

COMPANY NOTE

Estimate Change

USA | Healthcare | Pharmaceuticals/Specialty

February 16, 2012

Jefferies

Sagent Pharmaceuticals (SGNT) Q4 Rev. Upside; SGNT Maturing Quickly

Key Takeaway

4Q rev beat our estimates, but SGNT missed on EPS due to higher spend and slightly lower GM%. First-time '12 guidance fell short of our forecasts, but was driven primarily by a big boost in R&D, as SGNT looks to ensure its longer-term success, a move we won't argue with. With 18 expected new launches in 2012, continued progress on GM% expansion, and a significant opp'y w/ shortage products, we maintain our Buy rating.

The numbers. Rev grew 44% to \$48.5M (an all-time high), ahead of our \$47M estimate and consensus of ~\$45M. This came in *ahead* (last quarter was *behind*; see Exhibit 1) of IMS 4Q sales of \$42.0M. Some had worried about downside based on IMS so this is a good reminder that IMS is unreliable for SGNT. Total Opex of \$11.6M increased 35%, driven mainly by higher R&D (+74% vs. our +14%), while the gross margin on an adjusted basis (excluding \$4M in excess inventory reserves related to one of its heparin products) came in at 17.5%, a sequential increase vs. 17.0% seen in 3Q11, but below our 19.0%. As a result, EPS was (\$0.18), compared to our (\$0.08) and consensus of (\$0.11). See Exhibit 2 for a full 4Q variance analysis.

2012 guidance coulda been better, we see upside. Exhibit 3 (p.3) details first-time 2012 guidance. Overall, while revenue guidance of \$220-\$250M bracketed us (\$245.7M prior) and consensus (\$234.1M), expense items were much higher: 1) significantly higher R&D — \$22-26M is now 2x over 2011 due mainly to a \$10M investment in new pipeline opportunities, \$2M in PDUFA fees; and 2) GM% of 20-23%, which is below our prior ~25% estimate. However, SGNT might get closer to 25% if it can restructure the terms of the Strides JV. As a result, our 2012E EPS moves from \$0.45 to (\$0.25), noting that profitability, which we previously had modeled as a 1H12 event, now shifts to 2H12. For a summary of our estimate changes, see Exhibit 4.

Valuation/Risks

While profitability is being pushed out a few quarters into 2H12, we're maintaining our \$28 PT, which is based on a 20X PE multiple on our revised 2013 EPS of \$1.40. This is a premium PE to peers, but one justified given SGNT's growth profile, niche expertise in generic injectables, and its scarcity value as such a pure play. Risks include: slower than expected new generic product approvals, unforeseen manufacturing issues, pricing pressure, and failure to make progress on its longer-term financial targets.

USD	Prev.	2010A	Prev.	2011E	Prev.	2012E	Prev.	2013E
Rev. (MM)	--	74.1	150.9	152.4	245.9	235.0	--	351.4
EV/Rev		6.7x		3.3x		2.1x		1.4x
Consensus	--	--	(0.85)	(0.99)	0.46	0.36	1.80	1.66
EPS								
Mar	--	--	--	(2.09)A	0.00	(0.37)	--	--
Jun	--	--	--	(0.37)A	0.06	(0.15)	--	--
Sep	--	--	--	(0.17)A	0.14	0.06	--	--
Dec	--	--	(0.08)	(0.18)	0.26	0.20	--	--
FY Dec	--	NA	(0.97)	(1.12)	0.45	(0.25)	1.55	1.40
FY P/E				NM		NM		15.7x

BUY

Price target \$28.00

Price \$21.99

Financial Summary

Net Debt (MM): (\$117.1)

Market Data

52 Week Range:	\$29.23 - \$13.50
Total Entprs. Value (MM):	\$496.4
Market Cap. (MM):	\$613.5
Insider Ownership:	2.5%
Institutional Ownership:	67.9%
Shares Out. (MM):	27.9
Float (MM):	10.0
Avg. Daily Vol.:	98,775

