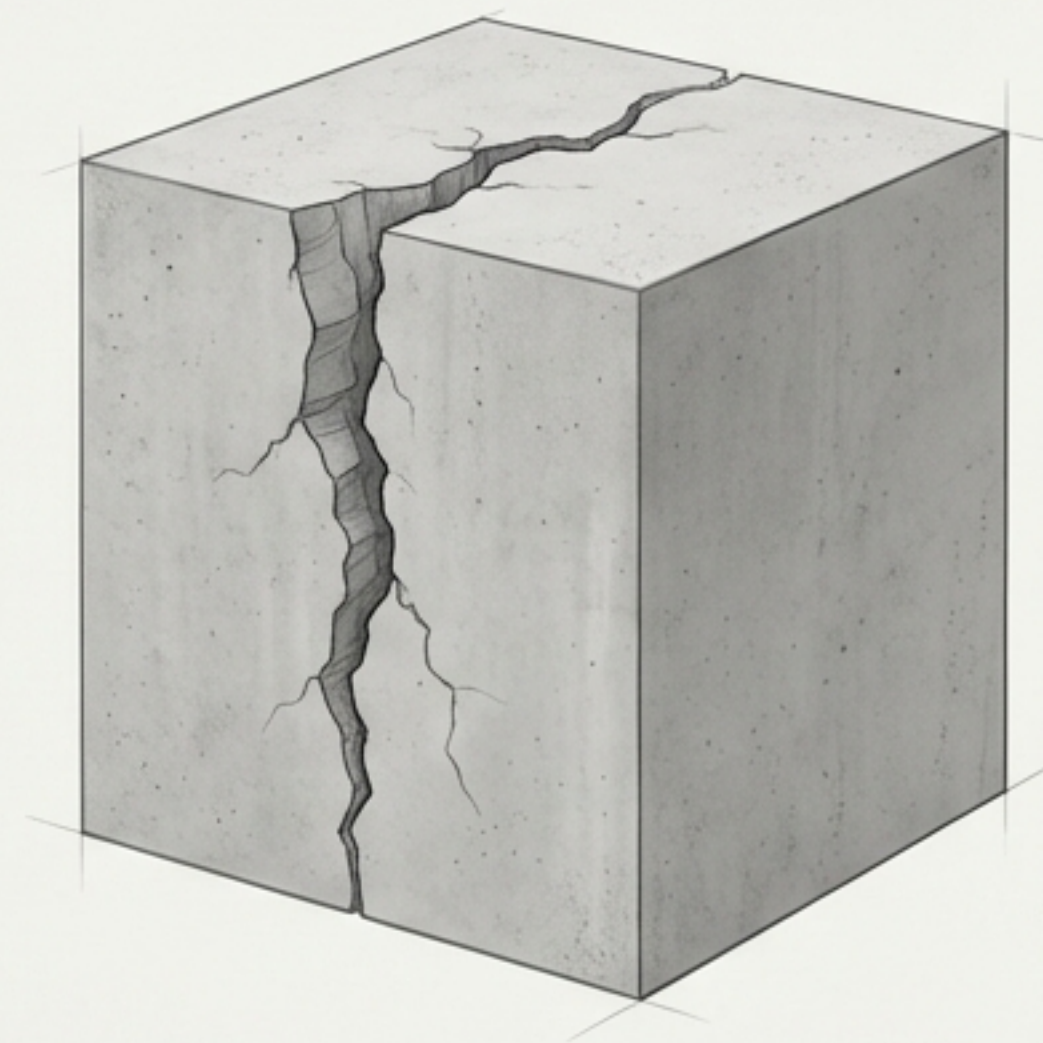


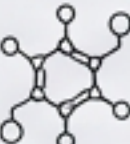
Stepan Company (SCL): The Erosion of Quality in a 'Specialty' Wrapper

