STEPHAN CO
Form 10-Q
May 14, 2002

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, 2002

Commission File No. 1-4436

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

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

1850 West McNab Road, Fort Lauderdale, Florida	33309
(Address of principal executive offices)	(Zip Code)

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

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

Approximate number of shares of Common Stock outstanding
as of May 10, 2002:

4,410,577

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

OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2002

INDEX

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

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR

PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This quarterly report contains certain "forward-looking" statements. The Stephan Co. (the "Company") desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement for the express purpose of availing itself of the protections of such safe harbor with respect to all such forward-looking statements. Such forward-looking statements involve known and unknown 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, performance, condition, trends or achievements projected, anticipated or implied by such forward-looking statements.

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

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

3

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31, 2002	December 31, 2001
CURRENT ASSETS		

Cash and cash equivalents	$ 8,865,983	$ 8,409,142
Certificate of deposit	277,500	-
Accounts receivable, net	1,684,476	1,808,828
Inventories	8,855,103	9,286,295
Income taxes receivable	296,552	345,220
Prepaid expenses and other current assets	288,071	266,460
TOTAL CURRENT ASSETS	20,267,685	20,115,945
CERTIFICATE OF DEPOSIT	7,307,500	7,585,000
PROPERTY, PLANT AND EQUIPMENT, net	2,237,114	2,308,003
INTANGIBLE ASSETS, net	23,225,213	23,432,105
OTHER ASSETS, net	3,525,187	3,621,103
TOTAL ASSETS	$ 56,562,699	$ 57,062,156

See notes to unaudited condensed consolidated financial statements

4

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2002	December 31, 2001
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,361,148	$ 2,560,051
Current portion of long-term debt	1,548,384	1,507,256
TOTAL CURRENT LIABILITIES	3,909,532	4,067,307

DEFERRED INCOME TAXES, net	1,628,948	1,535,285
LONG-TERM DEBT	7,198,930	7,758,370
TOTAL LIABILITIES	12,737,410	13,360,962
COMMITMENTS AND CONTINGENCIES (NOTE 3)		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value	44,106	44,106
Additional paid in capital	18,417,080	18,417,080
Retained earnings	26,715,666	26,591,571
	45,176,852	45,052,757
LESS: 125,000 CONTINGENTLY RETURNABLE SHARES	(1,351,563)	(1,351,563)
TOTAL STOCKHOLDERS' EQUITY	43,825,289	43,701,194
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 56,562,699	$ 57,062,156

See notes to unaudited condensed consolidated financial statements

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

	Three Months Ended March 31,	
	2002	2001
NET SALES	$ 6,319,916	$ 7,580,368
COST OF GOODS SOLD	3,541,173	4,222,480
GROSS PROFIT	2,778,743	3,357,888
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,421,318	2,729,383
OPERATING INCOME	357,425	628,505
OTHER INCOME(EXPENSE)		

Interest income	92,166	176,317
Interest expense	(135,622)	(205,015)
Royalty income	26,250	43,750
INCOME BEFORE INCOME TAXES	340,219	643,557
INCOME TAX EXPENSE	127,912	256,152
NET INCOME	$ 212,307	$ 387,405
BASIC AND DILUTED EARNINGS PER SHARE	$ .05	$ .09
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,285,577	4,285,577

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,	
	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 212,307	$ 387,405
Adjustments to reconcile net income to cash flows used in operating activities:		
Depreciation	83,118	96,744
Amortization	206,892	297,558
Amortization of other assets	-	29,174
Deferred income taxes	93,663	59,240
Provision for doubtful accounts	2,164	5,915
Changes in operating assets and liabilities:		
Accounts receivable	122,188	427,012
Inventories	431,192	(2,973)

Income taxes receivable	48,668	196,439
Prepaid expenses and other current assets	(21,611)	(56,196)
Other assets	95,916	38,661
Accounts payable and accrued expenses	(198,903)	(533,425)
Total adjustments	863,287	558,149
Net cash flows provided by operating activities	1,075,594	945,554

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

	Three Months Ended March 31,	
	2002	2001
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(12,229)	(22,026)
Purchase of intangible assets	-	(49,069)
Net cash flows used in investing activities	(12,229)	(71,095)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(518,312)	(389,636)
Dividends paid	(88,212)	(88,212)
Net cash flows used in financing activities	(606,524)	(477,848)
INCREASE IN CASH AND CASH EQUIVALENTS	456,841	396,611
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	8,409,142	13,559,268

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 8,865,983	$13,955,879

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2002 AND 2001

Supplemental Disclosures of Cash Flow Information:

Interest paid	$ 150,134	$ 189,268
Income taxes paid	$ 72,987	$ -

For the three months ended March 31, 2001, 16,320 shares of treasury stock, with an aggregate cost of $60,424, were retired.

