LILLY ELI & CO
Form 10-Q
August 06, 2008

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
Quarterly Report Under Section 13 or 15(d) of the
Securities Exchange Act of 1934
FOR THE QUARTER ENDED June 30, 2008
COMMISSION FILE NUMBER 001-6351
ELI LILLY AND COMPANY
(Exact name of Registrant as specified in its charter)

INDIANA	35-0470950
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

LILLY CORPORATE CENTER, INDIANAPOLIS, INDIANA 46285
(Address of principal executive offices)
Registrant s telephone number, including area code (317) 276-2000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of a large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

Yes o No þ

The number of shares of common stock outstanding as of July 20, 2008:

Class	Number of Shares Outstanding
Common	1,136,950,160

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)
Eli Lilly and Company and Subsidiaries

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions, except per-share data)			
Net sales	$5,150.4	$4,631.0	$9,958.0	$8,857.1
Cost of sales	1,200.9	998.9	2,312.2	1,921.4
Research and development	951.5	854.4	1,828.6	1,688.6
Marketing, selling, and administrative	1,700.1	1,524.7	3,250.6	2,861.5
Acquired in-process research and development (Note 4)	35.0	328.1	122.0	656.6
Asset impairments, restructuring, and other special charges (Note 5)	88.9		234.6	123.0
Other income net (Note 13)	(32.3)	(1.8)	(52.6)	(40.1)
	3,944.1	3,704.3	7,695.4	7,211.0
Income before income taxes	1,206.3	926.7	2,262.6	1,646.1
Income taxes (Note 10)	247.5	263.1	239.5	473.8
Net income	$ 958.8	$ 663.6	$2,023.1	$1,172.3
Earnings per share basic (Note 9)	$ .88	$ .61	$ 1.85	$ 1.08
Earnings per share diluted (Note 9)	$ .88	$ .61	$ 1.85	$ 1.08
Dividends paid per share	$ .47	$ .425	$ .94	$ .85

See Notes to Consolidated Condensed Financial Statements.

CONSOLIDATED CONDENSED BALANCE SHEETS
Eli Lilly and Company and Subsidiaries

	June 30, 2008	December 31, 2007
	(Dollars in millions)	
	(Unaudited)	(Restated, Note 2)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,868.3	$ 3,220.5
Short-term investments (Note 6)	2,301.7	1,610.7
Accounts receivable, net of allowances of $106.8 (2008) and $103.1 (2007)	2,739.0	2,673.9
Other receivables	738.2	1,030.9
Inventories	2,546.4	2,523.7
Deferred income taxes (Note 2)	622.5	642.8
Prepaid expenses	861.0	613.6
TOTAL CURRENT ASSETS	12,677.1	12,316.1
OTHER ASSETS		
Prepaid pension (Note 11)	1,851.5	1,670.5
Investments (Note 6)	1,070.8	577.1
Goodwill and other intangibles net (Note 4)	2,337.4	2,455.4
Sundry (Note 2)	1,144.7	1,280.6
	6,404.4	5,983.6
PROPERTY AND EQUIPMENT		
Land, buildings, equipment, and construction-in-progress	15,310.7	14,841.3
Less allowances for depreciation	(6,640.2)	(6,266.2)
	8,670.5	8,575.1
	$27,752.0	$ 26,874.8
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ 68.0	$ 413.7
Accounts payable	810.7	924.4
Employee compensation	551.5	823.8
Sales rebates and discounts	787.6	706.8
Dividends payable	521.8	513.6
Income taxes payable (Note 10)	504.5	238.4
Other current liabilities (Note 2)	2,014.7	1,816.1
TOTAL CURRENT LIABILITIES	5,258.8	5,436.8
Long-term debt	4,545.8	4,593.5

