STEPHAN CO
Form 10-K
April 15, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2002

Commission File No. 1-4436

THE STEPHAN CO.

(Exact Name of Registrant 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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, $.01 Par Value	AMERICAN STOCK EXCHANGE

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to the filing requirements for at least the past 90 days.

YES X ____ NO ______

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ( )

State the aggregate market value of the voting stock held by non-affiliates of the Registrant, computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within 60 days prior to the date of filing.

$10,596,531
as of March 14, 2003

The above amount excludes shares held by all executive officers and directors of the Registrant

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date:

4,410,577 Shares of Common Stock, $.01 Par Value,
as of March 14, 2003

List hereunder the following documents if incorporated by reference and the part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) any annual report to security holders; (2) any proxy or information statement; and (3) any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933:

Portions of the proxy statement for the Registrant's 2003 annual meeting of stockholders, scheduled to be filed no later than May 1, 2003, are incorporated by reference in Part III of this Form 10-K.

2

THE STEPHAN CO. AND SUBSIDIARIES
INDEX TO ANNUAL REPORT
ON FORM 10-K

		Page
PART I		
Item 1:	Business	4
Item 2:	Properties	9
Item 3:	Legal Proceedings	10
Item 4:	Submission of Matters to a Vote of Security Holders	11
PART II		
Item 5:	Market for the Registrant's Common Equity and Related Stockholder Matters	12
Item 6:	Selected Financial Data	13
Item 7:	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 7A:	Quantitative and Qualitative Disclosures about Market Risk.	22
Item 8:	Financial Statements and Supplementary Data	22
Item 9:	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	22
PART III		
Item 10:	Directors and Executive Officers of the Registrant	23
Item 11:	Executive Compensation	23
Item 12:	Security Ownership of Certain Beneficial Owners and Management	23
Item 13:	Certain Relationships and Related Transactions	23
Item 14:	Controls and Procedures	23
PART IV		
Item 15:	Exhibits, Financial Statement Schedules and Reports on Form 8-K	24
Signatures		26
Certifications		27-30

PART I

Certain statements in this Annual Report on Form 10-K ("Form 10-K") under "Item 1. Business", "Item 3. Legal Proceedings" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, condition (financial or otherwise), performance or achievements of the Registrant to be materially different from any future results, performance,

condition or achievements expressed or implied by such forward-looking statements.

Such factors include, but are not limited to, the following: general economic and business conditions; competition; relative success of operating initiatives; development and operating costs; advertising and promotional efforts; brand awareness; the existence or absence of adverse publicity; acceptance of any new product offerings; changing trends in customer tastes; the success of multi-branding; changes in business strategy or development plans; quality of management; costs and expenses incurred by the Company in pursuing strategic alternatives; availability, terms and deployment of capital; business abilities and judgment of personnel; availability of qualified personnel; labor and employee benefit costs; availability and cost of raw materials and supplies; changes in or newly-adopted accounting principles; changes in, or failure to comply with, law; changes in product mix and associated gross profit margins; and other factors or events referenced in this Form 10-K.

The Company does 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, the Company cautions 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 the ability of the Company to achieve its objectives and may cause actual results to differ materially from those projected, anticipated or implied herein.

Item 1. Business

GENERAL

The "Registrant" or the "Company", founded in 1897 and incorporated in the State of Florida in 1952, is engaged in the manufacture, sale and distribution of hair care and personal care products at both the wholesale and retail level. The Registrant is comprised of The Stephan Co. ("Stephan") and its eight wholly-owned subsidiaries, Foxy Products, Inc., Old 97 Company, Williamsport Barber and Beauty Corp., Stephan & Co., Scientific Research Products, Inc. of Delaware, Trevor Sorbie of America, Inc., Stephan Distributing, Inc. and Morris Flamingo-Stephan, Inc.

The Company has identified three reportable operating segments which are Professional Hair Care Products and Distribution ("Professional"), Retail Personal Care Products ("Retail") and Manufacturing. The Professional segment generally consists of a customer base of distributors which purchase the Company's hair care products and beauty and barber supplies for sale to salons and barbershops. In this segment, a distinction is made between "wet goods", which include shampoos, conditioners, gels and similar hair treatments, and "hard goods", which include scissors, clippers, combs, dryers and other products used in styling hair. The customer base for the Retail segment is mass merchandisers, chain drug stores and supermarkets which sell hair care and other personal care products directly to the end user. The Manufacturing segment manufactures products for subsidiaries of the Company, and manufactures private label brands for certain customers.

THE STEPHAN CO.

Headquartered in Fort Lauderdale, Florida, Stephan is principally engaged in the manufacture of hair care products for sale by two of its subsidiaries, Scientific Research Products, Inc. and Trevor Sorbie of America, Inc., and the manufacture of products marketed under the STEPHAN brand name. Stephan also manufactures, markets and distributes hair and skin care products under various trade names through Company subsidiaries. Retail product lines include brands such as Cashmere Bouquet talc, Quinsana Medicated talc, Balm Barr and Stretch Mark creams and lotions, Protein 29 liquid and gel grooming aids and Wildroot hair care products for men. These brands, included in the Retail segment of the Company's business, are manufactured at the Company's Tampa, Florida facility, as are the "Modern" brand of Stiff Stuff products. The sales of these products are also included in the Company's Retail segment. In addition, The Frances Denney division (included in the Retail segment) markets a full line of cosmetics through retail and mail order channels. Under the terms of an exclusive Trademark License and Supply Agreement with Color Me Beautiful, Inc., the Company markets the brand names HOPE, INTERLUDE and FADE-AWAY through several retail chains, including J.C. Penney, in the United States and Canada.

Stephan also manufactures and sells products under the brand name "STEPHAN'S". Such products consist of different types of shampoos, hair treatments, after-shave lotion, dandruff lotion, hair conditioners and hair spray which are distributed throughout the United States to approximately 350 beauty and barber distributors and are included in the Professional segment of the Company's business. The Registrant's trademark, "STEPHAN'S," and the design utilized thereby have been registered with the United States Patent and Trademark Office, which registration is due for renewal in November 2006. Retail brand sales of Stephan, including the Frances Denney product line, accounted for approximately $4,125,000 of the Company's 2002 sales.

Under certain trademark licenses, the Company has been granted the exclusive use of certain trademarks in connection with the manufacture and distribution of the Cashmere Bouquet product line of the Colgate-Palmolive Company in the United States and Canada. Any product sold under these license agreements is included in net sales for purposes of determining the

deferred payments.

Pursuant to an additional license and supply agreement, we have granted Color Me Beautiful, Inc. ("CMB") a license to distribute certain products of the Registrant's Frances Denney line and to supply the requirements of CMB for such products. The agreement provides for royalty payments by CMB based upon net sales, with guaranteed minimum annual royalty payments throughout the term of the agreement that are credited against accrued royalties. As a result of a continuing decline in sales of Frances Denney products, the Registrant has agreed to a reduction, on a temporary basis, in the amount of minimum royalty that CMB is required to pay.

The Company's Fort Lauderdale location serves as the Registrant's corporate headquarters. General management services are provided to its subsidiaries from this location.

No single customer accounted for more than 10% of the Registrant's consolidated revenues in 2002. Private label production, which is the manufacturing of products marketed and sold under the brand names of customers of the Company, was not significant in 2002.

OLD 97 COMPANY.

Old 97 Company ("Old 97"), a wholly-owned subsidiary of the Registrant, located in Tampa, Florida, markets products under brand names such as OLD 97, KNIGHTS, and TAMMY. In addition to selling more than 100 different products, including hair and skin care products, fragrances, personal grooming aids and household items, Old 97 serves as an additional manufacturing facility for the Company's products. Its Tampa facility manufactures most of the products sold under the Frances Denney line, all the talc manufactured for the Cashmere Bouquet and Quinsana brands, as well as all the other retail hair and skin care brands sold by Stephan and Stephan Distributing, Inc. The operations of Old 97 are included in the Manufacturing segment of the Company's business.

WILLIAMSPORT BARBER AND BEAUTY CORP.

Williamsport Barber and Beauty Corp. ("Williamsport"), a wholly-owned subsidiary of the Registrant, is located in Williamsport, Pennsylvania. Williamsport, a mail order beauty and barber supply company, with sales of approximately $4,373,000 in 2002, accounted for approximately 17.5% of the Registrant's consolidated revenues for the year and are included in the Professional business segment.

STEPHAN & CO.

Formerly known as Heads or Nails, Inc., Stephan & Co., a wholly-owned subsidiary, has focused on the distribution of personal care amenity products for cruise ships. Sales by Stephan & Co. for the year ended December 31, 2002 were insignificant.

SCIENTIFIC RESEARCH PRODUCTS, INC. OF DELAWARE.

Scientific Research Products, Inc. of Delaware ("Scientific") is a wholly-owned subsidiary which accounted for 11.2% of the Registrant's consolidated revenues in 2002, with sales of approximately $2,817,000. The majority of the sales of Scientific are included in the Retail business segment.

TREVOR SORBIE OF AMERICA, INC.

Prior to its acquisition, Sorbie Acquisition Co. ("Sorbie") was one of the Registrant's major customers and a distributor of a professional line of hair care products sold to salons in the United States and Canada through a network of distributors. Sales of Sorbie hair care products in 2002 were approximately $1,050,000, representing 4.2% of the Registrant's consolidated revenues, and are included in the Professional business segment of the Company's business.

STEPHAN DISTRIBUTING, INC.

In 1997 the Company's wholly-owned subsidiary, Stephan Distributing, Inc., acquired several product lines from New Image Laboratories, Inc. ("New Image"). The primary brands acquired were a professional hair care line of products marketed under the brand name "Image," and a retail hair care line known as "Modern" and marketed under the brand name "Stiff Stuff." A portion of the purchase price included a contingent payment of

125,000 shares of the Company's common stock payable upon the achievement of certain earnings levels.

