STEPHAN CO
Form 10-Q
November 21, 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: September 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 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

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 November 4, 2005:

4,389,805

THE STEPHAN CO. AND SUBSIDIARIES

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

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

	September 30, 2005	December 31, 2004
CURRENT ASSETS		

Cash and cash equivalents	$ 4,741,068	$ 4,402,463
Restricted cash	3,610,463	1,110,000
Accounts receivable, net	2,307,998	1,753,250
Inventories	6,734,431	7,164,901
Income taxes receivable	234,223	209,203
Prepaid expenses and other current assets	286,311	374,079
TOTAL CURRENT ASSETS	17,914,494	15,013,896
RESTRICTED CASH	-	3,430,408
PROPERTY, PLANT AND EQUIPMENT, net	1,698,709	1,627,227
GOODWILL, net	4,013,458	4,013,458
TRADEMARKS, net	8,364,809	8,364,809
DEFERRED ACQUISITION COSTS, net	160,941	216,652
OTHER ASSETS, net	1,905,693	2,052,405
TOTAL ASSETS	$ 34,058,104	$ 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

	September 30, 2005	December 31, 2004
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,588,196	$ 2,165,751
Current portion of long-term debt	3,515,000	1,110,000
TOTAL CURRENT LIABILITIES	6,103,196	3,275,751

DEFERRED INCOME TAXES, net	1,492,064	1,488,116
LONG-TERM DEBT	-	3,237,500
TOTAL LIABILITIES	7,595,260	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	8,862,215	9,116,859
TOTAL STOCKHOLDERS' EQUITY	26,462,844	26,717,488
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 34,058,104	$ 34,718,855

See notes to unaudited condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2005	2004
NET SALES	$ 17,141,001	$ 18,819,564
COST OF GOODS SOLD	10,437,736	10,977,964
GROSS PROFIT	6,703,265	7,841,600
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	6,712,074	7,566,271
OPERATING (LOSS)/INCOME	(8,809)	275,329
OTHER INCOME(EXPENSE)		
Interest income	86,061	145,616
Interest expense	(74,122)	(73,176)
Other income, net	37,500	320,245

INCOME BEFORE INCOME TAXES	40,630	668,014
INCOME TAX EXPENSE	31,884	249,195
NET INCOME	$ 8,746	$ 418,819
BASIC AND DILUTED EARNINGS PER SHARE	$ .00	$ .10
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,401,454	4,335,336

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 September 30,	
	2005	2004
NET SALES	$ 6,567,510	$ 7,305,025
COST OF GOODS SOLD	4,242,746	4,309,542
GROSS PROFIT	2,324,764	2,995,483
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,214,012	2,979,579
OPERATING INCOME	110,752	15,904
OTHER INCOME(EXPENSE)		
Interest income	34,567	46,805
Interest expense	(20,925)	(23,243)
Other income, net	12,500	2,100
INCOME BEFORE INCOME TAXES	136,894	41,566

INCOME TAX EXPENSE	43,038	12,222
NET INCOME	$ 93,856	$ 29,344
BASIC AND DILUTED EARNINGS PER SHARE	$ .02	$ .01
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,401,454	4,394,385

See notes to unaudited condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,746	$ 418,819
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation	108,302	118,631
Amortization of intangible assets	55,711	62,640
Write-down of inventories	60,000	100,000
Compensation expense resulting from exercise of stock options	-	415,430
Deferred income tax provision	3,948	269,187
Provision for doubtful accounts	24,414	61,323
Changes in operating assets and liabilities:		
Accounts receivable	(579,162)	(954,554)
Inventories	370,470	66,828
Income taxes receivable/payable	(25,020)	(13,122)
Prepaid expenses		

and other current assets	87,768	252,186
Other assets	146,712	437,320
Accounts payable and accrued expenses	422,445	(232,712)
Total adjustments	675,588	583,157
Net cash flows provided by operating activities	684,334	1,001,976

