



## PRICE TARGET REVISION | COMMENT

AUGUST 10, 2011

**Sagent Pharmaceuticals Inc (NASDAQ: SGNT)****Too Early to Give up on Management; Earnings Miss Product and Timing Specific****Outperform  
Above Average Risk**

|                         |       |                               |               |
|-------------------------|-------|-------------------------------|---------------|
| <b>Price:</b>           | 17.06 | <b>Price Target:</b>          | 25.00 ↓ 29.00 |
| <b>Shares O/S (MM):</b> | 27.8  | <b>Implied All-In Return:</b> | 47%           |
| <b>Dividend:</b>        | 0.00  | <b>Market Cap (MM):</b>       | 474           |
|                         |       | <b>Yield:</b>                 | 0.0%          |

**Investment Opinion**

**Event:** Weak Q2/11 earnings driven by lower than expected sales and a gross margin of 8.5% versus our 18.8%.

We have lowered our 2011 and 2012 EPS estimates to (\$0.87) and \$0.80 from (\$0.36) and \$1.01 respectively and reduced our price target to \$25.

We were surprised by the extent of yesterday's reaction (stock down 27% versus the S&P up 4.7%) to what we view as more product and timing specific related issues rather than something more structurally damaging to the company's long term business model. We appreciate that the current market punishes uncertainty however we also note that SGNT is a thinly traded stock where a few sellers can pressure stock price. We do however recognize that this was the company's first quarter report after its recent IPO and investors were looking to these results as an indication of management's execution ability and credibility. While we were undoubtedly disappointed by earnings, we are far from ready to dismiss management's ability to deliver against its goals.

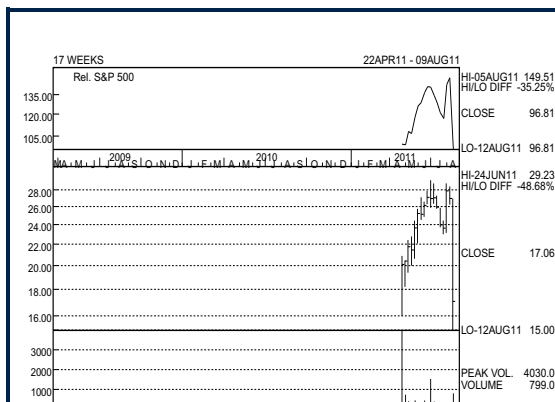
**Earnings miss was product and timing specific, not indicative of a broken business model:**

1. The company's current product portfolio is made up of a few key products and a wider range of lower margin products. As such, a swing in any one key product can significantly impact earnings. We expect greater stability and GM expansion will eventuate as the company rolls out its deep pipeline of higher margin products over the next few quarters.
2. A miss during a single quarter is not reflective of a broader shift in market dynamics nor future performance. Specifically, the current GM miss was driven by a launch delay of levofloxacin and competitive pricing pressure for heparin and topotecan
3. This is an operating leverage story and we continue to expect further earnings growth as the company expands its top line with minimal additional charges expected to SG&A and R&D.

**Management Record Remains Strong:** We remind investors that management has an extensive experience with a solid track record. The company has leveraged its relationships to build a deep pipeline and gain access to a broad customer base. A good pre-IPO example of execution is that the company generated significant market share for (averaging 18%) in a market dominated by large well established players.

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

For Required Conflicts Disclosures, see Page 6.

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

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

| FY Dec        | 2009A   | 2010A   | 2011E   | 2012E   |
|---------------|---------|---------|---------|---------|
| Revenue (MM)  | 29.2    | 74.1    | 142.9   | 229.3   |
| Prev.         |         |         | 155.5   | 243.8   |
| EPS (Op) - FD |         |         | (0.87)  | 0.80    |
| Prev.         |         |         | (0.36)  | 1.01    |
| P/E           | NM      | NM      | NM      | 21.3x   |
| Revenue (MM)  | Q1      | Q2      | Q3      | Q4      |
| 2011          | 30.3A   | 32.3A   | 36.7E   | 43.6E   |
| Prev.         |         | 34.5E   | 41.3E   | 49.3E   |
| EPS (Op) - FD |         |         |         |         |
| 2011          | (2.09)A | (0.37)A | (0.14)E | (0.03)E |
| Prev.         |         | (0.19)E | (0.03)E | 0.07E   |

All values in USD unless otherwise noted.