New Image commenced litigation against the Company seeking, among other things, a declaratory decree that the 125,000 shares of Common Stock held in escrow for the contingent payment of certain purchase price adjustments be released from escrow and turned over to New Image. Pursuant to a judgment dated March 20, 2001, the United States District Court for the Central District of California, among other decisions, granted the Company partial summary judgment in the amount of approximately $20,000 and New Image was granted partial summary judgment pursuant to which the escrow agent was directed to deliver the 125,000 shares to New Image. The Company appealed to the United States Court of Appeals for the Ninth Circuit and in an opinion issued on April 29, 2002, among other things, reversed the judgment of the United States District Court granting summary judgment in favor of New Image against the Company on New Image's contract claim for a price adjustment and on New Image's claim of breach of the implied covenant of good faith and fair dealing. Also in the opinion, the Ninth Circuit concurred with the lower court's ruling that on the present record New Image is not entitled to (i) damages equal to the diminution in the value of the Company's common stock price between the scheduled and actual disbursement dates or (ii) any attorney's fees. As a consequence of the Ninth Circuit's decision, the judgment granting New Image all shares of the Company's common stock being held in escrow has been reversed and the case has been remanded back to the United States District Court for further proceedings. On May 28, 2002, New Image filed a Motion for Rehearing with the Ninth Circuit Court of Appeals and on June 26, 2002, the Court denied the petition for rehearing. A pretrial hearing has been scheduled for

7

spring of 2003 in connection with the remaining claims of the parties to the litigation. The recorded value of trademarks assumes the return to the Company of the shares held in escrow.

Sales of professional brands acquired from New Image amounted to approximately $1,762,000 for the year ended December 31, 2002, which accounted for approximately 7.0% of the Registrant's consolidated revenues. Sales of New Image products are included in the Company's Professional business segment while sales of the Modern line are included in the Company's Retail business segment.

MORRIS FLAMINGO-STEPHAN, INC.

Morris-Flamingo, Inc. ("Morris Flamingo") is a barber and beauty supply wholesaler, which markets its products utilizing catalogs published under the Morris Flamingo brand name as well as the Major Advance brand name. Sales for the year ended December 31, 2002 were approximately $10,492,000, accounting for approximately 41.9% of the Registrant's consolidated revenues, and are included in the Professional segment of the Company's business.

SEGMENT INFORMATION

"Operating Segments and Related Information," which provides information on net sales, income before income taxes and cumulative effect of change in accounting principle, interest income and expense and depreciation and amortization for the last three years and identifiable assets for the last two years, for each of the Registrant's three business segments, is set forth in Note 9 of the consolidated financial statements included elsewhere in this Form 10-K.

RAW MATERIALS, PACKAGING and COMPONENTS INVENTORY

The materials utilized by the Registrant and its subsidiaries in the manufacture of its products consist primarily of common chemicals, alcohol, perfumes, labels, plastic bottles, caps and cartons. All materials are readily available at competitive prices from numerous sources and have in the past been purchased from domestic suppliers. Neither the Company nor any of its subsidiaries has ever experienced any significant shortage in supplies nor does it anticipate any such shortages in the reasonably foreseeable future. Due to market conditions in the petroleum industry, the Registrant continues to experience price increases in both raw material and component prices; however, it is not anticipated that these price increases will have a material adverse effect on operations and believes it can pass such increases on to customers.

The Company and its subsidiaries seek to maintain a level of finished goods inventory sufficient for a period of at least three months. The Registrant does not anticipate any change in such practice during the reasonably foreseeable future.

BACKLOG

As of December 31, 2002, the Company did not believe that the dollar amount of its backlog orders was significant.

RESEARCH AND DEVELOPMENT

During each of the three prior fiscal years ending December 31, 2002, expenditures by the Registrant and its subsidiaries on Company sponsored research relating to the development of new products, services or techniques or the improvement of existing products, services or techniques were not material and were expensed as incurred.

COMPETITION

The hair care and personal grooming business is highly competitive. The Company believes that the principal competitive factors are price and product quality. Products manufactured and sold by the Registrant and its subsidiaries compete with numerous varieties of other such products, many of which bear well known, respected and heavily advertised brand names and are produced and sold by companies having substantially greater financial, technical, personnel and other resources than the Registrant. Products produced by the Registrant and its subsidiaries account for a relatively insignificant portion of the total hair care and personal grooming products manufactured and sold annually in the United States.

GOVERNMENT AND INDUSTRY REGULATION, ENVIRONMENTAL MATTERS

Certain of the Registrant's products are subject to regulation by the Food and Drug Administration, in addition to other Federal, state and local regulatory agencies. The Company believes that its products are in substantial compliance with all applicable regulations. The Registrant does not believe that compliance with existing or presently proposed environmental standards, practices or procedures will have a material adverse effect on operations, capital expenditures or the competitive position of the Company.

EMPLOYEES

As of December 31, 2002, in addition to its five officers, the Company and its subsidiaries employed approximately 120 people engaged in the

production, warehousing and distribution of its products. Although the Company and its subsidiaries do not anticipate the need to hire a material number of additional employees, the Company believes that any such employees, if needed, would be readily available. No significant number of employees are covered by collective bargaining agreements and the Company believes its employee relationships are satisfactory.

Item 2. Properties

The Registrant's administrative, manufacturing and warehousing facilities are located in a building of approximately 33,000 square feet, which it owns, located at 1850 West McNab Road, Fort Lauderdale, Florida 33309. The Registrant utilizes approximately two-thirds of the space for the manufacture and warehousing of its products. The remainder of the space is utilized by the Registrant for its administrative offices. The Registrant also owns certain machinery and equipment suitable for the manufacture of its products that is housed in its facility in Fort Lauderdale, Florida. In addition to this facility, the Registrant leases

approximately 43,000 square feet of warehouse space located at 5300 North Powerline Road, Fort Lauderdale, Florida 33309, under a lease extension (with a November 30, 2003 cancellation option) which terminates July 31, 2004, at an annual net rental of $160,000.

Old 97 owns three buildings totaling approximately 42,000 square feet of space, one of which is located at 2306 35th Street, Tampa, Florida 33605. This building is utilized by Old 97 in the manufacture of its various product lines. A claim has been filed with the Department of Transportation in connection with a leased warehouse facility adjacent to this location which was utilized by Old 97, (see "Item 3. Legal Proceedings"). It also owns two buildings located at 4829 East Broadway Avenue, Tampa, Florida 33605. One building, comprising 12,500 square feet, is being used for office facilities and order fulfillment for the Frances Denney line. The second building, consisting of approximately 30,000 square feet, is used as a warehouse and distribution facility. From time to time, and as inventory levels dictate, Old 97 leases temporary warehouse space, generally on a short-term basis. The Company is currently leasing a 44,000 square foot warehouse located in close proximity to the general office and warehouse facility.

The Company leases office and warehouse space of approximately 6,000 square feet in Williamsport, Pennsylvania pursuant to a five-year lease expiring January 31, 2007. Monthly rent in the amount of $2,100 is payable to the former owner of Williamsport Barber Supply and the lease has a 60-day cancellation clause.

In connection with the Morris Flamingo acquisition, the Company entered into a lease, and subsequent lease extension, expiring in June 2005, for the office, warehouse and manufacturing facility located at 204 Eastgate Drive, Danville, Illinois 61834, at an annual rental payment of approximately $210,000, subject to annual consumer price index increases, with purchase options ranging from $1,850,000 to $2,000,000 over the remaining life of the lease. The Danville facility has 7,500 square feet of office space and 85,500 square feet of warehouse, distribution and manufacturing space. The landlord is Shaheen & Co., Inc, the former owner of Morris-Flamingo. Shouky A. Shaheen, a minority owner of Shaheen & Co., Inc., is currently a member of the Board of Directors and a significant shareholder of the Company.

Item 3. Legal Proceedings

In addition to the matters set forth below, the Company is involved in other litigation arising in the normal course of business. It is the opinion of management that none of such matters, at December 31, 2002, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

For a description of certain legal proceedings involving the Company and New Image, see Item 1. Business. For a description of certain legal proceedings involving the Company and a shareholder, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Events.

On November 1, 2001, a private label customer filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Faulding Healthcare (IP) Holdings, Inc. and Faulding Consumer, Inc. v. The Stephan Co., Old 97 Company and Frank Ferola, Sr., Case Number 01-019028 09, against the Company alleging causes of action for breach of contract, declaratory judgment, and trademark infringement. The Company denied the allegations and has filed a counter-claim against Faulding Consumer, Inc. the customer. The counter-claim alleges claims for breach of contract, anticipatory breach of contract and amounts stated stemming from Faulding's failure to provide continuing orders and failure to pay for certain raw materials and components. The Company seeks unspecified compensatory damages including lost profits, interest, attorneys fees and costs. At this time, the Registrant is unable to predict the outcome of this matter.

In November 2001, the Company filed a claim with the U.S. Department of Transportation ("DOT") in the 13th Judicial Circuit Court of Hillsborough County, Florida, in connection with the DOT's widening of Interstate Highway 4, which the Company alleged will result in the loss of an adjacent rental facility utilized by one of the Company's subsidiaries. At a hearing held on August 2, 2002, the Company was successful in asserting a position that would allow for damages to be paid to the Company by the DOT. The case is scheduled for mediation in May 2003, and there is a possibility that the Company may receive a material damage award. However, based on consultation with legal counsel, the Company is presently unable to accurately predict the amount or type of recovery that will result therefrom.

