

COMPANY NOTE

Target | Estimate Change

USA | Healthcare | Pharmaceuticals/Specialty

August 10, 2011

Jefferies

Sagent Pharmaceuticals (SGNT) Slips Happen in Generics; Not Worth 27%

Key Takeaway

SGNT missed Q2, particularly GM%. Given that it is a margin expansion story, the stock got annihilated (down 27%). Q2 was a perfect storm, but still highlights the vagaries of the generic model. As Sagent's products become more diverse, these will become much less likely. With the stock back near its IPO price, and only a slight hit to numbers, we think it's time to reload.

Q2 results. SGNT posted impressive revenue growth (+205% to \$32.3M), but this fell short of our and consensus estimates (\$35.6M & \$34.5M, respectively). The shortfall was due to a 12-day delay in getting Gx Levaquin bags approved -- pushing revenue from Q2 to Q3. And that product is now doing extremely well. GM%, however, was just 8.5%, well below our 20% forecast and cons. of 11.5%. Total OpEx of \$8.9M (+16%) came in below our projections (\$10.4M, +37%), with higher SG&A offsetting lower R&D. EPS was (\$0.37), a greater loss than our (\$0.27) and consensus of (\$0.21).

It's all about margins. With such a narrow top-line miss, SGNT's GM% miss was a clear investor focus as it was also down q/q (Q1 was 15.1%). For full year '11, SGNT guided GM% in the "mid-teens," thereby implying Q3 & Q4 GM% near or above 20%. Given Q2's 8.5%, this might seem a stretch, but for a company the size of SGNT, it only takes a few products to make a big difference. For example, newly launched Gx Levaquin has been doing well, and while 1st to market, it currently competes vs. only one other player (Sandoz). As current pricing remains healthy, this should boost Q3 GM%. Thus, w/ as many as 8 new products that could launch in 2H11 (examples include products like paclitaxel, see p.2 of this note), we think the GM% guidance is achievable.

Trimming estimates. Given pricing pressures on Gx Zosyn & Gemzar, we're adjusting our 2011 revenue from \$161M to \$152M, and modeling full year GM% at 16.1% (consistent with guidance, our previous estimate was 20%); 2011 EPS goes from (\$0.43) to (\$0.79) and 2012 EPS is \$0.50 vs. our prior \$0.58.

Valuation/Risks

Based on recent sector multiple contraction, we're now lowering our PT from \$31 to \$28 (64% upside), or 17.5x (19.4x prior) our '13 EPS of \$1.60. At 17.5x, this is a premium to peers, but deserved we think given SGNT's scarcity value (as a gx injectables pure play) and its high-growth profile. Risks include increased competition/pricing pressure, continued FDA delays, loss of key personnel, partnerships and/or contracts, and MFG issues.

USD	Prev.	2010A	Prev.	2011E	Prev.	2012E	Prev.	2013E
Rev. (MM)	--	74.1	161.4	151.6	--	245.9	--	351.4
EV/Rev		5.0x		2.5x		1.5x		1.1x
EPS								
Mar	--	--	--	(2.09)A	--	--	--	--
Jun	--	--	(0.27)	(0.37)	--	--	--	--
Sep	--	--	0.01	(0.11)	--	--	--	--
Dec	--	--	0.05	(0.01)	--	--	--	--
FY Dec	--	NA	(0.43)	(0.79)	0.58	0.50	--	1.60
FY P/E				NM		34.1x		10.7x

BUY

Price target \$28.00

(from \$31.00)

Price \$17.06

Financial Summary

Net Debt (MM): \$(101.3)

Market Data

52 Week Range: \$29.23 - \$15.00

Total Entprs. Value (MM): \$373.4

Market Cap. (MM): \$474.7

Insider Ownership: 2.5%

Institutional Ownership: 67.9%

Shares Out. (MM): 27.8

Float (MM): 6.3

Avg. Daily Vol.: 79,561

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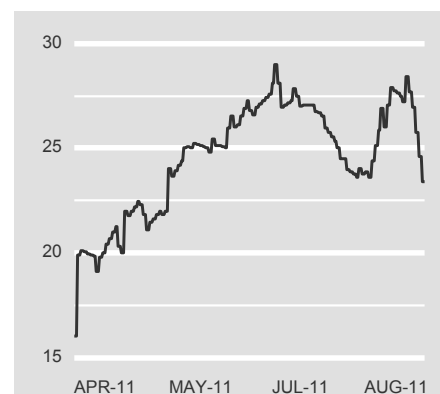
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Price Performance



