STEPHAN CO
Form 10-K
April 18, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, $.01 Par Value	AMERICAN STOCK EXCHANGE

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES [ ] NO [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES [ ] NO [X]

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 the filing requirements for at least the past 90 days. YES [X] NO [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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]

The aggregate market value of the voting and non-voting common equity shares held by non-affiliates as of June 30, 2006, the last business day of the Registrant's most recently completed second fiscal quarter was $9,742,912, based upon the reported sale price of $3.15 per share on the American Stock Exchange on such date.

The above amount excludes shares held by all executive officers and directors of the Registrant

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date:

4,389,805 Shares of Common Stock, $.01 Par Value,
as of March 30, 2007

List hereunder the following documents if incorporated by reference and the part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) any annual report to security holders; (2) any proxy or information statement; and (3) any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933:

NONE

THE STEPHAN CO. AND SUBSIDIARIES
INDEX TO ANNUAL REPORT
ON FORM 10-K

PART I

Certain statements in this Annual Report on Form 10-K ("Form 10-K") under "Item 1. Business", "Item 3. Legal Proceedings" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, condition (financial or otherwise), performance or achievements to be materially different from any future results, performance, condition or achievements expressed 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, the results of the audit and review processes performed by our independent auditors with respect to our Form 10-K for the year ended December 31, 2006; our ability to satisfactorily address any material weakness 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; 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.

Item 1. Business

GENERAL

The Company, founded in 1897 and incorporated in the State of Florida in 1952, is engaged in the manufacture, sale and distribution of hair care and personal care products at both the wholesale and retail level. The Company is comprised of The Stephan Co. ("Stephan") and its nine wholly-owned operating subsidiaries, Old 97 Company, Williamsport Barber and

Beauty Corp., Stephan & Co., Scientific Research Products, Inc. of Delaware, Sorbie Distributing Corporation, Stephan Distributing, Inc., Morris Flamingo-Stephan, Inc., American Manicure, Inc. and Lee Stafford Beauty Group, Inc.

The Company has identified three reportable operating segments, which are Professional Hair Care Products and Distribution ("Professional"), Retail Personal Care Products ("Retail") and Manufacturing. The Professional segment generally consists of a customer base of distributors, which purchase the Company's hair care products and beauty and barber supplies for sale to salons, barbershops and beauty schools. In this segment, a distinction is made between "wet goods", which include shampoos, conditioners, gels and similar hair treatments, and "hard goods", which include scissors, clippers, combs, dryers and other products used in the cutting and styling of hair. The customer base for our Retail segment is comprised of mass merchandisers, chain drug stores and supermarkets that sell hair care and other personal care products directly to the end user. The Manufacturing segment manufactures products for subsidiaries of the Company, and manufactures private label brands for certain customers.

THE STEPHAN CO.

Headquartered in Fort Lauderdale, Florida, we are principally engaged in the manufacture of hair care products for sale by one of our subsidiaries, Scientific Research Products, Inc. and the manufacture of products marketed under the STEPHAN brand name. We also manufacture, market and distribute hair and skin care products under various trade names through our subsidiaries. Retail product lines include brands such as Cashmere Bouquet talc, Quinsana Medicated talc, Balm Barr and Stretch Mark creams and lotions, Protein 29 liquid and gel grooming aids and Wildroot hair care products for men. These brands, included in the Retail segment of our business, are manufactured at our Tampa, Florida facility, as are our "Stiff Stuff" products. The sales of these products are also included in the Company's Retail segment. In addition, The Frances Denney division (included in the Retail segment) markets a full line of cosmetics through retail and mail order channels. Under the terms of an exclusive Trademark License and Supply Agreement with Color Me Beautiful, Inc., we market the

brand names HOPE, INTERLUDE and FADE-AWAY through several retail chains in the United States and Canada.

We also manufacture and sell products under the brand name "STEPHAN'S". Such products consist of different types of shampoos, hair treatments, after-shave lotion, dandruff lotion, hair conditioners and hair spray which are distributed throughout the United States to approximately 350 beauty and barber distributors and are included in our Professional segment. Our trademark, "STEPHAN'S," and the design utilized thereby have been registered with the United States Patent and Trademark Office, which registration is due for renewal in November 2011. Retail brand sales of Stephan, including the Frances Denney product line, accounted for approximately $2,797,000 of the Company's 2006 net sales.