In November 2002, a stockholder filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Joan Rosoff v. Frank F. Ferola, Shouky Shaheen, Leonard A. Genovese, Curtis Carlson, John DePinto, Thomas M. D'Ambrosio and The Stephan Co., Case Number 0222253, against the Company and others alleging certain breaches of fiduciary duties and responsibilities. The Company has filed a motion to dismiss the lawsuit. The Company believes it has meritorious defenses.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our security holders, through the solicitation of proxies or otherwise, during the quarter ended December 31, 2002.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

(a) Market Information

The Registrant's Common Stock is listed on the American Stock Exchange (the "Exchange"). The following table sets forth the range of high and low sales prices for the Registrant's Common Stock during each quarterly period within the two most recent fiscal years:

Quarter Ended	High Sales Price	Low Sales Price
March 31, 2001*	$ 3.00	$ 3.00
June 30, 2001*	3.40	2.91
September 30, 2001	3.20	2.89
December 31, 2001	3.19	2.75
March 31, 2002	$ 3.24	$ 2.75
June 30, 2002	3.83	3.00
September 30, 2002	3.66	3.00
December 31, 2002	3.56	3.29

* Trading of the Registrant's common stock on the Exchange was temporarily suspended for a portion of these periods.

(b) Holders

As of March 14, 2003, the Registrant's Common Stock was held of record by approximately 330 holders. The Registrant's Common Stock is believed to be held beneficially by approximately 1,200 shareholders in "street-name".

(c) Dividends

The Company declared and paid cash dividends at the rate of $.02 per share for each quarter in 1996 through 2002. Future dividends, if any, will be determined by the Company's Board of Directors, in its discretion, based on various factors, including the Company's profitability, cash on hand and anticipated capital needs.

There are no contractual restrictions, including any restrictions on the ability of any of the Registrant's subsidiaries, to transfer funds to the Company in the form of cash dividends, loans or advances, that currently materially limit the Registrant's ability to pay cash dividends or that the Registrant reasonably believes are likely to materially limit

the future payment of dividends on its Common Stock.

Item 6. Selected Financial Data

	2002	2001	2000	1999	1998
	(in thousands, except per share data)				
Net sales	$25,067	$28,296	$31,138	$34,356	$34,835
Income/(Loss) before income taxes and cumulative effect of change in accounting principle	1,400	746	1,006	3,036	(4)
Income/(Loss) before cumulative effect of change in accounting principle	503	608	622	1,843	(3)
Cumulative effect of change in accounting principle	(6,762)	-	-	-	-
Net (loss)/income	(6,259)	608	622	1,843	(3)
Current assets	20,284	20,116	28,199	27,447	27,961
Total assets	47,655	57,062	58,769	59,435	60,600
Current liabilities	3,514	4,067	4,521	3,725	5,332
Long term debt	6,395	7,758	9,124	10,418	11,718
PER COMMON SHARE (Basic and Diluted): (a)					
Income before cumulative effect of change in accounting principle	.12	.14	.14	.40	-
Cumulative effect of change in accounting principle	(1.58)	-	-	-	-
Net (loss)/income	(1.46)	.14	.14	.40	-
Cash dividends	.08	.08	.08	.08	.08

Notes to Selected Financial Data

(a) Net (loss)/income per common share is based upon the weighted average number of common shares outstanding in accordance with Statement of

Financial Accounting Standards No. 128. The weighted average number of shares outstanding were 4,285,577 for 2002, 4,285,577 for 2001, 4,385,019 for 2000, 4,567,439 for 1999, and 4,535,649 for 1998. The weighted average number of diluted shares outstanding were not significantly different in any of the aforementioned years.

The following data should be read in conjunction with the audited consolidated financial statements and related notes included elsewhere in this Form 10-K.

Selected Quarterly Financial Information (unaudited)
(in thousands, except per share data)

	Quarter Ended 3/31/02	Quarter Ended 6/30/02	Quarter Ended 9/30/02	Quarter Ended 12/31/02
Net sales	$ 6,320	$ 6,839	$ 6,721	$ 5,187
Gross profit	2,779	2,982	2,539	1,561
Net income/(loss) before cumulative effect of change in accounting principle	327	405	240	(469)
Cumulative effect of change in accounting principle, net of tax benefit of $1,663	(6,762)	-	-	-
Net (loss)/income	(6,435)	405	240	(469)
Net income/(loss) per common share:				
Before cumulative effect of change in accounting principle	.08	.09	.06	(.11)
Cumulative effect of change in accounting principle	(1.58)	-	-	-
Net (loss)/income	(1.50)	.09	.06	(.11)

	Quarter Ended 3/31/01	Quarter Ended 6/30/01	Quarter Ended 9/30/01	Quarter Ended 12/31/01
Net sales	$ 7,580	$ 7,833	$ 6,584	$ 6,299
Gross profit	3,358	3,213	2,858	2,624
Net income/(loss)	387	316	(90)	(5)
Net income/(loss) per share	.09	.07	(.02)	(.00)

Information presented above for the quarters ended March 31, 2002, June 30, 2002 and September 30, 2002 have been restated to reflect the retroactive application of the impairment loss recognized in accordance with the adoption of SFAS No. 142, effective January 1, 2002.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2002 AS COMPARED TO 2001

Net sales for 2002 decreased primarily as a result of declines in the revenues from the Company's Professional and Manufacturing business segments. The decline in net sales for the Professional segment was approximately $1,861,000. Over the past several years, there has been a consolidation in the distribution network for professional products and this has had an adverse impact on net sales. The Manufacturing segment experienced a decline in sales as a result of a decline in private label production. Management is negotiating with potential customers in order to enhance the private label business and is also encouraged by prospects generated in the first quarter of 2003. The Retail segment showed a small sales increase, largely on the strength of an increase in sales of talc products. In the retail environment, the Company continues to experience demands for considerable up-front concessions, such as slotting allowances, from major retailers in order to carry retail products from suppliers like Stephan.

Gross profit decreased $2,192,000, to $9,861,000 in 2002 when compared to 2001 levels. This decrease was due to an overall decline in net sales and a continuing change in the overall mix of business. The Morris Flamingo-Stephan and Williamsport subsidiaries (Professional business segment) accounted for approximately 59% of consolidated net sales, an increase of 9% over 2001 levels. These two subsidiaries have traditionally had lower gross margins than other entities comprising the professional group. The Company continues to devote efforts to improving the gross profit margins of these two divisions, though they have improved slightly over 2001.

The Retail Personal Care Products operating segment experienced a moderate increase in net sales, with a 41% increase in net sales of the brands acquired from Colgate offsetting decreased net sales of other retail brands. Net retail sales in 2002 were $6,728,000, as compared to $6,496,000 in 2001. By offering quantity discounts, the Company was successful in acquiring new customers, but experienced a lower gross margin due to discounts and promotional pricing. In addition, due to the continued consolidation in the chain-drug store industry, the amount of discounting and promotional allowances large retailers demand of their suppliers has increased, which reduces the gross profit margins on brands supplied to those retailers. The Company responded to these discounting pressures in an effort to maintain market share without materially sacrificing our profitability by selectively participating in promotional programs that would benefit both the Company and the customer.

15

Management of the Company was able to substantially reduce expenses, with selling, general and administrative expenses (SG&A) decreasing in excess of $2,850,000, from $11,363,000 in 2001 to $8,509,000 in 2002. The Company significantly reduced payroll and related costs as well as professional fees. In addition, the decline in sales resulted in reduced freight and delivery expenses. The implementation of SFAS No. 142, with respect to goodwill and trademark amortization, reduced amortization expense (which is included in SG&A) by $1,260,000 in 2002.

Interest expense decreased over $219,000 in 2002 as a result of a decrease in outstanding debt and lower interest rates; interest income also declined over $200,000 due to significantly lower interest rates. Interest income for the year ended December 31, 2002 was $378,000, compared to $580,000 earned in 2001. Other income included royalty payments from Color Me Beautiful of $105,000 in connection with the marketing of Frances Denney products, and a royalty fee of $43,750 for the temporary licensing of New Era products.

Income before income taxes and cumulative effect of a change in accounting principle was $1,400,000, an 88% increase over the corresponding period in 2001, as a result of the reasons indicated above; however income before the cumulative effect of a change in accounting principle as a result of the application of SFAS No. 142 was $503,000 for the year ended December 31, 2002, compared to $608,000 for the year ended December 31, 2001. This decrease was due to an abnormally high provision for income taxes as a result of a reduction in the realizable value of the Company's charitable contribution carryforward. This valuation allowance caused the effective tax rate for the year ended December 31, 2002 to increase to 64%, as compared to 18.5% for the prior year, and was taken because it is anticipated that the time limit on the deductibility of the charitable contribution carryforward will expire before it can be utilized. Should taxable income increase in the near future, some of this write down may be recoverable.

Net income for the year ended December 31, 2002 was adversely impacted by the write-down of goodwill and other intangible assets; an aggregate of approximately $8.4 million was written-off, with a net after tax effect of reducing income by approximately $6.8 million. The net loss for the year ended December 31, 2002, after taking into consideration the goodwill and other intangible assets charge, was $6,259,000.

Basic earnings per share for the year ended December 31, 2002, before the effect of the goodwill and other intangible assets charge was $.12, compared to $.14 for the year ended December 31, 2001. After giving effect to the adjustment for the impairment of goodwill and other intangible assets, the net loss per share was $1.46. The average number of shares outstanding, 4,285,577, was the same in 2002 and 2001.

YEAR ENDED DECEMBER 31, 2001 AS COMPARED TO 2000

Net sales for 2001 decreased as a result of an overall decline in revenues from the Company's Professional and Retail business segments.

While the sales and distribution of "hard goods" remained relatively unchanged, there was a decline in the net sales of "wet goods" (which comprise a significant portion of the "Retail" segment), of approximately $2,900,000.

Gross profit decreased $578,000, to $12,053,000 in 2001 when compared to 2000 levels. This decrease was primarily due to an overall decline in net sales. The overall gross profit percentage increased from 40.6% in 2000 to 42.6% for the year ended December 31, 2001. This increase was largely attributable to sales to new customers and more effective manu-facturing operations.