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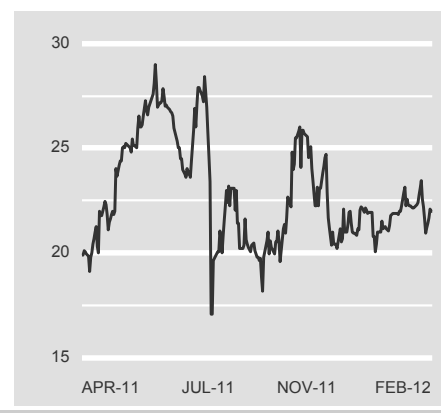
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Price Performance



Other Incremental 4Q11 Highlights

New Product/Pipeline Review

2011 concluded a very successful year for Sagent, as it launched 12 products and submitted another 17 for approval. Currently, Sagent has 41 products represented by 76 ANDAs either pending launch or awaiting FDA approval. This consists of and compares to 40 products represented by 75 ANDAs at the end of 3Q11. Based on Sagent's latest thinking, it expects to be able to launch 18 products in 2012, and file an additional 12-15 products for approval.

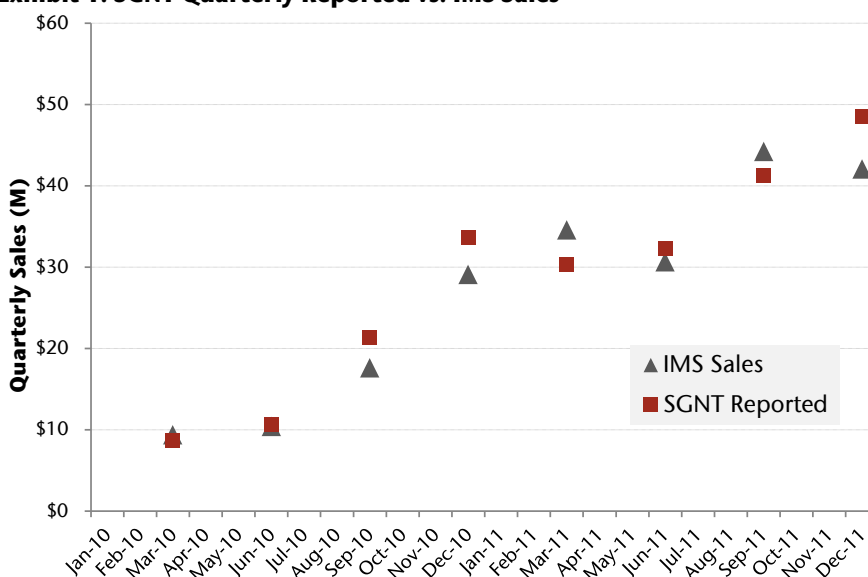
Making Progress on Shortage Products

According to the FDA's website, there are now 112 products on the critical shortage list, which represents an increase from the 75 that were listed on October 31, 2011 and 100 listed on January 26, 2012. Notably, of the 112 listed, 88 are injectable drugs, and within this, 18 are injected oncology drugs. (Our proprietary table is available on request.) This represents a significant opportunity for Sagent (and others focused on generic injectables). We note that within the 76 ANDAs that Sagent has either pending launch or awaiting approval, 20 are for shortage products. In our opinion, Sagent's Chengdu facility is perfectly suited to help the company make significant strides on shortage products. Chengdu is now fully operational, with Sagent now having submitted two ANDA submissions (the first in late 2011, the second in early 2012), and a third filing on the way (which Sagent believes could trigger an FDA inspection). Chengdu will initially focus on shortage products, and we believe first revenue could come by late 2013.

Evolution in the Product Mix

Given the more recent launch of higher value/higher margin products (i.e., oncology products, shortage products), Sagent has been successful in improving the product mix. Whereas for the year ended 2010, the split of revenue coming from anti-infective/critical care/oncology products was 55%/34%/11%, for the full-year 2011, that split was 42%/36%/23%. We expect this trend to continue throughout 2012 and beyond, helping to drive gross margin expansion.