Under certain trademark licenses, we have been granted the exclusive use of certain trademarks in connection with the manufacture and distribution of the Cashmere Bouquet product line of the Colgate-Palmolive Company in the United States and Canada. Any product sold under these license agreements is included in our net sales.

Pursuant to an additional license and supply agreement, we have granted

Color Me Beautiful, Inc. ("CMB") a license to distribute certain products of our Frances Denney line and to supply the requirements of CMB for such products. The agreement provides for royalty payments by CMB based upon net sales, with guaranteed minimum annual royalty payments throughout the term of the agreement that are credited against accrued royalties.

The Company's Fort Lauderdale location serves as our corporate headquarters. General management services are provided to our subsidiaries from this location.

No single customer accounted for more than 10% of our consolidated revenues in 2006. Private label production, which is the manufacturing of products marketed and sold under the brand names of customers of the Company, was not material in 2006.

OLD 97 COMPANY.

Old 97 Company ("Old 97"), a wholly-owned subsidiary of the Company, located in Tampa, Florida, markets products under brand names such as OLD 97, KNIGHTS, and TAMMY. In addition to selling more than 100 different products, including hair and skin care products, fragrances, personal grooming aids and household items, Old 97 serves as an additional manufacturing facility for our products. The Tampa facility manufactures most of the products sold under the Frances Denney line, all the talc manufactured for the Cashmere Bouquet and Quinsana brands, as well as all the other retail hair and skin care brands sold by Stephan, Stephan Distributing, Inc. and Sorbie Distributing Corporation. Old 97 also manufactures private label products for customers and sales, which were not material, are included in the Manufacturing segment of our business.

WILLIAMSPORT BARBER AND BEAUTY CORP.

Williamsport Barber and Beauty Corp. ("Williamsport"), a wholly-owned

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subsidiary of the Company, is located in Williamsport, Pennsylvania. Williamsport, a mail order beauty and barber supply company, with net sales of approximately $3,968,000 in 2006, accounted for approximately 18.2% of our consolidated revenues for the year and are included in the Professional business segment.

STEPHAN & CO.

Stephan & Co., a wholly-owned subsidiary, has focused on the distribution of personal care amenity products to resorts, spas and cruise ship lines. For the year ended December 31, 2006, Stephan & Co. had net sales of approximately $588,000.

SCIENTIFIC RESEARCH PRODUCTS, INC. OF DELAWARE.

Scientific Research Products, Inc. of Delaware ("Scientific") is a wholly-owned subsidiary, which accounted for 6.3% of our consolidated revenues in 2006, with net sales of approximately $1,380,000. The majority of the sales of Scientific are included in the Retail business segment.

SORBIE DISTRIBUTING CORPORATION

Sorbie Distributing Corporation ("Sorbie") is a wholly-owned subsidiary and a distributor of a professional line of hair care products sold to salons in the United States and Canada through a network of distributors. Net sales of Sorbie hair care products in 2006 were approximately $469,000, and are included in the Professional segment of the Company's business.

STEPHAN DISTRIBUTING, INC.

Stephan Distributing, Inc., wholly-owned subsidiary, distributes a professional hair care line of products marketed under the brand name "Image," and a retail hair care line marketed under the brand name "Stiff Stuff." Sales of Image professional brands amounted to approximately 4.2% of consolidated revenues, or approximately $926,000 of net sales for the year ended December 31, 2006. Sales of New Image products are included in the Company's Professional business segment while sales of the Modern line are included in the Company's Retail business segment.

MORRIS FLAMINGO-STEPHAN, INC.

Morris-Flamingo, Inc. ("Morris Flamingo") is a beauty and barber distributor, which markets its products utilizing catalogs published under the Morris Flamingo brand name as well as the Major Advance brand name. Net sales for the year ended December 31, 2006 were approximately $10,550,000, accounting for approximately 48.3% of our consolidated revenues, and are included in the Professional segment of the Company's business.

AMERICAN MANICURE, INC.

American Manicure, Inc. was established in June, 2005 to acquire the assets and business of AM Laboratories, Inc., a company that distributed

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"Natural" and "French" nail polish manicure kits to other distributors and salons. For the year ended December 31, 2006, net sales were approximately $256,000.

LEE STAFFORD BEAUTY GROUP, INC.

Incorporated in late 2005, Lee Stafford Beauty Group, Inc. was formed to act as the exclusive manufacturer, marketer and distributor of the Lee Stafford brand of hair care products in the United States. Lee Stafford is a well-known hairdresser in Great Britain, with salons in London, Essex and Brighton, as well as an upscale, unique product line distributed not only in the United Kingdom, but also Europe, Australia and several other countries. Sales for this company was nominal in 2006.

