CAPSTONE INVESTMENTS | Strategy, Vision, Innovation

Sagent Pharmaceuticals

(SGNT: NNM; $21.99)

Buy | Target: $27

February 17, 2012

John M. Putnam, CFA / 561-450-8827 / jputnam@capstoneinvestments.com

Company Statistics

12-month Price Target:	$27
Current Price:	$21.99
Fully Diluted Shares (M):	27.9
Market Cap (M):	$613.5
EV (M):	$513.5
52-wk Range:	$13.50-$29.23
Avg. Daily Vol. (000):	103
Book Value/sh:	$5.36

Financials

FYE Dec		**2011A**	**2012E**	**2013E**
Revenue (M):	Q1	$30.3	$44.0	--
	Q2	$32.3	$54.0	--
	Q3	$55.9	$62.5	--
	Q4	$48.5	$67.5	--
Total		**$149.3**	**$228.0**	**$280.0**
EPS:	Q1	-$0.02	-$0.19	--
	Q2	-$0.37	-$0.07	--
	Q3	-$0.17	-$0.00	--
	Q4	-$0.33	$0.08	--
Total		**-$0.89**	**-$0.18**	**$0.33**

Company Description

Located in Schaumburg, IL, SGNT was founded in 2006 and currently markets 30 products in various presentations and dosage formulations of injectable generic drugs. It has a sizeable pipeline of over 140 ANDA filed with the FDA since 2007 and counts 48 worldwide business partners. The Company completed a successful IPO in April, 2011. With approximately 100 employees in total, SGNT has developed a strong sales and marketing organization that has a worldwide footprint.

SGNT: BEATS ON TOP LINE - ADJUSTED EPS LOWER THAN FORECAST - BUY

- **SGNT finished 2011 with very strong revenue growth.** Revs of $48.5 million were $3 million greater than either we or the street expected and represented a Y/Y increase of 44%. The loss per share of $0.33 exceeded our estimate of a loss of $0.11 (also street consensus) as SGNT exited the dialysis heparin business which caused it to write-off $4 million in inventory which was accounted for in COGS, dropping the GM to 9.3%. GM would have been 17.5% without the write-off and SGNT would have had an adjusted loss per share of $0.18.
- **Launches 12 new products in 2011 including 3 in Q4.** Company launched 12 new products (33 presentations) during the year and filed an additional 17 bring its pipeline to 41 new products with 76 ANDAs either pending launch or awaiting FDA approval. 20 of these products are currently on the FDA's shortage list. A remarkable $42 million or 54% of the net revenue increase in 2011 came from products launched in December 2010 or in 2011. SGNT expects to file an additional 12-15 ANDAs in 2012, many of which could be approved in 2H 2012. In total, SGNT expects to launch 18 new products this year.
- **SG&A lower than forecast, offset by higher R&D.** On the positive side, SGNT is beginning to experience some leverage of its SG&A base as revenues continue to rise but this was offset by a strategic decision to increase R&D spending to further enhance product approvals going forward.
- **SGNT embarks on drug shortage program.** In an effort to address the overwhelming of shortage of injectable drugs which now numbers 300, SGNT is attempting to develop relationships with hospitals and other healthcare providers that would guarantee a supply of these drugs *but* at a reasonable price. The 2003 Medicare cost cap has made it difficult for manufacturers to make a profit, a situation that has contributed greatly to the drug shortage problem. Mgt. also hopes to entice the FDA into an early inspection of its state-of-the-art Chengdu, China facility where it plans where it plans to manufacture oncology drugs on the shortage list. SGNT also hopes to favorably conclude an FDA inspection of a plant in India which will manufacture 14 drugs, 4 of which are very large.
- **Continue to believe SGNT's WW partnering strategy will support superior revenue growth and profitability Q4 2012.** Maintain strong BUY recommendation and PT of $27.

WW COLLABORATION STRATEGY KEY TO FUTURE SUCCESS

As we note in our recent initiation of Sagent, the company has pursued a business model that pursues long-term strategic partnerships with pharmaceutical development and manufacturing companies around the globe. SGNT currently has 48 such relationships which, in our opinion, makes it unique in the generic injectable drug industry.

