



Stepan Co. (SCL)

Updated July 31st, 2022, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|----------------------------------|----------|
| Current Price: | \$112 | 5 Year CAGR Estimate: | 6.6% | Market Cap: | \$2.5 B |
| Fair Value Price: | \$114 | 5 Year Growth Estimate: | 5.0% | Ex-Dividend Date: | 08/30/22 |
| % Fair Value: | 98% | 5 Year Valuation Multiple Estimate: | 0.3% | Dividend Payment Date: | 09/15/22 |
| Dividend Yield: | 1.2% | 5 Year Price Target | \$145 | Years Of Dividend Growth: | 54 |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Rating: | Hold |

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 \$2.5 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 reported second quarter earnings on July 27th, 2022, and results were better than expected on both the top and bottom lines. Earnings-per-share on an adjusted basis came to \$2.30, which was an impressive 40 cents better than expected. Revenue was up 26% year-over-year to \$752 million, beating estimates by \$59 million.

Net income was a record at \$53 million, up from \$42 million, or \$1.81 in the year-ago period. Total volume was down 1% year-over-year, but pricing actions saw revenue soar.

Surfactant operating income was \$48.2 million, up from \$45.9 million a year ago. The increase was driven by improved product and customer mix, partially offset by a 3% decline in volumes.

Polymer operating income was a record at \$33.9 million, up sharply from \$23 million a year ago. The gain was due to margin recovery, improved mix, and a 2% increase in sales volume.

Specialty Product operating income was also a record at \$9.9 million, up from \$7 million in last year's comparable period. The gain was due to improved margins and mix, primarily.

Forex translation was a negative impact of \$1.9 million, or eight cents per share, compared to the year-ago period. We now see \$6.70 in earnings-per-share for this year following Q2 results.

Growth on a Per-Share Basis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$3.49 | \$3.18 | \$2.49 | \$3.32 | \$3.73 | \$3.92 | \$4.88 | \$5.12 | \$5.68 | \$6.16 | \$6.70 | \$8.55 |
| DPS | \$0.58 | \$0.65 | \$0.69 | \$0.73 | \$0.78 | \$0.86 | \$0.93 | \$1.03 | \$1.13 | \$1.27 | \$1.34 | \$1.97 |
| Shares¹ | 22 | 22 | 22 | 22 | 22 | 23 | 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, 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 yielded operating margin gains and worked nicely in 2020. Margins are likely to be volatile on a year-over-year basis in

¹ Share count in millions

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2022 given supply chain issues, which also caused margin problems in 2021. So long as this condition persists, Stepan's margins are at risk. We note that Q2 margins were outstanding, so it's possible the worst is behind it.

The company's dividend has grown steadily in the past decade; however, the stock has a current yield of just 1.2%. 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 | 16.7 | 17.0 |
| Avg. Yld. | 1.3% | 1.1% | 1.3% | 1.6% | 1.3% | 1.2% | 1.1% | 1.1% | 1.1% | 1.0% | 1.2% | 1.4% |

Stepan's price-to-earnings multiple has come well off its highs in recent weeks. The stock is 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% |

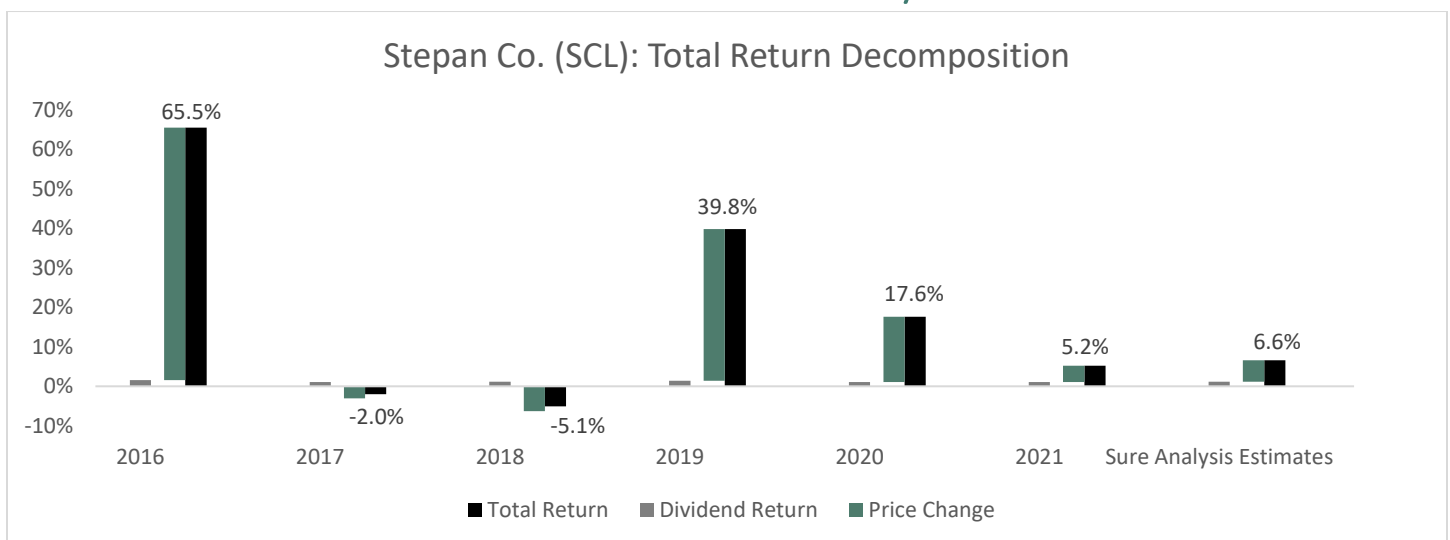
Stepan's payout ratio is just one-fifth of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