Exhibit 1: Last published estimates vs. revised estimates post 2Q2011 results

| US\$M, Except per share data | 2011E           | Pub             | Chg             | 2012E         | Pub           | Chg             | 2013E         | Pub           | Chg             |
|------------------------------|-----------------|-----------------|-----------------|---------------|---------------|-----------------|---------------|---------------|-----------------|
| <b>Revenue</b>               | <b>142.9</b>    | <b>155.5</b>    | <b>(12.6)</b>   | <b>229.3</b>  | <b>243.8</b>  | <b>(14.5)</b>   | <b>406.1</b>  | <b>416.7</b>  | <b>(10.5)</b>   |
| Cost of Goods Sold           | 120.0           | 123.3           | (3.3)           | 169.8         | 176.0         | (6.3)           | 260.2         | 264.6         | (4.4)           |
| Gross Profit                 | 22.9            | 32.2            | (9.3)           | 59.5          | 67.7          | (8.2)           | 145.9         | 152.1         | (6.2)           |
| <i>Gross Margin</i>          | 16.0%           | 20.7%           | (0.0)           | 26.0%         | 27.8%         | (0.0)           | 35.9%         | 36.5%         | (0.0)           |
| Product Development          | 10.4            | 11.3            | (0.9)           | 10.8          | 11.8          | (1.0)           | 11.4          | 12.4          | (1.1)           |
| % Sales                      | 7.3%            | 7.2%            | 0.0             | 4.7%          | 4.9%          | (0.0)           | 2.8%          | 3.0%          | (0.0)           |
| SG&A                         | 23.5            | 21.7            | 1.8             | 24.4          | 23.7          | 0.7             | 26.4          | 25.6          | 0.8             |
| % Sales                      | 16.4%           | 14.0%           | 0.0             | 10.7%         | 9.7%          | 0.0             | 6.5%          | 6.1%          | 0.0             |
| Equity (income) loss         | 3.2             | 3.7             | (0.5)           | 1.0           | 3.0           | (2.0)           | 1.0           | -             | 1.0             |
| EBITDA (adj)                 | (13.2)          | (3.4)           | (9.8)           | 25.6          | 31.5          | (5.9)           | 107.8         | 114.7         | (6.9)           |
| Depreciation                 | 0.2             | 0.2             | -               | 0.3           | 0.3           | -               | 0.3           | 0.3           | -               |
| Amortization                 | 0.7             | 0.8             | (0.1)           | 2.0           | 2.0           | -               | 0.3           | 0.3           | -               |
| Loss on Impairment           | -               | -               | -               | -             | -             | -               | -             | -             | -               |
| EBIT                         | (14.2)          | (4.4)           | (9.7)           | 23.3          | 29.2          | (5.9)           | 107.2         | 114.1         | (6.9)           |
| Total Other (Income)/Expense | (3.2)           | (2.5)           | (0.7)           | (0.7)         | (0.7)         | (0.0)           | 0.0           | 0.1           | (0.0)           |
| Pretax Income                | (17.4)          | (6.9)           | (10.5)          | 22.6          | 28.6          | (6.0)           | 107.2         | 114.2         | (7.0)           |
| Total Tax                    | -               | -               | -               | -             | -             | -               | 25.5          | 28.0          | (2.4)           |
| <i>Tax Rate (effective)</i>  | 0%              | 0%              | -               | 0%            | 0%            | -               | 24%           | 24%           | (0.0)           |
| GAAP Net Income              | -17.4           | -6.9            | (10.5)          | 22.6          | 28.6          | (6.0)           | 81.7          | 86.2          | (4.5)           |
| <i>Net Margin</i>            | NM              | NM              | NM              | 9.8%          | 11.7%         | (0.0)           | 20.1%         | 20.7%         | (0.0)           |
| <b>GAAP FD EPS</b>           | <b>(\$0.87)</b> | <b>(\$0.36)</b> | <b>(\$0.52)</b> | <b>\$0.80</b> | <b>\$1.01</b> | <b>(\$0.21)</b> | <b>\$2.78</b> | <b>\$2.94</b> | <b>(\$0.15)</b> |
| Avg. Shares (fully diluted)  | 20.0            | 19.6            | 0.4             | 28.3          | 28.3          | -               | 29.3          | 29.3          | -               |