An Investment Committee Analysis

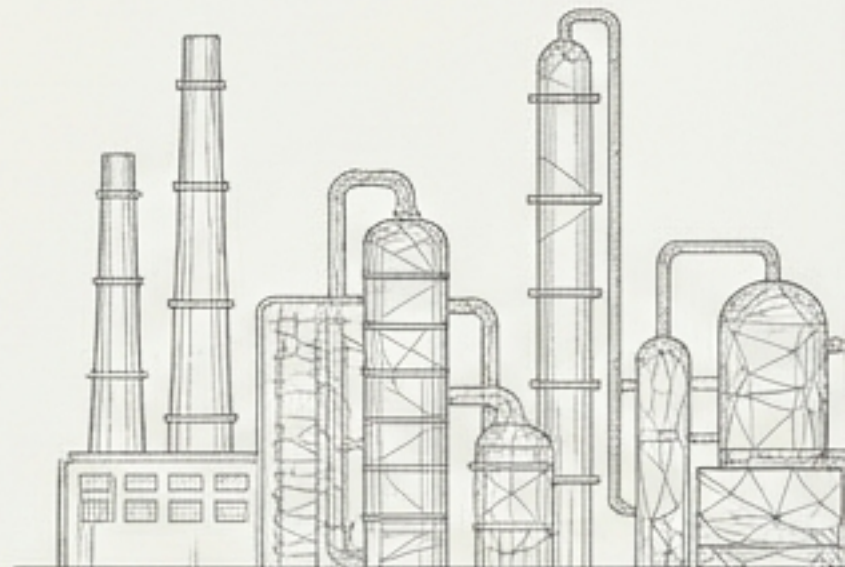


Executive Summary: A Value Trap Masquerading as a Compounder



The Narrative (The Bull Case)	The Reality (The Bear Case)	The Verdict
Dividend King: 58 consecutive years of increases. Specialty Chemical: Marketed as a niche player in surfactants and polymers. Defensive: Consumer staples exposure implies recession resistance.	ROIC Collapse: Returns have fallen from high-teens to ~3.2% (TTM), well below WACC (~8.9%). Commodity Economics: 70% of revenue (Surfactants) faces high buyer power and volatile feedstock costs. Capital Misallocation: The \$245M+ Pasadena plant is a drag on cash flow; payout ratio is stretched (~75-80%).	RATING: AVOID / UNDERWEIGHT SCL is destroying shareholder value with every dollar reinvested. The stock is priced for a perfect recovery that is far from guaranteed.

Surfactants: Commodity Economics with Specialty Branding



The Squeeze

Force 1: High Supplier Power (Feedstocks)

- **Volatile Prices:** Coconut oil spiked +70% in 2025 (avg \$2,500/MT). SCL is a price-taker on oleochemicals.

Force 1: High Supplier Power (Feedstocks)

Stepan Company (SCL)

- **Market Growth:** ~5.3% CAGR (GDP-like).
- **Differentiation:** Low. Basic sulfonation is mature technology.

Force 2: High Buyer Power (Mega-Cap Customers)

Threat: Customers possess "make vs. buy" leverage. If SCL pushes price, customers insource production.

P&G



The Tier 2/3 Pivot: Trading Pricing Pressure for Operational Inefficiency

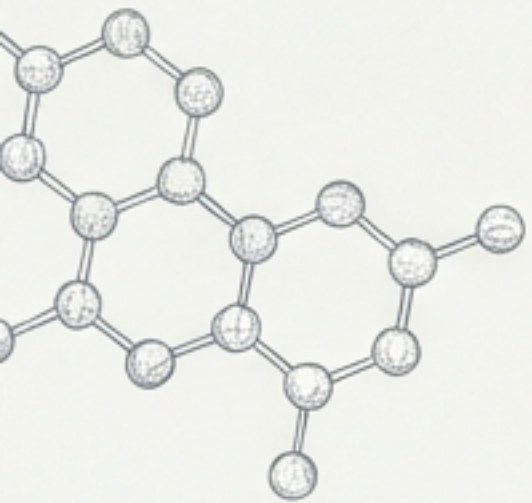
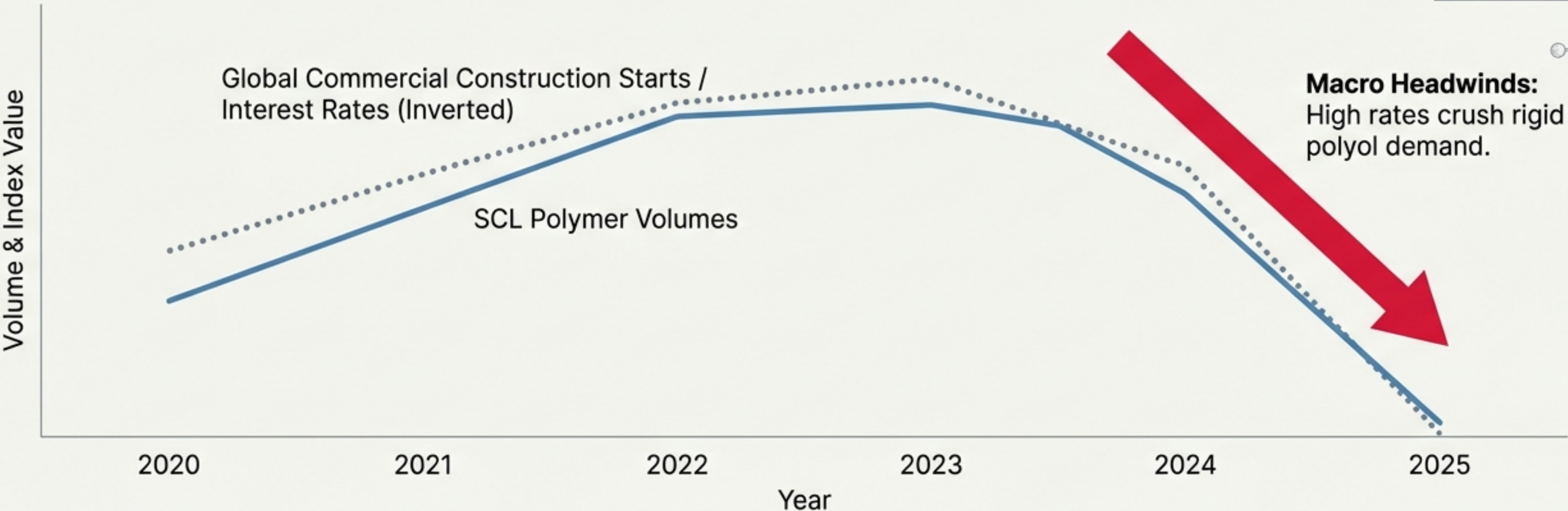
The Complexity Penalty



