STEPHAN CO
Form 10-Q
May 14, 2004

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, 2004

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
YES   NO X

Approximate number of shares of Common Stock outstanding
as of May 10, 2004:

4,410,577

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

OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2004

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2004

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; Stephan's ability to come into compliance with AMEX's continued listing requirements; regulatory approvals of the going-private transaction; 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,	December 31,

	2004	2003
CURRENT ASSETS		
Cash and cash equivalents	$14,429,042	$ 13,302,159
Accounts receivable, net	1,795,584	1,444,508
Inventories	7,280,940	7,497,262
Prepaid expenses and other current assets	196,110	784,601
TOTAL CURRENT ASSETS	23,701,676	23,028,530
CERTIFICATES OF DEPOSIT	5,365,000	5,642,500
PROPERTY, PLANT AND EQUIPMENT, net	1,662,078	1,702,330
GOODWILL, net	5,857,980	5,857,980
TRADEMARKS, net	8,664,809	8,664,809
DEFERRED ACQUISITION COSTS, net	277,893	298,773
OTHER ASSETS, net	2,848,539	2,867,958
TOTAL ASSETS	$ 48,377,975	$ 48,062,880

See notes to unaudited condensed consolidated financial statements

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THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2004	December 31, 2003
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 3,164,805	$ 2,614,731
Current portion of long-term debt	2,442,273	2,442,273
Income taxes payable	46,222	28,270

TOTAL CURRENT LIABILITIES	5,653,300	5,085,274
DEFERRED INCOME TAXES, net	1,168,051	1,133,051
LONG-TERM DEBT	4,070,000	4,347,500
TOTAL LIABILITIES	10,891,351	10,565,825
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	20,377,001	20,387,432
	38,838,187	38,848,618
LESS: 125,000 CONTINGENTLY RETURNABLE SHARES	(1,351,563)	(1,351,563)
TOTAL STOCKHOLDERS' EQUITY	37,486,624	37,497,055
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 48,377,975	$ 48,062,880

See notes to unaudited condensed consolidated financial statements

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

	Three Months Ended March 31,	
	2004	2003
NET SALES	$ 5,958,985	$ 6,949,058
COST OF GOODS SOLD	3,455,362	3,924,193
GROSS PROFIT	2,503,623	3,024,865
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,410,694	2,220,351
OPERATING INCOME	92,929	804,514
OTHER INCOME(EXPENSE)		
Interest income	51,091	65,218
Interest expense	(25,631)	(102,050)
Royalty income	12,500	12,500

INCOME BEFORE INCOME TAXES	130,889	780,182
INCOME TAX EXPENSE	53,108	299,701
NET INCOME	$ 77,781	$ 480,481
BASIC AND DILUTED EARNINGS PER SHARE:	$ .02	$ .11
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,344,220	4,301,140

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,	
	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 77,781	$ 480,481
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation	42,662	82,010
Amortization of intangible assets	20,880	23,358
Deferred income tax expense	35,000	246,407
Provision for doubtful accounts	33,192	14,602
Changes in operating assets and liabilities:		
Accounts receivable	(384,268)	(864,348)
Inventories	216,322	(402,516)
Income taxes payable/receivable	17,952	19,416
Prepaid expenses		

and other current assets	588,491	162,470
Other assets	19,419	725,946
Accounts payable and accrued expenses	550,074	436,038
Total adjustments	1,139,724	443,383
Net cash flows provided by operating activities	1,217,505	923,864

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,	
	2004	2003
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(2,410)	(2,335)
Net cash flows used in investing activities	(2,410)	(2,335)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(277,500)	(468,508)
Dividends paid	(88,212)	(88,212)
Change in certificates of deposit	277,500	277,500
Net cash flows used in financing activities	(88,212)	(279,220)
INCREASE IN CASH AND CASH EQUIVALENTS	1,126,883	642,309
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	13,302,159	10,785,995
CASH AND CASH EQUIVALENTS, END OF PERIOD	$14,429,042	$11,428,304

Supplemental Disclosures of Cash Flow Information:

Interest paid	$ 25,631	$ 145,803
Income taxes paid	$ -	$ 21,379

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2004 AND 2003

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.

