



# Stepan Co. (SCL)

Updated February 26<sup>th</sup>, 2022, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$105	<b>5 Year CAGR Estimate:</b>	7.8%	<b>Market Cap:</b>	\$2.3 B
<b>Fair Value Price:</b>	\$113	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	03/03/22
<b>% Fair Value:</b>	93%	<b>5 Year Valuation Multiple Estimate:</b>	1.5%	<b>Dividend Payment Date:</b>	03/15/22
<b>Dividend Yield:</b>	1.3%	<b>5 Year Price Target</b>	\$144	<b>Years Of Dividend Growth:</b>	54
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	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 \$2.3 billion and should do about \$2.6 billion in revenue. Stepan is also a Dividend King, having increased its payout for 54 consecutive years.

Stepan released Q4 earnings on February 17<sup>th</sup>, 2022, and results were somewhat mixed. Earnings-per-share came to 97 cents on an adjusted basis, which was three cents below estimates. However, revenue came in well ahead of estimates, rising 23% year-over-year to \$610 million, \$52 million ahead of estimates. Earnings were \$22.5 million in Q4, which was down from \$33.1 million a year ago. On a per-share basis, the decline was from \$1.42 to \$0.97. Sales volume was off -4% year-over-year, exacerbating earnings decline.

Surfactant operating income was \$32.4 million, down from \$43.3 million year-over-year. The decline was due to supply chain disruptions and lower sales volumes. Global surfactant sales volume fell -9% on lower demand for cleaning products in the consumer business, partially offset by higher commercial volumes.

Polymer operating income was \$12.9 million, down from \$22.8 million a year ago. Global polymer sales volume was up 12%. Rigid polyol volume was up 13%. Supply chain disruptions hit this segment as well. Stepan boosted pricing in all its segments to help offset supply chain issues, the latter of which it estimates cost the company about \$7 million in operating income in Q4.

We forecast \$6.65 in earnings-per-share for this year, as we expect supply chain constraints to begin to ease.

Stepan also announced its CEO, F. Quinn Stepan, Jr., will retire as CEO in April. The company noted he'd remain as non-executive Chairman, and that the current President and COO, Scott Behrens, will succeed Stepan as CEO.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$3.49	\$3.18	\$2.49	\$3.32	\$3.73	\$3.92	\$4.88	\$5.12	\$5.68	\$6.16	<b>\$6.65</b>	<b>\$8.49</b>
<b>DPS</b>	\$0.58	\$0.65	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.27	<b>\$1.34</b>	<b>\$1.97</b>
<b>Shares<sup>1</sup></b>	22	22	22	22	22	23	23	23	23	23	<b>23</b>	<b>23</b>

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, although it appears some of that additional demand is unwinding into 2022.

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

<sup>1</sup> 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 2022 given supply chain issues, which also caused margin problems in 2021. So long as this condition persists, Stepan's margins are at risk.

The company's dividend has grown steadily in the past decade; however, the stock has a current yield of just 1.3%. We expect the payout will rise by ~8% annually as the company has used its extra cash to fund dividend increases.

## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.2	18.6	21.0	14.0	16.3	19.1	16.5	18.0	18.4	20.0	15.8	17.0
Avg. Yld.	1.3%	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.0%	1.3%	1.4%

Stepan's price-to-earnings multiple has come well off its highs in recent weeks. The stock is now back under our estimate of fair value, which we peg at 17 times earnings. We think the company is going to see easing of supply chain disruptions this year, but it has become clear the market isn't willing to pay the same multiples for growth stocks.

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

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	16%	20%	27%	21%	21%	22%	19%	20%	20%	20%	20%	23%