Strategy vs. Reality

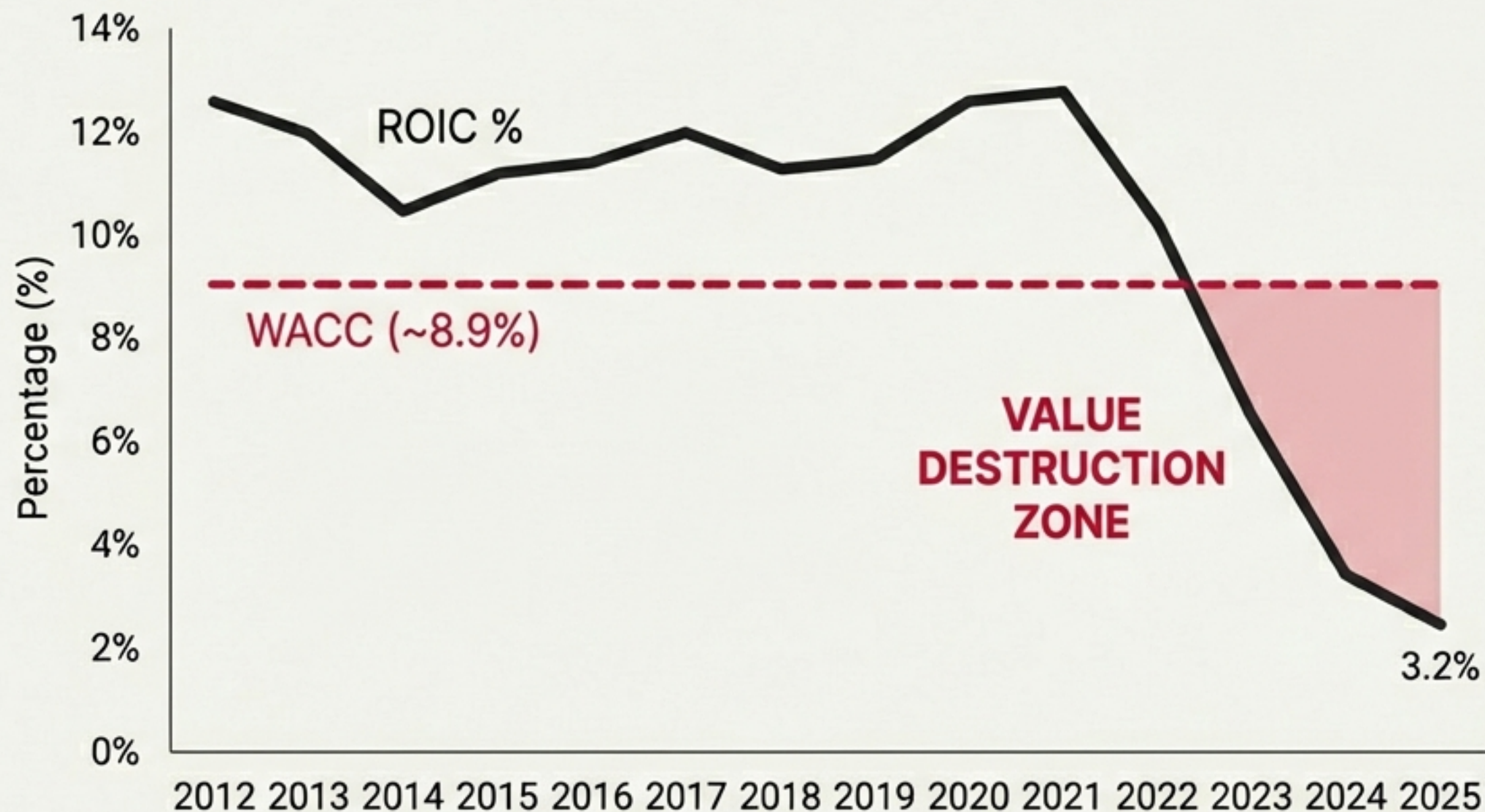
- **The Strategy:** Diversify revenue by targeting smaller "Tier 2 and Tier 3" accounts.
- **The Cost:** Complexity. Smaller batch sizes, less-than-truckload shipments, and higher SG&A dilute the benefits of continuous sulfonation.
- **The Result:** "Merchant Producer" trap. Limited to customers who cannot produce for themselves.