SEGMENT INFORMATION

"Operating Segments and Related Information," which provides information on net sales, income before income taxes and cumulative effect of change in accounting principle, interest income and expense and depreciation and amortization for the last three years and identifiable assets for the last two years, for each of our three business segments, is set forth in Note 9 of the consolidated financial statements included elsewhere in this Form 10-K.

RAW MATERIALS, PACKAGING and COMPONENTS INVENTORY

The materials utilized by the Company and our subsidiaries in the manufacture of its products consist primarily of common chemicals, alcohol, perfumes, labels, plastic bottles, caps and cartons. All materials are readily available at competitive prices from numerous sources and have in the past been purchased from domestic suppliers. Neither the Company nor any of our subsidiaries has ever experienced any significant shortage in supplies nor do we anticipate any such shortages in the reasonably foreseeable future. Due to market conditions in the petroleum industry, the Company continues to experience price increases in both raw material and component prices as well as an increase in overall freight costs; however, it is not anticipated that these price increases will have a material adverse effect on our operations and we believe that such increases can be passed on to our customers.

The Company and its subsidiaries seek to maintain a level of finished goods inventory sufficient for a period of at least three months. The Company does not anticipate any change in such practice during the reasonably foreseeable future.

BACKLOG

As of December 31, 2006 the Company did not have any significant amount of backlog orders.

RESEARCH AND DEVELOPMENT

During each of the three prior fiscal years ending December 31, 2006, expenditures on Company sponsored research relating to the development of

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new products, services or techniques or the improvement of existing products, services or techniques were not material and were expensed as incurred.

COMPETITION

The hair care and personal grooming business is highly competitive. We believe that the principal competitive factors are price and product quality. Products manufactured and sold by the Company and its subsidiaries compete with numerous varieties of other such products, many of which bear well known, respected and heavily advertised brand names and are produced and sold by companies having substantially greater financial, technical, personnel and other resources than the Company. Our products account for a relatively insignificant portion of the total hair care and personal grooming products manufactured and sold annually in the United States.

GOVERNMENT AND INDUSTRY REGULATION, ENVIRONMENTAL MATTERS

Certain of our products are subject to regulation by the Food and Drug Administration, in addition to other federal, state and local regulatory agencies. The Company believes that its products are in substantial compliance with all applicable regulations. The Company does not believe that compliance with existing or presently proposed environmental standards, practices or procedures will have a material adverse effect on operations, capital expenditures or the competitive position of the Company.

EMPLOYEES

As of December 31, 2006, in addition to its four executive officers, the Company and its subsidiaries employed 98 people engaged in the production, warehousing and distribution of its products. Although we do not anticipate the need to hire a material number of additional employees, the Company believes that any such employees, if needed, would be readily available. No significant number of employees are covered by collective bargaining agreements and the Company believes its employee relationships are satisfactory.

Item 1A: Risk Factors

An investor should carefully consider the risks described below, in addition to other information included elsewhere in this Annual Report on Form 10-K and other documents we file with the SEC. The risks and uncertainties described below are those that the Company has identified as material, but are not the only risks and uncertainties facing the Company. Our business is also subject to general risks and uncertainties that affect other companies, such as overall U.S. and non-U.S. economic and industry conditions, including global economic events, geopolitical events, changes in laws or accounting rules, terrorism and/or other international conflicts, natural disasters or other disruptions of unexpected economic/business conditions. Additional risks and uncertainties not currently known to us or that we currently believe are immaterial may also impact our business operations, financial results and liquidity.

Many of the markets we serve are highly competitive, which could limit the volume of products that we sell and reduce our operating margins.

Our products are sold in a competitive marketplace which is experiencing increased trade concentration and the growing presence of large-format retailers and discounters. With the growing trend toward retail trade consolidation, we are increasingly dependent on key retailers, and some of these retailers, including large-format retailers, have greater bargaining strength than we do. They may use this leverage to demand higher trade discounts, allowances or slotting fees which could lead to reduced sales or profitability. We believe that significant points of competition in our markets are product quality, price, product development, conformity, to customer specifications, reliability and timeliness of delivery, customer service and effectiveness of distribution. Maintaining and improving our competitive position requires continued investment by us in manufacturing, quality standards, marketing, customer service and support of our distribution networks. The Company may have insufficient resources in the future to continue to make such investments and, even if we make such investments, we may not be able to maintain or improve our competitive position.

