



Stepan Co. (SCL)

Updated March 9th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$88	5 Year CAGR Estimate:	1.9%	Market Cap:	\$2 B
Fair Value Price:	\$43	5 Year Growth Estimate:	15.0%	Ex-Dividend Date:	05/29/24 ¹
% Fair Value:	203%	5 Year Valuation Multiple Estimate:	-13.2%	Dividend Payment Date:	06/15/24
Dividend Yield:	1.7%	5 Year Price Target	\$87	Years Of Dividend Growth:	56
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Sell

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 billion and should do about \$2.4 billion in revenue this year. Stepan is also a Dividend King, having increased its payout for 56 consecutive years.

Stepan posted fourth quarter and full-year earnings on February 20th, 2024, and results were weak, missing estimates on both the top and bottom lines. Adjusted earnings-per-share came to 33 cents, which was four cents light of estimates. On a dollar basis, adjusted earnings were \$7.5 million, down from \$13.5 million a year ago. Revenue was \$532 million, which was down 15% year-over-year, as well as missing estimates by \$2.35 million. Sales volume was up 3% from the prior year.

Surfactant operating income was \$14.8 million, down from \$21.8 million a year ago. The decline was primarily attributable to lower unit margins that were partially offset by a 1% increase in global sales volume. Lower margins were due to less favorable product mix. Double-digit volume growth within the Personal Care end market was offset by lower demand in Agricultural end markets from customer inventory destocking.

Polymer operating income was \$12.6 million, up from \$3 million a year ago. The gain was due to a big 10% gain in global sales volume, while Global Rigid Polyols were up 12%.

Specialty Product Operating income was \$2.8 million, down from \$6.6 million in the prior year. The decline was due to lower margins and sales volumes.

We see \$2.55 in earnings-per-share for this year, as Stepan continues to work to rebuild earnings.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$2.49	\$3.32	\$3.73	\$3.92	\$4.88	\$5.12	\$5.68	\$6.16	\$6.65	\$2.21	\$2.55	\$5.13
DPS	\$0.69	\$0.73	\$0.78	\$0.86	\$0.93	\$1.03	\$1.13	\$1.27	\$1.37	\$1.47	\$1.50	\$2.20
Shares²	22	22	22	23	23	23	23	23	23	22	22	22

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 2023, and it appears there is still work to do on that front in 2024.

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

¹ Estimated date

² Share count in millions

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yielded operating margin gains. Margins were 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 2024, not necessarily because we think Stepan is better positioned than it was.

The company's dividend has grown steadily in the past decade, and the stock now yields 1.7%. We expect the payout will rise by ~8% annually as the company has used its extra cash to fund dividend increases.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	21.0	14.0	16.3	19.1	16.5	18.0	18.4	20.0	16.1	42.8	34.5	17.0
Avg. Yld.	1.3%	1.6%	1.3%	1.2%	1.1%	1.1%	1.1%	1.0%	1.3%	1.6%	1.7%	2.5%

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 2.5% given the projected decline in the valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	27%	21%	21%	22%	19%	20%	20%	20%	21%	67%	59%	43%

