STEPHAN CO
Form 10-Q
May 15, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Quarterly Period Ended: March 31, 2003

Commission File No. 1-4436

THE STEPHAN CO.
(Exact Name of Registrant as Specified in its Charter)

Florida	59-0676812
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1850 West McNab Road, Fort Lauderdale, Florida	33309
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, including Area Code: (954) 971-0600

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.
YES X NO

Approximate number of shares of Common Stock outstanding
as of May 12, 2003:

4,410,577

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13

OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2003

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2003

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR

PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This quarterly report contains certain "forward-looking" statements. The Stephan Co. (the "Company") desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement for the express purpose of availing itself of the protections of such safe harbor with respect to all such forward-looking statements. Such forward-looking statements involve risks, uncertainties and other factors which may cause the actual results, condition (financial or otherwise), performance, trends or achievements of the Company and its subsidiaries to be materially different from any results, condition, performance, trends or achievements projected, anticipated or implied by such forward-looking statements.

Such factors include, but are not limited to, the following: general economic and business conditions; competition; relative success of operating initiatives; development and operating costs; advertising and promotional efforts; brand awareness; the existence or absence of adverse publicity; acceptance of any new product offerings; changing trends in customer tastes; the success of multi-branding; changes in business strategy or development plans; quality of management; costs and expenses incurred by the Company in pursuing strategic alternatives; availability, terms and deployment of capital; business abilities and judgment of personnel; availability of qualified personnel; labor and employee benefit costs; availability and cost of raw materials and supplies; changes in or newly-adopted accounting principles; changes in, or failure to comply with, law; changes in product mix and associated gross profit margins; and other factors or events referenced in this Form 10-Q.

The Company does not undertake, subject to applicable law, any obligation to publicly release the results of any revisions which may be made to any forward-looking statements to reflect events or circumstances occurring after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Therefore, the Company cautions each reader of this report to carefully consider the specific factors and qualifications discussed herein with respect to such forward-looking statements, as such factors and qualifications could affect the ability of the Company to achieve its objectives and may cause actual results to differ materially from those projected, anticipated or implied herein.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31, 2003	December 31, 2002

CURRENT ASSETS		
Cash and cash equivalents	$11,428,304	$ 10,785,995
Accounts receivable, net	2,301,045	1,451,299
Inventories	8,026,280	7,623,764
Income taxes receivable	45,962	65,378
Prepaid expenses and other current assets	195,359	357,829
TOTAL CURRENT ASSETS	21,996,950	20,284,265
CERTIFICATES OF DEPOSIT	6,475,000	6,752,500
PROPERTY, PLANT AND EQUIPMENT, net	1,924,790	2,004,465
GOODWILL, net	5,857,980	5,857,980
TRADEMARKS, net	8,664,809	8,664,809
DEFERRED ACQUISITION COSTS, net	368,007	391,365
OTHER ASSETS, net	2,973,711	3,699,657
TOTAL ASSETS	$ 48,261,247	$ 47,655,041

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2003	December 31, 2002
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,454,274	$ 2,018,236
Current portion of long-term debt	2,243,081	1,496,147
TOTAL CURRENT LIABILITIES	4,697,355	3,514,383

DEFERRED INCOME TAXES, net	902,180	655,773
LONG-TERM DEBT	5,180,000	6,395,443
TOTAL LIABILITIES	10,779,535	10,565,599
COMMITMENTS AND CONTINGENCIES (NOTE 3)		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value	44,106	44,106
Additional paid in capital	18,417,080	18,417,080
Retained earnings	20,372,089	19,979,819
	38,833,275	38,441,005
LESS: 125,000 CONTINGENTLY RETURNABLE SHARES	(1,351,563)	(1,351,563)
TOTAL STOCKHOLDERS' EQUITY	37,481,712	37,089,442
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 48,261,247	$ 47,655,041

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2003	2002 (As Restated, See Note 1)
NET SALES	$ 6,949,058	$ 6,319,916
COST OF GOODS SOLD	3,924,193	3,541,173
GROSS PROFIT	3,024,865	2,778,743
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,220,351	2,237,792
OPERATING INCOME	804,514	540,951
OTHER INCOME(EXPENSE)		
Interest income	65,218	92,166
Interest expense	(102,050)	(135,622)
Royalty income	12,500	26,250
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	780,182	523,745

