

Sagent Pharmaceuticals

4Q Wrap-up: Higher Spend Impacting NT Results, Long-term Model Intact

Following today's 4Q results, we are lowering our 2012 EPS estimates for Sagent, mostly due to product launch timing (2H/12 weighted) and higher R&D spending as the company looks to accelerate its new product launches. As a result, our out-year sales and EPS estimates for the company are relatively unchanged. While Sagent is extremely well positioned to take advantage of supply shortages facing the generic injectables industry, in our view, we see a fairly balanced risk/reward profile for the stock at current levels and are maintaining our Neutral rating.

- **Pipeline weighted toward products on the shortage list.** Sagent's pipeline currently has 76 ANDAs representing 40 products, 20 of which are shortage products. With close to 300 products (both injectable and non-injectable) on the shortage list, we anticipate the FDA will treat applications for shortage products with a greater urgency than other applications.
- **R&D spend increase driven by 505(b)2 filings.** Sagent's planned increase in R&D spend for 2012 is mainly driven by the costs of filing 505(b)2 NDAs for a number of products. Filing a 505(b)2 will allow a Sagent to come to market faster than traditional ANDAs, which are now averaging around 30 months to gain approval.
- **2012 launches to be 2H weighted.** Sagent plans to launch around 18 products in 2012, many of which are expected in the second half of the year. This includes eight products from the Sagent-Strides partnership as Strides completes the transfer of these products into a new injectables facility. We expect launch flow to begin in late in the first quarter and accelerate throughout the year.
- **KSCP facility ready for inspection.** Sagent has filed two applications from its KSCP facility in China and expects to file a third shortly. The company believes that the third filing could trigger FDA interest in inspecting the facility. Sagent plans to initially focus the plant on products currently on the drug shortage list, which the company believes could get quicker reviews from FDA. A successful inspection would pave the way to approvals and launches from the facility into the US market. In addition, Sagent plans to use KSCP capacity to launch product into the Chinese domestic market and other emerging markets through its partners in the venture.

Neutral

SGNT, SGNT US

Price: \$21.99

Price Target: \$25.00

Generic Pharmaceuticals

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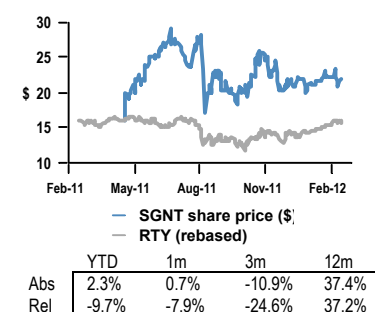
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Price Performance



Sagent Pharmaceuticals, Inc. (SGNT;SGNT US)

FYE Dec	2011A	2012E	2012E	2013E	2013E	2014E	2014E	2015E
		(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)	
EPS Reported (\$)								
Q1 (Mar)	(2.09)	(0.05)	(0.27)	-	-	-	-	-
Q2 (Jun)	(0.37)	0.03	(0.16)	-	-	-	-	-
Q3 (Sep)	(0.17)	0.11	0.06	-	-	-	-	-
Q4 (Dec)	(0.18)	0.24	0.27	-	-	-	-	-
FY	(1.12)	0.33	(0.07)	1.58	1.44	2.26	2.20	2.87
Bloomberg EPS FY (\$)	(0.94)	0.36	0.36	1.52	1.52	2.10	2.10	-

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

Price (\$)	21.99
Date Of Price	16 Feb 12
52-week Range (\$)	29.23 - 13.50
Mkt Cap (\$ mn)	613.32
Fiscal Year End	Dec
Shares O/S (mn)	28
Price Target (\$)	25.00
Price Target End Date	31 Dec 12

See page 8 for analyst certification and important disclosures.

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- **Adjusting estimates; DCF valuation remains unchanged.** Based on 4Q/11 performance and management's 2012 guidance comments, we are lowering our 2012 EPS estimates while leaving our topline assumptions relative unchanged. In addition, we are modestly lowering our 2013 and 2014 estimates based on higher expenses assumptions.
- **With Sagent rebuilding inventory of products launched in 2H/11,** we expect 1Q/12 top line performance to be below 4Q/11 with sales building through the year. In addition, we expect ex-Strides new product launches—which have expected margins north of 30%—should only be marginally diluted by Strides launches over the course of the year, resulting in a 2012 estimated gross margin around 22%.

