



PRICE TARGET REVISION | COMMENT

FEBRUARY 16, 2012

Sagent Pharmaceuticals Inc (NASDAQ: SGNT)

Long-term Story Still Intact; Reiterate Outperform

**Outperform
Above Average Risk**

Price:	21.99	Price Target:	24.00 ↓ 25.00
Shares O/S (MM):	27.8	Implied All-In Return:	9%
Dividend:	0.00	Market Cap (MM):	611
		Yield:	0.0%

Priced at market close February 16, 2012 ET.

Event: 4Q11 Results**Investment Opinion**

We affirm our Outperform rating, but lower our PT \$1 to \$24 on Sagent. Despite 4Q11 results and 2012 guidance that were below consensus the company continued to deliver directionally on its strategy, growing revenues, expanding gross margins, increasing operating leverage, and continuing to develop a pipeline of attractive products. We also expect Sagent to benefit from the current record shortages of many critical injectables. Sagent provided 2012 guidance for revenues of \$220-250mn with a minimum of 18 new product launches, roughly inline with consensus estimates of \$235.2mn. The company also guided for 2012 net income to be in the range of a \$5mn loss to break even, below consensus estimates of about \$9mn. While we had modeled greater profitability in 2012, the difference was driven by higher than expected Product Development spend guidance of \$22-26mn, which bodes well for new product launches in 2012 and beyond. We note that Sagent also guided for SG&A expense of \$30-34mn, mostly in line with our expectations. Additionally, 2012 gross margin guidance of 20-23% (versus ~ 15% for 2011) makes us comfortable with our long term margin expansion thesis for the company.

Revenue guidance solid, net income guidance driven by Product Development spend, which we see as a long term positive.

We see the top line guidance as solid if not conservative given our expectations for new product launches. Lower net income guidance is driven by higher than expected Product Development expense guidance of \$22-26mn. In our view, higher Product Development spend in 2012 will contribute to Sagent's long-term performance. We highlight management's comments that they have 6-8 products already planned for 2015-2017.

Operating leverage story intact; we expect Sagent to turn profitable in 2H12.

Management expects gross margins to reach 25-30% by 4Q12. We model gross margins reaching 25.6% in 2H12 and expanding in 2013 and beyond. We also highlight management's comments that 2012 Product Development spend is near the peak level expected going forward, which should drive further operating leverage in 2013 and beyond as Sagent adds new products to its portfolio.

**RBC Capital Markets, LLC****Shibani Malhotra (Analyst)**

(212) 618-3266; shibani.malhotra@rbccm.com

Austin Nelson (Associate)

(212) 428-3012; austin.nelson@rbccm.com

FY Dec	2010A	2011A	2012E	2013E
Revenue (MM)	74.1	152.4	227.4	319.5
Prev.		150.2	216.4	
EPS (Op) - FD		(1.32)	(0.24)	0.87
Prev.		(1.04)	0.53	
P/E	NM	NM	NM	25.3x
Revenue (MM)	Q1	Q2	Q3	Q4
2011	30.3A	32.3A	41.3A	48.5A
Prev.				46.3E
2012	42.4E	54.8E	64.1E	66.1E
EPS (Op) - FD				
2011	(2.09)A	(0.37)A	(0.17)A	(0.33)A
Prev.				(0.12)E
2012	(0.31)E	(0.03)E	0.05E	0.05E

All values in USD unless otherwise noted.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Conflicts Disclosures, see Page 5.

Near term launches target shortage drugs driving higher margins and helping Sagent build customer relationships. Sagent has filed its first two submissions from the KSCP JV facility in China, which is now fully operational. The company hopes to trigger an FDA inspection of the facility soon and plans to market critical oncology shortage products from the facility once they receive approval. Further, Sagent has 76 ANDAs on 41 products either awaiting FDA approval or pending launch, 20 of which are currently in shortage.

Changes to our model

In light of Sagent's 2012 guidance for revenues of \$220-250mn and net income in the range of a \$5mn loss to breakeven we have increased our 2012 revenue estimate to \$227.4mn from \$216.4mn. Given gross margin guidance of 20-23%, we have reduced our gross margin assumptions to 22.8% from 27.1%. Product Development expense guidance of \$22-\$26mn and SG&A guidance of \$30-40mn drive our Product Development assumptions up to \$22.4mn from \$12.1mn and our SG&A assumptions up to \$3.17mn from \$25.8mn. These changes drive our 2012 EPS estimate to a \$0.24 loss from a \$0.53 profit. On a quarterly basis we model 1Q12-4Q12 EPS of (\$0.31), (\$0.03), \$0.05 and \$0.05 respectively. For 2013 we model revenue of \$319.5mn and EPS of \$0.87. These changes drive our PT down \$1 to \$24.

