

UNITED STATES
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, 2022
OR

Transition Report Pursuant To Section 13 or 15(d) of the
Securities Exchange Act of 1934
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
5.00% Tangible Equity Units	ELAT	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 3, 2022 was 474,113,647.

ELANCO ANIMAL HEALTH INCORPORATED
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2022
TABLE OF CONTENTS

PART I

Item 1.	<u>FINANCIAL STATEMENTS</u>	
	<u>CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)</u>	<u>5</u>
	<u>CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)</u>	<u>6</u>
	<u>CONDENSED CONSOLIDATED BALANCE SHEETS</u>	<u>7</u>
	<u>CONDENSED CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)</u>	<u>8</u>
	<u>CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)</u>	<u>9</u>
	<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)</u>	<u>10</u>
Item 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	
	<u>OVERVIEW</u>	<u>26</u>
	<u>RESULTS OF OPERATIONS</u>	<u>30</u>
	<u>SUMMARY OF CHANGES</u>	<u>33</u>
	<u>LIQUIDITY AND CAPITAL RESOURCES</u>	<u>36</u>
Item 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>38</u>
Item 4.	<u>CONTROLS AND PROCEDURES</u>	<u>38</u>

PART II

Item 1.	<u>LEGAL PROCEEDINGS</u>	<u>40</u>
Item 1A.	<u>RISK FACTORS</u>	<u>40</u>
Item 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>40</u>
Item 3.	<u>DEFAULTS UPON SENIOR SECURITIES</u>	<u>40</u>
Item 4.	<u>MINE SAFETY DISCLOSURES</u>	<u>40</u>
Item 5.	<u>OTHER INFORMATION</u>	<u>40</u>
Item 6.	<u>EXHIBITS</u>	<u>41</u>

	<u>SIGNATURES</u>	<u>42</u>
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FORWARD-LOOKING STATEMENTS AND RISK FACTOR SUMMARY

This Quarterly Report on Form 10-Q (Form 10-Q) includes forward-looking statements within the meaning of the federal securities laws. These forward-looking statements, include, without limitation, statements concerning the impact on Elanco Animal Health Incorporated and its subsidiaries (collectively, Elanco, the Company, we, us or our) caused by the integration of Kindred Biosciences, Inc. (KindredBio) and the animal health business of Bayer Aktiengesellschaft (Bayer), expected synergies and cost savings, product launches, the coronavirus (COVID-19) global pandemic, conflict involving Russia and Ukraine and the potential impact on our business and global economic conditions, reduction of debt, expectations relating to liquidity and sources of capital, our expected compliance with debt covenants, cost savings, expenses, and reserves relating to restructuring actions, our industry and our operations, performance and financial condition, and including, in particular, statements relating to our business, growth strategies, distribution 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 risk 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 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 farm 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 farm animals;
- the impact on our operations, the supply chain, customer demand, and our liquidity as a result of the COVID-19 global health pandemic;
- the potential impact on our business and global economic conditions resulting from the conflict involving Russia and Ukraine;
- the success of our R&D and licensing efforts;
- misuse, off-label or counterfeiting use of our products;
- unanticipated safety, quality or efficacy concerns and the impact of identified concerns associated with our products;
- fluctuations in our business results due to seasonality and other factors;
- the impact of weather conditions and the availability of natural resources;
- risks related to the modification of foreign trade policy;
- risks related to currency rate fluctuations;
- our dependence on the success of our top products;
- the impact of customer exposure to rising costs and reduced customer income;
- the lack of availability or significant increases in the cost of raw materials;
- use of alternative distribution channels and the impact of increased or decreased sales to our channel distributors resulting in fluctuation in our revenues;
- risks related to the write-down of goodwill or identifiable intangible assets;
- risks related to the evaluation of animals;
- manufacturing problems and capacity imbalances;

- the impact of litigation, regulatory investigations, and other legal matters and the risk that our insurance policies may be insufficient to protect us from the impact of such matters;
- actions by regulatory bodies, including as a result of their interpretation of studies on product safety;
- risks related to tax expense or exposure;
- risks related to environmental, health and safety laws and regulations;
- risks related to our presence in foreign markets;
- challenges to our intellectual property rights or our alleged violation of rights of others;
- our dependence on sophisticated information technology and infrastructure and the impact of breaches of our information technology systems;
- the impact of increased regulation or decreased financial support related to farm animals;
- adverse effects of labor disputes, strikes, work stoppages, and the loss of key personnel or highly skilled employees;
- risks related to underfunded pension plan liabilities;
- our ability to complete acquisitions and successfully integrate the businesses we acquire, including KindredBio and the animal health business of Bayer (Bayer Animal Health);
- the effect of our substantial indebtedness on our business, including restrictions in our debt agreements that will limit our operating flexibility; and
- risks related to certain governance provisions in our constituent documents.

See Item 1A, “Risk Factors,” of Part I of our Annual Report on Form 10-K ([Form 10-K](#)) for the year ended December 31, 2021 filed with the United States (U.S.) Securities and Exchange Commission (SEC), and Part II of this Form 10-Q, 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 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. 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.

PART I**ITEM 1. FINANCIAL STATEMENTS**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Revenue	\$ 1,177	\$ 1,279	\$ 2,402	\$ 2,521
Costs, expenses and other:				
Cost of sales	484	551	993	1,120
Research and development	82	94	163	183
Marketing, selling and administrative	343	385	663	733
Amortization of intangible assets	133	129	270	276
Asset impairment, restructuring and other special charges	86	299	132	407
Interest expense, net of capitalized interest	67	60	119	121
Other (income) expense, net	—	(3)	9	(3)
	1,195	1,515	2,349	2,837
Income (loss) before income taxes	(18)	(236)	53	(316)
Income tax expense (benefit)	4	(26)	27	(45)
Net income (loss)	\$ (22)	\$ (210)	\$ 26	\$ (271)
Earnings (loss) per share:				
Basic	\$ (0.04)	\$ (0.43)	\$ 0.05	\$ (0.56)
Diluted	\$ (0.04)	\$ (0.43)	\$ 0.05	\$ (0.56)
Weighted average shares outstanding:				
Basic	488.4	487.3	488.2	487.0
Diluted	488.4	487.3	492.1	487.0

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Net income (loss)	\$ (22)	\$ (210)	\$ 26	\$ (271)
Other comprehensive income (loss):				
Cash flow hedges, net of taxes	8	(5)	117	48
Foreign currency translation	(470)	169	(555)	(297)
Defined benefit pension and retiree health benefit plans, net of taxes	(1)	3	(2)	11
Other comprehensive income (loss), net of taxes	(463)	167	(440)	(238)
Comprehensive loss	<u>\$ (485)</u>	<u>\$ (43)</u>	<u>\$ (414)</u>	<u>\$ (509)</u>

See notes to condensed consolidated financial statements.

Elanco Animal Health Incorporated
Condensed Consolidated Balance Sheets
(in millions, except share data)

	June 30, 2022 (Unaudited)	December 31, 2021
Assets		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 507	\$ 638
Accounts receivable, net of allowances of \$10 (2022) and \$12 (2021)	916	833
Other receivables	212	195
Inventories	1,334	1,373
Prepaid expenses and other	338	237
Total current assets	3,307	3,276
<i>Noncurrent Assets</i>		
Goodwill	5,898	6,172
Other intangibles, net	5,059	5,587
Other noncurrent assets	376	387
Property and equipment, net of accumulated depreciation of \$688 (2022) and \$1,041 (2021)	961	1,061
Total assets	\$ 15,601	\$ 16,483
Liabilities and Equity		
<i>Current Liabilities</i>		
Accounts payable	\$ 386	\$ 418
Employee compensation	113	185
Sales rebates and discounts	284	316
Current portion of long-term debt	56	294
Other current liabilities	499	430
Total current liabilities	1,338	1,643
<i>Noncurrent Liabilities</i>		
Long-term debt	6,007	6,025
Accrued retirement benefits	254	271
Deferred taxes	620	745
Other noncurrent liabilities	242	261
Total liabilities	8,461	8,945
<i>Commitments and Contingencies</i>		
<i>Equity</i>		
Preferred stock, no par value, 1,000,000,000 shares authorized; none issued	—	—
Common stock, no par value, 5,000,000,000 shares authorized, 474,097,334 and 473,119,786 shares issued and outstanding as of June 30, 2022 and December 31, 2021, respectively	—	—
Additional paid-in capital	8,712	8,696
Accumulated deficit	(923)	(949)
Accumulated other comprehensive loss	(649)	(209)
Total equity	7,140	7,538
Total liabilities and equity	\$ 15,601	\$ 16,483

See notes to condensed consolidated financial statements.

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

	Common Stock				Accumulated Other Comprehensive Income (Loss)					Total Equity
	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Cash Flow Hedge Gain (Loss)	Foreign Currency Translation	Defined Benefit Pension and Retiree Health Benefit Plans	Total		
December 31, 2020	471.9	\$ —	\$ 8,650	\$ (477)	\$ (61)	\$ 360	\$ 4	\$ 303	\$ 8,476	
Net loss	—	—	—	(61)	—	—	—	—	(61)	
Other comprehensive income (loss), net of tax	—	—	—	—	53	(466)	8	(405)	(405)	
Stock compensation	—	—	15	—	—	—	—	—	15	
Issuance of stock under employee stock plans, net	1.1	—	(18)	—	—	—	—	—	(18)	
March 31, 2021	473.0	—	8,647	(538)	(8)	(106)	12	(102)	8,007	
Net loss	—	—	—	(210)	—	—	—	—	(210)	
Other comprehensive income (loss), net of tax	—	—	—	—	(5)	169	3	167	167	
Stock compensation	—	—	16	—	—	—	—	—	16	
June 30, 2021	473.0	\$ —	\$ 8,663	\$ (748)	\$ (13)	\$ 63	\$ 15	\$ 65	\$ 7,980	
December 31, 2021	473.1	\$ —	\$ 8,696	\$ (949)	\$ 25	\$ (253)	\$ 19	\$ (209)	\$ 7,538	
Net income	—	—	—	48	—	—	—	—	48	
Other comprehensive income (loss), net of tax	—	—	—	—	109	(85)	(1)	23	23	
Stock compensation	—	—	14	—	—	—	—	—	14	
Issuance of stock under employee stock plans, net	1.0	—	(11)	—	—	—	—	—	(11)	
March 31, 2022	474.1	—	8,699	(901)	134	(338)	18	(186)	7,612	
Net loss	—	—	—	(22)	—	—	—	—	(22)	
Other comprehensive income (loss), net of tax	—	—	—	—	8	(470)	(1)	(463)	(463)	
Stock compensation	—	—	17	—	—	—	—	—	17	
Issuance of stock under employee stock plans, net	—	—	(4)	—	—	—	—	—	(4)	
June 30, 2022	474.1	\$ —	\$ 8,712	\$ (923)	\$ 142	\$ (808)	\$ 17	\$ (649)	\$ 7,140	

See notes to condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2022	2021
Cash Flows from Operating Activities		
Net income (loss)	\$ 26	\$ (271)
Adjustments to reconcile net income (loss) to cash flows from operating activities:		
Depreciation and amortization	347	372
Deferred income taxes	(40)	(114)
Stock-based compensation expense	31	31
Asset impairment and write-down charges	87	278
Loss on sale of assets	1	2
Gain on divestiture	(3)	—
Inventory fair value step-up amortization	—	63
Loss on extinguishment of debt	17	—
Proceeds from interest rate swap settlements	132	—
Changes in operating assets and liabilities	(369)	(190)
Other non-cash operating activities, net	21	—
Net Cash Provided by Operating Activities	250	171
Cash Flows from Investing Activities		
Net purchases of property and equipment	(45)	(35)
Cash paid for acquisitions, net of cash acquired	—	73
Purchases of intangible assets	(1)	(34)
Purchases of software	(13)	(12)
Other investing activities, net	(7)	(7)
Net Cash Used for Investing Activities	(66)	(15)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	425	—
Proceeds from revolving credit facility	563	150
Repayments of long-term borrowings	(528)	(37)
Repayments of revolving credit facility	(738)	(150)
Debt issuance costs	(1)	—
Other net financing transactions with Lilly	—	(11)
Other financing activities, net	(17)	(17)
Net Cash Used for Financing Activities	(296)	(65)
Effect of exchange rate changes on cash and cash equivalents	(19)	(17)
Net increase (decrease) in cash and cash equivalents	(131)	74
Cash and cash equivalents at January 1	638	506
Cash and cash equivalents at June 30	\$ 507	\$ 580

See notes to condensed consolidated financial statements.

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

Note 1. Background

Elanco is a global animal health company that innovates, develops, manufactures and markets products for pets and farm animals. We offer a portfolio of approximately 200 brands to pet owners, veterinarians and farm animal producers in more than 90 countries. Our products are generally sold worldwide directly to wholesalers, distributors, and independent retailers. Certain products are also sold directly to farm animal producers and veterinarians. We have a diversified business of products across species consisting of: dogs and cats (collectively, pet health) and cattle, poultry, swine and aqua (collectively, farm animal).

Elanco was incorporated in Indiana on September 18, 2018, and prior to that was a business unit of Eli Lilly and Company (Lilly).

Note 2. Basis of Presentation and Summary of Significant Accounting Policies

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with the U.S. Securities and Exchange Commission (SEC) requirements for interim reporting. As permitted under those rules, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the U.S. (GAAP) have been condensed or omitted. The information included in this Form 10-Q should be read in conjunction with our consolidated financial statements and accompanying notes for the year ended December 31, 2021 included in our [Form 10-K](#) filed with the SEC on February 28, 2022. In addition, results for interim periods should not be considered indicative of results for any other interim period or for the full year ending December 31, 2022 or any other future period.

In our opinion, the financial statements reflect all adjustments (including those that are normal and recurring) that are necessary for 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. Certain reclassifications of prior year information have been made to conform to the current year's presentation.

The significant accounting policies set forth in Note 3 to the consolidated financial statements in our Annual Report on [Form 10-K](#) for the year ended December 31, 2021 appropriately represent, in all material respects, the current status of our accounting policies, except as it relates to the adoption of the standard that was effective January 1, 2022 as described in Note 3: Implementation of New Financial Accounting Pronouncements.

Note 3. Implementation of New Financial Accounting Pronouncements

The following table provides a brief description of an accounting standard that was effective January 1, 2022 and was adopted on that date:

Standard	Description	Effect on the financial statements or other significant matters
ASU 2021-10, Government Assistance (Topic 832)	The amendments in this update require annual disclosure of transactions with governments that are accounted for by applying a grant or contribution model. The new pronouncement requires entities to provide information about the nature, terms and conditions associated with the transactions and the financial statement line items affected.	The adoption of this guidance did not have a material impact on our consolidated financial statements.