Net retail sales in 2001 were $6,496,000, as compared to $8,969,000 for 2000. The decline in such net sales was primarily due to an almost

across-the-board decline in the net sales of the Company's retail lines; however, the "Modern" and "Frances Denney" lines showed increases in 2001. The continuing consolidation in the chain-drug store industry continues to increase the amount of discounting and promotional allowances that must be extended to large retailers which often has an inhibiting effect on the number of SKU's (stock keeping units) that a retailer may carry.

Selling, general and administrative (SG&A) expenses decreased $290,000, from $11,653,000 in 2000 to $11,363,000 in 2001. The overall decline in SG&A expenses was due to a Company-wide decrease in payroll and general office expenses partially offset by the anticipated increases in consulting, marketing and legal and professional fees.

Interest expense decreased $174,000 from 2001 levels as the result of a decrease in outstanding debt and the refinancing of a long-term note payable in August 2001. Other income in 2001 includes a royalty payment of $175,000 from Color Me Beautiful in connection with the marketing of Frances Denney products.

Income taxes decreased $246,000, from $384,000 for the year ended December 31, 2000 to $138,000 for the year ended December 31, 2001, due to a combination of a decline in income before income taxes and a decrease in the overall amount of deferred income taxes.

Earnings per share for the year ended December 31, 2001 was $.14, equal to the amount for 2000. The average number of shares outstanding decreased in 2001, from 4,385,019 to 4,285,577, as a result of the repurchase, by the Company, of 165,780 shares during 2000.

LIQUIDITY AND CAPITAL RESOURCES

Working capital was approximately $16,770,000 at December 31, 2002, an increase of over $720,000 from December 31, 2001. Cash and cash equivalents increased to $10,786,000 compared to $8,409,000 as of December 31, 2001. Total cash, including certificates of deposit ("CDs"), increased from $15,994,000 at December 31, 2001 to $17,538,000 at December 31, 2002. The Company has continued to secure its outstanding long-term debt with Wachovia Bank with all of the CDs. While the CDs periodically mature, they are classified as non-current and not included in working capital or cash

17

and cash equivalents. The Company does not anticipate any significant capital expenditures in the near term and management believes that there is sufficient cash on hand and working capital to satisfy upcoming requirements, including any funds that may be needed in connection with the going-private transaction.

The Company does not have any off-balance sheet financing or similar arrangements.

Inventory levels continued to decline as management continued to engage its efforts to reduce the overall amount of inventory on hand, both through the use of more effective inventory control techniques, as well as a more thorough phasing out of old, obsolete or slow moving items. Overall, accounts payable and accrued expenses had decreased $542,000 as of December 31, 2002, when compared to the end of 2001, which decrease was largely the result of a decrease in accounts payable to vendors as well as a decline in accrued payroll due to the timing of year end payments.

The Company has not experienced any material adverse impact from the

effects of inflation in the last several years. Management maintains some flexibility to increase prices and does not have any binding contract pricing with either customers or vendors. Many of the Company's products, as well as the components used, are petroleum-based products, and as a result, the prices for raw materials are and will continue to be subject to oil prices which, in turn, are subject to various political or economic pressures. The Company does not presently foresee any material increase in the costs of raw materials or component costs, and believes it has the flexibility of calling upon multiple vendors and the ability to increase prices to offset any price changes.

NEW FINANCIAL ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." These standards made changes to the accounting for business combinations, goodwill and intangible assets. SFAS No. 141 requires all business combinations entered into subsequent to June 30, 2001 to be accounted for using the purchase method of accounting. SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives not be amortized, but be tested for impairment at least annually. SFAS No. 142 is effective for years beginning after December 15, 2001. Goodwill and intangible assets acquired subsequent to June 30, 2001 are immediately subject to the provisions of SFAS No. 142. The Company adopted SFAS No. 142 on January 1, 2002 and, as a result of impairment testing required under SFAS No. 142, the Company reduced the carrying value of certain goodwill and trademarks by approximately $8,424,000 ($6,762,000, net of taxes).

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes, but does not replace, SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and For Long-Lived Assets to be Disposed Of", as well as other earlier related pronouncements, either in whole or in part. SFAS No. 144

18

is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with earlier application is encouraged. The adoption of this statement did not have a significant effect on the Company's financial position, results of operations or cash flows.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements 4, 44 and 64, Amendment to FASB Statement 13, and Technical Corrections". One of the major changes of this Statement is to change the accounting for the classification of gains and losses from the extinguishment of debt. Currently, the Company does not have any circumstances that would make this Statement relevant.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". This Statement requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before a liability has been actually incurred. Adoption of this Statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Currently, the Company does not have any existing circumstances that would make this Statement relevant.

In November 2002, the FASB issued FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of SFAS Nos. 5, 57 and 107 and rescission of FASB Interpretation No. 34. The interpretation requires certain disclosures to be made by a guarantor about its obligations under certain guarantees that is issued. The Company does not have existing circumstances that would make this Interpretation relevant.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," an amendment of FASB Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the disclosure provisions of SFAS No. 148.

In January 2003, the FASB issued Financial Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 provides accounting guidance for consolidating of off-balance sheet entities with certain characteristics (variable interest entities). The consolidation requirements apply to variable interest entities created after January 31, 2003 and to variable interest entities in which the Company maintains an interest after June 30, 2003. The Company does not have existing circumstances that would make this statement relevant.

19

RECENT EVENTS

As previously reported, on April 16, 2002, the Company announced that the previously-formed Special Committee (consisting of two outside directors) had accepted a bid by a management led group. This initial bid was to purchase all of the Company's common stock at $4 per share in cash, which offer was later revised to $4.50 per share with $3.25 to be paid in cash, and $1.25 to be paid by a 42-month, unsecured debt instrument providing for interest at an annual rate of 4 1/2%. A separate payment fund, in an amount equal to 50% of the aggregate principal and interest amount due under the debt instrument, will be established by the management group to fund its payment obligations thereunder. The management group bid is subject to various conditions, including obtaining adequate financing. The management group is currently negotiating with lenders to obtain financing necessary for the transaction. There is no assurance that the group will be able to obtain such financing on acceptable terms or that the transaction will be consummated.

In late 2001 and during 2002 the Special Committee received from Curtis Rudolph, a shareholder of the Company, an indication of his interest in acquiring the Company; however, no offer was forthcoming. In November 2002, Mr. Rudolph initiated an action in Florida state court (Broward County, Florida) seeking to obtain a review of certain "books and records" of the Company to which he claimed he was entitled as a shareholder of the Company (See Item 3. Legal Proceedings). The Company had previously denied him access to those books and records due to his unwillingness to sign a non-disclosure agreement relating to the Company's non-public information in the standard form required of other potential bidders for the Company. In

January 2003, pursuant to a settlement agreement with the Company, Mr. Rudolph agreed to execute the non-disclosure agreement.

By letter dated January 13, 2003, Mr. Rudolph reiterated his interest in making a proposal to acquire the Company. On or about February 14, 2003, Mr. Rudolph submitted an unexecuted proposal to acquire substantially all of the assets and assume certain liabilities of the Company. The Special Committee rejected this proposal as it was unexecuted, contained certain unacceptable terms, was subject to unacceptable conditions, and was structured as an asset purchase rather than a stock purchase. In particular, the asset purchase structure presented substantial negative tax consequences to the Company and its shareholders and was deemed impractical. Under the circumstances, the Special Committee determined Mr. Rudolph's proposal to not be in the best interests of the Company's shareholders. The Board of Directors, through its Special Committee, has continued to negotiate with Mr. Rudolph, but no further offer has been forthcoming.

CURRENT TRENDS

The Company has had a broad-based increase in net sales for the first quarter of 2003, primarily as a result of the current war in the Middle East and the impact it is having on net sales of Quinsana Medicated Talc, a

branded retail item. Quinsana is experiencing a significant increase in net sales and as a result, net sales for this brand in the first quarter of 2003 were in excess of total net sales for this product for the entire prior year. Net sales is anticipated to be over 10% higher than the corresponding first quarter of 2001. There can be no assurances, however, that this trend will continue, nor that continuing market pricing pressures will not arise with respect to these sales.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates if different assumptions were used or different events ultimately transpire. We believe that the following are the most critical accounting policies that requires management to make difficult, subjective and/or complex judgments, often due to a need to make estimates about matters that are inherently uncertain:

VALUATION OF ACCOUNTS RECEIVABLE: The ultimate amount of collections received against outstanding accounts receivable must take into account returns, allowances and deductions that may be made by our customers. Many retailers to whom we sell products take deductions for various forms of marketing expenses, as well as participating in nationwide reclamation cooperatives for processing damaged goods. Other expenses to which we are subject to, in addition to those experienced in the retail environment (but also with Professional products sold to distributors) include deductions for freight if the invoice is paid within specified terms, co-op

advertising allowances, new store/warehouse allowances and, from time to time, limited rebate programs. We attempt to estimate these costs, as well as providing for anticipated bad debts, by recording allowances based upon our experience, economic conditions, normal customer inventory levels and/or competitive conditions. Actual returns, credits or allowances, as well as the condition of any product actually returned, may differ significantly from the estimates used by the Company.

INVENTORIES: Inventories are stated at the lower of cost, determined by the first-in, first-out (FIFO) method, or market. We periodically evaluate inventory levels, giving consideration to factors such as the physical condition of the goods, the sales patterns of finished goods and the useful life of particular packaging, componentry and finished goods and estimates a reasonable amount to be provided for slow moving, obsolete or damaged inventory. These estimates could vary significantly, either favorably or unfavorably, from actual requirements based upon future economic conditions, customer inventory levels or competitive factors that were not foreseen or did not exist when the valuation allowances were established.

