LILLY ELI & CO
Form 10-Q
April 30, 2010

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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 MARCH 31, 2010
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 (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

The number of shares of common stock outstanding as of April 20, 2010:

Class	Number of Shares Outstanding
Common	1,153,140,541

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended March 31,	
	2010	2009
	(Dollars in millions, except per-share data)	
Revenue	$ 5,485.5	$ 5,047.0
Cost of sales	1,122.5	816.4
Research and development	1,039.1	947.3
Marketing, selling, and administrative	1,614.4	1,529.2
Acquired in-process research and development (Note 3)	50.0	
Asset impairments, restructuring, and other special charges (Note 5)	26.2	
Other - net, expense (income) (Note 13)	(74.5)	70.7
	3,777.7	3,363.6
Income before income taxes	1,707.8	1,683.4
Income taxes (Note 10)	459.7	370.3
Net income	$ 1,248.1	$ 1,313.1
Earnings per share - basic and diluted (Note 9)	$ 1.13	$ 1.20
Dividends paid per share	$ .49	$ .49

See Notes to Consolidated Condensed Financial Statements.

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CONSOLIDATED CONDENSED BALANCE SHEETS
Eli Lilly and Company and Subsidiaries

	March 31, 2010 (Unaudited)	December 31, 2009
	(Dollars in millions)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 4,725.2	$ 4,462.9
Short-term investments (Note 6)	33.2	34.7
Accounts receivable, net of allowances of $115.0 (2010) and $109.9 (2009)	3,194.3	3,343.3
Other receivables	535.6	488.5
Inventories	2,471.1	2,849.9
Deferred income taxes	275.2	271.0
Prepaid expenses	1,017.8	1,036.2
TOTAL CURRENT ASSETS	12,252.4	12,486.5
OTHER ASSETS		
Investments (Note 6)	1,099.2	1,155.8
Goodwill and other intangibles - net (Note 4)	4,031.6	3,699.8
Sundry	1,827.6	1,921.4
	6,958.4	6,777.0
PROPERTY AND EQUIPMENT		
Land, buildings, equipment, and construction-in-progress	14,181.1	15,100.0
Less accumulated depreciation	(6,194.1)	(6,902.6)
	7,987.0	8,197.4
	$27,197.8	$ 27,460.9
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ 20.1	$ 27.4
Accounts payable	964.0	968.1
Employee compensation	506.1	894.2
Sales rebates and discounts	1,202.2	1,109.8
Dividends payable		538.0
Income taxes payable	192.1	346.7
Other current liabilities	2,773.1	2,683.9
TOTAL CURRENT LIABILITIES	5,657.6	6,568.1
Long-term debt	6,661.3	6,634.7
Accrued retirement benefit (Note 11)	2,024.2	2,334.7

Long-term income taxes payable (Note 10)	1,138.3	1,088.4
Deferred income taxes	81.2	84.8
Other noncurrent liabilities	1,172.9	1,224.9
	11,077.9	11,367.5
SHAREHOLDERS EQUITY (Notes 7 and 8)		
Common stock	721.3	718.7
Additional paid-in capital	4,623.9	4,635.6
Retained earnings	11,077.2	9,830.4
Employee benefit trust	(3,013.2)	(3,013.2)
Deferred costs-ESOP	(75.3)	(77.4)
Accumulated other comprehensive loss	(2,776.9)	(2,471.9)
Noncontrolling interests	2.7	1.6
	10,559.7	9,623.8
Less cost of common stock in treasury	97.4	98.5
	10,462.3	9,525.3
	$27,197.8	$ 27,460.9

See Notes to Consolidated Condensed Financial Statements.