Accrued retirement benefit (Note 11)	1,164.7	1,145.1
Long-term income taxes payable (Note 10)	970.3	1,196.7
Deferred income taxes	63.1	287.5
Other noncurrent liabilities (Note 2)	1,011.3	711.3
	7,755.2	7,934.1
SHAREHOLDERS EQUITY (Notes 7 and 8)		
Common stock	711.2	709.5
Additional paid-in capital	3,837.5	3,805.2
Retained earnings (Note 2)	12,800.4	11,806.7
Employee benefit trust	(2,635.0)	(2,635.0)
Deferred costs-ESOP	(91.0)	(95.2)
Accumulated other comprehensive income	214.1	13.2
	14,837.2	13,604.4
Less cost of common stock in treasury	99.2	100.5
	14,738.0	13,503.9
	$27,752.0	$ 26,874.8

See Notes to Consolidated Condensed Financial Statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
Eli Lilly and Company and Subsidiaries

	Six Months Ended June 30,	
	2008	2007
	(Dollars in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,023.1	$ 1,172.3
Adjustments to reconcile net income to cash flows from operating activities:		
Changes in operating assets and liabilities, net of acquisitions	(51.3)	(544.5)
Depreciation and amortization	559.0	507.6
Stock-based compensation expense	114.8	135.2
Change in deferred taxes	(41.5)	(464.8)
Acquired in-process research and development, net of tax	79.3	634.7
Other, net	100.1	39.8
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,783.5	1,480.3
CASH FLOWS FROM INVESTING ACTIVITIES		
Net purchases of property and equipment	(450.6)	(485.6)
Net change in short-term investments	(730.7)	63.7
Purchases of noncurrent investments	(979.3)	(358.2)
Proceeds from sales and maturities of noncurrent investments	474.8	811.4
Cash paid for acquisitions, net of cash acquired		(2,579.9)
Purchase of in-process research and development	(122.0)	(25.0)
Other, net	(66.3)	(34.7)
NET CASH USED IN INVESTING ACTIVITIES	(1,874.1)	(2,608.3)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(1,021.2)	(926.5)
Proceeds from issuance of long-term debt	0.1	2,500.0
Repayment of long-term debt	(7.4)	(1,002.2)
Net change in short-term borrowings	(349.3)	(372.9)
Other, net	(7.6)	20.6
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(1,385.4)	219.0
Effect of exchange rate changes on cash and cash equivalents	123.8	20.2
NET DECREASE IN CASH AND CASH EQUIVALENTS	(352.2)	(888.8)

Cash and cash equivalents at January 1	3,220.5	3,109.3
CASH AND CASH EQUIVALENTS AT JUNE 30	$ 2,868.3	$ 2,220.5

See Notes to Consolidated Condensed Financial Statements.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
Eli Lilly and Company and Subsidiaries

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Net income	$958.8	$663.6	$2,023.1	$1,172.3
Other comprehensive income[1]	7.1	215.1	200.9	246.8
Comprehensive income	$965.9	$878.7	$2,224.0	$1,419.1

[1] The significant component of other comprehensive income was a gain of $263.7 million from foreign currency translation adjustments for the six months ended June 30, 2008, respectively, compared with gains from foreign currency translation adjustments of $118.1 million and $191.6 million for the three months and six months ended June 30, 2007, respectively.

See Notes to Consolidated Condensed Financial Statements.

SEGMENT INFORMATION

We operate in one significant business segment pharmaceutical products. Operations of our animal health business segment are not material and share many of the same economic and operating characteristics as our pharmaceutical products. Therefore, they are included with pharmaceutical products for purposes of segment reporting. Our business segments are distinguished by the ultimate end user of the product: humans or animals. Performance is evaluated based on profit or loss from operations before income taxes. Income before income taxes for the animal health business for the second quarter of 2008 and 2007 was $28.4 million and $29.3 million, respectively, and $55.3 million and $67.5 million for the six months ended June 30, 2008 and 2007, respectively.

