
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 QUARTERLY PERIOD ENDED JUNE 30, 2019
COMMISSION FILE NUMBER 001-38661**

Elanco Animal Health Incorporated

(Exact name of Registrant as specified in its charter)

INDIANA
(State or other jurisdiction of
incorporation or organization)

82-5497352
(I.R.S. Employer
Identification No.)

2500 INNOVATION WAY, GREENFIELD, INDIANA 46140
(Address of principal executive offices)

Registrant's telephone number, including area code (877) 352-6261

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, no par value	ELAN	New York Stock Exchange

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares of common stock outstanding as of August 9, 2019 were 372,996,341

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Form 10-Q
For the Quarter Ended June 30, 2019
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Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the federal securities laws. This quarterly report contains forward-looking statements, including, without limitation, statements concerning our estimated "stand up" costs, our estimated interest expense, our industry and our operations, performance and financial condition, including in particular, statements relating to our business, growth strategies, product development efforts and future expenses.

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, by their nature, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. As a result, our actual results may differ materially from those contemplated by the forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include regional, national, or global political, economic, business, competitive, market, and regulatory conditions, including but not limited to the following:

- heightened competition, including from innovation or generics;
- the impact of disruptive innovations and advances in veterinary medical practices, animal health technologies and alternatives to animal-derived protein;
- changes in regulatory restrictions on the use of antibiotics in food animals;
- our ability to implement our business strategies or achieve targeted cost efficiencies and gross margin improvements;
- consolidation of our customers and distributors;
- an outbreak of infectious disease carried by food animals;
- the success of our R&D and licensing efforts;
- our ability to complete acquisitions and successfully integrate the businesses we acquire;
- misuse, off-label or counterfeiting use of our products;
- unanticipated safety, quality or efficacy concerns associated with our products;
- the impact of weather conditions and the availability of natural resources;
- risks related to our presence in emerging markets;
- changes in U.S. foreign trade policy, imposition of tariffs or trade disputes;
- the impact of global macroeconomic conditions; and
- the effect on our business resulting from our separation from Eli Lilly & Co. (Lilly), including the various costs associated with transition to a stand alone entity.

See "Risk Factors," of Part I of our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the Securities and Exchange Commission (SEC) and Item 1A, "Risk Factors," of Part II of this Quarterly Report on Form 10-Q and of Part II of our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2019, for a further description of these and other factors. Although we have attempted to identify important risk factors, there may be other risk factors not presently known to us or that we presently believe are not material that could cause actual results and developments to differ materially from those made in or suggested by the forward-looking statements contained in this quarterly report. If any of these risks materialize, or if any of the above assumptions underlying forward-looking statements prove incorrect, actual results and developments may differ materially from those made in or suggested by the forward-looking statements contained in this quarterly report. For the reasons described above, we caution you against relying on any forward-looking statements, which should also be read in conjunction with the other cautionary statements that are included elsewhere in this quarterly report. Any forward-looking statement made by us in this quarterly report speaks only as of the date hereof. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update or to revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless specifically expressed as such, and should be viewed as historical data.

PART I. Financial Information

Item 1. Financial Statements

Elanco Animal Health Incorporated
Unaudited Condensed Consolidated and Combined Statements of Operations
(Dollars and shares in millions, except per-share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenue	\$ 781.6	\$ 770.2	\$ 1,512.7	\$ 1,506.4
Costs, expenses and other:				
Cost of sales	356.0	431.5	699.8	791.5
Research and development	68.8	61.4	132.9	126.6
Marketing, selling and administrative	200.9	191.1	382.0	371.1
Amortization of intangible assets	49.3	49.4	98.3	98.6
Asset impairment, restructuring and other special charges (Note 6)	31.8	68.0	56.7	70.4
Interest expense, net of capitalized interest	20.7	—	41.5	—
Other—net, expense	3.9	8.8	6.5	10.7
	<u>731.4</u>	<u>810.2</u>	<u>1,417.7</u>	<u>1,468.9</u>
Income (loss) before income taxes	50.2	(40.0)	95.0	37.5
Income tax expense	14.3	22.8	27.6	27.6
Net income (loss)	<u>\$ 35.9</u>	<u>\$ (62.8)</u>	<u>\$ 67.4</u>	<u>\$ 9.9</u>
Earnings (loss) per share:				
Basic	\$ 0.10	\$ (0.21)	\$ 0.18	\$ 0.03
Diluted	\$ 0.10	\$ (0.21)	\$ 0.18	\$ 0.03
Weighted average shares outstanding:				
Basic	365.7	293.3	365.7	293.3
Diluted	367.0	293.3	366.5	293.3

See notes to unaudited condensed consolidated and combined financial statements.

Elanco Animal Health Incorporated
Unaudited Condensed Consolidated and Combined Statements of Comprehensive Income (Loss)
(Dollars in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net income (loss)	\$ 35.9	\$ (62.8)	\$ 67.4	\$ 9.9
Other comprehensive income (loss):				
Foreign currency translation	35.4	(224.9)	5.2	(105.7)
Defined benefit pension and retiree health benefit plans, net of taxes	0.2	2.0	2.2	1.4
Other comprehensive income (loss), net of tax	35.6	(222.9)	7.4	(104.3)
Comprehensive income (loss)	\$ 71.5	\$ (285.7)	\$ 74.8	\$ (94.4)

See notes to unaudited condensed consolidated and combined financial statements.

Elanco Animal Health Incorporated
Condensed Consolidated Balance Sheets
(Dollars in millions)

	June 30, 2019	December 31, 2018
	(Unaudited)	
Assets		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 385.1	\$ 474.8
Accounts receivable, net of allowances of \$5.7 (2019) and \$8.4 (2018)	757.2	651.8
Other receivables	74.3	57.6
Inventories (Note 7)	1,053.1	1,004.1
Prepaid expenses and other	102.3	113.9
Restricted cash (Note 15)	11.5	202.7
Total current assets	2,383.5	2,504.9
<i>Noncurrent Assets</i>		
Goodwill	2,959.6	2,958.0
Other intangibles, net	2,352.8	2,453.0
Other noncurrent assets	229.9	118.4
Property and equipment, net of accumulated depreciation of \$921.2 (2019) and \$878.6 (2018)	931.1	922.4
Total assets	\$ 8,856.9	\$ 8,956.7
Liabilities and Equity		
<i>Current Liabilities</i>		
Accounts payable	\$ 242.9	\$ 205.2
Employee compensation	67.3	98.9
Sales rebates and discounts	176.0	169.9
Current portion of long-term debt (Note 8)	27.1	29.0
Other current liabilities	205.4	199.0
Payable to Lilly (Note 15)	58.8	268.7
Total current liabilities	777.5	970.7
<i>Noncurrent Liabilities</i>		
Long-term debt (Note 8)	2,382.0	2,443.3
Accrued retirement benefits	108.4	109.1
Deferred taxes (Note 11)	147.8	114.6
Other noncurrent liabilities	175.7	121.5
Total liabilities	3,591.4	3,759.2
<i>Commitments and Contingencies (Note 12)</i>		
	—	—
<i>Equity</i>		
Common stock, no par value, 5,000,000,000 shares authorized, 365,707,233 and 365,643,911 shares issued and outstanding as of June 30, 2019 and December 31, 2018, respectively	—	—
Additional paid-in capital	5,396.5	5,403.3
Retained earnings	83.8	16.4
Accumulated other comprehensive loss	(214.8)	(222.2)
Total equity	5,265.5	5,197.5
Total liabilities and equity	\$ 8,856.9	\$ 8,956.7

See notes to unaudited condensed consolidated and combined financial statements.

Elanco Animal Health Incorporated
Unaudited Condensed Consolidated and Combined Statements of Equity
(Dollars and shares in millions)

	Common Stock		Additional Paid-in Capital	Net Parent Company Investment	Retained Earnings	Accumulated Other Comprehensive Income (Loss)			Total Equity
	Shares	Amount				Foreign Currency Translation	Defined Benefit Pension and Retiree Health Benefit Plans	Total	
December 31, 2017	293.3	\$ —	\$ —	\$ 8,036.9	\$ —	\$ (227.2)	\$ (29.4)	\$ (256.6)	\$ 7,780.3
Adoption of Accounting Standards Update 2016-16	—	—	—	(0.3)	—	—	—	—	(0.3)
Net income	—	—	—	72.7	—	—	—	—	72.7
Other comprehensive income (loss), net of tax	—	—	—	—	—	119.2	(0.6)	118.6	118.6
Transfers (to)/from Lilly, net ⁽¹⁾	—	—	—	(69.2)	—	—	—	—	(69.2)
March 31, 2018	293.3	\$ —	\$ —	\$ 8,040.1	\$ —	\$ (108.0)	\$ (30.0)	\$ (138.0)	\$ 7,902.1
Net income	—	—	—	(62.8)	—	—	—	—	(62.8)
Other comprehensive income (loss), net of tax	—	—	—	—	—	(224.9)	2.0	(222.9)	(222.9)
Transfers (to)/from Lilly, net ⁽¹⁾	—	—	—	(40.3)	—	—	—	—	(40.3)
June 30, 2018	293.3	\$ —	\$ —	\$ 7,937.0	\$ —	\$ (332.9)	\$ (28.0)	\$ (360.9)	\$ 7,576.1
December 31, 2018	365.6	\$ —	\$ 5,403.3	\$ —	\$ 16.4	\$ (218.2)	\$ (4.0)	\$ (222.2)	\$ 5,197.5
Net income	—	—	—	—	31.5	—	—	—	31.5
Other comprehensive income (loss), net of tax	—	—	—	—	—	(30.2)	2.0	(28.2)	(28.2)
Separation activities ⁽¹⁾	—	—	(7.0)	—	—	—	—	—	(7.0)
Stock compensation	—	—	2.4	—	—	—	—	—	2.4
Issuance of stock under employee stock plans, net	0.1	—	—	—	—	—	—	—	—
March 31, 2019	365.7	\$ —	\$ 5,398.7	\$ —	\$ 47.9	\$ (248.4)	\$ (2.0)	\$ (250.4)	\$ 5,196.2
Net income	—	—	—	—	35.9	—	—	—	35.9
Other comprehensive income (loss), net of tax	—	—	—	—	—	35.4	0.2	35.6	35.6
Separation activities ⁽¹⁾	—	—	(18.4)	—	—	—	—	—	(18.4)
Stock compensation	—	—	14.3	—	—	—	—	—	14.3
Other	—	—	1.9	—	—	—	—	—	1.9
June 30, 2019	365.7	\$ —	\$ 5,396.5	\$ —	\$ 83.8	\$ (213.0)	\$ (1.8)	\$ (214.8)	\$ 5,265.5

(1) See Note 15: Related Party Agreements and Transactions for further discussion.

See notes to unaudited condensed consolidated and combined financial statements.

Elanco Animal Health Incorporated
Unaudited Condensed Consolidated and Combined Statements of Cash Flows
(Dollars in millions)

	Six Months Ended June 30,	
	2019	2018
Cash Flows from Operating Activities		
Net income	\$ 67.4	\$ 9.9
Adjustments to Reconcile Net Income to Cash Flows from Operating Activities:		
Depreciation and amortization	152.4	149.6
Change in deferred income taxes	40.3	10.8
Stock-based compensation expense	21.9	13.3
Asset impairment charges	4.0	97.9
Changes in operating assets and liabilities	(205.2)	(98.3)
Other non-cash operating activities, net	(22.6)	0.7
Net Cash Provided by Operating Activities	58.2	183.9
Cash Flows from Investing Activities		
Net purchases of property and equipment	(51.8)	(56.5)
Other investing activities, net	(25.7)	(1.0)
Net Cash Used for Investing Activities	(77.5)	(57.5)
Cash Flows from Financing Activities		
Repayments of borrowings (Note 8)	(65.0)	—
Consideration paid to Lilly in connection with the Separation (Note 1)	(191.2)	—
Other net financing transactions with Lilly	5.0	(122.8)
Other financing activities, net	1.4	(0.9)
Net Cash Used for Financing Activities	(249.8)	(123.7)
Effect of exchange rate changes on cash and cash equivalents	(11.8)	(5.1)
Net decrease in cash, cash equivalents and restricted cash	(280.9)	(2.4)
Cash, cash equivalents and restricted cash at January 1	677.5	323.4
Cash, cash equivalents and restricted cash at June 30	\$ 396.6	\$ 321.0

	June 30,	
	2019	2018
Cash and cash equivalents	\$ 385.1	\$ 321.0
Restricted cash (Note 15)	11.5	—
Cash, cash equivalents and restricted cash at June 30	\$ 396.6	\$ 321.0

See notes to unaudited condensed consolidated and combined financial statements.

Elanco Animal Health Incorporated
Notes to Unaudited Condensed Consolidated and Combined Financial Statements
(Tables present dollars in millions, except per-share data)

Note 1. Nature of Business and Organization

Nature of Business

Elanco Animal Health Incorporated (Elanco Parent) and its subsidiaries (collectively, Elanco, the Company, we, us or our) was formed as a wholly-owned subsidiary of Eli Lilly and Company (Lilly). Elanco is a global animal health company that innovates, develops, manufactures and markets products for companion and food animals. We offer a diverse portfolio of more than 125 brands to veterinarians and food animal producers in more than 90 countries.

Organization

Elanco Parent was formed in 2018, as a wholly-owned subsidiary of Lilly, to serve as the ultimate parent company of substantially all of the animal health businesses of Lilly.

On September 24, 2018, Elanco Parent completed an initial public offering resulting in the issuance of 72.3 million shares of its common stock (including shares issued pursuant to the underwriters' option to purchase additional shares), which represented 19.8% of the outstanding shares, at \$24 per share (IPO) resulting in total net proceeds, after underwriting discounts and commissions, of \$1.7 billion. In connection with the completion of the IPO, through a series of equity and other transactions, Lilly transferred to Elanco Parent the animal health businesses that form its business going forward. In exchange Elanco Parent has paid, or will pay, to Lilly approximately \$4.2 billion, which includes the net proceeds from the IPO, the net proceeds from the debt offering completed by Elanco Parent in August 2018 and the term loan facility entered into by Elanco Parent in September 2018 (see Note 8: Debt). These transactions are collectively referred to herein as the Separation.

On February 8, 2019, Lilly announced an exchange offer whereby Lilly shareholders could exchange all or a portion of Lilly common stock for shares of Elanco common stock owned by Lilly. The disposition of Elanco shares was completed on March 11, 2019 and resulted in the full separation of Elanco and disposal of Lilly's entire ownership and voting interest in Elanco.

Note 2. Basis of Presentation

We have prepared the accompanying unaudited condensed consolidated and combined 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, revenue, 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 and combined financial statements and accompanying notes for the year ended December 31, 2018 included in our Annual Report on Form 10-K filed with the SEC on February 20, 2019.

For the periods after Separation, the financial statements are prepared on a consolidated basis and reflect the results of operations, comprehensive income, financial position, equity and cash flows resulting from our operations as an independent company. For periods prior to the Separation, our financial statements are combined, have been prepared on a standalone basis, and are derived from Lilly's consolidated financial statements and accounting records. The consolidated and combined financial statements reflect the financial position, results of operations and cash flows related to the animal health businesses that were transferred to Elanco Parent and are prepared in conformity with GAAP.

The combined financial statements include the attribution of certain assets and liabilities that historically have been held at the Lilly corporate level but which are specifically identifiable or attributable to the businesses that have been transferred to Elanco Parent. All intercompany transactions and accounts within Elanco have been eliminated. All transactions between us and Lilly are considered to be effectively settled in the combined financial statements at the time the intercompany transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the condensed consolidated and combined statement of equity as net parent company investment.

Prior to Separation, these combined financial statements include an allocation of expenses related to certain Lilly corporate functions, including executive oversight, treasury, legal, finance, human resources, tax, internal audit, financial reporting, information technology and investor relations, prior to IPO. These expenses have been allocated to us based on direct usage or benefit where specifically identifiable, with the remainder allocated primarily on a pro rata basis of revenue, headcount and other measures. We consider the expenses methodology and results to be reasonable for all periods presented. However, the allocations may not be indicative of the actual expense that would have been incurred had we operated as an independent, publicly traded company for the periods presented. It is impractical to estimate what the standalone costs of Elanco would have been in the historical periods. After the Separation, a Transitional Services Agreement (TSA) between Lilly and Elanco went into effect. Under the terms of the TSA, we will be able to use these Lilly services for a fixed term established on a service-by-service basis. We are paying Lilly mutually agreed upon fees for the Lilly services provided under the TSA. Our consolidated and combined financial statements reflect the charges for Lilly services after the IPO. See Note 15: Related Party Agreements and Transactions for additional details.

The income tax amounts in the combined financial statements have been calculated based on a separate return methodology and presented as if our operations were separate taxpayers in the respective jurisdictions. We file income tax returns in the United States (U.S.) federal jurisdiction and various state, local and non-U.S. jurisdictions. Prior to full separation, certain of these income tax returns were filed on a consolidated or combined basis with Eli Lilly and Company and/or its subsidiaries.