Exhibit 1: SGNT Quarterly Reported vs. IMS Sales



Source: Company reports, IMS

Exhibit 2: 4Q11 Variance Analysis

(\$ in millions, except for EPS)

Item	Actual	% Chg	Jefco	% Chg	Δ	Cons.	Comment
Total revenue	\$48.5	44%	\$47.0	40%	1.5	\$45.4	Nice revenue beat vs. us and consensus, and below the \$42.0M reported by IMS for the three months of 4Q11 (IMS does not capture direct sales from Sagent to GPO's). Contributions came from new 4Q11 launches, including orphenadrine, haloperidol, and rocuronium.
COGS	40.0	46%	38.1	39%	2.0		COGS excludes \$4.0M in excess inventory reserves related to a heparin code in the dialysis market.
GM%	17.5%	-70 bps	19.0%	+80 bps	(1.5%)		Was lower than we expected (19.0%) and lower than the year prior period (18.2%). That said, we were pleased to see a sequential improvement vs. 3Q11 GM% of 17.0%.
SG&A	7.0	18%	6.6	11%	0.4		Slightly higher than our forecast, due to an increase in headcount and higher costs of being a public company.
R&D	4.6	74%	3.0	14%	1.6		Meaningfully higher than we expected, with the increase due to a ramp in R&D investment (a good thing in our view) and increased ANDA filing fees.
Total OpEx	11.6	35%	9.6	12%	2.0		Higher total OpEx was driven by increases in both SG&A and R&D. The 35% increase in total OpEx compares to the 44% increase in revenue; in the future, we'd like to see greater operational leverage.
Net Income	(5.1)	NM	(2.2)	NM	(2.9)		
Adj. diluted EPS	(\$0.18)	NM	(\$0.08)	NM	(\$0.10)	(\$0.11)	A \$0.10 miss relative to our estimate (\$0.07 miss relative to consensus), but at this stage, EPS is not particularly meaningful for us. However, given increased OpEx relative to our previous estimates, full-year profitability is now pushed out to 2013.

Source: Jefferies estimates, company data, Thomson One for consensus

Exhibit 3: 2012 Financial Guidance

(\$ in millions, except for EPS)

Item	Guidance	% Chg	Old Jefco	% Chg	New Jefco	% Chg	Consensus	Comment
Total revenue	\$220-\$250	44%	\$245.9	63%	\$235.0	54%	\$234.1	Driven by continued performance of new products launched in 2011, and 18 expected launches in 2012 (but most will be back-end loaded).
GM%	20%-23%	-70 bps	24.6%	+920 bps	22.4%	+520 bps	26.0%	Lower than what we previously modeled, but there's potential upside if the Strides JV can be restructured.
SG&A	\$30-\$34	18%	28.0	13%	32.0	27%		Reflects annualization on public company costs and the addition of personnel to handle new projects.
R&D	\$22-\$26	74%	12.6	13%	24.0	88%		A significant increase: \$10M more in a commitment to the 2015-2017 time frame, and \$2M in new PDUFA fees.
Total OpEx	\$50-\$60	35%	40.6	13%	56.0	48%		Impacted by higher R&D, and ideally, we'd like to see more operating leverage.
Net Income	\$0-(\$5)		13.6	NM	(7.2)	NM		We're below guidance.
Adj. diluted EPS	NA		\$0.45	NM	(\$0.25)	NM	\$0.36	As a result of the new guidance, we're pushing profitability in 2013, but at this point, it's not a big deal.

Source: Jefferies estimates, company data, Thomson One for consensus

Exhibit 4: New Estimate Changes

(\$ in millions, except for EPS)