The results of operations for the three-month period ended March 31, 2004 is not necessarily indicative of the results to be achieved for the year ending December 31, 2004. The December 31, 2003 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 appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2003, previously filed with the Securities and Exchange Commission.

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. The Company has allocated substantially all of its business into three segments, which include professional hair care products and distribution, retail personal care products and manufacturing.

USE OF ESTIMATES: The preparation of 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 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 could differ from those estimates.

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, 2004 and December 31, 2003 were approximately $12,802,000 and $12,698,000, respectively.

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THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2004 AND 2003

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2004	December 31, 2003
Raw materials	$ 1,968,928	$ 2,007,174
Packaging and components	2,620,024	2,612,798
Work in progress	275,962	257,476
Finished goods	5,114,641	5,338,369
	9,979,555	10,215,817
Less: Amount included in other assets	(2,698,615)	(2,718,555)
	$ 7,280,940	$ 7,497,262

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 is inventory not anticipated to be utilized within one year and is comprised primarily of packaging, components and finished goods. The Company adjusts the carrying value of slow moving inventory, including the estimated costs of disposal, that may ultimately become unusable or obsolete.

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding. The weighted average number of shares outstanding was 4,344,220 for the three months ended March 31, 2004 and 4,301,140 for the three months ended March 31, 2003. For the three months ended March 31, 2004 and 2003, the Company had 597,570 and 732,120 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, 2004 and 2003.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2004 AND 2003

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK-BASED COMPENSATION: The Company adopted the disclosure requirements of Statement of Financial Accounting Standards ("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 (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2004	2003
Net income, as reported	$ 78	$ 480
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	30	25
Pro forma net income	$ 48	$ 455
Net income per share:		
As reported	$ .02	$ .11
Pro forma	$ .01	$ .11

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2004 AND 2003

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NEW FINANCIAL ACCOUNTING STANDARDS: In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), an interpretation of ARB 51. FIN 46, as revised in December 2003, provides guidance on identifying entities for which control is achieved through means other than through voting rights, variable interest entities ("VIE"), and how to determine when and which business enterprises should consolidate the VIE. In addition, FIN 46 requires both the primary beneficiary and all other enterprises with a significant variable interest in a VIE to make additional disclosures. The consolidation provisions of FIN 46 are effective immediately for variable interests in VIE's created after January 31, 2003. For variable interests in VIE's created before February 1, 2003, the provisions of FIN 46 are effective for the first interim or annual period ending after December 15, 2003. The adoption of FIN 46 did not require a change in accounting treatment since the Company has no investments in any VIE's.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This statement establishes standards for the classification and measurement of financial instruments that possess characteristics similar to both liability and equity instruments. SFAS No. 150 also addresses the classification of certain financial instruments that include an obligation to issue equity shares. On October 29, 2003, the FASB voted to defer, for an indefinite period, the application of certain provisions of the guidance in SFAS No. 150 until it could consider some of the resulting implementation issues. The Company has adopted certain provisions of SFAS No. 150 which did not have a material impact on the Company's financial condition or results of operations. The Company does not believe the effect of the provisions of SFAS No. 150 that have been deferred to future periods will have a material impact on the Company's financial statements.

NOTE 2: SEGMENT 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 STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2004 AND 2003

NOTE 2: SEGMENT INFORMATION (continued)

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 as shown below reflects an allocation of corporate overhead expenses (based upon sales) incurred by the Manufacturing segment. The following tables, in thousands, summarize Net Sales and Income Before Income Taxes by reportable segment:

	NET SALES		INCOME BEFORE INCOME TAXES	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2004	2003	2004	2003
Professional	$ 4,386	$ 4,565	$ 300	$ 369
Retail	1,446	2,251	34	580
Manufacturing	1,246	1,781	(111)	(41)
Total	7,078	8,597	223	908
Intercompany Manufacturing	(1,119)	(1,648)	(92)	(128)
Consolidated	$ 5,959	$ 6,949	$ 131	$ 780

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, 2004, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows. Additionally, 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, 2003.