Prior to Separation, Lilly maintained various benefit and combined stock-based compensation plans at a corporate level and other benefit plans at a country level. Our employees participated in such programs and the portion of the cost of those plans related to our employees is included in our financial statements. However, the condensed balance sheets do not include any equity issued related to stock-based compensation plans or any net benefit plan obligations unless the benefit plan covers only our dedicated employees or where the legal obligation associated with the benefit plan transferred to Elanco. Upon Lilly's full divestiture of Elanco in March 2019, all Lilly share-based awards held by our employees were converted into awards that will be settled in Elanco shares.

Prior to Separation, the equity balance in the combined financial statements represents the excess of total assets over liabilities, including intercompany balances between Elanco and Lilly (net parent company investment) and accumulated other comprehensive income/(loss). Net parent company investment is primarily impacted by contributions from Lilly which are the result of treasury activities and net funding provided by or distributed to Lilly. See Note 15: Related Party Agreements and Transactions for further information.

Note 3. Impact of Separation

In connection with the Separation, we issued \$2.0 billion aggregate principal amount of senior notes in a private placement, and we also entered into a \$750.0 million senior unsecured revolving credit facility and \$500.0 million senior unsecured term credit facility. In connection with the Separation, we entered into various agreements with Lilly, including a master separation agreement, a tax matters agreement and the TSA.

We will also continue to have certain ongoing relationships with Lilly as described in Note 15: Related Party Agreements and Transactions.

Note 4. Implementation of New Financial Accounting Pronouncements

The following table provides a brief description of an accounting standard that was effective January 1, 2019 and was adopted on that date:

Standard	Description	Effect on the financial statements or other significant matters
Accounting Standards Update 2016-02, <i>Leases</i>	This standard was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities, including leases classified as operating leases under previous GAAP, on the balance sheet and requiring additional disclosures about leasing arrangements.	We adopted the standard on January 1, 2019 using the modified retrospective approach, applied at the beginning of the period of adoption, and we elected the package of transition practical expedients. Upon adoption of the standard, we recorded \$84.9 million of right-of-use assets and \$85.3 million of operating lease liabilities on our consolidated balance sheet. Adoption of this standard did not have a material impact on our consolidated statement of operations for the six months ended June 30, 2019. See Note 10: Leases for further information.

The following table provides a brief description of the accounting standards that have not yet been adopted and could have a material effect on the consolidated financial statements:

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
Accounting Standards Update 2016-13, <i>Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</i>	This standard modifies the impairment model by requiring entities to use a forward-looking approach based on expected losses to estimate credit losses on certain types of financial instruments, including trade receivables. This may result in the earlier recognition of allowances for losses.	This standard is effective January 1, 2020, with early adoption permitted. We intend to adopt this standard on that date.	We are currently evaluating the effect of this standard on our financial statements.
Accounting Standards Update 2018-15, <i>Intangibles - Goodwill and Other Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract</i>	This guidance aligns the requirements for capitalizing implementation costs incurred in a cloud-based hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software.	This standard is effective January 1, 2020, with early adoption permitted. We intend to adopt this standard on that date.	We are currently evaluating the effect of this standard on our financial statements.

Note 5. Revenue

Product Sales

We recognize revenue primarily from product sales to customers. Revenue from sales of products is recognized at the point where the customer obtains control of the goods and we satisfy our performance obligation, which generally is at the time we ship the product to the customer. Payment terms differ by jurisdiction and customer, but payment terms in most of our major jurisdictions typically range from 30 to 100 days from date of shipment. Revenue for our product sales has not been adjusted for the effects of a financing component as we expect, at contract inception, that the period between when we transfer control of the product and when we receive payment will be one year or less. Any exceptions are either not material or we collect interest for payments made after the due date. Provisions for rebates and discounts, and returns are established in the same period the related sales are recognized. We generally ship product shortly after orders are received; therefore, we generally only have a few days of orders received but not yet shipped at the end of any reporting period. Shipping and handling activities are considered to be fulfillment activities and are not considered to be a separate performance obligation. We exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are imposed on our sales of product and collected from a customer.

Significant judgments must be made in determining the transaction price for sales of products related to anticipated rebates and discounts, and returns. The following describe the most significant of these judgments:

Sales Rebates and Discounts - Background and Uncertainties

- Most of our products are sold to wholesale distributors. We initially invoice our customers contractual list prices. Contracts with direct and indirect customers may provide for various rebates and discounts that may differ in each contract. As a consequence, to determine the appropriate transaction price for our product sales at the time we recognize a sale to a direct customer, we must estimate any rebates or discounts that ultimately will be due to the direct customer and other customers in the distribution chain under the terms of our contracts. Judgments are required in making these estimates.
- The rebate and discount amounts are recorded as a deduction to arrive at our net product sales. We estimate these accruals using an expected value approach.
- In determining the appropriate accrual amount, we consider our historical experience with similar incentives programs and current sales data to estimate the impact of such programs on revenue and continually monitor the impact of this experience and adjust as necessary. Although we accrue a liability for rebates related to these programs at the time the sale is recorded, the rebate related to that sale is typically paid up to six months after the rebate or incentive period expires. Because of this time lag, in any particular period rebate adjustments may incorporate revisions of accruals for several periods.

Our sales rebates and discounts are based on specific agreements and the majority relate to sales in the U.S. As of June 30, 2019 and 2018, the liability for sales rebates and discounts in the U.S. represents approximately 75% and 70%, respectively, of our total liability with the next largest country representing approximately 5% and 6%, respectively, of our total liability.

The following table summarizes the activity in the sales rebates and discounts liability in the U.S.:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Beginning balance	\$ 120.0	\$ 91.1	\$ 118.5	\$ 114.8
Reduction of revenue	80.6	56.2	146.3	100.7
Payments	(68.5)	(48.2)	(132.7)	(116.4)
Ending balance	<u>\$ 132.1</u>	<u>\$ 99.1</u>	<u>\$ 132.1</u>	<u>\$ 99.1</u>

Adjustments to revenue recognized as a result of changes in estimates for the judgments described above during the three and six months ended June 30, 2019 and 2018 for product shipped in previous periods were not material.

Sales Returns - Background and Uncertainties

- We estimate a reserve for future product returns related to product sales using an expected value approach. This estimate is based on several factors, including: local returns policies and practices; returns as a percentage of revenue; an understanding of the reasons for past returns; estimated shelf life by product; and estimate of

the amount of time between shipment and return. Adjustments to the returns reserve have been and may in the future be required based on revised estimates to our assumptions, which would have an impact on our consolidated results of operations. We record the return amounts as a deduction to arrive at our net product sales.

Actual product returns were less than 0.1% and approximately 0.2% of net revenue for the three and six months ended June 30, 2019 and 0.6% and 0.4% for the three and six months ended June 30, 2018, respectively, and have not fluctuated significantly as a percentage of revenue.

Disaggregation of Revenue

The following table summarizes our revenue disaggregated by product category:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Companion Animal Disease Prevention	\$ 223.4	\$ 214.0	\$ 409.3	\$ 415.3
Companion Animal Therapeutics	83.4	68.3	164.8	130.6
Food Animal Future Protein & Health	175.8	172.6	343.0	339.3
Food Animal Ruminants & Swine	271.5	297.1	545.6	579.6
Strategic Exits ⁽¹⁾	27.5	18.2	50.0	41.6
Revenue	\$ 781.6	\$ 770.2	\$ 1,512.7	\$ 1,506.4

(1) Represents revenue from business activities we have either exited or made a strategic decision to exit.

Note 6. Asset Impairment, Restructuring and Other Special Charges

Our total charges related to asset impairment, restructuring and other special charges, including integration of acquired businesses, in the unaudited condensed consolidated and combined statements of operations consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Cash expense (income):				
Severance and other costs	\$ (1.3)	\$ (2.7)	\$ (0.8)	\$ (2.6)
Integration and acquisition costs	33.1	2.8	53.5	5.6
Facility exit costs	—	10.2	—	9.7
Total cash expense	31.8	10.3	52.7	12.7
Non-cash expense:				
Asset impairment	—	57.7	4.0	57.7
Total non-cash expense	—	57.7	4.0	57.7
Total expense	\$ 31.8	\$ 68.0	\$ 56.7	\$ 70.4

Restructuring

We historically participated in Lilly's cost-reduction initiatives, which resulted in restructuring charges in the period prior to our IPO. The restructuring costs include severance and other costs incurred as a result of actions taken to reduce our cost structure.

Integration and acquisition costs

Integration and acquisition costs primarily represent charges and costs related to our integration efforts as a result of our acquired businesses, external costs directly related to acquiring businesses, including expenses for banking, legal, accounting, and other similar services, and costs to stand our organization up to be an independent company.

Facility exit costs

Facility exit costs primarily represent contract termination costs and reserves for costs related to facilities which we have exited.

Asset impairment

Asset impairment recognized during the six months ended June 30, 2019 resulted from the adjustment to fair value of intangible assets that were subject to product rationalization.

The following table summarizes the activity in our reserves established in connection with these restructuring activities:

	Facility exit costs	Severance	Total
Balance at December 31, 2017	\$ 34.9	\$ 43.1	\$ 78.0
Charges	21.2	—	21.2
Reserve adjustments	(11.5)	(2.6)	(14.1)
Cash paid	(9.9)	(28.4)	(38.3)
Balance at June 30, 2018	<u>\$ 34.7</u>	<u>\$ 12.1</u>	<u>\$ 46.8</u>
Balance at December 31, 2018	\$ 9.3	\$ 35.1	\$ 44.4
Charges	—	2.5	2.5
Reserve adjustments	—	(3.3)	(3.3)
Cash paid	(1.7)	(13.8)	(15.5)
Balance at June 30, 2019	<u>\$ 7.6</u>	<u>\$ 20.5</u>	<u>\$ 28.1</u>

Substantially all of the reserves are expected to be utilized in the next twelve months. We believe that the reserves are adequate.

Note 7. Inventories

We state all inventories at the lower of cost or net realizable value. We use the last-in, first-out (LIFO) method for a portion of our inventories located in the continental U.S. Other inventories are valued by the first-in, first-out (FIFO) method. FIFO cost approximates current replacement cost.

Inventories consisted of the following:

	June 30, 2019	December 31, 2018
Finished products	\$ 412.4	\$ 400.7
Work in process	610.2	570.4
Raw materials and supplies	72.7	80.4
Total (approximates replacement cost)	1,095.3	1,051.5
Decrease to LIFO cost	(42.2)	(47.4)
Inventories	<u>\$ 1,053.1</u>	<u>\$ 1,004.1</u>

Note 8. Debt

Long-term debt consisted of the following:

	June 30, 2019	December 31, 2018
Term credit facility	\$ 427.5	\$ 492.5
3.912% Senior Notes due 2021	500.0	500.0
4.272% Senior Notes due 2023	750.0	750.0
4.900% Senior Notes due 2028	750.0	750.0
Other obligations	0.3	0.5
Unamortized debt issuance costs	(18.7)	(20.7)
Total debt	2,409.1	2,472.3
Less current portion of long-term debt	27.1	29.0
Total long-term debt	\$ 2,382.0	\$ 2,443.3

On June 26, 2019, we completed an exchange offer pursuant to which privately issued Senior Notes were exchanged for publicly registered Senior Notes having substantially identical terms.

Note 9. Financial Instruments and Fair Value

Financial instruments that are potentially subject to credit risk consist principally of trade receivables. Collateral is generally not required. The risk associated with this concentration is mitigated by our ongoing credit-review procedures and insurance.

A large portion of our cash is held in a few major financial institutions. We monitor the exposure with these institutions and do not expect any of these institutions to fail to meet their obligations. All highly liquid investments with a maturity of three months or less from the date of purchase are considered to be cash equivalents. The cost of these investments approximates fair value. We also consider the carrying value of restricted cash balances to be representative of its fair value.

As of June 30, 2019 and December 31, 2018, we had \$16.3 million and \$15.3 million, respectively, of equity method investments included in other noncurrent assets in our condensed consolidated balance sheet.

The following table summarizes the fair value information at June 30, 2019 and December 31, 2018 for contingent consideration liabilities, the net investment hedge liability and long-term debt measured at fair value on a recurring basis in the respective balance sheet line items:

Financial statement line item	Carrying Amount	Fair Value Measurements Using			Fair Value
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
June 30, 2019					
Other current liabilities - contingent consideration	\$ (9.1)	\$ —	\$ —	\$ (9.1)	\$ (9.1)
Other noncurrent liabilities - contingent consideration	(68.1)	—	—	(68.1)	(68.1)
Other noncurrent assets/(liabilities) - cross currency interest rate contracts designated as net investment hedges	(0.5)	—	(0.5)	—	(0.5)
Long-term debt - senior notes	(2,000.0)	—	(2,137.0)	—	(2,137.0)
December 31, 2018					
Other current liabilities - contingent consideration	\$ (5.1)	\$ —	\$ —	\$ (5.1)	\$ (5.1)
Other noncurrent liabilities - contingent consideration	(69.0)	—	—	(69.0)	(69.0)
Other noncurrent assets/(liabilities) - cross currency interest rate contracts designated as net investment hedges	(7.4)	—	(7.4)	—	(7.4)
Long-term debt - senior notes	(2,000.0)	—	(2,005.0)	—	(2,005.0)

We determine our Level 2 fair value measurements based on a market approach using quoted market values, significant other observable inputs for identical or comparable assets or liabilities, or discounted cash flow analysis.

Contingent consideration liabilities relate to Galliprant[®] for which the fair value was estimated using a discounted cash flow analysis and Level 3 inputs, including projections representative of a market participant view for the probability of achieving potential future payments to Aratana Therapeutics, Inc. and an estimated discount rate. The amount to be paid as of June 30, 2019 was dependent upon certain development, success-based regulatory, and sales-based milestones. In addition, the amount of royalties to be paid is calculated as a percentage of net sales dependent upon the timing and geography and will, therefore, vary directly with increases and decreases in net sales of Galliprant[®]. There is no cap on the amount that may be paid pursuant to this arrangement. These liabilities were settled upon the closing of our acquisition of Aratana Therapeutics, Inc. on July 18, 2019. See Note 16: Subsequent Events for further discussion.

The Senior Notes are comprised of \$500.0 million of 3.912% Senior Notes due August 27, 2021, \$750.0 million of 4.272% Senior Notes due August 28, 2023, and \$750.0 million of 4.900% Senior Notes due August 28, 2028.

We have a term credit facility of \$427.5 million and \$492.5 million, respectively, recorded at amortized cost in our condensed consolidated balance sheets as of June 30, 2019 and December 31, 2018. We consider the carrying value of the term credit facility to be representative of its fair value as of June 30, 2019 and December 31, 2018. The fair value of this term credit facility is estimated based on quoted market prices of similar liabilities and is classified as Level 2.

In October 2018, we entered into a cross-currency fixed interest rate swap, 5-year, 750 million Swiss franc (CHF), which is designated as a net investment hedge (NIH) against CHF denominated assets for which the fair value was estimated based on quoted market values of similar hedges and is classified as Level 2. The NIH is expected to generate approximately \$25 million in cash and an offset to interest expense on an annual basis. During the three and

six months ended June 30, 2019, our interest expense was offset by \$6.1 million and \$12.2 million, respectively, as a result of the NIH. Over the life of the derivative, gains or losses due to spot rate fluctuations are recorded in cumulative translation adjustment. During the three months ended June 30, 2019, we recorded a \$6.8 million loss, net of tax, on the NIH, which is included in the change in the cumulative translation adjustment in other comprehensive income. There is a potential for significant 2023 settlement exposure as the U.S. dollar fluctuates against the Swiss franc. The risk management objective is to manage foreign currency risk relating to net investments in certain CHF denominated assets. Changes in fair value of the derivative instruments are recognized in a component of Accumulated Other Comprehensive Loss to offset the changes in the values of the net investments being hedged.

Note 10. Leases

We determine if an arrangement is a lease at inception. We have operating leases for corporate offices, research and development facilities, vehicles, and equipment. Our leases have remaining lease terms of one to 10 years, some of which have options to extend or terminate the leases. Finance leases are included in property and equipment, current portion of long-term debt, and long-term debt in our condensed consolidated balance sheets. Finance leases are not material to our condensed consolidated statements of operations, condensed consolidated balance sheets, or condensed consolidated statements of cash flows. Beginning January 1, 2019, operating leases are included in noncurrent assets, other current liabilities, and other noncurrent liabilities in our consolidated balance sheets.

Right-of-use assets included in noncurrent assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and operating lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate if it is readily determinable. The right-of-use asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain and there is a significant economic incentive to exercise that option.

Operating lease expense for right-of-use assets is recognized on a straight-line basis over the lease term. Variable lease payments, which represent lease payments that vary due to changes in facts or circumstances occurring after the commencement date other than the passage of time, are expensed in the period in which the obligation for these payments was incurred.