INCOME TAX EXPENSE	299,701	196,928
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	480,481	326,817
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET OF TAX BENEFIT OF $1,662,911	-	(6,761,576)
NET INCOME/(LOSS)	$ 480,481	$(6,434,759)
BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE:		
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	$ .11	$ .08
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	-	(1.58)
BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE:	$ .11	$ (1.50)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,301,140	4,285,577

See notes to unaudited condensed consolidated financial statements

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THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2003	2002 (As Restated, See Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income/(loss)	$ 480,481	$(6,434,759)
Adjustments to reconcile net income/(loss) to cash flows provided by operating activities:		
Depreciation	82,010	83,118
Amortization of intangible assets	23,358	23,365
Deferred income tax provision/(benefit)	246,407	(1,500,235)
Provision for doubtful accounts	14,602	2,164
Impairment loss on goodwill	-	8,424,487
Changes in operating assets and liabilities:		
Certificates of deposit	277,500	-
Accounts receivable	(864,348)	122,188

Inventories	(402,516)	431,192
Income taxes receivable	19,416	48,672
Prepaid expenses and other current assets	162,470	(21,611)
Other assets	725,946	95,916
Accounts payable and accrued expenses	436,038	(198,903)
Total adjustments	720,883	7,510,353
Net cash flows provided by operating activities	1,201,364	1,075,594

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2003	2002 (As Restated, See Note 1)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(2,335)	(12,229)
Net cash flows used in investing activities	(2,335)	(12,229)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(468,508)	(518,312)
Dividends paid	(88,212)	(88,212)
Net cash flows used in financing activities	(556,720)	(606,524)
INCREASE IN CASH AND CASH EQUIVALENTS	642,309	456,841
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	10,785,995	8,409,142
CASH AND CASH EQUIVALENTS, END OF PERIOD	$11,428,304	$ 8,865,983

Supplemental Disclosures of Cash Flow Information:

Interest paid	$ 145,803	$ 150,134
Income taxes paid	$ 21,379	$ 72,987

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2003 AND 2002

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION: In the opinion of management, all adjustments (consisting only of normal accruals) necessary for a fair presentation of the Stephan Company's (the "Company") financial position and results of operations are reflected in these unaudited interim financial statements.

Information presented for the quarter ended March 31, 2002 has been restated to reflect the adoption of a change in accounting principle, in accordance with SFAS No. 142 (See NEW FINANCIAL ACCOUNTING STANDARDS elsewhere in Note 1).

The results of operations for the three-month period ended March 31, 2003 is not necessarily indicative of the results to be achieved for the year ending December 31, 2003. The December 31, 2002 condensed consolidated balance sheet was derived from the audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). These interim financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2002 appearing in the Company's Form 10-K previously filed with the Securities and Exchange Commission.

Certain amounts previously reported in the 2002 financial statements and notes thereto were reclassified to conform to the 2003 presentation.

NATURE OF OPERATIONS: The Company is engaged in the manufacture, sale and distribution of hair and personal care grooming products principally throughout the United States. Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information", requires the reporting of segment information using a "management approach" as it relates to the operating segments of a business. The Company has allocated its business into three segments: (1) professional hair care products and distribution; (2) retail personal care products; and (3) manufacturing.

USE OF ESTIMATES: The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, money market investment accounts and short-term municipal bonds having maturities of 90 days or less. The Company maintains cash deposits at certain financial institutions in amounts in excess of the federally insured limit. Cash and cash equivalents held in interest-bearing accounts as of March 31, 2003 and December 31, 2002 were approximately $10,542,000 and $10,121,000, respectively.

