STEPAN COMPANY
Moderator: James Hurlbutt
April 27, 2005
8:00 A.M. CT

Operator: Ladies and gentlemen, thank you for standing by.

Welcome to the Stepan Company First Quarter 2005 Earnings Conference Call.

During the presentation, all participants will be a listening only mode. Afterwards, we will conduct a question and answer session. At that time, if you have a question, please press the 1 followed by the 4 in your telephone.

As the reminder, this conference is being recorded Wednesday April 27, 2005. I would now like to turn the conference over to Mr. James Hurlbutt, Vice President of Finance for Stepan Company.

Please go ahead, sir.

James Hurlbutt: Good morning and thank you for joining us.

Before I begin, please note that the information in this conference call contains forward-looking statements, which are not historical facts.

These statements involve risks and uncertainties that could cause actual results to differ materially including but not limited to prospects for our foreign operations and certain global and regional economic conditions, and factors detailed in the Company's Securities and Exchange Commission filings.

I will now take a few minutes to review our operating results.

Net sales for the first quarter of 2005 increased 19%, to $264.3 million from $221.4 million for the same period in 2004. Higher selling prices, increased sales volume and the translation effect from the weaker dollar accounted for the increase in sales.

Net income decreased to $3.2 million, or 33 cents per diluted share, for the first quarter compared with $4.0 million, or 42 cents per diluted share, a year ago.

Net income also included two items that had the net effect of increasing earnings by $300,000. Insurance proceeds of $600,000 after tax, related to a fire in the UK in 2004, increased income, while income attributable to deferred compensation plan obligations declined by $300,000 net of tax. Gross profit increased slightly to $29.8 million due to strong polymer volume that offset weakness in specialty products.

Operating income decreased from $8.0 million for the first quarter of 2004 to $6.9 million for the first quarter of 2005, primarily due to higher operating expenses.

Now I would like to highlight the performance in each of our three segments.

We begin with surfactants, which accounted for approximately 76% of the Company's sales for the first quarter of 2005. Surfactant sales increased 14% from higher selling prices and a 4% increase in volume. However, surfactant earnings declined due to higher research expenses, a weaker sales mix in North America and lower margins in Europe. Higher utility costs, driven by the rise in natural gas prices, also contributed to the lower earnings.

Turning to our polymer segment, which represented 22% of our revenue for the first quarter of 2005, we saw our polymer sales rise 53% in the first quarter due to higher selling prices caused by continuing raw material cost increases. Sales volume grew by 5% and earnings also improved as a result of the higher volume and improved sales mix. This led to a 51% increase in operating income. Higher margin polyurethane polyol volume growth was partially offset by a decline in phthalic anhydride volume due to a plant shutdown in March for maintenance.

And finally, specialty products, which accounted for 2% of the Company's first quarter 2005 sales, declined 27% stemming from unusually low flavor and pharmaceutical volumes. They are both expected to recover over the balance of 2005. Earnings for this group were lower as a result of the lower volumes of these high margin products.

Turning to expenses, our operating expenses increased by 6% during the first quarter, due to pension and health care costs and higher research costs.

The 21% increase in research cost stems from consulting on new technologies, increased biocidal product testing and laboratory renovation expenses. Research spending is expected to moderate over the rest of the year.

Administrative expense declined due to lower outside legal costs and reduced system implementation costs following the 2004 completion in Europe.

Looking at other income, interest expense decreased due to a higher mix of short-term debt and lower interest rates.

Regarding our Philippine joint venture, we incurred a loss during the first quarter due to an adverse change in product mix. Our results should improve during the course of 2005.

Turning to the balance sheet, total debt for the quarter stood at $144.9 million, up from $112.0 million at the end of 2004. Higher working capital requirements led to this seasonal increase in debt, as year-end receivables were very low.

Our total debt to total capitalization for the first quarter of 2005 was 46.3%, up from 43.7% last year. Capital expenditures were $8.2 million for the quarter. Our capital expenditure projection for 2005 is a range of $40 million to $46 million.

Looking ahead, business conditions look positive for the rest of this year. While specialty products have started off weakly, we expect earnings from this segment to recover in the second quarter.

