



Stepan Co. (SCL)

Updated May 31st, 2021 by Josh Arnold

Key Metrics

Current Price:	\$135	5 Year CAGR Estimate:	4.0%	Market Cap:	\$3.0 B
Fair Value Price:	\$122	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	05/27/21
% Fair Value:	110%	5 Year Valuation Multiple Estimate:	-1.9%	Dividend Payment Date:	06/15/21
Dividend Yield:	0.9%	5 Year Price Target	\$156	Years Of Dividend Growth:	53
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	10.9%

Overview & Current Events

Stepan Co. was founded in 1932 and at the outset, it sold only one product; a chemical to keep dust down on Illinois' country roads. Since that time, it has grown to manufacture basic and intermediate chemicals, with surfactants making up most of its revenue. It has a market capitalization of \$3 billion and should do about \$2.1 billion in revenue. Stepan is also a Dividend King, having increased its payout for 53 consecutive years.

Stepan reported first quarter earnings on April 27th, 2021, with results coming in ahead of expectations on both the top and bottom lines. Total sales were up 20% year-over-year as the company saw a favorable mix of factors that drove the top line higher. Volume was up 6%, selling, price and mix added 13% to the top line, and forex translation added the balance of 1%. On a segment basis, the vast majority of the increase was due to a 32% rise in sales of polymers, which was negatively impacted by COVID-19 in the year-ago period.

Polymer operating income was \$18 million in Q1, which was more than double the \$7.5 million in last year's Q1. The 32% increase in volume was the primary contributor, largely due to the INVISTA polyester polyol acquisition. Excluding this acquisition, volume was up 8%. Supply chain expenses also fell in Q1.

Surfactant operating income, which is the company's core segment, was up from \$36 million to \$53 million, driven by more favorable product mix, and higher demand in agricultural and oil field end markets. Like polymers, supply chain expenses fell for surfactants as well. Volume for surfactants was flat year-over-year.

Net income came to a record for Stepan of \$41 million, or \$1.74 per diluted share. This was up sharply from \$27.5 million, or \$1.18 per share respectively, in last year's Q1. On an adjusted basis, net income was \$42 million, or \$1.82 per share, up from \$24 million, or \$1.04 per share.

We've boosted our earnings estimate for this year to \$6.80 per share after a great start to 2021.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.21	\$3.49	\$3.18	\$2.49	\$3.32	\$3.73	\$3.92	\$4.88	\$5.12	\$5.68	\$6.80	\$8.68
DPS	\$0.53	\$0.58	\$0.65	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.22	\$1.79
Shares¹	20	22	22	22	22	22	23	23	23	23	23	23

Stepan's earnings have been somewhat inconsistent, but over time have grown at decent rates. The company is beholden to the world's manufacturers, so any sort of economic weakness can have severe consequences on earnings. It does boast a wide and deep array of customers, so concentration is not a problem, but as we've seen in the past, weakness in just one business line can cause Stepan's results to vary widely from one year to another. Stepan was in the right place at the right time with its surfactant business, capturing additional demand for 2020 and into 2021.

We are forecasting a five-year average earnings-per-share growth rate of 5%, consisting of mid-single-digit sales growth and slightly weaker margins over time. The company's cost-saving program has been in place for some time and has

¹ Share count in millions

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yielded operating margin gains and worked nicely in 2020. Margins are likely to be volatile on a year-over-year basis in 2021 given the lapping of pandemic conditions last year.

The company's dividend has grown steadily in the past decade. However, the payout is less than a quarter of earnings and the high valuation in the stock has led to a current yield of under 1%. We expect the payout will rise by ~8% annually as the company has used its extra cash to fund dividend increases in recent years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.3	13.2	18.6	21.0	14.0	16.3	19.1	16.5	18.0	18.4	19.9	18.0
Avg. Yld.	1.5%	1.3%	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	0.9%	1.1%

Stepan's price-to-earnings multiple remains high. The company's multiple could come back to more normalized levels over time, and we are forecasting a modest headwind to annual total returns for the next five years. While we think the company is well on its way to recovering from COVID-19, the valuation is still pricing in too much growth in our view.

