



Stepan Co. (SCL)

Updated November 9th, 2024, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$79 | 5 Year CAGR Estimate: | 5.9% | Market Cap: | \$1.8 B |
| Fair Value Price: | \$48 | 5 Year Growth Estimate: | 15.0% | Ex-Dividend Date: | 11/29/24 |
| % Fair Value: | 166% | 5 Year Valuation Multiple Estimate: | -9.7% | Dividend Payment Date: | 12/13/24 |
| Dividend Yield: | 1.9% | 5 Year Price Target | \$96 | Years Of Dividend Growth: | 57 |
| 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 \$1.8 billion and should do about \$2.2 billion in revenue this year. Stepan is also a Dividend King, having increased its payout for 57 consecutive years.

Stepan posted third quarter earnings on October 30th, 2024, and results were mixed. Adjusted earnings-per-share came in well ahead of expectations at \$1.03, which was 38 cents better than expected. Revenue, however, was off almost 3% year-over-year to \$547 million, and missed estimates by over \$30 million.

Global sales volume fell 1% year-over-year, as double-digit growth in several of the company's Surfactant end markets were fully offset by demand weakness in Polymers.

Adjusted EBITDA came to \$53.1 million, which was up 11% year-over-year. The gain was driven by higher Surfactant volume and margins, partially offset by margin weakness in Polymers.

Cash from operations came to \$22.7 million, while free cash flow was -\$4 million. Stepan noted it is on track to achieve \$50 million in cost savings this year, and \$13.3 million of that accrued in the third quarter.

The company also boosted the dividend by 2.7% to a new payout of \$1.54 per share annually, extending the company's dividend streak to 57 years.

We see \$2.50 in adjusted earnings-per-share for this year after Q3 results, as Stepan's mix of revenue and margins is not producing much in the way of growth.

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 | \$2.50 | \$5.03 |
| DPS | \$0.69 | \$0.73 | \$0.78 | \$0.86 | \$0.93 | \$1.03 | \$1.13 | \$1.27 | \$1.37 | \$1.47 | \$1.54 | \$2.26 |
| Shares¹ | 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 highly volatile sales growth and margins. The company's cost-saving program has been in place for some time and has yielded operating margin gains. Margins were volatile on a year-over-year basis in 2023 given supply chain issues, which also caused margin

¹ Share count in millions

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problems in 2021 and 2022. So long as this condition persists, Stepan's margins are at risk. We have a high estimate of growth because of the 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 1.9%. 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 | 31.6 | 19.0 |
| Avg. Yld. | 1.3% | 1.6% | 1.3% | 1.2% | 1.1% | 1.1% | 1.1% | 1.0% | 1.3% | 1.6% | 1.9% | 2.4% |

Stepan's price-to-earnings multiple has come well off its highs. The stock is much higher than our estimate of fair value, which we peg at 19 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 remain weak.

We see the yield having potential to rise to around 2.4% 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% | 62% | 45% |

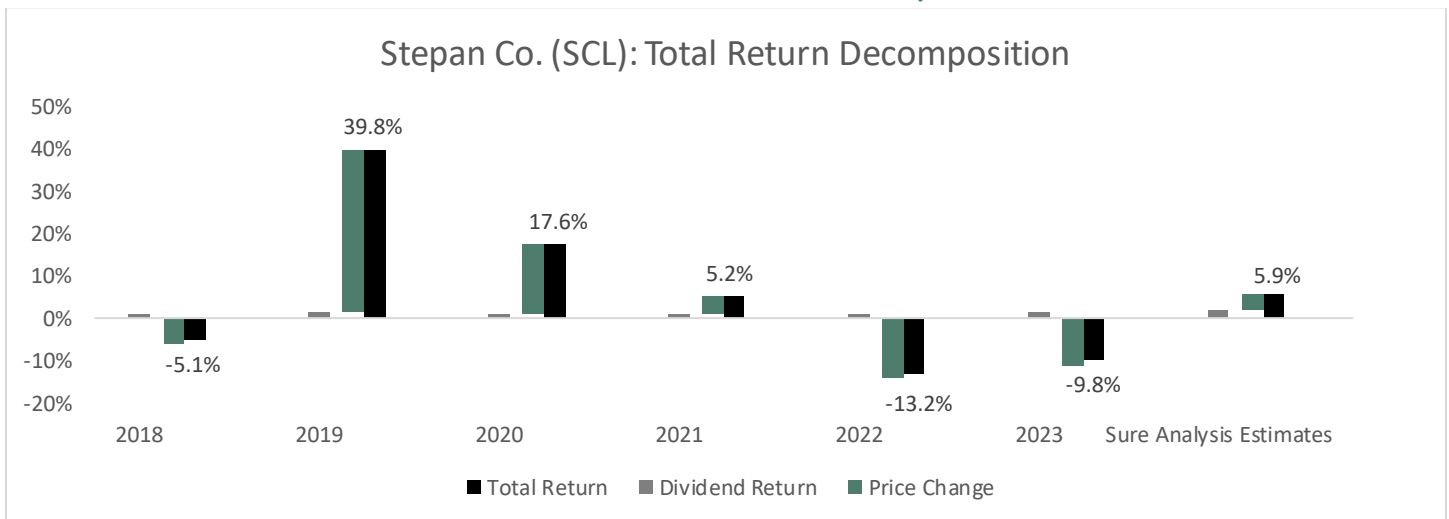
Stepan's payout ratio is about 62% of earnings, and we don't see it moving materially higher given the company's focus on investing in future growth. Struggles with earnings growth is likely to keep management slightly more cautious in the near term in raising the dividend.

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 5.9%, comprised of the 1.9% current yield, 15% earnings-per-share growth and a 9.7% headwind from the valuation. Given this, we're reiterating the stock at a hold rating.

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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