We may also be negatively affected by changes in the policies of our retail trade customers, such as inventory de-stocking, limitations on access to shelf space, delisting of our products and other conditions. In addition, private label brands sold by retail trade chains, which are typically sold at lower prices, are a source of competition for some of our product lines.

Consumers may reduce discretionary purchases of our products as a result of a general economic downturn or other external factors.

We believe that consumer spending on specific hair care and fragrance products may be influenced by general economic conditions and the availability of discretionary income. As a result, we may experience periods of declining sales during economic downturns. In addition, a general economic downturn may result in reduced traffic in our customers' stores which may, in turn, result in reduced net sales to our customers. Any resulting material reduction in our sales could have a material adverse effect on our business, its profitability or operating cash flows.

Our success depends on our ability to anticipate and respond to changing consumer preferences.

The markets in which our products compete are characterized by constant product innovation and changing consumer preferences. We believe that our success depends in large part upon our ability to anticipate and respond to changing consumer demands in a timely manner and to continually appeal to our target consumers. Any failure to offer products that respond to changing consumer preferences, or a shift in consumer preferences away from our products, could adversely affect retail and consumer acceptance of our products and have an adverse affect on our sales and our results of operations.

Increases in our raw material or component costs or difficulties within our supplier base could negatively affect our profitability.

Generally, our raw materials and component requirements are obtainable from various sources and in desired quantities. While we currently maintain alternative sources for raw materials and components, our business is subject to the risk of price fluctuations and, perhaps, periodic delays in the delivery of certain raw materials and components. Due to market conditions in the petroleum industry, the Company continues to experience price increases in both raw material and component prices as well as an increase in overall freight costs. While the rise in material costs may continue to impact our financial results, we have been able to offset most of these cost increases through price recovery from our customers and cost reductions. Our ability to continue to pass along cost increases on a going forward basis is not guaranteed. In addition, a failure by our suppliers to continue to supply us with raw materials or component parts on commercially reasonable terms, or at all, would have a material adverse effect on us.

We are exposed to certain inventory risks.

Our business is subject to the risk that the value of our inventory will be affected adversely by our suppliers' price reductions or by product changes affecting the usefulness or desirability of the products comprising our inventory. We take various actions, including monitoring our inventory levels and controlling the timing of purchases to reduce our inventory risk. We are subject to the risk that our inventory values may decline in value. In addition, the failure of anticipated orders to materialize could result in our holding a significant amount of unsold inventories. We may be required to offer sales discounts or other incentives to our customers in order to sell such inventories or to write down the carrying value of inventories we are unable to sell. Any such sales discounts or customer incentives or inventory write-downs could have an adverse affect on our sales and our results of operations.

Historically, the Company has grown primarily through acquisitions. If we are unable to identify attractive acquisition candidates and successfully integrate acquired operations, we may be adversely affected.

One of our principal growth strategies in the past has been to pursue strategic acquisition opportunities. A substantial portion of our historical growth has been from acquisitions. Attractive acquisition opportunities may not be identified or acquired in the future, financing may be unavailable on satisfactory terms or we may be unable to accomplish our strategic objectives in effecting a particular acquisition. We may encounter various risks in acquiring other companies or brands, including the possible inability to integrate an acquired line of business into our operations, diversion of management's attention and unanticipated problems, some or all of which could materially and/or adversely affect our business strategy, financial condition and results of operations.

The Company may be unable to successfully implement growth strategies. Our ability to realize growth opportunities, apart from acquisitions, may be limited.

The Company has identified growth opportunities involving new product development, cross-selling, product bundling, cost reduction measures and organic growth opportunities. However, our business operates in relatively stable marketplaces and it may be difficult to successfully pursue these strategies and realize material benefits therefrom. Even if the Company is successful, other risks attendant to our businesses and the economy generally may substantially or entirely eliminate the benefits. While we have been successful with some of these strategies in the past, our growth has principally come through acquisitions.

The price of our common stock may be volatile.

The trading price of our common stock may fluctuate widely as a result of a number of factors, many of which are outside our control. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market prices of many companies. These broad market fluctuations could adversely affect the market price of our common stock.

We may be unable to adequately protect our intellectual property.

