which has become exceedingly risk-sensitive to new drugs in well-treated areas.

Bears Say

- A large portion of Lilly's valuation is tied to the Alzheimer's drug solanezumab, which carries a high degree of risk as the majority of treatments developed for this disease have failed in the past.
- Several of Lilly's recently launched diabetes drugs are a few years behind competitive launches and some lack differentiation.
- The Alimta composition of matter patent expires in 2017, which could bring generics into the U.S. market ahead of the weaker 2022 patent.

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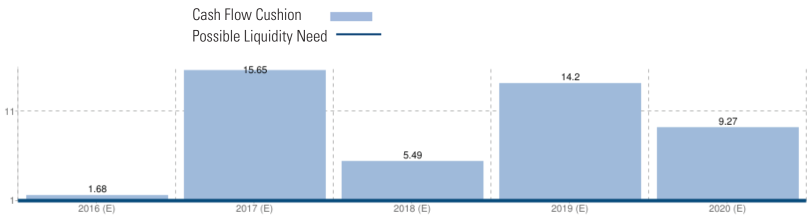
Five Year Adjusted Cash Flow Forecast (USD Mil)

	2016(E)	2017(E)	2018(E)	2019(E)	2020(E)
Cash and Equivalents (beginning of period)	4,452	5,453	5,844	6,497	7,286
Adjusted Available Cash Flow	647	3,417	1,734	1,928	2,071
Total Cash Available before Debt Service	5,098	8,870	7,577	8,425	9,357
Principal Payments	-2,681	-200	-1,000	-200	-600
Interest Payments	-209	-208	-207	-206	-205
Other Cash Obligations and Commitments	-149	-158	-172	-187	-204
Total Cash Obligations and Commitments	-3,039	-567	-1,379	-594	-1,010

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	4,452	67.6
Sum of 5-Year Adjusted Free Cash Flow	9,796	148.7
Sum of Cash and 5-Year Cash Generation	14,248	216.3
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	14,248	216.3
Sum of 5-Year Cash Commitments	-6,588	—

Financial Health

With strong cash flows derived from a stable and diversified product portfolio, Eli Lilly remains on solid financial footing. We expect the company's debt/EBITDA level to fall from the projected level of just over 2 times in 2016 to just below 1.5 times by 2020. Also, we expect the debt/capital ratio to fall from close to 45% in 2016 to 36% in 2020 as cash flows accrue over the years. Further, with its strong growth prospects, we don't expect Lilly will need to make any major acquisitions to drive growth. Nevertheless, we expect tuck-in acquisitions will augment growth for the company over the next decade.

Enterprise Risk

Lilly faces tough competition from both generics manufacturers and brand-name drugmakers. Also, governments and managed-care organizations continue to consolidate their purchasing power and exert pricing pressure. The company encounters considerable regulatory and legal risks, including product approvals, patent challenges, and liability lawsuits. Further, the patent risk on cancer drug Alimta (13% of sales) is elevated as the 2022 patent is not a strong composition of matter patent, which increases the likelihood of earlier-than-expected generic competition.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
DR. JOHN C LECHLEITER PHD	Director	751,188	01 Feb 2016	—
DR. JAN M. LUNDBERG, PHD		114,734	01 Feb 2016	—
JEFFREY N. SIMMONS		113,990	01 Feb 2016	—
ENRIQUE A. CONTERNO		113,572	01 Feb 2016	—
BARTON R. PETERSON		94,208	01 Feb 2016	—
SUSAN MAHONY, PHD		86,895	01 Feb 2016	—
MS. MARIA A. CROWE		82,504	01 Feb 2016	—
MR. DAVID A. RICKS		79,403	01 Feb 2016	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard PrimeCap Fund	2.63	4.63	—	31 Mar 2016
Vanguard Health Care Fund	2.35	3.99	1,350	31 Mar 2016
Vanguard Total Stock Mkt Idx	1.77	0.34	229	31 May 2016
Vanguard 500 Index Fund	1.13	0.40	126	31 May 2016
Vanguard Institutional Index Fund	0.98	0.40	86	31 May 2016
Concentrated Holders				
Vanguard Market Neutral	—	8.32	—	31 Mar 2016
ProFunds VP Pharmaceuticals	—	6.99	-3	31 Mar 2016
Eurizon Azioni Salute	0.01	6.97	—	29 Feb 2016
Polar Capital Glb Healthcare Gr & Inc	0.03	6.84	—	30 Apr 2016
Kinetics Medical Fund	—	6.77	—	31 Mar 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Royal London Asset Management Ltd	1.59	0.02	17,186	31 Mar 2016
Viking Global Investors LP	1.06	3.73	11,764	31 Mar 2016
BlackRock Investment Management (UK) Ltd.	0.60	0.40	6,620	31 Mar 2016
New Jersey Division of Pensions and Benefits	0.39	0.24	4,477	30 Jun 2010
BlackRock Fund Advisors	2.70	0.32	3,470	31 Mar 2016
Top 5 Sellers				
Capital World Investors	0.54	0.12	-3,672	31 Mar 2016
Merrill Lynch & Co Inc	0.56	0.27	-3,029	31 Mar 2016
Janus Capital Management LLC	0.51	0.54	-2,820	31 Mar 2016
T. Rowe Price Associates, Inc.	1.47	0.25	-2,659	31 Mar 2016
Columbia Mangmt Investment Advisers, LLC	0.04	0.02	-2,475	31 Mar 2016