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

	Three Months Ended March 31,	
	2010	2009
	(Dollars in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$1,248.1	$ 1,313.1
Adjustments to reconcile net income to cash flows from operating activities:		
Net marketing investigation charges paid	(56.5)	(1,063.1)
Other changes in operating assets and liabilities	(815.1)	(672.0)
Depreciation and amortization	299.4	306.3
Change in deferred taxes	230.5	129.1
Stock-based compensation expense	73.7	66.1
Acquired in-process research and development, net of tax	32.5	
Other, net	(54.6)	8.4
NET CASH PROVIDED BY OPERATING ACTIVITIES	958.0	87.9
CASH FLOWS FROM INVESTING ACTIVITIES		
Net purchases of property and equipment	(125.1)	(157.0)
Net change in short-term investments	(0.8)	286.2
Proceeds from sales and maturities of noncurrent investments	191.0	184.8
Purchases of noncurrent investments	(57.2)	(67.7)
Purchase of in-process research and development	(50.0)	
Other, net	(10.5)	(19.0)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(52.6)	227.3
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(539.2)	(536.8)
Net change in short-term borrowings	(7.9)	(4,243.6)
Proceeds from issuance of long-term debt	0.1	2,400.0
NET CASH USED IN FINANCING ACTIVITIES	(547.0)	(2,380.4)
Effect of exchange rate changes on cash and cash equivalents	(96.1)	(118.4)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	262.3	(2,183.6)
Cash and cash equivalents at January 1	4,462.9	5,496.7

CASH AND CASH EQUIVALENTS AT MARCH 31	$4,725.2	$ 3,313.1

See Notes to Consolidated Condensed Financial Statements.

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

	Three Months Ended March 31,	
	2010	2009
	(Dollars in millions)	
Net income	$1,248.1	$1,313.1
Other comprehensive loss, net of tax[1]	(305.0)	(343.5)
Comprehensive income	$ 943.1	$ 969.6

[1] The significant components of other comprehensive loss were losses of $377.0 million and $403.7 million from foreign currency translation adjustments for the three months ended March 31, 2010 and March 31, 2009, respectively.

See Notes to Consolidated Condensed Financial Statements.

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SEGMENT INFORMATION

We operate in one significant business segment - human pharmaceutical products. Operations of the animal health business segment are not material and share many of the same economic and operating characteristics as human 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 first quarters of 2010 and 2009 was $36.8 million and $35.7 million, respectively.

REVENUE BY CATEGORY

Worldwide revenue by category was as follows:

	Three Months Ended March 31,	
	2010	2009
	(Dollars in millions)	
Revenue to unaffiliated customers:		
Neuroscience	$2,244.1	$2,077.6
Endocrinology	1,477.8	1,396.4
Oncology	907.7	797.3
Cardiovascular	519.7	455.1
Animal health	289.6	264.1
Other pharmaceuticals	46.6	56.5
Total revenue	$5,485.5	$5,047.0

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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, 2009. We issued our financial statements by filing with the Securities and Exchange Commission (SEC) and have evaluated subsequent events up to the time of the filing.

Note 2: Implementation of New Financial Accounting Pronouncements

In March 2010, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force (EITF) guidance related to Revenue Recognition that applies to arrangements with milestones relating to research or development deliverables. This guidance provides criteria that must be met to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. This guidance is effective for us January 1, 2011 and is not expected to have a material impact to our consolidated financial position or results of operations.

In 2009, the FASB ratified EITF guidance related to Revenue Recognition that amends the previous guidance on arrangements with multiple deliverables. This guidance provides principles and application guidance on whether multiple deliverables exist, how the arrangements should be separated, and how the consideration should be allocated. It also clarifies the method to allocate revenue in an arrangement using the estimated selling price. This guidance is effective for us January 1, 2011, and is not expected to be material to our consolidated financial position or results of operations.

We adopted the FASB Statement on Transfers and Servicing, an amendment of previous authoritative guidance. The most significant amendments resulting from this Statement consist of the removal of the concept of a qualifying special-purpose entity (SPE) from previous authoritative guidance, and the elimination of the exception for qualifying SPEs from the Consolidation guidance regarding variable interest entities. This Statement was effective for us January 1, 2010, and had no effect on our consolidated financial position or results of operations.