While the Company believes that our trademarks, trade names and other intellectual property have significant value, the market for our products depends to a degree upon the value associated with our trademarks and trade names. Competitors may infringe on our trademarks or successfully avoid them through design innovation. Although most of our brand names are registered in the United States and certain foreign countries, we may not be successful in asserting trademark or trade name protection. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States. The costs required to protect our trademarks and trade names may be substantial. Additionally, an adverse outcome in any intellectual property litigation could subject us to significant liabilities to third parties, require us to license our intellectual property rights from others, require us to comply with injunctions to cease marketing or using certain products or brands, or require us to redesign, reengineer, or re-brand certain products or packaging. Further, we may incur costs in terms of legal fees and expenses, whether or not the claim is valid, to respond to intellectual property infringement claims. These or other liabilities or claims may increase or otherwise have a material adverse effect on our financial condition and future results of operations.

The Company has a significant amount of goodwill and intangible assets, and their future impairment could have a material adverse effect on our financial condition and results of operations.

The Company's goodwill and intangible assets were approximately $5,748,000 at December 31, 2006, and represented approximately 22% of total assets. For the years ended December 31, 2006 and 2004, the Company incurred impairment losses of $6,706,000 and $2,145,000, respectively, in connection with the valuation of intangible assets. Because of the continued significance of our goodwill and intangible assets, any future impairment

of these assets could have a material adverse effect on our financial results.

If we lose key personnel, or fail to attract and retain qualified experienced personnel, we may be unable achieve the Company's continuing objectives.

We believe that the future success of the Company depends upon the continued contributions of our highly qualified management personnel and on our ability to attract and retain those personnel. These individuals have developed strong relationships with customers and suppliers. There can be no assurance that our current employees will continue to work for us or that we will be able to hire the additional personnel necessary for our continued growth. The Company's future growth and success depends on our ability to identify, hire, train and retain qualified managerial personnel.

The impact of the Sarbanes-Oxley Act of 2002 will require the Company to implement significant changes to internal control procedures and will force the Company to incur substantial implementation and recurring costs.

The Public Company Accounting Oversight Board ("PCAOB"), adopted rules for purposes of implementing Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX 404"), which included revised definitions of material weaknesses and significant deficiencies in internal control over financial reporting. The PCAOB defined a material weakness as "a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected." The new rules describe certain circumstances as being both significant deficiencies and strong indicators that material weaknesses in internal control over financial reporting exist.

Management of the Company has identified deficiencies which, taken in the aggregate, amount to material weaknesses in our internal control over financial reporting. These material weaknesses in our internal controls over financial reporting 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 and advice from our independent registered public accounting firm. Inadequate internal control over financial reporting could cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our securities.

Pursuant to SOX 404, our management will be required to deliver a report that assesses the effectiveness of our internal control over financial reporting, and our auditors will be required to deliver an attestation report on management's assessment of and operating effectiveness of internal control over financial reporting. The effective implementation date of SOX 404 has been postponed for non-accelerated filers such as The Stephan Co. until the first year ending on or after December 15, 2007 and Auditor reporting requirements become effective for fiscal years ending on or after December 15, 2008. We have a substantial effort ahead of us to complete the documentation of our internal control system and financial processes, information systems, assessment of their design, remediation of control deficiencies identified in these efforts and management testing of the design and operation of internal control. Management has estimated that the costs associated with the implementation of SOX 404 will be material and may very well have an adverse effect on the financial position, results of operations and cash flows of the Company.

Failure to comply with laws and government regulations could adversely affect our ability to operate our business.

Many of our activities are regulated by federal and state statutes and regulations. The manufacture, formulation, packaging, labeling, distribution and advertising of our cosmetic, Over the Counter ("OTC") drug and device products are subject to regulation by one or more federal and/or state agencies, including but not limited to the Food and Drug Administration ("FDA"), the Department of Transportation ("DOT"), the Florida Department of Health ("FL DOH"), the Occupational Safety and Health Administration ("OSHA"), the Environmental Protection Agency ("EPA") as well as by foreign governments where we distribute some of our products. Failure to comply with the rules or regulations established by these agencies could subject us to enforcement actions or other consequences. For example, noncompliance with applicable FDA policies or requirements could subject us to suspensions of manufacturing or distribution of products, seizure of products, product recalls, fines, criminal penalties, injunctions, failure to approve pending product registrations or withdrawal of product manufacturing permits. Likewise, our manufacturing facilities are continually subject to inspection by governmental agencies. Manufacturing operations could be interrupted or halted if a regulatory authority is unsatisfied with the results of any inspection. Any interruptions of this type could result in materially reduced sales of our products or increased manufacturing costs. Further, failure to comply with such laws and regulations could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

An increase in product liability claims or product recalls could harm our business.