First, this strategy gives SGNT access to numerous pharmaceutical compounds and active pharmaceutical ingredients (API) which the company can pursue and bring to market based on its focus on customer needs. This allows SGNT to rapidly identify and file for regulatory approval, thereby constantly maintaining and building a strong new product pipeline.

Secondly, this strategy provides SGNT unprecedented access to world class, modern manufacturing capacity that meets or exceeds FDA standards and is fact, FDA inspected and approved. Unlike most of its competitors, such as Hospira with its 35 year old Rocky Mount facility, Sagent's manufacturing facilities average 3 to 5 years in age with several brand new plants awaiting FDA inspection. These new facilities are highly automated and require very little human intervention.

Finally, this collaborative strategy provides SGNT access to new markets around the world, many of which are classified as emerging. In many of these markets, such as China, demand is very strong and pricing is almost on a par with that of Western countries.

We continue to believe this business model/global partnering strategy will assure SGNT a steady and constant source of new injectable drugs for the foreseeable future, insuring superior revenue growth deep into this decade.

2012 OUTLOOK

Our 2012 and 2013 estimates, for which there was no previous guidance, are substantially scaled back from our previous optimistic outlook for more rapid gross margin improvement although our revenue estimates remain virtually unchanged. We now look for a loss of $0.18 per share in 2012 vs. our previous guesstimate of a profit of $0.30 per share. Likewise, using a more sober and flatter, trajectory for gross margin improvement in 2013 we now estimate EPS of $0.33 where once we had projected $0.88.

2012 will see a sequentially down Q1 both at the top line and also at the gross margin as a percentage of revenues. Top line of $ 44 mil. will be down because SGNT shipped more product in Q4 than it had anticipated and even though it had built inventory prior to the three product launches in Q4, its inventory is below optimal levels to be able to meet or exceed Q4. Unfortunately, inventory in the injectable pharmaceutical business takes 3 to 4 months to replenish.

Q1 will also be negatively impacted by a one-time expense for debt prepayment of about $1 mil. as the company has restructured its debt, lowering the interest rate.

We do expect gross margin to improve throughout 2012 and into 2013 on high manufacturing levels and improve manufacturing efficiencies. The second half of 2012 should experience the bulk of product approvals and launches and as such, we expect SGNT to be at about break-even in Q3 and to make a small profit in Q4 and thereafter.

INVESTMENT RISK

SGNT faces regulatory risks associated with the FDA and manufacturing challenges associated with foreign manufacturing.

VALUATION METHODOLOGY

Based on an EV/Revenue multiple of 3.1X our preliminary 2012 revenue forecast of $228 million results in a PT of $27.00 and as such, we rate the shares a BUY.

