STEPHAN CO
Form 10-Q
November 19, 2008

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

FORM 10-Q

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

For the quarterly period ended **September 30, 2008**

or

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

For the transition period from _____to______

Commission File Number 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)	(IRS 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

Former name, former address and former fiscal year, if changed since last report: not applicable.

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 such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

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

4,370,944 shares of common stock, $0.01 par value, as of November 10, 2008

THE STEPHAN CO. AND SUBSIDIARIES
INDEX TO QUARTERLY REPORT
ON FORM 10-Q

PART I – FINANCIAL INFORMATION

Item 1 - Financial Statements

Certain statements in this Quarterly Report on Form 10-Q ("Form 10-Q") under "Item 1. Financial Statements" and "Item 2. 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 our actual results, condition (financial or otherwise), performance or achievements to be materially different from any future results, performance, condition or achievements expressed or implied by such forward-looking statements.

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

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

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

The Stephan Co.
Condensed Consolidated Balance Sheets
(in thousands, except share data)

		September 30, 2008		December 31, 2007
CURRENT ASSETS				
Cash and cash equivalents	$	4,494	$	4,977
Short-term investments		3,150		3,950
Restricted cash		278		1,110
Accounts receivable, net		1,394		1,430
Inventories		5,536		4,240
Prepaid expenses and other current assets		364		306
TOTAL CURRENT ASSETS		15,216		16,013
Property, plant and equipment, net		1,436		1,419
Deferred income taxes		-		277
Trademarks, goodwill and other intangibles, net		6,744		5,749
Other assets		2,842		2,846
TOTAL ASSETS	$	26,238	$	26,304
CURRENT LIABILITIES				
Current portion of long-term debt	$	413	$	1,110
Accounts payable and accrued expenses		2,112		2,156
TOTAL CURRENT LIABILITIES		2,525		3,266
Long-term debt, less current portion		392		-
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY				
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued.				
Common stock, $.01 par value; 25,000,000 shares authorized; 4,389,771 shares issued at September 30, 2008 and December 31, 2007		44		44
Additional paid-in capital		17,796		17,736
Retained earnings		5,537		5,258
Treasury stock, 18,827 shares held at September 30, 2008, at cost		(56)		-
TOTAL STOCKHOLDERS' EQUITY		23,321		23,038
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$	26,238	$	26,304

See Notes to Consolidated Financial Statements.

Condensed Consolidated Statements of Operations
(in thousands, except share data)

	Quarter ended Sept. 30 2008	2007	Nine Months ended Sept. 30, 2008	2007
Revenue	**$ 5,420**	$ 5,600	**$ 14,129**	$ 15,747
Cost of revenue	**2,849**	2,960	**7,281**	8,491
Gross profit	**2,571**	2,640	**6,848**	7,256
Selling, general and administrative expenses	**2,194**	2,064	**6,130**	6,536
Operating income	**377**	576	**718**	720
Interest income	**36**	93	**193**	278
Interest expense	**(3)**	(6)	**(9)**	(20)
Income before income taxes	**410**	663	**902**	978
Provision for income taxes	**164**	260	**360**	389
NET INCOME	**$ 246**	$ 403	**$ 542**	$ 589
Basic income per share	**$ 0.06**	$ 0.09	$ 0.12	$ 0.13
Diluted income per share	**$ 0.06**	$ 0.09	$ 0.12	$ 0.13
Dividends per share	**$ 0.02**	$ 0.04	$ 0.06	$ 0.06

Note: Amounts for the third quarter and nine months of 2008 include results of operations of Bowman Barber and Beauty Supply, Inc. from August 14, the date of acquisition, to September 30, 2008. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

See Notes to Consolidated Financial Statements.

The Stephan Co.
Condensed Consolidated Statements of Cash Flows
(in thousands)

	Nine Months Ended Sept. 30, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
NET INCOME	$ **542**	$ 589
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	**87**	102
Stock option compensation	**60**	69
Deferred income taxes	**277**	321
Changes in operating assets & liabilities		
Accounts receivable	**76**	(124)
Inventories	**(1,089)**	(177)
Prepaid expenses and other current assets	**(50)**	(66)
Other assets	**4**	9
Accounts payable and accrued expenses	**(354)**	(81)
Total adjustments to net income	**(989)**	53
NET CASH FLOWS (USED IN) PROVIDED BY OPERATING ACTIVITIES	**(447)**	642
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of short-term investments	**800**	-
Acquisition of Bowman Beauty and Barber Supply, Inc. ("Bowman")	**(500)**	-
Purchases of property, plant and equipment	**(17)**	(16)
NET CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES	**283**	(16)
CASH FLOWS FROM FINANCING ACTIVITIES		
Decrease in restricted cash	**832**	836
Repayment of long-term debt	**(832)**	(832)
Purchases of treasury stock	**(56)**	-
Dividends	**(263)**	(263)
NET CASH FLOWS (USED IN) FINANCING ACTIVITIES	**(319)**	(259)
NET (DECRASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(483)**	367
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**4,977**	7,064
	$ **4,494**	$ 7,431