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2002 AND 2001

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION: In the opinion of management, all adjustments necessary for a fair presentation of the Company's 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, 2002 are not necessarily indicative of the results to be achieved for the year ending December 31, 2002. The December 31, 2001 condensed consolidated balance sheet was derived from the audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). These interim financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2001 appearing in the Company's Form 10-K 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. Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information", requires the reporting of segment information using a "management approach" as it relates to the operating segments of a business. The Company has allocated its business into three segments; (1) professional hair care products and distribution; (2) retail personal care products; and (3) manufacturing.

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

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, certificates of deposit (not pledged as collateral), and short-term municipal bonds having maturities of 90 days or less. The Company maintains cash deposits at certain financial institutions in amounts in excess of the federally insured limit of $100,000. Cash and cash equivalents held in interest bearing accounts as of March 31, 2002 and

December 31, 2001 were approximately $7,269,000 and $7,257,000, respectively.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2002 AND 2001

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, 2002	December 31, 2001
Raw materials	$ 2,225,555	$ 3,180,670
Packaging and components	3,308,432	3,448,541
Work in progress	333,752	341,507
Finished goods	6,086,830	5,502,599
	11,954,569	12,473,317
Less: Amount included in other assets	(3,099,466)	(3,187,022)
	$ 8,855,103	$ 9,286,295

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

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding. The weighted average number of shares outstanding was 4,285,577 for each of the three months ended March 31, 2002 and 2001. For the three months ended March 31, 2002 and 2001, the Company had 813,648 and 809,524 outstanding stock options, respectively. None of these options were included in the calculation of earnings per share because their inclusion would be anti-dilutive.

NEW FINANCIAL ACCOUNTING STANDARDS: In July 2001, FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". These standards make changes to the accounting for business combinations, goodwill and intangible assets. SFAS No. 141 requires all business combinations entered into subsequent to June 30, 2001 to be accounted for using the purchase method of accounting. SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2002 AND 2001

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

will not be amortized, but will be tested for impairment at least annually. SFAS No. 142 is effective for years beginning after December 15, 2001. Goodwill and intangible assets acquired subsequent to June 30, 2001 are immediately subject to the provisions of SFAS No. 142. The Company adopted SFAS No. 142 on January 1, 2002 and is in the initial phase of testing for the impairment of existing goodwill. For the three months ended March 31, 2002, implementation of SFAS No. 142 resulted in a decrease of pretax goodwill amortization of approximately $91,000, or $.01 per basic and diluted earnings per share. The table below reflects the impact of the implementation of SFAS No. 142 for the three months ended March 31, 2002 and 2001:

	Three Months Ended March 31, (in thousands)	
	2002	2001
Net income (as reported)	$ 212	$ 387
After tax goodwill amortization	-	58
Adjusted net income	$ 212	$ 445
Net income per share (basic and diluted)	$ .05	$ .09
After tax goodwill amortization	-	.01
Adjusted basic and diluted earnings per share	$ .05	$ .10

Amortization expense of other intangibles for the three months ended March 31, 2002 was $207,000. Amortization expense for other intangible assets recorded as of December 31, 2001, for the years ended December 31, 2002 through 2007 is anticipated to be as follows: 2002: $827,000; 2003: $728,000; 2004: $624,000; 2005: $624,000; 2006: $615,000; 2007: $603,000.