The following table provides a brief description of an accounting standard that is applicable to us but has not yet been adopted:

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
ASU 2020-04, <i>Reference rate reform (Topic 848) - Facilitation of the Effects of Reference Rate Reform on Financial Reporting</i> ; ASU 2021-01, <i>Reference Rate Reform (Topic 848): Scope</i>	ASU 2020-04 provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. ASU 2021-01 clarifies the scope of Topic 848 so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions.	Adoption of the guidance is optional and effective as of March 12, 2020 through December 31, 2022. Adoption is permitted at any time during the period on a prospective basis.	Our current credit facilities reference London Inter-Bank Offered Rate (LIBOR) as a benchmark rate. The underlying credit agreements include provisions which outline criteria for establishing a consistent replacement benchmark rate in the event that LIBOR is discontinued. Therefore, it is unlikely that we will need to adopt this optional guidance. However, we will continue to evaluate the impact as reference rate reform activities occur.

Note 4. Revenue

Our sales rebates and discounts are based on specific agreements. The most significant of our sales rebate and discount programs in terms of accrual and payment amounts, percentage of our products that are sold via these programs, and level of judgment required in estimating the appropriate transaction price, relate to our programs in the U.S., France and the United Kingdom (U.K.). As of June 30, 2022 and 2021, the aggregate liability for sales rebates and discounts for these countries represented approximately 77% and 73%, respectively, of our total liability.

The following table summarizes the activity in our global sales rebates and discounts liability:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Beginning balance	\$ 295	\$ 331	\$ 316	\$ 295
Reduction of revenue	176	178	355	367
Payments	(187)	(206)	(387)	(359)
Ending balance	\$ 284	\$ 303	\$ 284	\$ 303

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, 2022 and 2021 for product shipped in previous periods were not material.

Actual global product returns were approximately 1% of net revenue for the three and six months ended June 30, 2022 and 2021.

Disaggregation of Revenue

The following table summarizes our revenue disaggregated by product category:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Pet Health	\$ 612	\$ 685	\$ 1,251	\$ 1,330
Farm Animal:				
Cattle	248	224	495	485
Poultry	174	186	353	357
Swine	89	113	189	236
Aqua	42	44	85	67
Total Farm Animal	553	567	1,122	1,145
Contract Manufacturing ⁽¹⁾	12	27	29	46
Revenue	\$ 1,177	\$ 1,279	\$ 2,402	\$ 2,521

⁽¹⁾ Represents revenue from arrangements in which we manufacture products on behalf of a third party, including supply agreements associated with divestitures of products related to the acquisition of Bayer Animal Health.

Note 5. Acquisitions, Divestitures and Other Arrangements

KindredBio Acquisition

On August 27, 2021, we acquired KindredBio, a publicly traded biopharmaceutical company that develops innovative biologics focused on saving and improving the lives of pets. The acquisition further accelerates our pet health expansion, particularly by expanding our presence in dermatology.

The transaction was accounted for as a business combination under the acquisition method of accounting. The acquisition method requires, among other things, that assets acquired and liabilities assumed in a business combination be recognized at their fair values as of the acquisition date. The determination of estimated fair value requires management to make significant estimates and assumptions. The excess of the purchase price over the fair value of the acquired net assets, where applicable, has been recorded as goodwill. The results of operations of the acquisition is included in our condensed consolidated financial statements from the date of acquisition.

In connection with the merger agreement, we acquired all outstanding stock of KindredBio for \$9.25 per share, or an aggregate cash purchase consideration of \$444 million. We utilized our revolving credit facility and cash on hand to finance the acquisition.

On May 5, 2021, we signed an agreement with KindredBio to acquire exclusive global rights to KIND-030, a monoclonal antibody that is being developed for the treatment and prevention of canine parvovirus. We calculated the fair value of the liability associated with that agreement using an income approach leveraging the estimated sales royalty, sales milestone and technical milestone payments avoided, and settled the \$29 million liability upon the closing of our acquisition of KindredBio.

Revenue and loss from KindredBio included in our condensed consolidated statements of operations for the three and six months ended June 30, 2022 were immaterial.

The following table summarizes the preliminary amounts recognized for assets acquired and liabilities assumed as of the acquisition date:

Estimated Fair Value at August 27, 2021

Cash and cash equivalents	\$	31
Other net working capital		12
Property and equipment		33
Intangible assets, primarily acquired in-process research and development (IPR&D)		333
Deferred income taxes, net		(26)
Total identifiable net assets		383
Goodwill		32
Settlement of liability related to previous license agreement		29
Total consideration transferred	\$	444

The accounting for this acquisition is substantially complete, with the exception of the finalization of tax-related amounts and minor working capital adjustments. The measurement period adjustments recorded during 2022, which were made to reflect the facts and circumstances in existence as of the acquisition date, primarily related to changes in the estimated fair value of acquired IPR&D and minor tax and working capital adjustments. The net impact of these adjustments was not material. Finalization of the valuation during the measurement period could result in a change in the amounts recorded for the acquisition date fair value. The completion of the valuation will occur no later than one year from the acquisition date.

Property and equipment is mostly comprised of land, buildings, equipment (including laboratory equipment, furniture and fixtures, and computer equipment), and construction in progress. The estimated fair value of real and personal property was determined using the sales comparison data valuation technique, to the extent that market data for similar assets was available. When market pricing data was not available for a given asset or asset class, the direct replacement cost method was used.

The estimated fair values of acquired IPR&D were determined using the income approach, which is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset would generate over its remaining useful life. Some of the significant assumptions inherent in the development of these asset valuations include the estimated net cash flows for each year for each asset (including revenues, cost of sales, R&D expenses, marketing, selling and administrative expenses, and contributory asset charges), the appropriate discount rate necessary to measure the risk inherent in each future cash flow stream, the life cycle of each asset, the potential regulatory and commercial success risk, and competitive trends impacting the asset and each cash flow stream, as well as other factors.

The goodwill recognized from this acquisition is primarily attributable to KindredBio's assembled workforce and expected synergies. The majority of goodwill associated with this acquisition is not deductible for tax purposes.

Divestitures

Microbiome R&D platform carve-out

In April 2022, we signed an agreement to transfer assets associated with our microbiome R&D platform to a newly created, independent biopharmaceutical company, BiomEdit, focused on developing solutions for animal and human health. As part of the agreement, we retain a non-voting, minority stake in the company. Assets transferred include intellectual property and laboratory equipment. The book values of those assets were not material. In addition, we have entered into transitional services agreements with the company for certain services. We have determined that the disposal of the related net assets does not qualify for reporting as a discontinued operation because it does not represent a strategic shift that has or will have a major effect on our operations and financial results. During the three and six months ended June 30, 2022, we recorded a gain on the disposal of approximately \$3 million. While there is no certainty that additional equity in BiomEdit will be sold, the sale of additional Series A equity by the company during 2022 could result in additional gains.

Shawnee and Speke

During 2021, as part of our strategy to optimize our manufacturing footprint, we announced an agreement with TriRx Pharmaceuticals (TriRx) to sell our manufacturing sites in Shawnee, Kansas (Shawnee) and Speke, U.K. (Speke), including the planned transfer of approximately 600 employees. In connection with these arrangements, we also entered into long-term manufacturing and supply agreements, under which TriRx will manufacture existing Elanco products at both sites upon the closing of the transactions. On August 1, 2021, we completed the sale of our Shawnee site and expect to receive gross cash proceeds of \$51 million over a period of three years based on the terms of the agreement, beginning in the second half of 2022. On February 1, 2022, we completed the sale of our Speke site and expect to receive gross cash proceeds of \$29 million over a period of one year commencing 12 months from the closing date. Receivables for the expected cash proceeds are included in other receivables and other noncurrent assets on our condensed consolidated balance sheets. Upon closing, we recorded a contract asset of \$55 million for the favorable supply agreement, which is included in prepaid expenses and other and other noncurrent assets on our condensed consolidated balance sheets. The related assets for Speke were classified as held for sale as of December 31, 2021. The divestitures did not represent a strategic shift that has or will have a major effect on our operations and financial results, and therefore do not qualify for reporting as a discontinued operation. See Note 6: Asset Impairment, Restructuring and Other Special Charges for further information.

Assets Held For Sale

Assets and liabilities considered held for sale in connection with the above divestitures were included in the respective line items on our condensed consolidated balance sheets as follows:

	December 31, 2021
Inventories	\$ 31
Property and equipment, net	50
Total assets held for sale	\$ 81

BexCaFe Arrangement

On June 9, 2022, we signed a license agreement with BexCaFe, LLC (BexCaFe) for the development and commercialization of products related to an oral treatment intended to reduce glucose levels in diabetic cats. BexCaFe held the rights to the compound through a license agreement with similar terms and conditions. We will incur all development and regulatory costs associated with the products. Based on the guidance in Accounting Standards Codification (ASC) 810, *Consolidation*, we determined that BexCaFe represents a variable interest entity and that we are the primary beneficiary of BexCaFe because the terms of the license give us the power to direct the activities that most significantly impact the entity's economic performance. As a result, we consolidated BexCaFe, a development-stage company with no employees that did not meet the definition of a business, as of the date we signed the license agreement. Upon initial consolidation of BexCaFe, we measured an IPR&D asset at its fair value of \$59 million and recorded liabilities totaling \$59 million, which include contingent consideration of \$49 million based on the fair value of estimated future milestone payments and sales royalties owed under the license agreement. These liabilities are included in other current liabilities and other noncurrent liabilities on our condensed consolidated balance sheet as of June 30, 2022. The fair value of the contingent payments was calculated based on an income approach, with payments adjusted for probability of success and then discounted to a present value. There is no minimum payout due on the contingent consideration and the maximum payout is unlimited. Since BexCaFe did not meet the definition of a business, no goodwill was recorded and immediately after initial consolidation, we expensed the IPR&D asset because we concluded that it did not have an alternative future use. This amount is included in asset impairment, restructuring, and other special charges in our condensed consolidated statements of operations for the three and six months ended June 30, 2022.

Subsequent to the effective date of the license agreement, our condensed consolidated financial statements include the assets, liabilities, operating results and cash flows of BexCaFe. Based on the guidance in ASC 810, income and expense between us and BexCaFe have been eliminated against the income or expense included in the financial statements of BexCaFe. The resulting amounts after the effect of these eliminations were included in our condensed consolidated financial statements for the three and six months ended June 30, 2022 and were not material.

Note 6. Asset Impairment, Restructuring and Other Special Charges

In recent years, we have incurred substantial costs associated with restructuring programs and cost-reduction initiatives designed to achieve a flexible and competitive cost structure. As discussed further below, restructuring activities primarily include charges associated with facility rationalization and workforce reductions. In connection with our recent acquisitions, including the acquisition of Bayer Animal Health, we have also incurred costs associated with executing transactions and integrating acquired operations, which may include expenditures for banking, legal, accounting, and other similar services. In addition, we have incurred costs to stand up our organization as an independent company. All operating functions can be impacted by these actions; therefore, non-cash expenses associated with our tangible and intangible assets can be incurred as a result of revised fair value projections and/or determinations to no longer utilize certain assets in the business on an ongoing basis.

For finite-lived intangible assets and other long-lived assets, whenever impairment indicators are present, we calculate the undiscounted value of projected cash flows associated with the asset, or group of assets, and compare it to the carrying amount. If the carrying amount is greater, we record an impairment loss for the excess of book value over fair value. Determinations of fair value can result from a complex series of judgments and rely on estimates and assumptions. See Note 2: Basis of Presentation and Summary of Significant Accounting Policies for discussion regarding estimates and assumptions.

2021 Restructuring Programs

In 2021, we announced two separate restructuring programs to improve operating efficiencies.

The actions proposed in January 2021 focused on streamlining processes and delivering increased efficiency in functional areas, while improving the productivity of our investments in innovation. As part of the restructuring plan, we closed our R&D sites in Manukau, New Zealand and Cuxhaven, Germany. We have also reduced duplication and optimized structures in U.S. operations, marketing, manufacturing and quality central functions, and administrative areas. The restructuring resulted in the elimination of approximately 315 positions around the world. Activities related to this initiative resulted in net charges of \$3 million and \$44 million for the three and six months ended June 30, 2021, respectively, primarily consisting of severance costs and other non-cash charges. Restructuring charges under this program were substantially complete at the end of 2021.

The program announced in November 2021 included initiatives to consolidate certain international commercial operations into one organization, integrate our centralized global marketing organization into country level commercial organizations, transform and simplify our R&D organizational structure, and other organizational adjustments. In connection with the proposed restructuring, we eliminated 380 positions. During the three and six months ended June 30, 2022, we recorded adjustments of \$2 million and \$9 million, respectively, to reduce severance accruals resulting from final negotiations and certain restructured employees filling open positions. Restructuring charges under this program were substantially complete as of June 30, 2022; however, we may continue to make adjustments to our severance accruals to reflect changes in estimates resulting from ongoing negotiations.

Components of asset impairment, restructuring and other special charges are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Restructuring charges (credits):				
Severance and other costs ⁽¹⁾	\$ (2)	\$ 1	\$ (9)	\$ 28
Facility exit costs	1	—	2	—
Acquisition related charges:				
Transaction and integration costs ⁽²⁾	26	30	50	111
Non-cash and other items:				
Asset impairment ⁽³⁾	59	4	59	13
Asset write-down ⁽⁴⁾	—	267	28	269
Net periodic benefit cost (credits) (Note 14)	—	(8)	—	(17)
Settlements and other ⁽⁵⁾	2	5	2	3
Total expense	\$ 86	\$ 299	\$ 132	\$ 407

⁽¹⁾ 2022 credits primarily related to adjustments resulting from the reversal of severance accruals associated with the November 2021 program. For the three and six months ended June 30, 2021, charges mainly represent employee termination costs for the restructuring program announced and initiated in January 2021, partially offset by \$1 million and \$14 million, respectively, for the reversal of severance accruals associated with a restructuring program announced and initiated in 2020.

⁽²⁾ Transaction costs represent external costs directly related to acquiring businesses and primarily include expenditures for banking, legal, accounting and other similar services. Integration costs represent internal and external incremental costs directly related to integrating acquired businesses, including the acquisitions of KindredBio and Bayer Animal Health (e.g., expenditures for consulting, system and process integration, and product transfers), as well as independent company stand-up costs related to the implementation of new systems, programs, and processes.