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

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

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 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 scheduled in connection with the remaining claims of the parties has been postponed and settlement negotiations continue. The recorded value of trademarks assumes the return to the Company of the shares held in escrow.

In September 2003, in accordance with the Amended and Restated Sorbie Products Agreement, a Demand for Arbitration was submitted by Sorbie Acquisition Co. (Trevor Sorbie of America, Inc. "TSA") against Trevor Sorbie International, PLC ("PLC"). PLC also filed a Demand for Arbitration and both claims have been consolidated and will be heard together in Pittsburgh, Pennsylvania. TSA has denied the allegations raised by PLC and it has claimed that PLC's assertion of a right to royalty payments is premised upon an incorrect reading of the underlying agreement, and that damages should be awarded in favor of TSA based upon PLC's diversion of Sorbie product and failure to support the brand in violation of the agreement. The Company intends to defend itself against the allegations and does not believe this action will have any material adverse effect on our financial position or results of operations. However, it is early in the process and the Company is unable to predict the outcome of this matter.

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 to purchase all of the shares of common stock of the Company not already owned by such group. The acquisition group's initial bid 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%. On March 22, 2004, the Company announced that the bid was further revised to an all cash price of $4.60 per share, to more appropriately reflect the updated fairness opinion received from SunTrust Robinson Humphrey. On September 19, 2003, at no cost to shareholders, the Company entered into a Working Capital Management Account ("WCMA")

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

agreement with Merrill Lynch Business Financial Services Inc. providing for the creation of a WCMA line of credit not to exceed $5,000,000. Borrowings against the line of credit will be collateralized by the Company's accounts receivable and inventories and the debt will bear a variable interest rate using a 1-month LIBOR rate plus 2.25%. The provisions of the credit line include periodic accounting and reporting requirements, maintenance of certain business and financial ratios as well as restrictions on additional borrowings. As of March 31, 2004, the credit line remains unused.

On April 30, 2003, the Board of Directors approved a definitive merger agreement (the "Merger Agreement") pursuant to which the Company will be acquired by Gunhill Enterprises, Inc., a wholly-owned subsidiary of Eastchester Enterprises, Inc. Eastchester Enterprises, Inc. is owned by Frank F. Ferola, Thomas M. D'Ambrosio, John DePinto and Shouky A. Shaheen (all of whom are current Board members) 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 to be paid pursuant to the Merger Agreement is fair from a financial point of view to the stockholders other than the Acquisition Group. On October 24, 2003, the Company executed an Amended and Restated Merger Agreement extending certain dates and making minor changes to the original Merger Agreement and on November 4, 2003, in connection with the "going-private" transaction, the Company filed a Preliminary Proxy with the Securities and Exchange Commission. In March 2004, the Company executed a further amendment to the merger agreement which, among other things, incorporated the new consideration offered by the acquisition group of $4.60 per share in cash.

If prior to the closing of the transactions contemplated by the Merger Agreement, as amended, the Special Committee concludes 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, the Company 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. The Special Committee has agreed to extend the closing date of the transaction to no later than August 2, 2004. As

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

discussed above, the Company has secured a $5,000,000 line of credit with Merrill Lynch, a portion of which may be used in the "going-private" transaction. Company stockholder approval will be solicited by means of a proxy statement, which will be mailed by the Company 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. The Company incurred approximately $600,000 of expenses through March 31, 2004, and it is estimated that the remaining costs associated with this process will be in excess of $100,000.

As previously reported, due to 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 and to use good faith efforts to ensure that an annual meeting is held as soon as reasonably practicable. The Company included annual meeting materials in its revised proxy statement, filed with the Securities and Exchange Commission on April 13, 2004. In addition, the Company believed it was in violation of certain AMEX rules with respect to the composition of the Board of Directors and the Audit Committee which could subject the Company to civil penalties and/or the delisting of the Company's stock. The Company, based upon on-going discussions with AMEX and the Company's legal counsel, now believes that none of the aforementioned issues are of a material nature and any penalties, if levied, would not be material to the Company's financial position or results of operations.