Source: Company data, RBC Capital Markets estimates

Exhibit 2: 2Q2011 Reported Earnings vs. RBC Estimates

| P&L Analysis<br>(millions)     | 2Q:10A         | 2Q:11A          | YoY<br>Growth   | RBC<br>2Q:11E   | Difference<br>vs RBC | Variance      | Contribution<br>to EPS | Consensus<br>2Q11E |
|--------------------------------|----------------|-----------------|-----------------|-----------------|----------------------|---------------|------------------------|--------------------|
| <b>Total Sales</b>             | <b>\$10.6</b>  | <b>\$32.3</b>   | <b>205.4%</b>   | <b>\$34.5</b>   | <b>(\$2.2)</b>       | <b>-6.5%</b>  | <b>\$0.03</b>          | <b>\$34.5</b>      |
| COGS                           | \$10.7         | \$29.5          | 176.8%          | \$28.0          | \$1.5                | 5.3%          | \$0.01                 |                    |
| <b>Gross Profit</b>            | <b>(\$0.1)</b> | <b>\$2.7</b>    | <b>-2905.1%</b> | <b>\$6.5</b>    | <b>(\$3.7)</b>       | <b>-57.6%</b> | <b>\$0.02</b>          |                    |
| SG&A                           | \$4.4          | \$6.5           | 48.7%           | \$5.4           | \$1.0                | 19.0%         | \$0.01                 |                    |
| Product Development            | \$3.3          | \$2.4           | -27.4%          | \$3.1           | (\$0.7)              | -23.6%        | (\$0.00)               |                    |
| Equity (Income) Loss           | \$0.3          | \$0.5           | 57.8%           | \$1.0           | (\$0.5)              | -47.6%        | (\$0.00)               |                    |
| <b>Operating Income (Loss)</b> | <b>(\$8.1)</b> | <b>(\$6.6)</b>  | <b>-17.8%</b>   | <b>(\$3.1)</b>  | <b>(\$3.6)</b>       | <b>116.0%</b> | <b>(\$0.17)</b>        |                    |
| Interest and Other Income      | (\$0.2)        | (\$1.6)         | 600.9%          | (\$0.4)         | (\$1.1)              | 264.0%        | \$0.01                 |                    |
| Pretax Income                  | (\$8.7)        | (\$8.2)         | -5.7%           | (\$3.9)         | (\$4.3)              | 110.2%        | \$0.02                 |                    |
| Tax                            | \$0            | \$0.0           | NM              | \$0.0           | \$0.0                | NM            | \$0.00                 |                    |
| GAAP Net Income                | (\$8.7)        | (\$8.2)         | -5.7%           | (\$3.9)         | (\$4.3)              | 110.2%        | (\$0.21)               |                    |
| <b>GAAP Diluted EPS</b>        | <b>N/A</b>     | <b>(\$0.37)</b> | <b>NM</b>       | <b>(\$0.19)</b> | <b>(\$0.18)</b>      | <b>94.5%</b>  | <b>(\$0.18)</b>        | <b>(\$0.21)</b>    |
| Diluted Share Count            | N/A            | 22.2            | NM              | 20.5            | 1.7                  | 8.3%          | (\$0.08)               |                    |

| Margin Analysis<br>(as a % of sales) | 2Q:10A | 2Q:11A | YoY<br>Change | RBC<br>2Q:11E | Difference<br>vs RBC | Variance | Contribution<br>to EPS |
|--------------------------------------|--------|--------|---------------|---------------|----------------------|----------|------------------------|
| COGS                                 | 100.9% | 91.5%  | -9.5%         | 81.2%         | 10.3%                | 12.7%    |                        |
| Gross Margin                         | -0.9%  | 8.5%   | 9.5%          | 18.8%         | -10.3%               | -54.7%   |                        |
| SG&A                                 | 41.2%  | 20.1%  | -21.2%        | 15.8%         | 4.3%                 | 27.2%    |                        |
| Product Development                  | 31.0%  | 7.4%   | -23.6%        | 9.0%          | -1.6%                | -18.3%   |                        |
| Operating Margin                     | -76.3% | -20.5% | 55.8%         | -8.9%         | -11.6%               | 131.0%   |                        |
| Pretax Margin                        | -82.3% | -25.4% | 56.9%         | -11.3%        | -14.1%               | 124.8%   |                        |
| Tax Rate                             | 0.0%   | 0.0%   | 0.0%          | 0.0%          | 0.0%                 | NM       |                        |
| Net Margin                           | -82.3% | -25.4% | 56.9%         | -11.3%        | -14.1%               | 124.8%   |                        |