⁽³⁾ 2022 includes a charge of \$59 million related to the expensing of an IPR&D asset with no alternative future use licensed from BexCaFe during the second quarter. See Note 5: Acquisitions, Divestitures and Other Arrangements for further discussion. 2021 represents the impact of adjustments to fair value of property and equipment, IPR&D assets, and marketed products that were subject to product rationalization.

⁽⁴⁾ 2022 includes the finalization of the write-down charge upon the final sale of the Speke manufacturing site. 2021 represents adjustments recorded to write down assets classified as held for sale to an amount equal to fair value less costs to sell. These charges related to our Shawnee and Speke manufacturing sites. See Note 5: Acquisitions, Divestitures and Other Arrangements for further discussion. Also included are charges recorded to write down assets in Belford Roxo, Brazil; Basel, Switzerland; Cuxhaven, Germany; and Manukau, New Zealand that were classified as held and used to their current fair value. These charges were recorded in connection with announced restructuring programs.

- (5) 2022 includes a \$2 million measurement period adjustment to the charge associated with the settlement of a liability for future royalty and milestone payments triggered in connection with our acquisition of KindredBio. See Note 5: Acquisitions, Divestitures and Other Arrangements for further discussion. For the three and six months ended June 30, 2021, charges mainly represent accounting and advisory fees related to the planned sale of our Shawnee and Speke manufacturing sites, partially offset by a gain recorded on the divestiture of an early-stage IPR&D asset acquired as part of the Bayer Animal Health acquisition.

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

	Severance
Balance at December 31, 2020	\$ 130
Charges	42
Reserve adjustments	(14)
Cash paid	(70)
Balance at June 30, 2021	<u>\$ 88</u>
Balance at December 31, 2021	\$ 126
Reserve adjustments	(9)
Cash paid	(63)
Balance at June 30, 2022	<u>\$ 54</u>

These reserves are included in other current and noncurrent liabilities on our condensed consolidated balance sheets. Substantially all of the reserves are expected to be paid in the next 12 months primarily due to certain country negotiations and regulations. 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 or the weighted average cost method.

Inventories consisted of the following:

	June 30, 2022	December 31, 2021
Finished products	\$ 618	\$ 598
Work in process	545	565
Raw materials and supplies	222	256
Total	<u>1,385</u>	<u>1,419</u>
Decrease to LIFO cost	(51)	(46)
Inventories	<u>\$ 1,334</u>	<u>\$ 1,373</u>

Note 8. Equity

Tangible Equity Unit (TEU) Offering

On January 22, 2020, we completed our offering of 11 million, 5.00% TEUs. Total proceeds, net of issuance costs, were \$528 million. Each TEU, which has a stated amount of \$50, is comprised of a prepaid stock purchase contract (prepaid stock) and a senior amortizing note due February 1, 2023. Subsequent to issuance, each TEU may be legally separated into the two components. The prepaid stock is considered a freestanding financial instrument, indexed to Elanco common stock, and meets the conditions for equity classification.

The value allocated to the prepaid stock is reflected net of issuance costs in additional paid-in capital. The value allocated to the senior amortizing notes is reflected in current portion of long-term debt on the condensed consolidated balance sheets. Issuance costs related to the amortizing notes are reflected as a reduction of the carrying amount and will be amortized through the maturity date using the effective interest rate method.

The proceeds from the issuance were allocated to equity and debt based on the relative fair value of the respective components of each TEU as follows:

	Equity Component	Debt Component	Total
Fair value per unit	\$ 42.80	\$ 7.20	\$ 50.00
Gross proceeds	\$ 471	\$ 79	\$ 550
Less: Issuance costs	19	3	22
Net proceeds	\$ 452	\$ 76	\$ 528

The senior amortizing notes have an aggregate principal amount of \$79 million and bear interest at 2.75% per year. On each February 1, May 1, August 1, and November 1 until the maturity date, we will pay equal quarterly cash installments of \$0.6250 per each amortizing note with an initial principal amount of \$7.2007 (except for the first installment payment of \$0.6528 per amortizing note paid on May 1, 2020). Each installment constitutes a payment of interest and partial payment of principal, and in the aggregate will be equivalent to 5.00% per year with respect to the \$50 stated amount per TEU.

Unless settled early at the holder's or our election, each prepaid stock purchase contract will automatically settle on February 1, 2023 (the mandatory settlement date) for a number of shares of common stock per contract based on the average of the volume-weighted average trading prices during the 20 consecutive trading day period beginning on, and including the 21st scheduled trading day immediately preceding February 1, 2023 (applicable market value) with reference to the following settlement rates:

Applicable Market Value	Common Stock Issued
Equal to or greater than \$38.40	1.3021 shares (minimum settlement rate)
Less than \$38.40, but greater than \$32.00	\$50 divided by applicable market value
Less than or equal to \$32.00	1.5625 (maximum settlement rate)

The prepaid stock purchase contracts are mandatorily convertible into a minimum of 14 million shares or a maximum of 17 million shares of our common stock on the mandatory settlement date (unless redeemed by us or settled earlier at the unit holder's option). The 14 million minimum shares are included in the calculation of basic weighted average shares outstanding. The difference between the minimum and maximum shares represents potentially dilutive securities, which are included in the calculation of diluted weighted average shares outstanding on a pro rata basis to the extent that the average applicable market value is higher than \$32.00 but is less than \$38.40 during the period. The entire additional 3 million shares are included in diluted weighted average shares outstanding if the applicable market value is at or below \$32.00 and the impact is not anti-dilutive.

Note 9. Debt

Long-term debt consisted of the following:

	June 30, 2022	December 31, 2021
Incremental Term Facility due 2025 ⁽¹⁾	\$ 175	\$ —
Incremental Term Facility due 2028	496	499
Incremental Term Facility due 2029 ⁽²⁾	250	—
Term Loan B	4,027	4,118
Revolving Credit Facility	75	250
4.272% Senior Notes due 2023 ⁽³⁾	344	750
4.900% Senior Notes due 2028	750	750
TEU Amortizing Notes	20	34
Unamortized debt issuance costs	(74)	(82)
	6,063	6,319
Less current portion of long-term debt	56	294
Total long-term debt	\$ 6,007	\$ 6,025

⁽¹⁾ In June 2022, we entered into an incremental assumption agreement with Bank of America, N.A. supplementing and amending our existing credit agreement dated August 1, 2020 relating to our senior secured credit facility. The incremental assumption agreement provides for a new incremental term facility with an aggregate principal amount of \$175 million. The new incremental term facility bears interest at the Secured Overnight Financing Rate (Term SOFR), including a credit spread adjustment, plus 175 basis points and is payable in full on June 30, 2025. The proceeds were used to repay a portion of our outstanding obligations under our revolving credit facility.

⁽²⁾ In April 2022, we entered into an incremental assumption agreement with Farm Credit Mid-America, PCA supplementing and amending our existing credit agreement dated August 1, 2020 relating to our senior secured credit facility. The incremental assumption agreement provides for a new incremental term facility with an aggregate principal amount of \$250 million maturing on April 19, 2029. The new incremental term facility bears interest at Term SOFR, including a credit spread adjustment, plus 175 basis points and is payable in quarterly installments of principal and interest with a final balloon payment due on April 19, 2029. The proceeds were used to repay a portion of our outstanding obligations under our revolving credit facility.

⁽³⁾ In April 2022, we completed a tender offer and retired \$406 million in aggregate principal amount of our 4.272% Senior Notes due August 28, 2023, resulting in a debt extinguishment loss of approximately \$17 million recognized in interest expense, net of capitalized interest in the condensed consolidated statements of operations. The repayment was funded with proceeds received from a draw under our revolving credit facility.

We were in compliance with all of our debt covenants as of June 30, 2022.

Note 10. Financial Instruments and Fair Value

Financial instruments that are potentially subject to credit risk consist principally of trade receivables. We evaluate the creditworthiness of our customers on a regular basis, monitor economic conditions, and calculate allowances for estimated credit losses on our trade receivables on a quarterly basis using an expected credit loss model. We assess whether collectability is probable at the time of sale and on an ongoing basis. Collateral is generally not required. The risk associated with this concentration is mitigated by our ongoing credit-review procedures.

A large portion of our cash is held by 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 had investments without readily determinable fair values and equity method investments included in other noncurrent assets on our condensed consolidated balance sheets totaling \$31 million and \$22 million as of June 30, 2022 and December 31, 2021, respectively. Unrealized net gains and losses on our investments for the three and six months ended June 30, 2022 and 2021 were immaterial.

The following table summarizes the fair value information at June 30, 2022 and December 31, 2021 for foreign exchange contract assets (liabilities), investments, and cash flow hedge assets (liabilities) measured at fair value on a recurring basis in the respective balance sheet line items, as well as long-term debt (including TEU amortizing notes) for which fair value is disclosed on a recurring basis:

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, 2022					
Prepaid expenses and other - foreign exchange contracts not designated as hedging instruments	\$ 48	\$ —	\$ 48	\$ —	\$ 48
Prepaid expense and other - forward-starting interest rate contracts designated as cash flow hedges	18	—	18	—	18
Other noncurrent assets - forward-starting interest rate contracts designated as cash flow hedges	4	—	4	—	4
Other noncurrent assets - investments	9	9	—	—	9
Other current liabilities - foreign exchange contracts not designated as hedging instruments	(48)	—	(48)	—	(48)
Other noncurrent liabilities - forward-starting interest rate contracts designated as cash flow hedges	(3)	—	(3)	—	(3)
Long-term debt, including current portion	(6,137)	—	(5,892)	—	(5,892)
December 31, 2021					
Prepaid expenses and other - foreign exchange contracts not designated as hedging instruments	\$ 19	\$ —	\$ 19	\$ —	\$ 19
Other noncurrent assets - investments	13	13	—	—	13
Other noncurrent assets - forward-starting interest rate contracts designated as cash flow hedges	8	—	8	—	8
Other current liabilities - foreign exchange contracts not designated as hedging instruments	(20)	—	(20)	—	(20)
Long-term debt, including current portion	(6,401)	—	(6,518)	—	(6,518)

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

Derivative Instruments and Hedging Activities

We are exposed to market risks, such as changes in foreign currency exchange rates and interest rates. To manage the volatility related to these exposures, we have entered into various derivative transactions. We formally assess, designate and document, as a hedge of an underlying exposure, each qualifying derivative instrument that will be accounted for as an accounting hedge at inception. Additionally, we assess, both at inception and at least quarterly thereafter, whether the financial instruments used in the hedging transaction are effective at offsetting changes in either the fair values or cash flows of the underlying exposures. Derivative cash flows, with the exception of net investment hedges, are principally classified in the operating activities section of the condensed consolidated statements of cash flows, consistent with the underlying hedged item. Cash flows related to net investment hedges are classified in the investing activities section of the consolidated statements of cash flows. Our outstanding positions are discussed below.

Derivatives not designated as hedges

We may enter into foreign exchange forward or option contracts to reduce the effect of fluctuating currency exchange rates. These derivative financial instruments primarily offset exposures in the Euro, British pound, Swiss franc, Brazilian real, Australian dollar, Japanese yen, Canadian dollar, and Chinese yuan. Foreign currency derivatives used for hedging are put in place using the same or like currencies and duration as the underlying exposures and are recorded at fair value with the gain or loss recognized in other expense, net in the condensed consolidated statements of operations. Forward contracts generally have maturities not exceeding 12 months. At June 30, 2022 and December 31, 2021, we had outstanding foreign exchange contracts with aggregate notional amounts of \$1,085 million and \$1,212 million, respectively.

The amount of net gains (losses) on derivative instruments not designated as hedging instruments, recorded in other (income) expense, net were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Foreign exchange forward contracts ⁽¹⁾	\$ (7)	\$ 7	\$ (15)	\$ (27)

⁽¹⁾ These amounts were substantially offset in other (income) expense, net by the effect of changing exchange rates on the underlying foreign currency exposures.

Derivatives designated as hedges

We are subject to interest rate risk with regard to our existing floating-rate debt, and we utilize interest rate swap contracts to mitigate the variability in cash flows by effectively converting the floating-rate debt into fixed-rate debt. We recognize any differences between the variable interest rate payments and the fixed interest rate settlements with the swap counterparties as an adjustment to interest expense, net of capitalized interest over the life of the swaps. We have designated these swaps as cash flow hedges and record them at fair value on the condensed consolidated balance sheets. Changes in the fair value of the hedges are recognized in other comprehensive income (loss). Fair value is estimated based on quoted market values of similar hedges and is classified as Level 2. Our outstanding forward-starting interest rate swaps have maturities ranging between 2022 and 2025 with aggregate notional amounts of \$3,050 million and \$3,800 million as of June 30, 2022 and December 31, 2021, respectively.

The amounts of net gains (losses) on cash flow hedges recorded, net of tax, in other comprehensive income (loss), are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Forward-starting interest rate swaps	\$ 8	\$ (5)	\$ 117	\$ 48

During the three months ended June 30, 2022 and 2021, net gains (losses) on cash flow hedges recorded in other comprehensive income (loss) included an unrealized gain of \$33 million and an unrealized loss of \$5 million, respectively, related to mark-to-market adjustments. During the six months ended June 30, 2022 and 2021, net gains (losses) on cash flow hedges recorded in other comprehensive income (loss) included unrealized gains of \$143 million and \$48 million, respectively, related to mark-to-market adjustments.

In April 2022, we took advantage of market opportunities to restructure our interest rate swap portfolio. We unwound the existing swaps and simultaneously entered into new agreements with the same notional amounts and covering the same tenors. As a result, we received a cash settlement of \$132 million. This gain was initially recognized in accumulated other comprehensive loss and will be reclassified to interest expense, net of capitalized interest over the period during which the related interest payments will be made.

Additionally, as a result of the April 2022 interest rate swap settlement, other comprehensive income (loss) for the three and six months ended June 30, 2022 included a \$17 million reclassification of stranded tax benefit from accumulated other comprehensive loss, based on our policy to reclassify income tax effects from accumulated other comprehensive loss using the portfolio approach, as well as \$8 million of reclassification of unrealized gains. Other than the reclassification of the stranded tax benefit, there was no tax effect recorded in relation to our cash flow hedges for the three and six months ended June 30, 2022 and 2021 after the application of the U.S. valuation allowance. See Note 11: Income Taxes for further discussion.