We face an inherent business risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in adverse effects. While we have taken, and will continue to take, what we believe are appropriate precautions, we may not be able to avoid significant product liability exposure. We currently have product liability insurance, however, we cannot be assured that the level or breadth of any insurance coverage will suffice to fully cover all potential claims. Significant judgments against us for product liability for which we have no insurance could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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Product recalls or product field alerts may be issued at our discretion or the discretion of the FDA or other governmental agencies having regulatory authority over OTC drug, device and/or cosmetic product manufacture, formulation, packaging, labeling, distribution or advertising. Any recall or product field alert has the potential of damaging the reputation of the product or our reputation and/or having a material adverse effect on our business, financial condition, results of operations or cash flows.

Item 1B: Unresolved Staff Comments

None

Item 2. Properties

Our administrative, manufacturing and warehousing facilities are located in a building of approximately 33,000 square feet, owned by the Company, located at 1850 West McNab Road, Fort Lauderdale, Florida 33309. The Company utilizes approximately two-thirds of the space for the manufacture and warehousing of our products. The remainder of the space is utilized by the Company for its executive and administrative offices. The Company also owns certain machinery and equipment used in the manufacture of our products that are stored in the facility in Fort Lauderdale, Florida. In addition to this facility, effective May 1, 2006, the Company leases approximately 10,000 square feet of warehouse space located at 3137 N.W. 25th Avenue, Pompano Beach, Florida 33069, under the terms of a one year lease, for approximately $7,300 per month.

Old 97 owns three buildings totaling approximately 42,000 square feet of space, one of which is located at 2306 35th Street, Tampa, Florida 33605. This building is utilized by Old 97 in the manufacture of its various product lines. It also owns two buildings located at 4829 East Broadway Avenue, Tampa, Florida 33605. One building, comprising 10,500 square feet, is being used for office facilities and order fulfillment for the Frances Denney line. The second building, consisting of approximately 30,000 square feet, is used as a warehouse and distribution facility. In addition to the above facilities, Old 97 leases approximately 31,500 square feet of warehouse space located at 3906 East 21st Avenue, Tampa, Florida 33605, under the terms of a two-year lease ending July 31, 2008, for approximately $13,200 per month.

The Company leases office and warehouse space of approximately 6,000 square feet in Williamsport, Pennsylvania pursuant to a five-year lease expiring January 31, 2012. Monthly rent in the amount of $2,400 is payable to the former owner of Williamsport Barber Supply and the Company has the right to terminate the lease upon 30-days notice.

The Company leases an office, warehouse and manufacturing facility located at 204 Eastgate Drive, Danville, Illinois 61834. The facility has 7,500 square feet of office space and 85,500 square feet of warehouse, distribution and manufacturing space. The landlord is Shaheen & Co., Inc, the former owner of Morris-Flamingo. Shouky A. Shaheen, a minority owner of Shaheen & Co., Inc., is currently a member of the Board of Directors and a significant shareholder of the Company.

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On May 4, 2005, the Company entered into a Second Amendment of Lease Agreement (the "Amendment") with respect to the Danville, IL facility extending the term of the lease to June 30, 2015, with a five year renewal option, and increases the annual rental to approximately $303,000. The base rent is adjustable annually, in accordance with the existing master lease, the terms of which, including a 90-day right of termination by the Company, remain in full force and effect. The Amendment provides a purchase option, effective during the term of the lease, to purchase the premises at the then fair market value of the building, or to match any bona fide third-party offer to purchase the premises.

On July 6, 2005, the landlord notified the Company that its interpretation of the Amendment differs from that of the Company as to the existence of the 90-day right of termination. In October 2005, the landlord filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Shaheen & Co., Inc. (Plaintiff) v The Stephan Co., Case number 05-15175 seeking a declaratory judgment with respect to the validity of the 90-day right of termination. In addition, the lawsuit alleges damages with respect to costs incurred and the weakening of the marketability of the property. This matter is currently unresolved and the Company is unable, at this time, to determine the outcome of the litigation. However, if it is ultimately determined that the early termination provision has been eliminated with the Amendment, the Company's minimum lease obligation would amount to $303,000 in each of the years 2007 through 2011 and approximately $1,360,000 thereafter.

Item 3. Legal Proceedings

In addition to the matters set forth below, the Company is involved in other litigation arising in the normal course of business. It is the opinion of our management that none of such matters, at December 31, 2006, would likely, if adversely determined, have a material adverse effect on our financial position, results of operations or cash flows.