IMPAIRMENT OF LONG-LIVED ASSETS AND GOODWILL: The Company periodically evaluates whether events or circumstances have occurred that would indicate that long-lived assets may not be recoverable or that the remaining useful life may be impaired. When such events or circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected future cash flows resulting from the use of the asset. If the results of this testing indicates an impairment of the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of its cash inflows and outflows several years into the future and only takes into consideration circumstances known at the time of the impairment test.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and other intangible assets are to be evaluated for impairment on an annual basis, and between annual tests, whenever events or circumstances indicate that the carrying value of an asset may exceed its fair value. The use of various acceptable and appropriate methods of valuation requires the use of long-term planning forecasts and assumptions regarding industry-specific economic conditions that are outside the control of the Company.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

The Company does not own or maintain an interest in derivative or other financial instruments for which fair value disclosure would be required under Statement of Financial Accounting Standards No. 107. In addition, the Company does not invest in securities that would require disclosure of market risk, nor does it have floating rate loans or foreign currency exchange rate risks.

Item 8. Financial Statements and Supplementary Data

Reference is made to the consolidated financial statements and supplementary data contained elsewhere in this Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

The information required by Part III of this Form 10-K (Items 10-13) is incorporated herein by reference from the Registrant's proxy statement with respect to the Company's 2003 annual meeting of stockholders scheduled to be filed with the Securities and Exchange Commission no later than April 30, 2003.

Item 14: Controls and Procedures

As of a date within 90 days of the filing date of this annual report, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was performed under the supervision and with the participation of the Company's management, including the chief executive officer and principal financial officer. Based on that evaluation, the Company's management, including the chief executive officer and chief financial officer, concluded that the Company's disclosure controls and procedures were effective as of the evaluation date. Subsequent to the evaluation date, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls.

23

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Exhibits

10.1 Acquisition Agreement, dated December 31, 1995, between Colgate-Palmolive Company and The Stephan Co., with exhibits, including the Transition Agreement, included with the Form 8-K filed January 16, 1996, and as amended on January 22, 1996, is incorporated herein by reference.

10.2 Acquisition Agreement, dated December 31, 1995, between The Mennen Company and The Stephan Co., with exhibits, included with the Form 8-K filed January 16, 1996 and as amended on January 22, 1996, is incorporated herein by reference.

10.3 Letter agreement, dated December 31, 1995, between Colgate-Palmolive Company, The Mennen Company and The Stephan Co., included with the Form 8-K filed January 16, 1996 and as amended on January 22, 1996, is incorporated herein by reference.

10.4 Settlement Agreement and Amendment, dated December 5, 1996, between The Stephan Co., The Mennen Company and Colgate-Palmolive Company, included with the Form 10-K filed April 15, 1997, is incorporated herein by reference.

10.5 The Trademark License Agreement, dated December 5, 1996, between Colgate-Palmolive Canada, Inc. and The Stephan Co., included with the Form 10-K filed April 15, 1997, is incorporated herein by reference.

10.6 Trademark License and Supply Agreement, dated March 7, 1996, between Color Me Beautiful, Inc. and The Stephan Co., included with the Form 8-K filed March 20, 1996, is incorporated herein by reference.

10.7 Agreement, dated June 28, 1996, for the acquisition of Sorbie Acquisition Co. and Subsidiaries, with exhibits, included with the Form 8-K filed July 15, 1996, and as such was amended on August 21, September 16 and October 9, 1996, is incorporated herein by reference.

10.8 Amended and Restated Sorbie Products Agreement, dated June 27, 1996, among Sorbie Acquisition Co., Sorbie Trading Limited, Trevor Sorbie International, PLC and Trevor Sorbie, included with the Form 8-K/A filed August 21, 1996, is incorporated herein by reference.

10.9 Settlement Agreement and Amendment, dated December 5, 1996, between The Stephan Co., The Mennen Company and Colgate-Palmolive Company, included with the Form 10-K for the year ended December 31, 1996,

filed April 15, 1997, is incorporated herein by reference.

10.10 Trademark License and Supply Agreement, dated March 7, 1996, between Color Me Beautiful, Inc. and The Stephan Co., included with the Form 8-K filed March 20, 1996, is incorporated herein by reference.

24

10.11 Acquisition Agreement, dated as of May 23, 1997, between New Image Laboratories, Inc., The Stephan Co. and Stephan Distributing, Inc., in connection with the acquisition of brands, included with the Form 10-Q for the period ended June 30, 1997, filed August 13, 1997, is incorporated herein by reference.

10.12 Acquisition Agreement, dated as of March 18, 1998, between Morris Flamingo-Stephan, Inc., The Stephan Co., Morris-Flamingo, L.P., Morris-Flamingo Beauty Products, Inc., Shaheen & Co., Inc. and Shouky A Shaheen, included with the Form 10-Q for the period ended June 30, 1998, filed May 15, 1998, is incorporated herein by reference.

10.13 1990 Key Employee Stock Incentive Plan, as amended.

10.14 1990 Non-Employee (Outside Directors) Plan, as amended.

99.1 Chief Executive Officer Certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

99.2 Chief Financial Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Financial Statements and Financial Statement Schedules

(i) Financial Statements

Independent Auditors' Report.

Consolidated Balance Sheets as of December 31, 2002 and 2001.

Consolidated Statements of Operations for the years ended December 31, 2002, 2001, and 2000.

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2002, 2001, and 2000.

Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001, and 2000.

Notes to Consolidated Financial Statements.

(ii) Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders
of The Stephan Co.:

We have audited the accompanying consolidated balance sheets of The Stephan Co. and subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 5 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets in 2002 to conform to Statement of Financial Accounting Standards No. 142.

DELOITTE & TOUCHE LLP
Certified Public Accountants

Miami, Florida
April 11, 2003

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

ASSETS

	2002	2001
CURRENT ASSETS		
Cash and cash equivalents	$10,785,995	$ 8,409,142
Accounts receivable, net	1,451,299	1,808,828
Inventories	7,623,764	9,286,295
Income taxes receivable	65,378	345,220
Prepaid expenses and other current assets	357,829	266,460
TOTAL CURRENT ASSETS	20,284,265	20,115,945
CERTIFICATES OF DEPOSIT	6,752,500	7,585,000
PROPERTY, PLANT AND EQUIPMENT, net	2,004,465	2,308,003
INTANGIBLE ASSETS, net	14,914,154	23,432,105
OTHER ASSETS	3,699,657	3,621,103
TOTAL ASSETS	$47,655,041	$57,062,156

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

LIABILITIES AND STOCKHOLDERS' EQUITY

	2002	2001
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,018,236	$2,560,051
Current portion of long-term debt	1,496,147	1,507,256
TOTAL CURRENT LIABILITIES	3,514,383	4,067,307
DEFERRED INCOME TAXES, net	655,773	1,535,285
LONG-TERM DEBT, less current maturities	6,395,443	7,758,370
TOTAL LIABILITIES	10,565,599	13,360,962
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value; 25,000,000 shares authorized; 4,410,577 issued at December 31, 2002 and 2001	44,106	44,106
Additional paid in capital	18,417,080	18,417,080
Retained earnings	19,979,819	26,591,571
	38,441,005	45,052,757
LESS: 125,000 CONTINGENTLY RETURNABLE SHARES	(1,351,563)	(1,351,563)
TOTAL STOCKHOLDERS' EQUITY	37,089,442	43,701,194
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$47,655,041	$57,062,156

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

	2002	2001	2000
NET SALES	$25,066,950	$28,296,312	$31,137,782
COST OF GOODS SOLD	15,206,352	16,243,428	18,506,860
GROSS PROFIT	9,860,598	12,052,884	12,630,922
SELLING, GENERAL AND			

ADMINISTRATIVE EXPENSES	8,509,114	11,363,190	11,652,923
OPERATING INCOME	1,351,484	689,694	977,999
OTHER INCOME(EXPENSE)			
Interest income	378,441	579,866	724,728
Interest expense	(479,125)	(698,207)	(871,853)
Royalty income	148,750	175,000	175,000
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	1,399,550	746,353	1,005,874
INCOME TAX EXPENSE	896,880	138,398	383,647
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	502,670	607,955	622,227
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET OF TAX BENEFIT OF $1,662,911	(6,761,576)	-	-
NET (LOSS)/INCOME	$(6,258,906)	$ 607,955	$ 622,227
BASIC AND DILUTED (LOSS)/ EARNINGS PER SHARE:			
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	.12	.14	.14
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(1.58)	-	-
BASIC AND DILUTED (LOSS)/ EARNINGS PER SHARE	$ (1.46)	$ .14	$ .14
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,285,577	4,285,577	4,385,019

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

	Common Stock		Additional Paid in Capital	Retained Earnings	Contingently Returnable Shares	Treasury Stock
	Shares	Par Value				
Balances, Jan. 1, 2000	4,660,958	$ 46,610	$19,404,559	$26,075,919	$(1,351,563)	$(326,734)
Treasury stock purchased	-	-	-	-	-	(663,249)
Treasury stock						

retired	(234,061)	(2,341)	(927,218)	-	-	929,559
Dividends paid	-	-	-	(361,683)	-	-
Net income	-	-	-	622,227	-	-
Balances, Dec. 31, 2000	4,426,897	44,269	18,477,341	26,336,463	(1,351,563)	(60,424)
Treasury stock retired	(16,320)	(163)	(60,261)	-	-	60,424
Dividends paid	-	-	-	(352,847)	-	-
Net income	-	-	-	607,955	-	-
Balances, Dec. 31, 2001,	410,577	44,106	18,417,080	26,591,571	(1,351,563)	-
Dividends paid	-	-	-	(352,846)	-	-
Net loss	-	-	-	(6,258,906)	-	-
Balances, Dec. 31, 2002	4,410,577	$ 44,106	$18,417,080	$19,979,819	$(1,351,563)	$ -

