AstraZeneca plc

(AYZ-NYSE) Analyst Note

SUMMARY

AstraZeneca’s fourth-quarter 2014 core earnings of $0.76 per ADS missed the Zacks Consensus Estimate of $0.84 and were down 28% (CER) y-o-y due to higher expenses. Quarterly revenues increased 2% (CER) y-o-y to $6.7 billion in line with the Zacks Consensus Estimate. AstraZeneca expected its 2015 core earnings and revenues to increase in the low single-digit and mid single-digit percentage range respectively. We expect the top and the bottom line to remain as Nexium generics will enter the market soon. We are nonetheless encouraged by the company’s impending acquisition of rights to Actavis’ branded respiratory business in the U.S. and Canada. As a result we maintain a Neutral recommendation on the stock.

<table>
<thead>
<tr>
<th>Current Recommendation</th>
<th>NEUTRAL</th>
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<td>Prior Recommendation</td>
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<td>Date of Last Change</td>
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<td>Current Price (02/06/15)</td>
<td>$67.69</td>
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<td>Target Price</td>
<td>$71.00</td>
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SUMMARY

52-Week High $81.09
52-Week Low $62.45
One-Year Return (%) 10.30
Beta 0.58
Average Daily Volume (EPADS) 1,981,089

EPADS Outstanding (mil) 1,263
Market Capitalization ($mil) $85,492
Short Interest Ratio (days) 1.89
Institutional Ownership (%) 6
Insider Ownership (%) N/A

Annual Cash Dividend $2.80
Dividend Yield (%) 4.14

5-Yr. Historical Growth Rates
Sales (%) -7.1
Earnings Per EPADS (%) -5.8
Dividend (%) 4.2

P/E using TTM EPADS 15.8
P/E using 2015 Estimate 15.5
P/E using 2016 Estimate 16.5

Zacks Rank *: Short Term 1 – 3 months outlook 3 - Hold

* Definition / Disclosure on last page

ZACKS CONSENSUS ESTIMATES

Revenue Estimates
(In millions of $)

<table>
<thead>
<tr>
<th></th>
<th>Q1 (Mar)</th>
<th>Q2 (Jun)</th>
<th>Q3 (Sep)</th>
<th>Q4 (Dec)</th>
<th>Year (Dec)</th>
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<tr>
<td>2013</td>
<td>6,385 A</td>
<td>6,232 A</td>
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<td>2014</td>
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<td>6,542 A</td>
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<td>2015</td>
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<td>6,602 E</td>
<td>6,692 E</td>
<td>4,496 E</td>
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<td>2016</td>
<td></td>
<td></td>
<td></td>
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<td>24,066 E</td>
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</table>

Note: Qtrly. Figs. may not add up to annual figs. due to rounding off.

Earnings Per ADS Estimates (1 Share= 1 ADS)
(EPS is operating earnings before non-recurring items, but including employee stock options expenses)

<table>
<thead>
<tr>
<th></th>
<th>Q1 (Mar)</th>
<th>Q2 (Jun)</th>
<th>Q3 (Sep)</th>
<th>Q4 (Dec)</th>
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<td>2013</td>
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<td>$1.20 A</td>
<td>$1.21 A</td>
<td>$1.23 A</td>
<td>$5.05 A</td>
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<td>2014</td>
<td>$1.17 A</td>
<td>$1.30 A</td>
<td>$1.05 A</td>
<td>$0.76 A</td>
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<td>$1.20 E</td>
<td>$1.33 E</td>
<td>$1.07 E</td>
<td>$0.76 E</td>
<td>$4.36 E</td>
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<tr>
<td>2016</td>
<td></td>
<td></td>
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<td>$4.09 E</td>
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Note: Qtrly. Figs. may not add up to annual figs. due to rounding off.

Projected EPADS Growth - Next 5 Years % 2
AstraZeneca reported fourth-quarter 2014 core earnings of $0.76 per American Depositary Share (ADS) that missed the Zacks Consensus Estimate by 8 cents. Earnings were down 28% (at constant exchange rates or CER) year over year due to higher expenses.

AstraZeneca’s fourth-quarter revenues increased 2% (at CER) year over year to $6.7 billion. Revenues were in line with the Zacks Consensus Estimate. Strong performance at key growth platforms (Brilinta, diabetes, respiratory and Emerging Markets) benefited revenues.