Scenarios
Target Investment Thesis

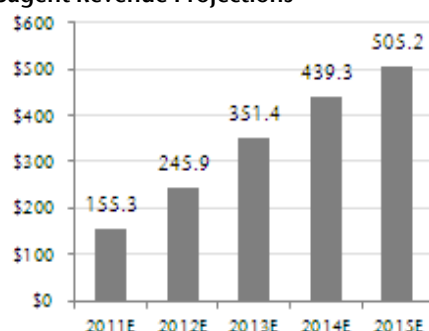
- Margin expansion story: GM% expected to increase from current 10-15% to 30-35% over the next several years
- Momentum with new product approvals should continue (Zosyn recently approved)
- Seasoned management team led by a CEO with a track record of success of building shareholder value
- Scarcity value: companies with generic injectables are highly sought-after assets
- PT – \$28, based on a 17.5x P/E on 2013 EPS of 1.60

Upside Scenario

- Slowdown in FDA approvals reverses
- Unannounced/unanticipated new ANDAs get approved and launched
- Sagent is able to secure better than expected GPO contract wins, which could boost market share for major products.
- Competition gets hit by regulatory delays, manufacturing deficiencies, and/or supply shortages
- PT – \$44, based on a higher 22x P/E multiple on higher 2013 EPS of \$2.00

Downside Scenario

- Key pipeline opportunities fail to get approved as expected
- ANDA backlog at FDA continues to grow
- ANDA approval times slow even further
- Deficiencies at manufacturing facilities lead to production delays and/or plant shutdowns
- Margin expansion fails to materialize; loss of personnel, partnerships, contracts
- PT – \$9, based on a lower 10x P/E multiple on 2013 EPS of \$0.90 and lowered revenue of \$250M.

Long Term Analysis
Sagent Revenue Projections


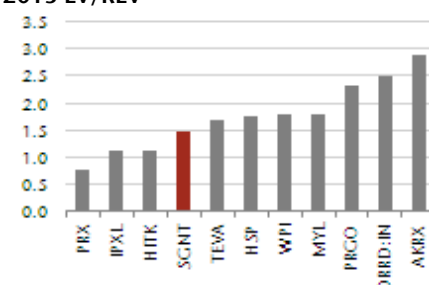
Source: Capital IQ

Long Term Financial Model Drivers

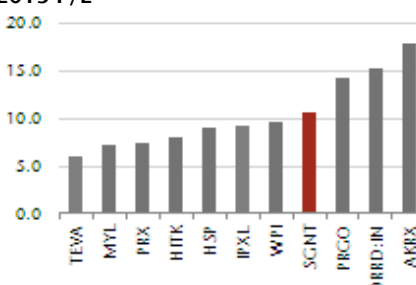
2011-15 Revenue CAGR	34.3%
2012-15 EPS CAGR	78.1%
2013-15 EPS CAGR	33.5%
GM Expansion (2010-15)	24.0%
Op. Margin Expansion (2012-15)	19.3%

Other Considerations

Sagent specializes in hospital-based generic injectable products, for which there are high barriers to entry, limited competition, and critical shortages for a number of key products. This, in our opinion, puts Sagent in the sweet spot among its generic peers. Ultimately, we believe this, combined with a rich history of consolidation among generic injectable pharmaceutical companies, could lead to Sagent being seen as an eventual M&A takeout candidate.

Peer Group (consensus estimates except SGNT)
2013 EV/REV


Source: Capital IQ

2013 P/E


Source: Capital IQ

Recommendation / Price Target

Ticker	Rec.	PT
AKRX	NC	-
HITK	NC	-
HSP	NC	-
IPXL	HOLD	\$19
MYL	NC	-
PRGO	NC	-
PRX	NC	-
SGNT	BUY	\$28
RDY	NC	-
TEVA	HOLD	\$53
WPI	NC	-

Catalysts

- 2H11 – Additional new product approvals (mainly for small, high margin products)
- 4Q11 – Additional ANDA filings, including those for products on FDA's Critical Shortage List (out of Sagent's Chengdu facility)
- FDA inspection and approval of the Chengdu facility (expected in 2012)
- Business development activity for products, businesses or both

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Company Description

Sagent Pharmaceuticals is a Schaumburg, IL-based US-focused generic pharmaceuticals company specializing in hospital-based, critical care injectable products. Founded in 2006, the company currently markets 27 products (including most recently, generics for Levaquin, Gemzar and Zosyn) and has a deep pipeline of 75 additional ANDAs (for 42 products) that are currently pending FDA approval. In addition, Sagent features a global network of partnerships (including Actavis and Strides) that helps it source, develop, and manufacture new products, and is led by an experienced management and commercial team (including CEO Jeffrey Yordon, an industry veteran who has helped build several other generic injectable pharmaceutical companies that ultimately were sold) that bring long-standing relationships with general purchasing organizations and the major drug distributors.

