



Stepan Co. (SCL)

Updated October 24th, 2023, by Josh Arnold

Key Metrics

Current Price:	\$74	5 Year CAGR Estimate:	3.2%	Market Cap:	\$1.7 B
Fair Value Price:	\$38	5 Year Growth Estimate:	15.0%	Ex-Dividend Date:	11/25/23
% Fair Value:	193%	5 Year Valuation Multiple Estimate:	-12.4%	Dividend Payment Date:	11/30/23
Dividend Yield:	2.0%	5 Year Price Target	\$77	Years Of Dividend Growth:	56
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 \$1.7 billion and should do about \$2.3 billion in revenue. Stepan is also a Dividend King, having increased its payout for 56 consecutive years.

Stepan posted third quarter earnings on October 18th, 2023, and results were much weaker than expected. Adjusted earnings-per-share came to 64 cents, which was 12 cents light of estimates. Revenue was off 22% to \$562 million, and missed estimates by \$42 million.

Adjusted EBITDA was \$48 million, a 44% decline year-over-year. The company is expanding its cost cutting activities and expects to realize \$50 million in pre-tax cost savings in 2024 to help offset inflation and increased expenses related to its new alkoxylation investment in Pasadena.

The company said they expect volume and margins to improve due to a continued recovery in rigid polyols demand, growth in surfactant volume, and lower raw material costs.

We've cut estimates again for this year to \$2.25 in earnings-per-share, but expect a very sharp rebound into 2024 and beyond.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$3.18	\$2.49	\$3.32	\$3.73	\$3.92	\$4.88	\$5.12	\$5.68	\$6.16	\$6.65	\$2.25	\$4.53
DPS	\$0.65	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.27	\$1.37	\$1.50	\$2.20
Shares¹	22	22	22	22	23	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 that tailwind dissipated in 2022. Global sales volumes were very weak in 2022, and that has carried on into 2023, taking margins with it.

We are forecasting a five-year average earnings-per-share growth rate of 15%, 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 risk. We boosted our estimate of growth because of the very low base for 2023, not necessarily because we think Stepan is better positioned than it was.

¹ Share count in millions

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The company's dividend has grown steadily in the past decade, and the stock now yields 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	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	32.9	17.0
Avg. Yld.	1.1%	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.0%	1.3%	2.0%	2.9%

Stepan's price-to-earnings multiple has come well off its highs in recent weeks. The stock is nearly double 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, and sales volumes declined sharply so far in 2023.

We see the yield having potential to rise to around 3% given the projected decline in the valuation.