The company reported 2014 core earnings of $4.28 per ADS, down 8% year over year at CER. Earnings also missed the Zacks Consensus Estimate of $4.34. Revenues in 2014 were up 3% year over year at CER to $26.1 billion. Revenues were below the Zacks Consensus Estimate of $26.2 billion.

Along with its financial results for the fourth quarter of 2014, the company also announced that it will be acquiring the U.S. and Canadian rights to Actavis’ branded respiratory business for $600 million. AstraZeneca will also be paying low single-digit royalties above a certain revenue target. The deal is expected to close in the first quarter of 2015.

All growth rates mentioned below are on a year-on-year basis and at CER.

The Quarter in Detail

U.S. revenues remained flat year over year in the fourth quarter at $2.6 billion. The company's key growth platforms performed well in this area however the increase was offset by the impact of completion of the acquisition of Bristol-Myers Squibb Company’s share of the global diabetes alliance.

European markets sales were also flat year over year, with generic erosion (loss of exclusivity of Seroquel XR and Atacand) completely offsetting the impact of the inclusion of diabetes revenues and Brilinta (EU trade name: Brilique). Established RoW revenues were down 8%. Revenues were hurt by generic competition of oncology products and inventory depletion of Seroquel IR in Japan. Revenues in Japan decreased 9%.

Nexium, which generated 14% of AstraZeneca’s total revenues in 2014, is expected to face generic competition soon.

We are impressed with the performance of drugs such as Onglyza (up 122% to $200 million), Symbicort (up 5% to $978 million), Bydureon (up 153% to $123 million), Byetta (up 31% to $69 million), Pulmicort (up 15% to $269 million) and FluMist (up 170% to $134 million).

Sales from Brilinta, a key area of focus, were $133 million in the reported quarter, up 52% year over year. Brilinta performed well in Europe and Emerging Markets.

Other Details

AstraZeneca’s core gross margin was down 0.6 percentage points to 79.7% in the fourth quarter of 2014. Core selling, general and administrative (SG&A) expenses increased 23% to $2.9 billion, primarily due to investments in the company’s growth platforms.
During the quarter, core research and development expenses increased 17% to $1.4 billion, reflecting higher investments in pipeline.

2015 Outlook

AstraZeneca expects revenues to increase in the mid single-digit percentage range in 2015. The 2015 Zacks Consensus Estimate currently stands at $24.6 billion. The company's guidance assumes the launch of Nexium generics in the U.S. soon.

The company expects core earnings to increase in the low single-digit percentage range in 2015. The 2015 Zacks Consensus Estimate is at $4.20 per share.

Our Take

We are encouraged by the company's plans to boost its respiratory business. AstraZeneca's respiratory portfolio is one of the key growth platforms at the company. The segment has performed encouragingly in 2014. The addition of Actavis' branded respiratory business will drive growth further.

Meanwhile, AstraZeneca's fourth-quarter results were disappointing with earnings missing our expectation. The company's near-term threat is that of Nexium going generic. Generic competition has adversely impacted AstraZeneca's revenues over the past few quarters and is expected to do so in the coming quarters too. This has put significant pressure on the company.

We are nonetheless encouraged by the recent approvals at AstraZeneca. The EU approvals of Duaklir Genuair (chronic obstructive pulmonary disease), Lynparza (ovarian cancer) and Movantik (opioid-induced constipation) were major milestones for the company. Lynparza was also approved in the U.S. These new product approvals will boost the top line, thereby driving growth.

AstraZeneca is also working on its pipeline to boost its product portfolio. The company currently has 133 programs in its pipeline, of which 118 are in the clinic.

VALUATION

AstraZeneca's fourth-quarter 2014 core earnings of $0.76 per ADS missed the Zacks Consensus Estimate of $0.84 and were down 28% (CER) y-o-y due to higher expenses. Quarterly revenues increased 2% (CER) y-o-y to $6.7 billion in line with the Zacks Consensus Estimate. AstraZeneca expected its 2015 core earnings and revenues to increase in the low single-digit and mid single-digit percentage range respectively.

We expect the top and the bottom line to remain as Nexium generics will enter the market soon. We are nonetheless encouraged by the company's impending acquisition of rights to Actavis' branded respiratory business in the U.S. and Canada. As a result we maintain a Neutral recommendation on the stock.