For a description of certain legal proceedings involving the Company and a shareholder, see Item 2. Properties above.

In March 2006, in a case styled Trevor Sorbie International, Plc. v. Sorbie Acquisition Co. (CASE NO. 05-14908-09), filed in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, Trevor Sorbie International, Plc. ("TSI") instituted efforts to collect on a judgment it has against Sorbie Acquisition Co. ("SAC"). The judgment derives from an October 25, 2004, Pennsylvania arbitration award in favor of TSI and against SAC with respect to certain royalties and interest due. The financial statements for the Company for the year ended December 31, 2006, reflect a liability of approximately $931,000, including interest, for payment of this judgment. Among other things, the Florida lawsuit alleges fraud and names as additional defendants The Stephan Co., Trevor

Sorbie of America, Inc. and Sorbie Distributing Corporation. The Company is vigorously defending this legal action against TSI. While management believes we 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, due to the limited

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discovery taken and the complexities of the issues involved, the Company cannot predict the outcome of the litigation.

In 1997, the Company's wholly-owned subsidiary, Stephan Distributing, Inc., acquired several product lines from New Image Laboratories, Inc. ("New Image"). The purchase price included a contingent payment of 125,000 shares of the Company's common stock payable upon the achievement of certain earnings levels. New Image commenced litigation against the Company seeking certain purchase price adjustments. The parties reached a settlement pursuant to a stipulation of settlement and amendments thereto which provided, among other things, as follows: (i) New Image relinquished title to 65,000 of the 125,000 shares of the Company's common stock held in escrow and received 60,000 shares, (subsequently, New Image elected to sell the Company its 60,000 shares for $285,000), (ii) Stephan was awarded

$44,000 in damages from New Image, (iii) dividends, and interest accrued thereon, held in the escrow account (approximately $72,000) were distributed with Stephan receiving 52% of such funds and New Image receiving 48% of such funds, which was used to satisfy, in part, the award under (ii) above. As a result of this settlement, the Company recorded an expense of approximately $285,000 and the amount is reflected as a reduction of royalty and other income on the consolidated statement of operations for the year ended December 31, 2004. Also in 2004, the amount of the contingently returnable shares recorded in the financial statements of the Company was offset against additional paid in capital when the shares were retired.

Item 4. Submission of Matters to a Vote of Security Holders

On November 9, 2006, the Company held an Annual Meeting of Stockholders to elect William Gross to another term as a Class III member of the Board of Directors and ratify the appointment of Goldstein Lewin & Co. as the Company's independent public accounting firm.

The results of the voting, with 3,470,839 shares voted, was as follows: For the election of William Gross to another term; 2,922,692 for with 548,147 withheld and with respect to the ratification of Goldstein Lewin & Co.; 3,370,917 for, 96,772 against and 3,150 abstaining.

No other business was presented for consideration at the Annual Meeting.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

(a) Market Information

The Company's Common Stock is listed on the American Stock Exchange (the "Exchange"). The following table sets forth the range of high and low sales prices for the Company's Common Stock for each quarterly period during the two most recent fiscal years:

Quarter Ended	High Sales Price	Low Sales Price
March 31, 2005	$ 5.10	$ 3.87
June 30, 2005	4.70	3.45
September 30, 2005	4.70	3.85
December 31, 2005	4.10	3.14

March 31, 2006	$ 3.75	$ 3.31
June 30, 2006	3.70	3.05
September 30, 2006	3.17	2.91
December 31, 2006	3.62	2.96

(b) Holders

As of March 30, 2007, the Company's Common Stock was held of record by approximately 345 holders. Additionally, the Company's Common Stock is believed to be held beneficially by approximately 695 shareholders in "street-name".

(c) Dividends

The Company declared and paid cash dividends at the rate of $.02 per share for each quarter in 1996 through 2006. Future dividends, if any, will be determined by the Company's Board of Directors, in its discretion, based on various factors, including the Company's profitability, cash on hand and anticipated capital needs. The Company paid a special dividend of $2.00 per share on September 15, 2004, to holders of record on September 8, 2004.

There are no contractual restrictions, including any restrictions on the ability of any of the Company's subsidiaries, to transfer funds to the Company in the form of cash dividends, loans or advances, that currently materially limit the Company's ability to pay cash dividends or that the Company reasonably believes are likely to materially limit the future payment of dividends on its Common Stock.