SALES BY PRODUCT CATEGORY

Worldwide sales by product category were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Net sales to unaffiliated customers				
Neurosciences	$2,126.7	$1,981.1	$4,098.1	$3,778.6
Endocrinology	1,518.4	1,360.6	2,929.2	2,626.4
Oncology	715.1	602.7	1,388.5	1,167.4
Cardiovascular	476.6	414.7	938.6	735.9
Animal health	254.5	214.7	489.9	429.8
Other pharmaceuticals	59.1	57.2	113.7	119.0
Net sales	$5,150.4	$4,631.0	$9,958.0	$8,857.1

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

We have prepared the accompanying unaudited consolidated condensed financial statements in accordance with the requirements of Form 10-Q and, therefore, they do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States (GAAP). In our opinion, the financial statements reflect all adjustments (including those that are normal and recurring) that are necessary for a fair presentation of the results of operations for the periods shown. In preparing financial statements in conformity with GAAP, we must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from those estimates.

The information included in this Quarterly Report on Form 10-Q should be read in conjunction with our consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Note 2: Restatement of Prior Period Financial Statements

During the second quarter of 2008, we determined that our methodology for calculating our return reserve for future product returns in accordance with Statement of Financial Accounting Standard No. 48 (SFAS 48), Revenue Recognition When Right of Return Exists, needed to be corrected. Using the revised methodology, our return reserve was understated by $247.5 million as of December 31, 2007, 2006 and 2005.

We performed an evaluation to determine if the errors resulting in the return reserve liability calculated using the revised methodology were material to any individual prior period, taking into account the requirements of the Securities Exchange Commission (SEC) Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). Based on this analysis, we concluded that while the cumulative error was material to the current and prior-year financial statements, the correction of the error would not be material to any individual period and, therefore, as provided for by SAB 108, the correction of the error does not require previously filed reports to be amended and the correction may be made the next time we file our prior period financial statements. We restated the 2007 balance sheet included in this filing. Financial statements for the years ended December 31, 2006 and 2007 will be restated no later than the filing of the December 31, 2008 Annual Report on Form 10-K.

The tables below present the effect of the financial statement adjustments related to the restatement of our previously reported financial statements for the years ended December 31, 2007, 2006 and 2005. The statements of income were not adjusted for any of the years or quarters because we concluded that the amount of the adjustment calculated using the revised methodology was not material in any period. The amount of the annual adjustment for 2005, 2006, or 2007 would have been $.01 per share or less. The aggregate statement of income impact from December 31, 2004 to December 31, 2007 would have been an additional expense of approximately $35 million on a pretax basis (approximately $23 million net of tax). Approximately $8 million of benefit on a pretax basis (approximately $5 million net of tax), recognized in the second quarter as a result of a reduction in the return reserve, was related to the first quarter of 2008.

The effect of the restatement on the consolidated balance sheets as of December 31, 2007, 2006 and 2005 is as follows:

2007	As Reported	Adjustments	As Restated
Current deferred tax asset	$ 583.6	$ 59.2	$ 642.8
Total current assets	12,256.9	59.2	12,316.1
Sundry (long-term deferred tax asset)	1,252.8	27.8	1,280.6
Total other assets	5,955.8	27.8	5,983.6
Total assets	26,787.8	87.0	26,874.8
Other current liabilities[1]	1,647.6	168.5	1,816.1
Total current liabilities	5,268.3	168.5	5,436.8
Other noncurrent liabilities	632.3	79.0	711.3
Total other noncurrent liabilities	7,855.1	79.0	7,934.1
Retained earnings	11,967.2	(160.5)	11,806.7
Total shareholders equity	13,664.4	(160.5)	13,503.9
Total liabilities and shareholders equity	26,787.8	87.0	26,874.8

