STEPHAN CO
Form 10-Q
September 30, 2005

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: June 30, 2005

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 NO X

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
YES NO X

Approximate number of shares of Common Stock outstanding
as of September 15, 2005:

4,389,805

THE STEPHAN CO. AND SUBSIDIARIES

QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2005

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2005

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. ("Stephan" or 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.

Words such as "projects," "believe," "anticipates," "estimate," "plans," "expect," "intends," and similar words and expressions are intended to identify forward-looking statements and are based on our current expectations, assumptions, and estimates about us and our industry. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct.

Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors, risks and uncertainties. These factors, risks and uncertainties include, without limitation, the possibility of delisting, or halt in trading of, the Company's common stock from the American Stock Exchange and the repercussions from any such delisting, or halt in trading; our ability to satisfactorily address any material weaknesses in our financial controls; general economic and business conditions; competition; the relative success of our operating initiatives; our development and operating costs; our advertising and promotional efforts; brand awareness for our product offerings; the existence or absence of adverse publicity; acceptance of any new product offerings; changing trends in customer tastes; the success of any multi-branding efforts; changes in our business strategy or development plans; the quality of our management team; costs and expenses incurred by us in pursuing strategic alternatives; the availability, terms and deployment of capital; the business abilities and judgment of our personnel; the availability of qualified personnel; our labor and employee benefit costs; the availability and cost of raw materials and supplies; changes in or newly-adopted accounting principles; changes in, or our failure to comply with, applicable laws and regulations;

changes in our product mix and associated gross profit margins; as well as management's response to these factors, and other factors that may be more fully described in the Company's literature, press releases and publicly-filed documents with the Securities and Exchange Commission. You are urged to carefully review and consider these disclosures, which describe certain factors that affect our business.

We do 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, we caution 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 our ability to achieve our objectives and may cause actual results to differ materially from those projected, anticipated or implied herein.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	June 30, 2005	December 31, 2004
CURRENT ASSETS		

Cash and cash equivalents	$ 4,460,537	$ 4,402,463
Restricted cash	1,110,000	1,110,000
Accounts receivable, net	1,470,486	1,753,250
Inventories	7,857,222	7,164,901
Income taxes receivable	257,769	209,203
Prepaid expenses and other current assets	114,768	374,079
TOTAL CURRENT ASSETS	15,270,782	15,013,896
RESTRICTED CASH	2,778,187	3,430,408
PROPERTY, PLANT AND EQUIPMENT, net	1,714,899	1,627,227
GOODWILL, net	4,013,458	4,013,458
TRADEMARKS, net	8,364,809	8,364,809
DEFERRED ACQUISITION COSTS, net	174,892	216,652
OTHER ASSETS, net	1,837,868	2,052,405
TOTAL ASSETS	$ 34,154,895	$ 34,718,855

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

	June 30, 2005	December 31, 2004
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,417,000	$ 2,165,751
Current portion of long-term debt	1,110,000	1,110,000
TOTAL CURRENT LIABILITIES	3,527,000	3,275,751

DEFERRED INCOME TAXES, net	1,488,611	1,488,116
LONG-TERM DEBT	2,682,500	3,237,500
TOTAL LIABILITIES	7,698,111	8,001,367
COMMITMENTS AND CONTINGENCIES (NOTE 3)		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value	43,898	43,898
Additional paid in capital	17,556,731	17,556,731
Retained earnings	8,856,155	9,116,859
TOTAL STOCKHOLDERS' EQUITY	26,456,784	26,717,488
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 34,154,895	$ 34,718,855

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2005	2004
NET SALES	$ 10,573,491	$ 11,514,539
COST OF GOODS SOLD	6,194,990	6,668,422
GROSS PROFIT	4,378,501	4,846,117
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	4,498,062	4,586,692
OPERATING (LOSS)/INCOME	(119,561)	259,425
OTHER INCOME(EXPENSE)		
Interest income	51,494	98,811
Interest expense	(53,197)	(49,933)
Other income, net	25,000	318,145