Surfactants sales grew over the quarter and we have been successful in recovering higher raw material, freight and natural gas costs in North America, but we have met greater resistance in Europe.

Surfactants will be increasing its sales of bio-diesel over the balance of the year. Demand for polymers also looks very strong for the balance of the year.

We are confident we can achieve full-year earnings growth.

This concludes my prepared remarks. At this time, I would like to turn the call over for questions.

Operator, please read the instructions for the questions portion of today's call.

Operator: Thank you.

Ladies and gentlemen, if you would like to register a question, please press the 1 followed by the 4 on your telephone.

You will hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the 1 followed by the 3.

If you're using a speakerphone, please lift your handset before entering your request.

One moment, please, for the first question.

The first question comes from the line of Beverly Machtinger from Grace & White.

Please proceed with your question.

Beverly Machtinger: Good morning, Jim.

James Hurlbutt: Good morning.

Beverly Machtinger: I was wondering if you could talk a little bit more about surfactants business in Europe and whether or not this weakness that you are seeing is customer-related or is that just a general economic condition situation?

James Hurlbutt: Well, we have an unusual situation going on right now in Europe but, generally, prices are being increased to cover higher raw material costs, but not at a fast enough rate to get our margins back to where they were, say a year - a year and a half ago.

Compounding the problem is the situation where one competitor has a plant in the United Kingdom that they plan to shut down by mid-year. This should be a good sign for us but what we're seeing is they're not raising prices as they try to keep that plant full for the balance of their operating period, through mid-year. So, they want to make sure they are covering overhead.

We hope that's a temporary problem. You would think that less capacity in the UK would certainly be beneficial to us over the long term. We believe that that site is the only major merchant competitor in the UK for us. So, barring significant imports from the continent of Europe, we would hope there will be some reasonable chance of getting our margins up in the UK, which is where we've seen most of the weakness in the last six months.

Beverly Machtinger: Okay. And then, if you could talk a little bit more about the surfactant business in general. I mean, overall, your margins still are not where they've been and, if anything, they are kind of weak - weaker, can you just give us a little idea of what's going on there as far as your product mix? Are you not being able to push through more value added?

Clearly, price - that you've been able to raise prices across the board, but overall, they don't seem to be bringing your margins back up to, you know, to where they've been.

James Hurlbutt: Well, we've been successful in North America with price increases across almost all product categories. Where we've seen some slowdown in mix, we had a slight deterioration in mix. Our distribution volume of higher margin products has been a little sluggish where we've had growth in other product lines. But the higher margin distribution business creates a mix issue, where we have less favorable mix coming in.

But overall, the price increases have been sticking in North America, you know, our costs have been growing as well. We've had higher pension costs, higher health care cost…

Beverly Machtinger: Yeah, but those are below the gross margin. Those are more operating, even your gross margin still hasn't recovered.

James Hurlbutt: Well, we have those costs in our plants as well.

Beverly Machtinger: Okay.

James Hurlbutt: So, when you talk about our gross profit line, that's got to cover the health care cost of the manufacturing sites and the pension cost at the manufacturing sites and the natural gas costs at those sites. I think we're pretty confident that the prospects for the balance of the year in North America look fairly strong. We've got additional volume coming with our bio-diesel participation this year, we had very low volume in the first quarter as we ramped our plant up in anticipation of a strong balance of the year in bio-diesel. That will certainly help spread more overhead out over a broader product portfolio.

So, I think the chance for margin improvement in North America continues to be strong for the balance of the year. Hopefully, we would see the same effect in Europe. particularly with less competition in the UK.

Beverly Machtinger: Okay, great. Thank you.

James Hurlbutt: Okay, thanks, Beverly.

Operator: Thank you. Ladies and gentlemen, as a reminder, to register for a question, please press the 1 followed by the 4 on your telephone.

It appears, at this time, that there are no further questions.

James Hurlbutt: Okay, I just wish to thank everybody for participating in today's call.

Thank you.

Operator: Thank you, ladies and gentlemen. That does conclude the conference call for today, we thank you for participation and ask that you please disconnect your lines.

Thank you and have a good day.

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