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Paclitaxel is Just One Example Many Potential New Launches

Sagent should be able to take advantage of the very high rate of injectible product shortages. Yesterday, a new paclitaxel shortage was announced (\$50M market according to IMS), with Teva (TEVA/\$39.76/HOLD), Bedford, and Sandoz all listed as having “manufacturing delays”. These three had 60% share in June; APP/Fresenius (FRE.GR/€64.10/Buy) and Hospira (HSP/\$45.33/NC) have the other 40% share. On the FDA approvals website, there are 3 others with approved ANDA’s – Mylan (MYL/\$18.59/NR), Accord, and Actavis. Since Sagent has rights on all of Actavis’ injectible generics, this may be one potential future \$10M opportunity. And there are many more of these.

Exhibit 1: 2Q11 Variance Table

Item	Actual	% Chg	Jefferies	% Chg	Variance	Consensus	Comment
Total revenue	32.3	205%	35.6	237%	(3.3)	34.5	A miss relative to our and consensus estimates; biggest swing factor was a 12-day delay in securing final FDA approval for generic Levaquin bags, which pushed the launch from 2Q to 3Q11. Given the shortfall in the quarter and expected competition for already launched products, we think it's prudent to adjust our 2011 revenue forecast (we now lower from \$161.4M to \$155.3M vs. current consensus of \$160.4M)
COGS	29.5	177%	28.5	167%	1.0		COGS was slightly higher than we expected; hurt by increased pricing pressure, particularly on generic Zosyn whereby innovator Pfizer drastically cut price to maintain >80% market share.
GM%	8.5%	+940 bps	20.0%	+2090 bps	(11.5%)	19.3%	2Q11 GM% came in much lower than anticipated due to several factors: 1) pricing pressure seen with generic Zosyn; 2) maturing markets for generic heparin and generic Hycamtin; and 3) negative 1% impact from a change in accounting for the Strides JV (but a benefit on the Other Income line), first-time full year 2011 GM% guidance provided in the "mid-teens", but is dependent on new product launches in 2H'11; longer-term 2013 GM% guidance of "mid-30's" was maintained.
SG&A	6.5	49%	5.0	15%	1.5		Came in \$1.5M above our estimate, due to a general increase in Sagent's infrastructure, but also one-time IPO-related expenses; going forward, management provided guidance of quarterly SG&A above \$5M (but not more than \$6M).
R&D	2.4	(27%)	5.4	66%	(3.1)		R&D spend was consistent with 1Q11 spend but below 2Q10 spend of \$3.3M; decrease attributed to the timing of costs associated with R&D projects, but importantly, the size of the pipeline remains unchanged (i.e., no products dropped out); we expect spending to pick up in 2H11.
Total OpEx	8.9	16%	10.4	37%			Given a 205% increase on the top-line, the 16% increase in total OpEx is illustrative of the leverage in Sagent's business model.
Net Income	(8.2)	(6%)	(5.6)	(35%)	(2.6)		
EPS	(\$0.37)	NM	(\$0.27)	NM	(\$0.09)	(\$0.21)	A 10 cent miss relative to our estimate and a 15 cent miss relative to consensus, but at this stage in the evolution of the Sagent story, we don't think the EPS miss matters as much as the GM% miss. Based on model changes, our new 2011 EPS goes from (\$0.43) to (\$0.86). mainly due to a decrease in our assumptions around GM%