Management 10 Jun 2016

We view Lilly's stewardship as relatively standard. While we believe that Lilly's use of $6.5 billion to acquire ImClone in 2008 is not likely to generate good returns, the partnership with Boehringer Ingelheim greatly improved the strategic outlook for the company. The verdict is still out regarding Lilly's decision to spend an industry-leading amount of capital (as a percentage of sales) on research and development, as the pipeline looks strong, but more phase 3 data is needed to determine the returns on the investment. While Lilly's purchase price of Novartis' animal healthcare business for more than $5 billion appears high, the increased entrenchment in animal health should increase Lilly's competitive advantages in this well-positioned industry.

John Lechleiter became CEO in April 2008. He had executive experience as the company's COO and as a board director since 2005. He brings a strong scientific background to the top spot, which differentiates Lilly from the majority of its competitors. Lechleiter joined Lilly in 1979 as a senior chemist. We believe his strong scientific background will give Lilly an edge over competing drug companies' CEOs with backgrounds in manufacturing, legal, or marketing functions. Even though Lechleiter is an insider, we believe he will instill the needed changes to address the patent challenges.

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Analyst Notes

Recent Drug Launches Support Lilly's 1Q; Solid Outlook Underappreciated by the Market 26 Apr 2016

Buoyed by new drug launches, Eli Lilly reported first-quarter results largely in line with our expectations, so we don't expect any significant impact on our $84 fair value estimate, and we continue to view the stock as undervalued. We believe the investment community doesn't fully appreciate the potential for long-term margin improvement and new pipeline drugs. The vast number of new product launches sets Lilly up for industry-leading growth (behind Bristol-Myers) and reinforces Lilly's wide moat.

In the quarter, new drugs contributed 7% to total sales, and we expect this to grow to over 30% by 2020. We believe Cyramza's indication in gastric cancer in Asian markets should help guide it toward peak annual sales of $2 billion. Diabetes drug Trulicity should hit peak sales over $2 billion, helped by an outcomes study (data expected in 2018) that is powered to show a cardiovascular benefit; we have increasing confidence in the study, given the outcomes benefit for similar drug Victoza from Novo. While diabetes drug Jardiance hasn't hit a sales inflection point yet from the cardiovascular benefit shown in its outcomes study, we expect an updated label in late 2016 to drive increased demand. For immunology drug Taltz, the inclusion of high PASI100 scores in the drug label should drive peak sales well above $1 billion. Last, we believe Alzheimer's drug solanezumab holds risk-adjusted peak sales of $4 billion (50% probability). We aren't overly concerned about the recent Phase III primary endpoint change to only cognition, as we believe a strong cognitive benefit, minor functional improvement, and good safety should drive approval.

On margins, Lilly looks poised to meet its 2018 guidance of R&D and SG&A as a percentage of sales reaching 18%-20% and 28%-30%, respectively. The margin improvement represents a gain of over 600 basis points from 2015, which, combined with accelerating sales growth, sets the company up for close to 10% annual earnings growth through 2018.