Polymers: Construction Cyclicalty Overrides the 'Green Premium'



The Secular Tailwinds Higher R-value codes and rPET usage are real but insufficient to offset volume troughs.	Regional Weakness 2024-2025 weakness in Europe and China.	Differentiation Limits "Green premium" offers no shield against macro-driven volume collapse.
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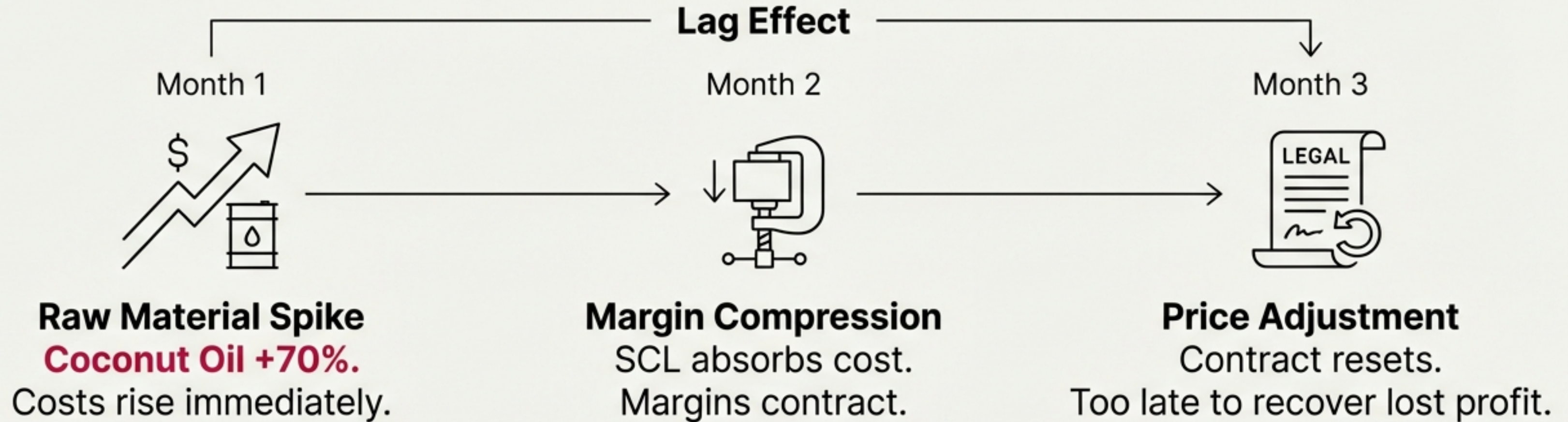
The Smoking Gun: ROIC Has Collapsed Below the Cost of Capital



Tiempos Headline

- **Invested Capital Bloat:** Capital base surged due to Pasadena (\$245M+) and acquisitions.
- **NOPAT Compression:** Operating profit halved.
- **Peer Comparison:** SCL (3.2%) vs. Croda (10-12%) vs. Innospec (Higher).

Margin Analysis: The Inflationary “Air Pocket”



11.9%

Gross Margin

Down from historical
15-18% band.

3.3%

Operating Margin

Thin buffer leaves no
room for error.