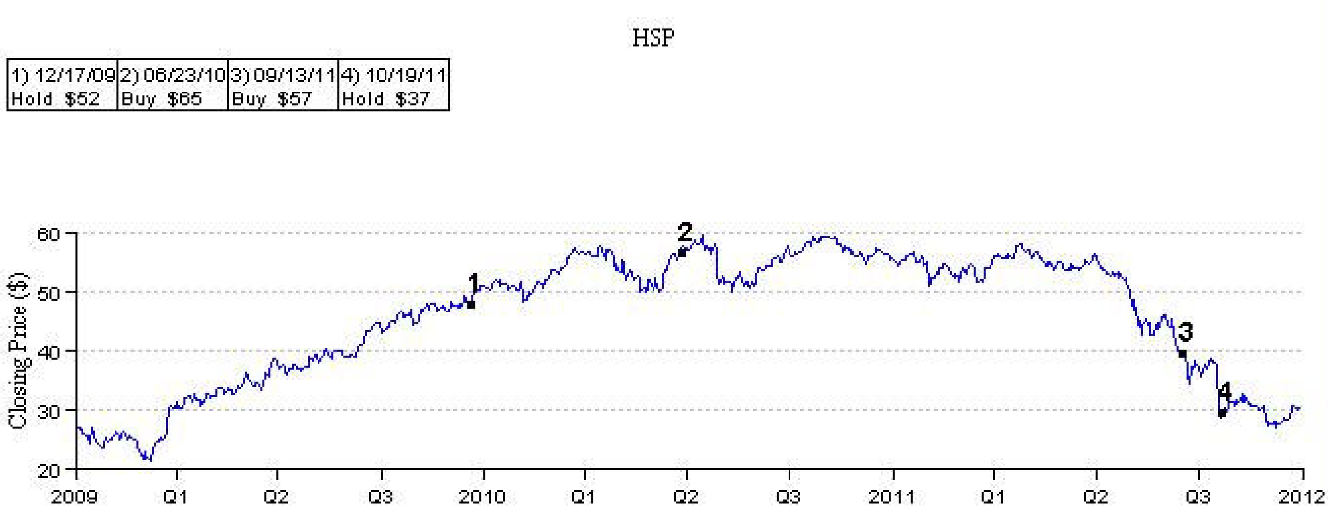
Figure 1: Sagent Earnings Model

Sagent Pharmaceuticals, Inc.
INCOME STATEMENT, 2010A-2012E
($ thousands, except per-share data)