We elected not to apply the recognition requirements of ASC 842, *Leases*, to short-term leases, which are deemed to be leases with a lease term of 12 months or less. Instead, we recognized lease payments in the condensed consolidated statements of operations on a straight-line basis over the lease term and variable payments in the period in which the obligation for these payments was incurred. We elected this policy for all classes of underlying assets. We elected not to apply the practical expedient related to the separation of lease and non-lease components or the practical expedient which allows entities to use hindsight when determining lease term.

The impact of operating leases to our condensed consolidated financial statements was as follows:

	Three months ended June 30, 2019	Six months ended June 30, 2019
Lease cost		
Operating lease cost	\$ 6.6	\$ 12.3
Short-term lease cost	0.2	0.4
Variable lease cost	0.6	1.1
Total lease cost	\$ 7.4	\$ 13.8
Other information		
Operating cash outflows from operating leases		\$ 11.8
Right-of-use assets obtained in exchange for new operating lease liabilities		—
Weighted-average remaining lease term - operating leases		5 years
Weighted-average discount rate - operating leases		4.2%

Supplemental balance sheet information related to our operating leases is as follows:

	Balance Sheet Classification	June 30, 2019
Right-of-use assets	Other noncurrent assets	\$ 81.3
Current operating lease liabilities	Other current liabilities	23.3
Non-current operating lease liabilities	Other noncurrent liabilities	58.3

As of June 30, 2019, the annual minimum lease payments of our operating lease liabilities were as follows:

Year 1	\$ 24.8
Year 2	19.6
Year 3	11.9
Year 4	9.2
Year 5	7.4
After Year 5	15.1
Total lease payments	88.0
Less imputed interest	(6.4)
Total	\$ 81.6

Note 11. Income Taxes

Provision for Taxes on Income	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Provision for Taxes on Income	\$ 14.3	\$ 22.8	\$ 27.6	\$ 27.6
Effective Tax Rate	28.5%	(57.0)%	29.0%	73.6%

During the periods presented in the condensed consolidated and combined financial statements for the three and six months ended June 30, 2018, our operations were generally included in the tax grouping of other Lilly entities within the respective entity's tax jurisdiction; however, in certain jurisdictions, we filed separate tax returns. Our income taxes for the three- and six-month periods ended June 30, 2019 reflect the results on a stand-alone basis independent of

Lilly, except for the period during which we were included in a combined tax return until full separation. In the jurisdictions in which we were included in a combined tax return, our income taxes were determined based on the tax matters agreement between us and Lilly. Prior to the Separation, the income tax expense included in these financial statements has been calculated using the separate return basis as if Elanco filed separate tax returns.

In 2017, the U.S. enacted the Tax Cuts and Jobs Act (2017 Tax Act), which significantly revised U.S. tax law. Guidance related to the 2017 Tax Act, including Notices, Proposed Regulations, and Final Regulations, has been issued, and we expect additional guidance will be issued in 2019. This additional guidance could materially impact our assumptions and estimates used to record our U.S. federal and state income tax expense resulting from the 2017 Tax Act.

We are included in Lilly's U.S. tax examinations by the Internal Revenue Service through the full separation date of March 11, 2019. Pursuant to the tax matters agreement we executed with Lilly in connection with the IPO, the potential liabilities or potential refunds attributable to pre-IPO periods in which Elanco was included in a Lilly consolidated or combined tax return remain with Lilly. Certain matters of Lilly's U.S. examination of tax years 2013 - 2015 effectively settled during the three months ended June 30, 2019 and the resulting adjustments will not require any cash tax payments by Elanco. These adjustments are recorded in Separation activities within shareholders' equity. See Note 15: Related Party Agreements and Transactions for further information. As a result of Lilly's U.S. examination, there was a reduction of state net operating loss carryovers of \$3.6 million gross, or \$2.9 million, net of federal benefit. Additionally, associated valuation allowances were reduced by the same amount. The examination of tax year 2015 remains ongoing, and we believe it is reasonably possible that this examination could reach conclusion within the next twelve months.

For the three and six months ended June 30, 2019, we incurred \$14.3 million and \$27.6 million, respectively, of income tax expense. For the three and six months ended June 30, 2019, our effective tax rate of 28.5% and 29.0%, respectively, differs from the statutory income tax rate primarily due to a one-time foreign exchange gain on the transfer of assets upon separation in addition to the impact of state income taxes.

For the three and six months ended June 30, 2018, we incurred \$22.8 million and \$27.6 million, respectively, of income tax expense. For the three and six months ended June 30, 2018, our effective tax rate differs from the statutory income tax rate primarily due to no benefits being recorded for losses incurred in the U.S. for asset impairments and contractual commitment charges associated with the suspension of commercial activities of Imrestor[®] due to full valuation allowances recorded in the U.S.

Note 12. Contingencies

We are party to various legal actions in the normal course of business. In determining whether a pending matter is significant for financial reporting and disclosure purposes, we consider both quantitative and qualitative factors in order to assess materiality. We record a liability for claims to the extent that we can formulate a reasonable estimate of their costs and there is a reasonable probability of incurring significant costs or expenses. At June 30, 2019 and December 31, 2018, we had no liabilities established related to litigation as there were no significant claims which were probable and estimable. We have not historically had any significant litigation expense and are not currently subject to a significant claim.

Note 13. Geographic Information

We operate as a single operating segment engaged in the development, manufacturing, marketing and sales of animal health products worldwide for both food animals and companion animals. Consistent with our operational structure, our President and Chief Executive Officer (CEO), as the chief operating decision maker, makes resource allocation and business process decisions globally across our consolidated business. Strategic decisions are managed globally with global functional leaders responsible for determining significant cost/investments and with regional leaders responsible for overseeing the execution of the global strategy. Our global research and development organization is responsible for development of new products. Our manufacturing organization is responsible for the manufacturing and supply of products and for the optimization of our supply chain. Regional leaders are responsible for the distribution and sale of our products and for local direct costs. The business is also supported by global corporate staff functions. Managing and allocating resources at the global corporate level enables our CEO to assess the overall level of resources available and how to best deploy these resources across functions, product types, regional commercial organizations and research and development projects in line with our overarching long-term corporate-wide strategic goals, rather than on a product or geographic basis. Consistent with this decision-making process, our CEO uses consolidated, single-segment financial information for purposes of evaluating performance, allocating resources, setting incentive compensation targets, as well as forecasting future period financial results.

Our products include Rumensin[®], Optaflexx[®], Denagard[®], Tylan[®], Maxiban[®] and other products for livestock and poultry, as well as Trifexis[®], Interceptor[®], Comfortis[®], Galliprant[®] and other products for companion animals.

We have a single customer that accounted for 12.5% of revenue for each of the three months ended June 30, 2019 and 2018, respectively, and for 12.2% and 11.7% of revenue for the six months ended June 30, 2019 and 2018, respectively. The product sales resulted in accounts receivable with this customer of \$98.1 million and \$96.4 million as of June 30, 2019 and December 31, 2018, respectively.

We are exposed to the risk of changes in social, political and economic conditions inherent in foreign operations and our results of operations and the value of our foreign assets are affected by fluctuations in foreign currency exchange rates.

Selected geographic area information was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenue—to unaffiliated customers ⁽¹⁾				
United States	\$ 395.0	\$ 366.4	\$ 778.9	\$ 726.4
International	386.6	403.8	733.8	780.0
Revenue	<u>\$ 781.6</u>	<u>\$ 770.2</u>	<u>\$ 1,512.7</u>	<u>\$ 1,506.4</u>

	June 30, 2019	December 31, 2018
Long-lived assets ⁽²⁾		
United States	\$ 637.0	\$ 602.6
United Kingdom	185.0	187.5
Other foreign countries	200.4	195.8
Long-lived assets	<u>\$ 1,022.4</u>	<u>\$ 985.9</u>

⁽¹⁾ Revenue is attributed to the countries based on the location of the customer.

⁽²⁾ Long-lived assets consist of property and equipment, net, and certain noncurrent assets.

Note 14. Earnings Per Share

As discussed in Note 1, Elanco Parent was formed for the purpose of facilitating the IPO. Lilly held all shares of Elanco Parent from the time of formation until the IPO.

Prior to IPO, there were an aggregate of 293,290,000 shares of our common stock held by Lilly (which represents the 100 shares held by Lilly prior to giving effect to the 2,932,900 -for-1 stock split that occurred on September 19, 2018). In connection with the completion of the IPO, an additional 72,335,000 shares were issued. Earnings per share was calculated based on the assumption that the shares held by Lilly were outstanding for all periods prior to IPO.

We compute basic earnings per share by dividing net earnings available to common shareholders by the actual weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if holders of unvested restricted stock units and stock options converted their holdings into common stock.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and as such, these shares are not included in the calculation of diluted earnings per share. For the three and six months ended June 30, 2019, approximately 0.1 million and 0.1 million shares, respectively, of potential common shares were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive.

Note 15. Related Party Agreements and Transactions

Transactions with Lilly Subsequent to Separation and Related to the Separation

Amounts due from/(due to) Lilly in connection with the Separation and agreed upon services were as follows:

	June 30, 2019	December 31, 2018
TSA	\$ (18.6)	\$ (28.0)
Other activities	(28.7)	(38.0)
Local country asset purchases	(11.5)	(202.7)
Total receivable from/(payable to) Lilly	\$ (58.8)	\$ (268.7)

As described in Note 1, we completed an IPO in September 2018 and Lilly fully divested of all ownership of Elanco in March 2019. In connection with the Separation, we entered into various agreements with Lilly related to the form of our separation and certain ongoing activities that will continue for a period of time. These included, among others, a master separation agreement (MSA), a TSA and a tax matters agreement. In addition, there was a portion of our operations for which the legal transfer of our net assets did not occur prior to the Separation due to certain regulatory requirements in each of these countries.

Transitional Services Agreement (TSA)

Historically, Lilly has provided us significant shared services and resources related to corporate functions such as executive oversight, treasury, legal, finance, human resources, tax, internal audit, financial reporting, information technology and investor relations, which we refer to collectively as the "Lilly Services." Under the terms of the TSA, we will be able to use Lilly Services for a fixed term established on a service-by-service basis. We will pay Lilly mutually agreed-upon fees for the Lilly Services provided under the TSA, which will be based on Lilly's cost (including third-party costs) of providing the Lilly Services through March 31, 2021, and subject to a mark-up of 7% thereafter, with additional inflation-based escalation beginning January 1, 2022. The fees under the TSA became payable for all periods beginning after October 1, 2018.

Separation Activities

Subsequent to our IPO, there continue to be transactions between us and Lilly related primarily to the completion of the local country asset purchases and finalization of assets and liabilities associated with the legal separation from Lilly, combined income tax returns and the impact of the tax matters agreement, historical Lilly retirement benefits, and centralized cash management. The net impact of these activities of \$18.4 million and \$25.4 million for the three and six months ended June 30, 2019 has been reflected as Separation Activities within shareholders' equity. The most significant of these activities includes the finalization of the local country valuation of business and the resulting impact on deferred tax assets and the impact of combined tax returns.

Other Activities

We continue to share certain services and back office functions with Lilly, which in certain instances result in Lilly paying costs for Elanco (e.g., utilities, local country operating costs, etc.) that are then passed through to Elanco for reimbursement. These amounts are included in cash flows from operating activities in our condensed consolidated and combined statements of cash flows. In addition, we operate through a single treasury settlement process and prior to the local country asset purchases (as described below) continued to transact through Lilly's processes in certain instances. As a result of these activities, there were certain amounts of financing that occurred between Lilly and Elanco during the six month periods ended June 30, 2019. These amounts are included in cash flows from financing activities in our condensed consolidated and combined statements of cash flows.

Local Country Asset Purchases

The legal transfer of certain of our net assets did not occur prior to the Separation due to certain regulatory requirements in each of these countries. The related assets, liabilities, and results of operations have been reported in our condensed consolidated and combined financial statements, as we are responsible for the business activities conducted by Lilly on our behalf and are subject to the risks and entitled to the benefits generated by these operations and assets under the terms of the MSA. We held restricted cash, and the associated payable to Lilly, at the date of Separation to fund the acquisition of these assets. As of June 30, 2019, the majority of these assets have been legally acquired and the remainder are expected to be purchased during 2019. Restricted cash and Payable to Lilly of \$ 11.5 million are recorded in the condensed consolidated balance sheet for the remainder of the assets expected to be

purchased by the end of 2019.

Transactions with Lilly Prior to Separation

Prior to the IPO, we did not operate as a standalone business and had various relationships with Lilly whereby Lilly provided services to us. The impact on our historical combined financial statements includes the following:

Transfers to/from Lilly, net

As discussed in Note 2: Basis of Presentation, net parent company investment is primarily impacted by contributions from Lilly which are the result of treasury activity and net funding provided by or distributed to Lilly. For the three and six months ended June 30, 2018, net transfers to Lilly were \$40.3 million and \$109.5 million, respectively. Activities that impacted the net transfers (to)/from Lilly include corporate overhead and other allocations, income taxes, retirement benefits, and centralized cash management.

Corporate overhead and other allocations

Prior to full separation, Lilly provided us certain services, including executive oversight, treasury, legal, finance, human resources, tax, internal audit, financial reporting, information technology and investor relations. We provide Lilly certain services related to manufacturing support. Our financial statements reflected an allocation of these costs. When specific identification is not practicable, the remainder have been allocated primarily on a proportional cost method on a basis of revenue or headcount.

The allocations of services from Lilly to us were reflected as follows in the condensed consolidated and combined statements of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Cost of sales	\$ —	\$ 7.3	\$ —	\$ 14.8
Research and development	—	0.7	—	1.5
Marketing, selling and administrative	—	27.5	—	54.8
Total	\$ —	\$ 35.5	\$ —	\$ 71.1

We provide Lilly certain services related to manufacturing support. Allocations of manufacturing support from us to Lilly were \$1.2 million and \$2.4 million for the for the three and six months ended June 30, 2018, respectively which reduced cost of sales in the unaudited condensed consolidated and combined statements of operations.

The financial information herein may not necessarily reflect our consolidated financial position, results of operations and cash flows in the future or what they would have been if we had been a separate, standalone entity during the periods presented. Management believes that the methods used to allocate expenses are reasonable.

Stock-based Compensation

Prior to full separation, our employees participated in Lilly stock-based compensation plans, the costs of which were allocated to us and recorded in cost of sales, research and development, and marketing, selling and administrative expenses in the unaudited condensed consolidated and combined statements of operations. The costs of such plans related to our employees were \$5.1 million for the six months ended June 30, 2019. The costs of such plans related to our employees were \$6.4 million and \$13.3 million for the three and six months ended June 30, 2018, respectively.

Retirement Benefits

Prior to full separation, our employees participated in defined benefit pension and other post retirement plans sponsored by Lilly, the costs and benefits of which were recorded in the unaudited condensed consolidated and combined statement of operations in cost of sales, research and development, and marketing, selling and administrative expenses. For the three and six months ended June 30, 2018, the benefit of such plans related to our employees was \$ 0.7 million and \$1.3 million, respectively.

Centralized Cash Management

Lilly uses a centralized approach to cash management and financing of operations. Until Separation, the majority of our business was party to Lilly's cash pooling arrangements to maximize Lilly's availability of cash for general

operating and investing purposes. Under these cash pooling arrangements, cash balances were swept regularly from our accounts. Cash transfers to and from Lilly's cash concentration accounts and the resulting balances at the end of each reporting period were reflected in net parent company investment in the condensed consolidated and combined statements of equity.

Debt

Lilly's third-party debt and the related interest expense were not allocated to us for any of the periods presented as we were not the legal obligor of the debt and Lilly borrowings were not directly attributable to our business.

Note 16. Subsequent Events

Aratana Acquisition

On April 26, 2019, we entered into an agreement (the Merger Agreement) to acquire Aratana Therapeutics, Inc. (Aratana). Aratana is a pet therapeutics company focused on innovative therapies for dogs and cats, and creator of the canine osteoarthritis medicine, Galliprant[®], the rights to which we acquired in 2016. Subject to the terms and conditions set forth in the Merger Agreement, upon the consummation of the merger, each share of Aratana common stock was converted into the right to receive 0.1481 shares of Elanco's common stock plus one contingent value right, which represents the right to receive a contingent payment of \$0.25 per share in cash upon the achievement of a specified milestone as outlined in the Merger Agreement. In connection with the transaction, we registered approximately 7.8 million shares of our stock during the three months ended June 30, 2019 for issuance to Aratana shareholders. Approximately 7.3 million shares were issued to previous Aratana shareholders upon closing, and the stock portion of the merger consideration represented \$241.6 million. The maximum aggregate contingent payment is approximately \$12 million. The transaction closed on July 18, 2019 and, as such, the accounting for this acquisition was incomplete at the time the condensed consolidated financial statements were issued.

Prevtec Acquisition

On July 31, 2019, we, through our wholly-owned subsidiary Elanco Canada Limited, acquired Prevtec Microbia, Inc. ("Prevtec"), pursuant to the terms of a share purchase agreement (the Share Purchase Agreement). Prevtec is a Canadian biotechnology company specializing in the development of vaccines intended to help prevent bacterial diseases in food animals. Prevtec is the maker of Coliprotec, a vaccine designed to protect pigs against post-weaning diarrhea and the effects of E. coli, which we were previously distributing in Europe and Canada.