We adopted the FASB Statement that amended the previous Consolidations guidance regarding variable interest entities and addressed the effects of eliminating the qualifying SPE concept from the guidance on Transfers and Servicing. This Statement responded to concerns about the application of certain key provisions of the previous guidance on Consolidations regarding variable interest entities, including concerns over the transparency of enterprises involvement with variable interest entities. This Statement was effective for us January 1, 2010, and had no effect on our consolidated financial position or results of operations.

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Note 3: Acquisitions

Acquisitions of Marketed Products and Products in Development

In March 2010, we entered into a license agreement with Acrux Limited to acquire the exclusive rights to commercialize its proprietary testosterone solution with the proposed tradename Axiron . The product is currently under regulatory review by the U.S. Food and Drug Administration (FDA) for the treatment of testosterone deficiency in men and has no alternative future use. The charge of $50.0 million for acquired in-process research and development (IPR&D) related to this arrangement was included as expense in the first quarter of 2010 and is deductible for tax purposes. In connection with this arrangement, our partner is entitled to future milestones and royalties based on sales if this product is approved for commercialization.

Note 4: Collaborations

We often enter into collaborative arrangements to develop and commercialize drug candidates. Collaborative activities might include research and development, marketing and selling (including promotional activities and physician detailing), manufacturing, and distribution. These collaborations often require milestone and royalty or profit share payments, contingent upon the occurrence of certain future events linked to the success of the asset in development, as well as expense reimbursements or payments to the third party. Revenues related to products sold by us pursuant to these arrangements are included in net product sales, while other sources of revenue (e.g., royalties and profit share payments) are included in collaboration and other revenue. Operating expenses for costs incurred pursuant to these arrangements are reported in their respective expense line item, net of any payments made to or reimbursements received from our collaboration partners. Each collaboration is unique in nature, and our more significant arrangements are discussed below. The following table summarizes the composition of our total revenue recognized from all transactions, including collaboration activity:

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(Dollars in millions)	
Net product sales	$5,332.5	$ 4,891.8
Collaboration and other revenue	153.0	155.2
Total revenue	$5,485.5	$ 5,047.0

Erbitux®

Prior to our acquisition in November 2008, ImClone Systems Inc. (ImClone) entered into several collaborations with respect to Erbitux, a product approved to fight cancer, while still in its development phase. The most significant collaborations operate in these geographic territories: the U.S., Japan, and Canada (Bristol-Myers Squibb Company); and worldwide except the U.S. and Canada (Merck KGaA). The agreements are expected to expire in 2018, upon which all of the rights with respect to Erbitux in the U.S. and Canada return to us. The following table summarizes the revenue recognized with respect to Erbitux:

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	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(Dollars in millions)	
Net product sales	$17.0	$ 26.1
Collaboration and other revenue	75.5	68.0
Total revenue	$92.5	$ 94.1

Bristol-Myers Squibb Company

Pursuant to a commercial agreement with Bristol-Myers Squibb Company and E.R. Squibb (collectively, BMS), relating to Erbitux, ImClone is co-developing and co-promoting Erbitux in the U.S. and Canada with BMS, exclusively, and in Japan with BMS and Merck KGaA. The companies have jointly agreed to expand the investment in the ongoing clinical development plan for Erbitux to further explore its use in additional tumor types. Under this arrangement, Erbitux research and development and other costs, up to threshold amounts, are the sole responsibility of BMS, with costs in excess of the thresholds shared by both companies according to a predetermined ratio. Responsibilities associated with clinical and other ongoing studies are apportioned between the parties under the agreement. Collaborative reimbursements received by ImClone for supply of clinical trial materials; for research and development; and for a portion of marketing, selling, and administrative expenses are recorded as a reduction to the respective expense line items on the consolidated condensed statement of operations. We receive a distribution fee in the form of a royalty from BMS, based on a percentage of net sales in the U.S. and Canada, which is recorded in collaboration and other revenue. Royalty expense paid to third parties, net of any reimbursements received, is recorded as a reduction of collaboration and other revenue.