Volume vs. Value

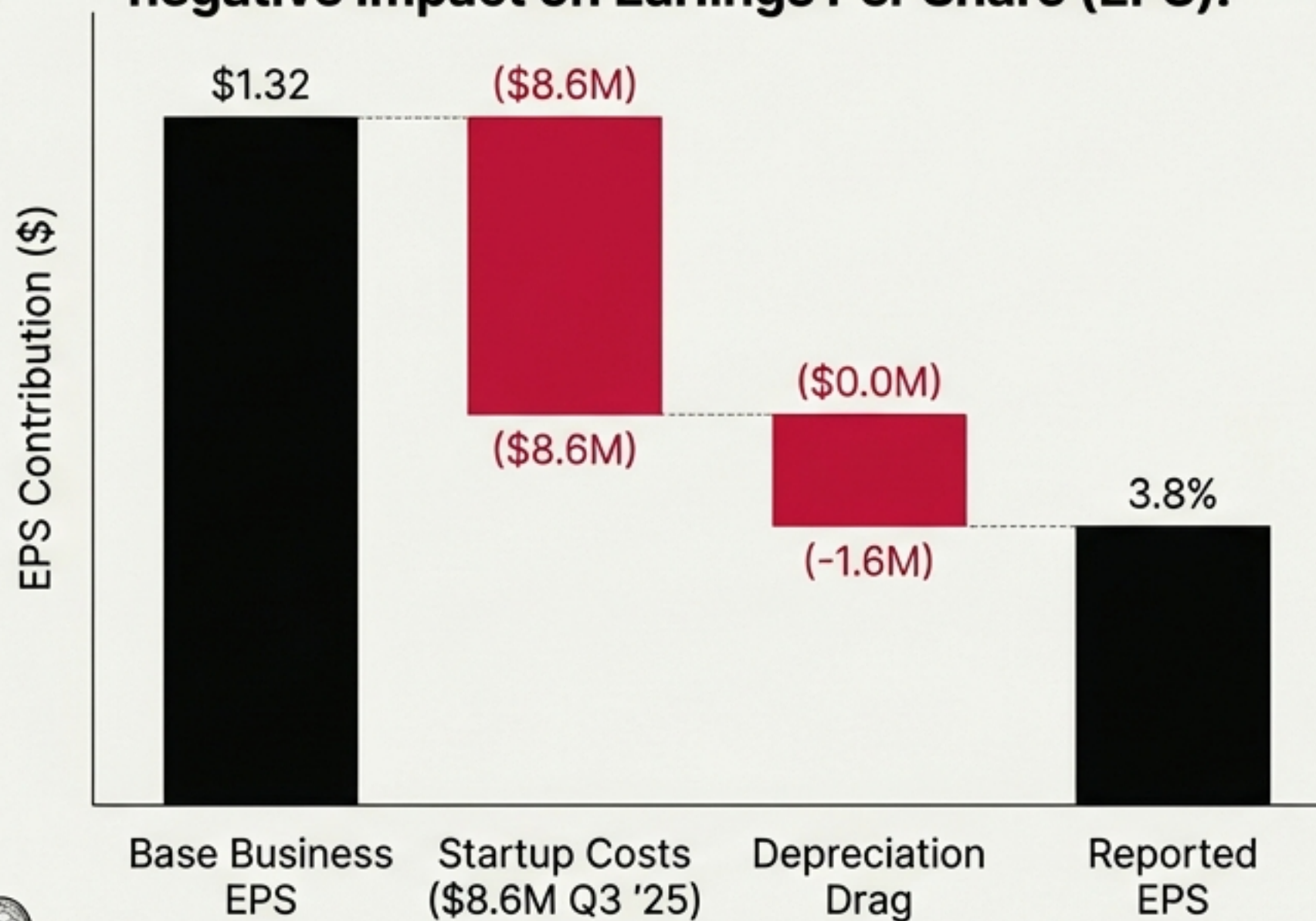
Volume vs. Value

Mix shift to lower-margin
Ag/Oilfield products dilutes profit.



The Pasadena Gambit: High Stakes, High Risk

Tiempos Headline chart: the m3ny's is the negative impact on Earnings Per Share (EPS).