Source: Company data, RBC Capital Markets estimates, StreetAccount consensus estimates

## Exhibit 3: Sum-of-Parts Valuation

| Discounted Cash Flow                             | 2010A         | 2011E         | 2012E      | 2013E       | 2014E       | 2015E        | 2016E        | Terminal     |
|--|---------------|---------------|------------|-------------|-------------|--------------|--------------|--------------|
| Revenue  | 74.1          | 142.9         | 229.3      | 406.1       | 492.4       | 568.0        | 647.5        |              |
| YOY Growth                                       |               | 93%           | 60%        | 77%         | 21%         | 15%          | 14%          |              |
| EBITDA   | (22.0)        | (13.2)        | 25.6       | 107.8       | 136.5       | 161.3        | 188.3        |              |
| EBITDA Margin                                    | -30%          | -9%           | 11%        | 27%         | 28%         | 28%          | 29%          |              |
| EBIT   | (22.6)        | (14.2)        | 23.3       | 107.2       | 135.9       | 160.5        | 187.3        |              |
| EBIT Margin                                      | -30%          | -10%          | 10%        | 26%         | 28%         | 28%          | 29%          |              |
| (+) Depreciation & Amortization                  | 0.6           | 1.0           | 2.3        | 0.6         | 0.6         | 0.8          | 1.0          |              |
| D&A as a % sales                                 | 0.8%          | 0.7%          | 1.0%       | 0.2%        | 0.1%        | 0.1%         | 0.2%         |              |
| (-) Cash Taxes                                   | -             | -             | -          | 25.5        | 35.7        | 32.3         | 65.9         |              |
| (-) CAPEX  | 0.3           | 0.1           | 0.2        | 0.3         | 1.0         | 1.5          | 2.0          |              |
| Capex as a % of sales                            | 0.5%          | 0.1%          | 0.1%       | 0.1%        | 0.2%        | 0.3%         | 0.3%         |              |
| (+) Change in Working Capital                    | (7.8)         | (22.8)        | (16.7)     | (26.0)      | (10.9)      | (6.6)        | (5.1)        |              |
| <b>Unlevered Free Cash Flow</b>                  | <b>(30.1)</b> | <b>(36.1)</b> | <b>8.7</b> | <b>55.9</b> | <b>88.9</b> | <b>120.8</b> | <b>115.3</b> | <b>913.2</b> |
| % of FCF to be received (time from current date) |               | 39%           | 100%       | 100%        | 100%        | 100%         | 100%         |              |
| <b>Total future FCF</b>                          |               | <b>(14.2)</b> | <b>8.7</b> | <b>55.9</b> | <b>88.9</b> | <b>120.8</b> | <b>115.3</b> | <b>913.2</b> |
| Discount factor                                  |               | 0.9           | 0.8        | 0.7         | 0.6         | 0.5          | 0.4          | 0.4          |
| <b>Unlevered PV FCF</b>                          |               | <b>(13.4)</b> | <b>7.0</b> | <b>39.2</b> | <b>53.7</b> | <b>62.9</b>  | <b>51.7</b>  | <b>409.7</b> |

| Valuation                 |             |
|---------------------------|-------------|
| NPV FCF                   | 201.1       |
| PV OF TV                  | 409.7       |
| PV of (FCF+ TV)           | 610.8       |
| Net Cash                  | (1.2)       |
| Equity Value              | 609.6       |
| Shares Outstanding        | 27.8        |
| Fair Value/Share          | 21.9        |
| <b>12mth Price Target</b> | <b>25.4</b> |

| Terminal Growth Rate |      | Discount Rate |         |       |       |       |
|----------------------|------|---------------|---------|-------|-------|-------|
|                      |      | 11.0%         | 13.5%   | 16.0% | 18.5% | 21.0% |
|                      | 0.0% | 836.9         | 649.9   | 523.1 | 431.9 | 363.6 |
|                      | 1.5% | 941.4         | 711.0   | 561.9 | 458.0 | 381.9 |
|                      | 3.0% | 1,085.1       | 789.6   | 609.6 | 489.1 | 403.2 |
|                      | 4.5% | 1,295.2       | 894.4   | 669.8 | 526.8 | 428.3 |
|                      | 6.0% | 1,631.3       | 1,041.1 | 748.0 | 573.7 | 458.5 |