Valuation

Using our DCF model, which assumes a cost of capital of 16% and a terminal growth rate of 3%, we calculate a 12-month price target of \$24 for Sagent.

Price Target Impediment

Major risks to our price target include:

- 1) Delay in timing or non-approval of ANDAs currently under FDA review.
- 2) Manufacturing issues and product recalls.
- 3) Greater than expected shift in gemcitabine market toward 2gm dose, which Sagent will not have in near-future
- 4) Lower than expected gross margins on new product launches.
- 5) Greater than anticipated competition and pricing pressure.
- 6) Loss of key personnel.

Company Description

Sagent is a generics injectable company that develops and sources products to sell in the United States. The company currently offers a portfolio of products across a range of therapeutic areas, including anti-infectives, oncology, and critical care in a variety of preparations. Sagent has developed an extensive international network of collaborations, which involves more than 60 worldwide manufacturing and development facilities. While a fairly new company, Sagent has developed or licensed more than 100 ANDAs and launched 24 products in the last three years, a testament to management's execution abilities.

Sagent Pharmaceuticals											RBC Capital Markets	
Shibani Malhotra											shibani.malhotra@rbccm.com	
INCOME STATEMENT												
US\$M, except per-share amounts	2010A	1Q11A	2Q11A	3Q11A	4Q11A	2011A	1Q12E	2Q12E	3Q12E	4Q12E	2012E	2013E
Total Revenue	74.1	30.3	32.3	41.3	48.5	152.4	42.4	54.8	64.1	66.1	227.4	319.5
Cost of Goods Sold	65.0	25.8	29.5	34.3	44.0	133.6	36.5	42.2	47.7	49.1	175.5	232.2
Gross Profit	9.0	4.6	2.7	6.9	4.5	18.8	5.9	12.6	16.4	16.9	51.9	87.2
Gross Margin	12.2%	15.1%	8.5%	16.8%	9.3%	12.3%	14.0%	23.0%	25.6%	25.6%	22.8%	27.3%
Product Development	11.2	2.4	2.4	3.5	4.6	12.8	5.1	5.7	5.9	5.7	22.4	23.5
% Sales	15.2%	7.8%	7.4%	8.4%	9.4%	8.4%	11.9%	10.4%	9.2%	8.7%	9.8%	7.3%
SG&A	18.9	5.0	6.5	6.7	7.0	25.1	7.2	7.4	8.0	9.0	31.7	34.2
% Sales	25.6%	16.4%	20.1%	16.2%	14.4%	16.5%	17.0%	13.6%	12.5%	13.6%	13.9%	10.7%
Equity (income) loss	1.5	0.7	0.5	0.4	0.9	2.5	0.4	0.3	0.1	0.0	0.8	(10.0)
EBIT	(22.6)	(3.4)	(6.6)	(3.6)	(8.0)	(21.7)	(6.7)	(0.8)	2.4	2.2	(2.9)	39.5
Operating Margin	NM	NM	NM	NM	NM	NM	NM	NM	3.8%	3.4%	NM	12.4%
Interest Income	0.0	0.0	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.3	0.2
Change in FV of preferred stock warrants	(0.8)	(0.5)	(0.4)	0.0	0.0	(0.8)	0.0	0.0	0.0	0.0	0.0	0.0
Interest Expense & Other	(1.1)	(0.5)	(1.2)	(1.2)	(1.2)	(4.2)	(2.1)	(0.2)	(0.2)	(0.2)	(2.7)	(0.2)
Total Other (Income)/Expense	(1.9)	(1.0)	(1.6)	(1.1)	(1.1)	(4.7)	(2.0)	(0.1)	(0.1)	(0.1)	(2.4)	(0.0)
Pretax Income	(24.5)	(4.4)	(8.2)	(4.7)	(9.1)	(26.4)	(8.8)	(1.0)	2.3	2.1	(5.3)	39.5
Pretax Margin	NM	NM	NM	NM	NM	NM	NM	NM	3.6%	3.2%	NM	12.4%
Underlying Taxes	0.0	-	-	-	-	0.0	(3.1)	(0.3)	0.8	0.7	(1.9)	13.8
Tax Credits	0.0	-	-	-	-	0.0	3.1	0.3	(0.8)	(0.7)	1.9	0.0
Total Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.7	1.5	13.8
Tax Rate (underlying)	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Tax Rate (effective)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	35.0%	35.0%	-29.2%	35.0%
GAAP Net Income	(24.5)	(4.4)	(8.2)	(4.7)	(9.1)	(26.4)	(8.8)	(1.0)	1.5	1.4	(6.8)	25.7
Net Margin	NM	NM	NM	NM	NM	NM	NM	NM	2.3%	2.1%	NM	8.0%
GAAP FD EPS		(\$2.09)	(\$0.37)	(\$0.17)	(\$0.33)	(\$1.32)	(\$0.31)	(\$0.03)	\$0.05	\$0.05	(\$0.24)	\$0.87
Avg. Shares (fully diluted)		2.1	22.1	27.9	27.9	20.0	28.4	28.4	28.4	28.4	28.4	29.4

