



# Stepan Co. (SCL)

Updated November 6<sup>th</sup>, 2022, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$105	<b>5 Year CAGR Estimate:</b>	9.1%	<b>Market Cap:</b>	\$2.3 B
<b>Fair Value Price:</b>	\$120	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	11/29/22
<b>% Fair Value:</b>	88%	<b>5 Year Valuation Multiple Estimate:</b>	2.7%	<b>Dividend Payment Date:</b>	12/15/22
<b>Dividend Yield:</b>	1.4%	<b>5 Year Price Target</b>	\$153	<b>Years Of Dividend Growth:</b>	55
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	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 \$2.3 billion and should do about \$2.6 billion in revenue. Stepan is also a Dividend King, having increased its payout for 55 consecutive years.

Stepan reported third quarter earnings on October 19<sup>th</sup>, 2022, and results were much better than expected. The company posted adjusted earnings-per-share of \$2.01, which was an impressive 41 cents better than expected. Revenue was up 19.3% year-over-year to \$719 million, which beat expectations by \$55 million.

The company noted sales volume declined 8% year-over-year, but this was more than offset by strong pricing actions undertaken to fight inflationary pressures.

Surfactant operating income was \$39 million, up from \$34.5 million a year ago. The gain was driven by improved product and customer mix that was partially offset by a decline of 8% in global sales volume.

Polymer operating income was \$31.9 million, soaring from \$19.8 million a year ago. The gain was due to improved margin recovery and mix, partially offset by a 10% decline in sales volume globally.

Forex translation reduced earnings by \$2.4 million, or 11 cents per share in Q3.

Stepan boosted its dividend for the 55<sup>th</sup> consecutive year for the December payment.

We now see \$7.05 in earnings-per-share for this year following very strong Q3 results from a margin perspective.

## 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>\$7.05</b>	<b>\$9.00</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>\$1.46</b>	<b>\$2.15</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. Global sales volumes were very weak into the second half of 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. 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. We

<sup>1</sup> Share count in millions

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note that Q3 margins were outstanding, so it's possible the worst is behind it. However, if sales volumes remain weak, margins are likely to follow suit.

The company's dividend has grown steadily in the past decade; however, the stock has a current yield of just 1.4%. 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	14.9	17.0
Avg. Yld.	1.3%	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.0%	1.4%	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%	21%	24%

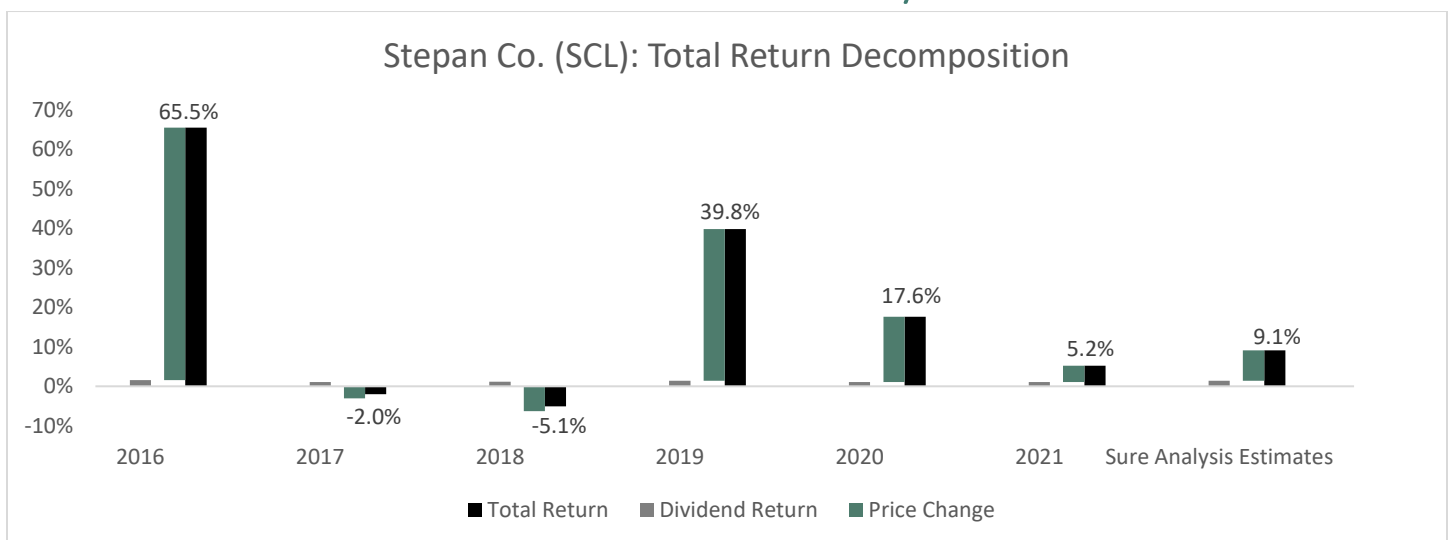
Stepan's payout ratio is just one-fifth of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

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 9.1%, comprised of the 1.4% current yield, 5% earnings-per-share growth and a 2.7% tailwind from the valuation. The valuation is essentially unchanged since our last update due to higher earnings estimates, and we reiterate our hold rating, but note materially higher expected returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	985	1,167	1,162	1,238	1,354	1,471	1,515	1,579	1,752	2,066
<b>Cash &amp; Equivalents</b>	77	133	85	176	226	299	300	315	350	159
<b>Accounts Receivable</b>	256	266	270	250	263	294	280	277	301	420
<b>Inventories</b>	162	172	183	170	174	173	232	204	219	306
<b>Goodwill &amp; Int. Ass.</b>	16	35	32	29	48	44	37	41	52	158
<b>Total Liabilities</b>	505	613	625	680	718	730	706	687	764	991
<b>Accounts Payable</b>	142	157	157	129	158	205	206	194	237	323
<b>Long-Term Debt</b>	182	271	274	331	317	291	276	222	199	364
<b>Shareholder's Equity</b>	477	552	536	557	635	740	807	892	987	1,074
<b>LTD/E Ratio</b>	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
<b>Return on Assets</b>	8.4%	6.8%	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%	7.2%
<b>Return on Equity</b>	18.3%	14.1%	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%	13.4%
<b>ROIC</b>	12.5%	9.8%	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%	10.5%
<b>Shares Out.</b>	22	22	22	22	22	23	23	23	23	23
<b>Revenue/Share</b>	79.35	82.04	84.10	77.70	76.48	82.35	85.48	79.72	80.40	100.74
<b>FCF/Share</b>	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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