Pursuant to the terms and conditions of the Share Purchase Agreement, the total consideration to be paid is approximately CAD \$78.5 million. We paid approximately CAD \$40.0 million at closing, with the remainder to be paid on September 30, 2019, subject to certain post-closing adjustments. In addition to this consideration, the sellers may receive up to CAD \$21.5 million in additional cash consideration, if specific sales milestones are achieved by December 31, 2021. Due to the timing, the accounting for this acquisition was incomplete at the time the condensed consolidated financial statements were issued.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations (Tables present dollars in millions, except per-share data)

The management's discussion and analysis of financial condition and results of operations is intended to assist the reader in understanding and assessing significant changes and trends related to our results of operations and financial position. This discussion and analysis should be read in conjunction with the unaudited condensed consolidated and combined financial statements and accompanying footnotes in Item 1 of Part I of this Quarterly Report on Form 10-Q. Certain statements in this Item 2 of Part I of this Quarterly Report on Form 10-Q constitute forward-looking statements. Various risks and uncertainties, including those discussed in "Forward-Looking Statements" and Item 1A, "Risk Factors," of Part I of our Annual Report on Form 10-K for the year ended December 31, 2018, may cause our actual results, financial position, and cash generated from operations to differ materially from these forward-looking statements.

Overview

Founded in 1954 as part of Eli Lilly and Company, Elanco is a premier animal health company that innovates, develops, manufactures and markets products for companion and food animals. Headquartered in Greenfield, Indiana, we are the fourth largest animal health company in the world, with revenue of \$3,066.8 million for the year ended December 31, 2018. Globally, we are #1 in medicinal feed additives, #2 in poultry and #3 in cattle, measured by 2017 revenue, according to Vetnosis.

We have one of the broadest portfolios of pet parasiticides in the companion animal sector. We offer a diverse portfolio of more than 125 brands that make us a trusted partner to veterinarians and food animal producers in more than 90 countries.

On September 24, 2018, we completed our initial public offering (IPO), pursuant to which we issued and sold 19.8% of our total outstanding shares. On September 20, 2018, our common stock began trading on the New York Stock Exchange (NYSE) under the symbol "ELAN." On September 24, 2018, immediately preceding the completion of the IPO, Lilly transferred to us substantially all of its animal health businesses in exchange for (i) all of the net proceeds (approximately \$1,659.7 million) we received from the sale of our common stock in the IPO, including the net proceeds we received as a result of the exercise in full of the underwriters' option to purchase additional shares, (ii) all of the net proceeds (approximately \$2,000 million) we received from the issuance of our senior notes and (iii) all of the net proceeds (\$498.6 million) we received from the entry into our term loan facility. In addition, immediately prior to the completion of the IPO, we entered into certain agreements with Lilly that provide a framework for our ongoing relationship with them.

On February 8, 2019, Lilly announced an exchange offer whereby Lilly shareholders could exchange all or a portion of Lilly common stock for shares of Elanco common stock owned by Lilly. On that date, we filed a Registration Statement on Form S-4 with the SEC in connection with that exchange offer. The disposition of Elanco shares was completed on March 11, 2019 and resulted in the full separation of Elanco and disposal of Lilly's entire ownership and voting interest in Elanco.

We operate our business in a single segment directed at fulfilling our vision of enriching the lives of people through food, making protein more accessible and affordable and through pet companionship, helping pets live longer, healthier lives. We advance our vision by offering products in four primary categories:

Companion Animal Disease Prevention (CA Disease Prevention) : We have one of the broadest parasiticide portfolios in the companion animal sector based on indications, species and formulations, with products that protect pets from worms, fleas and ticks. Combining our parasiticide portfolio with our vaccines presence, we are a leader in the United States (U.S.) in the disease prevention category based on share of revenue.

Companion Animal Therapeutics (CA Therapeutics) : We have a broad pain and osteoarthritis portfolio across species, modes of action, indications and disease stages. Pet owners are increasingly treating osteoarthritis in their pets, and our Galliprant[®] product is one of the fastest growing osteoarthritis treatments in the U.S. We also have treatments for otitis (ear infections), as well as cardiovascular and dermatology indications.

Food Animal Future Protein & Health (FA Future Protein & Health) : Our portfolio in this category, which includes vaccines, nutritional enzymes and animal only antibiotics, serves the growing demand for protein and includes innovative products in poultry and aquaculture production, where demand for animal health products is outpacing overall industry growth. We are focused on

developing functional nutritional health products that promote food animal health, including enzymes, probiotics and prebiotics. We are a leader in providing vaccines as alternatives to antibiotics to promote animal health based on share of revenue.

Food Animal Ruminants & Swine (FA Ruminants & Swine) : We have developed a range of food animal products used extensively in ruminant (e.g., cattle, sheep and goats) and swine production.

For the three months ended June 30, 2019 and 2018 , our revenue was \$781.6 million and \$770.2 million , respectively. For the three months ended June 30, 2019 and 2018 , our net income (loss) was \$35.9 million and \$(62.8) million , respectively.

For the six months ended June 30, 2019 and 2018 our revenue was \$1,512.7 million and \$ 1,506.4 million , respectively. For the six months ended June 30, 2019 and 2018 our net income was \$67.4 million and \$9.9 million , respectively.

Key Trends and Conditions Affecting Our Results of Operations

Industry Trends

The animal health industry, which focuses on both food animals and companion animals, is a growing industry that benefits billions of people worldwide.

As demand for animal protein grows, food animal health is becoming increasingly important. Factors influencing growth in demand for food animal medicines and vaccines include:

- one in three people need improved nutrition;
- increased global demand for protein, particularly poultry and aquaculture;
- natural resource constraints, such as scarcity of arable land, fresh water and increased competition for cultivated land, driving the need for more efficient food production;
- loss of productivity due to food animal disease and death;
- increased focus on food safety and food security; and
- human population growth, increased standards of living, particularly in many emerging markets, and increased urbanization.

Growth in food animal nutritional health products (enzymes, probiotics and prebiotics) is influenced, among other factors, by demand for antibiotic alternatives that can promote animal health and increase productivity.

Factors influencing growth in demand for companion animal medicines and vaccines include:

- increased pet ownership globally;
- pets living longer; and
- increased pet spending as pets are viewed as members of the family by owners

Factors Affecting Our Results of Operations

Product Development and New Product Launches

A key element of our targeted value creation strategy is to drive growth through portfolio development and product innovation, primarily in our three targeted growth categories of CA Disease Prevention, CA Therapeutics and FA Future Protein & Health. Since 2015, we've launched 11 new products, five of which were launched in 2017 and 2018. Revenue from these product launches contributed \$206.3 million to revenue for the six months ended June 30, 2019 . We continue to pursue the development of new chemical and biological molecules through our approach to innovation. Our future growth and success depends on both our pipeline of new products, including new products that we may develop through joint ventures and products that we are able to obtain through license or acquisition, and the expansion of the use of our existing products. We believe we are an industry leader in animal health research and development (R&D), with a track record of product innovation, business development and commercialization.

Productivity

Our results have benefited from our continued operational and productivity initiatives implemented following recent acquisitions and in response to changing market demand for antibiotics and other headwinds, such as competition with generics and innovation. We implemented a number of initiatives across manufacturing, R&D and marketing, selling and administrative, such as rationalization of stock keeping units, reduction of contract manufacturing organizations, implementation of lean manufacturing principles and procurement initiatives.



Foreign Exchange Rates

Significant portions of our revenue and costs are exposed to changes in foreign exchange rates. Our products are sold in more than 90 countries and, as a result, our revenue is influenced by changes in foreign exchange rates. During the six months ended June 30, 2019 and 2018, approximately 42% and 47%, respectively, of our revenue was denominated in foreign currencies. As we operate in multiple foreign currencies, including the Euro, British pound, Swiss franc, Brazilian real, Australian dollar, Japanese yen, Canadian dollar, Chinese yuan, and other currencies, changes in those currencies relative to the U.S. dollar impact our revenue, cost of goods and expenses, and consequently, net income. These fluctuations may also affect the ability to buy and sell our products between markets impacted by significant exchange rate variances. There has been limited impact on our revenue due to currency movements during the six months ended June 30, 2019 and 2018.

Our Relationship with Lilly and Additional Standalone Costs

During the period prior to the IPO, our business operated solely as part of a division of Lilly. Our combined financial statements have been derived from Lilly's consolidated financial statements and accounting records. Our combined financial statements reflect the financial position, results of operations and cash flows of the business that was transferred at the time of the Separation and do not purport to reflect what the results of operations, comprehensive income/(loss), financial position, equity or cash flows would have been had we operated as an independent, publicly traded company during the periods presented prior to the IPO.

Our historical results reflect an allocation of costs for certain Lilly corporate costs for periods prior to the IPO, including, among others, executive oversight, treasury, legal, finance, human resources, tax, internal audit, financial reporting, information technology and investor relations. These allocations are not necessarily indicative of the expenses we may incur as a standalone public company. Although we entered into certain agreements with Lilly in connection with the IPO and the Separation, the amount and composition of our expenses may vary from historical levels since the fees charged for the services under these agreements may be higher or lower than the costs reflected in the historical allocations. The total allocations included in our results for the three months ended June 30, 2019 and June 30, 2018 were \$0.0 million and \$35.5 million, respectively. The total allocations included in our results for the six months ended June 30, 2019 and June 30, 2018 were \$0.0 million and \$71.1 million, respectively. See Note 15: Related Party Agreements and Transactions in our unaudited condensed consolidated and combined financial statements.

We are currently investing in expanding our own administrative functions, including, but not limited to, information technology, facilities management, distribution, human resources and manufacturing, to replace services previously provided by Lilly. Because of initial stand up costs and overlaps with services previously provided by Lilly, we have incurred and expect to continue to incur certain temporary, duplicative expenses in connection with the Separation. We have also incurred and expect to continue to incur costs related to the build out of processes and systems to support finance and global supply and logistics, among others. We currently estimate these costs taken together to be in a range from \$240 million to \$290 million, net of potential real estate dispositions, of which a portion will be capitalized and the remainder will be expensed.

Lilly utilizes a centralized treasury management system, of which we were a part until our IPO. For periods prior to the IPO, our condensed consolidated and combined financial statements reflect cash held only in bank accounts in our legal name and no allocation of combined cash positions. Our unaudited condensed consolidated and combined financial statements do not reflect an allocation of Lilly's debt or any associated interest expense. In connection with the IPO, we incurred \$2.5 billion of long-term borrowings. Our historical results reflect \$29.6 million of interest expense during the year ended December 31, 2018 due to the timing of the borrowings, in comparison to \$20.7 million and \$41.5 million for the three and six months ended June 30, 2019, respectively. We have estimated interest expense of approximately \$85 million on an annual basis based on our borrowings as of June 30, 2019.

For the periods prior to the IPO, our condensed consolidated and combined financial statements reflect income tax expense (benefit) computed on a separate company basis, as if operating as a standalone entity or a separate consolidated group in each material jurisdiction in which we operate. Our condensed consolidated and combined financial statements for the periods prior to the IPO also reflect certain deferred tax assets and liabilities and income taxes payable based on this approach that did not transfer to us upon the separation, as the underlying tax attributes were used by Lilly or retained by Lilly. As a result of potential changes to our business model and the fact that certain deferred tax assets and liabilities and income taxes payable did not transfer to us, income tax expense (benefit) included in the condensed consolidated and combined financial statements may not be indicative of our future expected tax rate.

Our historical results prior to IPO also do not reflect the impact of costs we have incurred and expect to continue to incur as a consequence of becoming a standalone company, including incremental costs associated with being a publicly traded company.

We are seeking to institute competitive compensation policies and programs as a standalone public company, the expense for which may differ from the compensation expense allocated by Lilly in our condensed consolidated and combined financial statements.

As a result of the IPO, we became subject to the reporting requirements of the Securities Exchange Act of 1934 and the Sarbanes-Oxley Act. We have additional procedures and practices to establish or expand as a standalone public company. As a result, we will continue to incur additional costs as a standalone public company, including internal audit, external audit, investor relations, stock administration, stock exchange fees and regulatory compliance costs.

Asset Impairment, Restructuring and Other Special Charges

Our results have been impacted by asset impairment, restructuring and other special charges, including integration of acquired businesses, during the six months ended June 30, 2019 and 2018. These charges primarily include severance costs resulting from actions taken to reduce our cost structure, asset impairment charges related to product rationalization and site closures, and charges and costs related to our integration efforts as a result of our acquired businesses, external costs directly related to acquiring businesses, including expenses for banking, legal, accounting, and other similar services, and costs to stand our organization up to be an independent company.

For more information on these charges, see Note 6: Asset Impairment, Restructuring and Other Special Charges in our condensed consolidated and combined financial statements.

Results of Operations

The following discussion and analysis of our results of operations should be read along with our condensed consolidated and combined financial statements and the notes thereto.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Revenue	\$ 781.6	\$ 770.2	1 %	\$ 1,512.7	\$ 1,506.4	— %
Costs, expenses and other:						
Cost of sales	356.0	431.5	(17)%	699.8	791.5	(12)%
% of revenue	46%	56 %	(10)%	46%	53%	(7)%
Research and development	68.8	61.4	12 %	132.9	126.6	5 %
% of revenue	9%	8 %	1 %	9%	9%	— %
Marketing, selling and administrative	200.9	191.1	5 %	382.0	371.1	3 %
% of revenue	26%	25 %	1 %	25%	25%	— %
Amortization of intangible assets	49.3	49.4	— %	98.3	98.6	— %
% of revenue	6%	6 %	— %	6%	7%	— %
Asset impairment, restructuring and other special charges	31.8	68.0	(53)%	56.7	70.4	(19)%
Interest expense, net of capitalized interest	20.7	—	100 %	41.5	—	100 %
Other - net, expense	3.9	8.8	NM	6.5	10.7	NM
Income (loss) before taxes	50.2	(40.0)	NM	95.0	37.5	NM
% of revenue	6%	(5)%	11 %	6%	2%	4 %
Income tax expense	14.3	22.8	(37)%	27.6	27.6	— %
Net income (loss)	\$ 35.9	\$ (62.8)	NM	\$ 67.4	\$ 9.9	NM

Certain amounts and percentages may reflect rounding adjustments.

NM - Not meaningful

Revenue

On a global basis, our revenue within our product categories was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2019	2018	% Change	2019	2018	% Change
CA Disease Prevention	\$ 223.4	\$ 214.0	4 %	\$ 409.3	\$ 415.3	(1)%
CA Therapeutics	83.4	68.3	22 %	164.8	130.6	26 %
FA Future Protein & Health	175.8	172.6	2 %	343.0	339.3	1 %
FA Ruminants & Swine	271.5	297.1	(9)%	545.6	579.6	(6)%
Subtotal	754.1	752.0	— %	1,462.7	1,464.8	— %
Strategic Exits ⁽¹⁾	27.5	18.2	51 %	50.0	41.6	20 %
Total	\$ 781.6	\$ 770.2	1 %	\$ 1,512.7	\$ 1,506.4	— %

(1) Represents revenue from business activities we have either exited or made a strategic decision to exit.

Total revenue

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Total revenue increased \$ 11.4 million or 1% for the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 , reflecting a 2% increase due to higher volumes and a 2% increase due to prices, which were partially offset by a 3% unfavorable foreign exchange rate impact.

In summary, the total revenue increase was due primarily to:

- an increase in revenue of \$12.8 million or 6% from CA Disease Prevention products, excluding the impact of foreign exchange rates;
- an increase in revenue of \$17.8 million or 26% from CA Therapeutics products, excluding the impact of foreign exchange rates;
- an increase in revenue of \$12.1 million or 7% from FA Future Protein & Health products, excluding the impact of foreign exchange rates; and
- an increase in revenue of \$9.5 million or 52% from Strategic Exits, excluding the impact of foreign exchange rates.

partially offset by:

- a decrease in revenue of \$17.8 million or 6% from FA Ruminants & Swine products, excluding the impact of foreign exchange rates; and
- a decrease in revenue of \$23.0 million due to the negative impact of foreign exchange rates.

The detailed change in revenue by product category was as follows:

- CA Disease Prevention revenue increased by \$9.4 million or 4% for the quarter, driven by both increased volume and price, partially offset by an unfavorable impact from foreign exchange rates. The increase was driven by the continued uptake of Interceptor Plus[®] and Credelio[®], partially offset by declines in certain older generation parasiticides.
- CA Therapeutics revenue increased by \$15.1 million or 22% for the quarter, driven by increased volume and to a lesser extent price, partially offset by the impact of foreign exchange rates. The revenue increase was driven by increased demand for products across the therapeutics portfolio, primarily Galliprant[®].
- FA Future Protein & Health revenue increased by \$ 3.2 million or 2% for the quarter, driven by both increased volume and price, partially offset by an unfavorable impact from foreign exchange rates. Growth was driven by the aqua portfolio, and to a lesser extent, the poultry portfolio and nutritional health products.