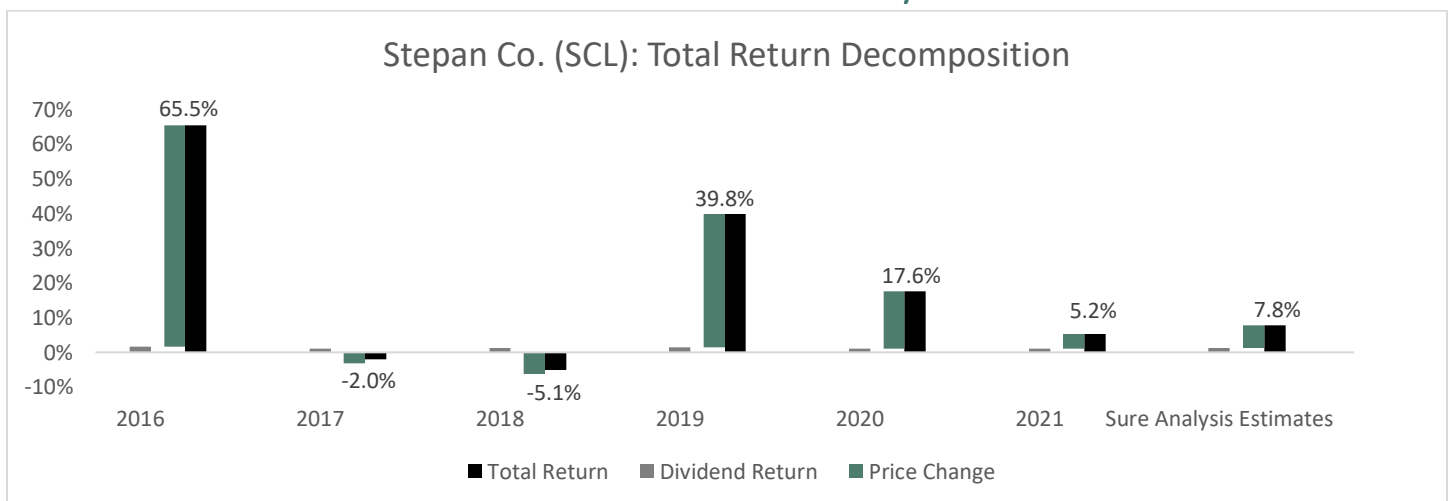
Stepan's payout ratio is just one-fifth of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

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 7.8%, comprised of the 1.3% current yield, 5% earnings-per-share growth and a small tailwind from the valuation. The valuation has moved lower since our last update due to higher 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
<b>Revenue</b>	1,843	1,804	1,881	1,927	1,776	1,766	1,925	1,994	1,859	1,870
<b>Gross Profit</b>	256	292	282	250	308	339	346	339	340	384
<b>Gross Margin</b>	13.9%	16.2%	15.0%	12.9%	17.4%	19.2%	18.0%	17.0%	18.3%	20.5%
<b>SG&amp;A Exp.</b>	97	117	125	109	138	149	135	133	155	143
<b>D&amp;A Exp.</b>	47	51	56	64	67	75	79	81	79	---
<b>Operating Profit</b>	118	129	110	95	120	135	158	152	129	173
<b>Operating Margin</b>	6.4%	7.1%	5.9%	4.9%	6.8%	7.6%	8.2%	7.6%	7.0%	9.2%
<b>Net Profit</b>	72	79	73	57	76	86	101	111	103	127
<b>Net Margin</b>	3.9%	4.4%	3.9%	3.0%	4.3%	4.9%	5.2%	5.6%	5.5%	6.8%
<b>Free Cash Flow</b>	(6)	26	57	(19)	64	109	120	84	113	---
<b>Income Tax</b>	32	36	23	18	27	28	46	27	23	43

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	901	985	1,167	1,162	1,238	1,354	1,471	1,515	1,579	1,752
<b>Cash &amp; Equivalents</b>	84	77	133	85	176	226	299	300	315	---
<b>Accounts Receivable</b>	261	256	266	270	250	263	294	280	277	---
<b>Inventories</b>	111	162	172	183	170	174	173	232	204	---
<b>Goodwill &amp; Int. Ass.</b>	18	16	35	32	29	48	44	37	41	---
<b>Total Liabilities</b>	496	505	613	625	680	718	730	706	687	764
<b>Accounts Payable</b>	138	142	157	157	129	158	205	206	194	---
<b>Long-Term Debt</b>	199	182	271	274	331	317	291	276	222	161
<b>Shareholder's Equity</b>	388	477	552	536	557	635	740	807	892	987
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	8.4%	8.4%	6.8%	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%
<b>Return on Equity</b>	19.9%	18.3%	14.1%	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%
<b>ROIC</b>	12.5%	12.5%	9.8%	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%
<b>Shares Out.</b>	20	22	22	22	22	22	23	23	23	23
<b>Revenue/Share</b>	82.13	79.35	82.04	84.10	77.70	76.48	82.35	85.48	79.72	80.40
<b>FCF/Share</b>	(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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