STEPHAN CO
Form 10-Q
August 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Quarterly Period Ended: June 30, 2006

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act).
Large accelerated filer[ ] Accelerated filer[ ] Non-accelerated filer[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 August 1, 2006:

4,389,805

THE STEPHAN CO. AND SUBSIDIARIES

QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2006

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THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2006

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

	June 30, 2006	December 31, 2005
CURRENT ASSETS		

Cash and cash equivalents	$ 5,897,001	$ 5,602,762
Restricted cash	2,872,998	3,335,557
Accounts receivable, net	1,853,180	1,431,650
Inventories	6,305,225	6,148,267
Income taxes receivable	-	22,893
Prepaid expenses and other current assets	148,589	311,905
TOTAL CURRENT ASSETS	17,076,993	16,853,034
PROPERTY, PLANT AND EQUIPMENT, net	1,634,660	1,682,951
GOODWILL, net	4,013,458	4,013,458
TRADEMARKS, net	8,364,809	8,364,809
DEFERRED ACQUISITION COSTS, net	109,173	142,185
OTHER ASSETS, net	1,641,134	1,721,169
TOTAL ASSETS	$ 32,840,227	$ 32,777,606

See notes to unaudited condensed consolidated financial statements

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THE STEPHAN CO. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	June 30, 2006	December 31, 2005
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,444,588	$ 2,002,728
Current portion of long-term debt	2,682,500	3,237,500
TOTAL CURRENT LIABILITIES	5,127,088	5,240,228

DEFERRED INCOME TAXES, net	1,439,467	1,343,257
TOTAL LIABILITIES	6,566,555	6,583,485
COMMITMENTS AND CONTINGENCIES (NOTE 3)		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value	43,898	43,898
Additional paid in capital	17,598,639	17,556,731
Retained earnings	8,631,135	8,593,492
TOTAL STOCKHOLDERS' EQUITY	26,273,672	26,194,121
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 32,840,227	$ 32,777,606

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2006	2005
NET SALES	$ 10,956,917	$ 10,573,491
COST OF GOODS SOLD	6,385,410	6,194,990
GROSS PROFIT	4,571,507	4,378,501
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	4,286,077	4,498,062
OPERATING INCOME/(LOSS)	285,430	(119,561)
OTHER INCOME(EXPENSE)		
Interest income	106,393	51,494
Interest expense	(67,976)	(53,197)
Other income, net	25,000	25,000

INCOME/(LOSS) BEFORE INCOME TAXES	348,847	(96,264)
INCOME TAX EXPENSE/(BENEFIT)	135,612	(11,154)
NET INCOME/(LOSS)	$ 213,235	$ (85,110)
BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE	$ .05	$ (.02)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,392,041	4,389,805

See notes to unaudited condensed consolidated financial statements

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

	Three Months Ended June 30,	
	2006	2005
NET SALES	$ 5,360,520	$ 5,056,680
COST OF GOODS SOLD	3,006,828	3,037,310
GROSS PROFIT	2,353,692	2,019,370
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,207,745	2,255,338
OPERATING INCOME/(LOSS)	145,947	(235,968)
OTHER INCOME(EXPENSE)		
Interest income	62,930	24,422
Interest expense	(36,178)	(21,935)
Other income, net	12,500	12,500
INCOME/(LOSS) BEFORE INCOME TAXES	185,199	(220,981)

INCOME TAX EXPENSE/(BENEFIT)	69,020	(61,673)
NET LOSS/(INCOME)	$ 116,179	$ (159,308)
BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE	$ .03	$ (.04)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,392,041	4,389,805

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income/(loss)	$ 213,235	$ (85,110)
Adjustments to reconcile net income/(loss) to cash flows provided by operating activities:		
Depreciation	76,030	72,628
Stock option compensation	41,908	-
Amortization of intangible assets	33,012	41,760
Write-down of inventories	-	20,000
Deferred income tax provision	96,210	495
Provision for doubtful accounts	44,316	22,222
Changes in operating assets and liabilities:		
Accounts receivable	(465,846)	260,542
Inventories	(156,958)	(712,321)
Income taxes receivable/payable	22,893	(48,566)
Prepaid expenses and other current assets	163,316	259,311