2006	As Reported	Adjustments	As Restated
Current deferred tax asset	$ 519.2	$ 59.2	$ 578.4
Total current assets	9,694.4	59.2	9,753.6
Sundry (long-term deferred tax asset)	1,885.3	27.8	1,913.1
Total other assets	4,108.7	27.8	4,136.5
Total assets	21,955.4	87.0	22,042.4
Other current liabilities	1,822.9	168.5	1,991.4
Total current liabilities	5,085.5	168.5	5,254.0
Other noncurrent liabilities	745.7	79.0	824.7
Total other noncurrent liabilities	5,889.2	79.0	5,968.2
Retained earnings	10,926.7	(160.5)	10,766.2
Total shareholders equity	10,980.7	(160.5)	10,820.2
Total liabilities and shareholders equity	21,955.4	87.0	22,042.4

2005	As Reported	Adjustments	As Restated
Current deferred tax asset	$ 756.4	$ 59.2	$ 815.6
Total current assets	10,795.8	59.2	10,855.0
Sundry (long-term deferred tax asset)	2,156.3	27.8	2,184.1
Total other assets	5,872.5	27.8	5,900.3
Total assets	24,580.8	87.0	24,667.8
Other current liabilities	1,838.9	168.5	2,007.4
Total current liabilities	5,716.3	168.5	5,884.8
Other noncurrent liabilities	826.1	79.0	905.1
Total other noncurrent liabilities	8,072.6	79.0	8,151.6
Retained earnings	10,027.2	(160.5)	9,866.7
Total shareholders equity	10,791.9	(160.5)	10,631.4

Total liabilities and shareholders equity	24,580.8	87.0	24,667.8

[1] The 2007 As Reported balance reflects the $94.1 million reclassification made in the first quarter of 2008 from accounts payable to other current liabilities.

Note 3: Implementation of New Financial Accounting Pronouncements

We adopted the provisions of Emerging Issues Task Force (EITF) Issue No. 07-3 (EITF 07-3), Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities, on January 1, 2008. Pursuant to EITF 07-3, nonrefundable advance payments for goods or services that will be used or rendered for future

research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense when the related goods are delivered or services are performed, or when the goods or services are no longer expected to be received. This Issue is to be applied prospectively for contracts entered into on or after the effective date.

We adopted the provisions of Financial Accounting Standards Board (FASB) Statement No. 157 (SFAS 157), Fair Value Measurements, on January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. The implementation of this Statement was not material to our consolidated financial position or results of operations.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 applies to all derivative instruments and related hedged items accounted for under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement requires entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. This Statement is effective for us January 1, 2009.

In December 2007, the FASB revised and issued Statement No. 141, Business Combinations (SFAS 141(R)). SFAS 141(R) changes how the acquisition method is applied in accordance with SFAS 141. The primary revisions to this Statement require an acquirer in a business combination to measure assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date, with limited exceptions specified in the Statement. This Statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with the Statement). Assets acquired and liabilities assumed arising from contractual contingencies as of the acquisition date are to be measured at their acquisition-date fair values, and assets or liabilities arising from all other contingencies as of the acquisition date are to be measured at their acquisition-date fair value, only if it is more likely than not that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6, Elements of Financial Statements. This Statement significantly amends other Statements and authoritative guidance, including FASB Interpretation No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, and now requires the capitalization of research and development assets acquired in a business combination at their acquisition-date fair values, separately from goodwill. SFAS No. 109, Accounting for Income Taxes, was also amended by this Statement to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. This Statement is effective for us for business combinations for which the acquisition date is on or after January 1, 2009.

In December 2007, in conjunction with SFAS 141(R), the FASB issued Statement No. 160, Accounting for Noncontrolling Interests. This Statement amends Accounting Research Bulletin No. 51, Consolidated Financial Statements (ARB 51), by requiring companies to report a noncontrolling interest in a subsidiary as equity in its consolidated financial statements. Disclosure of the amounts of consolidated net income attributable to the parent and the noncontrolling interest will be required. This Statement also clarifies that transactions that result in a change in a parent s ownership interest in a subsidiary that do not result in deconsolidation will be treated as equity transactions, while a gain or loss will be recognized by the parent when a subsidiary is deconsolidated. This Statement is effective for us January 1, 2009, and we do not anticipate the implementation will be material to our consolidated financial position or results of operations.