Changes to Our Estimates

Figure 1: Sagent 4Q/11 Performance v. JPM Estimates

\$ in millions

Sagent	JPM 4Q/11E	Reported 4Q/11A	Variance
Total revenue	\$44.7	\$48.5	\$3.8
Cost of goods sold	\$36.5	\$40.0	\$3.6
Gross profit	\$8.3	\$8.5	\$0.2
Gross margin	18.5%	17.5%	-104 bps
SG&A	\$6.6	\$7.0	\$0.4
R&D	\$3.5	\$4.6	\$1.1
Operating income	(\$2.3)	(\$4.0)	(\$1.7)
Operating margin	-5.2%	-8.3%	-305 bps
Interest/other (expense)	(\$1.1)	(\$1.1)	\$0.0
Tax rate			
EPS	(\$0.12)	(\$0.18)	(\$0.06)
Shares	28.0	27.9	-0.1

Source: Company reports and J.P. Morgan estimates.

Figure 2: Changes to Sagent Revenue and EPS Estimates

Sagent Period	EPS			Revenue (\$ millions)		
	Revised	Prior	Difference	Revised	Prior	Difference
1Q/12E	(\$0.27)	(\$0.05)	(\$0.22)	\$43	\$47	(\$4)
2Q/12E	(\$0.16)	\$0.03	(\$0.19)	\$52	\$56	(\$4)
3Q/12E	\$0.06	\$0.11	(\$0.05)	\$63	\$61	\$2
4Q/12E	\$0.27	\$0.24	\$0.03	\$80	\$71	\$9
2012E	(\$0.07)	\$0.33	(\$0.40)	\$238	\$234	\$4
2013E	\$1.44	\$1.58	(\$0.14)	\$347	\$333	\$14
2014E	\$2.20	\$2.26	(\$0.06)	\$439	\$407	\$32
2015E	\$2.87	\$2.58	\$0.29	\$537	\$469	\$68

Source: J.P. Morgan estimates.

Investment Thesis

Maintain Neutral Rating. We believe Sagent's unique injectable generic model, which combines a network of development and manufacturing partners with a highly experienced sales organization, positions the company well for long-term market share gains and significant top- and bottom-line growth. However, given the company is at a relatively early stage in its development, we believe near-term results could remain volatile and see a fairly balanced risk/reward at current levels.

Valuation

Maintain Dec-12 price target of \$25. As Sagent is not yet profitable and with few pure comparisons to Sagent in the generic pharmaceutical universe, we use a DCF methodology to arrive at our December 2012 price target of \$25 for SGNT shares.

Our DCF considers our estimates through 2015 and then modest revenue growth through 2025, flattening out thereafter. In addition, we expect Sagent's cost structure to remain consistent with 2015 levels. We believe our terminal growth rate of zero

(off 2030 estimated cash flow) reflects a long-term strategy of additional product launches and share gains offsetting any normal price erosion in the industry.

We estimate a weighted average cost of capital (WACC) of 10.5%, which is higher than our normal WACC estimates due to the risk in Sagent's business model relative to other more established generics companies. We expect Sagent's WACC will decrease over time as the company continues to build scale in the generics injectables market. We use a long-term estimated tax rate of 30% in our analysis.

Risks to Rating and Price Target

Risks to the downside include production issues working with a large number of suppliers, revenue concentration in a few product areas (Heparin), the critical need for margin expansion to achieve profitability, the reliance on the current management team's expertise and industry connections to continue to gain market share and a large insider hold of SGNT shares.

Risks to the upside include the potential for significant product launches in the near future as the company works to build out its portfolio, continued manufacturing and supply issues for other injectable generic competitors and the potential for revenue-accretive business development transactions.

Figure 3: Sagent Annual Revenue Estimates

\$ in millions

millions USD Fiscal year ends December 31	FY 2008A	FY 2009A	FY 2010A	FY 2011A	FY 2012E	FY 2013E	FY 2014E	FY 2015E
Revenue								
heparin			18.8	37.5	21.5	18.3	17.0	15.7
growth				99%	-43%	-15%	-7%	-7%
Levaquin (levofloxacin)			-	8.4	19.5	15.4	14.7	13.9
growth				0%	133%	-21%	-5%	-5%
New products			-	25.0	115.8	235.8	333.9	437.6
growth						104%	42%	31%
Current base business	12.0	29.2	55.2	81.5	81.5	77.4	73.6	69.9
growth		143%	89%	48%	0%	-5%	-5%	-5%
TOTAL REVENUE	12.0	29.2	74.1	152.4	238.3	347.0	439.2	537.1
growth		143%	153%	106%	56%	46%	27%	22%