During the three months ended June 30, 2022 and 2021, we reclassified \$7 million of net losses into interest expense, net of capitalized interest in our condensed consolidated statements of operations. During the six months ended June 30, 2022 and 2021, we reclassified \$10 million and \$14 million, respectively, of net losses into interest expense. Over the next 12 months, we expect to reclassify a gain of \$72 million, which includes \$53 million relating to the interest rate swap settlement, to interest expense, net of capitalized interest.

Note 11. Income Taxes

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Income tax expense (benefit)	\$ 4	\$ (26)	\$ 27	\$ (45)
Effective tax rate	(22.5)%	11.1 %	50.7 %	14.2 %

We were 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 our initial public offering (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. The U.S. examination of tax years 2016 to 2018 began in the fourth quarter of 2019 and remains ongoing. The resolution of this audit period will likely extend beyond the next 12 months.

For the three and six months ended June 30, 2022, we recognized income tax expense of \$4 million and \$27 million, respectively. Our effective tax rate of (22.5)% and 50.7%, respectively, differs from the statutory income tax rate largely due to changes in the earnings mix between periods resulting in projected losses in the U.S. The U.S. federal and state losses are subject to valuation allowances. The income tax expense was partially offset by the \$17 million income tax benefit reclassified from accumulated other comprehensive loss due to the termination of interest rate swaps during the period.

For the three and six months ended June 30, 2021, we recognized an income tax benefit of \$26 million and \$45 million, respectively. Our effective tax rate of 11.1% and 14.2%, respectively, differs from the statutory income tax rate primarily because the U.S. federal and state jurisdictions were currently generating losses that were subject to valuation allowances.

Note 12. Commitments and Contingencies

Legal Matters

On May 20, 2020, a shareholder class action lawsuit captioned *Hunter v. Elanco Animal Health Inc., et al.* was filed in the United States District Court for the Southern District of Indiana (the Court) against Elanco and certain executives. On September 3, 2020, the Court appointed a lead plaintiff, and on November 9, 2020, the lead plaintiff filed an amended complaint adding additional claims against Elanco, certain executives, and other individuals. The lawsuit alleges, in part, that Elanco and certain of its executives made materially false and/or misleading statements and/or failed to disclose certain facts about Elanco's supply chain, inventory, revenue and projections. The lawsuit seeks unspecified monetary damages and purports to represent purchasers of Elanco securities between September 30, 2018 and May 6, 2020, and purchasers of Elanco common stock issued in connection with Elanco's acquisition of Aratana. We filed a motion to dismiss on January 13, 2021. The timing of the Court's decision is uncertain. We believe the claims made in the case are meritless, and we intend to vigorously defend our position. The process of resolving these matters is inherently uncertain and may develop over an extended period of time; therefore, at this time, the ultimate resolution cannot be predicted.

On October 16, 2020, a shareholder class action lawsuit captioned *Saffron Capital Corporation v. Elanco Animal Health Inc., et al.* was filed in the Marion Superior Court of Indiana against Elanco, certain executives, and other individuals. On December 23, 2020, the plaintiffs filed an amended complaint adding an additional plaintiff. The lawsuit alleges, in part, that Elanco and certain of its executives made materially false and/or misleading statements and/or failed to disclose certain facts about Elanco's relationships with third party distributors and revenue attributable to those distributors within the registration statement on Form S-3 dated January 21, 2020 and accompanying prospectus filed in connection with Elanco's public offering which closed on or about January 27, 2020. The lawsuit seeks unspecified monetary damages and purports to represent purchasers of Elanco common stock or 5.00% TEUs issued in connection with the public offering. This case is currently stayed in deference to *Hunter v. Elanco Animal Health Inc.*

Claims seeking actual damages, injunctive relief, and/or restitution for allegedly deceptive marketing have been made against Elanco Animal Health Inc. and Bayer HealthCare LLC, along with other Elanco and Bayer entities, arising out of the use of *Seresto*[™], a non-prescription flea and tick collar for cats and dogs. During 2021, putative class action lawsuits were filed in federal courts in the U.S. alleging that the *Seresto* collars contain pesticides that can cause serious injury and death to cats and/or dogs wearing the product. The cases mention the existence of incident reports involving humans, but no plaintiff has claimed personal harm from the product. In August 2021, the lawsuits were consolidated by the Judicial Panel on Multidistrict Litigation, and the cases were transferred to the Northern District of Illinois. We are vigorously defending these lawsuits.

Further, in March 2021, a U.S. House of Representatives subcommittee chair requested that Elanco produce certain documents and information related to the *Seresto* collar and further made a request to temporarily recall *Seresto* collars from the market. On June 15, 2022, the subcommittee held a hearing at which our President and Chief Executive Officer (CEO) testified. During and after the hearing, the subcommittee chair repeated his request that Elanco voluntarily recall the collars and also requested that the Environmental Protection Agency (EPA) commence administrative proceedings that would allow the EPA to remove *Seresto* from the market.

Seresto is a pesticide registered with the EPA. A non-profit organization submitted a petition to the EPA requesting that the agency take action to cancel *Seresto*'s pesticide registration and suspend the registration pending cancellation. The EPA is considering this petition and asked for public comment. We submitted a comment to the EPA supporting the safety profile of *Seresto*. Data and scientific evaluation used during the product registration process and through pharmacovigilance review supports the product's positive safety profile and efficacy. Therefore, we believe no removal, recall, or cancellation of the pesticide registration is warranted, nor has it been suggested by any regulatory agency. We continue to stand behind the safety profile for *Seresto*, and it remains available to consumers globally.

We are party to various other 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 accrue for liability claims to the extent that it is probable we will incur a loss and we can formulate a reasonable estimate of the costs. As of June 30, 2022 and December 31, 2021, we had no material liabilities established related to litigation as there were no significant claims which were probable and estimable. We are not currently subject to a significant claim other than the lawsuits noted above.

Regulatory Matters

On July 1, 2021, we received a subpoena from the SEC relating to our channel inventory and sales practices prior to mid-2020. We have cooperated in providing documents and information to the SEC and will continue to do so. Management believes that its actions were appropriate.

Other Commitments

As of June 30, 2022, we have a lease commitment that has not yet commenced for our new corporate headquarters in Indianapolis, Indiana. Total minimum lease payments are estimated to be approximately \$310 million over a term of 25 years, excluding extensions. Final lease payments may vary depending on the actual cost of certain construction activities. Lease commencement is expected in 2024.

The land for our new corporate headquarters is located in a Tax Increment Finance District, and the project is, in part, funded through Tax Incremental Financing (TIF) through an incentive agreement between us and the City of Indianapolis. The agreement provides for an estimated total incentive of \$64 million to be funded by the City of Indianapolis in connection with the future tax increment revenue generated from the developed property. In December 2021, as part of a funding and development agreement entered into between us and the developer, we made a commitment to use the expected TIF proceeds towards the cost of developing and constructing the headquarters. In exchange, the developer reimbursed us up to the \$64 million commitment in 2021. We expect to refund approximately \$15 million to the developer within the next 12 months, and this amount is included in other current liabilities on our condensed consolidated balance sheet as of June 30, 2022. As a result, it is our expectation that our future lease payments will be reduced. The remaining accrued incentive is included in other noncurrent liabilities on our condensed consolidated balance sheets and will be amortized over the lease term beginning at the commencement date and offset future rent expense.

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 pets and farm animals. Consistent with our operational structure, our 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 costs/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 *AviPro*[™], *Baytril*[™], *Cydectin*[™], *Catosal*[™], *Denagard*[™], *Maxiban*[™], *Rumensin*[™], *Pulmotil*[™], and other products for livestock and poultry, as well as *Advantage*[™], *Advantix*[™], *Advocate*[™] (collectively referred to as the *Advantage Family*), *Credelio*[™], *Duramune*[™], *Galliprant*[™], *Interceptor*[™] *Plus*, *Seresto*, *Trifexis*[™], and other products for pets.

We have a single customer that accounted for 10% of revenue for the three months ended June 30, 2022 and 2021, and 10% and 8% of revenue for the six months ended June 30, 2022 and 2021, respectively. Product sales with this customer resulted in accounts receivable of \$78 million and \$74 million as of June 30, 2022 and December 31, 2021, 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,	
	2022	2021	2022	2021
Revenue				
United States	\$ 539	\$ 581	\$ 1,061	\$ 1,114
International	638	698	1,341	1,407
Revenue	\$ 1,177	\$ 1,279	\$ 2,402	\$ 2,521

Note 14. Retirement Benefits

The following table summarizes net periodic benefit cost (income) relating to our defined benefit pension plans:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Service cost	\$ 3	\$ 5	\$ 7	\$ 10
Interest cost	1	—	2	1
Expected return on plan assets	(1)	(1)	(3)	(3)
Amortization of prior service cost	(1)	(2)	(2)	(4)
Amortization of net actuarial loss	—	—	—	1
Net curtailments and settlements (Note 6)	—	(8)	—	(17)
Net periodic benefit cost (income)	\$ 2	\$ (6)	\$ 4	\$ (12)

The components of net periodic benefit cost (income) other than service cost and net curtailments and settlements are included in other (income) expense, net in our condensed consolidated statements of operations. Net curtailments and settlements are included in asset impairment, restructuring and other special charges in our condensed consolidated statements of operations.

Note 15. Earnings (Loss) Per Share

We compute basic earnings (loss) per share by dividing net income (loss) available to common shareholders by the actual weighted average number of common shares outstanding for the reporting period. Elanco has variable common stock equivalents relating to certain equity awards in stock-based compensation arrangements and the TEU prepaid stock purchase contracts (see Note 8: Equity for further discussion). Diluted earnings per share reflects the potential dilution that could occur if holders of the unvested equity awards and unsettled TEUs converted their holdings into common stock. The weighted average number of potentially dilutive shares outstanding is calculated using the treasury stock method. Potential common shares that would have the effect of increasing diluted earnings per share (or reducing loss per share) are considered to be anti-dilutive and as such, these shares are not included in the calculation of diluted earnings (loss) per share.

Basic and diluted earnings (loss) per share are calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Net income (loss) available to common shareholders	\$ (22)	\$ (210)	\$ 26	\$ (271)
Determination of shares:				
Weighted average common shares outstanding	488.4	487.3	488.2	487.0
⁽¹⁾ Assumed conversion of dilutive common stock equivalents	—	—	3.9	—
Diluted weighted average shares outstanding	488.4	487.3	492.1	487.0
Earnings (loss) per share ⁽²⁾				
Basic	\$ (0.04)	\$ (0.43)	\$ 0.05	\$ (0.56)
Diluted	\$ (0.04)	\$ (0.43)	\$ 0.05	\$ (0.56)

⁽¹⁾ For periods with a reported net loss, dilutive common stock equivalents are not assumed to have been issued since their effect is anti-dilutive. As a result, basic and diluted weighted average shares are the same, causing diluted net loss per share to be equivalent to basic net loss per share. For the three months ended June 30, 2022 and 2021, approximately 3.2 million and 4.2 million, respectively, of potential common shares were excluded from the calculation of diluted earnings (loss) per share because their effect was anti-dilutive. For the six months ended June 30, 2022 and 2021, approximately 1.6 million and 4.3 million, respectively, of potential common shares were excluded from the calculation of diluted earnings (loss) per share because their effect was anti-dilutive.

⁽²⁾ Due to rounding conventions, earnings (loss) per share may not recalculate precisely based on the amounts presented within this table.

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 (MD&A) 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 condensed consolidated financial statements and accompanying footnotes in Item 1 of Part I of this Form 10-Q. Certain statements in this Item 2 of Part I of this Form 10-Q constitute forward-looking statements. Various risks and uncertainties, including those discussed in "Forward-Looking Statements" of this Form 10-Q, in Item 1A, "Risk Factors" of Part II of this Form 10-Q, and in Item 1A, "Risk Factors" of Part I of our [Form 10-K](#) for the year ended December 31, 2021, may cause our actual results, financial position, and cash generated from operations to differ materially from these forward-looking statements. Further, due to the seasonality of our pet health sales, interim results are not necessarily an appropriate base from which to project annual results.

Overview

Elanco is a global animal health company that develops products for pets and farm animals in more than 90 countries. With a heritage dating back to 1954, we rigorously innovate to improve the health of animals and to benefit our customers while fostering an inclusive, cause-driven culture for our employees. 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.

On August 27, 2021, we acquired KindredBio, a biopharmaceutical company that develops innovative biologics focused on saving and improving the lives of pets. We had previously signed an agreement with KindredBio in the second quarter of 2021 to acquire exclusive global rights to KIND-030, a monoclonal antibody in development for the treatment and prevention of canine parvovirus. The acquisition of KindredBio further accelerates our opportunity for expansion in pet health, notably by expanding our research efforts in dermatology. See Note 5: Acquisitions, Divestitures and Other Arrangements to the condensed consolidated financial statements for additional information on the acquisition. Subsequent to the acquisition date, our consolidated financial statements include the assets, liabilities, operating results and cash flows of KindredBio.

On August 1, 2020, we completed the acquisition of Bayer Animal Health. The acquisition expanded our pet health product category, advancing our planned portfolio mix transformation and creating a better balance between our farm animal and pet health product categories. Our product portfolio and pipeline have been enhanced by the addition of Bayer Animal Health, which complements our commercial operations and international infrastructure.

We offer a diverse portfolio of approximately 200 brands that make us a trusted partner to pet owners, veterinarians and farm animal producers. Our products are generally sold worldwide to third-party distributors and independent retailers, and directly to farm animal producers and veterinarians. With the acquisition of Bayer Animal Health, we have expanded our presence in retail and e-commerce channels in order to meet pet owners where they want to purchase.

We operate our business in a single segment directed at fulfilling our vision of food and companionship enriching life – all to advance the health of animals, people and the planet. We advance our vision by offering products in these two primary categories:

Pet Health: Our pet health portfolio is focused on parasiticides, vaccines and therapeutics. We have one of the broadest parasiticide portfolios in the pet health sector based on indications, species and formulations, with products that protect pets from worms, fleas and ticks. Our *Seresto* and *Advantage Family* products are over-the-counter treatments for the elimination and prevention, respectively, of fleas and ticks, and complement our prescription parasiticide products, *Credelio*, *Interceptor Plus*, and *Trifexis*. Our vaccines portfolio provides differentiated prevention coverage for a number of important pet health risks and is available in the U.S. only. In 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. Additionally, we have products that offer treatment for otitis (ear infections) with *Claro*, as well as treatments for certain cardiovascular and dermatology indications.