INVENTORIES: Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market, and are as follows:

	March 31, 2003	December 31, 2002
Raw materials	$ 2,192,666	$ 2,162,273
Packaging and components	3,182,643	3,100,917
Work in progress	304,006	328,976
Finished goods	5,169,226	5,579,290
	10,848,541	11,171,456
Less: Amount included in other assets	(2,822,261)	(3,547,692)
	$ 8,026,280	$ 7,623,764

Raw materials principally include surfactants, chemicals and fragrances used in the production process. Packaging materials include cartons, inner sleeves and boxes used in the actual product, as well as outer boxes and cartons used for shipping purposes. Components are the actual bottles or containers (plastic or glass), jars, caps, pumps and similar materials that become part of the finished product. Finished goods include hair dryers, electric clippers, lather machines, scissors and salon furniture. Included in other assets are raw materials, packaging and components inventory not anticipated to be utilized in less than one year.

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net income/(loss) by the weighted average number of shares of common stock outstanding. The weighted average number of shares outstanding was 4,301,140 for the three months ended March 31, 2003 and 4,285,577 for the three months ended March 31, 2002. For the three months ended March 31, 2003 and 2002, the Company had 732,120 and 813,648 outstanding stock options, respectively, a significant portion of which were anti-dilutive. The inclusion of dilutive stock options in the calculation of earnings per share did not have any impact on the earnings per share for the three months ended March 31, 2003 and 2002.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2003 AND 2002

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK-BASED COMPENSATION: The Company adopted the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure". SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternate methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation and to require prominent disclosures in both annual and interim financial statements about the methods of accounting for stock-based compensation and the effect of the method used on reported results. As permitted by SFAS No's. 148 and 123, the Company continues to apply the accounting provisions of APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations, with regard to the measurement of compensation cost for options granted under the Company's existing plans. No stock-based compensation cost is reflected in net income as all options granted under the plans had an exercise price not less than the market value of the underlying common stock on the date of grant. Had expense been recognized using the fair value method described in SFAS No. 123, using the Black-Scholes option-pricing model, the Company would have reported the following results of operations:

	Three Months Ended March 31,	
	2003	2002
Net income/(loss), as reported	$ 480	$ (6,435)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	25	48
Pro forma net income/(loss)	$ 455	$ (6,483)
Net income/(loss) per share:		
As reported	$ .11	$ (1.50)
Pro forma	$ .11	$ (1.51)

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2003 AND 2002

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NEW FINANCIAL ACCOUNTING STANDARDS: In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". These standards made changes to the accounting for business combinations, goodwill and intangible assets. SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment at least annually. The Company adopted SFAS No. 142 on January 1, 2002. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level upon adoption and at least annually thereafter. The initial step requires that the Company determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of the reporting unit. If the fair value exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the reporting unit may be impaired. The amount, if any, of the impairment would then be measured in the second step. As a result of the impairment review mandated by SFAS No. 142, the Company determined that the carrying value of certain goodwill and other intangible assets with indefinite lives was impaired, decreasing the carrying value of goodwill and other such intangible assets by approximately $8,424,000 ($6,762,000, net of taxes), effective in the quarter ended March 31, 2002. The above impairment charge impacted several different subsidiaries and divisions. Based upon information available to the Company, in general, goodwill and trademark valuations were performed using present value techniques involving estimates of future cash flows.

Amortization expense for deferred acquisition costs, recorded as of March 31, 2003 is anticipated to be as follows: 2003: $93,000; 2004: $84,000; 2005: $82,000; 2006: $66,000; 2007: $66,000.

In November 2002, the FASB issued FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of SFAS Nos. 5, 57 and 107 and rescission of FASB Interpretation No. 34. The interpretation requires certain disclosures to be made by a guarantor about its obligations under certain guarantees that is issued. The Company does not have existing circumstances that would make this Interpretation relevant.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," an amendment of FASB Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2003 AND 2002

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the disclosure provisions of SFAS No. 148.

In January 2003, the FASB issued Financial Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 provides accounting guidance for consolidating of off-balance sheet entities with certain characteristics (variable interest entities). The consolidation requirements apply to variable interest entities created after January 31, 2003 and to variable interest entities in which the Company maintains an interest after June 30, 2003. The Company does not have existing circumstances that would make this Statement relevant.

