STEPHAN CO
Form 10QSB
August 13, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-QSB

x **Quarterly Report Under Section 13 or 15(d) of The Securities Exchange Act of 1934**
For the quarterly period ended: June 30, 2007

¨ **Transition Report Under Section 13 or 15(d) of the Exchange Act**
For the transition period from ______ to ______

Commission File No. 1-4436

THE STEPHAN CO.

(Exact Name of Small Business Issuer as Specified in its Charter)

Florida	**59-0676812**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
1850 West McNab Road, Fort Lauderdale, Florida	**33309**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s Telephone Number, including Area Code: (954) 971-0600

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

Approximate number of shares of Common Stock outstanding as of July 31, 2007:

4,389,783

Transitional Small Business Disclosure Format (Check One): YES ¨ NO x

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The Stephan Co. and Subsidiaries

June 30, 2007

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR

PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This quarterly report contains certain forward-looking statements. The Stephan Co. (Stephan or the Company) desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement for the express purpose of availing itself of the protections of such safe harbor with respect to all such forward-looking statements. Such forward-looking statements involve risks, uncertainties and other factors which may cause the actual results, condition (financial or otherwise), performance, trends or achievements of the Company and its subsidiaries to be materially different from any results, condition, performance, trends or achievements projected, anticipated or implied by such forward-looking statements.

Words such as projects, believe, anticipates, estimate, plans, expect, intends, and similar words and expressions are intended to identif forward-looking statements and are based on our current expectations, assumptions, and estimates about us and our industry. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct.

Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors, risks and uncertainties. These factors, risks and uncertainties include, without limitation, our ability to satisfactorily address any material weaknesses in our financial controls; general economic and business conditions; competition; the relative success of our operating initiatives; our development and operating costs; our advertising and promotional efforts; brand awareness for our product offerings; the existence or absence of adverse publicity; acceptance of any new product offerings; changing trends in customer tastes; the success of any multi-branding efforts; changes in our business strategy or development plans; the quality of our management team; costs and expenses incurred by us in pursuing strategic alternatives; the availability, terms and deployment of capital; the business abilities and judgment of our personnel; the availability of qualified personnel; our labor and employee benefit costs; the availability and cost of raw materials and supplies; changes in or newly-adopted accounting principles; changes in, or our failure to comply with, applicable laws and regulations; changes in our product mix and associated gross profit margins; as well as management s response to these factors, and other factors that may be more fully described in the Company s literature, press releases and publicly-filed documents with the Securities and Exchange Commission. You are urged to carefully review and consider these disclosures, which describe certain factors that affect our business.

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We do not undertake, subject to applicable law, any obligation to publicly release the results of any revisions, which may be made to any forward-looking statements to reflect events or circumstances occurring after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Therefore, we caution each reader of this report to carefully consider the specific factors and qualifications discussed herein with respect to such forward-looking statements, as such factors and qualifications could affect our ability to achieve our objectives and may cause actual results to differ materially from those projected, anticipated or implied herein.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

Assets

	June 30, 2007	December 31, 2006
Cash and cash equivalents	$ 7,452,754	$ 7,064,332
Restricted cash	1,110,000	1,110,000
Accounts receivable, net	2,140,637	1,716,733
Inventories	4,861,616	4,792,357
Prepaid expenses and other current assets	211,841	335,429
TOTAL CURRENT ASSETS	15,776,848	15,018,851
Restricted cash	557,963	1,206,392
Property, plant and equipment, net	1,507,529	1,573,560
Deferred income taxes	725,402	864,471
Goodwill, net	2,602,802	2,602,802
Trademarks, net	3,069,507	3,069,507
Deferred acquisition costs, net	43,149	76,161
Other assets, net	2,249,260	2,354,295
TOTAL ASSETS	$ 26,532,460	$ 26,766,039

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

Liabilities and Stockholders Equity

	June 30, 2007	December 31, 2006
Accounts payable and accrued expenses	$ 2,309,795	$ 2,215,449
Current portion of long-term debt	1,110,000	1,110,000
TOTAL CURRENT LIABILITIES	3,419,795	3,325,449
Long-term debt	555,000	1,110,000
TOTAL LIABILITIES	3,974,795	4,435,449
Commitments And Contingencies (Note 3)		
Common stock, $.01 par value	43,898	43,898
Additional paid-in capital	17,693,644	17,646,069
Retained earnings	4,820,123	4,640,623
TOTAL STOCKHOLDERS EQUITY	22,557,665	22,330,590
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 26,532,460	$ 26,766,039