AstraZeneca's current trailing 12-month P/E multiple is 15.8, compared to the industry average of 20.8 and the S&P 500 average of 18.9. The stock is trading at 15.5x our 2015 earnings estimate. Our target price of $71 is based on 16.7x our 2015 EPADS estimate.
# Key Indicators

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<th>P/E F1</th>
<th>P/E F2</th>
<th>Est. 5-Yr EPADS Gr%</th>
<th>P/CF (TTM)</th>
<th>P/E 5-Yr High (TTM)</th>
<th>P/E 5-Yr Low (TTM)</th>
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<tr>
<td><strong>AstraZeneca (AZN)</strong></td>
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<td>2.0</td>
<td>8.0</td>
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<td><strong>TTM is trailing 12 months; F1 is 2015 and F2 is 2016, CF is operating cash flow</strong></td>
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<th>EV/EBITDA (TTM)</th>
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Earnings Surprise and Estimate Revision History

ASTRAZENECA PLC (AZN) Price EPS Surprises

Price ($) 4/30/10 10/15/10 4/1/11 9/1/11 3/2/12 8/17/12 2/1/13 7/1/13 1/3/14 6/20/14 12/5/14
<< 3/31/94

<< 2/21/03


ZACKS INVESTMENT RESEARCH
The analysts contributing to this report do not hold any shares of AZN. The EPS and revenue forecasts are the Zacks Consensus estimates. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts' personal views as to the subject securities and issuers. Zacks certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed herein are subject to change. This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. Zacks uses the following rating system for the securities it covers. Outperform: Zacks expects that the subject company will outperform the broader U.S. equity market over the next six to twelve months. Neutral: Zacks expects that the company will perform in line with the broader U.S. equity market over the next six to twelve months. Underperform: Zacks expects the company will underperform the broader U.S. Equity market over the next six to twelve months. The current distribution of Zacks Ratings is as follows on the 1121 companies covered: Outperform - 15.5%, Neutral - 77.0%, Underperform – 6.8%. Data is as of midnight on the business day immediately prior to this publication.

Our recommendation for each stock is closely linked to the Zacks Rank, which results from a proprietary quantitative model using trends in earnings estimate revisions. This model is proven most effective for judging the timeliness of a stock over the next 1 to 3 months. The model assigns each stock a rank from 1 through 5. Zacks Rank 1 = Strong Buy. Zacks Rank 2 = Buy. Zacks Rank 3 = Hold. Zacks Rank 4 = Sell. Zacks Rank 5 = Strong Sell. We also provide a Zacks Industry Rank for each company which provides an idea of the near-term attractiveness of a company's industry group. We have 264 industry groups in total. Thus, the Zacks Industry Rank is a number between 1 and 264. In terms of investment attractiveness, the higher the rank the better. Historically, the top half of the industries has outperformed the general market. In determining Risk Level, we rely on a proprietary quantitative model that divides the entire universe of stocks into five groups, based on each stock’s historical price volatility. The first group has stocks with the lowest values and are deemed Low Risk, while the 5th group has the highest values and are designated High Risk. Designations of Below-Average Risk, Average Risk, and Above-Average Risk correspond to the second, third, and fourth groups of stocks, respectively.

NOTE: THIS IS A NEWS-ONLY UPDATE; THE REST OF THIS REPORT HAS NOT BEEN UPDATED YET.

OVERVIEW

AstraZeneca plc, headquartered in London, UK, is one of the largest biopharmaceutical companies in the world. AstraZeneca was formed on Apr 6, 1999 through the merger of Sweden's Astra AB and UK's Zeneca Group plc. AstraZeneca's business can be broken down into separate lines based on therapeutic classes. These include: gastrointestinal, cardiovascular, respiratory, oncology, neuroscience, infection and other. Well known products in the company's portfolio include Crestor (cholesterol management), Nexium (acid reflux management), Symbicort (asthma), Seroquel (schizophrenia and bipolar mania), Zoladex (prostate and breast cancer) and Atacand (hypertension and symptomatic heart failure). However, most of these products are facing generic competition.

In 2013, U.S. sales declined 9% (at constant exchange rates [CER]), primarily hurt by the loss of exclusivity of several key products including Seroquel. Strong performance by Symbicort, Faslodex and Onglyza partially offset the decline in revenues.