NOTE 2: SEGMENT INFORMATION

In accordance with the guidelines established by SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company has identified three reportable operating segments based upon how its management evaluates its business. These segments are Professional Hair Care Products and Distribution ("Professional"), Retail Personal Care Products ("Retail") and "Manufacturing". The Professional segment has a customer base consisting generally of distributors that purchase the Company's hair products and beauty and barber supplies for sale to salons and barbershops. The customer base for the Retail segment consists of mass merchandisers, chain drug stores and supermarkets that sell products to end-users. The Manufacturing segment manufactures products for different subsidiaries of the Company and manufactures private label brands for customers.

The Company conducts operations principally in the United States and sales to international customers are not material to its consolidated net sales. Income Before Income Taxes and Cumulative Effect of Change in Accounting Principle as shown below reflects an allocation of corporate overhead expenses incurred by the Manufacturing segment. The following tables, in thousands, summarize Net Sales and Income Before Income Taxes and Cumulative Effect of Change in Accounting Principle by reportable segment:

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2003 AND 2002

NOTE 2: SEGMENT INFORMATION (continued)

	NET SALES	INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE
	Three Months	Three Months

	Ended March 31, 2003	Ended March 31, 2002 (Restated)	Ended March 31, 2003	Ended March 31, 2002 (Restated)
Professional	$ 4,565	$ 4,454	$ 369	$ 233
Retail	2,251	1,702	580	399
Manufacturing	1,781	1,740	(41)	28
Total	8,597	7,896	908	660
Intercompany Manufacturing	(1,648)	(1,576)	(128)	(136)
Consolidated	$ 6,949	$ 6,320	$ 780	$ 524

NOTE 3: COMMITMENTS AND CONTINGENCIES

In addition to the matters set forth below, the Company is involved in other litigation matters arising in the ordinary course of business. It is the opinion of management that none of such matters, at March 31, 2003, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

The United States Court of Appeals for the Ninth Circuit entered an order on April 29, 2002 that, among other things, reversed the judgment of the United States District Court granting summary judgment in favor of New Image Laboratories, Inc. ("New Image") against the Company on New Image's contract claim for a price adjustment and on New Image's claim of breach of the implied covenant of good faith and fair dealing. In addition, the Ninth Circuit's opinion affirmed the lower court's ruling that on the present record New Image is not entitled to (i) damages equal to the diminution in the value of the Company's common stock price between the scheduled and actual disbursement dates or (ii) any attorney's fees. As a consequence of the Ninth Circuit's decision, the judgment granting New Image all 125,000 shares of the Company's common stock being held in escrow has been reversed and the case has been remanded back to the United States District Court for further proceedings. On May 28, 2002, New Image filed a

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

Motion for Rehearing with the Ninth Circuit Court of Appeals and on June 26, 2002, the Court denied the petition for rehearing. A pretrial hearing has been scheduled for June 16, 2003 in connection with the remaining claims of the parties to the litigation.

On November 1, 2001, a private label customer filed a lawsuit against the Company alleging causes of action for breach of contract, declaratory judgment, and trademark infringement. The Company denied the allegations and has counter-sued the customer. The counterclaim seeks unspecified compensatory damages, interest, attorneys fees, costs and other relief on the breach of contract and anticipatory breach claims and, in excess of $400,000 on an account stated claim. On April 16, 2003, the District Court of Appeals for the 4th District of Florida reversed a ruling by the lower trial court granting the customer a temporary injunction. The customer has moved for a rehearing of the issue. At this time, the Company is unable to predict the outcome of this matter.

In November 2001, the Company filed a claim with the U.S. Department of Transportation ("DOT") in the 13th Judicial Circuit Court of Hillsborough County, Florida, in connection with the DOT's widening of Interstate Highway 4, which the Company alleged will result in the loss of an adjacent rental facility utilized by one of the Company's subsidiaries. At a hearing held on August 2, 2002, the Company was successful in asserting a position that would allow for damages to be paid to the Company by the DOT. Court ordered mediation held in May 2003 has not been completed and it is still anticipated that the Company could receive a material damage award. After consultation with legal counsel at this time, the Company is presently unable to accurately predict the amount or type of recovery that will result therefrom.