The yield is likewise showing that Stepan is overvalued relative to its history. We see a potentially lower valuation and a rising payout moving the yield up to 1.1% in five years' time, up from the current 0.9%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	16%	16%	20%	27%	21%	21%	22%	19%	20%	20%	18%	21%

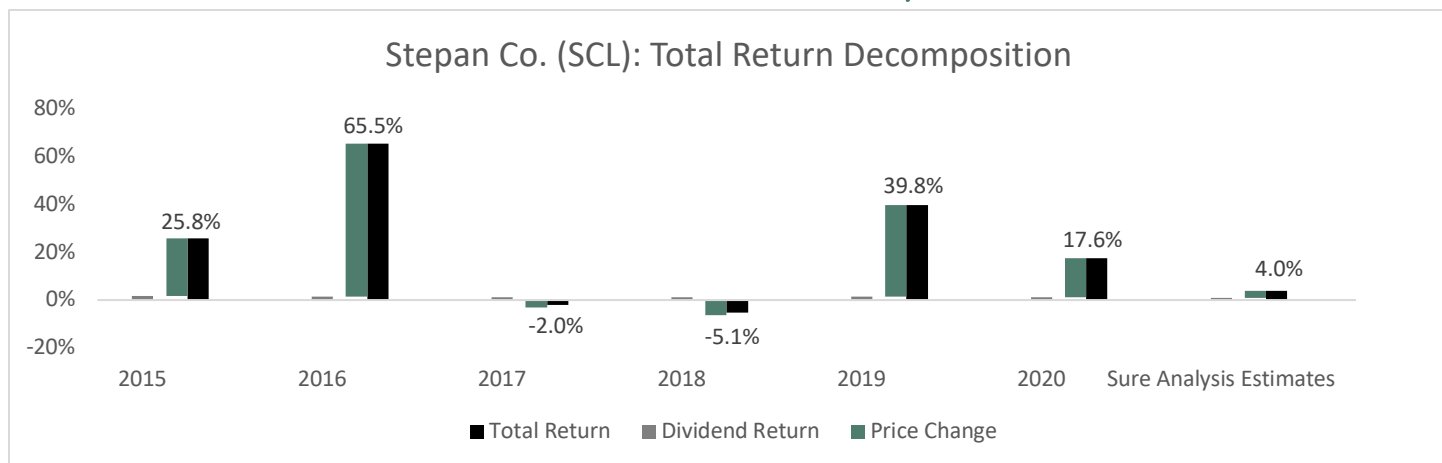
Stepan's payout ratio is just one-fifth of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

The company's competitive advantage is in its diverse, global customer base and many decades of engineering experience. Stepan's competitors cannot easily supplant its position with existing customers given the often-custom nature of what Stepan engineers for them. However, Stepan is certainly not immune to economic weakness and as we've seen, its earnings-per-share history shows that results can bounce around from one year to another.

Final Thoughts & Recommendation

Stepan is still trading in excess of our estimate of fair value. We are forecasting total annual returns for the next five years of 4%, comprised of the 0.9% current yield, 5% earnings-per-share growth and a small headwind from the valuation. The valuation remains an issue today, as it has been for some time. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1,843	1,804	1,881	1,927	1,776	1,766	1,925	1,994	1,859	1,870
Gross Profit	256	292	282	250	308	339	346	339	340	384
Gross Margin	13.9%	16.2%	15.0%	12.9%	17.4%	19.2%	18.0%	17.0%	18.3%	20.5%
SG&A Exp.	97	117	125	109	138	149	135	133	155	143
D&A Exp.	47	51	56	64	67	75	79	81	79	---
Operating Profit	118	129	110	95	120	135	158	152	129	173
Operating Margin	6.4%	7.1%	5.9%	4.9%	6.8%	7.6%	8.2%	7.6%	7.0%	9.2%
Net Profit	72	79	73	57	76	86	101	111	103	127
Net Margin	3.9%	4.4%	3.9%	3.0%	4.3%	4.9%	5.2%	5.6%	5.5%	6.8%
Free Cash Flow	(6)	26	57	(19)	64	109	120	84	113	---
Income Tax	32	36	23	18	27	28	46	27	23	43

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	901	985	1,167	1,162	1,238	1,354	1,471	1,515	1,579	1,752
Cash & Equivalents	84	77	133	85	176	226	299	300	315	---
Accounts Receivable	261	256	266	270	250	263	294	280	277	---
Inventories	111	162	172	183	170	174	173	232	204	---
Goodwill & Int. Ass.	18	16	35	32	29	48	44	37	41	---
Total Liabilities	496	505	613	625	680	718	730	706	687	764
Accounts Payable	138	142	157	157	129	158	205	206	194	---
Long-Term Debt	199	182	271	274	331	317	291	276	222	161
Shareholder's Equity	388	477	552	536	557	635	740	807	892	987
D/E Ratio	0.50	0.38	0.49	0.51	0.59	0.50	0.39	0.34	0.25	0.16

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	8.4%	8.4%	6.8%	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%
Return on Equity	19.9%	18.3%	14.1%	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%
ROIC	12.5%	12.5%	9.8%	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%
Shares Out.	20	22	22	22	22	22	23	23	23	23
Revenue/Share	82.13	79.35	82.04	84.10	77.70	76.48	82.35	85.48	79.72	80.40
FCF/Share	(0.26)	1.14	2.51	(0.84)	2.82	4.72	5.14	3.62	4.84	---

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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