Farm Animal: Our farm animal portfolio consists of products designed to prevent, control and treat health challenges primarily focused on cattle (beef and dairy), swine, poultry, and aquaculture (cold and warm water) production. Our products include medicated feed additives, injectable antibiotics, vaccines, insecticides, and enzymes, among others. We have a wide range of farm animal products, including *Rumensin* and *Baytril*, both of which are used extensively in ruminants (e.g., cattle, sheep and goats). In poultry, our *Maxiban* product, is a valuable offering for the control and prevention of intestinal disease.

A summary of our 2022 revenue and net income (loss) compared with the same period in 2021 is as follows:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Revenue	\$ 1,177	\$ 1,279	\$ 2,402	\$ 2,521
Net income (loss)	(22)	(210)	26	(271)

Increases or decreases in inventory levels at our channel distributors can positively or negatively impact our quarterly and annual revenue results, leading to variations in revenues. This can be a result of various factors, such as end customer demand, new customer contracts, heightened and generic competition, the need for certain inventory levels, our ability to renew distribution contracts with expected terms, our ability to implement commercial strategies, regulatory restrictions, unexpected customer behavior, proactive measures taken by us in response to shifting market dynamics, payment terms we extend, which are subject to internal policies, and procedures and environmental factors beyond our control, including weather conditions and the COVID-19 global pandemic.

Key Trends and Conditions Affecting Our Results of Operations

Industry Trends

The animal health industry, which includes both pets and farm animals, is a growing industry that benefits billions of people worldwide.

We believe that factors influencing growth in demand for pet 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.

As demand for animal protein grows, farm animal health is becoming increasingly important. We believe that factors influencing growth in demand for farm animal medicines and vaccines include:

- two in three people needing 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 farm 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 farm 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 Affecting Our Results of Operations

Russia-Ukraine Conflict

In February 2022, Russia commenced military action against Ukraine. In response, the U.S. and certain other countries imposed and continue to impose significant sanctions and export controls against Russia, Belarus and certain individuals and entities connected to Russian or Belarusian political, business, and financial organizations. The U.S. and certain other countries could impose further sanctions, trade restrictions, and other retaliatory actions if the conflict continues or worsens. The broader consequences of the conflict, including related inflationary pressures, geopolitical tensions, additional retaliatory actions taken by the U.S. and other countries, and any counter retaliatory actions by Russia or Belarus in response, including, for example, potential cyberattacks or the disruption of energy and commodity exports, are likely to cause regional instability and could materially adversely affect global trade, currency exchange rates, regional economies and the global economy. The situation remains uncertain and it is difficult to predict the impact that the conflict and actions taken in response to the conflict will have on our business; however, they could increase our costs, disrupt our supply chain, reduce our sales and earnings, or otherwise adversely affect our business and results of operations.

As a global animal health leader, we have an obligation to support the health of animals and people. At the center of that work is ensuring access and availability of food. At this time, we are limiting our business in Russia to only the essential products that support these needs, while complying with all imposed sanctions. We do not manufacture products or source any materials from companies in Russia for use in our products, nor do we conduct business with the Russian government. During the six months ended June 30, 2022, revenue to Russian and Ukrainian customers represented approximately 1% of our consolidated revenue. Assets held in Russia as of June 30, 2022 represented less than 1% of our consolidated assets.

COVID-19 Pandemic and Resulting Operating Environment

We continue to closely monitor the impact of the COVID-19 pandemic, including its variants, and the related economic effects on all aspects of our business, including impacts on our operations, supply chain, and customer demand. The extent to which the COVID-19 pandemic may impact our financial condition and results of operations remains uncertain and is dependent on developments that are out of our control, including measures being taken by authorities to mitigate against the spread of COVID-19, such as the recent lockdowns in China, the emergence of new variants and the availability and successful administration of effective vaccines. We cannot predict the impact that the ongoing COVID-19 pandemic will have on our employees, customers, vendors and suppliers; however, the COVID-19 pandemic has had and may continue to have an adverse impact on our business if these parties continue to experience negative effects.

While the situation surrounding the COVID-19 pandemic remains fluid, the effects have disrupted the global supply chain across all modes of transportation, which in turn has resulted in less reliable transportation schedules and increased freight costs. This disruption, combined with increased demand for key raw materials, including those used in COVID-19 vaccine manufacturing, and labor constraints has also impacted our suppliers, resulting in shortages of raw materials or components required to manufacture our products. We continue to work closely with suppliers and freight partners to mitigate impacts to our operations and customers, including the addition of new transportation routes and targeted increases of certain safety stocks. Although we regularly monitor the financial health of companies in our supply chain, prolonged financial hardship on our suppliers and labor shortages could continue to disrupt our ability to obtain key raw materials, adversely affecting our operations. The global industry freight environment has experienced, and could continue to experience, lead time disruptions and increases in shipping costs, negatively impacting our profitability.

Our Acquisition of Bayer Animal Health and KindredBio

We have incurred and expect to continue to incur expenses in connection with our acquisitions of Bayer Animal Health and KindredBio, including fees for professional services such as legal, accounting, consulting, and other advisory fees and expenses. Expenses incurred in 2021 and thus far in 2022 are primarily related to integration activities. In addition, we have 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 and to expand administrative functions, including, but not limited to, information technology, facilities management, distribution, human resources, and manufacturing, to replace services previously provided by the former parent company of Bayer Animal Health. We anticipate that these additional costs will be partially offset by expected synergies.

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. We continue to pursue the development of new chemical and biological molecules through our approach to innovation. Our future growth and success depend 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 R&D, with a track record of product innovation, business development and commercialization.

Competition

We face intense competition. Principal methods of competition vary depending on the particular region, species, product category, or individual product. Some of these methods include new product development, including generic alternatives to our products, quality, price, service and promotion.

Our primary competitors include animal health medicines and vaccines companies such as Zoetis Inc.; Boehringer Ingelheim Vetmedica, Inc., the animal health division of Boehringer Ingelheim GmbH; and Merck Animal Health, the animal health division of Merck & Co., Inc. We also face competition globally from manufacturers of generic drugs, as well as from producers of nutritional health products, such as DSM Nutritional Products AG and Danisco Animal Nutrition, the animal health division of E.I. du Pont de Nemours and Company, a subsidiary of DowDuPont, Inc. There are also several new start-up companies working in the animal health area. In addition, we compete with numerous other producers of animal health products throughout the world.

Productivity

Our results during the periods presented have benefited from operational and productivity initiatives implemented following recent acquisitions and in response to changing market demand for antibiotics and other headwinds.

Prior to the acquisition of Bayer Animal Health, our acquisitions within the last six years added in the aggregate \$1.4 billion in revenue, 4,600 full-time employees, and 12 manufacturing and eight R&D sites. The acquisitions of Bayer Animal Health on August 1, 2020 and KindredBio on August 27, 2021 added 3,950 full-time employees, 10 manufacturing sites, and five R&D sites (before company-wide restructuring activities initiated in 2020 and 2021). In addition, from 2015 to 2021, changing market demand for antibiotics and other headwinds, such as competition with generics and innovation, affected some of our highest gross margin products, resulting in a change to our product mix and driving operating margin lower. In response, we implemented a number of initiatives across the manufacturing, R&D and marketing, selling and administrative functions. Our manufacturing cost savings strategies included improving manufacturing processes and headcount through lean manufacturing (minimizing waste while maintaining productivity), closing and selling manufacturing sites, consolidating our CMO network, strategically insourcing certain projects, and pursuing cost savings opportunities through alternate sources of supply. Additional cost savings have resulted from reducing the number of R&D sites, sales force consolidation and reducing discretionary and other general and administrative operating expenses.

Seasonality

The results of our pet health business may fluctuate due to seasonality. For example, based upon historical results, approximately 70% and 60% of total annual revenue contributed by our higher-margin parasiticide products *Seresto* and *Advantage Family*, respectively, has occurred during the first half of the year, which is reflective of the flea and tick season in the Northern Hemisphere. Therefore, a period-to-period comparison of our historical results may not be meaningful and fluctuations in total revenue for our pet health products are not necessarily an indication of future performance.

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, 2022 and 2021, approximately 52% and 51%, 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 sales 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. Currency movements decreased revenue by 4% during the six months ended June 30, 2022. Currency movements had a limited impact on revenue during the six months ended June 30, 2021.

Results of Operations

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

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Revenue	\$ 1,177	\$ 1,279	(8)%	\$ 2,402	\$ 2,521	(5)%
Costs, expenses and other:						
Cost of sales	484	551	(12)%	993	1,120	(11)%
% of revenue	41 %	43 %	(2)%	41 %	44 %	(3)%
Research and development	82	94	(13)%	163	183	(11)%
% of revenue	7 %	7 %	— %	7 %	7 %	— %
Marketing, selling and administrative	343	385	(11)%	663	733	(10)%
% of revenue	29 %	30 %	(1)%	28 %	29 %	(1)%
Amortization of intangible assets	133	129	3 %	270	276	(2)%
% of revenue	11 %	10 %	1 %	11 %	11 %	— %
Asset impairment, restructuring and other special charges	86	299	(71)%	132	407	(68)%
Interest expense, net of capitalized interest	67	60	12 %	119	121	(2)%
Other (income) expense, net	—	(3)	NM	9	(3)	NM
Income (loss) before income taxes	(18)	(236)	92 %	53	(316)	117 %
% of revenue	(2)%	(18)%	16 %	2 %	(13)%	15 %
Income tax expense (benefit)	4	(26)	115 %	27	(45)	160 %
Net income (loss)	\$ (22)	\$ (210)	90 %	\$ 26	\$ (271)	110 %

Certain amounts and percentages may reflect rounding adjustments.

NM - Not meaningful

Disaggregated Revenue

On a global basis, our revenue by product category for the three months ended June 30, 2022 and 2021 is summarized as follows:

(Dollars in millions)	Revenue		% of Total Revenue		Increase (Decrease)		
	2022	2021	2022	2021	\$ Change	% Change	CER ⁽¹⁾
Pet Health	\$ 612	\$ 685	52 %	54 %	\$ (73)	(11)%	(7)%
Farm Animal	553	567	47 %	44 %	(14)	(2)%	3 %
Subtotal	1,165	1,252	99 %	98 %	(87)	(7)%	(3)%
Contract Manufacturing ⁽²⁾	12	27	1 %	2 %	(15)	(56)%	(53)%
Total	\$ 1,177	\$ 1,279	100 %	100 %	(102)	(8)%	(4)%

Note: Numbers may not add due to rounding

⁽¹⁾ Constant exchange rate (CER), a non-GAAP measure, is defined as revenue growth excluding the impact of foreign exchange. The calculation assumes the same foreign currency exchange rates that were in effect for the comparable prior-year period were used in translation of the current period results. We believe this metric provides a useful comparison to previous periods.

⁽²⁾ Represents revenue from arrangements in which we act as a contract manufacturer, including supply agreements associated with divestitures of products related to the acquisition of Bayer Animal Health.

On a global basis, the effect of price, foreign exchange rates and volumes on changes in revenue for the three months ended June 30, 2022 and 2021 was as follows:

Three months ended June 30, 2022

(Dollars in millions)	Revenue	Price	FX Rate	Volume	Total	CER
Pet Health	\$ 612	1%	(4)%	(8)%	(11)%	(7)%
Farm Animal	553	2%	(5)%	1%	(2)%	3%
Subtotal	1,165	1%	(4)%	(4)%	(7)%	(3)%
Contract Manufacturing	12	—%	(2)%	(53)%	(56)%	(53)%
Total	\$ 1,177	1%	(4)%	(5)%	(8)%	(4)%

Three months ended June 30, 2021

(Dollars in millions)	Revenue	Price	FX Rate	Volume ⁽¹⁾	Total	CER
Pet Health	\$ 685	6%	3%	161%	170%	167%
Farm Animal	567	—%	6%	73%	79%	73%
Subtotal	1,252	2%	5%	112%	120%	115%
Contract Manufacturing	27	—%	—%	69%	69%	69%
Total	\$ 1,279	2%	5%	111%	118%	114%

Note: Numbers may not add due to rounding

⁽¹⁾ Impact of 2021 revenue from Bayer Animal Health is reflected in volume.

On a global basis, our revenue by product category for the six months ended June 30, 2022 and 2021 is summarized as follows:

(Dollars in millions)	Revenue		% of Total Revenue		Increase (Decrease)		
	2022	2021	2022	2021	\$ Change	% Change	CER
Pet Health	\$ 1,251	\$ 1,330	52 %	53 %	\$ (79)	(6)%	(3)%
Farm Animal	1,122	1,145	47 %	45 %	(23)	(2)%	2 %
Subtotal	2,373	2,475	99 %	98 %	(102)	(4)%	— %
Contract Manufacturing	29	46	1 %	2 %	(17)	(37)%	(34)%
Total	\$ 2,402	\$ 2,521	100 %	100 %	(119)	(5)%	(1)%

Note: Numbers may not add due to rounding

On a global basis, the effect of price, foreign exchange rates and volumes on changes in revenue for the six months ended June 30, 2022 and 2021 was as follows:

Six months ended June 30, 2022

(Dollars in millions)	Revenue	Price	FX Rate	Volume	Total	CER
Pet Health	\$ 1,251	1%	(3)%	(4)%	(6)%	(3)%
Farm Animal	1,122	1%	(4)%	—%	(2)%	2%
Subtotal	2,373	1%	(4)%	(2)%	(4)%	—%
Contract Manufacturing	29	—%	(2)%	(34)%	(37)%	(34)%
Total	\$ 2,402	1%	(4)%	(2)%	(5)%	(1)%

Six months ended June 30, 2021

(Dollars in millions)	Revenue	Price	FX Rate	Volume ⁽¹⁾	Total	CER
Pet Health	\$ 1,330	4%	2%	183%	189%	187%
Farm Animal	1,145	1%	3%	49%	53%	50%
Subtotal	2,475	2%	2%	100%	105%	102%
Contract Manufacturing	46	—%	—%	31%	31%	31%
Total	\$ 2,521	2%	2%	98%	103%	100%

Note: Numbers may not add due to rounding

⁽¹⁾ Impact of 2021 revenue from Bayer Animal Health is reflected in volume.

Revenue

Pet Health revenue decreased by \$73 million, or 11%, for the three months ended June 30, 2022, driven by a decrease in volume and an unfavorable impact from foreign exchange rates, partially offset by an increase in price. On a constant currency basis, the decrease of 7% was primarily attributable to lower volumes in U.S. parasiticides, driven by declines in older generation products, supply chain disruptions for certain products and increased competition.