In November 2002, a stockholder filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Joan Rosoff v. Frank F. Ferola, Shouky Shaheen, Leonard A. Genovese, Curtis Carlson, John DePinto, Thomas M. D'Ambrosio and The Stephan Co., Case Number 0222253, against the Company alleging certain breaches of fiduciary duties and responsibilities. The Company has filed a motion to dismiss the lawsuit and believes it has meritorious defenses.

Other than the above, there has been no material change in the status of any other pending litigation since the Company's last filing of Form 10-K with the Securities and Exchange Commission for the year ended December 31, 2002.

As previously reported, on April 16, 2002, the Company announced that the previously-formed Special Committee (consisting of two outside directors) had accepted a bid by a management led group. This initial bid

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

was to purchase all of the Company's common stock at $4 per share in cash, which offer was later revised to $4.50 per share with $3.25 to be paid in cash, and $1.25 to be paid by a 42-month, unsecured debt instrument providing for interest at an annual rate of 4 1/2%. To fund its payment obligations thereunder, the management group, utilizing its best efforts, intends to establish a separate payment fund in an amount equal to 50% of the aggregate principal and interest amount due under the debt instrument. The management group bid is subject to various conditions, including obtaining adequate financing. The management group is currently negotiating with lenders to obtain financing necessary for the transaction. There is no assurance that the group will be able to obtain such financing on acceptable terms or that the transaction will be consummated.

In late 2001 and during 2002 the Special Committee received from Curtis Rudolph, a shareholder of the Company, an indication of his interest in acquiring the Company; however, no offer was forthcoming. In November 2002, Mr. Rudolph initiated an action in Florida state court (Broward County, Florida) seeking to obtain a review of certain "books and records" of the Company to which he claimed he was entitled as a shareholder of the Company. The Company had previously denied him access to those books and records due to his unwillingness to sign a non-disclosure agreement relating to the Company's non-public information in the standard form required of other potential bidders for the Company. In January 2003, pursuant to a settlement agreement with the Company, Mr. Rudolph agreed to execute the non-disclosure agreement.

By letter dated January 13, 2003, Mr. Rudolph reiterated his interest in making a proposal to acquire the Company. On or about February 14, 2003, Mr. Rudolph submitted an unexecuted proposal to acquire substantially all of the assets and assume certain liabilities of the Company. The Special Committee rejected this proposal as it was unexecuted, contained certain unacceptable terms, was subject to unacceptable conditions, and was structured as an asset purchase rather than a stock purchase. In particular, the asset purchase structure presented substantial negative tax consequences to the Company and its shareholders and was deemed impractical. Under the circumstances, the Special Committee determined Mr. Rudolph's proposal to not be in the best interests of the Company's shareholders. The Board of Directors, through its Special Committee, has continued to negotiate with Mr. Rudolph, but no further offer has been forthcoming.

On April 30, 2003, the Board of Directors approved a definitive merger agreement (the "Agreement") pursuant to which Stephan (the "Company") will be acquired by Gunhill Enterprises, Inc., a wholly-owned subsidiary of Eastchester Enterprises, Inc. Eastchester Enterprises, Inc. is owned by

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

Frank F. Ferola, Thomas M. D'Ambrosio, John DePinto and Shouky A. Shaheen together with their affiliates (the "Acquisition Group"). The Company entered into the Agreement following approval by its Board of Directors based in part upon the unanimous recommendation of the Special Committee comprised of non-management and disinterested directors of the Company's Board of Directors. The Special Committee has received an opinion from SunTrust Robinson Humphrey that the "Merger Consideration" is fair from a financial point of view to the stockholders other than the Acquisition Group.

By the terms of the merger agreement with the Acquisition Group, the Special Committee is expressly authorized to engage, until May 30, 2003, in discussions and negotiations, and to share information, with third parties who may be interested in acquiring the Company in order to seek a potentially superior acquisition proposal. If a superior proposal is not received during this 30-day period, and the Special Committee concludes thereafter that its failure to provide information to, or engage in discussions with, third parties who are interested in acquiring the Company, would be inconsistent with its fiduciary duties to Stephan's stockholders, then the Special Committee may thereafter continue to provide information to, and engage in discussions and negotiations with, such interested parties. Under specified circumstances, Stephan has the right to terminate the Agreement and to enter into an agreement with a party proposing a competing transaction which is deemed superior to the transaction proposed by the Acquisition Group.