Other assets	80,035	214,537
Accounts payable and accrued expenses	441,860	251,249
Total adjustments	376,776	381,857
Net cash flows provided by operating activities	590,011	296,747

See notes to unaudited condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2006	2005
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in restricted cash	462,559	652,221
Purchase of property, plant and equipment	(27,739)	(160,300)
Net cash flows provided by investing activities	434,820	491,921
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(555,000)	(555,000)
Dividends paid	(175,592)	(175,594)
Net cash flows used in financing activities	(730,592)	(730,594)
INCREASE IN CASH AND CASH EQUIVALENTS	294,239	58,074
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	5,602,762	4,402,463
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,897,001	$ 4,460,537
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 22,789	$ 31,025

Income taxes paid	$ 33,381	$ 22,016

See notes to unaudited condensed consolidated financial statements

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2006 AND 2005

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS: The Stephan Company (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.

BASIS OF PRESENTATION: In the opinion of management, all adjustments (consisting only of normal accruals) 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 and six month periods ended June 30, 2006 is not necessarily indicative of the results to be achieved for the year ending December 31, 2006. The December 31, 2005 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, 2005, previously filed with the Securities and Exchange Commission.

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

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, money market investment accounts and short-term municipal bonds having maturities after 90 days or less when acquired. The Company maintains cash deposits at certain financial institutions in amounts in excess of the federally insured limit. Cash and cash equivalents held in interest-bearing accounts as of June 30, 2006 and December 31, 2005 were approximately $5,329,000 and $5,095,000, respectively.

INVENTORIES: Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market, and are as follows:

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

	June 30, 2006	December 31, 2005
Raw materials	$ 1,612,424	$ 1,692,277
Packaging and components	2,178,230	2,238,763
Work in progress	570,421	454,217
Finished goods	3,499,836	3,402,742
	7,860,911	7,787,999
Less: Amount included in other assets	(1,555,686)	(1,639,732)
	$ 6,305,225	$ 6,148,267

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 4,392,041 and 4,389,805, respectively, for the six months ended June 30, 2006 and 2005. For the three months ended June 30, 2006 and 2005, the weighted average number of shares outstanding was 4,392,041 and 4,389,805, respectively. For the six months ended June 30, 2006 and 2005, the Company had 396,178 and 355,298 outstanding stock options, respectively, a significant portion of which were anti-dilutive. The inclusion of dilutive stock options in the calculation of earnings per share did not have any impact on the earnings per share for the three month period ended June 30, 2006. Stock options were not included in the calculation of earnings per share for the six and three month periods ended June 30, 2005 because all options would be anti-dilutive as a result of the net loss for the respective periods.

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK-BASED COMPENSATION: Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised), "Share-Based Payment" ("FAS 123R"), and chose to utilize the modified prospective transition method. Under this method, compensation costs recognized at June 30, 2006 relate to the estimated fair value at the grant date of 75,310 stock options granted subsequent to January 1, 2006 in accordance with FAS 123R. Prior to the adoption of FAS 123R the Company accounted for stock options in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," and recognized no compensation expense in net income for stock options granted and has elected the disclosure only provisions of FAS 123. In accordance with the provisions of FAS 123R, options granted prior to January 1, 2006, have not been restated to reflect the adoption of FAS 123R. The required services for awards prior to January 1, 2006 had been rendered prior to December 31, 2005.

As a result of adopting FAS 123R on January 1, 2006, the Company's net income for the six and three month periods ended June 30, 2006 was reduced because the Company recognized approximately $42,000 and $21,000, respectively, of compensation expense (included in Selling, General and Administrative Expenses) in the periods that stock options were granted. The impact on basic and diluted earnings per share for the six months and quarter ended June 30, 2006 was not material and the per share earnings remained at $.05 and $.03, respectively. For the six months and quarter ended June 30, 2005, no compensation expense was recorded for options granted in the period, as indicated above. The Company has used the Black-Scholes option pricing model to estimate the fair value of stock options using the following assumptions as at June 30, 2006:

Life expectancy - Key Employee	10 years
Life expectancy - Outside Director	5 years
Risk-free interest rate	5.2%
Expected volatility	61.1%
Dividends per share	2.1%
Weighted average fair value at grant date	$1.88