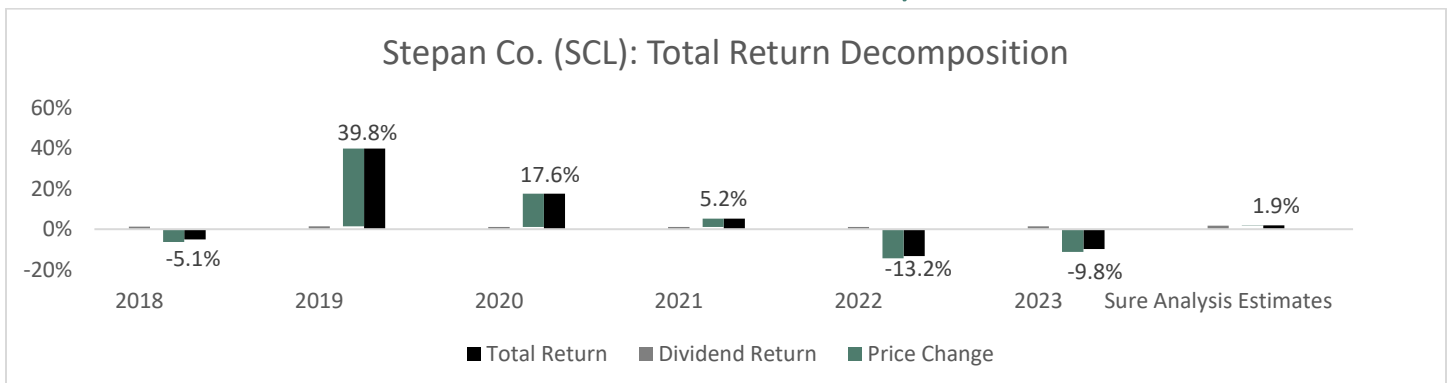
Stepan's payout ratio is about 60% of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth. Struggles with earnings growth is likely to keep management slightly more cautious in the near term in raising the dividend.

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 1.9%, comprised of the 1.7% current yield, 15% earnings-per-share growth and a 13.2% headwind from the valuation. The valuation is lower since our last update due primarily to higher earnings estimates, but nonetheless we are reducing our rating from hold to sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	1,927	1,776	1,766	1,925	1,994	1,859	1,870	2,346	2,773	2,326
Gross Profit	250	308	339	346	339	340	384	396	427	278
Gross Margin	12.9%	17.4%	19.2%	18.0%	17.0%	18.3%	20.5%	16.9%	15.4%	12.0%
SG&A Exp.	109	138	149	135	133	155	143	159	152	146
D&A Exp.	64	67	75	79	81	79	82	91	95	105
Operating Profit	95	120	135	158	152	129	173	175	209	73
Operating Margin	4.9%	6.8%	7.6%	8.2%	7.6%	7.0%	9.2%	7.5%	7.5%	3.1%
Net Profit	57	76	86	101	111	103	127	138	147	40
Net Margin	3.0%	4.3%	4.9%	5.2%	5.6%	5.5%	6.8%	5.9%	5.3%	1.7%
Free Cash Flow	(19)	64	109	120	84	113	109	(122)	(141)	(85)
Income Tax	18	27	28	46	27	23	43	35	42	8

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,162	1,238	1,354	1,471	1,515	1,579	1,752	2,066	2,433	2,363
Cash & Equivalents	85	176	226	299	300	315	350	159	174	130
Accounts Receivable	270	250	263	294	280	277	301	420	437	422
Inventories	183	170	174	173	232	204	219	306	403	266
Goodwill & Int. Ass.	32	29	48	44	37	41	52	158	154	150
Total Liabilities	625	680	718	730	706	687	764	991	1,267	1,147
Accounts Payable	157	129	158	205	206	194	237	323	376	233
Long-Term Debt	274	331	317	291	276	222	199	364	455	654
Shareholder's Equity	536	557	635	740	807	892	987	1,074	1,166	1,216
LTD/E Ratio	0.51	0.59	0.50	0.39	0.34	0.25	0.20	0.34	0.39	0.54

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	4.9%	6.3%	6.6%	7.1%	7.4%	6.7%	7.6%	7.2%	6.5%	1.7%
Return on Equity	10.5%	13.9%	14.5%	14.7%	14.4%	12.1%	13.5%	13.4%	13.1%	3.4%
ROIC	7.0%	8.9%	9.4%	10.2%	10.5%	9.4%	11.2%	10.5%	9.6%	2.2%
Shares Out.	22	22	22	23	23	23	23	23	23	23
Revenue/Share	84.10	77.70	76.48	82.35	85.48	79.72	80.40	100.74	120.24	101.36
FCF/Share	(0.84)	2.82	4.72	5.14	3.62	4.84	4.71	(5.25)	(6.10)	(3.72)

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

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