See notes to unaudited condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2005	2004
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	929,945	824,839
Purchase of property, plant and equipment	(179,784)	(42,541)
Net cash flows provided by investing activities	750,161	782,298
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(832,500)	(2,164,773)
Dividends paid	(263,390)	(8,998,741)
Proceeds from exercise of stock options	-	75,576
Net cash flows used in financing activities	(1,095,890)	(11,087,938)
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	338,605	(9,303,664)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,402,463	13,302,159
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 4,741,068	$ 3,998,495

Supplemental Disclosures of
Cash Flow Information:

Interest paid	$ 45,387	$ 175,918
Income taxes paid	$ 45,771	$ 69,659

Supplemental Disclosure of Non-Cash Investing and Financing Activities:

On August 20, 2004, 125,000 contingently returnable shares, carried at $1,351,563, were retired and Common Stock and Additional Paid in Capital were reduced by the same amount in the aggregate.

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED SEPTEMBER 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 nine and three-month periods ended September 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 September 30, 2005 and December 31, 2004 were approximately $4,020,000 and $3,824,000, respectively.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED SEPTEMBER 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:

	September 30, 2005	December 31, 2004
Raw materials	$ 1,591,855	$ 1,827,553
Packaging and components	2,450,865	2,187,901
Work in progress	266,413	429,552
Finished goods	4,229,472	4,651,422
	8,538,605	9,096,428
Less: Amount included in other assets	(1,804,174)	(1,931,527)
	$ 6,734,431	$ 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 4,401,454 and 4,335,336, respectively, for the nine months ended September 30, 2005 and 2004. For the three months ended September 30, 2005 and 2004, the weighted average number of shares outstanding was 4,401,454 and 4,394,385, respectively. For the nine months ended September 30, 2005 and 2004, the Company had 351,240 and 291,822 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 nine and three month periods ended September 30, 2005.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED SEPTEMBER 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):

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2005	2004	2005	2004
Net income, as reported	$ 9	$ 419	$ 94	$ 29
Add: Stock-based compensation included in reported net income, net of related tax effects	-	272	-	272
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(100)	(371)	(50)	(308)
Pro forma net (loss)/income	$ (91)	$ 320	$ 44	$ (7)
Net (loss)/income per share:				
As reported	$ .00	$ .10	$ .02	$ .01
Pro forma	$ (.02)	$ .07	$ .01	$ .00

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 $825,000 with a corresponding increase in cash flows used in financing activities for the nine months ended September 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. 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:

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

NOTE 2: SEGMENT INFORMATION (continued)

	NET SALES Nine Months Ended Sept. 30, 2005	2004	NET SALES Three Months Ended Sept. 30, 2005	2004
Professional	$13,377	$13,897	$ 5,065	$ 5,293
Retail	3,221	4,435	1,269	1,811
Manufacturing	4,058	4,194	1,642	1,431
Total	20,656	22,526	7,976	8,535
Intercompany Manufacturing	(3,515)	(3,706)	(1,408)	(1,230)
Consolidated	$17,141	$18,820	$ 6,568	$ 7,305

	INCOME BEFORE INCOME TAXES Nine Months Ended Sept. 30, 2005	2004	INCOME BEFORE INCOME TAXES Three Months Ended Sept. 30, 2005	2004
Professional	$ 702	$ 485	$ 246	$ 18
Retail	(25)	366	(12)	20
Manufacturing	(636)	(183)	(97)	4
Consolidated	$ 41	$ 668	$ 137	$ 42

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 September 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)