We are responsible for the manufacture and supply of all requirements of Erbitux in bulk-form active pharmaceutical ingredient (API) for clinical and commercial use in the territory, and BMS will purchase all of its requirements of API for commercial use from us, subject to certain stipulations per the agreement. Sales of Erbitux to BMS for commercial use are reported in net product sales.

Merck KGaA

A development and license agreement between ImClone and Merck KGaA (Merck) with respect to Erbitux granted Merck exclusive rights to market Erbitux outside of the U.S. and Canada, and co-exclusive rights with BMS and ImClone in Japan. Merck also has rights to manufacture Erbitux for supply in its territory. We manufacture and provide a portion of Merck s requirements for API, which is included in net product sales. We also receive a royalty on the sales of Erbitux outside of the U.S. and Canada, which is included in collaboration and other revenue as earned. Collaborative reimbursements received for supply of product; for research and development; and marketing, selling, and administrative expenses are recorded as a reduction to the respective expense line items on the consolidated condensed statement of operations. Royalty expense paid to third parties, net of any royalty reimbursements received, is recorded as a reduction of collaboration and other revenue.

Necitumumab

In January 2010, we restructured the commercial agreement with BMS described above to allow for the co-development and co-commercialization of necitumumab, which is currently in Phase III clinical testing for non-small cell lung cancer. Within this restructured arrangement, we and BMS have agreed to share in the cost of developing and potentially commercializing necitumumab in the U.S., Canada, and Japan. We maintain exclusive rights to necitumumab in all other markets. We will fund 45 percent of the development costs for studies that will be used only in the U.S., and 72.5 percent for global studies. We will be responsible for the manufacturing of API and BMS will be responsible for manufacturing the finished product. We could receive a payment of $250.0 million upon approval in the U.S. In the U.S. and Canada, BMS will record sales

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and we will receive 45 percent of the profits for necitumumab, while we will provide 50 percent of the selling effort. In Japan, we and BMS will share costs and profits evenly.

Exenatide

We are in a collaborative arrangement with Amylin Pharmaceuticals (Amylin) for the joint development, marketing, and selling of Byetta® (exenatide injection) and other forms of exenatide such as exenatide once weekly. Byetta is presently approved as an adjunctive therapy to improve glycemic control in patients with type 2 diabetes who have not achieved adequate glycemic control using metformin, a sulfonylurea or a combination of metformin and sulfonylurea; and in the U.S. only, as an adjunctive therapy in patients using a thiazolidinedione (with or without metformin) and as a monotherapy. Lilly and Amylin are co-promoting exenatide in the U.S. Amylin is responsible for manufacturing and primarily utilizes third-party contract manufacturers to supply Byetta. However, we are manufacturing Byetta pen delivery devices for Amylin. We are responsible for development and commercialization costs outside the U.S. Under the terms of our arrangement, we report as collaboration and other revenue our 50 percent share of gross margin on Amylin s net product sales in the U.S. We report as net product sales 100 percent of sales outside the U.S. and our sales of Byetta pen delivery devices to Amylin. The following table summarizes the revenue recognized with respect to Byetta:

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(Dollars in millions)	
Net product sales	$ 43.2	$ 27.3
Collaboration and other revenue	72.5	70.2
Total revenue	$115.7	$ 97.5

We pay Amylin a percentage of the gross margin of exenatide sales outside of the U.S., and these costs are recorded in cost of sales. Under the 50/50 profit-sharing arrangement for the U.S., in addition to recording as revenue our 50 percent share of exenatide s gross margin, we also record 50 percent of U.S. research and development costs and marketing and selling costs in the respective line items on the consolidated condensed statements of operations.