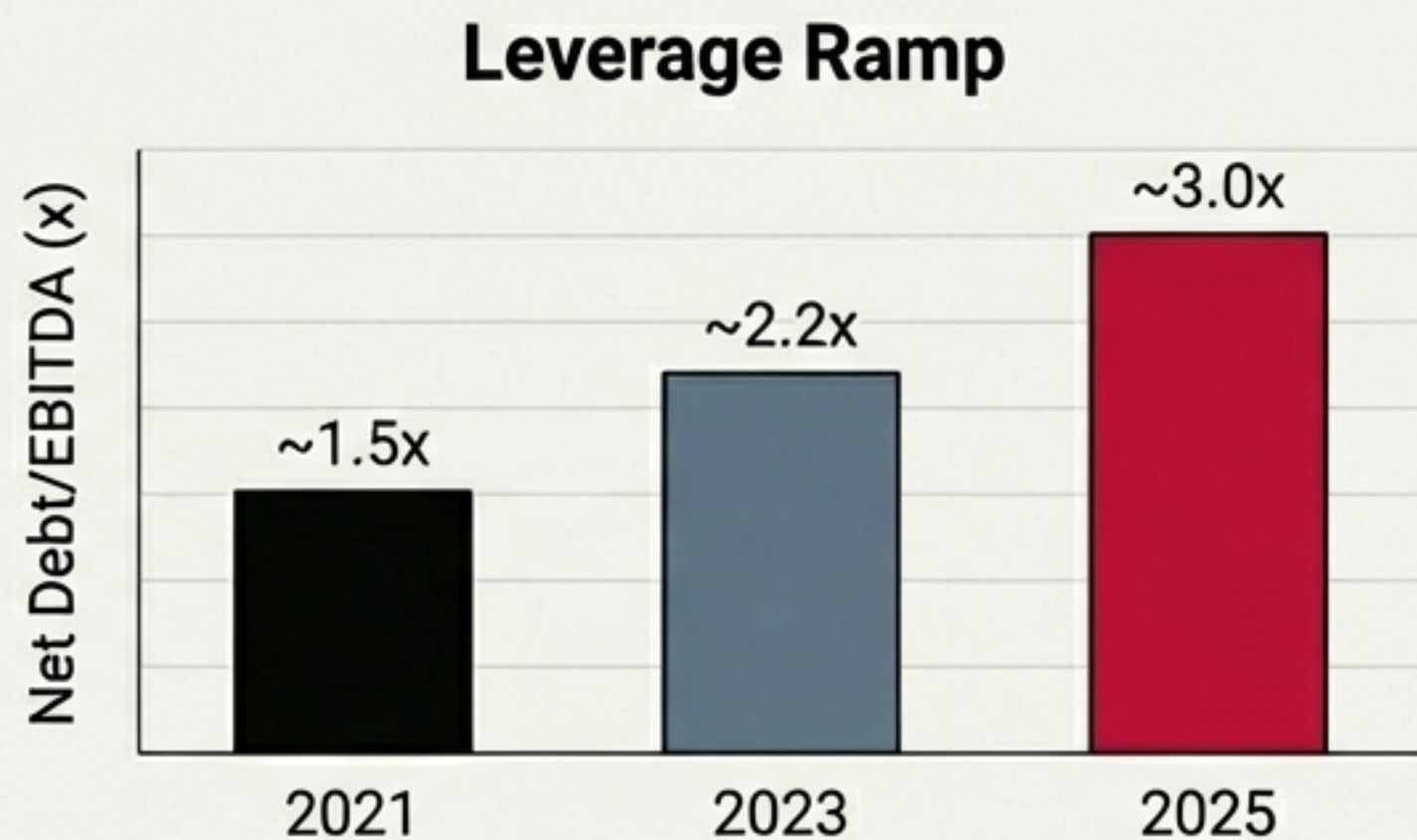
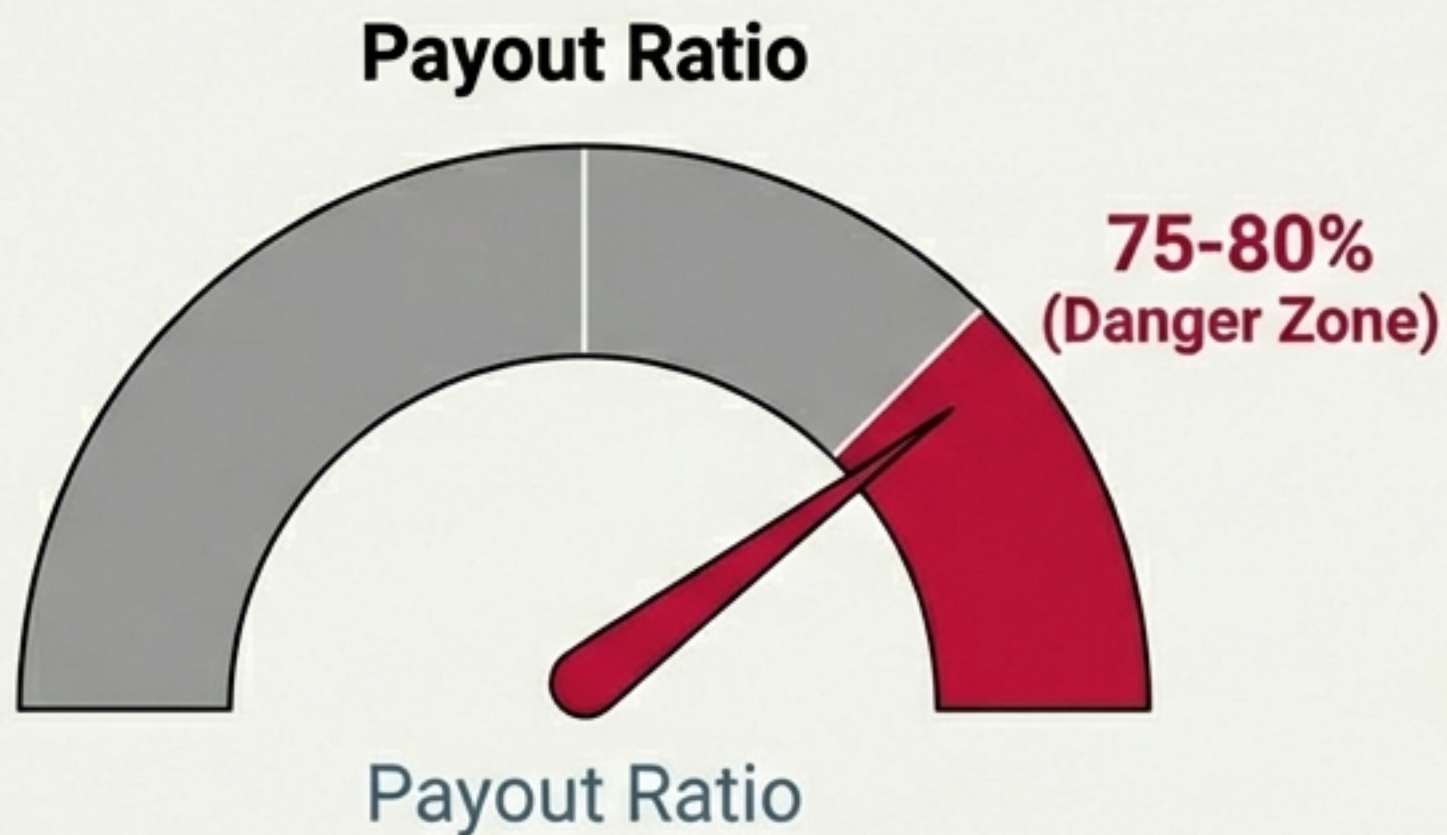
The "Valley of Death"