In December 2007, the FASB ratified the consensus reached by the EITF on Issue No. 07-1 (EITF 07-1), Accounting for Collaborative Arrangements. EITF 07-1 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. This Issue is effective for us beginning January 1, 2009 and will be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. While we have not yet completed our analysis, we do not anticipate the implementation of this Issue will be material to our consolidated financial position or results of operations.

Note 4: Acquisitions and Collaborations

SGX Pharmaceuticals, Inc. Acquisition

On July 8, 2008, we entered into a definitive merger agreement to acquire all of the outstanding common stock of SGX Pharmaceuticals, Inc. (SGX), a collaboration partner since 2003. The acquisition allows us to integrate SGX s structure-guided drug discovery platform into our drug discovery efforts. It also gives us access to FAST™, SGX s fragment-based, protein structure guided drug discovery technology, and to a portfolio of preclinical oncology compounds focused on a number of kinase targets.

Under the terms of the agreement, the outstanding shares of SGX common stock would be redeemed for an aggregate purchase price of approximately $64 million in cash. Consummation of the acquisition is expected in the second half of 2008 and is subject to approval of SGX shareholders, clearance under the Hart-Scott-Rodino Antitrust Improvements Act, and certain other closing conditions. If the transaction closes in 2008, we expect to incur a one-time charge to earnings for acquired in-process research and development (IPR&D), but it is premature to estimate what that charge will be.

ICOS Corporation Acquisition

On January 29, 2007, we acquired all of the outstanding common stock of ICOS Corporation (ICOS), our partner in the Lilly ICOS LLC joint venture for the manufacture and sale of Cialis® for the treatment of erectile dysfunction. The acquisition brings the full value of Cialis to us and enables us to realize operational efficiencies in the further development, marketing, and selling of this product. Under the terms of the agreement, each outstanding share of ICOS common stock was redeemed for $34 in cash for an aggregate purchase price of approximately $2.3 billion, which was financed through borrowings.

The acquisition has been accounted for as a business combination under the purchase method of accounting. Under the purchase method of accounting, the assets acquired and liabilities assumed from ICOS are recorded at their respective fair values as of the acquisition date in our consolidated financial statements. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill in the amount of $646.7 million. No portion of this goodwill is expected to be deductible for tax purposes. ICOS s results of operations are included in our consolidated financial statements from the date of acquisition.

We have determined the following estimated fair values for the assets purchased and liabilities assumed as of the date of acquisition. The determination of estimated fair value required management to make significant estimates and assumptions.

	Estimated Fair Value at January 29, 2007
Cash and short-term investments	$ 197.7
Developed product technology (Cialis)[1]	1,659.9
Acquired in-process research and development	303.5
Tax benefit of net operating losses	404.1
Goodwill	646.7
Other assets and liabilities net	(32.1)
Deferred taxes	(583.5)
Long-term debt assumed	(275.6)
Total purchase price	$ 2,320.7

[1] The intangible asset will be

amortized over the remaining expected patent lives of Cialis in each country; patent expiry dates range from 2015 to 2017.

The acquired IPR&D represented compounds under development that had not yet achieved regulatory approval for marketing. New indications for and formulations of the Cialis compound in clinical testing at the time of the acquisition represented approximately 48 percent of the estimated fair value of the IPR&D. The remaining value of IPR&D represents several other products in development, with no one asset comprising a significant portion of this value. In accordance with FIN 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, these IPR&D intangible assets totaling $303.5 million have been written off by a charge to income immediately subsequent to the acquisition because the compounds do not have any alternative future use. This charge is not deductible for tax purposes. The ongoing activity with respect to each of these compounds under development is not material to our research and development expenses.