- FA Ruminants & Swine revenue decreased by \$25.6 million or 9% driven by a decline in volume and to a lesser extent unfavorable impact from foreign exchange rates. The decline in revenue was driven by challenges in the international business, primarily softness in swine products due to African Swine Fever, particularly in Asia, the continued implementation of antimicrobial policies in certain Asian countries, and product rationalizations aligned with our productivity agenda. In the United States, unfavorable purchasing patterns for Rumensin[®] and a disruption of global supply of certain cattle products due to production issues at a contract manufacturer were partially offset by favorable purchasing patterns in other cattle products, primarily Optaflexx[®].
- Strategic Exits revenue increased by \$9.3 million to \$ 27.5 million and represented 4% of total revenue. The increase is due to higher contract manufacturing demand for companion animal vaccines and a favorable comparison in the second quarter related to the manufacturing of human growth hormone for Lilly, as this contract manufacturing agreement was not in place until the fourth quarter of 2018.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Total revenue increased \$ 6.3 million or less than 1% for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 , reflecting a 2% increase due to higher volumes and an increase of 1% due to price, offset by a 3% unfavorable foreign exchange rate.

In summary, the total revenue increase was due primarily to:

- an increase in revenue of \$39.2 million or 30% from CA Therapeutics products, excluding the impact of foreign exchange rates;
- an increase in revenue of \$20.4 million or 6% from FA Future Protein & Health products, excluding the impact of foreign exchange rates; and
- an increase in revenue of \$8.3 million or 20% from Strategic Exits, excluding the impact of foreign exchange rates.

partially offset by:

- a decrease in revenue of \$17.4 million or 3% from FA Ruminants & Swine products, excluding the impact of foreign exchange rates; and
- a decrease in revenue of \$44.2 million due to the negative impact of foreign exchange rates.

The detailed change in revenue by product category was as follows:

- CA Disease Prevention revenue decreased by \$6.0 million or 1% , primarily driven by an unfavorable impact from foreign exchange rates with no offset from price and volume. Declines in older generation parasiticide products and Companion Animal vaccines were partially offset by continued growth in Credelio[®] , Interceptor Plus[®] and certain other parasiticide products.
- CA Therapeutics revenue increased by \$34.2 million or 26% , driven by increased volume and to a lesser extent price, partially offset by the impact of foreign exchange rates. The revenue increase was driven by increased demand for products across the therapeutics portfolio, primarily Galliprant[®] .
- FA Future Protein & Health revenue increased \$3.7 million or 1% , driven by both increased volume and price, partially offset by an unfavorable impact from foreign exchange rates. Growth was driven by the aqua portfolio and, to a lesser extent, nutritional health products, partially offset by timing of international purchasing patterns for poultry feed additives portfolio.
- FA Ruminants & Swine revenue decreased by \$34.0 million or 6% driven by a decline in volume and to a lesser extent the unfavorable impact from foreign exchange rates and price. The decline in revenue was driven by challenges in the international business, primarily softness in swine products due to African Swine Fever, particularly in Asia, the continued implementation of antimicrobial policies in certain Asian countries, and product rationalizations aligned with our productivity agenda. In the United States, unfavorable purchasing patterns for Rumensin[®] were partially offset by favorable purchasing patterns

for other cattle products, primarily Optaflexx[®].

- Strategic Exits revenue increased by \$8.4 million to \$50.0 million and represented 3% of total revenue.

Costs and Expenses and Other

Cost of sales

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Cost of sales decreased \$75.5 million in the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 due primarily to manufacturing productivity improvements as well as charges recorded during the three months ended June 30, 2018 for inventory adjustments related to the suspension of commercial activities of Imrestor[®] and the closure of the Larchwood, Iowa facility.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Cost of sales decreased \$ 91.7 million in the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 due primarily to manufacturing productivity improvements and charges recorded during the six months ended June 30, 2018 for inventory adjustments related to the suspension of commercial activities of Imrestor[®] and the closure of the Larchwood, Iowa facility, partially offset by unfavorable product mix and higher affiliate losses and logistics costs.

Research and development

Three months ended June 30, 2019 vs. three months ended June 30, 2018

R&D expenses increased \$7.4 million for the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 primarily due to the timing of project spend within the year, increased project spend as a result of program progression, and increased costs as a result of operating as a standalone company during the three months ended June 30, 2019.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

R&D expenses increased \$ 6.3 million for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 primarily due to the timing of project spend within the year, increased project spend as a result of program progression, and increased costs as a result of operating as a standalone company during the six months ended June 30, 2019.

Marketing, selling and administrative

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Marketing, selling and administrative expenses increased \$9.8 million for the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 due primarily to increased marketing expenses for Credelio[®], Galliprant[®], and Interceptor Plus[®], as well as increased expenses as a result of operating as a public company, partially offset by lower selling costs and continued productivity initiatives and cost control measures across the business.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Marketing, selling and administrative expenses increased \$ 10.9 million for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 due primarily to increased marketing expenses for Credelio[®], Galliprant[®], and Interceptor Plus[®], as well as increased expenses as a result of operating as a public company, partially offset by slightly lower selling costs and continued productivity initiatives and cost control measures across the business.

Amortization of intangible assets

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Amortization of intangible assets decreased \$0.1 million for the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 .

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Amortization of intangible assets decreased \$ 0.3 million for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 .

Asset impairment, restructuring and other special charges

For additional information regarding our asset impairment, restructuring and other special charges, see Note 6: Asset

Impairment, Restructuring and Other Special Charges to our condensed consolidated and combined financial statements.

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Asset impairment, restructuring and other special charges decreased \$ 36.2 million to \$31.8 million for the three months ended June 30, 2019 from \$68.0 million for the three months ended June 30, 2018 primarily due to exit costs and impairment charges recorded during the three months ended June 30, 2018 which did not repeat, partially offset by higher integration costs during the three months ended June 30, 2019 associated with the implementation of new systems, programs, and processes due to the Separation from Lilly.

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Asset impairment, restructuring and other special charges decreased \$ 13.7 million to \$ 56.7 million for the six months ended June 30, 2019 from \$ 70.4 million for the six months ended June 30, 2018 primarily due to exit costs and impairment charges recorded during the six months ended June 30, 2018 which did not repeat, partially offset by higher external costs directly related to acquiring businesses and higher integration costs during the six months ended June 30, 2019 associated with the implementation of new systems, programs, and processes due to the Separation from Lilly.

Interest expense, net of capitalized interest

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Interest expense, net of capitalized interest, was \$20.7 million for the three months ended June 30, 2019 due to our issuance of debt in the third quarter of 2018. There was no interest expense in the three months ended June 30, 2018 .

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Interest expense, net of capitalized interest, was \$41.5 million for the six months ended June 30, 2019 due to our issuance of debt in the third quarter of 2018. There was no interest expense in the six months ended June 30, 2018 .

Income tax expense

Three months ended June 30, 2019 vs. three months ended June 30, 2018

Income tax expense decreased \$8.5 million for the three months ended June 30, 2019 as compared to the three months ended June 30, 2018 primarily due to mix of income by jurisdiction and full valuation allowances recorded in 2018 for losses incurred in the U.S. due to asset impairments and contractual commitments related to the suspension of commercial activities for Imrestor[®].

Six months ended June 30, 2019 vs. six months ended June 30, 2018

Income tax expense is flat for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018 . Income tax expense decreased due to mix of income by jurisdiction and full valuation allowances recorded in 2018 for losses incurred in the U.S. due to asset impairments and contractual commitments related to the suspension of commercial activities for Imrestor[®]. This decrease was offset by a one-time foreign exchange gain on the transfer of assets upon Separation from Lilly in addition to the impact of state income taxes reflected in our income tax expense for the six months ended June 30, 2019. See Note 11: Income Taxes for further information.

Liquidity and Capital Resources

Our primary sources of liquidity are cash on hand, cash flows from operations and funds available under our Credit Facilities. As a significant portion of our business is conducted outside the U.S., we hold a significant portion of cash outside of the U.S. We monitor and adjust the amount of foreign cash based on projected cash flow requirements. Our ability to use foreign cash to fund cash flow requirements in the U.S. may be impacted by local regulations and, to a lesser extent, following U.S. tax reforms, the income taxes associated with transferring cash to the U.S. As our structure evolves as a standalone company, we may change that strategy, particularly to the extent we identify tax efficient reinvestment alternatives for our foreign earnings or change our cash management strategy.

Our principal liquidity needs going forward include funding existing marketed and pipeline products, capital expenditures, business development in our targeted areas, interest expense and an anticipated dividend. We believe our cash and cash equivalents on hand, our operating cash flows and our existing financing arrangements will be sufficient to support our cash needs for the foreseeable future, including for at least the next 12 months.

Our ability to meet future funding requirements may be impacted by macroeconomic, business and financial volatility. As markets change, we will continue to monitor our liquidity position. However, a challenging economic environment

or an economic downturn may impact our liquidity or ability to obtain future financing. See Forward-Looking Statements for further information.

Cash Flows

The following table provides a summary of cash flows from operating, investing and financing activities for the periods presented:

	Six Months Ended June 30,		%
	2019	2018	Change
Net cash provided by (used for):			
Operating activities	\$ 58.2	\$ 183.9	(68)%
Investing activities	(77.5)	(57.5)	35 %
Financing activities	(249.8)	(123.7)	102 %
Effect of exchange-rate changes on cash and cash equivalents	(11.8)	(5.1)	131 %
Net decrease in cash, cash equivalents and restricted cash	\$ (280.9)	\$ (2.4)	11,604 %

Operating activities

Our cash provided by operating activities decreased by \$ 125.7 million , from \$ 183.9 million for the six months ended June 30, 2018 to \$ 58.2 million for the six months ended June 30, 2019 . The decrease in operating cash flows was primarily attributable to increases in accounts receivable, inventories and other assets during the period. The impact of these items was partially offset by an increase in net income.

Investing activities

Our cash used for investing activities increased by \$20.0 million , to \$77.5 million for the six months ended June 30, 2019 compared to \$ 57.5 million for the six months ended June 30, 2018 . The change was primarily driven by an increase in purchases of software from 2018 to 2019.

Financing activities

Our cash used for financing activities increased by \$ 126.1 million , from \$ 123.7 million for the six months ended June 30, 2018 to \$ 249.8 million for the six months ended June 30, 2019 . The increase was attributable to \$65.0 million of payments on the Term credit facility as well as increased cash outflow as a result of net cash consideration of \$63.4 million paid to Lilly in connection with the local country asset purchases and other financing activities in connection with the Separation during the six months ended June 30, 2019 and other financing with Lilly during the period.

Description of Indebtedness

For a complete description of our outstanding debt as of June 30, 2019 and December 31, 2018 , see Note 8 to our condensed consolidated and combined financial statements.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements that currently have a material effect or that are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

The preparation of financial statements in accordance with GAAP requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. There are certain of our accounting policies that are considered critical, as these policies are the most important to the depiction of our financial statements and require significant, difficult or complex judgments, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in Item 7, "Management's Discussion & Analysis of Results of Financial Condition and Results of Operations," of our Annual Report on Form 10-K for the year ended December 31, 2018 . There have been no significant changes in the application of our critical accounting policies during the six months ended June 30, 2019 , aside from our adoption of ASC 842, *Leases* , on January 1, 2019. See Note 10: *Leases* in our condensed consolidated and combined financial statements for further information.

Contractual Obligations

See Contractual Obligations included in Item 7, "Management's Discussion & Analysis of Results of Financial Condition and Results of Operations," of our Annual Report on Form 10-K for the year ended December 31, 2018 .

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Exchange Risk

We operate on a global basis and are exposed to the risk that our earnings, cash flows and equity could be adversely impacted by fluctuations in foreign exchange rates. We are primarily exposed to foreign exchange risk with respect to net assets denominated in the Euro, Swiss franc, British pound, Canadian dollar, Australian dollar and Brazilian real. As part of the TSA, Lilly maintained a foreign currency risk management program through a central shared entity, which entered into derivative contracts to hedge foreign currency risk associated with forecasted transactions for the entire company, including historically for our operations. Gains and losses on derivative contracts entered into by Lilly were previously allocated to our results to the extent they were to cover exposure related to our business and offset gains and losses on underlying foreign currency exposures. We have implemented our own foreign currency risk management program and assumed all hedging activities in the second quarter of 2019.

We face foreign currency exchange exposures when we enter into transactions arising from subsidiary trade and loan payables and receivables denominated in foreign currencies. We also face currency exposure that arises from translating the results of our global operations to the U.S. dollar at exchange rates that have fluctuated from the beginning of the period. We may enter into foreign currency forward or option derivative contracts to reduce the effect of fluctuating currency exchange rates in future periods, but our historical results do not reflect the impact of any such derivatives related to our exposure to foreign currency impacts on translation.

We estimate that a hypothetical 10% adverse movement in all foreign currency exchange rates related to the translation of the results of our foreign operations would decrease our net income by approximately \$5.3 million for the six months ended June 30, 2019 .

We also bear foreign exchange risk associated with the future cash settlement of an existing NIH. In October 2018, we entered into a fixed interest rate, 5-year, 750 million Swiss franc NIH against Swiss franc assets. The NIH is expected to generate approximately \$25 million in cash and contra interest expense per year; however, there is potential for significant 2023 settlement exposure on the 750 million Swiss franc notional if the U.S. dollar devalues versus the Swiss franc.

Interest Risk

We are exposed to interest rate risk on the long-term debt we incurred in connection with our IPO. Prior to our IPO, we did not have any interest rate exposure. We have cash flow risk associated with our \$427.5 million of borrowings under the Term Facility that pay interest based on variable rates. We actively monitor our exposure and will enter into financial instrument to fix the interest rate based on our assessment of the risk.

Recently Issued Accounting Pronouncements

For discussion of our new accounting standards, see Note 4: Implementation of New Financial Accounting Pronouncements to our condensed consolidated and combined financial statements.

Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures* . Under applicable SEC regulations, management of a reporting company, with the participation of the principal executive officer and principal financial officer, must periodically evaluate the company's "disclosure controls and procedures," which are defined generally as controls and other procedures of a reporting company designed to ensure that information required to be disclosed by the reporting company in its periodic reports filed with the SEC (such as this Form 10-Q) is recorded, processed, summarized, and reported on a timely basis.

Our management, with the participation of Jeff Simmons, president and chief executive officer, and Todd Young, executive vice president and chief financial officer, evaluated our disclosure controls and procedures as of June 30, 2019 . Based on this evaluation, the chief executive officer and the chief financial officer concluded that the disclosure controls and procedures are effective.

(b) *Changes in Internal Controls* . During the second quarter of 2019 , there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

(none)

Item 1A. Risk Factors

Other than the revisions set forth below, there have been no material changes from the risk factors disclosed in Part I of our Annual Report on Form 10-K for the year ended December 31, 2018 and Item 1A, "Risk Factors," of Part II of our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2019.

Generic products may be viewed as more cost-effective than our products.

We face competition from products produced by other companies, including generic alternatives to our products. We depend on patents and regulatory data exclusivity periods to provide us with exclusive marketing rights for some of our products. Patents for individual products expire at different times based on the date of the patent filing (or sometimes the date of patent grant) and the legal term of patents in the jurisdictions where such patents are obtained. The extent of protection afforded by our patents varies from jurisdiction to jurisdiction and is limited by the scope of the claimed subject matter of our patents, the term of the patent and the availability and enforcement of legal remedies in the applicable jurisdiction. In 2018, approximately 72% of our revenue was from products that did not have patent protection, including revenue from some of our top products such as Rumensin[®], Maxiban[®], Denagard[®] and Tylan Premix[®]. Other products are protected by patents that expire over the next several years. For example, certain patents related to Trifexis[®] expire as early as 2020 in the U.S., 2021 in Japan and 2025 in European territories. As the patents for a brand name product expire, competitors may begin to introduce generic or other alternatives, and as a result, we may face competition from lower-priced alternatives to many of our products. For example, we have experienced significant competitive headwinds from generic ractopamine in the U.S. In the third quarter of 2013, a large established animal health company received U.S. approval for generic ractopamine. U.S. revenue from Optaflexx[®], our ractopamine beef product, has declined at a compound annual growth rate of 24% from 2015 to 2018 as a result of generic competition and international regulatory restrictions. In the third quarter of 2019, an established animal health company received U.S. approval for generic monensin in cattle and goats for certain indications. U.S. revenue from Rumensin[®] may decline as a result of the generic competition. We may face similar competition in the future for existing products that do not benefit from exclusivity or for existing products with material patents expiring in the future. See "Business of Elanco - Intellectual Property."

Generic competitors are becoming more aggressive in terms of launching products before patent rights expire, and, because of attractive pricing, sales of generic products are an increasing percentage of overall animal health sales in certain regions. Although the impact of generic competition in the animal health industry to date has not typically mirrored that seen in human health, product pricing and the impact of generic competition in the future may more closely mirror human health as a result of changes in industry dynamics, such as channel expansion, consolidation, an increase in the availability and use of pet insurance and the potential for generic competition by established animal health businesses. If animal health customers increase their use of new or existing generic products, our business, financial condition and results of operations could be materially adversely affected.