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

RESULTS OF OPERATIONS

For the three months ended March 31, 2004, net sales were $5,959,000, compared to $6,949,000 for the three months ended March 31, 2003, a decline of $990,000. Gross profit for the three months ended March 31, 2004 was $2,504,000, compared to gross profit of $3,025,000 achieved for the corresponding three-month period in 2003. The decline in net sales and gross profit is substantially a result of the return to a normal level of

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

military orders for Quinsana Medicated Talc. As indicated in previous filings, the first and second quarters of 2003 were favorably impacted by military orders as troops were deployed to the Middle East conflict. In addition, and for largely the same reason as above, the gross margin for the three months ended March 31, 2004 declined to 42% as compared to 43.5% for the three months ended March 31, 2003.

Net income was $78,000 for the three months ended March 31, 2004 compared to net income of $480,000 for the comparable three months ended March 31, 2003. Basic and diluted earnings per share were $.02 for the three months ended March 31, 2004, compared to $.11 for the three months ended March 31, 2003.

As a result of the decline in net sales noted above, significantly all of the sales decline for the quarter ended March 31, 2004 can be attributed to the Retail segment of the business. Professional hard goods experienced a small increase; however, this was offset by a decline in Professional wet goods sales.

Selling, general and administrative ("SG&A") expenses for the three months ended March 31, 2004 increased $190,000 when compared to the corresponding three-month period of 2003. The Company experienced across the board increases in SG&A, with advertising and catalog costs, business insurance and expenses in connection with the "going-private" transaction accounting for a substantial portion of these increases.

Interest expense for the three months ended March 31, 2004 decreased approximately $76,000 when compared to the corresponding three-month period of 2003 as interest on the outstanding obligation to Colgate-Palmolive ceased to accrue as of December 31, 2003. On April 7, 2004, the Company and Colgate-Palmolive mutually agreed to settle all outstanding claims and issues between them. The net result of this settlement was a reduction of the outstanding obligation by approximately $418,000. This amount will be reflected as a gain in the second quarter of 2004. Interest income for the three months ended March 31, 2004 decreased approximately $14,000 when compared to the corresponding three-month period of 2003, as a result of lower interest rates. Although the Company had more cash invested in 2004, it received lower interest rates on its investments as overall interest rates continue to decline.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $1,127,000 to $14,429,000 as of

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

March 31, 2004 from $13,302,000 as of December 31, 2003. Total cash of $19,794,000 includes $5,365,000 of cash invested in certificates of deposit pledged as collateral for a bank loan. Total current assets at March 31, 2004 were $23,702,000 compared to $23,029,000 at December 31, 2003.

As a result of continuing efforts to increase sales, the Company has tried to enhance product exposure by increasing the frequency of catalog distribution for Professional hard goods as well as taking on new product lines. In 2004, the Morris-Flamingo Stephan subsidiary was successful in becoming a distributor for a well-known and frequently used text book series for beauty schools. While this commitment required a substantial opening order, the addition of this line is already having a positive impact on sales and the Company is optimistic that this line will aid in increasing overall sales in 2004. This commitment represents a significant portion of the increase in accounts payable as of March 31, 2004.

Other than the amounts required to pay the officers bonuses and to retire the Colgate-Palmolive debt (representing an aggregate amount of approximately $1,681,000), the Company does not anticipate any other 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

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

Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission.

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, 2004 (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, 2004 AND 2003

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:

10.17 Second Amended and Restated Agreement and Plan of Merger, dated March 24, 2004, by and among The Stephan Co., Gunhill Enterprises and Eastchester Enterprises, including exhibits, included with Form 8-K filed March 30, 2004, is incorporated herein by reference.

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 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.

32.2 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, 2004

Current report on Form 8-K filed on March 30, 2004, in connection with a Second Amended and Restated Agreement and Plan of Merger signed on March 24, 2004, between The Stephan Co., Eastchester Enterprises, Inc. and Gunhill Enterprises, Inc.

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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 14, 2004

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
May 14, 2004