New Product Assumptions								
3Q/11 products	20.0	39.0	37.1	35.2	33.4			
growth		95%	-5%	-5%	-5%			
4Q/11 products	5.0	6.3	6.3	6.3	6.3			
growth		0%	0%	0%	0%			
2011 New Products	25.0	45.3	43.3	41.4	39.7			
growth		0%	-4%	-4%	-4%			
1Q/12 products		12.0	11.4	11.4	10.8			
growth		0%	-5%	0%	-5%			
2Q/12 products		13.5	17.1	17.1	16.2			
annualized growth		0%	27%	0%	-5%			
3Q/12 products		30.0	57.0	57.0	54.2			
annualized growth		0%	90%	0%	-5%			
4Q/12 products		15.0	57.0	57.0	54.2			
annualized growth		0%	280%	0%	-5%			
2012 New Products		70.5	142.5	142.5	135.4			
growth		0%	102%	0%	-5%			
2013 products			50.0	75.0	75.0			
growth			0%	50%	0%			
2014 products				75.0	112.5			
growth				0%	50%			
2015 products					75.0			
growth					0%			
Total New Products	25.0	115.8	235.8	333.9	437.6			

Source: Company reports and J.P. Morgan estimates.

Figure 4: Sagent Quarterly Financial Model

\$ in millions

millions USD Fiscal year ends December 31	FY 2006A	FY 2007A	FY 2008A	FY 2009A	FY 2010A	Mar 2011 1QA	Jun 2011 2QA	Sep 2011 3QA	Dec 2011 4QA	FY 2011A	Mar 2012 1QE	Jun 2012 2QE	Sep 2012 3QE	Dec 2012 4QE	FY 2012E	FY 2013E	FY 2014E	FY 2015E
Income Statement																		
Net sales	-	0.1	12.0	29.2	74.1	30.3	32.3	41.3	48.5	152.4	43.4	51.8	63.3	79.7	238.3	347.0	439.2	537.1
COGS	-	0.1	11.9	28.8	65.0	25.8	29.5	34.3	40.0	129.6	36.4	42.2	48.5	59.0	186.1	250.1	309.2	371.8
Gross profit	-	0.0	0.1	0.4	9.0	4.6	2.7	6.9	8.5	22.8	7.0	9.6	14.9	20.7	52.1	96.9	130.0	165.3
Research & Development	-	2.5	14.9	12.4	11.2	2.4	2.4	3.5	4.6	12.8	5.5	6.5	6.5	7.3	25.8	25.8	25.8	25.8
SG&A	1.7	10.6	15.0	16.7	18.9	5.0	6.5	6.7	7.0	25.1	7.7	8.1	8.0	8.1	31.9	33.5	35.2	36.9
Equity in JV	-	0.7	1.1	1.5	1.5	0.7	0.5	0.4	0.9	2.5	(1.0)	(1.0)	(2.0)	(3.0)	(7.0)	(15.0)	(20.0)	(30.0)
Total operating expense	1.7	13.8	31.1	30.6	31.6	8.0	9.4	10.5	12.5	40.4	12.2	13.6	12.5	12.3	50.6	44.2	40.9	32.7
Operating income (loss)	(1.7)	(13.8)	(31.0)	(30.1)	(22.6)	(3.4)	(6.6)	(3.6)	(4.0)	(17.7)	(5.2)	(4.0)	2.3	8.4	1.5	52.6	89.1	132.6
Interest income & other	0.0	0.6	0.5	0.1	0.0	0.0	0.1	0.1	0.1	0.3	0.1	0.0	0.0	0.0	0.2	0.3	0.7	1.6
Interest expense	(0.1)	(0.0)	-	(0.5)	(1.1)	(0.5)	(1.2)	(1.2)	(1.2)	(4.2)	(2.2)	(0.5)	(0.5)	(0.5)	(3.6)	(1.9)	(1.4)	(1.0)
Change in value of p/s warrants	-	-	-	-	(0.8)	(0.5)	(0.4)	-	-	(0.8)	-	-	-	-	-	-	-	-