CASH AND CASH EQUIVALENTS AT END OF THIRD QUARTER				
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Interest paid	**$**	**12**	$	20
Income taxes paid	**$**	**-**	$	82
Note payable issued to former owner of Bowman and other liabilities assumed	**$**	**(528)**	$	-

See Notes to Consolidated Financial Statements.

The Stephan Co. And Subsidiaries
Notes To Condensed Consolidated Financial Statements
Quarters ended September 30, 2008 and 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS: The Company is engaged in the manufacture, sale and distribution of hair grooming and personal care products principally throughout the United States and has allocated substantially all of its business into two segments: Brands and Distributors.

BASIS OF PRESENTATION: In the opinion of management, the accompanying unaudited, interim condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Company's annual financial statements as of December 31, 2007. These interim financial statements have not been audited. However, management believes the accompanying unaudited, interim financial statements contain all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the consolidated financial position of The Stephan Co. and subsidiaries as of September 30, 2008 and the results of their operations and cash flows for the nine months then ended. The results of operations and cash flows for the interim period are not necessarily indicative of the results of operations or cash flows that can be expected for the year ending December 31, 2008.

USE OF ESTIMATES: The preparation of consolidated financial statements in conformity with U.S. GAAP 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 revenue 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 require management to make difficult, subjective and/or complex judgments, often due to a need to make estimates about matters that are inherently uncertain:

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, Sorbie Distributing Corporation, Stephan Distributing, Inc., Morris Flamingo-Stephan, Inc., American Manicure, Inc., Bowman Barber and Beauty Supply, Inc., and Lee Stafford Beauty Group, Inc. (collectively, the "Company"). All significant inter-Company balances and transactions have been eliminated in consolidation. Certain reclassifications (having no net profit or loss impact) have been made to the previously reported amounts in the 2007 financial statements to reflect comparability with the 2008 presentation.

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 their remaining useful lives 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 projection of their associated cash flows and then the discounting of these projected cash flows to their present value.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and other indefinite-lived 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 at September 30, 2008. The Company has less than $7.0 million of intangibles subject to future impairment testing. No events or circumstances occurred that indicated a possible impairment of intangible assets during the quarter and nine months ended September 30, 2008.

MAJOR CUSTOMERS: There were no sales to any single customer in excess of 10% of revenue in 2008 or 2007. 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.

STOCK-BASED COMPENSATION: Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised), “Share-Based Payment” (“SFAS 123(R)”), and chose to utilize the modified prospective transition method. Under this method, compensation costs recognized in 2008 and 2007 relate to the estimated fair value at the grant date of stock options granted each year subsequent to January 1, 2006. Prior to the adoption of SFAS 123(R) the Company accounted for stock options in accordance with APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and, using the intrinsic value of the grant to determine stock option value, recognized no compensation expense in net income for stock options granted and elected the “disclosure only” provisions of SFAS 123. In accordance with the provisions of SFAS 123(R), options granted prior to January 1, 2006 have not been restated to reflect the adoption of SFAS 123(R). The required services for awards prior to January 1, 2006 had been rendered prior to December 31, 2005.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's net income for the year-to-date periods ended September 30, 2008 and 2007 was reduced as a result of the Company's recognition of approximately $60,000 and $69,000 (net of income tax benefit), respectively, and for the quarterly periods then ended by $20,000 and $21,000. These amounts have been included in compensation expense (included in Selling, General and Administrative Expenses). The impact on basic and diluted earnings per share for the nine months ended September 30 of each year was approximately $0.01 per common share; the effect on the third quarter was approximately $0.005 per common share of each year. The Company employed the Black-Scholes option pricing model to estimate the fair value of stock options using assumptions consistent with past practices. On January 1, 2008 the company granted 50,000 shares to our CEO and on June 30, 2008 granted a total of 20,248 shares to our outside directors.

FAIR VALUE OF FINANCIAL INSTRUMENTS: The Company, using available market information and recognized valuation methodologies, has determined the estimated fair values of financial instruments that are presented herein. 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 instruments.

The following methods and assumptions were used to estimate fair value: 1) the carrying amounts of cash and cash equivalents, short-term investments, accounts receivable and accounts payable were assumed to approximate fair value due to their short-term nature; 2) debt service cash flows were discounted using current interest rates for