Completion of the merger is subject to customary closing conditions, including stockholder approval, and the Agreement does include a financing contingency. Stephan stockholder approval will be solicited by means of a joint proxy/registration statement, which will be mailed by Stephan to stockholders upon completion of the required Securities and Exchange Commission filing and review process.

Independent legal counsel and investment banking advisors have been retained to advise the Special Committee in connection with the transaction. After incurring approximately $225,000 of expenses through March 31, 2003, it is estimated that the remaining costs associated with this process will be in excess of $450,000.

As a result of the length of time for the going private transaction to be consummated, the Company has not submitted any matters to a vote of its security holders since the Company's September 1, 2000 Annual Meeting. In accordance with the rules and regulations of the American Stock Exchange (AMEX), the Company was required to promptly notify its stockholders and AMEX, in writing, indicating the reasons for the failure to have a meeting

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

and to use good faith efforts to ensure that an annual meeting is held as soon as reasonably practicable. In addition, the current composition of the Board of Directors and the current composition of the Audit Committee are in violation of AMEX rules. The continuing non-compliance with these AMEX rules could subject the Company to civil penalties, in addition to the possibility that the stock of the Company could be removed from listing.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

For the three months ended March 31, 2003, net sales were $6,949,000, compared to $6,320,000 for the three months ended March 31, 2002, an increase of $629,000. Gross profit for the three months ended March 31, 2003 was $3,025,000, compared to gross profit of $2,779,000 achieved for the corresponding three-month period in 2002. Operating income of $805,000 for the three months ended March 31, 2003 was $264,000 higher than the $541,000 achieved in the three months ended March 31, 2002. Income before the cumulative effect of a change in accounting principle for the three months ended March 31, 2003 was $480,000, compared to $327,000 achieved in the comparable period for 2002. As a result of the application of SFAS No. 142, net income for the three months ended March 31, 2003 was $480,000 compared to a net loss of $6,435,000 for the three months ended March 31, 2002. Basic and diluted earnings per share before the cumulative effect of a change in accounting principle were $.11 for the three months ended March 31, 2003, compared to $.08 for the three months ended March 31, 2002 but after taking into consideration the impact of the application of SFAS No. 142, the per share amount for the first quarter of 2002 was a net loss of

$1.50.

The Company experienced an overall 10% increase in consolidated net sales in the three-month period ended March 31, 2003 compared with the same period in 2002. The Professional segment achieved a modest 2.5% increase in net sales primarily due to increases in net sales of Image products and hard goods, offset by a decline in net sales of Sorbie and New Era.

As indicated in previous filings, the Company experienced a broad-based increase in net retail sales for the first quarter of 2003 due to a higher demand for Quinsana Medicated Talc, a branded retail item, as a result of the war in the Middle East. As a result, net sales of this brand in the first quarter of 2003 were in excess of total net sales for the entire prior year, however, there can be no assurances that this trend will continue, or that continuing market pricing pressures will not arise with

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

respect to these sales. As a result of the increase in net sales, coupled with increases in other retail brands, the Retail segment experienced a $549,000, or 32% increase over net sales for the three-months ended March 31, 2002. Net sales from private label manufacturing and other sales showed a slight increase from the corresponding three-month period in 2002.

Gross profit for the three months ended March 31, 2003 increased approximately 9% over the corresponding period in 2002; however, the gross profit margin for the three months ended March 31, 2003 declined slightly, from 43.97% for the three months ended March 31, 2002 to 43.53% for the three months ended March 31, 2003.

Selling, general and administrative expenses for the three months ended March 31, 2003 decreased slightly, by $18,000, from a restated $2,238,000 to $2,220,000, when compared to the corresponding three-month period of 2002. The prior year's quarter ended March 31, 2002 was restated to give effect to a reduction in amortization expense as a result of the implementation of SFAS No. 142, effective as of January 1, 2002.