(LOSS)/INCOME BEFORE INCOME TAXES	(96,264)	626,448
INCOME TAX (BENEFIT)/EXPENSE	(11,154)	236,973
NET (LOSS)/INCOME	$ (85,110)	$ 389,475
BASIC AND DILUTED (LOSS)/EARNINGS PER SHARE	$ (.02)	$ .09
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,389,805	4,360,043

See notes to unaudited condensed consolidated financial statements

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

	Three Months Ended June 30,	
	2005	2004
NET SALES	$ 5,056,680	$ 5,555,554
COST OF GOODS SOLD	3,037,310	3,213,060
GROSS PROFIT	2,019,370	2,342,494
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,255,338	2,175,998
OPERATING (LOSS)/INCOME	(235,968)	166,496
OTHER INCOME(EXPENSE)		
Interest income	24,422	47,720
Interest expense	(21,935)	(24,302)
Other income, net	12,500	305,645
(LOSS)/INCOME BEFORE INCOME TAXES	(220,981)	495,559

INCOME TAX (BENEFIT)/EXPENSE	(61,673)	183,865
NET (LOSS)/INCOME	$ (159,308)	$ 311,694
BASIC AND DILUTED (LOSS)/EARNINGS PER SHARE	$ (.04)	$ .07
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,389,805	4,365,376

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)/income	$ (85,110)	$ 389,475
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation	72,628	81,007
Amortization of intangible assets	41,760	41,760
Write-down of inventories	20,000	-
Deferred income tax provision	495	266,601
Provision for doubtful accounts	22,222	39,932
Settlement of Colgate-Palmolive debt	-	(417,745)
Changes in operating assets and liabilities:		
Accounts receivable	260,542	(306,419)
Inventories	(712,321)	119,301
Income taxes payable	(48,566)	306
Prepaid expenses and other current assets	259,311	654,246

Other assets	214,537	(176,381)
Accounts payable and accrued expenses	251,249	(164,341)
Total adjustments	381,857	138,267
Net cash flows provided by operating activities	296,747	527,742

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2005	2004
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	652,221	555,000
Purchase of property, plant and equipment	(160,300)	(37,226)
Net cash flows provided by investing activities	491,921	517,774
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(555,000)	(1,469,528)
Dividends paid	(175,594)	(176,423)
Net cash flows used in financing activities	(730,594)	(1,645,951)
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	58,074	(600,435)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,402,463	13,302,159
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 4,460,537	$12,701,724
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 31,025	$ 152,681

Income taxes paid	$ 22,016	$ 46,595

See notes to unaudited condensed consolidated financial statements

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THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2005 AND 2004

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 and six-month periods ended June 30, 2005 is not necessarily indicative of the results to be achieved for the year ending December 31, 2005. The December 31, 2004 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, 2004, 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 after 90 days or less when acquired. 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 June 30, 2005 and December 31, 2004 were approximately $4,170,000 and $3,824,000, respectively.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2005 AND 2004

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:

	June 30, 2005	December 31, 2004
Raw materials	$ 1,777,060	$ 1,827,553
Packaging and components	2,425,225	2,187,901
Work in progress	217,881	429,552
Finished goods	5,173,878	4,651,422
	9,594,044	9,096,428
Less: Amount included in other assets	(1,736,822)	(1,931,527)
	$ 7,857,222	$ 7,164,901

Raw materials 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 reduces the carrying value of inventory to provide for these slow moving goods that includes the estimated costs of disposal of inventory 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 4,389,805 and 4,360,043, respectively, for the six months ended June 30, 2005 and 2004. For the three months ended June 30, 2005 and 2004, the weighted average number of shares outstanding was 4,389,805 and 4,365,376, respectively. For the six months ended June 30, 2005 and 2004, the Company had 355,298 and 597,570 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 month period ended June 30, 2004. Stock options were not included in the calculation of earnings per share for the six and three month periods ended