Income (loss) before taxes	(1.7)	(13.2)	(30.5)	(30.5)	(24.5)	(4.4)	(8.2)	(4.7)	(5.1)	(22.4)	(7.4)	(4.4)	1.9	8.0	(2.0)	51.0	88.4	133.2
Income tax	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(7.7)	(22.1)	(46.6)
NET INCOME	(1.7)	(13.2)	(30.5)	(30.5)	(24.5)	(4.4)	(8.2)	(4.7)	(5.1)	(22.4)	(7.4)	(4.4)	1.9	8.0	(2.0)	43.4	66.3	86.6
Adjusted EPS						(2.09)	(0.37)	(0.17)	(0.18)	(1.12)	(0.27)	(0.16)	0.06	0.27	(0.07)	1.44	2.20	2.87
Basic shares outstanding						2.1	22.2	27.9	27.9	20.0	27.9	27.9	28.0	28.0	27.9	28.0	28.1	28.1
FD shares outstanding						2.1	22.2	27.9	27.9	20.0	27.9	27.9	30.0	30.0	27.9	30.0	30.1	30.1
Margins																		
Gross margin	37.5%	0.6%	1.5%	12.2%	15.1%	8.5%	16.8%	17.5%	14.9%	16.1%	18.5%	23.5%	26.0%	21.9%	27.9%	29.6%	30.8%	30.8%
R&D	nm	124.5%	42.4%	15.2%	7.8%	7.4%	8.4%	9.4%	8.4%	12.7%	12.5%	10.3%	9.1%	10.8%	7.4%	5.9%	4.8%	4.8%
SG&A	nm	125.1%	57.1%	25.6%	16.4%	20.1%	16.2%	14.4%	16.5%	17.8%	15.6%	12.7%	10.1%	13.4%	9.7%	8.0%	6.9%	6.9%
Equity in JV		9.1%	5.1%	2.0%	2.2%	1.6%	1.0%	1.9%	1.7%	-2.3%	-1.9%	-3.2%	-3.8%	-2.9%	-4.3%	-4.6%	-5.6%	-5.6%
Opex	nm	258.7%	104.6%	42.7%	26.4%	29.1%	25.6%	25.8%	26.5%	28.2%	26.2%	19.8%	15.4%	21.3%	12.7%	9.3%	6.1%	6.1%
Operating margin	nm	-258.1%	-103.1%	-30.5%	-11.3%	-20.5%	-8.7%	-8.3%	-11.6%	-12.1%	-7.7%	3.7%	10.5%	0.6%	15.2%	20.3%	24.7%	24.7%
Pretax margin	nm	-253.7%	-104.5%	-33.1%	-14.4%	-25.4%	-11.5%	-10.6%	-14.7%	-17.1%	-8.5%	3.0%	10.0%	-0.8%	14.7%	20.1%	24.8%	24.8%
Tax rate	nm	nm	nm	nm	nm	nm	nm	nm	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	15.0%	25.0%	35.0%	35.0%
NET MARGIN	nm	-253.7%	-104.5%	-33.1%	-14.4%	-25.4%	-11.5%	-10.6%	-14.7%	-17.1%	-8.5%	3.0%	10.0%	-0.8%	14.7%	20.1%	24.8%	24.8%
Growth Rates																		
Sales					153%	251%	205%	94%	44%	106%	43%	61%	53%	64%	56%	46%	27%	22%
COGS					126%	208%	177%	85%	46%	99%	41%	43%	41%	47%	44%	34%	24%	20%
R&D					-10%	-16%	-27%	37%	74%	14%	133%	174%	88%	59%	102%	0%	0%	0%
SG&A					14%	19%	49%	49%	18%	33%	55%	25%	20%	15%	27%	5%	5%	5%
Equity in JV					-1%	55%	58%	89%	88%	71%	-249%	-291%	-599%	-422%	-377%	114%	33%	50%
Opex					3%	8%	18%	46%	38%	28%	53%	45%	19%	-2%	25%	-13%	-8%	-20%
Operating income																nm	69%	49%
Pretax income																	73%	51%
NET INCOME																	53%	31%
EPS																	53%	30%

Source: Company reports and J.P. Morgan estimates.

