

STEPAN
Moderator: James Hurlbutt
February 10, 2005
9:00 am CT

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

Welcome to the Fourth Quarter and Year end Results Conference Call.

During the presentation all participants will be in a listen-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 on your telephone.

As a reminder, this conference is being recorded Thursday, February 10, 2005.

I would now like to turn the conference over to Mr. James Hurlbutt, Vice President of Finance. Please go ahead, sir.

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

Before I begin, please note that 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 filing.

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

Net sales for the fourth quarter of 2004 increased 19% to \$239.4 million from \$201.3 million for the same period in 2003.

Higher selling prices due to increased raw material costs contributed \$32.5 million to net sales. And the translation effect from the weaker dollar accounted for the remaining \$5.6 million increase in sales.

Overall, margin weakness in Europe coupled with weaker surfactant volume adversely affected the fourth quarter.

Net income rose to \$600,000, or 4 cents per diluted share, for the fourth quarter compared with a loss of \$3.4 million, or 41 cents per share, a year ago.

Gross profit improved 14%, or \$3.1 million, mainly a result of a 13% increase in polymer volume.

Surfactant gross profit also increased in North America and Latin America but was more than offset by a larger decline in Europe as a result of continuing higher cost for raw materials.

Operating results improved from a loss of \$5.8 million in the fourth quarter of 2003 to roughly breakeven for the current quarter. The improvement is due to a \$3.1 million improvement in gross profit and a \$2.7 million reduction in cost largely attributable to charges recorded in the fourth quarter of 2003 for an asset impairment, severance, and higher deferred compensation expense.

The deferred compensation plan results in expense when the price of Stepan Company stock increases.

Other income included \$1 million of foreign exchange gain, which substantially offset losses incurred during the first three quarters of 2004. This results from the sharp fluctuations of the value of the U.S. dollar.

The income tax provision benefited from a lowering of tax reserves by \$300,000 after the conclusion of an audit of U.S. income tax returns for the period of 2000 through 2002.

Sales for the full year 2004 were up 19%, to \$935.8 million, from \$784.9 million the prior year, and were positively impacted by higher selling prices, a 5% volume increase, and foreign currency translation contributions.

Full-year 2004 net income doubled to \$10.3 million, or \$1.05 per diluted share, from \$4.9 million, or 45 cents per diluted share, in 2003. Gross profit also increased by \$7.2 million, or 7%, as a result of the growth in polymer volume.

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

Let's start with Surfactants, which accounted for approximately 76% of the Company's sales for the full year 2004.

North American surfactant sales, mix, and volume improved resulting in a 14% improvement in operating income. Latin American income rose on improved fabric softener volume.

This improvement was more than offset by deteriorating profit margins and the difficulty of recovering higher raw material costs in Europe as a result of excess industry capacity and heightened competition.

Turning to our Polymer segment, which represented 21% of our revenue for the full year 2004, we saw our polymer volumes rise 17% in 2004, which led to a 31% increase in operating income. Higher volume and a partial recovery of prior margin erosion led to significant earnings improvement in both phthalic anhydride and polyurethane polyol.

And finally, Specialty Products, which accounted for 3% of the Company's full-year 2004 sales, showed improvements over the course of the year. Operating income for Specialty Products rose 17% on improved sales volume to the pharmaceutical and food ingredient markets.

Turning to expenses, overall operating expenses declined 2% for the full year 2004. Administrative expense was down \$3.4 million. Prior year administrative expense included a \$2.1 million environmental remediation charge and severance costs of \$900,000. Also within administrative expense, deferred compensation decreased by \$1.3 million.

R&D expenses were up 5% for the year as we continue to focus our efforts on innovations into new markets or higher margin applications in existing markets. Current high-priority projects include a polymer for the flexible foam market and surfactants for use in soap bars.

Looking at other income, interest expense decreased 10% from the prior year due to a higher mix of lower interest rate short-term debt. Other income declined as gains from foreign exchange of \$1.7 million in 2003 dropped to a loss of \$100,000 in 2004.

Turning to the balance sheet, 2004 year-end debt was \$112 million, down from \$115.7 million at the end of 2003.

Our total debt to total capitalization at the end of 2004 was 40%, down from 41.6% at the end of 2003.