Interest expense for the three months ended March 31, 2003 decreased approximately $34,000 when compared to the corresponding three-month period of 2002 as a direct result of lower interest rates and a decreased level of outstanding indebtedness. It is anticipated that interest expense will continue to decline. Interest income for the three months ended March 31, 2003 decreased approximately $27,000 when compared to the corresponding three-month period of 2002, also as a result of lower interest rates. Although the Company had more cash invested in 2003, it received lower interest rates on its investments as overall interest rates continue to decline.

Other income is comprised of royalty fees received from the licensing of Frances Denney products.

The provision for income taxes increased approximately $103,000, to $300,000 for the three months ended March 31, 2003, from the $197,000 incurred in the corresponding period in 2002, as a result of higher income before the cumulative effect of a change in accounting principle. The income tax rate was relatively consistent, with an effective rate of 38.4% for the three months ended March 31, 2003 compared to 37.6% for the three months ended March 31, 2002. As a result of the implementation of SFAS No. 142, the Company recorded a tax benefit of $1,662,911 for the quarter ended March 31, 2002.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $642,000 to $11,428,000 as of March 31, 2003 from $10,786,000 as of December 31, 2002. Total cash of $17,903,000 includes $6,475,000 of cash invested in certificates of deposit pledged as collateral for a bank loan. Accounts receivable increased $850,000 and inventories increased by approximately $403,000 from the amounts at December 31, 2002 as the result of an increase in sales, and in particular, as a result of the increase in net sales of the Quinsana Medicated Talc as indicated above.

Total current assets at March 31, 2003 were $21,997,000 compared to $20,284,000 at December 31, 2002. Working capital increased $530,000 when compared to December 31, 2002, in spite of an increase in the current portion of long term debt of approximately $747,000 as a result of the final payment due to the Colgate-Palmolive Company in January 2004.

The Company does not anticipate any significant capital expenditures in the near term and management believes that there is sufficient cash on hand and working capital to satisfy upcoming requirements, including any funds that may be needed in connection with the going-private transaction.

The Company does not have any off-balance sheet financing or similar arrangements.

NEW FINANCIAL ACCOUNTING STANDARDS

See Note 1 to the Financial Statements included in Part I, Item 1 for a discussion of new financial accounting standards.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results would differ significantly from those estimates if different assumptions were used or unexpected events transpire. Please see Item 7 in the Company's

Form 10-K for the year ended December 31, 2002 filed with the Securities and Exchange Commission.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2003 AND 2002

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company does not participate in derivative or other financial instruments for which fair value disclosure would be required under SFAS No. 107. In addition, the Company does not invest in securities that would require disclosure of market risk, nor does it have floating rate loans or foreign currency exchange rate risks.

ITEM 4. CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES: Based upon an evaluation of the Company's disclosure controls and procedures, which was completed as of March 31, 2003 (the "Evaluation Date"), the Company's principal executive officer and chief financial officer have concluded that the disclosure controls and procedures in place were effective as of the Evaluation Date.

(b) CHANGES IN INTERNAL CONTROLS: To the best of the Company's knowledge and belief, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2003 AND 2002

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 3 to the Financial Statements included in Part I, Item 1 for a discussion of legal proceedings.

Other than the above, there has been no material change in the status of any other pending litigation since our last periodic report.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit 99.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 99.2 Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K during the quarter ended March 31, 2003

None.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE STEPHAN CO.

/s/ Frank F. Ferola

Frank F. Ferola
President and Chief Executive Officer
May 15, 2003

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
May 15, 2003

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Frank F. Ferola, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Stephan Co.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

6. The Registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Frank F. Ferola

Frank F. Ferola

Chief Executive Officer
May 15, 2003

CERTIFICATION OF CHIEF FINANCIAL OFFICER

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David A. Spiegel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Stephan Co.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

CERTIFICATION OF CHIEF FINANCIAL OFFICER (continued)

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

6. The Registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ David A. Spiegel

David A. Spiegel
Chief Financial Officer
May 15, 2003