REVENUE												
US\$M	2010A	1Q11A	2Q11A	3Q11A	4Q11A	2011A	1Q12E	2Q12E	3Q12E	4Q12E	2012E	2013E
Base Molecules	51.2	13.9	16.0	16.7	18.3	64.9	17.7	18.1	18.1	16.0	70.0	72.6
2010												
Heparin	19.6	12.3	11.5	8.1	8.0	39.9	5.9	5.8	5.8	5.7	23.2	21.6
Topotecan	2.7	2.5	2.0	2.2	1.9	8.5	1.8	1.7	1.6	1.5	6.5	6.2
Ampicillin	0.6	0.8	1.3	1.5	1.7	5.3	0.9	1.4	1.6	1.9	5.8	6.0
2011												
Gemcitabine	-	-	-	3.3	2.7	6.0	2.6	2.2	1.6	1.6	8.0	6.1
Levofloxacin	-	-	-	7.5	8.3	15.8	8.0	7.4	6.2	6.2	27.7	18.7
Piperacillin and Tazobactam	-	-	-	0.3	0.3	0.6	0.5	0.5	0.5	0.5	1.9	2.1
Other	0.9	1.4	1.7	1.7	7.4	11.4	5.2	9.5	13.6	17.6	45.8	46.9
2012												
2013												
Total	74.1	30.3	32.3	41.3	48.5	152.4	42.4	54.8	64.1	66.1	227.4	319.5

Source: Company Reports, RBC Capital Markets Estimates

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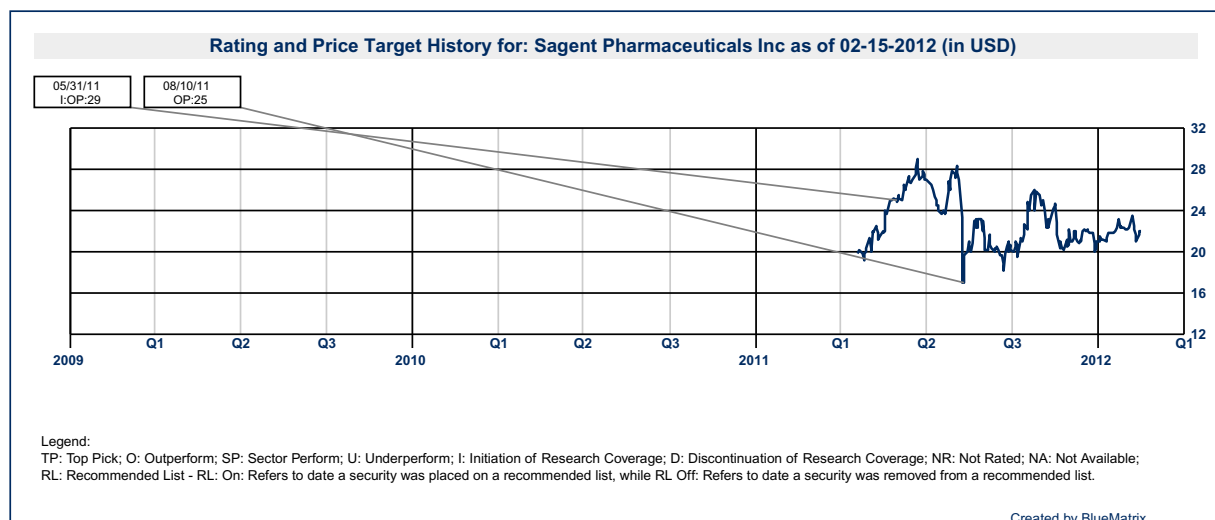
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