Pet Health revenue decreased by \$79 million, or 6%, for the six months ended June 30, 2022, driven by a decrease in volume and an unfavorable impact from foreign exchange rates, partially offset by an increase in price. On a constant currency basis, the decrease of 3% was primarily attributable to lower volumes in U.S. parasiticides, driven by declines in older generation products, supply chain disruptions for certain products and increased competition.

Farm Animal revenue decreased by \$14 million, or 2%, for the three months ended June 30, 2022, driven by an unfavorable impact from foreign exchange rates, partially offset by increases in price and volume. On a constant currency basis, growth was driven by increased demand for ruminant products internationally, most notably sheep products, and certain customer programs that shifted sales expected in the third quarter of 2022 into the second quarter of 2022, partially offset by a continued decline in demand in the swine market, particularly in China, which began in the second half of 2021, as well as increased competition in the European swine market.

Farm Animal revenue decreased by \$23 million, or 2%, for the six months ended June 30, 2022, driven by an unfavorable impact from foreign exchange rates, partially offset by an increase in price. On a constant currency basis, growth was driven by improved producer demand and innovation in poultry and strong aqua demand during the first quarter of 2022. Growth was also favorably impacted by increased demand for ruminant products internationally, most notably sheep products, and certain customer programs that shifted sales expected in the third quarter of 2022 into the second quarter of 2022. These increases were partially offset by a continued decline in demand in the swine market, particularly in China, which began in the second half of 2021, as well as the impact of generic competition on price for certain cattle brands and increased competition in the European swine market.

Cost of Sales

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Cost of sales	\$ 484	\$ 551	(12)%	\$ 993	\$ 1,120	(11)%
% of revenue	41 %	43 %		41 %	44 %	

Cost of sales as a percentage of revenue decreased for the three months ended June 30, 2022, primarily due to improvements in manufacturing productivity, price, and the effect of foreign exchange rates on international inventories sold, partially offset by unfavorable product mix and inflationary impacts on input costs, freight and conversion costs.

Cost of sales as a percentage of revenue decreased for the six months ended June 30, 2022, primarily due to amortization of the fair value adjustment of \$63 million recorded from the acquisition of Bayer Animal Health in the first half of 2021, price, improvements in manufacturing productivity and the effect of foreign exchange rates on international inventories sold, partially offset by unfavorable product mix and inflationary impacts on input costs, freight and conversion costs. Excluding the \$63 million fair value adjustment for the six months ended June 30, 2021, cost of sales as a percentage of revenue would have been approximately 42%.

Research and Development

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Research and development	\$ 82	\$ 94	(13)%	\$ 163	\$ 183	(11)%
% of revenue	7 %	7 %		7 %	7 %	

R&D expenses decreased \$12 million and \$20 million for the three and six months ended June 30, 2022, respectively. R&D expenses were favorably impacted by cost savings realized as a result of 2021 restructuring activities, lower professional service costs due the rationalization of certain R&D projects, and the impact of foreign exchange.

Marketing, Selling and Administrative

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Marketing, selling and administrative	\$ 343	\$ 385	(11)%	\$ 663	\$ 733	(10)%
% of revenue	29 %	30 %		28 %	29 %	

Marketing, selling and administrative expenses decreased \$42 million and \$70 million for the three and six months ended June 30, 2022, respectively, primarily driven by disciplined cost management across the business, cost savings realized as a result of 2021 restructuring activities, changes in our promotional programs which resulted in a decrease in marketing expense, and the impact of foreign exchange. These decreases more than offset the impact of inflation during the periods.

Amortization of Intangible Assets

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Amortization of intangible assets	\$ 133	\$ 129	3 %	\$ 270	\$ 276	(2)%

Amortization of intangible assets increased \$4 million for the three months ended June 30, 2022, primarily due to the timing of finalizing the valuation of intangible assets acquired from the Bayer Animal Health acquisition in the prior year, partially offset by the impact of foreign exchange rates.

Amortization of intangible assets decreased \$6 million for the six months ended June 30, 2022, primarily due to the timing of finalizing the valuation of intangible assets acquired from the Bayer Animal Health acquisition in the prior year, as well as the impact of foreign exchange rates.

Asset Impairment, Restructuring and Other Special Charges

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Asset impairment, restructuring and other special charges	\$ 86	\$ 299	(71)%	\$ 132	\$ 407	(68)%

For additional information regarding our asset impairment, restructuring and other special charges, see Note 6: Asset Impairment, Restructuring and Other Special Charges to the condensed consolidated financial statements.

Asset impairment, restructuring and other special charges decreased \$213 million for the three months ended June 30, 2022, primarily due to a \$265 million charge recorded during the three months ended June 30, 2021 to write down assets at our Shawnee and Speke manufacturing sites that were classified as held for sale to an amount equal to fair value less costs to sell, as well as a period over period decrease in overall acquisition-related charges, which include transaction costs related to acquisitions and costs associated with the implementation of new systems, programs, and processes due to both our separation from Lilly and the integration of Bayer Animal Health. These decreases were partially offset by a one-time charge of \$59 million related to the expensing of an IPR&D asset licensed from BexCaFe during the three months ended June 30, 2022. See Note 5: Acquisitions, Divestitures and Other Arrangements for further discussion.

Asset impairment, restructuring and other special charges decreased \$275 million for the six months ended June 30, 2022, primarily due to a \$265 million charge recorded during the six months ended June 30, 2021 to write down assets at our Shawnee and Speke manufacturing sites that were classified as held for sale to an amount equal to fair value less costs to sell, as well as a period over period decrease in severance charges and overall acquisition-related charges, which include transaction costs related to acquisitions and costs associated with the implementation of new systems, programs, and processes due to both our separation from Lilly and the integration of Bayer Animal Health. See Note 6: Asset Impairment, Restructuring and Other Special Charges for further discussion. These decreases were partially offset by a \$28 million asset write-down charge recorded upon the final sale of our Speke manufacturing site and a one-time charge of \$59 million related to the expensing of an IPR&D asset licensed from BexCaFe during the six months ended June 30, 2022. See Note 5: Acquisitions, Divestitures and Other Arrangements for further discussion.

Interest Expense, Net of Capitalized Interest

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Interest expense, net of capitalized interest	\$ 67	\$ 60	12 %	\$ 119	\$ 121	(2)%

Interest expense, net of capitalized interest increased \$7 million for the three months ended June 30, 2022, primarily due to a \$17 million debt extinguishment loss recorded upon the retirement of a portion of the aggregate principal on our 4.272% Senior Notes due August 28, 2023 during the period and higher interest on variable-rate debt due to increases in rates, partially offset by the favorable impact of refinancing at lower interest rates and a lower average debt balance.

Interest expense, net of capitalized interest decreased \$2 million for the six months ended June 30, 2022, primarily due to the favorable impact of refinancing at lower interest rates, partially offset by a \$17 million debt extinguishment loss recorded upon the retirement of a portion of the aggregate principal on our 4.272% Senior Notes due August 28, 2023 during the three months ended June 30, 2022 and higher interest on variable-rate debt due to increases in rates.

Other (Income) Expense, Net

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Other (income) expense, net	\$ —	\$ (3)	NM	\$ 9	\$ (3)	NM

Other expense recorded during the three months ended June 30, 2022 primarily consisted of mark-to-market adjustments on equity investments and foreign exchange losses. These amounts were fully offset by the gain recognized on the disposal of our microbiome R&D platform, as well as certain components of net periodic benefit cost. See Note 14: Retirement Benefits to the condensed consolidated financial statements for further discussion related to net periodic benefit cost (income) recorded during the period. Other income recorded during the three months ended June 30, 2021 consisted of certain components of net periodic benefit income and an up-front payment received in relation to an asset assignment agreement, partially offset by foreign exchange losses.

Other expense recorded during the six months ended June 30, 2022 primarily consisted of mark-to-market adjustments on equity investments and foreign exchange losses, partially offset by the gain recognized on the disposal of our microbiome R&D platform, as well as certain components of net periodic benefit cost. See Note 14: Retirement Benefits to the condensed consolidated financial statements for further discussion related to net periodic benefit cost (income) recorded during the period. Other income recorded during the six months ended June 30, 2021 consisted of certain components of net periodic benefit income, an up-front payment received in relation to an asset assignment agreement, and up-front payments received, milestones earned, and equity issued to us in relation to a license agreement. This income was partially offset by losses recorded in relation to divestitures and foreign exchange losses.

Income Tax Expense (Benefit)

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change
Income tax expense (benefit)	\$ 4	\$ (26)	(115)%	\$ 27	\$ (45)	(160)%
Effective tax rate	(22.5)%	11.1 %		50.7 %	14.2 %	

Income tax expense increased for the three and six months ended June 30, 2022, primarily due changes in earnings mix which caused the U.S. federal and state jurisdictions to generate losses which are subject to valuation allowances. The effective tax rate decreased for the three months ended June 30, 2022 driven by the change in U.S. valuation allowances and the income tax benefit due to the termination of interest rate swaps. The effective tax rate for the six months ended June 30, 2022 increased due to adjustments in jurisdictional earnings mix, slightly offset by the income tax benefit due to the termination of interest rate swaps. See Note 11: Income Taxes to the condensed consolidated financial statements.

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 internationally, 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. We intend to indefinitely reinvest foreign earnings for continued use in our foreign operations. 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.

We believe our primary sources of liquidity are sufficient to fund our short-term and long-term existing and planned capital requirements, which include working capital obligations, funding existing marketed and pipeline products, capital expenditures, business development in our targeted areas, short-term and long-term debt obligations which include principal and interest payments as well as interest rate swaps, operating lease payments, purchase obligations, and costs associated with the integrations of Bayer Animal Health and KindredBio. In addition, we have the ability to access capital markets to obtain debt refinancing for longer-term funding, if required, to service our long-term debt obligations. Further, we believe we have sufficient cash flow and liquidity to remain in compliance with our debt covenants.

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 "Item 1A. Risk Factors - We may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful" in Part I of our [Form 10-K](#) for the year ended December 31, 2021.

Cash Flows

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

(Dollars in millions) Net cash provided by (used for):	Six Months Ended June 30,		
	2022	2021	\$ Change
Operating activities	\$ 250	\$ 171	\$ 79
Investing activities	(66)	(15)	(51)
Financing activities	(296)	(65)	(231)
Effect of exchange-rate changes on cash and cash equivalents	(19)	(17)	(2)
Net increase (decrease) in cash and cash equivalents	\$ (131)	\$ 74	\$ (205)

Operating activities

Cash provided by operating activities increased \$79 million to \$250 million for the six months ended June 30, 2022 from \$171 million for the six months ended June 30, 2021, primarily due to an increase in net income after adjusting for non-cash items as well as proceeds of \$132 million from interest rate swap settlements. These increases were partially offset by changes in operating assets and liabilities, particularly changes in inventories, other assets, and accounts payable and other liabilities as compared to the prior year. In the past, we have extended our payment terms for distributors on occasion. Although we presently have no plans to do so in the future, it is possible that we will need to extend payment terms in certain situations as a result of the COVID-19 global health pandemic, competitive pressures and the need for certain inventory levels at our channel distributors to avoid supply disruptions. If so, such extensions of customer payment terms could result in additional uses of our cash flow.

Investing activities

Our cash used for investing activities was \$66 million for the six months ended June 30, 2022 as compared to \$15 million for the six months ended June 30, 2021. The change was primarily driven by cash received during the six months ended June 30, 2021 as a result of the finalization of the working capital adjustment for the acquisition of Bayer Animal Health as well as an increase in cash used for net purchases of property and equipment in the current period, partially offset by a year over year decrease in cash used for purchases of intangible assets.

Financing activities

Our cash used for financing activities was \$296 million for the six months ended June 30, 2022 as compared to cash used for financing activities of \$65 million for the six months ended June 30, 2021. Cash used for financing activities during the six months ended June 30, 2022 primarily reflected the tender offer completed during the period as well as net repayments on our revolving credit facility and the repayment of indebtedness outstanding under our term loan B credit facility, partially offset by proceeds from our newly issued incremental term facilities. Cash used for financing activities during the six months ended June 30, 2021 primarily reflected the repayment of indebtedness outstanding under our term loan B credit facility and cash paid to Lilly in connection with local country asset purchases.

Description of Indebtedness

For a complete description of our existing debt and available credit facilities as of June 30, 2022 and December 31, 2021, see Note 9: Debt within Item 8, "Financial Statements and Supplementary Data," of Part II of our [Form 10-K](#) for the year ended December 31, 2021. New developments are discussed in Note 9: Debt of this Form 10-Q.

Contractual Obligations

Our contractual obligations and commitments as of June 30, 2022 are primarily comprised of long-term debt obligations, operating leases, and purchase obligations. Our long-term debt obligations are comprised of our expected principal and interest obligations and our interest rate swaps. Purchase obligations consist of open purchase orders as of June 30, 2022 and contractual payment obligations with significant vendors which are noncancelable and are not contingent. These obligations are primarily short-term in nature.

As of June 30, 2022, we also have an additional lease commitment that has not yet commenced for our new corporate headquarters in Indianapolis, Indiana. Total minimum lease payments are estimated to be approximately \$310 million over a term of 25 years, excluding extensions. Final lease payments may vary depending on the actual cost of certain construction activities. Lease commencement is expected in 2024.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. GAAP requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Certain of our accounting policies are considered critical because these policies are the most important to the depiction of our financial statements and require significant, difficult or complex judgments by us, often requiring the use of estimates about the effects of matters that are inherently uncertain. Actual results that differ from our estimates could have an unfavorable effect on our financial position and results of operations. We apply estimation methodologies consistently from year to year. Such policies are summarized in Item 7, "Management's Discussion & Analysis of Results of Financial Condition and Results of Operations," of our [Form 10-K](#) for the year ended December 31, 2021. There have been no significant changes in the application of our critical accounting policies during the six months ended June 30, 2022.

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, British pound, Swiss franc, Brazilian real, Australian dollar, Japanese yen, Canadian dollar, and Chinese yuan.

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.

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 \$10 million for the six months ended June 30, 2022.

We generally identify hyperinflationary markets as those markets whose cumulative inflation rate over a three-year period exceeds 100%. We have concluded that our Argentina subsidiary is operating in a hyperinflationary market. As a result, beginning in the second quarter of 2018, the functional currency of our Argentina subsidiary changed from the local currency to the U.S. dollar. During the six months ended June 30, 2022, revenue in Argentina represented less than 1% of our consolidated revenue. Assets held in Argentina as of June 30, 2022 represented less than 1% of our consolidated assets.