A New Drug Application has been submitted to the FDA for Bydureon , the proposed brand name for exenatide once weekly. Amylin is constructing and will operate a manufacturing facility for exenatide once weekly, and we have entered into a supply agreement in which Amylin will supply exenatide once weekly product to us for sales outside the U.S. The estimated total cost of the facility is approximately $550 million. In 2008, we paid $125.0 million to Amylin, which we will amortize to cost of sales over the estimated life of the supply agreement beginning with product launch. We would be required to reimburse Amylin for a portion of any future impairment of this facility, recognized in accordance with GAAP. A portion of the $125.0 million payment we made to Amylin would be creditable against any amount we would owe as a result of impairment. We have also agreed to loan up to $165.0 million to Amylin at an indexed rate beginning December 1, 2009; no amounts have been loaned pursuant to this arrangement and any borrowings have to be repaid by June 30, 2014. We have also agreed to cooperate with Amylin in the development, manufacturing, and marketing of exenatide once weekly in a dual-chamber cartridge pen configuration. We will contribute 60 percent of the total initial capital costs of the project, our portion of which will be approximately $130 million, of which we have contributed approximately $62 million as of March 31, 2010.

Cymbalta®

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Boehringer Ingelheim

We have been in a collaborative arrangement with Boehringer Ingelheim (BI) to jointly market and promote Cymbalta (duloxetine), a product for the treatment of major depressive disorder, diabetic peripheral neuropathic pain, generalized anxiety disorder, and fibromyalgia, outside the U.S. and Japan. Pursuant to the terms of the agreement, we generally shared equally in development, marketing, and selling expenses, and paid BI a commission on sales in the co-promotion territories. We manufacture the product for all territories. Reimbursements or payments for the cost sharing of marketing, selling, and administrative expenses were recorded in the respective expense line items in the consolidated condensed statements of operations. The commission paid to BI was recorded in marketing, selling, and administrative expenses. In March 2010, the parties agreed to terminate this agreement, and the exclusive rights to develop and market duloxetine for all indications in countries outside the U.S. and Japan were re-acquired by us. In connection with the arrangement, we paid BI approximately $400 million and will also pay a royalty to BI on our sales in these countries through 2012. We record these costs as intangible assets and will amortize to marketing, selling and administrative expenses over the life of the original agreement, which is through 2015.

Quintiles

We were in a collaborative arrangement with Quintiles Transnational Corp. (Quintiles) to jointly market and promote Cymbalta in the U.S. since Cymbalta s launch in 2004. Pursuant to the terms of the agreement, Quintiles shared in the costs to co-promote Cymbalta with us and receives a commission based upon net product sales. According to that agreement, Quintiles obligation to promote Cymbalta expired during 2009, and we will pay a lower rate on net product sales for three years after completion of the promotion efforts specified in that agreement. The commissions paid to Quintiles are recorded in marketing, selling, and administrative expenses.

Effient®

We are in a collaborative arrangement with Daiichi Sankyo Company, Limited (D-S) to develop, market, and promote Effient, an antiplatelet agent for the treatment of patients with acute coronary syndrome (ACS) who are being managed with an artery-opening procedure known as percutaneous coronary intervention (PCI). The product was approved for marketing by the European Commission under the trade name Efient® in February 2009, and the initial sales were recorded in the first quarter of 2009. The product was also approved for marketing by the FDA under the tradename Effient in July 2009, and the initial sales in the U.S. were recorded in the third quarter. Within this arrangement, we and D-S have agreed to co-promote under the same trademark in certain territories (including the U.S. and five major European markets), while we have exclusive marketing rights in certain other territories. D-S has exclusive marketing rights in Japan. Under the agreement, we paid D-S an upfront license fee and milestones related to successful development and product launch. The parties share approximately 50/50 in the profits, as well as in the costs of development and marketing in the co-promotion territories. A third party manufactures bulk product, and we produce the finished product for our exclusive and co-promotion territories. We record product sales in our exclusive and co-promotion territories. In our exclusive territories, we pay D-S a royalty specific to these territories. Profit share payments made to D-S are recorded as marketing, selling, and administrative expenses. All royalties paid to D-S and the third-party manufacturer are recorded in cost of sales. Worldwide Effient sales were $8.8 million in the first quarter of 2010. The acceleration in total prescription growth sequentially from last quarter has generated a substantial reduction in the original product stocking. We and D-S continue to make progress in gaining reimbursement and access for the product.