For a complete review of the Alzheimer's market, please see our report titled "Wide-Moat Firms in Alzheimer's Disease: Why the Market is Mispricing the Opportunity." In this report, we highlight that the market appears to be undervaluing the opportunity across the board, and we believe it is underestimating the progress that has been made with trial design, drug design, side-effect management, and lower regulatory hurdles. By 2020, we estimate that sales from new Alzheimer's drugs will reach over $4 billion, compared with consensus expectations of approximately $2 billion.

New Lilly/Astra Safety Data Supports Our Above-Consensus Alzheimer's Drug Sales; Eisai Data Next 08 Apr 2016

Reinforcing our conviction in the next generation of Alzheimer's drugs, AstraZeneca and Eli Lilly announced that the phase 2 part of their Alzheimer's Amaranth study with BACE inhibitor AZD3293 successfully navigated a safety review and will continue on to the phase 3 portion of the study (with data likely in 2019). Further, likely buoyed by the confidence in the safety review, the companies announced a new phase 3 study called Daybreak in Alzheimer's patients with mild dementia. The passing of the safety hurdle is important, as the class of drugs that inhibit this enzyme (BACE inhibitors) has seen two significant failures. Lilly's BACE inhibitor LY2886721 was the first to enter midstage development, but liver toxicity ended development in 2013. However, because liver toxicity is not a known side effect of BACE inhibition, this was not believed to be a class effect. Roche also discontinued its BACE program after this announcement, but it is not clear whether the program had safety problems. Roche continues to pursue BACE as a target preclinically, and several other firms, led by Merck, are in advanced development with new BACE inhibitors. While we don't anticipate any changes to our fair value

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Analyst Notes

estimate or moat rating based on the new data, the solid safety signal supports our above-consensus expectations for next-generation Alzheimer's drugs.

The next key data points in Alzheimer's will likely come from Eisai's beta amyloid antibody BAN2401 (mid-2016 efficacy data) and BACE inhibitor E2609 (mid-2016 safety data). We think the most likely scenario is that Biogen and partner Eisai will continue to focus on phase 3 drug aducanumab as the beta-amyloid of choice (rather than also moving BAN2401 to phase 3), but we expect them to continue development of E2609 as a single agent and in combination with aducanumab.

For a complete review of the Alzheimer's market, please see our report titled "Wide-Moat Firms in Alzheimer's Disease: Why the Market is Mispricing the Opportunity." In this report, we highlight that the market appears to be undervaluing the opportunity across the board, and we believe it is underestimating the progress that has been made with trial design, drug design, side-effect management, and lower regulatory hurdles. By 2020, we estimate that sales from new Alzheimer's drugs will reach over $4 billion, compared with consensus expectations of approximately $2 billion.

Lilly Posts Steady 4Q as New Drug Launches Offset Generic Competition; No Fair Value Change 28 Jan 2016

We are holding steady to our $84 fair value estimate for Eli Lilly following fourth-quarter results that largely matched our expectations and those of consensus. However, we believe increasing concern related to pricing power is creating pressure for the stock, particularly as Lilly took an aggregate 10% price increase in the U.S. in 2015. While we believe Lilly has increased exposure to potential U.S. drug pricing reforms, particularly for dual-eligible Medicare/ Medicaid patients to shift to Medicaid reimbursement, its strong pipeline and robust portfolio of currently marketed drugs support our wide moat rating and provide protection against negative U.S. drug pricing reforms.

In the quarter, new product launches helped offset lingering patent losses, leading to a 6% operational sales increase excluding recently acquired assets (Novartis animal health and full Erbitux rights), and we expect this trend will continue into 2016. While the majority of new diabetes drug launches are progressing well, disappointing Jardiance U. S. sales of $15 million in the quarter are somewhat concerning. We continue to project this drug will generate over $4 billion for Lilly's share of the copromotion deal with Boehringer Ingelheim, as its impressive 38% reduction in cardiovascular death should significantly shift market share when the data is added to the drug's label in mid-2016. Additionally, we expect new pipeline drug launches (notably immunology drugs baricitinib and ixekizumab) will more than offset increasing patent pressures in 2017 with the expected generic competition to erectile dysfunction drug Cialis and cardiovascular drug Effient.