The above assumptions are based on a number of factors as follows: (i) expected volatility was determined using the historical volatility of the Company's stock price, (ii) the expected term of the options is based on the period of time that the options granted are expected to be outstanding, and (iii) the risk free rate is the U.S. Treasury rate effective at the time of grant for the duration of the options granted. Compensation cost is recognized on a straight-line basis over the vesting period.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2006 AND 2005

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NEW FINANCIAL ACCOUNTING STANDARDS: In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3", effective for accounting changes and corrections of errors made in fiscal year 2006 and beyond. The effect of this statement on the Company's consolidated financial statements will be determined based upon the nature and significance of future accounting changes or errors that would be subject to this statement.

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/(Loss) 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/(Loss) Before Income Taxes by reportable segment:

	NET SALES		NET SALES	
	Six Months Ended June 30,		Three Months Ended June 30,	
	2006	2005	2006	2005
Professional	$ 8,208	$ 8,311	$ 3,956	$ 4,056
Retail	2,168	1,953	1,159	826
Manufacturing	2,324	2,416	1,083	1,262
Total	12,700	12,680	6,198	6,144
Intercompany Manufacturing	(1,743)	(2,107)	(837)	(1,087)
Consolidated	$10,957	$10,573	$ 5,361	$ 5,057

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THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED JUNE 30, 2006 AND 2005

NOTE 2: SEGMENT INFORMATION (continued)

	INCOME/(LOSS) BEFORE INCOME TAXES		INCOME/(LOSS) BEFORE INCOME TAXES	
	Six Months Ended June 30,		Three Months Ended June 30,	
	2006	2005	2006	2005
Professional	$ 657	$ 456	$ 312	$ 140
Retail	350	(13)	303	(48)
Manufacturing	(658)	(539)	(430)	(313)
Consolidated	$ 349	$ (96)	$ 185	$ (221)

NOTE 3: COMMITMENTS AND CONTINGENCIES

The Company is involved in litigation matters arising in the ordinary course of business. It is the opinion of management that none of these matters, at June 30, 2006, 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, 2005.

THE STEPHAN CO. AND SUBSIDIARIES
QUARTERLY REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
JUNE 30, 2006 AND 2005

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

RESULTS OF OPERATIONS

Six months ended June 30, 2006:

For the six months ended June 30, 2006, net sales were $10,957,000, compared to $10,573,000 achieved in the corresponding six months of 2005. Gross profit for the six months ended June 30, 2006 was $4,572,000, compared to gross profit of $4,379,000 achieved for the corresponding six-month period in 2005. The increase in net sales and gross profit is the result of an increase in net sales of the Retail brands segment in addition to an increase in net sales of amenities. The overall gross profit for the six months ended June 30, 2006 was 41.7% as compared to 41.4% for the six months ended June 30, 2005.

Selling, general and administrative ("SGA") expenses for the six months ended June 30, 2006 decreased by $212,000, to $4,286,000, when compared to the corresponding 2005 six-month period total of $4,498,000. This decrease can be attributed to a decline in rent expense as warehouse facilities were consolidated and/or reduced, as well as a decline in professional fees.

Interest expense for the six months ended June 30, 2006 was $68,000, an increase of approximately $15,000 from the $53,000 incurred in the corresponding period of 2005. For the six months ended June 30, 2006, the Company accrued $45,000 in interest expense related to the Sorbie judgment, more than offsetting any decline in interest expense on our bank debt. While the Company believes it may ultimately prevail and/or settle for an amount substantially below the amount already accrued, management continues to accrue interest on the entire obligation because it can not predict the outcome of the litigation. Interest income of $106,000 for the six months ended June 30, 2006 was higher than the $51,000 earned in the corresponding six months of 2005 due to an increase in invested cash and the overall increase in interest rates. Other income includes royalty fees received from the licensing of Frances Denney products.

Net income for the six-month period ended June 30, 2006 was $213,000, compared to a net loss of $85,000 for the six months ended June 30, 2005. Increased sales, an increased gross profit and a reduction in SGA expenses all contributed to income from operations of $285,000 for the six months ended June 30, 2006, compared to a loss from operations of $120,000 for the comparable period in 2005. Income taxes for the six months ended June 30, 2006 were $136,000, comprised of a net current state income tax provision of $28,000 and a deferred Federal income tax provision of $108,000.