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss)/income	$(6,258,906)	$ 607,955	$ 622,227
Adjustments to reconcile net (loss)/ income to net cash flows provided by/(used in) operating activities:			
Depreciation	333,632	394,556	423,077
Amortization of intangibles	93,464	1,353,568	1,190,232
Amortization of other assets	-	146,137	102,014
Deferred income tax (benefit)/provision	(879,512)	(142,520)	234,855

Provision for doubtful accounts	80,725	131,164	97,627
Impairment loss on goodwill	8,424,487	-	-
Changes in operating assets and liabilities:			
Accounts receivable	276,804	1,086,561	(230,565)
Inventories	1,662,531	1,091,556	1,576,340
Income taxes receivable	279,842	682,892	(898,972)
Prepaid expenses and other current assets	(91,369)	(59,399)	83,949
Certificates of deposit	832,500	(7,585,000)	-
Other assets	(78,554)	(551,392)	14,846
Accounts payable and accrued expenses	(541,815)	(441,669)	1,145,051
Total adjustments	10,392,735	(3,893,546)	3,738,454
Net cash flows provided by/(used in) operating activities	4,133,829	(3,285,591)	4,360,681

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

	2002	2001	2000
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment	(30,094)	(85,038)	(140,879)
Purchase of intangible assets	-	(49,070)	(71,096)
Net cash flows used in investing activities	(30,094)	(134,108)	(211,975)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayments of long-term debt	(1,374,036)	(9,517,580)	(1,643,710)
Proceeds from notes payable to bank	-	8,140,000	-
Acquisition of treasury stock	-	-	(663,249)

Dividends paid	(352,846)	(352,847)	(361,683)
Net cash flows used in financing activities	(1,726,882)	(1,730,427)	(2,668,642)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	2,376,853	(5,150,126)	1,480,064
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	8,409,142	13,559,268	12,079,204
CASH AND CASH EQUIVALENTS, END OF PERIOD	$10,785,995	$ 8,409,142	$13,559,268

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

Supplemental Disclosures of Cash Flow Information:

	2002	2001	2000
Interest paid	$ 448,650	$ 651,533	$ 809,804
Income taxes paid	$ 212,324	$ 100,614	$1,422,013

Supplemental Disclosure of Non-Cash Investing and Financing Activities:

For the year ended December 31, 2000, equipment costing $99,340 was purchased from a customer and the purchase price was applied against the outstanding account receivable.

For the years ended December 31, 2001 and 2000, 16,320 and 234,061 shares of treasury stock, respectively, were retired.

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of The Stephan Co. and its wholly-owned subsidiaries, Foxy Products, Inc., Old 97 Company, Williamsport Barber and Beauty Supply Corp., Stephan & Co., Scientific Research Products, Inc. of Delaware, Trevor Sorbie of America, Inc., Stephan Distributing, Inc. and Morris Flamingo-Stephan, Inc. (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS: The Company is engaged in the manufacture, sale, and distribution of hair and personal care grooming products principally throughout the United States. Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," requires the reporting of segment information using a "management approach" as it relates to the operating segments of a business. As explained more fully in Note 9, the Company has allocated substantially all of its business into three segments, which include professional hair care products and distribution, retail personal care products and manufacturing.

USE OF ESTIMATES: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

MAJOR CUSTOMERS: There were no sales to any single customer in excess of 10% of net sales in 2002. The Company performs ongoing credit

evaluations of its customers' financial condition and, generally, requires no collateral. The Company does not believe that its customers' credit risk represents a material risk of loss to the Company. However, the loss of a large customer could have an adverse effect on the Company.

GOODWILL and OTHER INTANGIBLE ASSETS: Goodwill is the excess of the purchase price over the fair value of identifiable assets acquired in transactions accounted for as a purchase. The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002. Goodwill and trademarks having indefinite lives, which were being amortized over various periods, are no longer being amortized and in accordance with SFAS No. 142, are now subject to periodic testing for impairment. Deferred acquisition costs that have definite lives are continuing to be amortized over their estimated useful lives of 10 years. Goodwill and trademarks of a reporting unit (as defined in SFAS No. 142) are tested for impairment on an annual basis at a minimum, or as circumstances dictate. As a result of

implementing SFAS No. 142, the Company incurred a $6,762,000 impairment charge (net of an income tax benefit of $1,663,000) in 2002.

IMPAIRMENT OF LONG-LIVED ASSETS: Long-lived assets are reviewed for impairment whenever events or changes in circumstances warrant, which may be an indication that the carrying value of the asset may ultimately be unrecoverable. The Company uses fair value methods to determine the amount of impairment, if any. If necessary, an impairment loss equal to the difference between the asset's fair value and its carrying value is recognized.

STOCK-BASED COMPENSATION: SFAS No. 123, "Accounting for Stock-Based Compensation", permits entities to recognize as an expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 allows entities to continue to measure compensation cost for stock-based awards using the intrinsic value based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and to provide pro forma net income and pro forma earnings per share disclosures as if the fair value method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123. There were no stock based compensation charges in operations during 2002, 2001 or 2000.

The following table illustrates the effect on net (loss)/income and net loss)/income per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share data):

	2002	2001	2000
Net (loss)/income, as reported	$ (6,259)	$ 608	$ 622
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	65	76	318

Pro forma net (loss)/income	$ (6,324)	$ 532	$ 304
Net (loss)/income per share:			
As reported	$(1.46)	$ .14	$ .14
Pro forma	$(1.48)	$ .12	$ .07

F-10

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FAIR VALUE OF FINANCIAL INSTRUMENTS: SFAS No. 107, "Disclosure about Fair Value of Financial Instruments," requires disclosure of the fair value of financial instruments, both assets and liabilities, recognized and not recognized in the consolidated balance sheets of the Company, for which it is practicable to estimate fair value. The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and recognized valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market sale of such instrument.

The following methods and assumptions were used to estimate fair value:

- the carrying amounts of cash and cash equivalents, receivables and accounts payable approximate fair value due to their short term nature;

- discounted cash flows using current interest rates for financial instruments with similar characteristics and maturity were used to determine the fair value of notes payable and debt.

As of December 31, 2002 and 2001 there were no significant differences in the carrying values and fair market values of financial instruments.

REVENUE RECOGNITION: Revenue is recognized when all significant contractual obligations have been satisfied, which involves the delivery of manufactured goods and reasonable assurance as to the collectability of the resulting account receivable.

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, certificates of deposit, U. S. Government issues, and 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 federally insured limits of $100,000. Cash and cash equivalents held in interest-bearing accounts as of December 31, 2002 and 2001 were approximately $10,121,000 and $7,257,000, respectively. At December 31, 2002 and 2001, the Company excluded certificates of deposit in the amount of $6,752,500 and $7,585,000, respectively, from the above as they are pledged as collateral for a bank loan.

INVENTORIES: Inventories are stated at the lower of cost (determined on the first-in, first-out basis) or market. Direct labor and overhead costs charged to inventories for the years ended December 31, 2002 and 2001 were approximately $2,614,000 and $2,838,000, respectively. Direct

labor and overhead costs capitalized in inventories as of December 31, 2002 and 2001 were approximately $1,257,000 and $1,443,000, respectively.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

PROPERTY, PLANT AND EQUIPMENT: Property, plant and equipment are recorded at cost. Routine repairs and maintenance are expensed as incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	15-30 years
Machinery and equipment	5-10 years
Furniture and office equipment	3-5 years

INCOME TAXES: Income taxes are calculated under the asset and liability method of accounting. Deferred income taxes are recognized by applying the enacted statutory rates applicable to future year differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. A valuation allowance is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net income/(loss) by the weighted average number of shares of common stock outstanding. For the years ended December 31, 2002, 2001 and 2000, the Company had 672,120, 743,648 and 739,524 outstanding stock options, respectively. None of these options were included in the calculation of earnings per share because their inclusion would be anti-dilutive.

NEW FINANCIAL ACCOUNTING STANDARDS: In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". These standards made changes to the accounting for business combinations, goodwill and intangible assets. SFAS No. 141 requires all business combinations entered into subsequent to June 30, 2001 to be accounted for using the purchase method of accounting. SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment at least annually. SFAS No. 142 is effective for years beginning after December 15, 2001. Goodwill and intangible assets acquired subsequent to June 30, 2001 are immediately subject to the provisions of SFAS No. 142. The Company adopted SFAS No. 142 on January 1, 2002. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level upon adoption and at least annually thereafter. The initial step requires that the Company determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of the reporting unit. If the fair value exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the reporting unit may be impaired. The amount, if any, of the impairment would then be measured in the second step (See Note 5).

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes, but does not replace, SFAS No. 121, "Accounting for the Impairment of Long-Lived

Assets and for Long-Lived Assets to be Disposed Of", as well as other earlier related pronouncements, either in whole or in part. SFAS No. 144 is

effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The adoption of this statement did not have a significant effect on the Company's financial position, results of operations or cash flows.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements 4, 44 and 64, Amendment to FASB Statement 13, and Technical Corrections". One of the major changes of this Statement is to change the accounting for the classification of gains and losses from the extinguishment of debt. Currently, the Company does not have any circumstances that would make this Statement relevant.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". This Statement requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before a liability has been actually incurred. Adoption of this Statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Currently, the Company does not have any existing circumstances that would make this Statement relevant.

In November 2002, the FASB issued FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of SFAS Nos. 5, 57 and 107 and rescission of FASB Interpretation No. 34. The interpretation requires certain disclosures to be made by a guarantor about its obligations under certain guarantees that is issued. The Company does not have existing circumstances that would make this Interpretation relevant.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," an amendment of FASB Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the disclosure provisions of SFAS No. 148.

In January 2003, the FASB issued Financial Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 provides accounting guidance for consolidating of off-balance sheet entities with certain characteristics (variable interest entities). The consolidation requirements apply to variable interest entities created after January 31, 2003 and to variable interest entities in which the Company maintains an interest after June 30, 2003. The Company does not have existing circumstances that would make this Statement relevant.