June 30, 2005 because all options would be anti-dilutive as a result of the net loss for the respective periods.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2005 AND 2004

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):

	Six Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
Net (loss)/income, as reported	$ (85)	$ 389	$ (159)	$ 312
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	50	63	30	33
Pro forma net (loss)/income	$ (135)	$ 326	$ (189)	$ 279
Net (loss)/income per share:				
As reported	$ (.02)	$ .09	$ (.04)	$ .07
Pro forma	$ (.03)	$ .07	$ (.05)	$ .06

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2005 AND 2004

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NEW FINANCIAL ACCOUNTING STANDARDS: In December 2004, the Financial Accounting Standards Board ("FASB") issued a revised Statement of Financial Accounting Standards ("SFAS") No. 123 impacting the accounting treatment for share-based payments. The revised statement requires companies to reflect in the income statement compensation expense related to the grant-date fair value of stock options and other equity-based compensation issued to employees over the period that such awards are earned. The statement is effective for the Company's 2006 fiscal year.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections". This statement replaces previous issued guidance and changes the requirements for the accounting and reporting of voluntary changes in accounting principles.

RECLASSIFICATIONS: Restricted cash collateralizing the current portion of long-term debt was reclassified as a current asset at December 31, 2004. Changes in restricted cash balances have been presented as cash flows from investing activities in the accompanying Consolidated Statements of Cash Flows. Such amounts were previously classified as cash flows from financing activities. As a result, net cash flows used in investing activities in the aforementioned Statements decreased by $555,000 with a corresponding increase in cash flows used in financing activities for the six months ended June 30, 2004.

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 Company conducts operations principally in the United States and sales to international customers are not material to its consolidated net sales. (Loss)/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 (Loss)/Income Before Income Taxes by reportable segment:

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2005 AND 2004

NOTE 2: SEGMENT INFORMATION (continued)

	NET SALES Six Months Ended June 30, 2005	2004	NET SALES Three Months Ended June 30, 2005	2004
Professional	$ 8,311	$ 8,604	$ 4,056	$ 4,218
Retail	1,953	2,624	826	1,177
Manufacturing	2,416	2,763	1,262	1,519
Total	12,680	13,991	6,144	6,914
Intercompany Manufacturing	(2,107)	(2,476)	(1,087)	(1,358)
Consolidated	$10,573	$11,515	$ 5,057	$ 5,556

	(LOSS)/INCOME BEFORE INCOME TAXES Six Months Ended June 30, 2005	2004	(LOSS)/INCOME BEFORE INCOME TAXES Three Months Ended June 30, 2005	2004
Professional	$ 456	$ 630	$ 140	$ 330
Retail	(13)	378	(48)	344
Manufacturing	(539)	(382)	(313)	(178)
Consolidated	$ (96)	$ 626	$ (221)	$ 496

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 these matters, at June 30, 2005, 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, 2004.

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

As previously reported, 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.

Specifically, the Company was not in compliance with Section 704 of the AMEX Company Guide in that it has not held an annual meeting of stockholders since September 1, 2000. In addition, the Company was not in compliance with Sections 134, 1101 and 1003(d) of the AMEX Company guide due to the failure to file a timely Annual Report on Form 10-K for the year ended December 31, 2004 and the Quarterly Report on Form 10-Q for the period ended March 31, 2005. On June 7, 2005, The Company received notification that the AMEX was proceeding with delisting procedures. Following a delisting hearing before an AMEX Listing Qualifications Panel held on July 27, 2005, on August 3, 2005, the Company received the Panel's unanimous written decision granting the Company an extension of time until September 30, 2005, to regain compliance with AMEX listing standards. However, the Panel also unanimously agreed that should the Company not be in complete compliance with AMEX listing standards by September 30, 2005, the AMEX could then immediately move to delist the Company's common stock. The Panel based its decision upon the Company's representations at the hearing and its public filings. The Company held an annual meeting of shareholders on September 29, 2005, and with the filing of this Report and its Form 10-Q for the quarter ended June 30, 2005, expects to be current with all of its periodic filings with the SEC and in compliance with applicable AMEX rules.