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%	67%	49%

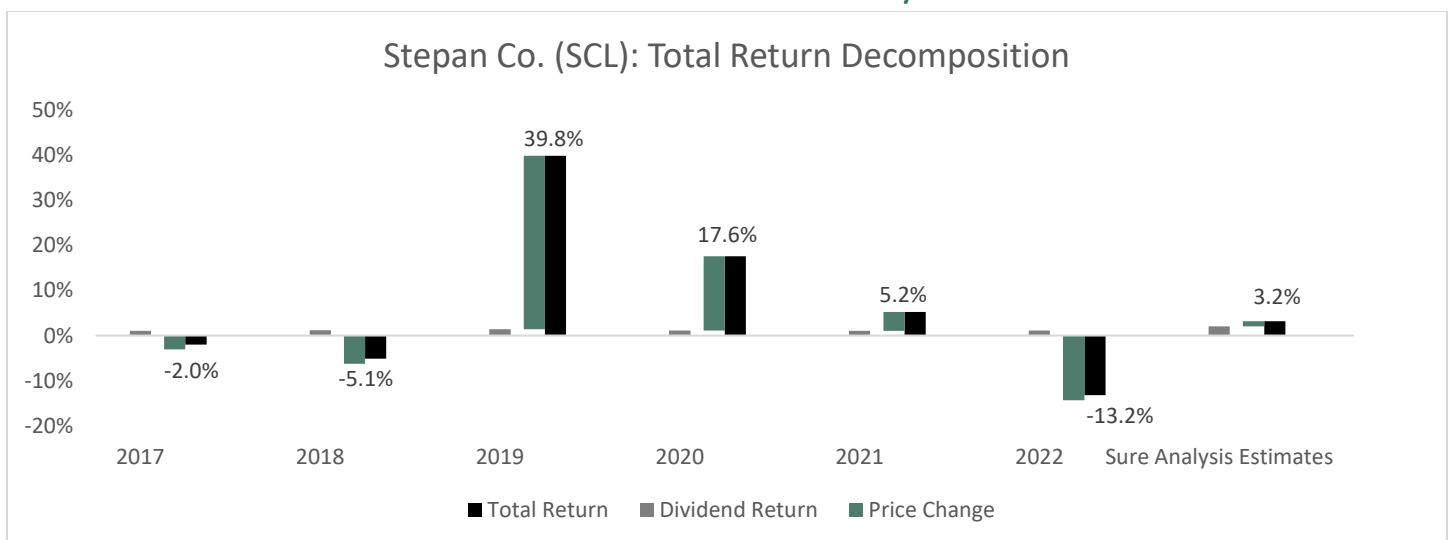
Stepan's payout ratio is about two-thirds of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth. Struggles with earnings growth is likely to keep management slightly more cautious in the near term in raising the dividend.

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 3.2%, comprised of the 2% current yield, 15% earnings-per-share growth and a 12.4% headwind from the valuation. The valuation is higher since our last update due to lower earnings estimates, but nonetheless we are boosting our rating from sell to hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,881	1,927	1,776	1,766	1,925	1,994	1,859	1,870	2,346	2,773
Gross Profit	282	250	308	339	346	339	340	384	396	427
Gross Margin	15.0%	12.9%	17.4%	19.2%	18.0%	17.0%	18.3%	20.5%	16.9%	15.4%
SG&A Exp.	125	109	138	149	135	133	155	143	159	152
D&A Exp.	56	64	67	75	79	81	79	82	91	95
Operating Profit	110	95	120	135	158	152	129	173	175	209
Operating Margin	5.9%	4.9%	6.8%	7.6%	8.2%	7.6%	7.0%	9.2%	7.5%	7.5%
Net Profit	73	57	76	86	101	111	103	127	138	147
Net Margin	3.9%	3.0%	4.3%	4.9%	5.2%	5.6%	5.5%	6.8%	5.9%	5.3%
Free Cash Flow	57	(19)	64	109	120	84	113	109	(122)	(141)
Income Tax	23	18	27	28	46	27	23	43	35	42

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,167	1,162	1,238	1,354	1,471	1,515	1,579	1,752	2,066	2,433
Cash & Equivalents	133	85	176	226	299	300	315	350	159	174
Accounts Receivable	266	270	250	263	294	280	277	301	420	437
Inventories	172	183	170	174	173	232	204	219	306	403
Goodwill & Int. Ass.	35	32	29	48	44	37	41	52	158	154
Total Liabilities	613	625	680	718	730	706	687	764	991	1,267
Accounts Payable	157	157	129	158	205	206	194	237	323	376
Long-Term Debt	271	274	331	317	291	276	222	199	364	455
Shareholder's Equity	552	536	557	635	740	807	892	987	1,074	1,166
LTD/E Ratio	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
Return on Assets	6.8%	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%	7.2%	6.5%
Return on Equity	14.1%	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%	13.4%	13.1%
ROIC	9.8%	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%	10.5%	9.6%
Shares Out.	22	22	22	22	23	23	23	23	23	23
Revenue/Share	82.04	84.10	77.70	76.48	82.35	85.48	79.72	80.40	100.74	120.24
FCF/Share	2.51	(0.84)	2.82	4.72	5.14	3.62	4.84	4.71	(5.25)	(6.10)

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

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