Capital expenditures were \$10.6 million for the quarter, \$33.8 million for the full year.

Our capital expenditure projection for 2005 is a range of \$42 to \$47 million dollars.

Looking forward, Polymers are experiencing strong demand and greater global market penetration. Our Chinese polyol joint venture should be operational by mid-year.

We continue to look for opportunities within the Surfactant business, particularly focusing on soap bars, agricultural chemicals, and fabric softeners including developing a new fabric softener plant at our Philippine joint venture.

In North America, business fundamentals look good for both Surfactants and Polymers. We also expect European surfactant margins to improve over the course of 2005 as we recover the higher raw material cost coupled with the plant shutdown of one of our largest competitors in the United Kingdom.

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 question portion of today's call.

Operator: Thank you.

Ladies and gentlemen, if you would like 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 are using a speakerphone, please lift your handset before entering your request.

One moment, please, for the first question.

Our first question comes from the line of Beverly Machtinger from Grace and White. Please proceed with your question.

Beverly Machtinger: Hi, Jim. I have a couple of questions. First, raw material cost. Clearly, you've been raising prices to offset those rising costs. Can you give us some idea where those costs are headed? Have they stabilized? Do you see any kind of decline or increase coming down the road? Can you just give us some feel on that?

James Hurlbutt: We've had very mixed signals, unfortunately. We've seen, as with crude oil bouncing up and down. We saw some price decreases announced for January and then suddenly followed by announcements of increases

coming back the other way in February. So it's a very tenuous situation right now.

Our own internal feeling is that we hope we've seen the peak of the volatility by the end of last year. At least stability would be a good thing for us, in terms of getting our margins back to where we want them to be.

But we'd like to be optimistic that we're actually going to see some declines over the course of the year. It would seem to us that it would be more likely we would have declines than continuing increases. But because of the volatility of crude oil, that's very hard to predict.

Beverly Machtinger: Is your pricing now stable or do you think you can possibly push some more price increases to your customers?

James Hurlbutt: Well, we would still like to, and we did a fairly good job of recovering all of our raw material cost increases in North America. We were much, much less successful in Europe, and that's where we've got to get our pricing up further, in Europe. Not that we won't be looking for selective opportunities for price increases in North America, but particularly Europe, we will be raising prices.

Beverly Machtinger: And can you give us a little bit more feedback on what's happening in your Polymer segment? I mean you had really outstanding growth, and I was wondering if this is coming from new products, customers. I mean, what has stimulated this demand?

James Hurlbutt: There have been two factors. One is just the whole industry-wide demand has surged. We see two things going on in addition to just our end-use markets having very strong economic conditions, we do think there was some benefit in the fourth quarter of all of the repair work due to the hurricanes in Florida. A lot of our polyol goes into slab stock insulation for the roofs of flat-roofed warehouses. And, there was a lot of roof damage in the Southeast as a result of the hurricanes.

And there's also been a pent-up demand when the economy wasn't doing so well, people were deferring replacing roofs. And we're seeing much higher roof replacement.

And it's not just driven by pent-up demand; the higher energy prices encouraged people to put more foam insulation on the roofs of their buildings because they save money, they can get a payback actually from that investment through lower heating and air-conditioning cost.

So just all of those factors combined, plus our greater global market penetration in Europe, and, we are shipping to China from the U.S. in advance of our Chinese plant being up and running. So we are close to sold out in our capacity, not just in polyols within the Polymer Group but also in phthalic anhydride which has had a solid surge in demand with the first real margin improvement last year that we've had in many, many years.

Beverly Machtinger: So you don't see any letdown going into 2005?

James Hurlbutt: No, our business management in that area is very optimistic that 2005 is going to be a very solid year for the Polymer Group with improved earnings.

Beverly Machtinger: Great. Okay, I'll pass it along to the next person.

James Hurlbutt: Okay, thanks, Beverly.

Operator: Ladies and gentlemen, as a reminder, to register a question, press 1-4 on your telephone.

Mr. Hurlbutt, there are no further questions at this time. I will now turn the conference back to you, sir.

James Hurlbutt: I just wish to thank everybody for joining us today on this conference call. And I look forward to talking to you again in the future. Thank you.

Operator: Ladies and gentlemen, that does conclude our conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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