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes, but does not replace, SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of", as well as other earlier related pronouncements, either in whole or in part. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The adoption of this statement did not have a significant effect on the Company's financial position, results of operations or cash flows.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2002 AND 2001

NOTE 2: SEGMENT INFORMATION

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

The Company conducts operations primarily 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 incurred by the Manufacturing segment. The following tables, in thousands, summarize Net Sales and Income Before Income Taxes by reportable segment:

	NET SALES		INCOME BEFORE INCOME TAXES	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2002	2001	2002	2001
Professional	$ 4,454	$ 4,948	$ 204	$ 239
Retail	1,702	1,628	244	256
Manufacturing	1,740	2,644	28	311
Total	7,896	9,220	476	806
Intercompany Manufacturing	(1,576)	(1,640)	(136)	(162)
Consolidated	$ 6,320	$ 7,580	$ 340	$ 644

NOTE 3: COMMITMENTS AND CONTINGENCIES

In addition to the matters set forth below, the Company is involved in other litigation matters arising in the ordinary course of business. It is the opinion of management that none of such matters, at March 31, 2002, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

NOTE 3: COMMITMENTS AND CONTINGENCIES (Continued)

On March 5, 2001, the Company announced that its Board of Directors had formed a two-person, special committee to explore various strategic alternatives to enhance shareholder value. Four members of the Company's management and directors, exclusive of the committee members, formed a group to purchase all of the Company's outstanding capital stock in a going private transaction. Independent legal counsel and investment banking advisors were retained to advise and assist in the transaction. After incurring approximately $154,000 of expenses through March 31, 2002, it is estimated that the remaining costs associated with this process will be in excess of $475,000. On April 16, 2002, the Company announced that the special committee of its Board of Directors had, after an auction conducted by Robinson Humphrey Company LLC, its investment banker, accepted a bid by the four members of the Company's management and directors. Such bid is to purchase all of the Company's common stock at $4 per share. No other viable bids were received by the committee for the entire Company. The management bid is subject to various conditions, including obtaining adequate financing. The Company's management is currently in the process of negotiating with lenders to obtain financing necessary for the transaction. There can be no assurance that the bidder will be able to obtain such financing on acceptable terms or that the transaction will be consummated.

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

Other than the foregoing, there has been no change in the status of other pending litigation since last reported in the financial statements for the year ended December 31, 2001.

14

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2002 AND 2001

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

RESULTS OF OPERATIONS

For the three months ended March 31, 2002, net sales were $6,320,000, compared to $7,580,000 for the three months ended March 31, 2001, a decline of $1,260,000. Principally as a result of the decline in net sales, gross profit for the three months ended March 31, 2002 was $2,779,000, compared to gross profit of $3,358,000 achieved for the corresponding three-month period in 2001. Net income of $212,000 for the three months ended March 31, 2002, declined from the $387,000 achieved in the three months ended March 31, 2001, largely as a result of a decrease in net sales as discussed below. Basic and diluted earnings per share were $.05 for the three months ended March 31, 2002, compared to $.09 for the three months ended March 31, 2001.

The Company experienced a decline in net sales for the Professional and Manufacturing segments of its business in the three-month period ended March 31, 2002, with such segments declining a total of approximately $1,340,000 in the aggregate. Net sales from private label manufacturing declined by almost $790,000 from the corresponding three-month period in 2001 because the Company is no longer manufacturing for a large private label customer. The net sales decline of almost $490,000 in the Professional segment was primarily due to continued industry-wide consolidation described in previously filed reports. The gross profit margin for the three months ended March 31, 2002 declined slightly, from 44.30% for the three months ended March 31, 2001 to 43.97% for the three months ended March 31, 2002, but has increased when compared to both the entire 2001 fiscal year. Management believes that it will be able to replace lost sales with new customers and/or increased sales to existing customers as a result of the sales initiatives started in 2001, and would anticipate that these sales will have a positive impact by the third quarter of 2002 and thereafter.

Selling, general and administrative expenses for the three months ended March 31, 2002 decreased by $308,000, from $2,729,000 to $2,421,000, when compared to the corresponding three-month period of 2001. The reduction in expenses was due, in part, to a decline in amortization of over $120,000, largely as a result of the implementation of SFAS No. 142 and decreases in office expenses and freight charges.

Interest income for the three months ended March 31, 2002 decreased over $84,000 when compared to the corresponding three-month period of 2001 as a direct result of significantly lower interest rates. For the same reason, and as a result of the refinancing of debt in August 2001, interest expense for the three months ended March 31, 2002 decreased approximately $69,000 from the corresponding three-month period of 2001.