The Company believes that if its common stock is delisted from AMEX, such delisting is not expected to have a direct impact on the financial condition or operations of the Company, but it could adversely affect the liquidity and price of the Company's common stock, as well as the Company's ability to raise additional capital.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2005 AND 2004

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

RESULTS OF OPERATIONS

Six months ended June 30, 2005:

For the six months ended June 30, 2005, net sales were $10,573,000, compared to $11,515,000 achieved in the corresponding six months of 2004. Gross profit for the six months ended June 30, 2005 was $4,379,000, compared to gross profit of $4,846,000 achieved for the corresponding six-month period in 2004. The decline in net sales and gross profit is a result of a decrease in net sales of the Professional Wet Goods segment as well as a decline in net sales of the Retail brands segment. These declines were largely a result of an overall decrease in demand. The overall gross margin for the six months ended June 30, 2005 was 41.4% as compared to 42.1% for the six months ended June 30, 2004.

Selling, general and administrative expenses for the six months ended June 30, 2005 decreased by $89,000, to $4,498,000, when compared to the corresponding 2004 six-month period total of $4,587,000. This decrease was due to an across the board decline in selling expenses, offset by an increase in general and administrative expenses, and in particular, legal and professional fees in connection with various SEC, AMEX and audit matters.

Interest expense for the six months ended June 30, 2005 was $53,000, a decrease of approximately $3,000 from the $50,000 incurred in the corresponding period of 2004. The Company continues to accrue interest on the Sorbie arbitration award, offsetting any decline in interest expense on our bank debt. Interest income of $51,000 for the six months ended June 30, 2005 was lower than the $99,000 earned in the corresponding six months of 2004 due to a decline in invested cash as a result of the special $2.00 per share dividend distributed to shareholders in September 2004. Other income includes royalty fees received from the licensing of Frances Denney products.

The net loss for the six-month period ended June 30, 2005 was $85,000, compared to net income of $389,000 for the six months ended June 30, 2004. This difference is a result of several unique circumstances that occurred and were reflected in "other income" in the first half of fiscal 2004. As indicated in previously filed reports, 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 an outstanding debt obligation by approximately $418,000. This amount is reflected in other income in the second quarter of 2004. In addition to the Colgate-Palmolive settlement, other income was also impacted by the

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

settlement of another lawsuit. In one case, the Company received $150,000 in connection with a customer's failure to perform on a purchase order issued by them to the Company.

As a result of the loss for the six-month period ended June 30, 2005, there is a net benefit for income taxes of $11,000, after taking into account state income taxes of $19,000.

The basic and diluted loss per share was $0.02 for the six months ended June 30, 2005, compared to earnings per share of $0.09 for the six months ended June 30, 2004, based on a weighted average number of shares outstanding of 4,389,805 and 4,360,043, respectively.

Three months ended June 30, 2005:

For the three months ended June 30, 2005, net sales were $5,057,000, compared to $5,556,000 for the three months ended June 30, 2004, a decline of $499,000. Gross profit for the three months ended June 30, 2005 was $2,019,000, compared to gross profit of $2,342,000 achieved for the corresponding three-month period in 2004. As indicated above, similarly to the six-month period, the decline in net sales and gross profit is a result of a decrease in net sales of the Professional Wet Goods segment as well as a decline in net sales of the Retail brands segment. The gross margin for the three months ended June 30, 2005 was 39.9% as compared to 42.2% for the three months ended June 30, 2004, due in most part to the change in the sales mix.

Selling, general and administrative expenses for the three months ended June 30, 2005 increased by $79,000, from $2,176,000 to $2,255,000, when compared to the corresponding three-month period of 2004, primarily as a result of increase professional fees as discussed above.