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Revenue	$ 10,316,078	$ 10,981,917
Cost Of Goods Sold	5,899,589	6,385,410
Gross Profit	4,416,489	4,596,507
Selling, General And Administrative Expenses	4,137,035	4,331,267
Operating Profit	279,454	265,240
Other Income (Expense)		
Interest income	185,671	106,393
Interest expense on long-term debt	(14,295)	(22,787)
Income Before Income Taxes	450,830	348,846
Income Tax Expense	183,534	135,611
Net Income	$ 267,296	$ 213,235
Net Income Per Share:		
Basic	$ .06	$ .05
Diluted	$ .06	$ .05

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

	Three Months Ended June 30, 2007	2006
Revenue	$ 5,106,714	$ 5,373,020
Cost Of Goods Sold	2,856,669	3,006,828
Gross Profit	2,250,045	2,366,192
Selling, General And Administrative Expenses	2,061,583	2,232,933
Operating Profit	188,462	133,259
Other Income (Expense)		
Interest income	95,117	62,929
Interest expense on long-term debt	(7,092)	(10,991)
Income Before Income Taxes	276,487	185,197
Income Tax Expense	112,737	69,018
Net Income	$ 163,750	$ 116,179
Net Income Per Share:		
Basic	$ .04	$ .03
Diluted	$ .04	$ .03

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 267,296	$ 213,235
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation	68,088	76,030
Stock-based compensation	47,659	41,908
Amortization	33,012	33,012
Deferred income taxes	139,068	96,210
Changes in operating assets and liabilities:		
Accounts receivable	(423,904)	(421,530)
Inventories	(69,259)	(156,958)
Prepaid expenses and other current assets	123,588	186,209
Change in other assets	105,035	80,035
Accounts payable and accrued expenses	94,346	441,860
Net cash flows provided by operating activities	384,929	590,011

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2007	2006
CASH FLOWS FROM INVESTING ACTIVITIES:		
Reduction in restricted cash	648,429	462,559
Purchase of property, plant and equipment	(2,057)	(27,739)
Net cash flows provided by investing activities	646,372	434,820
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(555,000)	(555,000)
Dividends paid	(87,796)	(175,592)
Purchase & retirement of common stock	(83)	
Net cash flows used in financing activities	(642,879)	(730,592)
INCREASE IN CASH AND CASH EQUIVALENTS	388,422	294,239
Cash And Cash Equivalents, Beginning Of Period	7,064,332	5,602,762
Cash And Cash Equivalents, End Of Period	$ 7,452,754	$ 5,897,001
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 12,787	$ 22,789
Income taxes paid	$ 50,044	$ 33,381

See notes to unaudited condensed consolidated financial statements.

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The Stephan Co. and Subsidiaries

Notes To Unaudited Condensed Consolidated Financial Statements

Quarters Ended June 30, 2007 and 2006

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
NATURE OF OPERATIONS: The Stephan Co. (the Company) is engaged principally in the manufacture, sale and distribution of hair and personal care grooming products throughout the United States. We have allocated substantially all of our business into three segments: professional hair care products, retail personal care products and manufacturing/other.

BASIS OF PRESENTATION: In our opinion, all adjustments (consisting only of normal accruals) necessary for a fair presentation of the Company s financial position and results of operations are reflected in these unaudited interim condensed consolidated financial statements. Certain reclassifications of prior year amounts have been made to effect comparability with current year classifications.

The results of operations for the six and three-month periods ended June 30, 2007 are not necessarily indicative of the results to be achieved for the year ending December 31, 2007. The December 31, 2006 condensed consolidated balance sheet was derived from the audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes in our Annual Report on Form 10-K for the year ended December 31, 2006, previously filed with the Securities and Exchange Commission.

USE OF ESTIMATES: The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, CDs, money market investments and short-term municipal bonds having maturities of 90 days or less when acquired. The Company maintains cash deposits at certain financial institutions in amounts in excess of the federally insured limit.