Shouky A. Shaheen, a minority owner of Shaheen & Co., Inc., who owns the building the Company leases in Danville, IL, is currently a member of the Board of Directors and a significant shareholder of the Company. On May 4, 2005, the Company entered into a Second Amendment of Lease Agreement (the "Amendment") for the Danville facility. The Amendment extends the term of the lease to June 30, 2015, with a five year renewal option. The base rent is adjustable annually, in accordance with the existing master lease, whose terms, including a 90-day right of termination by the Company, remain in full force and effect; however, the enforceability of this termination clause is the subject of a recent legal action (see below). In addition, the Company has a purchase option, during the term of the lease, to purchase the premises at the then fair market value of the building, or to match any bona fide third-party offer to purchase the premises. On July 6, 2005, the landlord notified the Company that its interpretation of the Amendment differs from that of the Company as to the existence of the 90-day right of termination. On October 14, 2005, in the Circuit Court of the 17th Judicial Circuit for Broward County, Florida, Shaheen & Co., Inc. commenced a lawsuit seeking a declaratory judgment with respect to the cancellation rights contained in the Amendment, in addition to an unspecified amount for damages. This matter is currently unresolved and the Company is unable, at this time, to determine the outcome of the litigation.

On September 29, 2005, the Company held its Annual Meeting of Stockholders and filed its Form 10-Q for the three months ended March 31, 2005. On September 30, 2005, the Company filed its Form 10-Q for the six and three month periods ended June 30, 2005. Accordingly, the Company has complied with the August 3, 2005 decision of the Listing Qualifications Panel of the American Stock Exchange ("AMEX") Committee on Securities, which required the Company to regain compliance with all AMEX listing standards by September 30, 2005, or face immediate delisting. On October 31, 2005, the Company received notice from AMEX confirming the above and that the Hearings Department considers the matters resolved in a satisfactory manner. The AMEX letter also indicated that the Company was now subject to the provisions of Section 1009(h) of the AMEX Company Guide, which subjects the Company to accelerated procedures in connection with the initiation of delisting procedures should the Company again fall below continued listing standards within one year.

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

RESULTS OF OPERATIONS

Nine months ended September 30, 2005:

For the nine months ended September 30, 2005, net sales were $17,141,000, compared to $18,820,000 achieved in the corresponding nine months of 2004. Gross profit for the nine months ended September 30, 2005 was $6,703,000, compared to gross profit of $7,842,000 achieved for the corresponding nine-month period in 2004. The decline in net sales and gross profit is largely a result of a decrease in the net sales of the Professional segment as well as a decline in net sales of the Retail segment. These declines were a result of an overall decrease in demand. The overall gross margin for the nine months ended September 30, 2005 was 39.1% as compared to 41.7% for the nine months ended September 30, 2004. This decline in the gross profit margin can be attributed to the change in the sales mix, however the Company is also beginning to see some deterioration of gross margin as a result of the recent significant increase in oil prices, which impacted not only our delivery costs, but also our raw material and componentry costs.

Selling, general and administrative expenses for the nine months ended September 30, 2005 decreased by $854,000, to $6,712,000, when compared to the corresponding 2004 nine-month total of $7,566,000. This decrease was due to an across the board decline in selling expenses, and a decrease in general and administrative expenses. Selling expenses in 2004 also included additional expenses due to the impact of a one-time adjustment for the loss in connection with the previously disclosed Sorbie arbitration and general and administrative expenses were adversely impacted by the expense attributed to the cashless exercise of stock options by certain officers. These two specific items in 2004 represented over $600,000 of the total decrease noted above.

Interest expense for the nine months ended September 30, 2005 was $74,000, an increase of $1,000 from the $73,000 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 resulting from the reduced amount outstanding. Interest income of $86,000 for the nine months ended September 30, 2005 was lower than the $146,000 earned in the corresponding nine months of 2004 due to a decline in invested cash as a result of the special $2 per share dividend distributed to shareholders in September 2004. Other income represents royalty fees received from the licensing of Frances Denney products.

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

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

Net income for the nine-month period ended September 30, 2005 was $9,000, compared to $419,000 for the nine months ended September 30, 2004. In addition to a decline in net sales for the nine months ended September 30, 2005, the difference is also attributable to 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 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.