The Thesis: Move capacity to US Gulf Coast for cheaper ethylene access.

The Reality: Significant cash outlay (\$245M+) and P&L drag for 2 years.

The Risk: Utilization. The plant must run at high rates to cover fixed costs. If Ag/Oilfield demand falters in 2026 (e.g., oil <\$60/bbl), the asset becomes a stranded cost.

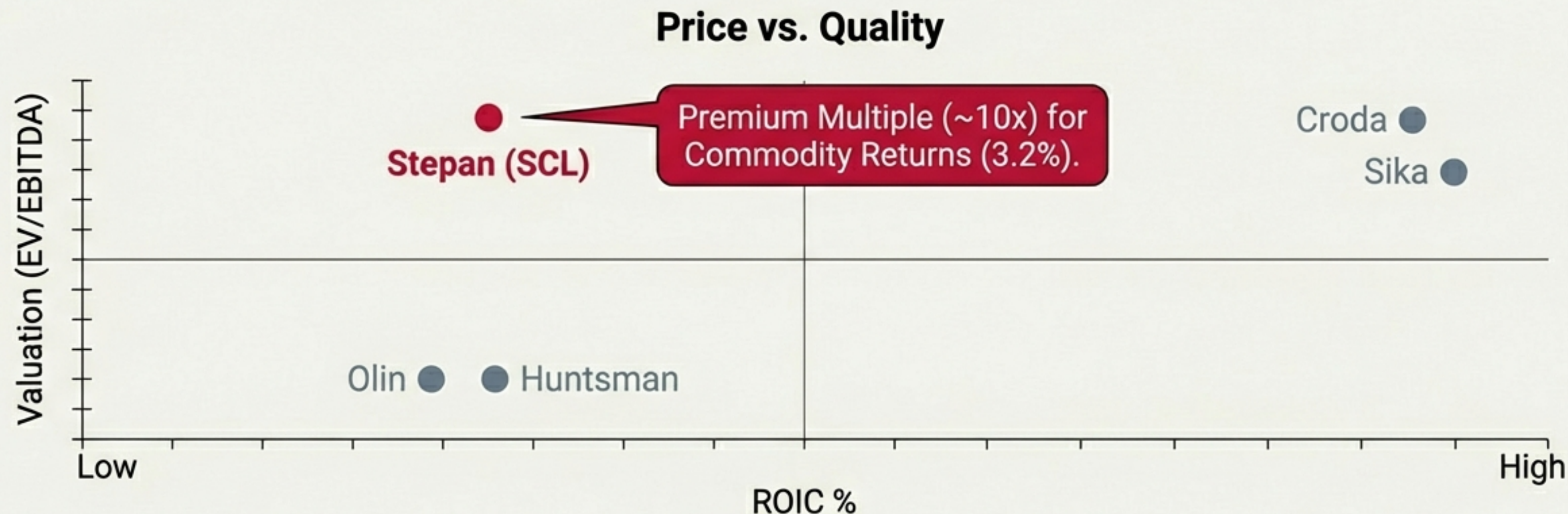
The Dividend Trap: Rigid Allocation Strains the Balance Sheet



Analysis: Cash from Ops < Dividends + Capex.

