STEPHAN CO
Form 10-Q
September 29, 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: March 31, 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
MARCH 31, 2005

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 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; the continuing risks associated with our failure to be in compliance with our periodic reporting requirements with the Securities and Exchange Commission (specifically our delinquent Form 10-Q report for the quarter ended June 30, 2005); 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

	March 31, 2005	December 31, 2004
CURRENT ASSETS		

Cash and cash equivalents	$ 4,901,267	$ 4,402,463
Restricted cash	1,110,000	1,110,000
Accounts receivable, net	1,575,679	1,753,250
Inventories	7,403,377	7,164,901
Income taxes receivable	219,884	209,203
Prepaid expenses and other current assets	227,239	374,079
TOTAL CURRENT ASSETS	15,437,446	15,013,896
RESTRICTED CASH	3,441,616	3,430,408
PROPERTY, PLANT AND EQUIPMENT, net	1,697,765	1,627,227
GOODWILL, net	4,013,458	4,013,458
TRADEMARKS, net	8,364,809	8,364,809
DEFERRED ACQUISITION COSTS, net	195,772	216,652
OTHER ASSETS, net	1,846,305	2,052,405
TOTAL ASSETS	$ 34,997,171	$ 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

	March 31, 2005	December 31, 2004
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,698,968	$ 2,165,751
Current portion of long-term debt	1,110,000	1,110,000
TOTAL CURRENT LIABILITIES	3,808,968	3,275,751

DEFERRED INCOME TAXES, net	1,524,316	1,488,116
LONG-TERM DEBT	2,960,000	3,237,500
TOTAL LIABILITIES	8,293,284	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	9,103,258	9,116,859
TOTAL STOCKHOLDERS' EQUITY	26,703,887	26,717,488
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 34,997,171	$ 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

	Three Months Ended March 31,	
	2005	2004
NET SALES	$ 5,516,811	$ 5,958,985
COST OF GOODS SOLD	3,157,680	3,455,362
GROSS PROFIT	2,359,131	2,503,623
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,242,724	2,410,694
OPERATING INCOME	116,407	92,929
OTHER INCOME(EXPENSE)		
Interest income	27,072	51,091
Interest expense	(31,262)	(25,631)
Royalty income	12,500	12,500

INCOME BEFORE INCOME TAXES	124,717	130,889
INCOME TAX EXPENSE	50,519	53,108
NET INCOME	$ 74,198	$ 77,781
BASIC AND DILUTED EARNINGS PER SHARE:	$ .02	$ .02
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,418,630	4,344,220

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,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 74,198	$ 77,781
Adjustments to reconcile net income to cash flows provided by operating activities:		
Depreciation	36,659	42,662
Amortization of intangible assets	20,880	20,880
Write-down of inventories	20,000	80,607
Deferred income tax expense	36,200	35,000
Provision for doubtful accounts	9,835	33,192
Changes in operating assets and liabilities:		
Accounts receivable	167,736	(384,268)
Inventories	(258,476)	135,715

Income taxes payable/receivable	(10,681)	17,952
Prepaid expenses and other current assets	146,840	588,491
Other assets	206,100	19,419
Accounts payable and accrued expenses	533,217	550,074
Total adjustments	908,310	1,139,724
Net cash flows provided by operating activities	982,508	1,217,505

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,	
	2005	2004
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	(11,208)	277,500
Purchase of property, plant and equipment	(107,197)	(2,410)
Net cash flows (used in)/provided by investing activities	(118,405)	275,090
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(277,500)	(277,500)
Dividends paid	(87,799)	(88,212)
Net cash flows used in financing activities	(365,299)	(365,712)
INCREASE IN CASH AND CASH EQUIVALENTS	498,804	1,126,883
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,402,463	13,302,159
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 4,901,267	$14,429,042

Supplemental Disclosures of Cash Flow Information:

Interest paid	$ 15,960	$ 25,631
Income taxes paid	$ -	$ -

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 MARCH 31, 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-month period ended March 31, 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 March 31, 2005 and December 31, 2004 were approximately $ 3,270,000 and $3,824,000, respectively.