Source: Company data, RBC Capital Markets estimates

## 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 \$25 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<br>Shibani Malhotra |        |        |          |          |          |          | RBC Capital Markets<br>shibani.malhotra@rbccm.com |        |        |
|--|--------|--------|----------|----------|----------|----------|---|--------|--------|
| INCOME STATEMENT                           |        |        |          |          |          |          |   |        |        |
| US\$M, except per-share amounts            | 2009A  | 2010A  | 1Q11A    | 2Q11A    | 3Q11E    | 4Q11E    | 2011E   | 2012E  | 2013E  |
| Total Revenue                              | 29.2   | 74.1   | 30.3     | 32.3     | 36.7     | 43.6     | 142.9   | 229.3  | 406.1  |
| Cost of Goods Sold                         | 28.8   | 65.0   | 25.8     | 29.5     | 30.4     | 34.4     | 120.0   | 169.8  | 260.2  |
| Gross Profit                               | 0.4    | 9.0    | 4.6      | 2.7      | 6.3      | 9.2      | 22.9  | 59.5   | 145.9  |
| Gross Margin                               | 1.5%   | 12.2%  | 15.1%    | 8.5%     | 17.3%    | 21.1%    | 16.0%   | 26.0%  | 35.9%  |
| Product Development                        | 12.4   | 11.2   | 2.4      | 2.4      | 2.8      | 2.8      | 10.4  | 10.8   | 11.4   |
| % Sales                                    | 42.4%  | 15.2%  | 7.8%     | 7.4%     | 7.7%     | 6.5%     | 7.3%  | 4.7%   | 2.8%   |
| SG&A                                       | 16.7   | 18.9   | 5.0      | 6.5      | 6.0      | 6.0      | 23.5  | 24.4   | 26.4   |
| % Sales                                    | 57.1%  | 25.6%  | 16.4%    | 20.1%    | 16.5%    | 13.7%    | 16.4%   | 10.7%  | 6.5%   |
| Equity (income) loss                       | 1.5    | 1.5    | 0.7      | 0.5      | 1.0      | 1.0      | 3.2   | 1.0    | 1.0    |
| EBIT                                       | (30.1) | (22.6) | (3.4)    | (6.6)    | (3.5)    | (0.6)    | (14.2)  | 23.3   | 107.2  |
| Operating Margin                           | NM     | NM     | NM       | NM       | NM       | NM       | NM  | 10.2%  | 26.4%  |
| Interest Income                            | 0.1    | 0.0    | 0.0      | 0.1      | 0.1      | 0.1      | 0.2   | 0.3    | 0.3    |
| Change in FV of preferred stock warrants   | 0.0    | (0.8)  | (0.5)    | (0.4)    | 0.0      | 0.0      | (0.8)   | -      | 0.0    |
| Interest Expense & Other                   | (0.5)  | (1.1)  | (0.5)    | (1.2)    | (0.4)    | (0.4)    | (2.6)   | (1.0)  | (0.2)  |
| Total Other (Income)/Expense               | (0.4)  | (1.9)  | (1.0)    | (1.6)    | (0.4)    | (0.3)    | (3.2)   | (0.7)  | 0.0    |
| Pretax Income                              | (30.5) | (24.5) | (4.4)    | (8.2)    | (3.9)    | (1.0)    | (17.4)  | 22.6   | 107.2  |
| Pretax Margin                              | NM     | NM     | NM       | NM       | NM       | NM       | NM  | 9.8%   | 26.4%  |
| Underlying Taxes                           | 0.0    | 0.0    | -        | -        | -        | -        | 0.0   | 7.9    | 37.5   |
| Tax Credits                                | 0.0    | 0.0    | -        | -        | -        | -        | 0.0   | (7.9)  | (12.0) |
| Total Tax                                  | 0.0    | 0.0    | 0.0      | 0.0      | 0.0      | 0.0      | 0.0   | 0.0    | 25.5   |
| Tax Rate (underlying)                      | 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%   | 23.8%  |
| GAAP Net Income                            | (30.5) | (24.5) | (4.4)    | (8.2)    | (3.9)    | (1.0)    | (17.4)  | 22.6   | 81.7   |
| Net Margin                                 | NM     | NM     | NM       | NM       | NM       | NM       | NM  | 9.8%   | 20.1%  |
| GAAP FD EPS                                |        |        | (\$2.09) | (\$0.37) | (\$0.14) | (\$0.03) | (\$0.87)  | \$0.80 | \$2.78 |
| Avg. Shares (fully diluted)                |        |        | 2.1      | 22.1     | 27.8     | 27.8     | 20.0  | 28.3   | 29.3   |