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INVENTORIES: Inventories are stated at the lower of cost (deter-mined on a first-in, first-out basis) or market:

	June 30, 2007	December 31, 2006
Raw materials	$ 1,292,329	$ 1,457,575
Packaging and components	2,062,222	2,138,017
Work-in-process	471,396	605,848
Finished goods	3,357,280	2,872,305
	7,183,227	7,073,745
Less: Amount included in other assets	(2,321,611)	(2,281,388)
	$ 4,861,616	$ 4,792,357

Raw materials include chemicals and fragrances used in the production process. Packaging and components include cartons, inner sleeves, boxes, bottles, containers, jars, caps, pumps and similar items. Finished goods are comprised of manufactured and purchased wet goods and purchased hard goods including hair dryers, electric clippers, lather machines, scissors and salon accessories.

Packaging, components and finished goods that are not anticipated to be used within one year are categorized as other assets. We reduce the value of inventory, included in other assets, to provide for the cost, including the estimated costs of disposal, of slow moving goods that may ultimately become unusable or obsolete.

BASIC AND DILUTED NET INCOME PER SHARE: Basic net income per share was computed by dividing net income by the weighted average shares of common stock outstanding (4,389,805 shares). Diluted net income per share was computed by dividing net income by the weighted average shares of common stock outstanding increased by shares assumed to be outstanding after the exercise of certain stock options.

The inclusion of dilutive stock options in the calculation of diluted net income per share was not significant for the six- or three-month periods ended June 30, 2007 and 2006. We have approximately 400,000 stock options outstanding, of which approximately 150,000 are in the money and therefore used in the calculation of diluted net income per share.

In late June 2007 we purchased 22 shares of common stock as an accommodation to a shareholder. The stock was later retired and the shares are no longer outstanding.

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STOCK-BASED COMPENSATION: As a result of adopting FAS 123R on January 1, 2006, we incurred compensation expense related to stock options by $48,000 and $25,000 for the six- and three-month periods ended June 30, 2007, respectively. For the six- and three-month periods ended June 30, 2006, our net income was reduced by approximately $42,000 in both periods. The impact on basic and diluted net income per share was approximately $.01 in all periods presented.

NEW FINANCIAL ACCOUNTING STANDARDS: In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159), which establishes a fair value option under which entities can elect to report certain financial assets and liabilities at fair value, with changes in fair value recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact, if any, that SFAS 159 will have on our financial statements.

In September 2006, the Securities and Exchange Commission staff published Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 addresses the effect on current year financial statements of prior year uncorrected errors. SAB No. 108 was effective for fiscal years ended after November 15, 2006. The adoption of SAB No. 108 by us in the fourth quarter of 2006 did not have a material impact on our consolidated financial statements.

In July 2006 the FASB issued FASB Interpretation No. 48, (FIN 48) Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 . FIN 48 requires that we recognize in our financial statements the impact of a tax position taken or expected to be taken in a tax return, provided that such position is more likely than not of being sustained on audit. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not anticipate that FIN 48 will have an adverse effect on our financial statements.

NOTE 2: COMMITMENTS AND CONTINGENCIES

We are involved in litigation matters arising in the ordinary course of business. It is our opinion that none of these matters, at June 30, 2007, would likely, if adversely determined, have a material adverse effect on our financial position, results of operations or cash flows. Additionally, there has been no material change in the status of any pending litigation since our last filing of Form 10-K with the Securities and Exchange Commission for the year ended December 31, 2006.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Comparison of the Six-Month Periods ended June 30, 2007 and June 30, 2006:

Our revenue was $10.3 million for the six months ended June 30, 2007, a decrease of 6.1% from the comparable period in 2006, principally due to shortfalls in our two main product segments: professional and retail. Revenue in our professional segment, consisting principally of lower margin hard goods sold to distributors, accounted for approximately 75.0% of our total revenue for the six-month period ended June 30, 2007 and declined 6.3% from the comparable period in the prior year. Revenue in our retail segment, principally comprised of chain stores and mass merchandisers, accounted for approximately 16.0% of our total revenue for this six-month period and was 12.5% less than the revenue for the comparable 2006 period. Revenue for the remaining sales categories was greater than that in 2006 by 11.8%. We are re-evaluating the manner in which we allocate costs to our product segments to better reflect their profit or loss. We intend to report segment profit or loss in our annual report on Form 10-KSB for the year ending December 31, 2007.

Revenue by Segment

($ in thousands)

	Six Months 2007	Six Months 2006	% Increase (Decrease)
Professional	$ 7,708	$ 8,228	(6.3)%
Retail	1,696	1,937	(12.5)%
Manufacturing/Other	912	817	11.8