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, 2005	December 31, 2004
Raw materials	$ 1,821,033	$ 1,827,553
Packaging and components	2,357,839	2,187,901
Work in progress	291,748	429,552
Finished goods	4,681,037	4,651,422
	9,151,657	9,096,428
Less: Amount included in other assets	(1,748,280)	(1,931,527)
	$ 7,403,377	$ 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 4,418,630 for the three months ended March 31, 2005 and 4,344,220 for the three months ended March 31, 2004. For the three months ended March 31, 2005 and 2004, the Company had 341,822 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 months ended March 31, 2005 and 2004.

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

	Three Months Ended March 31,	
	2005	2004
Net income, as reported	$ 74	$ 78
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	20	30
Pro forma net income	$ 54	$ 48
Net income per share:		
As reported	$ .02	$ .02
Pro forma	$ .01	$ .01

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 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 provided by investing activities in the aforementioned Statements increased by $277,500 with a corresponding decrease in cash flows used in financing activities for the quarter ended March 31, 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 MARCH 31, 2005 AND 2004

NOTE 2: SEGMENT INFORMATION (continued)

	NET SALES		INCOME BEFORE INCOME TAXES	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2005	2004	2005	2004
Professional	$ 4,255	$ 4,386	$ 316	$ 300
Retail	1,127	1,446	34	34
Manufacturing	1,155	1,246	(181)	(111)
Total	6,537	7,078	169	223
Intercompany Manufacturing	(1,020)	(1,119)	(44)	(92)
Consolidated	$ 5,517	$ 5,959	$ 125	$ 131

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 March 31, 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.

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

NOTE 3: COMMITMENTS AND CONTINGENCIES (continued)

period ended March 31, 2005. On June 7, 2005, The Company received notification that the AMEX was proceeding with delisting procedures. Following a 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 has an annual meeting of shareholders scheduled for 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
MARCH 31, 2005 AND 2004

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

RESULTS OF OPERATIONS

For the three months ended March 31, 2005, net sales were $5,517,000 compared to $5,959,000 for the three months ended March 31, 2004, a decline of $442,000. Gross profit for the three months ended March 31, 2005 was $2,359,000, compared to gross profit of $2,504,000 achieved for the corresponding three-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 gross margin for the three months ended March 31, 2005 was 42.8% as compared to 42% for the three months ended March 31, 2004.

Net income was $74,000 for the three months ended March 31, 2005 compared to net income of $78,000 for the comparable three months ended March 31, 2004. Basic and diluted earnings per share were $.02 for both the three months ended March 31, 2005 and 2004.

Selling, general and administrative ("SG&A") expenses for the three months ended March 31, 2005 decreased $168,000 when compared to the corresponding three-month period of 2004. The Company experienced across the board decreases 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 decreases. These very same expenses had, in the corresponding periods, spiked upward when comparing the first quarter of 2004 with the first quarter of 2003.

Interest expense for the three months ended March 31, 2005 increased approximately $6,000 when compared to the corresponding three-month period in 2004 as a result of increased interest accruals on the Trevor Sorbie debt resulting from the adverse arbitration decision in 2004. Interest income for the three months ended March 31, 2005 decreased approximately $24,000 when compared to the corresponding three-month period in 2004, as a result of having less cash on hand primarily due to the payment of the special $2.00 per share dividend in September 2004.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $499,000 to $4,901,000 as of March 31, 2005 from $4,402,000 as of December 31, 2004. Total cash of $9,453,000 includes $4,552,000 of cash invested in a restricted money market account pledged as collateral for a bank loan. The Company has continued to secure its outstanding long-term debt with Wachovia Bank with restricted cash.

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

The long-term portion of restricted cash is classified as non-current and not included in working capital or cash and cash equivalents. Total current assets at March 31, 2005 were $15,437,000 compared to $15,014,000 at December 31, 2004. Working capital decreased $110,000 from December 31, 2004, and was approximately $11,628,000 at March 31, 2005.

The Company is currently considering construction of additional warehouse facilities on the Tampa, Florida manufacturing property, estimated to cost approximately $1,000,000. The Company is reviewing construction designs and site plans, and has obtained the necessary permits. 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 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 March 31, 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 March 31, 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
MARCH 31, 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 29, 2005

/s/ David A. Spiegel

David A. Spiegel

Principal Financial and
Accounting Officer
September 29, 2005

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