Interest income for the three-month period ended June 30, 2005 was $24,000, a decrease of approximately $24,000 when compared to $48,000 earned in the corresponding three-month period of 2004, as a result of less invested cash.

The income tax benefit for the three months ended June 30, 2005 was $62,000 compared to net income taxes of $184,000 for the three-month period ended June 30, 2004. For the three months ended June 30, 2005, there was a net loss of $159,000 compared to net income of $312,000 for the corresponding period in 2004, due largely to other income items explained above. Basic and diluted loss per share was $0.04 for the three months

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

ended June 30, 2005 and earnings per share of $0.07 for the three months ended June 30, 2004, based on a weighted average number of shares of 4,389,805 and 4,365,376, respectively.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $58,000 from December 31, 2004, to $4,460,000 at June 30, 2005. Total cash of $8,349,000 at June 30, 2005 includes $3,888,000 of cash invested in a restricted money market account pledged as collateral for a bank loan. Accounts receivable were $1,470,000 at June 30, 2005, a decrease of $283,000 from the $1,753,000 at December 31, 2004; inventories increased approximately $692,000 from $7,165,000 at December 31, 2004 to $7,857,000 at June 30, 2005, as the Company increased inventory levels for anticipated third-quarter sales.

Total current assets at June 30, 2005 were $15,271,000 compared to $15,014,000 at December 31, 2004. Working capital increased $6,000 when compared to December 31, 2004. The Company currently anticipates construction of additional warehouse facilities on the Tampa, Florida manufacturing property, estimated to cost approximately $1,000,000. The Company continues to review construction designs and site plans, obtained the necessary permits and expects to begin construction in the fourth quarter of 2005. As has been the case in the past, the bulk of the Company's insurance policies renew in July, so it is anticipated that approximately $250,000 will be paid in the third quarter of 2005 for these renewals. Other than the above, 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.

In June 2005, the Company acquired the "American Manicure" nail care line for approximately $150,000. This product line offers a less toxic alternative to "French" manicures. Under the terms of the agreement, a substantial portion of the purchase price was for existing inventory, and the former owner of the business will receive a monthly royalty on sales of the product line; this monthly royalty is not considered material at the present time.

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

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

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 Annual Report on Form 10-K for the year ended December 31, 2004 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: As of the end of the period covered by this quarterly report, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was performed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that a material weakness existed in our internal controls over financial reporting and consequently our disclosure controls and procedures were not effective, as of the end of the period covered by this quarterly report, in timely alerting them as to material information relating to our Company (including our consolidated subsidiaries) required to be included in this quarterly report.

ITEM 4. CONTROLS AND PROCEDURES (continued)

The material weakness in our internal controls over financial reporting as of June 30, 2005 related to the fact that as a small public company, we have an insufficient number of personnel with clearly delineated and fully documented responsibilities and with the appropriate level of accounting expertise and we have insufficient documented procedures to identify and prepare a conclusion on matters involving material accounting issues and to independently review conclusions as to the application of generally accepted accounting principles. The lack of a sufficient number of accounting personnel is not considered appropriate for an internal control structure designed for external reporting purposes. The principal factors management considered in determining whether a material weakness existed in this regard was based upon management's evaluation discussed above and advice from our previous independent registered public accounting firm. As a result, management has determined that a material weakness in the effectiveness of the Company's internal controls over financial reporting existed as of June 30, 2005.

(b) CHANGES IN INTERNAL CONTROLS: No change in the Company's internal control over financial reporting occurred during the Company's first fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. However, management of the Company, as well as the Audit Committee, recognizes that current staffing levels will have to be enhanced and/or institute arrangements with other accounting firms to act in a consulting capacity in an effort to satisfy our reporting obligations and over-all standards of disclosure controls and procedures.

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2005 AND 2004

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

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.

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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
September 30, 2005

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
September 30, 2005