Margins were largely flat year over year, but we expect over 300 basis points of margin expansion from 2015 through 2018 as new high-margin drugs gain critical mass. The majority of Lilly's new drugs hold strong pricing power relative to the firm's insulin and animal healthcare businesses.

For a more complete review of the potential U.S. drug pricing reforms, please see our Select report, "Low Odds of U.S. Drug Pricing Reforms Create Favorable Valuations."

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2013	2014	2015	Forecast 2016	Forecast 2017	5-Year Proj. CAGR
Revenue	-4.1	2.3	-15.1	1.8	6.9	6.4	8.1
EBIT	-13.2	6.0	-39.5	1.9	17.0	16.6	14.8
EBITDA	-10.4	4.6	-32.8	2.3	8.9	12.0	11.0
Net Income	-1.1	19.0	-27.7	12.2	3.3	13.4	10.5
Diluted EPS	0.4	22.6	-26.9	13.1	4.3	13.7	11.1
Earnings Before Interest, after Tax	-15.5	18.3	-35.9	-20.3	40.7	14.9	18.3
Free Cash Flow	-35.4	-11.9	-170.3	-143.5	119.5	7.6	27.9

Profitability	3-Year Hist. Avg	2013	2014	2015	2016	2017	5-Year Proj. Avg
Operating Margin %	21.4	26.4	18.9	18.9	20.6	22.6	23.8
EBITDA Margin %	28.2	32.7	25.9	26.0	26.5	27.9	28.7
Net Margin %	18.1	19.5	16.6	18.3	17.7	18.9	19.6
Free Cash Flow Margin %	3.6	20.5	-17.0	7.3	14.9	15.1	16.1
ROIC %	15.0	25.1	11.8	8.2	11.9	12.4	14.7
Adjusted ROIC %	16.1	26.7	12.6	9.1	13.5	14.0	16.5
Return on Assets %	8.9	13.5	6.6	6.6	8.6	10.1	11.6
Return on Equity %	19.8	28.9	14.5	16.1	21.2	24.8	26.8

Leverage	3-Year Hist. Avg	2013	2014	2015	2016	2017	5-Year Proj. Avg
Debt/Capital	0.33	0.23	0.34	0.42	0.44	0.42	0.40
Total Debt/EBITDA	1.44	0.69	1.59	2.04	2.05	1.82	1.64
EBITDA/Interest Expense	37.84	47.18	34.11	32.22	27.05	30.46	34.85

Valuation Summary and Forecasts

	2014	2015	2016(E)	2017(E)
Price/Fair Value	1.17	1.05	—	—
Price/Earnings	22.8	24.6	20.3	17.8
EV/EBITDA	15.3	18.7	15.1	13.4
EV/EBIT	20.9	25.7	19.3	16.6
Free Cash Flow Yield %	4.2	1.8	4.0	4.3
Dividend Yield %	2.7	2.3	2.8	3.1

Key Valuation Drivers

Cost of Equity %	7.5
Pre-Tax Cost of Debt %	5.5
Weighted Average Cost of Capital %	7.2
Long-Run Tax Rate %	21.0
Stage II EBI Growth Rate %	3.5
Stage II Investment Rate %	14.0
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	34,000	32.2	32.22
Present Value Stage II	29,629	28.0	28.08
Present Value Stage III	42,043	39.8	39.85
Total Firm Value	**105,673**	**100.0**	**100.15**
Cash and Equivalents	4,452	—	4.22
Debt	-10,601	—	-10.05
Preferred Stock	—	—	—
Other Adjustments	-2,369	—	-2.25
Equity Value	**97,154**	**—**	**92.08**
Projected Diluted Shares	1,055		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Income Statement (USD Mil)
Fiscal Year Ends in December