NOTE 2. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2002 and 2001 consisted of the following:

	2002	2001
Trade accounts receivable	$1,614,580	$1,961,053
Less: Allowance for doubtful accounts	(163,281)	(152,225)
Accounts receivable, net	$1,451,299	$1,808,828

The following is an analysis of the allowance for doubtful accounts for the year ended December 31:

	2002	2001	2000
Balance, beginning of year	$ 152,225	$ 105,002	$ 125,846
Provision for doubtful accounts	80,725	131,164	97,627
Uncollectible accounts written off, net of recoveries	(69,669)	(83,941)	(118,471)
Balance, end of year	$ 163,281	$ 152,225	$ 105,002

NOTE 3. INVENTORIES

Inventories at December 31, 2002 and 2001 consisted of the following:

	2002	2001
Raw materials	$ 2,162,273	$ 3,180,670
Packaging and components	3,100,917	3,448,541
Work in progress	328,976	341,507
Finished goods	5,579,290	5,502,599
	11,171,456	12,473,317
Less: Amount included in other assets	(3,547,692)	(3,187,022)
Balance, end of year	$ 7,623,764	$ 9,286,295

Raw materials include surfactants, chemicals and fragrances used in the production process. Packaging materials include cartons, inner sleeves and boxes used in the actual product, as well as outer boxes and cartons used for shipping purposes. Components are the bottles or containers (plastic or glass), jars, caps, pumps and similar materials that will become part of the finished product. Finished goods also include hair dryers, electric clippers, lather machines, scissors and salon furniture. Included in other assets is inventory not anticipated to be utilized within one year.

F-14

NOTE 4. PROPERTY, PLANT, AND EQUIPMENT

Property, plant and equipment at December 31, 2002 and 2001 consisted of the following:

	2002	2001

Land	$ 379,627	$ 379,627
Buildings and improvements	2,129,570	2,094,046
Machinery and equipment	1,934,774	1,950,866
Furniture and office equipment	526,762	554,948
	4,970,733	4,979,487
Less: accumulated depreciation	(2,966,268)	(2,671,484)
Balance, end of year	$2,004,465	$2,308,003

NOTE 5. INTANGIBLE ASSETS

Intangible assets at December 31, 2002 and 2001 consisted of the following:

	2002	2001
Goodwill	$ 8,311,359	$10,932,135
Trademarks	13,370,762	19,117,395
Deferred acquisition costs	964,529	1,021,607
	22,646,650	31,071,137
Less: accumulated amortization	(7,732,496)	(7,639,032)
Balance, end of year	$14,914,154	$23,432,105

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment at least annually. The Company adopted SFAS No. 142 on January 1, 2002. SFAS No. 142 requires that goodwill and other intangible assets be tested for impairment upon adoption and at least annually thereafter.

As a result of the impairment review mandated by SFAS No. 142, the Company determined that the carrying value of certain goodwill and other intangible assets with indefinite lives was impaired, decreasing the carrying value of goodwill and other such intangible assets by approximately $8,424,000 ($6,762,000, net of taxes).

The above impairment charge impacted several different subsidiaries and divisions. Based upon information available to the Company, in general, goodwill and trademark valuations were performed using present value techniques involving estimates of future cash flows. The changes

NOTE 5. INTANGIBLE ASSETS (Continued)

in the carrying amount of goodwill and trademarks, by segment impacted, for the year ended December 31, 2002 can be summarized as follows (in thousands, except per share data):

	Total	Professional	Retail

Balance, December 31, 2001	$ 31,071	$ 12,796	$ 18,275
Goodwill and trademark impairment for 2002	(8,424)	(3,440)	(4,984)
Balance, December 31, 2002	$ 22,647	$ 9,356	$ 13,291

Amortization of goodwill and other intangible assets ceased upon adoption of SFAS No. 142 on January 1, 2002. The table below reflects the impact of the implementation of SFAS No. 142 for the years ended December 31, 2002, 2001 and 2000 (in thousands, except per share data):

	2002	2001	2000
Income before cumulative effect of change in accounting principle (as reported)	$ 503	$ 608	$ 622
After tax goodwill amortization	-	1,026	682
Adjusted income before cumulative effect of change in accounting principle	$ 503	$1,634	$1,304
Income per share before cumulative effect of change in accounting principle (as reported) (basic and diluted)	$ .12	$ .14	$ .14
Pro forma basic and diluted earnings per share before cumulative effect of change in accounting principle	$ .12	$ .38	$ .30

Amortization expense for other intangible assets, recorded as of December 31, 2002, 2001 and 2000 was $93,000, $98,000 and $88,000. Amortization expense for other intangible assets, recorded as of December 31, 2002, for the years ended December 31, 2003 through 2007 is anticipated to be as follows: 2003: $93,000; 2004: $84,000; 2005: $82,000; 2006: $66,000; 2007: $66,000.

F-16

NOTE 6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2002 and 2001 consisted of the following:

	2002	2001
Accounts payable	$ 486,262	$ 824,864
Accrued marketing expenses	673,125	613,166
Accrued payroll and bonuses	272,254	651,877
Accrued legal and professional fees	285,401	249,479
Other accrued expenses	301,194	220,665
Balance, end of year	$ 2,018,236	$ 2,560,051

NOTE 7. LONG-TERM DEBT

Long-term debt at December 31, 2002 and 2001 consisted of the following:

	2002	2001
2.66% note payable to bank, principal of $92,500 plus interest due monthly through August 2, 2006; collateralized by a security interest in a certificate of deposit of like amount, which bears interest at 50 basis points below the interest charged on the note.	$ 6,567,500	$ 7,677,500
Guaranteed minimum payments of $250,000 due semi-annually to Colgate-Palmolive through January 31, 2004, discounted at an 8% rate; collateralized by a security interest in the brand trade-marks acquired from Colgate-Palmolive, with a net carrying value of approximately $7,300,000.	1,324,090	1,588,126
	7,891,590	9,265,626
Less: current portion	(1,496,147)	(1,507,256)
Long-term debt	$ 6,395,443	$ 7,758,370

At December 31, 2002, approximate maturities of long-term debt are $1,496,000 in 2003, $2,048,000 in 2004, $1,110,000 in 2005 and $3,237,000 in 2006.

NOTE 8. INCOME TAXES

The (benefit)/provision for income taxes is comprised of the following for the years ended December 31:

	2002	2001	2000
Current Tax:			
Federal	$ -	$ 213,843	$ 162,680
State	113,482	67,075	(13,888)
Total Current	113,482	280,918	148,792
Deferred Tax:			
Federal	703,396	(83,715)	181,917
State	80,002	(58,805)	52,938
Total Deferred	783,398	(142,520)	234,855

Total provision for income taxes	$ 896,880	$ 138,398	$ 383,647

The tax benefit of $1,663,000 resulting from the cumulative effect of a change in accounting principle is deferred in its entirety and is reduced by the current year's tax provision of $897,000, resulting in a net tax benefit for the year ended December 31, 2002 of $766,000.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

The net deferred income tax liability in the accompanying consolidated balance sheets includes deferred tax assets and liabilities attributable to the following items:

	2002	2001
Net operating losses	$ (105,900)	
Accounts receivable allowances	(64,496)	$ (60,129)
Property, plant and equipment	68,758	101,792
Amortization of intangibles	984,776	2,048,920
Charitable contribution carryforward	(268,359)	(282,793)
State income taxes	(34,912)	(83,162)
Accrued liabilities and other	(192,453)	(189,343)
	387,414	1,535,285
Valuation allowance	268,359	-
Deferred income tax liability, net	$ 655,773	$ 1,535,285

NOTE 8. INCOME TAXES (Continued)

The provision for Federal and state income taxes differs from statutory tax expense (computed by applying the U.S. Federal corporate tax rate to income before taxes) as follows:

	2002	2001	2000
Amount computed on pretax income	35.0%	35.0%	35.0%
Increase(decrease) in taxes:			
State income taxes, net of federal tax benefit	9.1	.7	2.6
Change in valuation allowance	19.2	-	-
Goodwill	.2	16.8	7.1
Benefit of graduated rates	(1.0)	(1.0)	(1.0)
Tax exempt interest	(1.8)	(3.3)	(4.0)
Other	3.3	(29.7)	(1.6)
Total income tax	64.0%	18.5%	38.1%

For the year ended December 31, 2002, the tax provision was increased by approximately $268,000 in order to provide for the likelihood that the Company's charitable contribution carryforward will expire unused.

For the year ended December 31, 2001, the tax provision was reduced by approximately $210,000 due to a reduction for tax liabilities which are no longer required.

NOTE 9. SEGMENT INFORMATION

In accordance with the guidelines established by SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company has identified three reportable operating segments based upon how management evaluates its business. These segments are Professional Hair Care Products and Distribution ("Professional"), Retail Personal Care Products ("Retail") and Manufacturing. The Professional segment generally has a customer base of distributors that purchase the Company's hair products and beauty and barber supplies for sale to salons and barbershops. The customer base for the Retail segment is mass merchandisers, chain drug stores and supermarkets that sell the product to the end user. The Manufacturing segment manufactures products for subsidiaries of the Company, and manufactures private label brands for customers.