TPG-Axon Capital

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In 2008, we entered into an agreement with an affiliate of TPG-Axon Capital (TPG) for the Phase III development of semagacestat and solanezumab, our two lead molecules for the treatment of mild to moderate Alzheimer s disease. Under 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. Reimbursements received from TPG for its portion of research and development costs incurred related to the Alzheimer s treatments are recorded as a reduction to the research and development expense line item on the consolidated condensed statements of operations. The reimbursement from TPG has not been and is not expected to be material in any period.

Summary of Collaboration Related Commission and Profit Share Payments

The aggregate amount of commission and profit share payments included in marketing, selling, and administrative expense pursuant to the collaborations described above was $65.1 million and $77.6 million in the quarters ended March 31, 2010 and 2009, respectively.

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

We recognized asset impairments, restructuring and other special charges of $26.2 million in the first quarter of 2010 as a result of our previously announced initiatives to reduce our cost structure and global workforce as well as previously announced strategic decisions. These charges primarily related to severance costs, which are expected to be paid in the first half of 2010, and exit costs incurred in the first quarter of 2010.

Note 6: Financial Instruments

Financial instruments that potentially subject us to credit risk consist principally of trade receivables and interest-bearing investments. Wholesale distributors of life-sciences products account for a substantial portion of trade receivables; collateral is generally not required. The risk associated with this concentration is mitigated by our ongoing credit review procedures and insurance. Major financial institutions represent the largest component of our investments in corporate debt securities. In accordance with documented corporate policies, we limit the amount of credit exposure to any one financial institution or corporate issuer. We are exposed to credit-related losses in the event of nonperformance by counterparties to risk-management instruments but do not expect any counterparties to fail to meet their obligations given their high credit ratings.

Accounting Policy for Risk-Management Instruments

Our derivative activities are initiated within the guidelines of documented corporate risk-management policies and do not create additional risk because gains and losses on derivative contracts offset losses and gains on the assets, liabilities, and transactions being hedged. As derivative contracts are initiated, we designate the instruments individually as either a fair value hedge or a cash flow hedge. Management reviews the correlation and effectiveness of our derivatives on a quarterly basis.

For derivative contracts that are designated and qualify as fair value hedges, the derivative instrument is marked to market with gains and losses recognized currently in income to offset the respective losses and gains recognized on the underlying exposure. For derivative contracts that are designated and qualify as cash flow hedges, the effective portion of gains and losses on these contracts is reported as a component of other comprehensive loss and reclassified into earnings in the same period the hedged transaction affects earnings. Hedge ineffectiveness is immediately recognized in earnings. Derivative contracts that are not designated as hedging

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instruments are recorded at fair value with the gain or loss recognized currently in earnings during the period of change.

We may enter into foreign currency forward and purchase option contracts to reduce the effect of fluctuating currency exchange rates (principally the euro, the British pound, and the Japanese yen). Foreign currency derivatives used for hedging are put in place using the same or like currencies and duration as the underlying exposures. Forward contracts are principally used to manage exposures arising from subsidiary trade and loan payables and receivables denominated in foreign currencies. These contracts are recorded at fair value with the gain or loss recognized in other-net, expense (income). The purchased option contracts are used to hedge anticipated foreign currency transactions, primarily intercompany inventory activities expected to occur within the next year. These contracts are designated as cash flow hedges of those future transactions, and the impact on earnings is included in cost of sales.

We may enter into foreign currency forward contracts and currency swaps as fair value hedges of firm commitments. Forward and purchase option contracts generally have maturities not exceeding 12 months. At March 31, 2010, we did not hold any foreign currency option contracts. At March 31, 2010, we had outstanding foreign currency forward commitments to purchase 415 million British pounds and sell 457 million euro, commitments to purchase 869 million U.S. dollars and sell 644 million euro, and commitments to buy 1.06 billion euro and sell 1.44 billion U.S. dollars, which will settle within five months.