There are several methods that can be used to determine the estimated fair value of the acquired IPR&D. We utilized the income method, which applies a probability weighting to the estimated future net cash flows that are derived from projected sales revenues and estimated costs. These projections are based on factors such as relevant market size, patent protection, historical pricing of similar products, and expected industry trends. The estimated future net cash flows are then discounted to the present value using an appropriate discount rate. This analysis is performed for each project independently. The discount rate we used in valuing the acquired IPR&D projects was 20 percent.

Other Acquisitions

During the second quarter of 2007, we acquired all of the outstanding stock of both Hypnion, Inc. (Hypnion), a privately held neuroscience drug discovery company focused on sleep disorders, and Ivy Animal Health, Inc. (Ivy), a privately held applied research and pharmaceutical product development company focused on the animal health industry, for $445.0 million in cash. The ongoing activities with respect to these companies products in development are not material to our research and development expenses. The results of operations are included in our consolidated condensed financial statements from the respective dates of acquisition.

The acquisition of Hypnion provides us with a broader and more substantive presence in the area of sleep disorder research and ownership of HY10275, a novel Phase II compound with a dual mechanism of action aimed at promoting better sleep onset and sleep maintenance. This was Hypnion s only significant asset. For this acquisition, we recorded a charge of $291.1 million, representing the estimated fair value of the acquired compound, to acquired IPR&D in the second quarter of 2007 because the development-stage compound acquired did not have any alternative future use. This charge was not deductible for tax purposes. Because Hypnion was a development-stage company, the transaction was accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill was not recorded.

The acquisition of Ivy provides us with products that complement those of our animal health product line. This acquisition has been accounted for as a business combination under the purchase method of accounting. We have allocated $88.7 million of the purchase price to other identifiable intangible assets, primarily related to marketed products, $37.0 million to acquired IPR&D, and $25.0 million to goodwill. The IPR&D represents products in development that are not yet approved for marketing and have no alternative future use. Accordingly, the $37.0 million allocated to acquired IPR&D was expensed immediately subsequent to the acquisition. The other identifiable intangible assets will be amortized over their estimated remaining useful lives of 10 to 20 years. Goodwill resulting from this acquisition has been fully allocated to the animal health business segment. The amount allocated to each of the intangible assets acquired, including goodwill, is expected to be deductible for tax purposes.

Product Acquisitions

In June 2008, we entered into a licensing and development agreement with TransPharma Medical Ltd. (TransPharma) to acquire rights to its product and related drug delivery system for the treatment of osteoporosis. The product, which is administered transdermally using TransPharma s proprietary technology, is currently in Phase II clinical testing, and has no alternative future use. Under the arrangement, we also gain non-exclusive access to TransPharma s ViaDerm drug delivery system for the product. As with many development-phase products, launch of the product, if approved, is not expected in the near term. The charge of $35.0 million for acquired IPR&D related to this arrangement was included as expense in the second quarter of 2008 and is deductible for tax purposes.

In December 2007, we entered into an agreement with BioMS Medical Corp. to acquire the rights to its compound for the treatment of multiple sclerosis. This agreement became effective upon clearance under the Hart-Scott-Rodino Anti-Trust Improvements Act in January 2008. At the inception of this agreement, this compound was in the development stage (Phase III clinical trials) and had no alternative future use. As with many development-phase compounds, launch of the product, if approved, was not expected in the near term. The charge of $87.0 million for acquired IPR&D related to this arrangement was included as expense in the first quarter of 2008 and is deductible for tax purposes.

In January 2007, we entered into an agreement with OSI Pharmaceuticals, Inc. to acquire the rights to its compound for the treatment of type 2 diabetes. At the inception of this agreement, this compound was in the development stage (Phase I clinical trials) and had no alternative future use. As with many development-phase compounds, launch of the product, if approved, was not expected in the near term. The charge of $25.0 million for acquired IPR&D related to this arrangement was included as expense in the first quarter of 2007 and is deductible for tax purposes.