				Forecast	
	2013	2014	2015	*2016*	*2017*
Revenue	**23,113**	**19,616**	**19,959**	***21,345***	***22,703***
Cost of Goods Sold	4,908	4,933	5,037	*5,056*	*5,562*
Gross Profit	**18,205**	**14,683**	**14,922**	***16,289***	***17,141***
Selling, General & Administrative Expenses	7,126	6,621	6,533	*6,309*	*6,697*
Research & Development	5,531	4,734	4,796	*5,188*	*4,949*
Other Operating Expense (Income)	-559	-368	-175	*-120*	*-50*
Depreciation & Amortization (if reported separately)	—	—	—	*505*	*404*
Operating Income (ex charges)	**6,107**	**3,697**	**3,767**	***4,407***	***5,140***
Restructuring & Other Cash Charges	178	669	902	*350*	*250*
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	**5,930**	**3,028**	**2,865**	***4,057***	***4,890***
Interest Expense	160	149	161	*209*	*208*
Interest Income	120	121	87	*82*	*88*
Pre-Tax Income	**5,889**	**3,000**	**2,790**	***3,929***	***4,769***
Income Tax Expense	1,205	610	382	*828*	*1,003*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	—	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**4,685**	**2,391**	**2,409**	***3,101***	***3,766***
Weighted Average Diluted Shares Outstanding	1,085	1,074	1,066	*1,055*	*1,052*
Diluted Earnings Per Share	**4.32**	**2.23**	**2.26**	***2.94***	***3.58***
Adjusted Net Income	4,503	3,258	3,656	*3,776*	*4,283*
Diluted Earnings Per Share (Adjusted)	**4.15**	**3.03**	**3.43**	***3.58***	***4.07***
Dividends Per Common Share	1.96	1.96	2.00	*2.09*	*2.38*
EBITDA	**7,375**	**4,407**	**4,292**	***5,309***	***6,089***
Adjusted EBITDA	**7,553**	**5,076**	**5,195**	***5,659***	***6,339***

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December	2013	2014	2015	*Forecast 2016*	*Forecast 2017*
Cash and Equivalents	5,397	4,827	4,452	*5,453*	*5,844*
Investments	—	5,406	—	—	—
Accounts Receivable	3,434	3,235	3,513	*3,743*	*3,981*
Inventory	2,929	2,740	3,446	*3,255*	*3,581*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	1,344	1,378	1,163	*1,307*	*1,307*
Current Assets	**13,105**	**17,585**	**12,574**	***13,758***	***14,712***
Net Property Plant, and Equipment	7,976	7,964	8,054	*8,406*	*8,917*
Goodwill	1,550	1,758	4,040	*4,040*	*4,040*
Other Intangibles	2,781	2,884	5,035	*4,529*	*4,125*
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	—	—	—	—	—
Long-Term Non-Operating Assets	9,837	6,987	5,867	*5,867*	*5,867*
Total Assets	**35,249**	**37,178**	**35,569**	***36,600***	***37,662***
Accounts Payable	1,119	1,128	1,338	*1,247*	*1,372*
Short-Term Debt	1,013	2,689	2,628	*1,800*	*1,890*
Deferred Tax Liabilities (Current)	793	1,467	1,467	*1,467*	*1,467*
Other Short-Term Liabilities	5,992	5,924	2,797	*2,797*	*2,797*
Current Liabilities	**8,917**	**11,207**	**8,230**	***7,310***	***7,525***
Long-Term Debt	4,200	5,368	7,972	*9,822*	*9,672*
Deferred Tax Liabilities (Long-Term)	—	—	—	—	—
Other Long-Term Operating Liabilities	2,942	2,652	2,616	*2,616*	*2,616*
Long-Term Non-Operating Liabilities	1,549	2,563	2,160	*2,160*	*2,160*
Total Liabilities	**17,608**	**21,790**	**20,979**	***21,909***	***21,974***
Preferred Stock	—	—	—	—	—
Common Stock	699	695	691	*691*	*691*
Additional Paid-in Capital	5,050	5,292	5,552	*5,552*	*5,552*
Retained Earnings (Deficit)	16,992	16,483	16,012	*16,908*	*18,173*
(Treasury Stock)	-94	-91	-90	*-884*	*-1,153*
Other Equity	-5,016	-7,005	-7,594	*-7,594*	*-7,594*
Shareholder's Equity	**17,631**	**15,373**	**14,571**	***14,673***	***15,669***
Minority Interest	9	15	19	*19*	*19*
Total Equity	**17,641**	**15,388**	**14,590**	***14,692***	***15,688***

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Morningstar Analyst Forecasts