During the first quarter of 2022, Turkey's three-year cumulative inflation rate exceeded 100%, and we concluded that Turkey became a hyperinflationary economy for accounting purposes. As of April 1, 2022, we applied hyperinflationary accounting for our subsidiary in Turkey and changed its functional currency from the Turkish lira to the U.S. dollar. During the six months ended June 30, 2022, revenue in Turkey represented less than 1% of our consolidated revenue. Assets held in Turkey as of June 30, 2022 represented less than 1% of our consolidated assets.

While the hyperinflationary conditions did not have a material impact on our business during the six months ended June 30, 2022, in the future, we may incur larger currency devaluations, which could have a material adverse impact on our results of operations.

Interest Risk

Our variable-rate debt is exposed to interest rate fluctuations based on LIBOR and Term SOFR. As of June 30, 2022, we held certain interest rate swap agreements with a notional value of \$3,050 million that have the economic effect of modifying our variable-interest so that a portion of the variable-rate interest payable becomes fixed. During the six months ended June 30, 2022, we recorded a gain of \$117 million, net of taxes on these interest rate swaps in other comprehensive income (loss). See Note 10: Financial Instruments and Fair Value to the condensed consolidated financial statements for further information.

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 Jeffrey N. Simmons, president and chief executive officer, and Todd S. Young, executive vice president and chief financial officer, evaluated our disclosure controls and procedures as of June 30, 2022. 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 2022, 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

ITEM 1. LEGAL PROCEEDINGS

See Note 12: Commitments and Contingencies to the condensed consolidated financial statements for a summary of our legal proceedings, which is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Our risk factors are documented in Item 1A of Part I of our [Form 10-K](#) for the year ended December 31, 2021, which is incorporated herein by reference. There have been no material changes from the risk factors previously disclosed in the [Form 10-K](#).

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
3.1	Amended and Restated Articles of Incorporation of Elanco Animal Health Incorporated, effective May 18, 2022 (filed herewith).
3.2	Elanco Animal Health Incorporated Amended and Restated Bylaws, effective May 18, 2022 (incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed with the SEC on May 19, 2022).
10.1	Consulting Agreement, dated April 12, 2022, by and between Aaron Schacht and Elanco US Inc. (filed herewith).
10.2	Incremental Assumption Agreement dated April 19, 2022 by and among Elanco Animal Health Incorporated, Elanco US Inc., the subsidiary loan parties party thereto, Farm Credit Mid-America, PCA, as incremental term lender, and Goldman Sachs Bank USA, as the term facility agent (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on April 20, 2022).
10.3	Incremental Assumption Agreement dated June 28, 2022 by and among Elanco Animal Health Incorporated, Elanco US Inc., the subsidiary loan parties party thereto, Bank of America, N.A., as incremental term lender, each other person party thereto as incremental term lender, and Goldman Sachs Bank USA, as the term facility agent (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the SEC on June 29, 2022).
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.
104	Cover Page Interactive Data File (formatted as Inline XBRL document and included in Exhibit 101).

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 8, 2022	<u>/s/ Jeffrey N. Simmons</u> Jeffrey N. Simmons President and Chief Executive Officer
Date:	August 8, 2022	<u>/s/ Todd S. Young</u> Todd S. Young Executive Vice President, Chief Financial Officer

ELANCO ANIMAL HEALTH INCORPORATED
(an Indiana corporation)
AMENDED AND RESTATED ARTICLES OF INCORPORATION

(As amended and restated May 20, 2022)

1. The name of the Corporation shall be

ELANCO ANIMAL HEALTH INCORPORATED.
2. The purposes for which the Corporation is formed are to engage in any lawful act or activity for which a corporation may be organized under the Indiana Business Corporation Law, as amended from time to time (the “IBCL”).
3. The period during which the Corporation is to continue as a corporation is perpetual.
4. The total number of shares which the Corporation shall have authority to issue is 6,000,000,000 shares, consisting of 5,000,000,000 shares of Common Stock and 1,000,000,000 shares of Preferred Stock. The Corporation’s shares do not have any par or stated value, except that, solely for the purpose of any statute or regulation imposing any tax or fee based upon the capitalization of the Corporation, each of the Corporation’s shares shall be deemed to have no par value per share.
5. The following provisions shall apply to the Corporation’s shares:
 - (a) The Corporation shall have the power to acquire (by purchase, redemption, or otherwise), hold, own, pledge, sell, transfer, assign, reissue, cancel, or otherwise dispose of the shares of the Corporation in the manner and to the extent now or hereafter permitted by the laws of the State of Indiana (but such power shall not imply an obligation on the part of the owner or holder of any share to sell or otherwise transfer such share to the Corporation), including the power to purchase, redeem, or otherwise acquire the Corporation’s own shares, directly or indirectly, and without pro rata treatment of the owners or holders of any class or series of shares, unless, after giving effect thereto, the Corporation would not be able to pay its debts as they become due in the usual course of business or the Corporation’s total assets would be less than its total liabilities (and without regard to any amounts that would be needed, if the Corporation were to be dissolved at the time of the purchase, redemption, or other acquisition, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those of the holders of the shares of the Corporation being purchased, redeemed, or otherwise acquired, unless otherwise expressly provided with respect to a series of Preferred Stock). Shares of the Corporation purchased, redeemed, or otherwise acquired by it shall constitute authorized but unissued shares, unless prior to any such purchase, redemption or other acquisition or within thirty (30) days thereafter the Board of Directors adopts a resolution providing that such shares constitute authorized and issued but not outstanding shares.
 - (b) Preferred Stock of any series that has been redeemed (whether through the operation of a retirement or sinking fund or otherwise) or purchased by the Corporation, or which, if convertible, have been converted into shares of the Corporation of any other class or series, may be reissued as a part of such series or of any other series of Preferred Stock, subject to such limitations (if any) as may be fixed by the Board of Directors with respect to such series of Preferred Stock in accordance with the provisions of Article 7 of these Amended and Restated Articles of Incorporation.
 - (c) The Corporation may, by action of the Board of Directors, dispose of, issue, and sell shares of the Corporation in accordance with, and in such amounts as may be permitted by, the laws of the State of Indiana and the provisions of these Amended and Restated Articles of Incorporation and for such consideration, at such price or prices, at such time or times and upon

such terms and conditions (including the privilege of selectively repurchasing the same) as the Board of Directors of the Corporation shall determine, without the authorization or approval by any shareholders of the Corporation. Shares may be disposed of, issued, and sold to such persons, firms, or corporations as the Board of Directors may determine, without any preemptive or other right on the part of the owners or holders of other shares of the Corporation of any class or kind to acquire such shares by reason of their ownership of such other shares.

6. The following provisions shall apply to the Common Stock:

(a) Except as otherwise provided by the IBCL and subject to such shareholder disclosure and recognition procedures (which may include voting prohibition sanctions) as the Corporation may by action of its Board of Directors establish, shares of Common Stock shall have unlimited voting rights and each outstanding share of Common Stock shall, when validly issued by the Corporation, entitle the record holder thereof to one vote at all shareholders' meetings on all matters submitted to a vote of the shareholders of the Corporation.

(b) Shares of Common Stock shall be equal in every respect, but such equality of rights shall not imply equality of treatment as to purchase or other acquisition of shares by the Corporation. Subject to the rights of the holders of any outstanding series of Preferred Stock, the holders of Common Stock shall be entitled to share ratably in such dividends or other distributions (other than purchases or other acquisitions of shares by the Corporation), if any, as are declared and paid from time to time on the Common Stock at the discretion of the Board of Directors.

(c) In the event of any liquidation, dissolution, or winding up of the Corporation, either voluntary or involuntary, after payment shall have been made to the holders of any outstanding series of Preferred Stock of the full amount to which they shall be entitled, the holders of Common Stock shall be entitled, to the exclusion of the holders of the Preferred Stock of any and all series, to share, ratably according to the number of shares of Common Stock held by them, in all remaining assets of the Corporation available for distribution to its shareholders, except as otherwise may be provided in an applicable certificate of designation for a series of Preferred Stock.

7. The Board of Directors is hereby expressly authorized to provide, out of the unissued shares of Preferred Stock, for one or more series of Preferred Stock. Before any shares of any such series are issued, the Board of Directors shall fix, and hereby is expressly empowered to fix, by the adoption and filing in accordance with the IBCL, of an amendment or amendments to these Amended and Restated Articles of Incorporation, the terms of such Preferred Stock or series of Preferred Stock, including the following:

(a) the designation of such series, the number of shares to constitute such series and the stated value thereof if different from the par value thereof;

(b) whether the shares of such series shall have voting rights, in addition to any voting rights provided by law, and, if so, the terms of such voting rights, which may be limited and may include the right, under specified circumstances, to elect directors in addition to those to be elected by the holders of Common Stock;

(c) the dividends, if any, payable on such series, whether any such dividends shall be cumulative, and, if so, from what dates, the conditions and dates upon which such dividends shall be payable, the preference or relation which such dividends shall bear to the dividends payable on any shares of stock of any other class or any other series of Preferred Stock;

(d) whether the shares of such series shall be subject to redemption by the Corporation and, if so, the times, prices and other conditions of such redemption;

(e) the amount or amounts payable upon shares of such series upon, and the rights of the holders of such series in, the voluntary or involuntary liquidation, dissolution or winding up, or upon any distribution of the assets, of the Corporation;

(f) whether the shares of such series shall be subject to the operation of a retirement or sinking fund and, if so, the extent to and manner in which any such retirement or sinking fund shall be applied to the purchase or redemption of the shares of such series for retirement or other corporate purposes and the terms and provisions relative to the operation thereof;

(g) whether the shares of such series shall be convertible into, or exchangeable for, shares of stock of any other class or any other series of Preferred Stock or any other securities (whether or not issued by the Corporation) and, if so, the price or prices or the rate or rates of conversion or exchange and the method, if any, of adjusting the same, and any other terms and conditions of conversion or exchange;

(h) the limitations and restrictions, if any, to be effective while any shares of such series are outstanding upon the payment of dividends or the making of other distributions on, and upon the purchase, redemption or other acquisition by the Corporation of, the Common Stock or shares of stock of any other class or any other series of Preferred Stock;

(i) the conditions or restrictions, if any, upon the creation of indebtedness of the Corporation or upon the issue of any additional stock, including additional shares of such series or of any other series of Preferred Stock or of any other class of stock; and

(j) any other powers, preferences and relative, participating, optional and other special rights, and any qualifications, limitations and restrictions thereof.

Except to the extent otherwise expressly provided in these Amended and Restated Articles of Incorporation or required by law, (i) no share of Preferred Stock shall have any voting rights other than those which shall be fixed by the Board of Directors pursuant to this Article 7 and (ii) no share of Common Stock shall have any voting rights with respect to any amendment to the terms of any series of Preferred Stock; *provided, however,* that in the case of this clause (ii) the terms of such series of Preferred Stock, as so amended, could have been established without any vote of any shares of Common Stock.

8. The Corporation shall have the power to declare and pay dividends or other distributions upon the issued and outstanding shares of the Corporation, subject only to the limitations set forth in the IBCL. The Corporation shall have the power to issue shares of one class or series as a share dividend or other distribution in respect of that class or series or one or more other classes or series.

9. The following provisions are inserted for the management of the business and for the conduct of the affairs of the Corporation, and it is expressly provided that the same are intended to be in furtherance and not in limitation or exclusion of the powers conferred by statute:

(a) The number of directors of the Corporation, exclusive of directors who may be elected by the holders of any one or more series of Preferred Stock pursuant to Article 9(b) (the "Preferred Stock Directors"), shall not be less than five, the exact number to be fixed from time to time solely by resolution of the Board of Directors, acting by not less than a majority of the directors then in office.

(b) The Board of Directors (exclusive of Preferred Stock Directors, if any) shall be divided into three classes as nearly equal in number as possible, with the term of office of one class expiring at each annual meeting. The Board of Directors may assign members of the Board of Directors already in office upon the effectiveness of the Corporation's registration statement on Form S-1, as amended, filed with the Securities and Exchange Commission in connection with the initial listing of Common Stock on a stock exchange (the "Effective Time") to such classes as of the Effective Time. The term of office of the initial Class I directors shall expire at the first annual meeting following the Effective Time; the term of office of the initial Class II directors shall expire at the second annual meeting following the Effective Time; and the term of office of

the initial Class III directors shall expire at the third annual meeting following the Effective Time. Commencing with the first annual meeting of shareholders following the Effective Time, each class of directors whose term shall then expire shall be elected to hold office for a three-year term. In the case of any vacancy on the Board of Directors, including a vacancy created by an increase in the number of directors, the vacancy shall be filled by election of the Board of Directors with the director so elected to serve for the remainder of the term of the director being replaced or, in the case of an additional director, for the remainder of the term of the class to which the director has been assigned. All directors shall continue in office until the election and qualification of their respective successors in office, their death, their resignation in accordance with Section 2.7 of the bylaws of the Corporation (as amended, restated or otherwise modified from time to time, the "Bylaws"), their removal in accordance with Article 9(c) below and Section 2.8 of the Bylaws, or if there has been a reduction in the number of directors, until the end of their respective terms. When the number of directors is changed, any newly created directorships or any decrease in directorships shall be so assigned among the classes by a majority of the directors then in office, though less than a quorum, as to make all classes as nearly equal in number as possible. No decrease in the number of directors shall have the effect of shortening the term of any incumbent director. Election of directors need not be by written ballot unless the Bylaws so provide.

(c) Any director or directors (exclusive of Preferred Stock Directors, if any) may be removed from office at any time, but only for cause and only by the affirmative vote of at least a majority of all the outstanding shares of Voting Stock (as defined below), voting together as a single class.

(d) Notwithstanding any other provision of these Amended and Restated Articles of Incorporation or of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class of Voting Stock required by law or these Amended and Restated Articles of Incorporation, the affirmative vote of at least a majority of all the outstanding shares of Voting Stock, voting together as a single class, shall be required to alter, amend or repeal this Article 9.

(e) For purposes of these Amended and Restated Articles of Incorporation, the term "Voting Stock" shall mean all shares of any class of capital stock of the Corporation which are entitled to vote generally in the election of directors.