| REVENUE                     |       |       |       |       |       |       |       |       |       |
|-----------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| US\$M                       | 2009A | 2010A | 1Q11A | 2Q11E | 3Q11E | 4Q11E | 2011E | 2012E | 2013E |
| Base Molecules              | 29.2  | 51.2  | 13.9  | 16.0  | 15.1  | 15.2  | 60.2  | 65.4  | 69.5  |
| 2010                        |       |       |       |       |       |       |       |       |       |
| Heparin                     |       | 19.6  | 12.3  | 11.5  | 11.4  | 11.3  | 46.5  | 44.8  | 43.5  |
| Topotecan                   |       | 2.7   | 2.5   | 2.0   | 2.2   | 2.1   | 8.8   | 9.1   | 7.2   |
| Ampicillin                  |       | 0.6   | 0.8   | 1.3   | 1.5   | 1.7   | 5.3   | 5.8   | 6.0   |
| 2011                        |       |       |       |       |       |       |       |       |       |
| Gemcitabine                 |       |       | -     | -     | 2.2   | 5.2   | 7.4   | 22.6  | 27.7  |
| Levofloxacin                |       |       | -     | -     | 1.4   | 1.9   | 3.3   | 9.6   | 10.1  |
| Piperacillin and Tazobactam |       |       | -     | -     | 0.5   | 1.0   | 1.5   | 5.6   | 7.9   |
| Other                       |       |       | 0.9   | 1.4   | 2.4   | 5.2   | 9.9   | 36.9  | 58.0  |
| 2012                        |       |       |       |       |       |       |       | 29.6  | 82.6  |
| 2013                        |       |       |       |       |       |       |       |       | 93.7  |
| Total                       | 29.2  | 74.1  | 30.3  | 32.3  | 36.7  | 43.6  | 142.9 | 229.3 | 406.1 |

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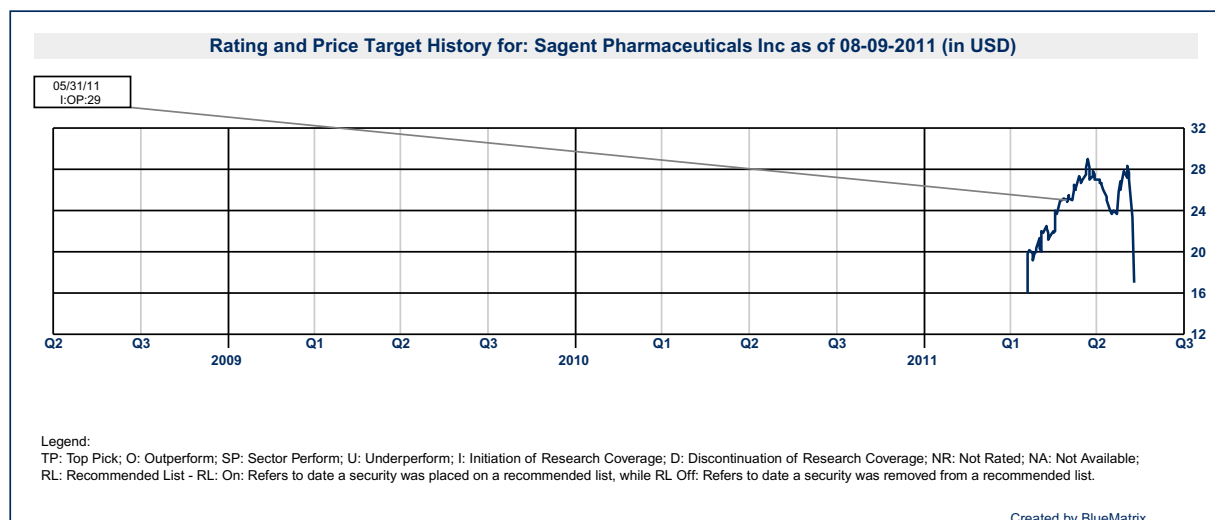
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|---|-------|---------|--|---------|
| Rating  | Count | Percent | Investment Banking<br>Serv./Past 12 Mos. |         |
|   |       |         | Count                                    | Percent |
| BUY[TP/O]   | 749   | 52.30   | 217                                      | 28.97   |
| HOLD[SP]  | 625   | 43.60   | 133                                      | 21.28   |
| SELL[U]   | 59    | 4.10    | 10                                       | 16.95   |



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