Cash Flow (USD Mil)
Fiscal Year Ends in December

				Forecast	
	2013	2014	2015	*2016*	*2017*
Net Income	4,685	2,391	2,408	*3,101*	*3,766*
Depreciation	891	843	796	*747*	*795*
Amortization	555	536	632	*505*	*404*
Stock-Based Compensation	145	156	218	*210*	*223*
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	286	-36	-748	—	—
Other Non-Cash Adjustments	-433	517	385	—	—
(Increase) Decrease in Accounts Receivable	-153	117	-305	*-230*	*-238*
(Increase) Decrease in Inventory	-287	-307	-736	*191*	*-326*
Change in Other Short-Term Assets	117	412	-339	*-144*	—
Increase (Decrease) in Accounts Payable	-70	-261	462	*-92*	*125*
Change in Other Short-Term Liabilities	—	—	—	—	—
Cash From Operations	**5,735**	**4,367**	**2,773**	***4,289***	***4,749***
(Capital Expenditures)	-1,012	-1,163	-1,066	*-1,100*	*-1,305*
Net (Acquisitions), Asset Sales, and Disposals	136	-536	-4,781	—	—
Net Sales (Purchases) of Investments	-1,018	3,623	1,162	—	—
Other Investing Cash Flows	-179	-5,833	4,712	—	—
Cash From Investing	**-2,073**	**-3,909**	**27**	***-1,100***	***-1,305***
Common Stock Issuance (or Repurchase)	-1,698	-800	-750	*-794*	*-268*
Common Stock (Dividends)	-2,121	-2,101	-2,127	*-2,205*	*-2,501*
Short-Term Debt Issuance (or Retirement)	—	2,681	-2,681	*-828*	*90*
Long-Term Debt Issuance (or Retirement)	-11	-42	2,499	*1,850*	*-150*
Other Financing Cash Flows	—	187	139	*-210*	*-223*
Cash From Financing	**-3,829**	**-75**	**-2,919**	***-2,188***	***-3,053***
Exchange Rates, Discontinued Ops, etc. (net)	-22	-342	-86	—	—
Net Change in Cash	**-189**	**41**	**-205**	***1,001***	***391***

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	0.89	14.7	15.4	15.1	12.6	11.1	11.2	13.2	14.1	14.7	3.3	3.7	3.9	3.7	4.0	4.0
Bristol-Myers Squibb Company BMY	0.94	34.2	27.9	21.9	45.8	20.1	16.4	112.9	22.6	24.1	8.0	7.7	7.4	6.9	6.4	5.7
Average		24.5	21.7	18.5	29.2	15.6	13.8	63.1	18.4	19.4	5.7	5.7	5.7	5.3	5.2	4.9
Eli Lilly and Co LLY US	**0.77**	**24.6**	**20.3**	**17.8**	**18.7**	**15.1**	**13.4**	**54.6**	**25.1**	**23.3**	**6.4**	**5.5**	**5.1**	**4.7**	**3.8**	**3.5**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	101,779 USD	9.0	13.6	14.9	11.7	18.4	20.8	9.5	12.1	17.0	4.4	5.3	7.3	3.5	3.3	3.3
Bristol-Myers Squibb Company BMY	31,748 USD	16.1	18.5	22.8	22.7	25.2	30.4	10.8	28.0	33.5	4.8	12.8	15.7	2.2	2.3	2.8
Average		12.6	16.1	18.9	17.2	21.8	25.6	10.2	20.1	25.3	4.6	9.1	11.5	2.9	2.8	3.1
Eli Lilly and Co LLY US	**35,569** USD	**8.2**	**11.9**	**12.4**	**9.1**	**13.5**	**14.0**	**16.1**	**21.2**	**24.8**	**6.6**	**8.6**	**10.1**	**2.3**	**2.8**	**3.1**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	39,498 USD	-6.5	-1.0	-1.2	-5.3	30.6	17.1	2.9	2.0	1.7	-79.2	210.8	-4.7	2.0	2.0	1.7
Bristol-Myers Squibb Company BMY	16,560 USD	4.3	12.0	13.3	-13.0	153.3	24.4	8.9	26.9	27.3	-84.0	421.0	-5.1	2.7	26.9	27.3
Average		-1.1	5.5	6.1	-9.2	92.0	20.8	5.9	14.5	14.5	-81.6	315.9	-4.9	2.4	14.5	14.5
Eli Lilly and Co LLY US	**19,959** USD	**1.8**	**6.9**	**6.4**	**1.9**	**17.0**	**16.6**	**13.1**	**4.3**	**13.7**	**-143.5**	**119.5**	**7.6**	**2.0**	**4.5**	**13.7**