The Company conducts operations primarily in the United States and sales to international customers are not material to consolidated revenues. The following tables, in thousands, summarize significant accounts and balances by reportable segment:

NOTE 9. SEGMENT INFORMATION (Continued)

	NET SALES			INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE		
	2002	2001	2000	2002	2001	2000
Professional	$17,891	$19,752	$20,393	$ 1,081	$ 379	$ 1,011
Retail	6,728	6,496	8,969	885	596	1,265
Manufacturing	7,144	9,358	8,330	(29)	325	(621)
Total	31,763	35,606	37,692	1,937	1,300	1,655
Intercompany Manufacturing	(6,696)	(7,310)	(6,554)	(537)	(554)	(649)
Consolidated	$25,067	$28,296	$31,138	$ 1,400	$ 746	$ 1,006

	INTEREST INCOME			INTEREST EXPENSE		
	2002	2001	2000	2002	2001	2000
Professional	$ 233	$ 316	$ 338	$ 270	$ 388	$ 387
Retail	95	150	310	201	292	465
Manufacturing	50	114	77	8	18	20
Total	$ 378	$ 580	$ 725	$ 479	$ 698	$ 872

	DEPRECIATION AND AMORTIZATION			TOTAL ASSETS	
	2002	2001	2000	2002	2001
Professional	$ 135	$ 941	$ 882	$15,284	$17,963
Retail	43	799	744	20,280	24,574
Manufacturing	249	154	89	12,091	14,525
Total	$ 427	$1,894	$1,715	$47,655	$57,062

The accounting policies used for each of the segments are the same as those used for the Company generally, and are described in the summary of significant accounting policies in Note 1. Included in Manufacturing net sales are intercompany sales to related segments, which are generally recorded at cost plus 10%. Management of the Company evaluates the performance of each segment based upon results of operations before income taxes, intercompany allocations, interest and amortization.

NOTE 10. COMMITMENTS AND CONTINGENCIES

The Company has entered into employment agreements with certain officers. These agreements, which expire on various dates through January 2006, provide for incentive bonuses based on consolidated income before taxes or earnings per share. No significant bonuses were paid in the years 2000 through 2002.

Annual rent payments due under non-cancelable operating leases at December 31, 2002 are:

2003	$ 209,600
2004	209,600
2005	104,800
	$ 524,000

Annual rent expense for each of the last three years is as follows:

2002	$600,800
2001	624,400
2000	579,300

Included in rent expense above for the years ended December 31, 2002, 2001 and 2000 is $179,000, $191,000 and $192,000, respectively, paid to Shaheen & Co., Inc., the former owner of Morris Flamingo. Shouky A. Shaheen, a minority owner of Shaheen & Co., Inc., is currently a member of the Board of Directors and a significant shareholder of the Company.

In addition to the matters set forth below, the Company is involved in other litigation arising in the normal course of business. It is the opinion of management that none of such matters, at December 31, 2002, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

The United States Court of Appeals for the Ninth Circuit entered an order on April 29, 2002 that, among other things, reversed the judgment of the United States District Court granting summary judgment in favor of New Image Laboratories, Inc. ("New Image") against the Company on New Image's contract claim for a price adjustment and on New Image's claim of breach of the implied covenant of good faith and fair dealing. In addition, the Ninth Circuit's opinion affirmed the lower court's ruling that on the present record New Image is not entitled to (i) damages equal to the diminution in the value of the Company's common stock price between the scheduled and actual disbursement dates or (ii) any attorney's fees. As a consequence of the Ninth Circuit's decision, the judgment granting New Image all 125,000 shares of the Company's common stock being held in escrow has been reversed and the case has been remanded back to the United States District Court for further proceedings. On May 28, 2002, New Image filed a Motion for Rehearing with the Ninth Circuit Court of Appeals and on June 26, 2002, the Court denied the petition for rehearing. A pretrial hearing has been scheduled for the early part of 2003 in connection with the remaining claims of the parties to the litigation.

On November 1, 2001, a private label customer filed a lawsuit against the Company alleging causes of action for breach of contract, declaratory judgment, and trademark infringement. The Company denied the allegations and has counter-sued the customer. The counterclaim seeks unspecified compensatory damages, interest, attorneys fees, costs and other relief on the breach of contract and anticipatory breach claims and, in excess of $400,000 on the account stated claim. At this time, the Company is unable to predict the outcome of this matter.

In November 2001, the Company filed a claim with the U.S. Department of Transportation ("DOT") in the 13th Judicial Circuit Court of Hillsborough County, Florida, in connection with the DOT's widening of Interstate Highway 4, which the Company alleged will result in the loss of an adjacent rental facility utilized by one of the Company's subsidiaries. At a hearing held on August 2, 2002, the Company was successful in asserting a position that would allow for damages to be paid to the Company by the DOT. The case has been scheduled for mediation in May 2003, where it is anticipated that the Company could receive a material damage award. After consultation with legal counsel at this time, the Company is presently unable to accurately predict the amount or type of recovery that will result therefrom.

In November 2002, a stockholder filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Joan Rosoff v. Frank F. Ferola, Shouky Shaheen, Leonard A. Genovese, Curtis Carlson, John DePinto, Thomas M. D'Ambrosio and The Stephan Co., Case Number 0222253, against the Company alleging certain breaches of fiduciary duties and responsibilities. The Company has filed a motion to dismiss the lawsuit. The Company believes it has meritorious defenses.

As previously reported, on April 16, 2002, the Company announced that the previously-formed Special Committee (consisting of two outside directors) had accepted a bid by a management led group. This initial bid was to purchase all of the Company's common stock at $4 per share in cash, which offer was later revised to $4.50 per share with $3.25 to be paid in cash, and $1.25 to be paid by a 42-month, unsecured debt instrument providing for interest at an annual rate of 4 1/2%. A separate payment fund, in an amount equal to 50% of the aggregate principal and interest

amount due under the debt instrument, will be established by the management group to fund its payment obligations thereunder. The management group bid is subject to various conditions, including obtaining adequate financing. The management group is currently negotiating with lenders to obtain financing necessary for the transaction. There is no assurance that the group will be able to obtain such financing on acceptable terms or that the transaction will be consummated.

In late 2001 and during 2002 the Special Committee received from Curtis Rudolph, a shareholder of the Company, an indication of his interest in acquiring the Company; however, no offer was forthcoming. In November 2002, Mr. Rudolph initiated an action in Florida state court (Broward County, Florida) seeking to obtain a review of certain "books and records" of the Company to which he claimed he was entitled as a shareholder of the

Company (See Item 3. Legal Proceedings). The Company had previously denied him access to those books and records due to his unwillingness to sign a non-disclosure agreement relating to the Company's non-public information in the standard form required of other potential bidders for the Company. In January 2003, pursuant to a settlement agreement with the Company, Mr. Rudolph agreed to execute the non-disclosure agreement.

By letter dated January 13, 2003, Mr. Rudolph reiterated his interest in making a proposal to acquire the Company. On or about February 14, 2003, Mr. Rudolph submitted an unexecuted proposal to acquire substantially all of the assets and assume certain liabilities of the Company. The Special Committee rejected this proposal as it was unexecuted, contained certain unacceptable terms, was subject to unacceptable conditions, and was structured as an asset purchase rather than a stock purchase. In particular, the asset purchase structure presented substantial negative tax consequences to the Company and its shareholders and was deemed impractical. Under the circumstances, the Special Committee determined Mr. Rudolph's proposal to not be in the best interests of the Company's shareholders. The Board of Directors, through its Special Committee, has continued to negotiate with Mr. Rudolph, but no further offer has been forthcoming.

Independent legal counsel and investment banking advisors were retained to advise the Special Committee in connection with the transaction. After incurring approximately $200,000 of expenses through December 31, 2002, it is estimated that the remaining costs associated with this process will be in excess of $450,000.

As a result of the length of time for the going private transaction to be consummated, the Company has not submitted any matters to a vote of its security holders since the Company's September 1, 2000 Annual Meeting. In accordance with the rules and regulations of the American Stock Exchange (AMEX), the Company was required to promptly notify its stockholders and AMEX, in writing, indicating the reasons for the failure to have a meeting and to use good faith efforts to ensure that an annual meeting is held as soon as reasonably practicable. In addition, the current composition of the Board of Directors and the current composition of the Audit Committee are in violation of AMEX rules. The continuing non-compliance with these AMEX rules could subject the Company to civil penalties, in addition to the possibility that the stock of the Company could be removed from listing.

NOTE 11. CAPITAL STOCK AND STOCK OPTIONS

1,000,000 shares of preferred stock, $0.01 par value are authorized; however, no shares have been issued.

In 1990, the shareholders of the Company approved the 1990 Key Employee Stock Incentive Plan, as amended, and the 1990 Non-Employee (Outside Directors) Plan, as amended, and in 2000, the shareholders approved a ten-year extension of both plans. The aggregate number of shares currently authorized pursuant to the Key Employee Plan, as adjusted for stock splits and shareholder-approved increases in 1994 and 1997, is

870,000 shares. The number of shares and terms of each grant is determined by the Compensation Committee of the Board of Directors, in accordance with the 1990 Key Employee Plan, as amended.

The Outside Directors Plan provides for annual grants, as adjusted for stock splits, of 5,062 shares to non-employee directors. Such grants are granted on the earlier of June 30 or the date of the Company's Annual Meeting of Shareholders, at the fair market value at the date of grant. The aggregate number of shares reserved for granting under this plan, as adjusted for stock splits, is 202,500.

Stock options are granted at the discretion of the Compensation Committee of the Board of Directors. The options become exercisable one year from the grant date and are exercisable within a maximum of 10 years from the date of grant. Stock option activity for 2002, 2001, and 2000 is set forth below:

	Key Employee Incentive Plan	Avg. Price	Outside Directors Plan	Avg. Price
Outstanding at December 31, 1999..	430,695	$15.17	75,930	$11.05
Granted..........................	268,075	3.87	20,248	4.50
Canceled.........................	(45,300)	9.02	(10,124)	15.50
Exercised........................	-		-	
Outstanding at December 31, 2000..	653,470	9.69	86,054	8.98
Granted..........................	70,000	3.00	20,248	3.05
Canceled.........................	(76,000)	14.78	(10,124)	15.75
Exercised........................	-		-	
Outstanding at December 31, 2001..	647,470	8.36	96,178	7.02
Granted..........................	70,000	3.00	20,248	3.67
Canceled.........................	(146,59			