Sagent Pharmaceuticals: Summary of Financials

Income Statement - Annual	FY11A	FY12E	FY13E	FY14E	Income Statement - Quarterly	1Q12E	2Q12E	3Q12E	4Q12E
Revenues	152	238	347	439	Revenues	43	52	63	80
Cost of products sold	130	186	250	309	Cost of products sold	36	42	48	59
Gross profit	23	52	97	130	Gross profit	7	10	15	21
SG&A	25	32	33	35	SG&A	8	8	8	8
R&D	13	26	26	26	R&D	6	7	7	7
Operating Income	40	51	44	41	Operating income	12	14	13	12
Note: EBITDA	(14)	7	58	94	Note: EBITDA	(4)	(3)	4	10
Net interest income / (expense)	(4)	(3)	(2)	(1)	Net interest income / (expense)	(2)	(0)	(0)	(0)
Other income / (expense)	(1)	0	0	0	Other income / (expense)	0	0	0	0
Pretax income	(22)	(2)	51	88	Pretax income	(7)	(4)	2	8
Income taxes	0	0	(8)	(22)	Income taxes	0	0	0	0
Net income - GAAP	-	-	-	-	Net income - GAAP	-	-	-	-
Net income - recurring	(22)	(2)	43	66	Net income - recurring	(7)	(4)	2	8
Diluted shares outstanding	20	28	30	30	Diluted shares outstanding	28	28	30	30
EPS - excluding non-recurring	(1.12)	(0.07)	1.44	2.20	EPS - excluding non-recurring	(0.27)	(0.16)	0.06	0.27
EPS - recurring	(1.12)	(0.07)	1.44	2.20	EPS - recurring	(0.27)	(0.16)	0.06	0.27
Balance Sheet and Cash Flow Data	FY11A	FY12E	FY13E	FY14E	Ratio Analysis	FY11A	FY12E	FY13E	FY14E
Cash and cash equivalents	27	(20)	22	82	Sales growth	-	-	-	-
Accounts receivable	38	62	63	73	EBIT growth	-	-	-	-
Inventories	44	66	66	77	EPS growth	-	-	-	-
Other current assets	80	80	80	80					
Current assets	189	188	231	312	Gross margin	-	-	-	-
PP&E	1	2	3	6	EBIT margin	-	-	-	-
Total assets	216	217	272	371	EBITDA margin	-	-	-	-
					Tax rate	-	-	-	-
Total debt	34	24	24	24	Net margin	-	-	-	-
Total liabilities	71	72	74	82					
Shareholders' equity	145	145	198	289	Debt / EBITDA	-	-	-	-
					Debt / Capital (book)	-	-	-	-
Net income (including charges)	(22)	(2)	51	88	Return on assets (ROA)	-	-	-	-
D&A	3	5	5	5	Return on equity (ROE)	-	-	-	-
Change in working capital	(29)	(35)	1	(14)	Return on invested capital (ROIC)	-	-	-	-
Other									
Cash flow from operations	(43)	(36)	44	62	Enterprise value / sales	-	-	-	-
					Enterprise value / EBITDA	-	-	-	-
Capex	(0)	(1)	(2)	(3)	Free cash flow yield	-	-	-	-
Free cash flow	(43)	(37)	42	60					
Cash flow from investing activities	(80)	(1)	(2)	(3)					
Cash flow from financing activities	115	(10)	0	0					
Dividends	-	-	-	-					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

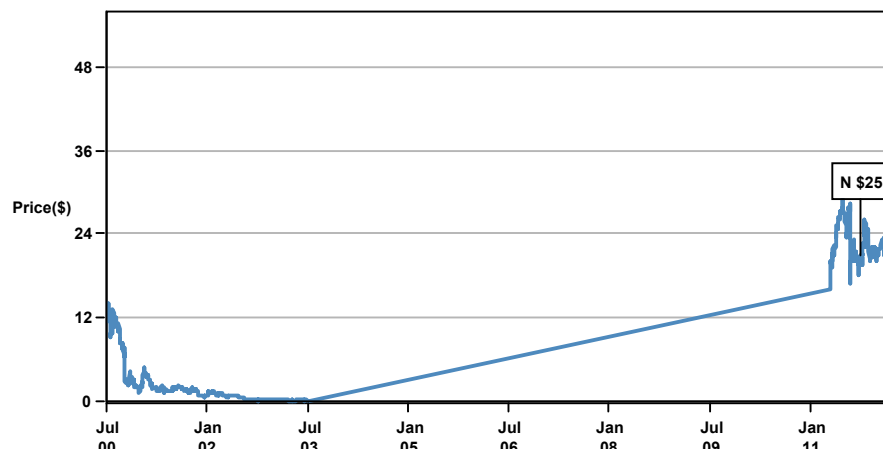
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- **Market Maker:** JPMS makes a market in the stock of Sagent Pharmaceuticals.

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Sagent Pharmaceuticals (SGNT, SGNT US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Sep 28, 2011.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings: OW = Overweight, N= Neutral, UW = Underweight

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J.P. Morgan Equity Research Ratings Distribution, as of January 6, 2012

	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	47%	42%	12%
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