In connection with these arrangements, our partners are generally entitled to future milestones and royalties based on sales should these products be approved for commercialization.

Collaborations

We have entered into an agreement with an affiliate of TPG-Axon Capital (TPG) for the Phase III development of our gamma-secretase inhibitor and our A-beta antibody, our two lead molecules for the treatment of mild to moderate Alzheimer s disease. Pursuant to the terms of the agreement, both we and TPG will provide funding for the Alzheimer s clinical trials. Funding from TPG will not exceed $325 million and could extend into 2014. In exchange for their funding, TPG may receive success-based milestones totaling $330 million and mid- to high- single digit royalties that are contingent upon the successful development of the Alzheimer s treatments. The royalties will be paid for approximately eight years after launch of a product. Our reported research and development costs related to the Alzheimer s treatments are reflected net of the at-risk funding we receive from TPG for their share of the development costs. The funding from TPG is not expected to be material in any period.

Note 5: Asset Impairments, Restructuring, and Other Special Charges

In the second quarter of 2008, we recognized restructuring and other special charges of $88.9 million. In addition, we recognized non-cash charges of $57.1 million for the write-down of impaired manufacturing assets that had no future use, which are included in cost of sales. In April 2008, we announced a voluntary exit program that was offered to employees primarily in manufacturing. Components of the second-quarter restructuring charge include total severance costs of $53.5 million related to these programs and $35.4 million related to exit costs incurred during the second quarter in connection with previously announced strategic decisions made in prior periods. Substantially all of these costs were paid by the end of July 2008.

In March 2008, we terminated development of our AIR® Insulin program, which was being conducted in collaboration with Alkermes, Inc. The program had been in Phase III clinical

development as a potential treatment for type 1 and type 2 diabetes. This decision was not a result of any observations during AIR Insulin trials relating to the safety of the product, but rather was a result of increasing uncertainties in the regulatory environment, and a thorough evaluation of the evolving commercial and clinical potential of the product compared to existing medical therapies. As a result of this decision, we halted our ongoing clinical studies and are transitioning the AIR Insulin patients in these studies to other appropriate therapies. We have implemented a patient program in the U.S., and other regions of the world where allowed, to provide clinical trial participants with appropriate financial support to fund their medications and diagnostic supplies through the end of 2008.

We recognized asset impairment, restructuring, and other special charges of $145.7 million in the first quarter of 2008. These charges are primarily related to the decision to terminate development of AIR Insulin. Components of these charges include non-cash charges of $40.9 million for the write-down of impaired manufacturing assets that had no use beyond the AIR Insulin program, as well as charges of $91.7 million for estimated contractual obligations and wind-down costs associated with the termination of clinical trials and certain development activities, and costs associated with the patient program to transition participants from AIR Insulin. This amount includes an estimate of Alkermes wind-down costs for which we are contractually obligated. The wind-down activities and patient programs should be substantially complete by the end of 2008. The remaining component of these charges, $13.1 million, is related to exit costs incurred in the first quarter of 2008 in connection with previously announced strategic decisions made in prior periods.

In connection with previously announced strategic decisions, we recorded asset impairment, restructuring, and other special charges of $123.0 million in the first quarter of 2007. These charges primarily related to a voluntary severance program at one of our U.S. plants and other costs related to this action as well as management actions taken in the fourth quarter of 2006. The component of these charges related to the non-cash asset impairment was $67.6 million, and was necessary to adjust the carrying value of the assets to fair value. These restructuring activities were substantially complete at December 31, 2007.

Note 6: Fair Value Measurements

The following table summarizes certain fair value information at June 30, 2008 for assets and liabilities measured at fair value on a recurring basis, as well as the carrying amount of certain other investments:

		Fair Value Measurements Using Quoted Prices in