Income tax expense for the nine months ended September 30, 2005 was $32,000 including state income taxes approximating $23,000, significantly lower than the corresponding period last year as a result of lower taxable income.

The basic and diluted earnings per share was $0.00 for the nine months ended September 30, 2005, compared to $0.10 for the nine months ended September 30, 2004, based on a weighted average number of shares outstanding of 4,401,454 and 4,335,336, respectively.

Three months ended September 30, 2005:

For the three months ended September 30, 2005, net sales were $6,568,000, compared to $7,305,000 for the three months ended September 30, 2004, a decline of $737,000. Gross profit for the three months ended September 30, 2005 was $2,325,000, compared to gross profit of $2,995,000 achieved for the corresponding three-month period in 2004. As indicated above, similarly to the nine-month period, the decline in net sales and gross profit is a result of a decrease in net sales of the Professional segment as well as a decline in net sales of the Retail segment. The gross margin for the three months ended September 30, 2005 was 35.4% as compared to 41.0% for the three months ended September 30, 2004, due in most part to the change in the sales mix as discussed previously.

Selling, general and administrative expenses for the three months ended September 30, 2005 decreased by $765,000, from $2,980,000 to $2,215,000, when compared to the corresponding three-month period of 2004,

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

as a result of incurring certain "one-time" expenses in 2004, as discussed above.

Interest income for the three-month period ended September 30, 2005 was $35,000, a decrease of approximately $12,000 when compared to $47,000 earned in the corresponding three-month period of 2004, as a result of less invested cash.

Income tax expense for the three months ended September 30, 2005 was $43,000 compared to $12,000 for the three-month period ended September 30, 2004, based upon higher earnings for the 2005 period when compared to the corresponding 2004 period.

Basic and diluted earnings per share was $0.02 for the three months ended September 30, 2005 and $0.01 for the three months ended September 30, 2004, based on a weighted average number of shares of 4,401,454 and 4,394,385, respectively.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $339,000 from December 31, 2004, to $4,741,000 at September 30, 2005. Total cash of $8,352,000 at September 30, 2005 includes $3,610,000 of cash invested in a restricted money market account pledged as collateral for a bank loan. All of the restricted cash, as well as the entire balance of the loan payable, are reflected in current assets and current liabilities due to the August 2006 maturity date of the note and related collateral. The Company is in the process of negotiating for the August 2006 balloon payment to be converted into a term loan on similar terms and upon the completion of the process the collateral and balance due will be appropriately reclassified. Accounts receivable were $2,308,000 at September 30, 2005, an increase of $555,000 from the $1,753,000 at December 31, 2004; inventories decreased approximately $431,000 from $7,165,000 at December 31, 2004 to $6,734,000 at September 30, 2005, as inventory levels declined and receivables increased as a result of historically higher sales in the third quarter.

Total current assets at September 30, 2005 were $17,914,000 compared to $15,014,000 at December 31, 2004. Working capital increased $73,000 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, obtain the necessary permits and expects to begin construction in the first quarter

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

of 2006. 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.

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 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

ITEM 4. CONTROLS AND PROCEDURES (continued)

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.

The material weakness in our internal controls over financial reporting as of September 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 September 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.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
SEPTEMBER 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On September 29, 2005, the Company held an Annual Meeting of Stock-holders to elect a Board of Directors and transact such other business as may properly come before the Meeting. The results of the election for members of the Board were as follows:

Board Member	Class	Votes For	Votes withheld
William M. Gross	I	3,420,906	195,574
Shouky A. Shaheen	II	3,417,516	198,964
Curtis Carlson	II	3,426,616	189,864
David Pawl	II	3,609,505	6,975
Elliot Ross	II	3,610,405	6,075
Richard Barone	III	3,610,515	5,965
Frank F. Ferola	III	3,435,015	181,465

No other business was presented for consideration at the Meeting.

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
November 21, 2005

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
November 21, 2005

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