



# Stepan Co. (SCL)

Updated February 26<sup>th</sup>, 2023, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$105	<b>5 Year CAGR Estimate:</b>	6.2%	<b>Market Cap:</b>	\$2.3 B
<b>Fair Value Price:</b>	\$94	<b>5 Year Growth Estimate:</b>	7.0%	<b>Ex-Dividend Date:</b>	03/02/23
<b>% Fair Value:</b>	111%	<b>5 Year Valuation Multiple Estimate:</b>	-2.1%	<b>Dividend Payment Date:</b>	03/15/23
<b>Dividend Yield:</b>	1.4%	<b>5 Year Price Target</b>	\$132	<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 fourth quarter earnings on February 16<sup>th</sup>, 2023, and results were mixed. Adjusted earnings-per-share came to 59 cents, which was three cents better than expected. Revenue, however, was up less than 3% year-over-year to \$627 million. This was fractionally lower than expected by analysts. Total volume plummeted 17% year-over-year, but was offset by pricing increases.

Surfactant operating income was \$21.8 million, down sharply from \$32.4 million a year ago. This decline was due to a 15% decline in global sales volume that was partially offset by improved product mix.

Polymer operating income was \$3 million, down from \$12.9 million a year ago. This decline was due to a 23% sales volume reduction, reflecting customer inventory destocking.

Specialty Product operating income was \$6.6 million, up from \$2.1 million year-over-year, due to better margins, and customer mix. Forex negatively impacted net income by two cents per share.

We start 2023 with an earnings-per-share estimate of \$5.55, which would be the lowest value since 2019, if achieved, as volume remains of great concern.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$3.18	\$2.49	\$3.32	\$3.73	\$3.92	\$4.88	\$5.12	\$5.68	\$6.16	\$6.65	<b>\$5.55</b>	<b>\$7.78</b>
<b>DPS</b>	\$0.65	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.27	\$1.37	<b>\$1.46</b>	<b>\$2.15</b>
<b>Shares<sup>1</sup></b>	22	22	22	22	23	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 that tailwind dissipated in 2022. Global sales volumes were very weak in 2022, and we believe that will carry on at least into 2023.

We are forecasting a five-year average earnings-per-share growth rate of 7%, 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 2023 given supply chain issues, which also caused margin problems in 2021 and 2022. So long as this condition persists, Stepan's margins are at

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

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risk. We boosted our estimate of growth because of the low base for 2023, not necessarily because we think Stepan is better positioned than it was.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	18.6	21.0	14.0	16.3	19.1	16.5	18.0	18.4	20.0	16.1	18.9	17.0
Avg. Yld.	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.0%	1.3%	1.4%	1.6%

Stepan's price-to-earnings multiple has come well off its highs in recent weeks. The stock is over 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	20%	27%	21%	21%	22%	19%	20%	20%	20%	21%	26%	28%

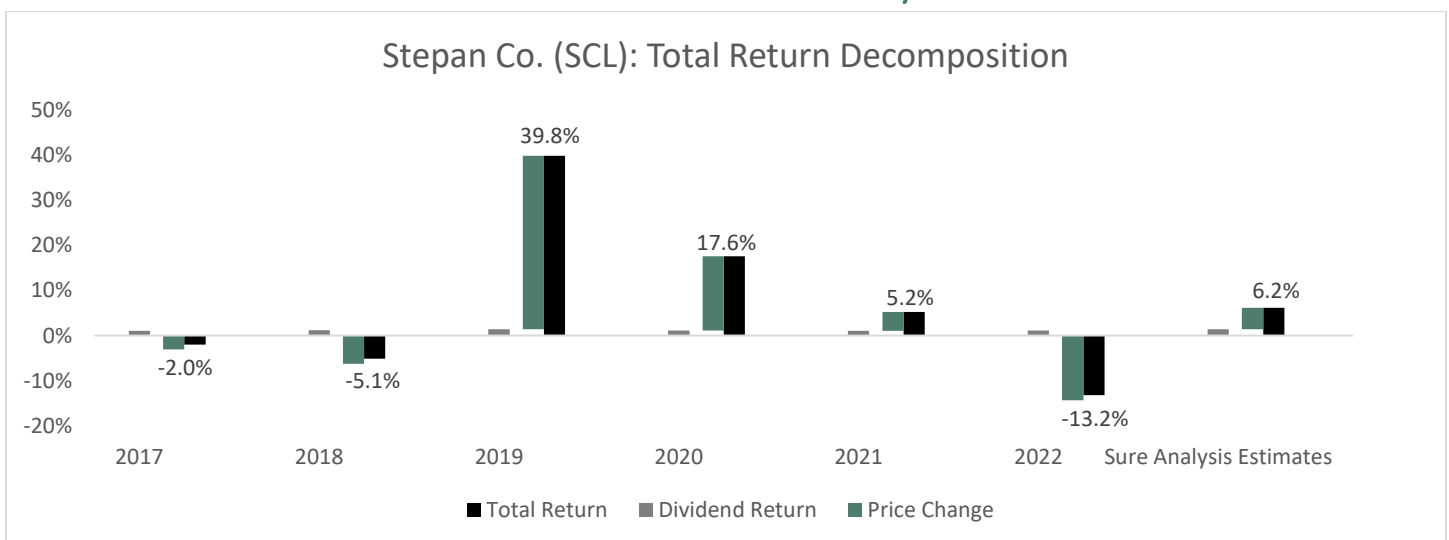
Stepan's payout ratio is just one-quarter of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth.