15

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2002 AND 2001

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

Other income is comprised of a $26,250 quarterly royalty fee from the licensing of Frances Denney products.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $457,000 from December 31, 2001, to $8,866,000 at March 31, 2002. Total cash of $16,451,000 includes $7,585,000 of cash invested in certificates of deposit pledged as collateral for a bank loan. Accounts receivable decreased $124,000 and inventories decreased by approximately $431,000 from the amounts at December 31, 2001 as the result of a decrease in sales.

Total current assets at March 31, 2002 were $20,268,000 compared to $20,116,000 at December 31, 2001. Working capital increased $310,000 when compared to December 31, 2001.

On March 5, 2001, the Company announced that its Board of Directors had formed a two-person, special committee to explore various strategic alternatives to enhance shareholder value. Four members of the Company's management and directors, exclusive of the committee members, formed a group to purchase all of the Company's outstanding capital stock in a going private transaction. Independent legal counsel and investment banking advisors were retained to advise and assist in the transaction. After incurring approximately $154,000 of expenses through March 31, 2002, it is estimated that the remaining costs associated with this process will be in excess of $475,000. On April 16, 2002, the Company announced that the special committee of its Board of Directors had, after an auction conducted by Robinson Humphrey Company LLC, its investment banker, accepted a bid by the four members of the Company's management and directors. Such bid is to purchase all of the Company's common stock at $4 per share. No other viable bids were received by the committee for the entire Company. The management bid is subject to various conditions, including obtaining adequate financing. The Company's management is currently in the process of negotiating with lenders to obtain financing necessary for the transaction. There can be no assurance that the bidder will be able to obtain such financing on acceptable terms or that the transaction will be consummated.

NEW FINANCIAL ACCOUNTING STANDARDS

In July 2001, FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". These standards make changes to the accounting for business combinations, goodwill and intangible assets. SFAS No. 141 requires all business combinations entered into subsequent to June 30, 2001 to be accounted for using the purchase

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

method of accounting. SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment at least annually. SFAS No. 142 is effective for years beginning after December 15, 2001. Goodwill and intangible assets acquired subsequent to June 30, 2001 are immediately subject to the provisions of SFAS No. 142. The Company adopted SFAS No. 142 on January 1, 2002 and is in the initial phase of testing for the impairment of existing goodwill. For the three months ended March 31, 2002, implementation of SFAS No. 142 resulted in a decrease of pretax goodwill amortization of approximately $91,000, or $.01 per basic and diluted earnings per share. The table below reflects the impact of the implementation of SFAS No. 142 for the three months ended March 31, 2002 and 2001:

	Three Months Ended March 31, (in thousands)	
	2002	2001
Net income (as reported)	$ 212	$ 387
After tax goodwill amortization	-	58

Adjusted net income	$ 212	$ 445
Net income per share (basic and diluted)	$ .05	$ .09
After tax goodwill amortization	-	.01
Adjusted basic and diluted earnings per share	$ .05	$ .10

Amortization expense of other intangibles for the three months ended March 31, 2002 was $207,000. Amortization expense for other intangible assets recorded as of December 31, 2001, for the years ended December 31, 2002 through 2007 is anticipated to be as follows: 2002: $827,000; 2003: $728,000; 2004: $624,000; 2005: $624,000; 2006: $615,000; 2007: $603,000.

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes, but does not replace, SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of", as well as other earlier related pronouncements,

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

either in whole or in part. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The adoption of this statement did not have a significant effect on the Company's financial position, results of operations or cash flows.

The Company does not have any off-balance sheet financings.

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 ultimately transpire. Please refer to Item 7 in the Company's Form 10-K for the year ended December 31, 2001 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.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
MARCH 31, 2002 AND 2001

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

Other than the above, there has been no material change in the status of any other pending litigation since the date that the Company's Form 10-K was filed with the Securities and Exchange Commission for the year ended December 31, 2001.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE STEPHAN CO.

/s/ Frank F. Ferola

Frank F. Ferola
President and Chief Executive Officer
May 14, 2002

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
May 14, 2002

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.

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Frank F. Ferola
President and Chief Executive Officer
May 14, 2002

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David A. Spiegel
Principal Financial and
 Accounting Officer
May 14, 2002