Year end Dec. 31	2012E			2013E			2014E			2015E		
	OLD	NEW	Δ	OLD	NEW	Δ	OLD	NEW	Δ	OLD	NEW	Δ
Total Revenue	245.9	235.0	(10.9)	351.4	351.4	0.0	439.3	439.3	0.0	505.2	505.2	0.0
Gross Margin	24.6%	22.4%	(2.1%)	32.3%	31.0%	(1.3%)	34.4%	34.4%	0.0%	35.0%	35.0%	0.0%
SG&A	28.0	32.0	4.0	30.2	34.6	4.3	32.1	36.6	4.6	33.7	38.5	4.8
% of total rev	11.4%	13.6%	2.2%	8.6%	9.8%	1.2%	7.3%	8.3%	1.0%	6.7%	7.6%	1.0%
R&D	12.6	24.0	11.4	13.9	26.4	12.5	15.0	28.5	13.5	15.7	29.9	14.2
% of total rev	5.1%	10.2%	5.1%	3.9%	7.5%	3.6%	3.4%	6.5%	3.1%	3.1%	5.9%	2.8%
Operating Margin	5.4%	(3.0%)	(8.5%)	19.1%	14.5%	(4.6%)	23.5%	20.9%	(2.5%)	25.2%	23.2%	(2.0%)
Tax Rate	(1.7%)	0.0%	1.7%	29.6%	20.0%	(9.6%)	31.8%	36.0%	4.2%	32.6%	248.5%	215.8%
Net Income	5.5%	(7.2)	(7.2)	13.5%	40.8	40.7	16.0%	58.9	58.7	17.0%	75.1	75.0
Adj. Diluted EPS	\$0.45	(\$0.25)	(\$0.70)	\$1.55	\$1.40	(\$0.14)	\$2.25	\$1.99	(\$0.27)	\$2.70	\$2.48	(\$0.21)
Shares Out. (MM)	30.0	28.5	(1.5)	30.6	29.1	(1.5)	31.2	29.7	(1.6)	31.8	30.2	(1.6)
YoY Growth (%)												
Total Revenues	63%	54%	(9%)	43%	50%	7%	25%	25%	0%	15%	15%	0%
SG&A	13%	27%	14%	8%	8%	0%	6%	6%	0%	5%	5%	0%
R&D	13%	88%	75%	10%	10%	0%	8%	8%	0%	5%	5%	0%
Net Income	13%	NM	--	9%	NM	--	7%	44%	38%	5%	28%	23%
Adj. Diluted EPS	NM	NM	--	241%	NM	--	46%	41%	(4%)	20%	25%	5%

Source: Jefferies estimates, company data

Exhibit 5: New Sagent Pharmaceuticals Summary P&L

(In millions of \$, except per share amount)

Year End: December 31	2009	2010	4Q11	2011E	1Q12E	2Q12E	3Q12E	4Q12E	2012E	2013E	2014E	2015E	2016E
Total Revenue	\$29.2	\$74.1	\$48.5	\$152.4	\$42.0	\$54.0	\$68.0	\$71.0	\$235.0	\$351.4	\$439.3	\$505.2	\$581.0
COGS	\$28.8	\$65.0	\$40.0	\$129.6	\$34.9	\$43.2	\$52.4	\$51.8	\$182.3	\$242.5	\$288.2	\$328.4	\$374.7
Gross Profit	\$0.4	\$9.0	\$8.5	\$22.8	\$7.1	\$10.8	\$15.6	\$19.2	\$52.8	\$108.9	\$151.1	\$176.8	\$206.2
Gross Margin	1.5%	12.2%	17.5%	14.9%	17.0%	20.0%	23.0%	27.0%	22.4%	31.0%	34.4%	35.0%	35.5%
SG&A	\$16.7	\$18.9	\$7.0	\$25.1	\$8.0	\$8.0	\$8.0	\$8.0	\$32.0	\$34.6	\$36.6	\$38.5	\$40.4
R&D	12.4	11.2	4.6	12.8	6.0	6.0	6.0	6.0	24.0	26.4	28.5	29.9	31.4
Total OpEx	29.1	30.2	11.6	37.9	14.0	14.0	14.0	14.0	56.0	61.0	65.1	68.4	71.8
Operating Margin	(104.5%)	(33.1%)	(10.6%)	(14.7%)	(19.9%)	(7.8%)	2.4%	8.0%	(3.0%)	14.5%	20.9%	23.2%	25.2%
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	20.0%	36.0%	36.0%	36.0%
Net Income	(30.5)	(24.5)	(5.1)	(22.4)	(10.5)	(4.2)	1.6	5.9	(7.2)	40.8	58.9	75.1	93.7
Net Margin	(104.5%)	(33.1%)	(11%)	(14.7%)	(24.9%)	(7.8%)	2.4%	8.3%	(3.0%)	11.6%	13.4%	14.9%	16.1%
Adj. Diluted EPS	NA	NA	(\$0.18)	(\$1.12)	(\$0.37)	(\$0.15)	\$0.06	\$0.20	(\$0.25)	\$1.40	\$1.99	\$2.48	\$3.04
Shares Out. (MM)	0.0	0.0	27.9	20.0	27.9	27.9	29.0	29.2	28.5	29.1	29.7	30.2	30.8
Year-over Year Growth													
Total Revenue	143%	153%	44%	106%	38%	67%	65%	46%	54%	50%	25%	15%	15%
COGS	141%	126%	46%	99%	35%	46%	52%	29%	41%	33%	19%	14%	14%
SG&A	11%	14%	18%	33%	61%	24%	20%	14%	27%	8%	6%	5%	5%
R&D	(17%)	(10%)	74%	14%	155%	153%	73%	31%	88%	10%	8%	5%	5%
Total OpEx	(3%)	4%	35%	26%	91%	58%	38%	21%	48%	9%	7%	5%	5%
Net Income	0%	(20%)	42%	(8%)	NM	NM	NM	NM	NM	NM	44%	28%	25%
Adj. Diluted EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	41%	25%	22%