Significant portions of our operations are conducted in Europe and could be impacted by the withdrawal of the United Kingdom (UK) from the EU, commonly referred to as "Brexit."

In June 2016, voters in the UK approved an advisory referendum to withdraw from the EU, commonly referred to as Brexit. On March 29, 2017, the UK Prime Minister formally notified the European Council of the UK's intention to withdraw from the EU under Article 50 of the Treaty of Lisbon. The notice began a two-year negotiation period to establish the withdrawal terms. In April 2019, the EU extended the end date of the negotiation period to October 31, 2019, although the UK could leave the EU sooner, depending on political developments. The referendum and notice created political, regulatory and economic uncertainty, particularly in the UK and the EU, and this uncertainty may persist for years if the withdrawal becomes effective in October 2019 without clarification as to whether the UK will continue to be party to the EU Free Trade Agreements (FTA) at the end of the negotiation period.

Our business is subject to substantial regulation. If the UK withdraws from the EU without an agreement and mutual recognition of the EU FTAs, we may not be able to market certain products that entered the EU market following

marketing authorization by UK authorities in all the nations that are parties to FTAs with the EU unless and until we have obtained all required regulatory approvals in each jurisdiction where we proposed to market those products.

In addition, the uncertainty related to Brexit has caused foreign exchange rate fluctuations in the past, including the strengthening of the U.S. dollar relative to the euro and British pound immediately following the announcement of Brexit. The implementation of, or further developments with respect to, Brexit could further impact foreign exchange rates, which could materially adversely affect our business, financial condition and results of operations.

A withdrawal with no deal in place could significantly disrupt the free movement of goods, services, and people between the UK and the EU, and result in increased legal and regulatory complexities, as well as potential higher costs of conducting business in Europe and declining gross domestic product in many European markets. The UK's vote to exit the EU could also result in similar referendums or votes in other European countries in which we do business.

If no agreement is reached at the end of the extended negotiation period on October 31, 2019 and the UK's separation becomes effective, unless the remaining EU members unanimously agree to an additional extension, the uncertainty surrounding the terms of the UK's withdrawal and its consequences could adversely impact consumer and investor confidence, and could affect sales or regulation of our products. Any of these effects, among others, could materially adversely affect our business, financial condition and results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(none)

Item 3. Defaults Upon Senior Securities

(none)

Item 4. Mine Safety Disclosures

(none)

Item 5. Other Information

(none)

Item 6. Exhibits

The following exhibits are either filed or furnished herewith (as applicable) or, if so indicated, incorporated by reference to the documents indicated in parentheses, which have previously been filed or furnished with the Securities and Exchange Commission.

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of April 26, 2019, by and among Elanco Animal Health Incorporated, Elanco Athens Inc. and Aratana Therapeutics, Inc. (including the Form of Contingent Value Rights Agreement) (filed with 8-K on April 26, 2019 as Exhibit 2.1)
10.1	Elanco Animal Health Incorporated Executive Deferral Plan (filed herewith).
31.1	Section 302 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Section 302 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	Interactive Data Files.

Index to Exhibits

<u>Exhibit Number</u>	<u>Description</u>
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10.1*	Elanco Animal Health Incorporated Directors' Deferral Plan (filed herewith).
31.1*	Sarbanes-Oxley Section 302 certification of Jeff Simmons
31.2*	Sarbanes-Oxley Section 302 certification of Todd Young
32*	Section 1350 certification of Jeff Simmons and Todd Young
101	Interactive Data Files.
*	Filed herewith.
**	Furnished herewith

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

ELANCO ANIMAL HEALTH INCORPORATED

(Registrant)

Date: August 13, 2019

/s/ Jeffrey N. Simmons

Jeffrey N. Simmons

President and Chief Executive Officer

Date: August 13, 2019

/s/ Todd S. Young

Todd S. Young

Executive Vice President, Chief Financial Officer

**ELANCO ANIMAL HEALTH INCORPORATED
EXECUTIVE DEFERRAL PLAN**

Elanco Animal Health Incorporated (the “ **Company** ”), hereby establishes the Elanco Animal Health Incorporated Executive Deferral Plan (the “ **Plan** ”), effective June 1, 2019 (the “ **Effective Date** ”), for the purpose of attracting and retaining high quality executives and promoting in them increased efficiency and an interest in the successful operation of the Company. The Plan is intended to, and shall be interpreted to, comply in all respects with Code Section 409A and those provisions of ERISA applicable to an unfunded plan maintained primarily to provide deferred compensation benefits for a select group of “ **management or highly compensated employees.** ”

ARTICLE I

ARTICLE II

DEFINITIONS

1. “ **Account** ” or “ **Accounts** ” shall mean the bookkeeping account or accounts established under this Plan pursuant to Article 4.
 2. “ **Base Salary** ” shall mean a Participant’s annual base salary, excluding incentive and discretionary bonuses, commissions, reimbursements and other non-regular remuneration, received from the Company prior to reduction for any salary deferrals under benefit plans sponsored by the Company, including but not limited to, plans established pursuant to Code Section 125 or qualified pursuant to Code Section 401(k).
 3. “ **Beneficiary** ” or “ **Beneficiaries** ” shall mean the person, persons or entity designated as such pursuant to Section 7.1.
 4. “ **Board** ” shall mean the Board of Directors of the Company.
 5. “ **Bonus(es)** ” shall mean amounts paid to the Participant by the Company in the form of discretionary or annual incentive compensation or any other bonus designated by the Committee, before reductions for contributions to or deferrals under any pension, deferred compensation or benefit plans sponsored by the Company.
 6. “ **Code** ” shall mean the Internal Revenue Code of 1986, as amended, as interpreted by Treasury regulations and applicable authorities promulgated thereunder.
 7. “ **Committee** ” shall mean the person or persons appointed by the Board to administer the Plan in accordance with Article 9.
 8. “ **Company Contributions** ” shall mean the contributions made by the Company pursuant to Section 3.3.
 9. “ **Company Contribution Account** ” shall mean the Account maintained for the benefit of the Participant that is credited with Company Contributions, if any, pursuant to Section 4.2.
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10. “ **Compensation** ” shall mean all amounts eligible for deferral for a particular Plan Year under Section 3.1.

11. “ **Crediting Rate** ” shall mean the notional gains and losses credited on the Participant’s Account balance that are based on the Participant’s choice among the investment alternatives where made available by the Committee or upon a fixed rate of interest, as applicable, pursuant to Section 3.4 of the Plan.

12. “ **Deferral Account** ” shall mean an Account maintained for each Participant that is credited with Participant deferrals pursuant to Section 4.1.

13. “**Director**” shall mean a member of the Board.

14. “ **Disability** ” or “ **Disabled** ” shall mean (consistent with the requirements of Code Section 409A) that the Participant (a) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (b) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the Participant’s Employer. For purposes of this Plan, a Participant shall be Disabled if determined to be totally disabled by the Social Security Administration. A Participant shall also be Disabled if determined to be disabled in accordance with the applicable disability insurance program of such Participant’s Employer, provided that the definition of “disability” applied under such disability insurance program complies with the requirements of this Section.

15. “ **Distributable Amount** ” shall mean the vested balance in the applicable Account as determined under Article 4.

16. “ **Eligible Executive** ” shall mean a highly compensated or management-level employee of an Employer selected by the Committee to be eligible to participate in the Plan.

17. “**Employer(s)**” shall be defined as follows:

(a) **Except as otherwise provided in part (b) of this Section, the term “Employer” shall mean the Company and/or any of its subsidiaries (now in existence or hereafter formed or acquired) that have been selected by the Board to participate in the Plan and have adopted the Plan as a sponsor.**

(b) **For the purpose of determining whether a Participant has experienced a Separation from Service, the term “Employer” shall mean:**

(1) **The entity for which the Participant performs services and with respect to which the legally binding right to compensation deferred or contributed under this Plan arises; and**

(2) **All other entities with which the entity described above would be aggregated and treated as a single employer under Code Section 414(b) (controlled group of corporations) and Code Section 414(c) (a group of trades or businesses, whether or not incorporated, under common control), as applicable. In order to identify the group of entities described in the preceding sentence, the Committee shall use an ownership threshold of at least 50% as a substitute**

for the 80% minimum ownership threshold that appears in, and otherwise must be used when applying, the applicable provisions of (A) Code Section 1563 for determining a controlled group of corporations under Code Section 414(b), and (B) Treas. Reg. §1.414(c)-2 for determining the trades or businesses that are under common control under Code Section 414(c).

18. “ **ERISA** ” shall mean the Employee Retirement Income Security Act of 1974, as amended, including Department of Labor and Treasury regulations and applicable authorities promulgated thereunder.

19. “ **Financial Hardship** ” shall mean a severe financial hardship to the Participant resulting from an illness or accident of the Participant, the Participant’s spouse, or a dependent (as defined in Code Section 152, without regard to Code Section 152(b)(1), (b)(2), and (d)(1)(B))) of the Participant, loss of the Participant’s property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant, but shall in all events correspond to the meaning of the term “ **unforeseeable emergency** ” under Code Section 409A.

20. “ **Fund** ” or “ **Funds** ” shall mean one or more of the investments selected by the Committee pursuant to Section 3.4 of the Plan.

21. “ **Hardship Distribution** ” shall mean an accelerated distribution of benefits or a cancellation of deferral elections pursuant to Section 6.5 to a Participant who has suffered a Financial Hardship.

22. “ **Interest Rate** ” shall mean, for each Fund, the rate of return derived from the net gain or loss on the assets of such Fund, as determined by the Committee.

23. “ **Participant** ” shall mean any Eligible Executive who becomes a Participant in this Plan in accordance with Article 2.

24. “ **Participant Election(s)** ” shall mean the forms or procedures by which a Participant makes elections with respect to (a) voluntary deferrals of his/her Compensation, (b) if applicable, the Funds, which shall act as the basis for crediting of interest on Account balances where permitted by the Committee, and (c) the form and timing of distributions from Accounts. Participant Elections may take the form of an electronic communication followed by appropriate confirmation according to specifications established by the Committee.

25. “ **Payment Date** ” shall mean the date by which a total distribution of the Distributable Amount shall be made or the date by which installment payments of the Distributable Amount shall commence.

(a) For benefits triggered by the Participant’s Separation from Service, the Payment Date shall be the first business day of the seventh month directly following the month in which the Separation from Service occurs, and the applicable amount shall be calculated as of the last business day of the sixth month following the month in which the Separation from Service occurs. Subsequent installments, if any, shall be made in January of each Plan Year following the Plan Year in which the initial installment payment was payable and shall be calculated as of the last business day of the preceding December.

(b) For benefits triggered by (i) the death of a Participant or (ii) the Disability of a Participant prior to Separation from Service, the Payment Date shall be the first business day of the month commencing after the month in which the event triggering the payout occurs, and the applicable amount shall be calculated as of the last business day of the month in which the event triggering the payout occurs. In the case of death, the Committee shall be provided with documentation reasonably necessary to establish the fact of the Participant's death; and

(c) The Payment Date of a Scheduled Distribution shall be the first business day of January of the Plan Year in which the distribution is scheduled to commence pursuant to the Participant Election, and the applicable Distributable Amount shall be calculated as of the last business day of the preceding December. Subsequent installments, if any, shall be calculated as of the last business day of December of each succeeding Plan Year after the initial calculation, and shall be made in January of each Plan Year following the Plan Year in which the initial installment payment was payable.

Notwithstanding the foregoing, the Payment Date shall not be before the earliest date on which benefits may be distributed under Code Section 409A without violation of the provisions thereof, as reasonably determined by the Committee. Payments may be made following the applicable Payment Date, provided such payments are made in accordance with Code Section 409A, including without limitation Treas. Reg. §1.409A-3(d).

26. “ **Performance-Based Compensation** ” shall mean compensation the entitlement to or amount of which is contingent on the satisfaction of pre-established organizational or individual performance criteria relating to a performance period of at least 12 consecutive months, as determined by the Committee in accordance with Treas. Reg. §1.409A-1(e).

27. “ **Plan Year** ” shall mean the calendar year, except that the first Plan Year shall begin on the Effective Date and end on the last day of the calendar year in which the Effective Date occurs.

28. “ **Scheduled Distribution** ” shall mean a scheduled distribution date elected by the Participant for distribution of amounts from the Deferral Account, including notional earnings thereon, as provided under Section 6.4.

29. “ **Separation from Service** ” shall mean a termination of services provided by a Participant to his or her Employer, whether voluntarily or involuntarily, other than by reason of death or Disability, as determined by the Committee in accordance with Treas. Reg. §1.409A-1(h). In determining whether a Participant has experienced a Separation from Service, the following provisions shall apply:

(a) For a Participant who provides services to an Employer as an employee, except as otherwise provided in part (c) of this Section, a Separation from Service shall occur when such Participant has experienced a termination of employment with such employer. A Participant shall be considered to have experienced a termination of employment when the facts and circumstances indicate that the Participant and his or her employer reasonably anticipate that either (i) no further services will be performed for the employer after a certain date, or (ii) that the level of bona fide services the Participant will perform for the employer after such date (whether as an employee or as an independent contractor) will permanently decrease to no more than 20% of the average level of bona fide services performed by such Participant (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or the full period of services to the employer if the Participant has been providing services to the Employer less than 36 months).

If a Participant is on military leave, sick leave, or other bona fide leave of absence, the employment relationship between the Participant and the Employer shall be treated as continuing intact, provided that the period of such leave does not exceed 6 months, or if longer, so long as the Participant retains a right to reemployment with the Employer under an applicable statute or by contract. If the period of a military leave, sick leave, or other bona fide leave of absence exceeds 6 months and the Participant does not retain a right to reemployment under an applicable statute or by contract, the employment relationship shall be considered to be terminated for purposes of this Plan as of the first day immediately following the end of such 6-month period. In applying the provisions of this paragraph, a leave of absence shall be considered a bona fide leave of absence only if there is a reasonable expectation that the Participant will return to perform services for the Employer.

(b) For a Participant, if any, who provides services to an Employer as an independent contractor, except as otherwise provided in part (c) of this Section, a Separation from Service shall occur upon the expiration of the contract (or in the case of more than one contract, all contracts) under which services are performed for such Employer, provided that the expiration of such contract(s) is determined by the Committee to constitute a good-faith and complete termination of the contractual relationship between the Participant and such Employer.

(c) For a Participant, if any, who provides services to an Employer as both an employee and an independent contractor, a Separation from Service generally shall not occur until the Participant has ceased providing services for such Employer as both an employee and as an independent contractor, as determined in accordance with the provisions set forth in parts (a) and (b) of this Section, respectively.

Notwithstanding the foregoing provisions in this part (c), if a Participant provides services for an Employer as both an employee and as a Director, to the extent permitted by Treas. Reg. §1.409A-1(h)(5) the services provided by such Participant as a Director shall not be taken into account in determining whether the Participant has experienced a Separation from Service as an employee, and the services provided by such Participant as an employee shall not be taken into account in determining whether the Participant has experienced a Separation from Service as a Director.

ARTICLE III

ARTICLE IV

PARTICIPATION

2.1 Enrollment Requirements; Commencement of Participation

(a) As a condition to participation, each Eligible Executive shall complete, execute and return to the Committee the appropriate Participant Elections, as well as such other documentation and information as the Committee reasonably requests, by the deadline(s) established by the Committee. In addition, the Committee shall establish from time to time such other enrollment requirements as it determines, in its sole discretion, are necessary.

(b) Each Eligible Executive shall commence participation in the Plan on the date that the Committee determines that the Eligible Executive has met all enrollment requirements set forth in this Plan and required by the Committee, including returning all required documents to the Committee within the specified time period.

(c) If an Eligible Executive fails to meet all requirements established by the Committee within the period required, that Eligible Executive shall not be eligible to participate in the Plan during such Plan Year.

ARTICLE V

ARTICLE VI

CONTRIBUTIONS & DEFERRAL ELECTIONS

1. Elections to Defer Compensation. Elections to defer Compensation shall take the form of a whole percentage (less applicable payroll withholding requirements for Social Security and income taxes and employee benefit plans, as determined in the sole and absolute discretion of the Committee) of up to a maximum of:

- (a) 70% of Base Salary and
- (b) 100% of Bonuses.

The Committee may, in its sole discretion, adjust for each Plan Year on a prospective basis the maximum deferral percentages described in this Section for one or more types of Compensation (including, without limitation, for particular types of Bonuses) and for one or more subsequent Plan Years; such revised deferral percentages shall be indicated on a Participant Election form approved by the Committee. Notwithstanding the foregoing, in no event shall the maximum deferral percentages be adjusted after the last date on which deferral elections for the applicable type(s) of Compensation must be submitted and become irrevocable in accordance with Section 3.2 below and the requirements of Code Section 409A.