In the normal course of business, our operations are exposed to fluctuations in interest rates. These fluctuations can vary the costs of financing, investing, and operating. We address a portion of these risks through a controlled program of risk management that includes the use of derivative financial instruments. The objective of controlling these risks is to limit the impact of fluctuations in interest rates on earnings. Our primary interest rate risk exposure results from changes in short-term U.S. dollar interest rates. In an effort to manage interest rate exposures, we strive to achieve an acceptable balance between fixed and floating rate debt and investment positions and may enter into interest rate swaps or collars to help maintain that balance. Interest rate swaps or collars that convert our fixed-rate debt or investments to a floating rate are designated as fair value hedges of the underlying instruments. Interest rate swaps or collars that convert floating rate debt or investments to a fixed rate are designated as cash flow hedges. Interest expense on the debt is adjusted to include the payments made or received under the swap agreements. At March 31, 2010, approximately 97 percent of our total debt is at a fixed rate. We have converted approximately 65 percent of our fixed-rate debt to floating rates through the use of interest rate swaps.

The Effect of Risk-Management Instruments on the Statement of Operations

Both the losses on the hedged fixed-rate debt and the offsetting gains on the related interest rate swaps for the first quarter of 2010 were $31.6 million. In the first quarter of 2009, both the gains on the hedged fixed-rate debt and the offsetting losses on the related interest rate swaps were $139.6 million. These amounts net to zero for each quarter and were included in other - net, expense (income).

We expect to reclassify $11.9 million of pretax net losses on cash flow hedges of the variability in expected future interest payments on floating rate debt from accumulated other comprehensive loss to earnings during the next 12 months.

Other-net, expense (income) for the three months ended March 31, 2010 and 2009, includes the effective portion of losses on interest rate contracts in designated cash flow hedging relationships reclassified from accumulated other comprehensive loss into income of $2.2 million and $2.5 million, respectively, and the net gains on foreign exchange contracts not designated as hedging instruments recognized in income of $6.8 million and $36.6 million, respectively. The effective portion of net gains on interest rate contracts in designated cash flow hedging relationships recorded in other comprehensive loss for the three months ended March 31, 2010 and 2009, was zero and $37.8 million, respectively.

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During the three months ended March 31, 2010 and 2009, net losses related to ineffectiveness and net losses related to the portion of our risk-management hedging instruments, fair value and cash flow hedges excluded from the assessment of effectiveness were not material.

Fair Value of Financial Instruments

The following tables summarize certain fair value information at March 31, 2010 and December 31, 2009 for assets and liabilities measured at fair value on a recurring basis, as well as the carrying amount and amortized cost of certain other investments:

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Description	Carrying Amount	Amortized Cost	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
March 31, 2010						
Short-term investments						
Corporate debt securities	$ 19.1	$ 19.2	$	$ 19.1	$	$ 19.1
U.S. government and agencies	13.9	13.9	13.9			13.9
Other securities	0.2	0.2		0.2		0.2
	$ 33.2	$ 33.3				
Noncurrent investments						
Corporate debt securities	$ 172.3	$175.4	$	$ 172.3	$	$ 172.3
Mortgage-backed	229.3	288.1		229.3		229.3
Asset-backed	58.9	73.0		58.9		58.9
U.S. government and agencies	75.5	75.5	75.5			75.5
Other debt securities	7.0	9.7		3.4	3.6	7.0
Marketable equity	409.4	186.9	409.4			409.4
Equity method and other investments	146.8	146.8				NA
	$ 1,099.2	$955.4				
Long-term debt, including current portion	$(6,681.0)	NA	$	$ (6,844.8)	$	$(6,844.8)
Risk-management instruments						
Interest rate contracts designated as hedging instruments						
Sundry	$ 160.3	NA	$	$ 160.3	$	$ 160.3
Foreign exchange contracts not designated as hedging	14.0	NA		14.0		14.0

instruments				
Prepaid expenses				
Other current liabilities	(9.1)	NA	(9.1)	(9.1