Note: in millions of \$, except for EPS

Source: Jefferies estimates, company data, Bloomberg for consensus

Exhibit 2: Summary P&L

Year End: December 31	2009	2010	1Q11	2Q11	3Q11E	4Q11E	2011E	2012E	2013E	2014E	2015E
Total Revenue	\$29.2	\$74.1	\$30.3	\$32.3	\$42.0	\$47.0	\$151.6	\$245.9	\$351.4	\$439.3	\$505.2
COGS	\$28.8	\$65.0	\$25.8	\$29.5	\$34.9	\$37.1	\$127.3	\$185.9	\$236.2	\$287.7	\$326.4
Gross Profit	\$0.4	\$9.0	\$4.6	\$2.7	\$7.1	\$9.9	\$24.3	\$60.0	\$115.3	\$151.6	\$178.8
Gross Margin	1.5%	12.2%	15.1%	8.5%	17.0%	21.0%	16.1%	24.4%	32.8%	34.5%	35.4%
SG&A	\$16.7	\$18.9	\$5.0	\$6.5	\$5.8	\$5.8	\$23.1	\$25.4	\$27.4	\$29.0	\$30.5
R&D	12.4	11.2	2.4	2.4	2.7	2.7	10.1	11.5	12.7	13.7	14.4
Operating Margin	(104.5%)	(33.1%)	(14.4%)	(25.4%)	(7.2%)	(0.6%)	(10.5%)	6.3%	19.8%	24.0%	26.2%
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	3.7%	29.8%	31.9%	32.7%
Net Income	(30.5)	(24.5)	(4.4)	(8.2)	(3.0)	(0.3)	(15.9)	15.0	48.9	71.7	89.1
Net Margin	(104.5%)	(33.1%)	(14%)	(25%)	(7%)	(1%)	(10.5%)	6.1%	13.9%	16.3%	17.6%
Adjusted EPS	NA	NA	(\$2.09)	(\$0.37)	(\$0.11)	(\$0.01)	(\$0.79)	\$0.50	\$1.60	\$2.30	\$2.80
Shares Out. (MM)	0.0	0.0	2.1	22.2	27.6	28.0	20.0	30.0	30.6	31.2	31.8
Year-over Year Growth											
Total Revenue	143%	153%	251%	205%	97%	40%	105%	62%	43%	25%	15%
COGS	141%	126%	208%	177%	88%	35%	96%	46%	27%	22%	13%
SG&A	11%	14%	19%	49%	29%	(2%)	22%	10%	8%	6%	5%
R&D	(17%)	(10%)	(16%)	(27%)	7%	3%	(10%)	14%	10%	8%	5%
Net Income	0%	(20%)	(40%)	(6%)	(38%)	(92%)	(35%)	(195%)	226%	47%	24%
Adjusted EPS	NM	NM	NM	NM	NM	NM	NM	(163%)	219%	44%	22%

Note: in millions of \$, except for EPS

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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Jefferies makes a market in Sagent Pharmaceuticals.

Jefferies makes a market in Impax Laboratories, Inc.

Jefferies makes a market in Teva Pharmaceutical Industries Ltd.

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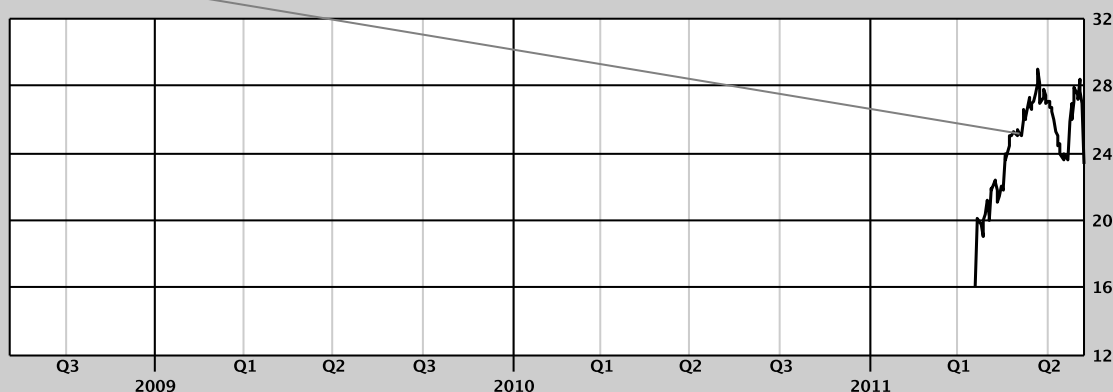
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Other Companies Mentioned in This Report

- Fresenius SE (FRE GR: €64.10, BUY)
- Impax Laboratories, Inc. (IPXL: \$15.79, HOLD)
- Teva Pharmaceutical Industries Ltd (TEVA: \$39.76, HOLD)

Rating and Price Target History for: Sagent Pharmaceuticals (SGNT) as of 08-08-2011

06/03/11
I:B:\$31



Rating and Price Target History for: Fresenius SE (FRE GR) as of 08-08-2011

02/09/10
I:B:EUR64

08/09/10
B:EUR65

01/20/11
B:EUR72

06/30/11
B:EUR81



Rating and Price Target History for: Impax Laboratories, Inc. (IPXL) as of 08-08-2011

Rating and Price Target History for: Teva Pharmaceutical Industries Ltd (TEVA) as of 08-08-2011

Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	681	53.20%	37	5.43%
HOLD	533	41.70%	30	5.63%
UNDERPERFORM	65	5.10%	3	4.62%

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