10. The Corporation shall, to the fullest extent permitted by applicable law now or hereafter in effect, indemnify any person who is or was a director, officer or employee of the Corporation (an "Eligible Person") and who is or was involved in any manner (including, without limitation, as a party or a witness) or is threatened to be made so involved in any threatened, pending or completed investigation, claim, action, suit or proceeding, whether civil, criminal, administrative or investigative (including, without limitation, any action, suit or proceeding by or in the right of the Corporation to procure a judgment in its favor) (a "Proceeding") by reason of the fact that such Eligible Person is or was a director, officer or employee of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee, partner, member, manager, trustee, fiduciary or agent of another corporation, partnership, joint venture, limited liability company, trust or other enterprise (including, without limitation, any employee benefit plan), against all expenses (including attorneys' fees), judgments, fines or penalties (including excise taxes assessed with respect to an employee benefit plan) and amounts paid in settlement actually and reasonably incurred by such Eligible Person in connection with such Proceeding; provided, however, that the foregoing shall not apply to a Proceeding commenced by an Eligible Person except to the extent provided otherwise in the Bylaws or an agreement with an Eligible Person. The Corporation may establish provisions supplemental to or in furtherance of the provisions of this Article 10, including, but not limited to, provisions concerning the determination of any Eligible Person to indemnification, mandatory or permissive advancement of expenses to an Eligible Person incurred in connection with a Proceeding, the effect of any change in control of the Corporation on indemnification and advancement of expenses and the funding or other payment of amounts necessary to effect indemnification and advancement of expenses, in the Bylaws or in agreements with any Eligible Person.

11. The provisions of IBCL §23-1-42 shall not apply to the acquisition of shares of the Corporation.

12. Except as otherwise expressly provided in these Amended and Restated Articles of Incorporation, the Corporation reserves the right to amend, alter or repeal any provision contained in these Amended and Restated Articles of Incorporation, in the manner now or hereafter prescribed by law, and all rights conferred upon shareholders herein are subject to this reservation.

13. Subject to the rights of the holders of preferred stock to elect any directors voting separately as a class or series, at each annual meeting of shareholders, the directors to be elected at the meeting shall be chosen by a plurality of the votes cast by the holders of shares entitled to vote in the election at the meeting, provided a quorum is present. For purposes of this Article 13, a "plurality of the votes cast" shall mean that the individuals with the highest number of votes are elected as directors up to the maximum number of directors to be elected.

Consulting Agreement

This CONSULTING AGREEMENT (the “Agreement”) is made by and between Aaron Schacht (“you” or “Consultant”) and Elanco US Inc., and its affiliates (the “Company”) (collectively, the “Parties”).

RECITALS

WHEREAS, the Company desires that Consultant provide certain Services (as defined below) to the Company and its affiliates; and

WHEREAS, Consultant desires to perform such Services.

AGREEMENT

NOW THEREFORE, in consideration of the promises and mutual covenants contained herein and for other good and valuable consideration, the adequacy and receipt of which are hereby acknowledged, the Parties agree as follows:

1. EFFECTIVE DATE. Your engagement hereunder shall be effective as of April [____], 2022 (the “Effective Date”).

2. CONSULTANT’S SERVICES. Subject to reasonable notice from the Company and your reasonable availability, you agree to perform the services (the “Services”) as described in Attachment 1 to this Agreement, as it may be amended in writing from time to time by the Parties, provided that any amendment is signed by you and a duly authorized representative of Company. This Agreement is entered into as an exception to the reemployment restrictions under the Severance Agreement between the Consultant and the Company, it shall not otherwise amend the reemployment restrictions of the Severance Agreement.

3. COMPLIANCE WITH LAW AND ELANCO POLICIES. In the performance of the Services and obligations under this Agreement, you shall comply:

(a) With any statute, law, treaty, rule, code, ordinance, regulation, permit, interpretation, certificate or order of a Governmental Authority, or any judgment, decision, decree, injunction, writ, order subpoena, or like action of any court, arbitrator or other government entity (each an “Applicable Law” and collectively, the “Applicable Laws”). A “Governmental Authority” means any state, local or foreign government entity, authority, agency, instrumentality, court, tribunal, regulatory commission or other body, whether legislative, judicial, administrative or executive (or a combination thereof), any arbitrator to whom a dispute has been presented under government rule or by agreement of the parties with an interest in the dispute.

(b) With all applicable Elanco policies and professional or good practice standards or codes applicable to the nature of the Services provided, including, but not limited to applicable provisions of Elanco’s Vendor Privacy and Security Standard as revised by Elanco from time to time and published at <https://www.elanco.com/suppliers> or otherwise made available to Consultant. If applicable, Consultant shall promptly, upon execution of this Agreement, complete and provide all information that may be requested of Consultant as part of the Vendor Privacy and Security Standard, including completion of Exhibit A to the Vendor Privacy and Security Standard. Notwithstanding the above, Consultant agrees to delete any

Personal Information, as defined by the Elanco Vendor Privacy Standard, included or embedded in any deliverable or Work Product sent to Elanco.

4. FEES. In exchange for your performance of the Services, the Company will provide you with a consulting fee in the amount described in Attachment 1 to this Agreement (the "Consulting Fees"). You will be responsible for providing the Company with an invoice for each month the Services are performed. The Company will pay the invoice within sixty (60) days of receipt of the invoice. The Company will reimburse you for any reasonable travel or other business expenses incurred by you in connection with the performance of the Services provided you comply with Elanco's Supplier Travel Policy. The parties acknowledge that no compensation is earned for time spent in travel. In the event payments are not received by you within eighty (80) days after becoming due, you may suspend performance of all Services until payment has been made in full.

5. TERM AND TERMINATION OF AGREEMENT.

(a) The term of this Agreement shall commence on the Effective Date and shall continue for the period specified in Attachment 1, unless earlier terminated in accordance with this Section 4. Any extension of the term of this Agreement will be subject to mutual written agreement between you and a duly authorized officer of the Company.

(b) The Company may terminate this Agreement for any reason upon providing you with seven (7) days' written notice pursuant to Section 10(f) of this Agreement. You may terminate this Agreement for any reason immediately upon providing the Company written notice pursuant to Section 10(f) of this Agreement. You or the Company may terminate this Agreement, effective immediately upon written notice to the other party to this Agreement, if the other party materially breaches this Agreement.

(c) In the event of termination pursuant to this Section 4, the Company shall pay you on a pro-rata basis any Consulting Fees then due and payable for any Services completed up to and including the date of such termination. You will have no other rights to any payments from the Company under this Agreement.

(d) Upon expiration or termination of this Agreement for any reason, or at any other time upon the Company's written request, you shall within five (5) calendar days after such expiration or termination: (i) deliver to the Company all deliverables related to the Services (whether complete or incomplete) and all hardware, software, tools, equipment, or other materials provided for your use by the Company; and (ii) deliver to the Company all tangible documents and materials (and any copies) containing, reflecting, incorporating, or based on the Confidential Information (as defined below).

(e) Sections 8, 9, 10, and 11 of this Agreement will survive termination of this Agreement.

6. RELATIONSHIP OF THE PARTIES.

(a) You acknowledge and agree that you are entering into this Agreement as, and you shall continue to be, an independent contractor. In no circumstance shall you look to the Company as your employer, partner, agent, or principal. You agree that as an independent contractor, you do not have authority to bind the Company, and you shall not make any agreements or representations on the Company's behalf without the Company's prior written consent. Under this Agreement, you shall not be entitled to any benefits accorded to the Company's employees, including workers' compensation, disability insurance, retirement plans, or vacation or sick pay; for the avoidance of doubt, this does not affect any benefits to which you

may have become entitled, may be entitled pursuant to arrangements in place, prior to the Effective Date, including any benefits to which you may be entitled under the Consolidated Omnibus Budget Reconciliation Act of 1985.

(b) You acknowledge and agree that you are obligated to report to the applicable tax authorities all fees or other payments you receive pursuant to this Agreement. You acknowledge and agree that you have an obligation to pay all self-employment and other taxes on such income. The Company will not be responsible for any withholding or paying any taxes related to amounts paid you under this Agreement. You shall be responsible for, and shall indemnify the Company against, all such taxes or contributions, including penalties and interest.

7. PLACE OF WORK. You are generally free to perform the Services at your chosen location. You further acknowledge and agree that you shall furnish all tools and materials necessary to accomplish the Services other than office equipment provided by the Company. You acknowledge that the Company shall not control the manner or means by which you perform the Services, but you agree to provide such Services in a commercially reasonable manner.

8. CONFIDENTIAL INFORMATION. You acknowledge and agree that the Company's business and continued success depend upon the use and protection of confidential and proprietary business information, including, without limitation, source codes, all business plans and marketing strategies; hiring processes; interview preparation processes; information concerning existing and prospective employees; information concerning existing and prospective markets and customers; financial information; information concerning the development of new products and services; and technical and nontechnical data related to designs, specifications, compilations, inventions, improvements, methods, processes, procedures and techniques (all such information being "Confidential Information"). The status of information as Confidential Information is not affected by the means of communication to or acquisition by you. For purposes of this Agreement, Confidential Information does not include any information of the Company that: (1) becomes publicly available without any improper disclosure by you or is independently developed by you; or (2) you are required to disclose by a court, tribunal, or other government entity, in which case you agree to provide the Company with reasonable prior notice and to cooperate with the Company in challenging the disclosure, at the Company's expense. In the course of performing the Services, you may gain access to the Company's Confidential Information. You therefore agree during the term of this Agreement and after its termination, that you will not use, disclose or divulge any Confidential Information for any reason, except with prior written authorization by the Company. Your obligations under this Agreement are in addition to any obligations you may have under state or federal law. Notwithstanding any other provision of this Agreement to the contrary, you have the right to (a) disclose in confidence trade secrets to federal, state, and local government officials, or to an attorney, for the sole purpose of reporting or investigating a suspected violation of the law or (b) disclose trade secrets in a document filed in a lawsuit or other proceeding so long as that filing is made under seal and protected from public disclosure. Nothing in this Agreement is intended to conflict with 18 U.S.C. § 1833(b) or create liability for disclosures of trade secrets that are expressly allowed by 18 U.S.C. § 1833(b).

9. INVENTIONS AND WORK PRODUCT. You acknowledge and agree that all rights, title and interest, including intellectual property rights, in and to any materials that result from your performance of the Services and all copies thereof, including works in progress, in whatever media (the "Inventions"), shall be and hereby are assigned to Company as its sole and exclusive property. Any work product that constitutes "work made for hire" (within the meaning of United States copyright law) will be treated as such. On the Company's request, you agree to assist the Company, at the Company's expense, to obtain patents or copyrights for such Inventions, including the disclosure of all pertinent information and data, the execution of all

applications, specifications, oaths, and assignments, and all other instruments and papers that the Company shall deem necessary to apply for and to assign or convey to the Company, its successors, and assigns or nominees, the sole and exclusive right, title, and interest in such Inventions without further consideration.

10. **OTHER BUSINESS ACTIVITIES.** You may be engaged or employed in any other business, trade, profession, or other activity while providing services to the Company; provided that you abide by the terms of Sections 7 and 8 of this Agreement when performing such services.

11. **MISCELLANEOUS PROVISIONS.**

(a) **Assignability.** Except as otherwise provided in this Agreement, you may not sell, assign or delegate any rights or obligations under this Agreement. The Company may freely assign this Agreement at any time. Subject to the limits on assignment stated above, this Agreement will inure to the benefit of, be binding on, and be enforceable against each of the Parties hereto and their respective successors and assigns.

(b) **Entire Agreement.** This Agreement constitutes the entire agreement between the Parties with respect to the subject matter of this Agreement and supersedes all prior written and oral agreements between the Parties regarding the subject matter of this Agreement.

(c) **Amendments; Waivers.** This Agreement shall not be varied, altered, modified, changed or in any way amended except by an instrument in writing executed by you and a duly authorized representative of the Company.

(d) **Severability.** If any provision of this Agreement, or the application thereof to any person, place, or circumstance, shall be held by an arbitrator or a court of competent jurisdiction to be invalid, unenforceable, or void, the remainder of this Agreement and such provisions as applied to other persons, places, and circumstances shall remain in full force and effect, and such provision shall be enforced to fullest extent consistent with applicable law.

(e) **Governing Law; Jurisdiction; Venue.** This Agreement will be deemed to have been entered into and will be construed and enforced in accordance with the laws of State of Indiana, without regard to conflicts of laws principles. Any action or proceeding by either party to enforce this Agreement shall be brought only in any state or federal court located in the County of Indianapolis, Indiana. The Parties hereby irrevocably submit to the exclusive jurisdiction of these courts and waive the defense of inconvenient forum to the maintenance of any action or proceeding in such venue.

(f) **Notices.** Any notice under this Agreement must be in writing and shall be effective upon delivery by hand or five business days after deposit in the United States mail, postage prepaid, certified or registered, and addressed to the Company or to you at the corresponding address below. You are obligated to notify the Company in writing of any change in your address. Notice of change of address shall be effective only when done in accordance with this Section 10(f).

Company's Notice Address:

Elanco US Inc.
2500 Innovation Way
Greenfield, IN 46140
Attn.: Marcela Kirberger, General Counsel

Your Notice Address:

Aaron Schacht
[Address]
[City, State Zip]

12. Acknowledgment. The Parties acknowledge that: (i) they have each had the opportunity to consult with independent counsel of their own choice concerning this Agreement and have done so to the extent they deem necessary, and (ii) they each have read and understand this Agreement, are fully aware of its legal effect, and have entered into it voluntarily and freely based on their own judgment and not on any promises or representations other than those contained in this Agreement. The parties' representatives may sign separate, identical counterparts of this document; taken together, they constitute one agreement.

The Parties have duly executed this Agreement as of the date first written above.

Elanco US, Inc.

By: /s/ John Gate
Name: John Gate
Title: Director, R&D Procurement

April 12, 2022
Date

AARON SCHACHT
/s/ Aaron Schacht
Signature

April 8, 2022
Date

Attachment 1

Services to be Performed by Consultant

All capitalized terms in this Attachment 1 have the same meaning as in the Agreement unless otherwise indicated. You shall perform the following services for the Company during the term of the Agreement:

1. **Description of Services:** Service as member of the Company's independent Science and Technology Advisory Board and general consulting on various special projects that Elanco may ask you to advise on. The Company will initiate the respective services or projects and agree with you on expected timing and specific scope of services.
2. **Maximum Hours Requirement:** No more than [ten (10)] hours per week without your prior consent.
3. **Term of Engagement:** 12 months.
4. **Fees:** Two hundred fifty dollars (\$250) per hour.

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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 8, 2022

By: /s/ Jeffrey N. Simmons

Jeffrey N. Simmons
President and Chief Executive Officer

**CERTIFICATION OF THE
CHIEF EXECUTIVE OFFICER AND
CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

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, 2022 (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 8, 2022

/s/ Jeffrey N. Simmons

Jeffrey N. Simmons
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 8, 2022

/s/ Todd S. Young

Todd S. Young
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)