



Stepan Co. (SCL)

Updated October 30th, 2021, by Josh Arnold

Key Metrics

Current Price:	\$120	5 Year CAGR Estimate:	5.0%	Market Cap:	\$2.7 B
Fair Value Price:	\$113	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	11/29/21
% Fair Value:	106%	5 Year Valuation Multiple Estimate:	-1.1%	Dividend Payment Date:	12/15/21
Dividend Yield:	1.1%	5 Year Price Target	\$145	Years Of Dividend Growth:	54
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	9.8%

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 \$2.7 billion and should do about \$2.3 billion in revenue. Stepan is also a Dividend King, having increased its payout for 54 consecutive years.

Stepan reported third quarter earnings on October 20th, 2021, and results were well ahead of estimates for both revenue and adjusted earnings. Total revenue soared 30% year-over-year to \$603 million. This was also \$62 million ahead of expectations as Stepan soared past the analyst community's expectations. Total net income was \$37 million, or \$1.59 per share, both of which were higher year-over-year from \$33 million and \$1.43 per share, respectively.

Surfactant operating income was \$35 million, down from \$41 million in the year-ago period. The decline was due to supply chain disruptions, lower sales volume, and the non-recurrence of a \$2 million insurance recovery in the year-ago period. Global surfactant sales volume declined -6% and reflected lower demand for cleaning products in the consumer products business. Polymer operating income was \$20 million, down from \$22 million a year ago. Sales volume soared 27% as rigid polyol volume was up 32% due to the INVISTA acquisition. Operating income declined due to supply chain disruptions and the non-recurrence of an insurance recovery and a legal settlement from last year.

We now forecast \$6.30 per share in earnings for this year following Q3 results.

Stepan increased its dividend by 9.8% to a new annualized payout of \$1.34 per share, which is the company's 54th consecutive annual dividend increase.

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	\$6.30	\$8.04
DPS	\$0.53	\$0.58	\$0.65	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.34	\$1.97
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 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. Supply chain issues caused margin problems in Q3, and so long as this condition persists, Stepan's margins are at risk.

¹ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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The company's dividend has grown steadily in the past decade; however, the stock has a current yield of just 1.1%. We expect the payout will rise by ~8% annually as the company has used its extra cash to fund dividend increases.

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	19.0	18.0
Avg. Yld.	1.5%	1.3%	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.1%	1.4%

Stepan's price-to-earnings multiple has come well off its highs in recent weeks. The stock is now back over our estimate of fair value, which we peg at 18 times earnings. We think the company is well on its way to recovering from COVID-19, but the valuation moved higher due to lower earnings estimates.

We see the yield remaining about where it is today for the foreseeable future.

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%	21%	25%

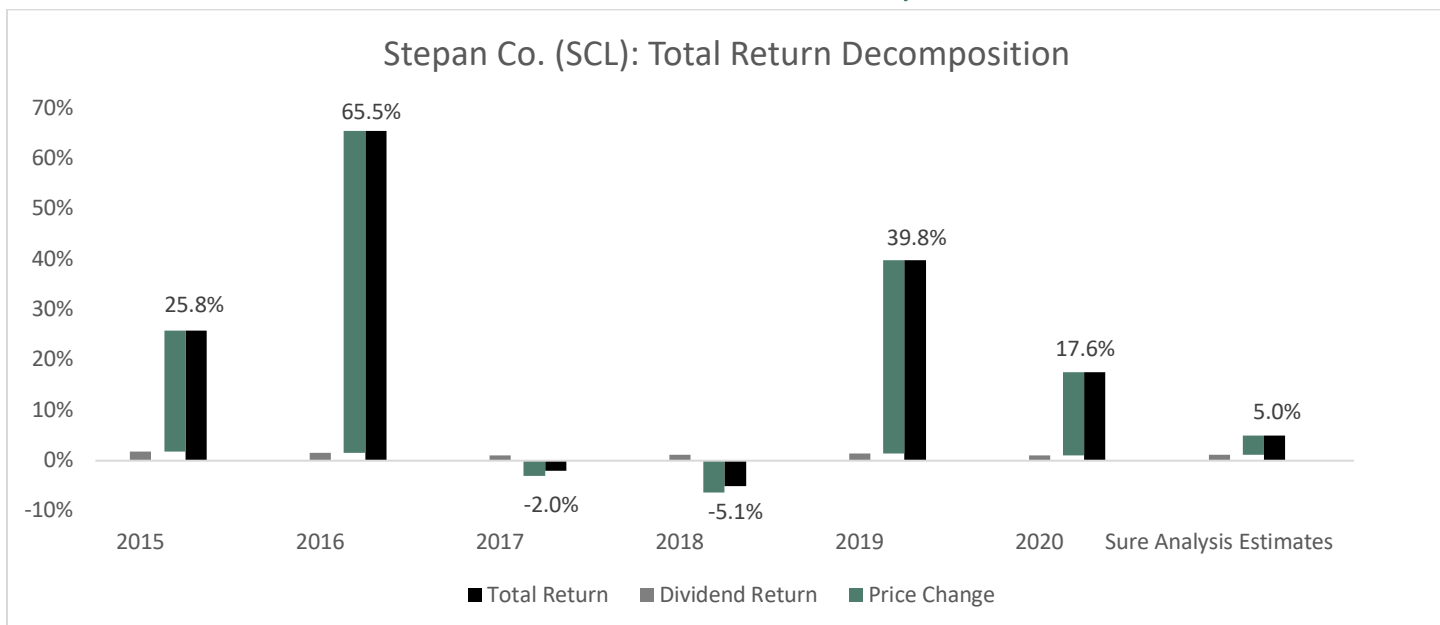
Stepan's payout ratio is just one-fifth of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

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

We are forecasting total annual returns for the next five years of 5%, comprised of the 1.1% current yield, 5% earnings-per-share growth and a small headwind from the valuation. The valuation has moved higher since our last update due to lower earnings estimates, but mid-single-digit total returns have us reiterating our 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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