Notwithstanding the foregoing, the Committee may determine that one or more types of Compensation shall not be made available for deferral for one or more Plan Years and, consistent with such determination, the impacted types of Compensation shall not appear on a Participant Election form.

2. Timing of Deferral Elections; Effect of Participant Election(s).

(a) General Timing Rule for Deferral Elections. Except as otherwise provided in this Section 3.2, in order for a Participant to make a valid election to defer Compensation, the Participant must submit Participant Election(s) on or before the deadline established by the Committee, which shall be no later than the December 31st preceding the Plan Year in which such compensation will be earned.

Any deferral election made in accordance with this Section 3.2(a) shall be irrevocable; provided, however, that if the Committee permits or requires Participants to make a deferral election by the deadline described above for an amount that qualifies as Performance-Based Compensation, the Committee may permit a Participant to subsequently change his or her deferral election for such compensation by submitting new Participant Election(s) in accordance with Section 3.2(c) below.

(b) Timing of Deferral Elections for New Plan Participants. An Eligible Executive who first becomes eligible to participate in the Plan on or after the beginning of a Plan Year, as determined in accordance with Treas. Reg. §1.409A-2(a)(7)(ii) and the “plan aggregation” rules provided in Treas. Reg. §1.409A-1(c)(2), may be permitted to make an election to defer the portion of Compensation attributable to services to be performed after such election, provided that the Participant submits Participant Election(s) on or before the deadline established by the Committee, which in no event shall be later than thirty (30) days after the Participant first becomes eligible to participate in the Plan.

If a deferral election made in accordance with this Section 3.2(b) relates to compensation earned based upon a specified performance period, the amount eligible for deferral shall be equal to (i) the total amount of compensation for the performance period, multiplied by (ii) a fraction, the numerator of which is the number of days remaining in the service period after the Participant's deferral election is made, and the denominator of which is the total number of days in the performance period.

Any deferral election made in accordance with this Section 3.2(b) shall become irrevocable no later than the 30th day after the date the Participant first becomes eligible to participate in the Plan.

(c) Timing of Deferral Elections for Performance-Based Compensation. Subject to the limitations described below, the Committee may determine that an irrevocable deferral election for an amount that qualifies as Performance-Based Compensation may be made by submitting Participant Election(s) on or before the deadline established by the Committee, which in no event shall be later than six (6) months before the end of the performance period.

In order for a Participant to be eligible to make a deferral election for Performance-Based Compensation in accordance with the deadline established pursuant to this Section 3.2(c), the Participant must have performed services continuously from the later of (i) the beginning of the performance period for such compensation, or (ii) the date upon which the performance criteria for such compensation are established, through the date upon which the Participant makes the deferral election for such compensation. In no event shall a deferral election submitted under this Section 3.2(c) be permitted to apply to any amount of Performance-Based Compensation that has become readily ascertainable.

(d) Timing Rule for Deferral of Compensation Subject to Risk of Forfeiture. With respect to compensation (i) to which a Participant has a legally binding right to payment in a subsequent year, and (ii) that is subject to a forfeiture condition requiring the Participant's continued services for a period of at least twelve (12) months from the date the Participant obtains the legally binding right, the Committee may determine that an irrevocable deferral election for such compensation may be made by timely delivering Participant Election(s) to the Committee in accordance with its rules and procedures, no later than the 30th day after the Participant obtains the legally binding right to the compensation, provided that the election is made at least twelve (12) months in advance of the earliest date at which the forfeiture condition could lapse, as determined in accordance with Treas. Reg. §1.409A-2(a)(5).

Any deferral election(s) made in accordance with this Section 3.2(d) shall become irrevocable no later than the 30th day after the Participant obtains the legally binding right to the compensation subject to such deferral election(s).

(e) Separate Deferral Elections for Each Plan Year. In order to defer Compensation for a Plan Year, a Participant must submit a separate deferral election with respect to Compensation for such Plan Year by affirmatively filing a Participant Election during the enrollment period established by the Committee prior to the beginning of such Plan Year (or at such other time contemplated under this Section 3.2), which election shall be effective on the first day of the next following Plan Year (unless otherwise specified on the Participant Election).

3. Company Contributions. The Company shall have the discretion to make Company Contributions to the Plan at any time and in any amount on behalf of any Participant. Company Contributions shall be made in the complete and sole discretion of the Company and no Participant

shall have the right to receive any Company Contribution in any particular Plan Year regardless of whether Company Contributions are made on behalf of other Participants.

4. Investment Elections.

(a) Participant Designation. At the time of entering the Plan and/or of making a deferral election under the Plan, the Participant may be permitted by the Committee to designate, on a Participant Election provided by the Committee, the Funds in which the Participant's Accounts shall be deemed to be invested for purposes of determining the amount of earnings and losses to be credited to each Account. In such event, the Participant may specify that all or any percentage of his or her Accounts shall be deemed to be invested, in whole percentage increments, in one or more of the Funds selected as alternative investments under the Plan from time to time by the Committee pursuant to subsection (b) of this Section. If a Participant fails to make an election among the Funds, or if no election is permitted by the Committee at the time of entering the Plan and/or making a deferred election under the Plan, the Participant's Account balance shall automatically be allocated into a default Fund determined by the Committee in its sole discretion. A Participant may be permitted to change any designation made under this Section as permitted by the Committee by filing a revised election, on a Participant Election provided by the Committee. Notwithstanding the foregoing, the Committee, in its sole discretion, may impose limitations on the frequency with which one or more of the Funds elected in accordance with this Section may be added or deleted by such Participant; furthermore, the Committee, in its sole discretion, may impose limitations on the frequency with which the Participant may change the portion of his or her Account balance allocated to each previously or newly elected Fund.

(b) Investment Funds. The Committee may select, in its sole and absolute discretion, each of the types of commercially available investments communicated to the Participant pursuant to subsection (a) of this Section to be the Funds. Where made available for selection by the Participants, the Interest Rate of each such commercially available investment shall be used to determine the amount of earnings or losses to be credited to the Participant's Account under Article IV. The Participant's choice among investments, where applicable, shall be solely for purposes of calculation of the Crediting Rate on Accounts. The Company and the Employers shall have no obligation to set aside or invest amounts as directed by the Participant and, if the Company and/or the Employer elects to invest amounts as directed by the Participant, the Participant shall have no more right to such investments than any other unsecured general creditor.

(c) Fixed Rate of Return. Notwithstanding Sections 3.4(a) and 3.4(b) above, the Committee may determine, in its sole discretion, that for one or more Plan Years the Crediting Rate for Participant Accounts under the Plan shall be based upon a fixed rate of return selected by the Committee, and no Participant designation among Funds shall be permitted during such period.

5. Distribution Elections.

(a) Initial Election. At the time of making a deferral election under the Plan, the Participant shall designate the time and form of distribution of deferrals made pursuant to such election (together with any earnings credited thereon) from among the alternatives specified under Article VI for the applicable distribution. Such distribution election(s) for a given Plan Year shall relate solely to that Plan Year. A new distribution election may be made at the time of subsequent deferral elections with respect to deferrals in Plan Years beginning after the election is made, in accordance with the Participant Election forms.

(b) Modification of Elections. A distribution election with respect to previously deferred amounts may only be changed under the terms and conditions specified in Code Section 409A and this Section. Except as permitted under Code Section 409A, no acceleration of a distribution is permitted. A subsequent election that delays or changes the form of payment upon Separation from Service or as a Scheduled Distribution for a Plan Year shall be permitted if and only if all of the following requirements are met:

(1) the new election does not take effect until at least twelve (12) months after the date on which the new election is made;

(2) the new election delays payment for at least five (5) years from the date that payment would otherwise have been made or commenced, absent the new election; and

(3) in the case of payments made according to a Scheduled Distribution, the new election is made not less than twelve (12) months before the date on which payment would have been made (or, in the case of installment payments, the first installment payment would have been made) absent the new election.

For purposes of application of the above change limitations, installment payments shall be treated as a single payment under Code Section 409A. Only one (1) change shall be allowed to be made by a Participant with respect to each Plan Year's election as to the benefits to be received by such Participant upon Separation from Service. In addition, only one (1) change shall be allowed to be made by a Participant with respect to each Plan Year's Scheduled Distribution election, if any. Election changes made pursuant to this Section shall be made in accordance with rules established by the Committee and shall comply with all requirements of Code Section 409A and applicable authorities.

ARTICLE VII

ARTICLE VIII

ACCOUNTS

1. Deferral Accounts. The Committee shall establish and maintain a Deferral Account for each Participant under the Plan. In the event the Committee permits designation of Funds by the Participant, each Participant's Deferral Account shall be further divided into separate subaccounts ("**Fund Subaccounts**"), each of which corresponds to a Fund designated pursuant to Section 3.4. A Participant's Deferral Account shall be credited as follows:

(a) As soon as reasonably practicable after amounts are withheld and deferred from a Participant's Compensation, the Committee shall credit the Participant's Deferral Account with an amount equal to the Compensation deferred by the Participant; where Participant designation of Funds is permitted by the Committee, the portion of the Participant's deferred Compensation designated under Section 3.4 to be deemed to be invested in a Fund shall be credited to the applicable Fund Subaccount;

(b) Where applicable, on each business day the Fund Subaccounts of a Participant's Deferral Account shall be credited with earnings or losses in an amount equal to that determined by multiplying the balance credited to such Fund Subaccount as of the prior day, less any distributions valued as of the end of the prior day, by the Interest Rate for the corresponding Fund as determined by the Committee pursuant to Section 3.4(b);

(c) In the event the Committee determines a fixed rate of return for determining the Crediting Rate applicable to Participant Accounts in accordance with Section 3.4(c), the Participant Accounts shall be adjusted to reflect the applicable Crediting Rate on the date or dates determined by the Committee in its sole discretion; and

(d) In the event that a Participant elects for a given Plan Year's deferral of Compensation a Scheduled Distribution, all amounts attributed to the deferral of Compensation for such Plan Year shall be accounted for in a manner which allows separate accounting for the deferral of Compensation and deemed earnings and losses associated with amounts allocated to each such separate Scheduled Distribution.

2. Company Contribution Account. The Committee shall establish and maintain a Company Contribution Account for each Participant under the Plan. In the event the Committee permits designation of Funds by the Participant, each Participant's Company Contribution Account shall be further divided into separate Fund Subaccounts corresponding to the Fund designated pursuant to Section 3.4(a). A Participant's Company Contribution Account shall be credited as follows:

(a) As soon as reasonably practicable after a Company Contribution is made, the Company shall credit the Participant's Company Contribution Account with an amount equal to the Company Contributions made on behalf of that Participant; where Participant designation of Funds is permitted by the Committee, the portion of the Company Contributions designated under Section 3.4 to be deemed to be invested in a certain Fund shall be credited to the applicable Fund Subaccount;

(b) Where applicable, on each business day the Fund Subaccounts of a Participant's Company Contribution Account shall be credited with earnings or losses in an amount equal to that determined by multiplying the balance credited to such Fund Subaccount as of the prior day, less any distributions valued as of the end of the prior day, by the Interest Rate for the corresponding Fund as determined by the Committee pursuant to Section 3.4(b); and

(c) In the event the Committee determines a fixed rate of return for determining the Crediting Rate applicable to Participant Accounts in accordance with Section 3.4(c), the Participant Company Contribution Accounts shall be adjusted to reflect the applicable Crediting Rate on the date or dates determined by the Committee in its sole discretion.

3. Trust. The Company shall be responsible for the payment of all benefits under the Plan. At its discretion, the Company may establish one or more grantor trusts for the purpose of providing for payment of benefits under the Plan. Such trust or trusts may be irrevocable, but the assets thereof shall be subject to the claims of the Company's creditors. Benefits paid to the Participant from any such trust or trusts shall be considered paid by the Company for purposes of meeting the obligations of the Company under the Plan.

4. Statement of Accounts. The Committee shall provide each Participant with electronic statements at least quarterly setting forth the Participant's Account balance as of the end of each applicable period.

1. Vesting of Deferral Accounts. The Participant shall be vested at all times in amounts credited to the Participant's Deferral Account.
2. Vesting of Company Contribution Account. Amounts credited to the Participant's Company Contribution Account shall be vested based upon the schedule or schedules determined by the Company in its sole discretion and communicated to the Participant.

1. Separation from Service Distributions. Except as otherwise provided herein, in the event of a Participant's Separation from Service, the Distributable Amount credited to the Participant's Deferral Account and Company Contribution Account (excluding any Scheduled Distributions that commenced distribution prior to the Separation from Service) shall be paid to the Participant in a lump sum on the Payment Date following the Participant's Separation from Service, unless the Participant has made an alternative benefit election on a timely basis to receive substantially equal annual installments over up to ten (10) years. In accordance with a Participant Election approved by the Committee, for each Plan Year the Participant may elect a separate form of distribution applicable upon Separation from Service for the deferrals and Company Contributions, if any, attributable to such Plan Year. A Participant may delay and/or change the form of payment applicable upon Separation from Service for one or more Plan Years, provided any such revised election complies with the requirements of Section 3.5.
 2. Disability Distributions. Except as otherwise provided herein, in the event of a Participant's Disability prior to Separation from Service, the Distributable Amount credited to the Participant's Deferral Account and Company Contribution Account (excluding any Scheduled Distributions that commenced distribution prior to the Disability) shall be paid to the Participant in a lump sum on the Payment Date following the Participant's Disability.
 3. Death Benefits. Notwithstanding any provision in this Plan to the contrary, in the event that the Participant dies prior to complete distribution of his or her Accounts under the Plan, the Participant's Beneficiary shall receive a death benefit equal to the Distributable Amount (or remaining Distributable Amount in the event installment payments have commenced) credited to the Participant's Deferral Account and Company Contribution Account in a lump sum on the Payment Date following the Participant's death.
 4. Scheduled Distributions.
 - (a) Scheduled Distribution Election. Participants shall be entitled to elect to receive a Scheduled Distribution from the Deferral Account applicable to all of the Participant's Compensation deferrals for a particular Plan Year. In the case of a Participant who has elected to receive a Scheduled Distribution, on the applicable Payment Date such Participant shall receive the Distributable Amount with respect to the applicable Plan Year's Compensation deferrals, including any earnings thereon, which have been elected by the Participant in accordance with Section 3.5 of the Plan. The Committee shall determine the earliest commencement date that may be elected by
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the Participant for each Scheduled Distribution and such date shall be indicated on the Participant Election. The Participant may elect to receive the Scheduled Distribution in a single lump sum or substantially equal annual installments over a period of up to five (5) years. A Participant may delay and/or change the form of payment for a Scheduled Distribution, provided such revised election complies with the requirements of Section 3.5. By way of clarification, the Company Contribution Account shall not be distributable as a Scheduled Distribution.

(b) Relationship to Other Benefits.

(1) In the event of a Participant's Separation from Service, Disability or death prior to the initial Payment Date for a Scheduled Distribution, such Scheduled Distribution shall not be distributed under this Section 6.4, but rather shall be distributed in accordance with the other applicable Section of this Article VI.

(2) In the event of a Participant's Separation from Service or Disability after one or more Scheduled Distributions has commenced installment payments on the applicable Payment Date, such Scheduled Distribution(s) shall continue to be paid at the same time and in the same form as if the Separation from Service or Disability, as applicable, had not occurred.

(3) In the event of a Participant's death after one or more Scheduled Distributions has commenced installment payments on the applicable Payment Date, the remaining Distributable Amount of such Scheduled Distribution(s) shall be distributed in accordance with Section 6.3.

5. Hardship Distributions.

(a) Upon a finding that the Participant has suffered a Financial Hardship, in accordance with Code Section 409A, the Committee may, at the request of the Participant, accelerate distribution of benefits and/or approve cancellation of deferral elections under the Plan, subject to the following conditions:

(1) The request to take a Hardship Distribution shall be made by submitting a form provided by the Committee.

(2) Upon a finding that the Participant has suffered a Financial Hardship in accordance with Treasury Regulations promulgated under Code Section 409A, the Committee may, at the request of the Participant, accelerate distribution of benefits and/or approve cancellation of current deferral elections under the Plan in the amount reasonably necessary to alleviate such Financial Hardship. The amount distributed pursuant to this Section with respect to the Financial Hardship shall not exceed the amount necessary to satisfy such Financial Hardship, plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(3) The amount (if any) determined by the Committee as a Hardship Distribution shall be paid in a single cash lump sum as soon as practicable after the end of the calendar month in which the Hardship Distribution determination is made by the Committee.

(b) In the event a Participant receives a hardship distribution under an Employer's qualified 401(k) plan pursuant to Treas. Reg. §1.401(k)-1(d)(3), the Committee may (i) cancel the

Participant's current deferral elections under this Plan and/or (ii) preclude the Participant from submitting additional deferral elections pursuant to Article III, to the extent deemed necessary to comply with Treas. Reg. §1.401(k)-1(d)(3).