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin % 2015	2016(E)	2017(E)	EBITDA Margin % 2015	2016(E)	2017(E)	Operating Margin % 2015	2016(E)	2017(E)	Net Margin % 2015	2016(E)	2017(E)	Free Cash Flow Margin % 2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	10,195 USD	62.2	*76.1*	*75.9*	32.4	*38.8*	*38.8*	16.2	*21.4*	*25.3*	25.8	*26.2*	*26.4*	28.2	*28.2*	*27.4*
Bristol-Myers Squibb Company BMY	3,378 USD	76.4	*76.3*	*76.7*	15.3	*32.6*	*35.3*	13.0	*29.5*	*32.4*	20.4	*23.1*	*25.7*	6.1	*28.4*	*23.5*
Average		69.3	*76.2*	*76.3*	23.9	*35.7*	*37.1*	14.6	*25.5*	*28.9*	23.1	*24.7*	*26.1*	17.2	*28.3*	*25.5*
Eli Lilly and Co LLY US	**3,656** USD	**74.8**	***76.3***	***75.5***	**26.0**	***26.5***	***27.9***	**18.9**	***20.6***	***22.6***	**18.3**	***17.7***	***18.9***	**8.6**	***14.9***	***15.2***

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2015	2016(E)	2017(E)	Debt/Total Cap % 2015	2016(E)	2017(E)	EBITDA/Interest Exp. 2015	2016(E)	2017(E)	Total Debt/EBITDA 2015	2016(E)	2017(E)	Assets/Equity 2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	26,514 USD	59.4	*62.3*	*64.2*	37.2	*38.4*	*39.1*	19.0	*20.5*	*23.2*	2.1	*1.7*	*1.7*	2.3	*2.3*	*2.4*
Bristol-Myers Squibb Company BMY	6,689 USD	46.9	*42.1*	*39.6*	31.9	*29.6*	*28.4*	13.8	*26.9*	*35.3*	2.6	*1.1*	*0.9*	2.2	*2.2*	*2.1*
Average		53.2	*52.2*	*51.9*	34.6	*34.0*	*33.8*	16.4	*23.7*	*29.3*	2.4	*1.4*	*1.3*	2.3	*2.3*	*2.3*
Eli Lilly and Co LLY US	**10,601** USD	**72.8**	***79.2***	***73.8***	**42.1**	***44.2***	***42.5***	**32.2**	***27.1***	***30.5***	**2.0**	***2.1***	***1.8***	**2.4**	***2.5***	***2.4***

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2015	2016(E)	2017(E)	Current Ratio 2015	2016(E)	2017(E)	Quick Ratio 2015	2016(E)	2017(E)	Cash/Short-Term Debt 2015	2016(E)	2017(E)	Payout Ratio % 2015	2016(E)	2017(E)
Merck & Co Inc MRK USA	155,701 USD	4.73	*5.57*	*6.25*	1.55	*1.69*	*1.72*	1.31	*1.51*	*1.55*	5.19	*7.41*	*7.14*	115.2	*98.4*	*73.6*
Bristol-Myers Squibb Company BMY	118,938 USD	5.32	*6.64*	*6.79*	1.88	*1.95*	*1.96*	1.73	*1.78*	*1.80*	64.24	*80.18*	*81.14*	158.3	*66.4*	*62.7*
Average		5.03	*6.11*	*6.52*	1.72	*1.82*	*1.84*	1.52	*1.65*	*1.68*	34.72	*43.80*	*44.14*	136.8	*82.4*	*68.2*
Eli Lilly and Co LLY US	**80,105** USD	**4.18**	***5.17***	***5.55***	**1.53**	***1.88***	***1.96***	**1.11**	***1.44***	***1.48***	**1.69**	***3.03***	***3.09***	**88.5**	***71.1***	***66.4***

Research Methodology for Valuing Companies

Components of Our Methodology

- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

We believe that a company's intrinsic worth results from the future cash flows it can generate.
The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies

Economic Moat
Financial Health
Stewardship
Uncertainty
Moat Trend

Morningstar Fair Value

Margin of Safety
Market Pricing

Morningstar Rating™ For Stocks
★★★★★

Source: Morningstar, Inc.