2013 sales in Europe were down 9% (CER) due to generic competition (Nexium, Arimidex, Seroquel IR and Merrem). Established ROW sales were down 10% to approximately $4.0 billion. Sales in emerging markets climbed 8% to $5.4 billion.

In Jun 2007, AstraZeneca acquired biotechnology company MedImmune for $15.6 billion thus strengthening its product portfolio further. In Aug 2011, AstraZeneca sold its Astra Tech business to DENTSPLY for about $1.8 billion in cash. In a bid to add late-stage candidates to its pipeline, AstraZeneca entered into a number of deals (Almirall's respiratory franchise, Bristol-Myers' diabetes portfolio, Pearl Therapeutics and Omthera Pharmaceuticals) in the last few quarters and struck agreements with companies such as FibroGen, Inc.
REASONS TO BUY

- **Strong Diversified Portfolio:** AstraZeneca has a strong product portfolio and is one of the leading players in the global cardiovascular market. The company is working on driving Brilinta sales and is also focusing on its cardio-metabolism (includes diabetes), respiratory and oncology portfolios. We are positive on the Bristol-Myers deal under which AstraZeneca gained global rights to major diabetes products like Onglyza, Kombiglyze XR/Komboglyze, Farxiga, Byetta, Bydureon and Symlin. The inclusion of this diabetes franchise is expected to boost revenues by approximately $1 billion on a pro forma basis and will be accretive to earnings from 2017.

  Meanwhile, the approval of Epanova (severe hypertriglyceridemia), Farxiga (type II diabetes), Lynparza (cancer), Movantik (opioid induced constipation), and Xigduo (type II diabetes) was a major positive for the company. These new product approvals will boost the top line thereby driving growth.

- **Emerging Markets - A Focus Area:** AstraZeneca, which operates in multiple countries across the globe, is focusing on emerging markets. Revenues from emerging markets climbed 8% to $5.4 billion in 2013 supported by strong growth in China. Emerging markets represent significant commercial opportunity given factors like pricing pressure in the EU and intensifying generic competition affecting sales in large pharmaceutical markets. AstraZeneca plans to accelerate investment and build capabilities in emerging markets, primarily China. AstraZeneca's operations in emerging markets should stand it in good stead going forward. The company is also looking towards Africa for growth.

- **Cost Cutting Initiatives:** With a major part of its top line exposed to generic competition, AstraZeneca is looking towards cost-cutting initiatives to drive the bottom line. The company is seeking to lessen the impact of the genericization of key products by reducing its cost structure.

  The company has initiated a major overhaul of its research and development (R&D) segment with R&D activities expected to be primarily centered in three facilities - in the UK (Cambridge – to be completed in 2016), the U.S. (Gaithersburg) and Sweden (Mölndal). The SG&A segment will also be optimized. The initiative will result in the relocation and termination of approximately 2,500 and 5,050 roles, respectively. The company has expanded the restructuring program, which integrates the earlier programs along with the new ones. The overall initiative is expected to cost approximately $3.2 billion. The restructuring initiative is expected to generate savings of $1.1 billion per annum by the end of 2016. The new initiatives also include the termination of an additional 550 employees. These actions should drive the bottom line. Streamlining of operations along with increased focus on R&D will benefit the company in the long run.

- **Acquisitions & Deals to Boost Growth:** The company is working on bolstering its pipeline and is looking at suitable acquisitions and deals. In order to strengthen its respiratory franchise, AstraZeneca acquired Almirall's respiratory franchise in a deal slated to be neutral in 2015 and accretive in 2016.

  In Dec 2013, AstraZeneca boosted its diabetes portfolio by acquiring Bristol-Myers’ global diabetes business for an upfront payment of $2.7 billion. AstraZeneca plans to capitalize on its strong presence in emerging markets to promote its diabetes franchise.