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 6.6%, comprised of the 1.2% current yield, 5% earnings-per-share growth and a small tailwind from the valuation. The valuation is essentially unchanged 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 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 1,804 | 1,881 | 1,927 | 1,776 | 1,766 | 1,925 | 1,994 | 1,859 | 1,870 | 2,346 |
| Gross Profit | 292 | 282 | 250 | 308 | 339 | 346 | 339 | 340 | 384 | 396 |
| Gross Margin | 16.2% | 15.0% | 12.9% | 17.4% | 19.2% | 18.0% | 17.0% | 18.3% | 20.5% | 16.9% |
| SG&A Exp. | 117 | 125 | 109 | 138 | 149 | 135 | 133 | 155 | 143 | 159 |
| D&A Exp. | 51 | 56 | 64 | 67 | 75 | 79 | 81 | 79 | 82 | 91 |
| Operating Profit | 129 | 110 | 95 | 120 | 135 | 158 | 152 | 129 | 173 | 175 |
| Operating Margin | 7.1% | 5.9% | 4.9% | 6.8% | 7.6% | 8.2% | 7.6% | 7.0% | 9.2% | 7.5% |
| Net Profit | 79 | 73 | 57 | 76 | 86 | 101 | 111 | 103 | 127 | 138 |
| Net Margin | 4.4% | 3.9% | 3.0% | 4.3% | 4.9% | 5.2% | 5.6% | 5.5% | 6.8% | 5.9% |
| Free Cash Flow | 26 | 57 | (19) | 64 | 109 | 120 | 84 | 113 | 109 | (122) |
| Income Tax | 36 | 23 | 18 | 27 | 28 | 46 | 27 | 23 | 43 | 35 |

Balance Sheet Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 985 | 1,167 | 1,162 | 1,238 | 1,354 | 1,471 | 1,515 | 1,579 | 1,752 | 2,066 |
| Cash & Equivalents | 77 | 133 | 85 | 176 | 226 | 299 | 300 | 315 | 350 | 159 |
| Accounts Receivable | 256 | 266 | 270 | 250 | 263 | 294 | 280 | 277 | 301 | 420 |
| Inventories | 162 | 172 | 183 | 170 | 174 | 173 | 232 | 204 | 219 | 306 |
| Goodwill & Int. Ass. | 16 | 35 | 32 | 29 | 48 | 44 | 37 | 41 | 52 | 158 |
| Total Liabilities | 505 | 613 | 625 | 680 | 718 | 730 | 706 | 687 | 764 | 991 |
| Accounts Payable | 142 | 157 | 157 | 129 | 158 | 205 | 206 | 194 | 237 | 323 |
| Long-Term Debt | 182 | 271 | 274 | 331 | 317 | 291 | 276 | 222 | 199 | 364 |
| Shareholder's Equity | 477 | 552 | 536 | 557 | 635 | 740 | 807 | 892 | 987 | 1,074 |
| LTD/E Ratio | 0.38 | 0.49 | 0.51 | 0.59 | 0.50 | 0.39 | 0.34 | 0.25 | 0.20 | 0.34 |

Profitability & Per Share Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------------------------|-------|-------|--------|-------|-------|-------|-------|-------|-------|--------|
| Return on Assets | 8.4% | 6.8% | 4.9% | 6.3% | 6.6% | 7.1% | 7.4% | 6.7% | 7.6% | 7.2% |
| Return on Equity | 18.3% | 14.1% | 10.5% | 13.9% | 14.5% | 14.7% | 14.4% | 12.1% | 13.5% | 13.4% |
| ROIC | 12.5% | 9.8% | 7.0% | 8.9% | 9.4% | 10.2% | 10.5% | 9.4% | 11.2% | 10.5% |
| Shares Out. | 22 | 22 | 22 | 22 | 22 | 23 | 23 | 23 | 23 | 23 |
| Revenue/Share | 79.35 | 82.04 | 84.10 | 77.70 | 76.48 | 82.35 | 85.48 | 79.72 | 80.40 | 100.74 |
| FCF/Share | 1.14 | 2.51 | (0.84) | 2.82 | 4.72 | 5.14 | 3.62 | 4.84 | 4.71 | (5.25) |

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

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