Year ends December 31	2010A					2011A					2012E					2013E
	1Q	2Q	3Q	4Q	2010	Q1	2Q	3Q	4Q	2011	Q1	2Q	3Q	4Q	2012E	
Net Product Sales	$ 8,644	$ 10,560	$ 21,269	$ 33,583	$ 74,056	$ 30,344	$ 32,254	$ 41,281	$ 48,526	$ 149,277	$ 44,000	$ 54,000	$ 62,500	$ 67,500	$ 228,000	$ 280,000
Costs and Expenses:																
Cost of Revenues	8,351	10,658	18,535	27,469	65,013	21,544	29,505	34,344	44,032	129,425	36,740	42,660	47,500	49,275	176,175	201,600
Gross Profit	$ 293	$ (98)	$ 2,734	$ 6,114	$ 9,043	$ 8,800	$ 2,749	$ 6,937	$ 4,494	22,980	$ 7,260	$ 11,340	$ 15,000	$ 18,225	51,825	$ 78,400
Product Development	2,794	3,272	2,534	2,623	11,223	2,357	2,374	3,460	4,572	12,763	3,960	5,130	5,938	6,413	21,440	25,200
SG&A	4,166	4,355	4,481	5,929	18,931	4,976	6,476	6,688	7,009	25,149	6,160	7,290	8,375	8,775	30,600	39,200
Equity in Net Loss of JV	435	332	212	497	1,476	673	524	401	933	2,531	250	250	250	250	1,000	2,800
Total Operating Expenses	7,395	7,959	7,227	9,049	31,630	8,006	9,374	10,549	12,514	40,443	10,370	12,670	14,563	15,438	53,040	67,200
EBIT	$ (7,102)	$ (8,057)	$ (4,493)	$ (2,935)	$ (22,587)	$ 794	$ (6,625)	$ (3,612)	$ (8,020)	(17,463)	$ (3,110)	$ (1,330)	$ 438	$ 2,788	(1,215)	$ 11,200
Interst Income	$ 4	$ 4	$ 14	$ 12		$ 19	$ 56	$ 104	$ 105	284	$ 19	$ 56	$ 104	$ 100	279	$ 150
Interst Expense	$ (239)	$ (228)	$ (243)	$ (419)	$ (1,129)	$ (520)	$ (1,242)	$ (1,223)	$ (1,210)	$ (4,195)	$ (2,200)	$ (600)	$ (600)	$ (600)	$ (4,000)	$ (2,000)
Chg. In F.V. Pref. Stk. War.	$ -	$ (408)	$ (140)	$ (265)	$ (813)	(480)	$ (384)	$ -		(864.0)			$ -		-	
Earnings before income taxes	$ (7,337)	$ (8,689)	$ (4,862)	$ (3,607)	$ (24,495)	$ (187)	$ (8,195)	$ (4,731)	$ (9,125)	$ (22,238)	$ (5,291)	$ (1,874)	$ (59)	$ 2,288	$ (4,936)	$ 9,350
Provision for income taxes					$ -					-					-	
Net earnings	$ (7,337)	$ (8,689)	$ (4,862)	$ (3,607)	$ (24,495)	$ (187)	$ (8,195)	$ (4,731)	$ (9,125)	$ (22,238)	$ (5,291)	$ (1,874)	$ (59)	$ 2,288	$ (4,936)	$ 9,350
Avg. shares outst. (diluted)	1,891.0	1,943.8	1,972.0	2,000	1,952	9,773	22,149	27,875	27,891	21,922	27,891	27,891	27,891	27,891	27,891	28,500
EPS (Basic & FD)	$ (3.88)	$ (4.47)	$ (2.47)	$ (1.80)	$ (12.62)	$ (0.02)	$ (0.37)	$ (0.17)	$ (0.33)	$ (0.89)	$ (0.19)	$ (0.07)	$ (0.00)	$ 0.08	$ (0.18)	$ 0.33
Adjusted EPS									$ (0.18)							
RATIOS:																
(as a percentage of total revenues)																
Gross Margin	3.4%	-0.9%	12.9%	18.2%	12.2%	29.0%	8.5%	16.8%	9.3%	15.4%	16.5%	21.0%	24.0%	27.0%	22.7%	28.0%
Product Development	32.3%	31.0%	11.9%	7.8%	15.2%	7.8%	7.4%	8.4%	9.4%	8.5%	9.0%	9.5%	9.5%	9.5%	9.4%	9.0%
SG&A	48.2%	41.2%	21.1%	17.7%	25.6%	16.4%	20.1%	16.2%	14.4%	16.8%	14.0%	13.5%	13.4%	13.0%	13.4%	14.0%
Equity in Net Loss of JV	5.0%	3.1%	1.0%	1.5%	2.0%	2.2%	1.6%	1.0%	1.9%	1.7%	1.0%	1.0%	1.0%	1.0%	0.4%	1.0%
Interest Income	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Interst Expense	-2.8%	-2.2%	-1.1%	-1.2%	-1.5%	-1.7%	-3.9%	-3.0%	-2.5%	-2.8%	-5.0%	-1.1%	-1.0%	-0.9%	-1.8%	-2.0%
Chg. In F.V. Pref. Stk. War.	0.0%	0.0%	0.0%	0.0%	-1.1%											
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating Margin	-82.2%	-76.3%	-21.1%	-8.7%	-30.5%	2.6%	-20.5%	-8.7%	-16.5%	-11.7%	-7.1%	-2.5%	0.7%	4.1%	-0.5%	4.0%
Pretax Margin	-84.9%	-82.3%	-22.9%	-10.7%	-33.1%	-0.6%	-25.4%	-11.5%	-18.8%	-14.9%	-12.0%	-3.5%	-0.1%	3.4%	-2.2%	3.3%
Net Margin	-84.9%	-82.3%	-22.9%	-10.7%	-33.1%	-0.6%	-25.4%	-11.5%	-18.8%	-14.9%	-12.0%	-3.5%	-0.1%	3.4%	-2.2%	3.3%

Source: Company reports and CapStone Investments estimates

IMPORTANT DISCLOSURES
Price charts generated by Jovus, Inc



To receive price charts on the companies mentioned in this report, please contact CapStone Investments at the numbers below.

CapStone Rating Distribution (as of December 31, 2011):

Buy: 56% of stocks have this rating (0% were investment banking clients within the last 12 months)
Hold: 41% of stocks have this rating (0% were investment banking clients within the last 12 months)
Sell: 3% of stocks have this rating (0% were investment banking clients within the last 12 months)

Explanation of Ratings

Buy: Describes stocks we believe could increase by more than 15% over the next twelve months.
Hold: Describes stocks we believe could change plus or minus 15% over the next twelve months.
Sell: Describes stocks we believe could decline by more than 15% over the next twelve months.
No Rating: Describes stocks we cover on which adequate information to make a recommendation is not available.