  The Jun 2012 acquisition of Ardea added Ardea's lead candidate, lesinurad (chronic treatment of gout), to AstraZeneca's pipeline. The candidate possesses blockbuster potential. Other acquisitions include Omthera and AlphaCore, both boosting the company's cardiovascular pipeline. The Pearl Therapeutics acquisition added chronic obstructive pulmonary disease (COPD) candidate, PT003, to AstraZeneca's pipeline.
In addition to acquisitions, the company is pursuing co-development deals with companies like Nektar, Isis and Merck to boost its pipeline. AstraZeneca inked a deal with Pfizer in Aug 2012 for the marketing of an OTC version of AstraZeneca’s Nexium (gastroesophageal reflux disease and peptic ulcers). AstraZeneca received an upfront payment of $250 million from Pfizer and is entitled to milestone and royalty payments on product launches and sales. This will boost its balance sheet. AstraZeneca will continue marketing the prescription product and also supply the OTC product to Pfizer. We believe the company will sign more such accretive deals.

**Pipeline Moving Along:** AstraZeneca has been seeing significant progress with its pipeline. Apart from gaining approval for quite a few products in 2014, the company has about 14 candidates in phase III or under regulatory review. AstraZeneca is targeting 14-16 submissions and 8-10 approvals in 2015-2016.

Promising pipeline candidates include brodalumab (psoriasis, phase III), roxadustat (oral treatment of anemia in patients with chronic kidney disease, phase III), AZD9291 (regulatory filing for second line therapy for non-small cell lung cancer expected in the second quarter of 2015) and AZD3293 (Alzheimer’s disease, phase II/III). AstraZeneca is also working on bringing immuno-oncology treatments to market and has about 29 immuno-oncology combination trials underway or planned. Immuno-oncology, a therapeutic area attracting a lot of interest, represents huge commercial potential. MEDI4736 is being evaluated for a variety of tumors including head and neck cancer (phase II, monotherapy) and NSCLC (phase III, monotherapy).

**REASONS TO SELL**

**Generics Eroding Revenues:** The generic competition that AstraZeneca is currently facing has put significant pressure on the company. Atacand, Toprol-XL, Seroquel and Merrem are already facing generic competition in the U.S. Crestor is facing a steep decline in revenues in Canada and Australia due to the loss of exclusivity in these markets. Additionally, Crestor is slated to lose exclusivity in the U.S. in Jul 2016 (including pediatric exclusivity). However, a generic version of the product may enter the market in May 2016. Moreover, Nexium went off patent in the U.S. from May 27, 2014 though generics are yet to enter the market. The genericization of key products will make it challenging for the company to drive its top line. Meanwhile, the new guidelines issued by the American Academy of Pediatrics will significantly impact Synagis sales in the fourth quarter of 2014 and into 2015.

**Pipeline Setbacks:** Although AstraZeneca has several candidates in its pipeline in different stages of development, the company has had its share of pipeline setbacks. For example, the development of prostate cancer candidate, zibotentan, was discontinued in early 2011 and the biological license application for motavizumab (for the prophylaxis of serious respiratory syncytial virus) was withdrawn in 2010. Additionally, AstraZeneca suffered two major back-to-back pipeline setbacks in Dec 2011 with the development of olaparib (ovarian cancer) being discontinued and major depressive disorder candidate, TC-5214, failing to meet its primary endpoint in a phase III study. TC-5214’s development has been discontinued by the company. Meanwhile, the failure of Crestor to significantly reduce plaque buildup in heart arteries compared to Pfizer’s Lipitor, as per data from the SATURN study presented in Sep 2011, was another setback for AstraZeneca. In Jun 2013, AstraZeneca decided to return the rights to its rheumatoid arthritis candidate, fostamatinib, to Rigel. AstraZeneca took this decision based on mixed data from the OSKIRA phase III program and will no longer pursue regulatory filings for the candidate. Given that AstraZeneca is up against generic competition, the company’s pipeline needs to deliver.

In Jun 2013, AstraZeneca’s efforts to increase the patient base for Onglyza also failed when the product did not meet the primary efficacy endpoint in a phase IV study. Positive data from the study would have increased Onglyza’s share in the DPP-4 inhibitor market and provided a much-needed boost to revenues.
Intense Competition: In addition to generic threats, AstraZeneca's products already face intense competition in the market from both large pharma companies as well as small and mid-sized companies. One of AstraZeneca's key focus areas, the diabetes market, is heavily crowded with a number of products present in the market. AstraZeneca's Forxiga belongs to the same class (SGLT2) as Johnson & Johnson's Invokana. Bydureon, a GLP-1 receptor agonist with a once weekly dosing is facing competition from Glaxo's Tanzeum and Lilly's Trulicity. Loss of market share due to intense competition will severely impact AstraZeneca's top line.