Detailed Methodology Documents and Materials*
- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

*Please contact a sales representative for more information.

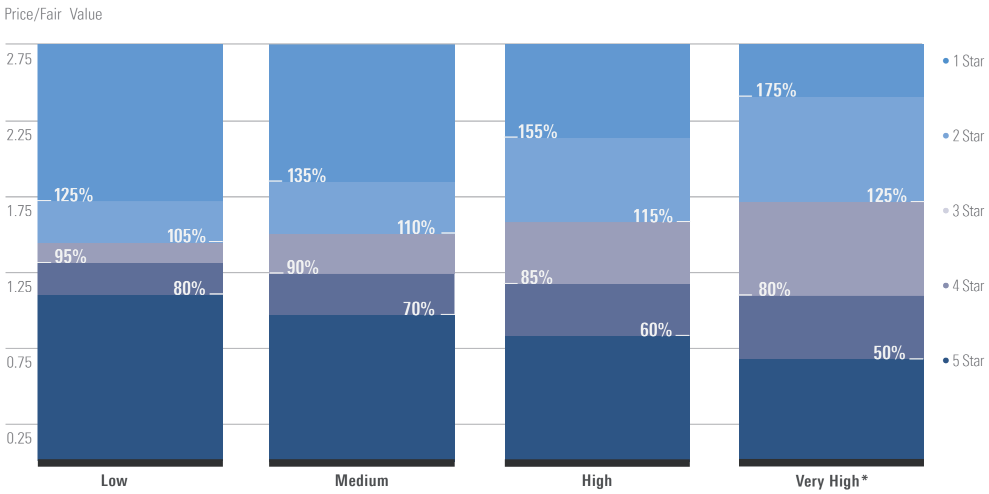
which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Source: Morningstar, Inc.

Eli Lilly and Co LLY (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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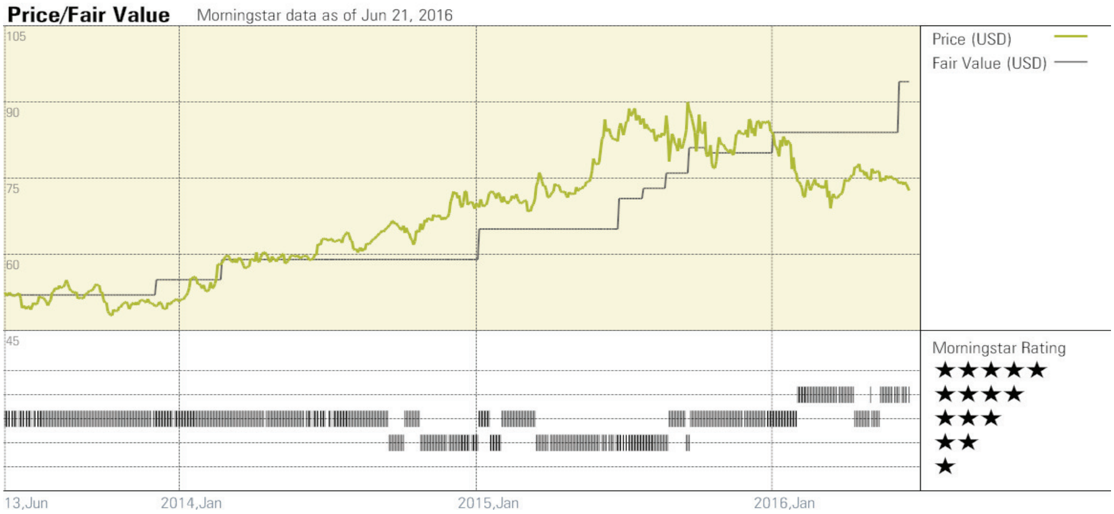

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The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate, and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
72.57 USD	94.00 USD	65.80 USD	126.90 USD	Medium	Wide	Stable	Standard	Drug Manufacturers

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