CapStone Equity Research Disclosures as of February 17, 2012

Company	Disclosure
Hospira (HSP)	None
Sagent Pharmaceuticals (SGNT)	None

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

CapStone Investments Equity Research Disclosure Legend

1. CapStone Investments makes a market in the securities of the subject company.
2. The analyst serves as an officer, director, or advisory board member of the subject company.
3. The analyst or a member of the analyst's household has a financial interest in the securities of the subject company (this interest may include, without limitation, whether it consists of any a) Long position, b) Short position, c) Rights, d) Warrants or e) Futures, g) Put options or h) Call options).
4. CapStone Investments or an affiliate of CapStone Investments has managed or co-managed a public offering of securities for the subject company in the last 12 months.
5. CapStone Investments or an affiliate of CapStone Investments has received compensation for investment banking services from the subject company in the last 12 months.
6. CapStone Investments expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
7. CapStone Investments or its affiliates beneficially own 1% or more of the common stock of the subject company as calculated in accordance with Section 13(d) of the Securities Exchange Act of 1934.
8. The subject company is, or during the past 12 months was, a client of CapStone Investments, which provided non-investment banking, securities-related services to, and received compensation from, the subject company for such services. The analyst or employees of CapStone Investments with the ability to influence the substance of this report knows the foregoing facts.

9. An affiliate of CapStone Investments received compensation from the subject company for products or services other than investment banking services during the past 12 months. The analyst or employees of CapStone Investments with the ability to influence the substance of this report know or have reason to know the foregoing facts.

The analyst(s) principally responsible for preparation of this report received compensation that is based upon many factors, including the firm's overall investment banking revenue.

Analyst Certification
I, John M. Putnam, CFA, was principally responsible for the preparation of this research report certify that the views expressed in this research report accurately reflect his/her (their) personal views about the subject security(ies) or issuer(s) and that his/her (their) compensation was not, is not, or will not be directly or indirectly related to the specific recommendations or views contained in this research report.

OTHER DISCLOSURES

CapStone Investments research, advisory and other services are provided to institutional investors with the explicit understanding that payment is required under customary industry commission rates. Continued usage of our research by you constitutes your assent to these terms.

CapStone Investments prepared the information and opinions in this report. CapStone Investments has no obligation to inform you when opinions or information in this report change.

FINRA Regulation has adopted rules that will prohibit research analysts from trading in securities of covered companies during specified time periods before and after the publication of research.

This report is for information purposes only. Under no circumstances is it to be used or considered as a solicitation to buy or sell any securities. While the information contained herein has been obtained from sources we believe to be reliable, CapStone Investments, a FINRA Member Firm and a Member of SIPC, does not represent that it is accurate or complete, and accordingly, should not be relied upon as such. Notwithstanding this, CapStone Investments verifies that the information provided regarding its registration status and other material facts, including disclosures made on behalf of its relevant persons and entities are in fact accurate. Risk factors and actual results may differ significantly from the information contained herein. This report or any portion hereof may not be reprinted, sold, or redistributed without the written consent of CapStone Investments.

This report is prepared for Institutional Consideration Only. Estimates of future performance are based on assumptions that may not be realized. Past performance is not necessarily a guide to future performance.

CapStone Investments will effect agency transactions in the securities mentioned, on behalf of its clients submitting orders to buy or sell.

CapStone Investments makes its research reports available in real-time to institutional investors through Bloomberg, Thomson Reuters, TheMarkets.com, FactSet, Capital IQ and Zack's Investment Research.

Institutional Sales:	**Trading:**	**Corporate:**
Thomas A. Dillon III, CFA Head of Equities 12760 High Bluff Drive, Suite 120 San Diego, CA 92130 941-685-3789	Craig Warner Director of Trading CapStone Investments 12760 High Bluff Drive Suite 120 San Diego, CA 92130 858-875-4550	Steve Capozza President CapStone Investments 12760 High Bluff Drive Suite 120 San Diego, CA 92130 800-327-5566