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 6.2%, comprised of the 1.4% current yield, 7% earnings-per-share growth and a 2.1% headwind from the valuation. The valuation is much higher since our last update due to lower earnings estimates, and we reiterate our hold rating, and note the lower total returns expected.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	1,881	1,927	1,776	1,766	1,925	1,994	1,859	1,870	2,346	2,773
<b>Gross Profit</b>	282	250	308	339	346	339	340	384	396	427
<b>Gross Margin</b>	15.0%	12.9%	17.4%	19.2%	18.0%	17.0%	18.3%	20.5%	16.9%	15.4%
<b>SG&amp;A Exp.</b>	125	109	138	149	135	133	155	143	159	152
<b>D&amp;A Exp.</b>	56	64	67	75	79	81	79	82	91	---
<b>Operating Profit</b>	110	95	120	135	158	152	129	173	175	209
<b>Operating Margin</b>	5.9%	4.9%	6.8%	7.6%	8.2%	7.6%	7.0%	9.2%	7.5%	7.5%
<b>Net Profit</b>	73	57	76	86	101	111	103	127	138	147
<b>Net Margin</b>	3.9%	3.0%	4.3%	4.9%	5.2%	5.6%	5.5%	6.8%	5.9%	5.3%
<b>Free Cash Flow</b>	57	(19)	64	109	120	84	113	109	(122)	---
<b>Income Tax</b>	23	18	27	28	46	27	23	43	35	42

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	1,167	1,162	1,238	1,354	1,471	1,515	1,579	1,752	2,066	2,433
<b>Cash &amp; Equivalents</b>	133	85	176	226	299	300	315	350	159	---
<b>Accounts Receivable</b>	266	270	250	263	294	280	277	301	420	---
<b>Inventories</b>	172	183	170	174	173	232	204	219	306	---
<b>Goodwill &amp; Int. Ass.</b>	35	32	29	48	44	37	41	52	158	---
<b>Total Liabilities</b>	613	625	680	718	730	706	687	764	991	1,267
<b>Accounts Payable</b>	157	157	129	158	205	206	194	237	323	---
<b>Long-Term Debt</b>	271	274	331	317	291	276	222	199	364	455
<b>Shareholder's Equity</b>	552	536	557	635	740	807	892	987	1,074	1,166
<b>LTD/E Ratio</b>	0.49	0.51	0.59	0.50	0.39	0.34	0.25	0.20	0.34	0.39

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	6.8%	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%	7.2%	6.5%
<b>Return on Equity</b>	14.1%	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%	13.4%	13.1%
<b>ROIC</b>	9.8%	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%	10.5%	9.6%
<b>Shares Out.</b>	22	22	22	22	23	23	23	23	23	23
<b>Revenue/Share</b>	82.04	84.10	77.70	76.48	82.35	85.48	79.72	80.40	100.74	120.24
<b>FCF/Share</b>	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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