Source: Jefferies estimates, company data

Company Description

Sagent Pharmaceuticals is a specialty pharmaceuticals company focused primarily on hospital-based, generic injectable drugs sold in the US. Founded in 2006, Sagent has sourcing, development, manufacturing, and sales and marketing capabilities, and has amassed an extensive, global network of partnerships and collaborations that provide for a low cost business model and a deep pipeline of ANDA opportunities.

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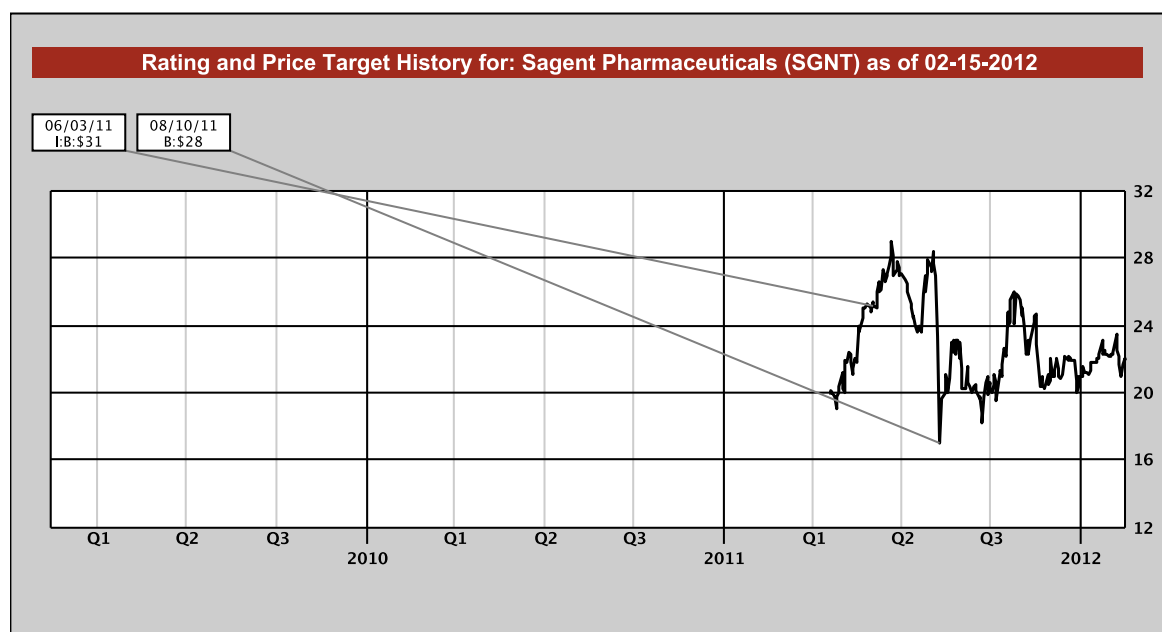
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			Count	Percent
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