6.6 Limited Cashouts. Notwithstanding any provision in this Plan to the contrary, the Committee may, in its sole discretion, distribute in a mandatory lump sum any Participant's entire Deferral Account and/or Company Contribution Account under the Plan, provided that any such distribution is made in accordance with the requirements of Treas. Reg. §1.409A-3(j)(4)(v) or its successor (each such payment, a "Limited Cashout"). Specifically, any such Limited Cashout pursuant to this Section 6.6 shall be subject to the following requirements:

(a) The Committee's exercise of discretion to make the Limited Cashout shall be evidenced in writing no later than the date of the lump sum payment;

(b) The lump sum payment shall result in the termination and liquidation of the entirety of the Participant's Deferral Account and/or Company Contribution Account under the Plan, as applicable, as well as the Participant's interest in all other plans, agreements, methods, programs, or other arrangements with respect to which deferrals of compensation are treated as having been deferred under a single nonqualified deferred compensation plan under Treas. Reg. §1.409A-1(c)(2) with the Account(s) that is being distributed from this Plan; and

(c) The lump sum payment (and the Participant's entire interest in any and all other "plans" that would be aggregated with the Account(s) being distributed from this Plan in accordance with Treas. Reg. §1.409A-1(c)(2)) is not greater than the applicable dollar amount under Code Section 402(g)(1)(B) at the time of the Limited Cashout.

Any such Limited Cashout shall be calculated as of the last business day of the month in which the Committee's determination to make the Limited Cashout occurs, and such lump sum payment shall be made within sixty (60) days following such determination.

ARTICLE XIII

PAYEE DESIGNATIONS AND LIMITATIONS

1. Beneficiaries.

(a) Beneficiary Designation. The Participant shall have the right, at any time, to designate any person or persons as Beneficiary (both primary and contingent) to whom payment under the Plan shall be made in the event of the Participant's death. If the Participant names someone other than his or her spouse as a Beneficiary, the Committee may, in its sole discretion, determine that spousal consent is required to be provided in a form designated by the Committee, executed by such Participant's spouse and returned to the Committee. The Beneficiary designation shall be effective when it is submitted to and acknowledged by the Committee during the Participant's lifetime in the format prescribed by the Committee.

(b) Absence of Valid Designation. If a Participant fails to designate a Beneficiary as provided above, or if every person designated as Beneficiary predeceases the Participant or dies prior to complete distribution of the Participant's benefits, then the Committee shall deem the Participant's estate to be the Beneficiary and shall direct the distribution of such benefits to the Participant's estate.

2. Payments to Minors. In the event any amount is payable under the Plan to a minor, payment shall not be made to the minor, but instead such payment shall be made (a) to that person's living parent(s) to act as custodian, (b) if that person's parents are then divorced, and one parent is the sole custodial parent, to such custodial parent, to act as custodian, or (c) if no parent of that person is then living, to a custodian selected by the Committee to hold the funds for the minor under the Uniform Transfers or Gifts to Minors Act in effect in the jurisdiction in which the minor resides. If no parent is living and the Committee decides not to select another custodian to hold the funds for the minor, then payment shall be made to the duly appointed and currently acting guardian of the estate for the minor or, if no guardian of the estate for the minor is duly appointed and currently acting within sixty (60) days after the date the amount becomes payable, payment shall be deposited with the court having jurisdiction over the estate of the minor.

3. Payments on Behalf of Persons Under Incapacity. In the event that any amount becomes payable under the Plan to a person who, in the sole judgment of the Committee, is considered by reason of physical or mental condition to be unable to give a valid receipt therefore, the Committee may direct that such payment be made to any person found by the Committee, in its sole judgment, to have assumed the care of such person. Any payment made pursuant to such determination shall constitute a full release and discharge of any and all liability of the Committee and the Company under the Plan.

ARTICLE VIII **LEAVE OF ABSENCE**

ARTICLE XIV

ARTICLE XV

LEAVE OF ABSENCE

1. Paid Leave of Absence. If a Participant is authorized by the Participant's Employer to take a paid leave of absence from the employment of the Employer, and such leave of absence does not constitute a Separation from Service, (a) the Participant shall continue to be considered eligible for the benefits provided under the Plan, and (b) deferrals shall continue to be withheld during such paid leave of absence in accordance with Article III.

2. Unpaid Leave of Absence. If a Participant is authorized by the Participant's Employer to take an unpaid leave of absence from the employment of the Employer for any reason, and such leave of absence does not constitute a Separation from Service, such Participant shall continue to be eligible for the benefits provided under the Plan. During the unpaid leave of absence, the Participant shall not be allowed to make any additional deferral elections. However, if the Participant returns to employment, the Participant may elect to defer for the Plan Year following his or her return to employment and for every Plan Year thereafter while a Participant in the Plan, provided such deferral elections are otherwise allowed and a Participant Election is delivered to and accepted by the Committee for each such election in accordance with Article III above.

ARTICLE IX
ADMINISTRATION

ARTICLE XVI

ARTICLE XVII

ADMINISTRATION

1. Committee. The Plan shall be administered by a Committee appointed by the Board, which shall have the exclusive right and full discretion (a) to appoint agents to act on its behalf, (b) to select and establish Funds, (c) to interpret the Plan, (d) to decide any and all matters arising hereunder (including the right to remedy possible ambiguities, inconsistencies, or admissions), (e) to make, amend and rescind such rules as it deems necessary for the proper administration of the Plan and (f) to make all other determinations and resolve all questions of fact necessary or advisable for the administration of the Plan, including determinations regarding eligibility for benefits payable under the Plan. All interpretations of the Committee with respect to any matter hereunder shall be final, conclusive and binding on all persons affected thereby. No member of the Committee or agent thereof shall be liable for any determination, decision, or action made in good faith with respect to the Plan. The Company will indemnify and hold harmless the members of the Committee and its agents from and against any and all liabilities, costs, and expenses incurred by such persons as a result of any act, or omission, in connection with the performance of such persons' duties, responsibilities, and obligations under the Plan, other than such liabilities, costs, and expenses as may result from the bad faith, willful misconduct, or criminal acts of such persons.

2. Claims Procedure. Any Participant, former Participant or Beneficiary may file a written claim with the Committee setting forth the nature of the benefit claimed, the amount thereof, and the basis for claiming entitlement to such benefit. The Committee shall determine the validity of the claim and communicate a decision to the claimant promptly and, in any event, not later than ninety (90) days after the date of the claim. The claim may be deemed by the claimant to have been denied for purposes of further review described below in the event a decision is not furnished to the claimant within such ninety (90) day period. If additional information is necessary to make a determination on a claim, the claimant shall be advised of the need for such additional information within forty-five (45) days after the date of the claim. The claimant shall have up to one hundred eighty (180) days to supplement the claim information, and the claimant shall be advised of the decision on the claim within forty-five (45) days after the earlier of the date the supplemental information is supplied or the end of the one hundred eighty (180) day period. Every claim for benefits which is denied shall be denied by written notice setting forth in a manner calculated to be understood by the claimant (a) the specific reason or reasons for the denial, (b) specific reference to any provisions of the Plan (including any internal rules, guidelines, protocols, criteria, etc.) on which the denial is based, (c) description of any additional material or information that is necessary to process the claim, and (d) an explanation of the procedure for further reviewing the denial of the claim and shall include an explanation of the claimant's right to submit the claim for binding arbitration in the event of an adverse determination on review.

3. Review Procedures. Within sixty (60) days after the receipt of a denial on a claim, a claimant or his/her authorized representative may file a written request for review of such denial. Such review shall be undertaken by the Committee and shall be a full and fair review. The claimant shall have the right to review all pertinent documents. The Committee shall issue a decision not later than sixty (60) days after receipt of a request for review from a claimant unless special circumstances, such as the need to hold a hearing, require a longer period of time, in which case a decision shall be rendered as soon as possible but not later than one hundred twenty (120) days after receipt of the claimant's request for review. The decision on review shall be in writing and shall include specific

reasons for the decision written in a manner calculated to be understood by the claimant with specific reference to any provisions of the Plan on which the decision is based and shall include an explanation of the claimant's right to submit the claim for binding arbitration in the event of an adverse determination on review.

ARTICLE XVIII

ARTICLE XIX

MISCELLANEOUS

1. Termination of Plan. Although each Employer anticipates that it will continue the Plan for an indefinite period of time, there is no guarantee that any Employer will continue the Plan or will not terminate the Plan at any time in the future. Accordingly, each Employer reserves the right to terminate the Plan with respect to all of its Participants. In the event of a Plan termination, no new deferral elections shall be permitted for the affected Participants and such Participants shall no longer be eligible to receive new Company Contributions. However, after the Plan termination the Account balances of such Participants shall continue to be credited with deferrals attributable to any deferral election that was in effect prior to the Plan termination to the extent deemed necessary to comply with Code Section 409A and related Treasury Regulations, and additional amounts shall continue to be credited or debited to such Participants' Account balances pursuant to Article IV. In addition, following a Plan termination, Participant Account balances shall remain in the Plan and shall not be distributed until such amounts become eligible for distribution in accordance with the other applicable provisions of the Plan. Notwithstanding the preceding sentence, to the extent permitted by Treas. Reg. §1.409A-3(j)(4)(ix) or as otherwise permitted under Code Section 409A, the Employer may provide that upon termination of the Plan, all Account balances of the Participants shall be distributed, subject to and in accordance with any rules established by such Employer deemed necessary to comply with the applicable requirements and limitations of Code Section 409A.

2. Amendment. Any Employer may, at any time, amend or modify the Plan in whole or in part with respect to that Employer. Notwithstanding the foregoing, no amendment or modification shall be effective to decrease the value of a Participant's vested Account balance in existence at the time the amendment or modification is made.

3. Unsecured General Creditor. The benefits paid under the Plan shall be paid from the general assets of the Company, and the Participant and any Beneficiary or their heirs or successors shall be no more than unsecured general creditors of the Company with no special or prior right to any assets of the Company for payment of any obligations hereunder. It is the intention of the Company that this Plan be unfunded for purposes of ERISA and the Code.

4. Restriction Against Assignment. The Company shall pay all amounts payable hereunder only to the person or persons designated by the Plan and not to any other person or entity. No part of a Participant's Accounts shall be liable for the debts, contracts, or engagements of any Participant, Beneficiary, or their successors in interest, nor shall a Participant's Accounts be subject to execution by levy, attachment, or garnishment or by any other legal or equitable proceeding, nor shall any such person have any right to alienate, anticipate, sell, transfer, commute, pledge, encumber, or assign any benefits or payments hereunder in any manner whatsoever. No part of a Participant's Accounts shall be subject to any right of offset against or reduction for any amount payable by the Participant or Beneficiary, whether to the Company or any other party, under any arrangement other than under the terms of this Plan.

5. Withholding. The Participant shall make appropriate arrangements with the Company for satisfaction of any federal, state or local income tax withholding requirements, Social Security and other employee tax or other requirements applicable to the granting, crediting, vesting or payment of benefits under the Plan. There shall be deducted from each payment made under the Plan or any other Compensation payable to the Participant (or Beneficiary) all taxes that are required to be withheld by the Company in respect to such payment or this Plan. To the extent permissible under Code Section 409A, the Company shall have the right to reduce any payment (or other Compensation) by the amount of cash sufficient to provide the amount of said taxes.

6. Code Section 409A. The Company intends that the Plan comply with the requirements of Code Section 409A (and all applicable Treasury Regulations and other guidance issued thereunder) and shall be operated and interpreted consistent with that intent. Notwithstanding the foregoing, the Company makes no representation that the Plan complies with Code Section 409A.

7. Effect of Payment. Any payment made in good faith to a Participant or the Participant's Beneficiary shall, to the extent thereof, be in full satisfaction of all claims against the Committee, its members, the Employer and the Company.

8. Errors in Account Statements, Deferrals or Distributions. In the event an error is made in an Account statement, such error shall be corrected on the next statement following the date such error is discovered. In the event of an operational error, including, but not limited to, errors involving deferral amounts, overpayments or underpayments, such operational error shall be corrected in a manner consistent with and as permitted by any correction procedures established under Code Section 409A. If any portion of a Participant's Account(s) under this Plan is required to be included in income by the Participant prior to receipt due to a failure of this Plan to comply with the requirements of Code Section 409A, the Committee may determine that such Participant shall receive a distribution from the Plan in an amount equal to the lesser of (i) the portion of his or her Account required to be included in income as a result of the failure of the Plan to comply with the requirements of Code Section 409A, or (ii) the unpaid vested Account balance.

9. Domestic Relations Orders. Notwithstanding any provision in this Plan to the contrary, in the event that the Committee receives a domestic relations order, as defined in Code Section 414(p)(1)(B), pursuant to which a court has determined that a spouse or former spouse of a Participant has an interest in the Participant's benefits under the Plan, the Committee shall have the right to immediately distribute the spouse's or former spouse's vested interest in the Participant's benefits under the Plan to such spouse or former spouse to the extent necessary to fulfill such domestic relations order, provided that such distribution is in accordance with the requirements of Code Section 409A.

10. Employment Not Guaranteed. Nothing contained in the Plan nor any action taken hereunder shall be construed as a contract of employment or as giving any Participant any right to continue the provision of services in any capacity whatsoever to the Employer.

11. No Guarantee of Tax Consequences. The Employer, Company, Board and Committee make no commitment or guarantee to any Participant that any federal, state or local tax treatment will apply or be available to any person eligible for benefits under the Plan and assume no liability whatsoever for the tax consequences to any Participant.

12. Successors of the Company. The rights and obligations of the Company under the Plan shall inure to the benefit of, and shall be binding upon, the successors and assigns of the Company.

13. Notice. Any notice or filing required or permitted to be given to the Company or the Participant under this Agreement shall be sufficient if in writing and hand-delivered, or sent by registered or certified mail, in the case of the Company, to the principal office of the Company, directed to the attention of the Committee, and in the case of the Participant, to the last known address of the Participant indicated on the employment records of the Company. Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification. Notices to the Company may be permitted by electronic communication according to specifications established by the Committee.

14. Headings. Headings and subheadings in this Plan are inserted for convenience of reference only and are not to be considered in the construction of the provisions hereof.

15. Gender, Singular and Plural. All pronouns and any variations thereof shall be deemed to refer to the masculine, feminine, or neuter, as the identity of the person or persons may require. As the context may require, the singular may be read as the plural and the plural as the singular.

16. Governing Law. The Plan is intended to be an unfunded plan maintained primarily to provide deferred compensation benefits for a select group of “ **management or highly compensated employees** ” within the meaning of Sections 201, 301 and 401 of ERISA and therefore to be exempt from Parts 2, 3 and 4 of Title I of ERISA. To the extent any provision of, or legal issue relating to, this Plan is not fully preempted by federal law, such issue or provision shall be governed by the laws of the State of *Indiana*.

17. Entire Agreement. Unless specifically indicated otherwise, this Plan supersedes any and all prior communications, understandings, arrangements or agreements between the parties, including the Employer, the Company, the Board, the Committee and any and all Participants, whether written, oral, express or implied relating thereto.

18. Binding Arbitration. Any claim, dispute or other matter in question of any kind relating to this Plan which is not resolved by the claims procedures under this Plan shall be settled by arbitration in accordance with the applicable employment dispute resolution rules of the American Arbitration Association. Notice of demand for arbitration shall be made in writing to the opposing party and to the American Arbitration Association within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall a demand for arbitration be made after the date when the applicable statute of limitations would bar the institution of a legal or equitable proceeding based on such claim, dispute or other matter in question. The decision of the arbitrators shall be final and may be enforced in any court of competent jurisdiction. The arbitrators may award reasonable fees and expenses to the prevailing party in any dispute hereunder and shall award reasonable fees and expenses in the event that the arbitrators find that the losing party acted in bad faith or with intent to harass, hinder or delay the prevailing party in the exercise of its rights in connection with the matter under dispute.

IN WITNESS WHEREOF, the Board has approved the adoption of this Plan as of the Effective Date and has caused the Plan to be executed by its duly authorized representative this 8th day of May, 2019.

ELANCO ANIMAL HEALTH INCORPORATED

By

Name

Title

CERTIFICATIONS

I, Jeffrey N. Simmons, certify that:

1. I have reviewed this report on Form 10-Q of Elanco Animal Health Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [Paragraph omitted in accordance with the Exchange Act Rule 13a - 14(a)];
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2019

By: /s/ Jeff Simmons

Jeff Simmons

President and Chief Executive Officer

CERTIFICATIONS

I, Todd S. Young, certify that:

1. I have reviewed this report on Form 10-Q of Elanco Animal Health Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [Paragraph omitted in accordance with the Exchange Act Rule 13a - 14(a)];
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2019

By: /s/ Todd Young

Todd Young

Executive Vice President and Chief Financial Officer

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Elanco Animal Health Incorporated, an Indiana corporation (the "Company"), does hereby certify that, to the best of their knowledge:

The Quarterly Report on Form 10-Q for the quarter ended June 30, 2019 (the "Form 10-Q") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 13, 2019

/s/ Jeff Simmons

Jeff Simmons
President, and Chief Executive Officer

Date: August 13, 2019

/s/ Todd Young

Todd Young
Executive Vice President and Chief Financial Officer