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

Basic and diluted earnings per share was $0.05 for the six months ended June 30, 2006, compared to a loss per share of $0.02 for the six ended June 30, 2005, based on a weighted average number of shares outstanding of 4,392,041 and 4,389,805, respectively.

Three months ended June 30, 2006:

For the three months ended June 30, 2006, net sales were $5,361,000, compared to $5,057,000 for the three months ended June 30, 2005, an increase of $304,000. Gross profit for the three months ended June 30, 2006 was $2,354,000, compared to gross profit of $2,019,000 achieved for the corresponding three-month period in 2005. As indicated above, similarly to the six-month period ended June 30, 2006, the increase in net sales and gross profit is a result of an increase in net sales of the Retail brands segment. The gross profit for the three months ended June 30, 2006 was 43.9% as compared to 39.9% for the three months ended June 30, 2005, due in a large part to the favorable change in the sales mix.

Selling, general and administrative expenses for the three months ended June 30, 2006 decreased by $47,000, from $2,255,000 to $2,208,000, when compared to the corresponding three-month period of 2005.

Interest income for the three-month period ended June 30, 2006 was $63,000, an increase of approximately $39,000 when compared to $24,000 earned in the corresponding three-month period of 2005, primarily as a result of rising interest rates.

The income tax expense for the three months ended June 30, 2006 was $69,000 compared to a net income tax benefit of $62,000 for the three-month period ended June 30, 2005. For the three months ended June 30, 2006, net income was $116,000 compared to a net loss of $159,000 for the corresponding period in 2005. Basic and diluted earnings per share was $0.03 for the three months ended June 30, 2006 and a net loss per share of $0.04 for the three months ended June 30, 2005, based on a weighted average number of shares of 4,392,041 and 4,389,805, respectively.

LIQUIDITY & CAPITAL RESOURCES

Cash and cash equivalents increased $294,000 from December 31, 2005, to $5,897,000 at June 30, 2006. Total cash of $8,770,000 at June 30, 2006 includes $2,873,000 of cash invested in a restricted money market account pledged as collateral for a bank loan. Accounts receivable were $1,853,000 at June 30, 2006, an increase of $421,000 from the $1,432,000 at December 31, 2005 due to the increased level of sales; inventories increased

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

approximately $157,000 from $6,148,000 at December 31, 2005 to $6,305,000 at June 30, 2006, as the Company increased inventory levels for anticipated third-quarter sales.

Total current assets at June 30, 2006 were $17,077,000 compared to $16,853,000 at December 31, 2005. Working capital increased $337,000 when compared to December 31, 2005. The Company is still negotiating construction of additional warehouse facilities on the Tampa, Florida manufacturing property, estimated to cost approximately $1,000,000. As has been the case in the past, the bulk of the Company's insurance policies renew in July; as a result, it is anticipated that approximately $350,000 will be paid in the third quarter of 2006 for these renewals. Other than the above, the Company does not anticipate any significant capital expenditures in the near term and management believes that there is sufficient cash on hand and working capital to satisfy upcoming requirements.

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, 2005 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 June 30, 2006 related to the fact that as a small public company, we have an insufficient number of personnel with clearly delineated and fully documented responsibilities and with the appropriate level of accounting expertise and we have insufficient documented procedures to identify and prepare a conclusion on matters involving material accounting issues and to independently review conclusions as to the application of generally accepted accounting principles. The lack of a sufficient number of accounting personnel is not considered appropriate for an internal control structure designed for external reporting purposes. The principal factors management considered in determining whether a material weakness existed in this regard was based upon management's evaluation discussed above and advice from our previous independent registered public accounting firm. As a result, management has determined that a material weakness in the effectiveness of the Company's internal controls over financial reporting existed as of June 30, 2006.

(b) CHANGES IN INTERNAL CONTROLS: No change in the Company's internal control over financial reporting occurred during this reporting period 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
JUNE 30, 2006 AND 2005

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.

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
August 14, 2006

/s/ David A. Spiegel

David A. Spiegel
Principal Financial and
Accounting Officer
August 14, 2006

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