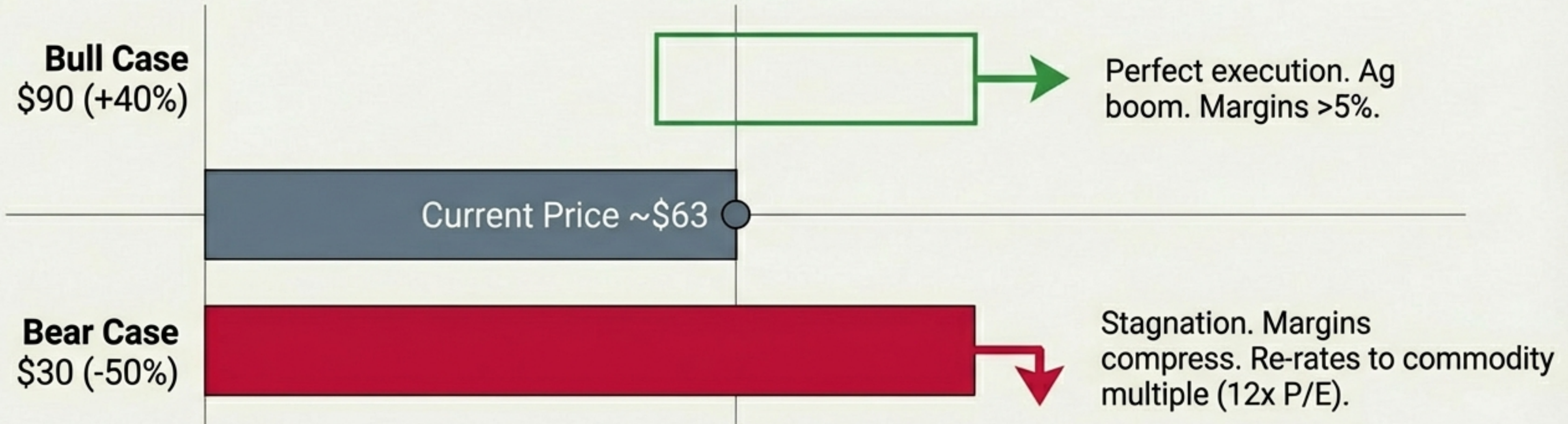
Conclusion: The dividend is safe for now, but it comes at the expense of deleveraging or opportunistic buybacks. **SCL is borrowing to pay shareholders.**

Valuation: Stuck in 'No Man's Land'



No Margin of Safety: The current price (~\$63) implies a flawless execution of the 2026 recovery. Peers with similar economics trade at 6x-8x EBITDA.

Scenario Analysis: Asymmetric Downside Risk



Risk/Reward is negative. The market is capitalizing earnings that haven't materialized yet.

Beyond the Financials: Operational and Governance Red Flags

Operational Reliability



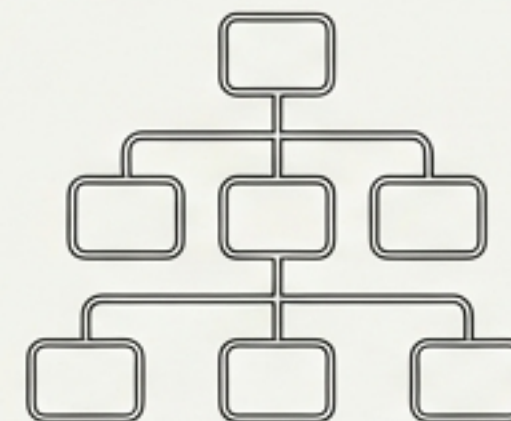
- **Asia Fraud (2024): \$6.8M** loss via social engineering signals **weak controls**.
- **Millsdale Outages:** Recurring reliability issues require heavy maintenance capex.

Macro Volatility



- **Oil Dependency:** EOR demand tied to **\$70+ oil**. Drop below **\$60 slashes budgets**.
- **Ag Volatility:** Weather-dependent crop protection is not a secular growth engine.

Governance



- **Family Control:** Stepan family owns ~5-7%; insulates management.
- **Missed Targets:** Executive comp ROIC modifier was **-30%** (2022-2024).

Final Verdict: A Mediocre Business Priced for Perfection



ROIC Broken:

< 4% returns in a 9% rate world.



Moat Eroded:

Squeezed by suppliers and mega-cap customers.



Growth Expensive:

Coming via capital intensity, not pricing power.

**AVOID /
UNDERWEIGHT**

Wait for 2-3 quarters of proven ROIC inflection before deploying capital. Until then, SCL is a 'show me' story with a negative risk skew.