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Item 6. Selected Financial Data

(in thousands, except per share data)

	2006	2005	2004	2003	2002
Net sales	$21,836	$22,262	$23,951	$25,336	$25,067
(Loss)/Income before income taxes and cumulative effect of change in accounting principle	(5,731)	(244)	(2,034)	1,487	1,400
(Loss)/Income before cumulative effect of change in accounting principle	(3,602)	(172)	(2,176)	760	503
Cumulative effect of change in accounting principle, net of tax	-	-	-	-	(6,762)
Net (loss)/income	(3,602)	(172)	(2,176)	760	(6,259)

Current assets	15,019	16,853	15,014	24,139	20,284
Total assets	26,766	32,778	34,719	48,063	47,655
Current liabilities	3,325	5,240	3,276	5,085	3,514
Long term debt	1,110	-	3,238	4,348	6,395
PER COMMON SHARE (Basic and Diluted): (a)					
(Loss)/Income before cumulative effect of change in accounting principle	(.82)	(.04)	(.50)	.18	.12
Cumulative effect of change in accounting principle	-	-	-	-	(1.58)
Net (loss)/income	(.82)	(.04)	(.50)	.18	(1.46)
Cash dividends	.08	.08	2.08	.08	.08

Notes to Selected Financial Data

(a) Net (loss)/income per common share is based upon the weighted average number of common shares outstanding in accordance with

Statement of Financial Accounting Standards No. 128. The weighted average number of diluted shares outstanding were 4,389,805 for 2006 and 2005, 4,348,908 for 2004, 4,312,711 for 2003, and 4,285,577 for 2002. The weighted average number of basic shares outstanding were not significantly different in any of the aforementioned years.

The following data should be read in conjunction with the audited consolidated financial statements and related notes included elsewhere in this Form 10-K.

Selected Quarterly Financial Information (unaudited)
(in thousands, except per share data)

	Quarter Ended 3/31/06	Quarter Ended 6/30/06	Quarter Ended 9/30/06	Quarter Ended 12/31/06
Net sales	$ 5,596	$ 5,361	$ 6,097	$ 4,782
Gross profit	2,218	2,354	2,572	1,897
Net income/(loss)	97	116	366	(4,181)
Net income/(loss) per share	.02	.03	.08	(.95)

	Quarter Ended 3/31/05	Quarter Ended 6/30/05	Quarter Ended 9/30/05	Quarter Ended 12/31/05

Net sales	$ 5,517	$ 5,057	$ 6,568	$ 5,120
Gross profit	2,359	2,019	2,325	1,792
Net income/(loss)	74	(159)	94	(181)
Net income/(loss) per share	.02	(.04)	.02	(.04)

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2006 AS COMPARED TO 2005

For the year ended December 31, 2006, the Company incurred a net loss of approximately $3,602,000 as a result of a significant impairment to goodwill and other intangible assets in the Company's Retail "reporting unit", which includes the Frances Denney and LeKair brands, as well as the brands acquired from Colgate-Palmolive, Inc. ("CP") in December 1995. Based upon a valuation analysis of intangible assets for the year ended December 31, 2006, prepared with the assistance of an independent valuation firm, the Company reduced all of the goodwill attributed to the acquisition of Scientific Research Products, Inc., acquired in 1994, by approximately $1,411,000 and all of the trademarks associated with the brands LeKair, New

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Era and Frances Denney, in addition to substantially all of the value assigned to the brands acquired from CP, totaling approximately $5,295,000. The impairment of the trademarks has been included in Selling, General and Administrative expenses, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". After taking into consideration prior years sales trends, the Company took a conservative approach to the sales projections used in connection with certain analysis by the valuation firm. Management believes that the remaining carrying value of the above-mentioned retail trademarks is less than the Company would realize if the brands were offered to third-party buyers, based upon disclosed sales prices and multiples of brand revenue indicated in published industry results.

In 2006, the Company's gross profit increased in spite of a decline in overall net revenues. Net sales for the year ended December 31, 2006 was $21,836,000, a decline of $426,000 from the previous year, but gross profit increased to $9,041,000 when compared to $8,495,000 for the year ended December 31, 2005. This increase, as well as an increase in the gross profit margin from 38.2% in 2005 to 41.4% in 2006, was generally due to a change in the sales mix as well as management's effective use of inventory that was previously written off. Income from operations, before taking into consideration the impairment of intangibles, was approximately $839,000 as a result of the increase in the gross profit described above, as well as a decline in recurring selling, general and administration expenses ("SG&A"). Reductions in payroll and related expenses, rent expense due to consolidation of warehouse space and legal and professional expenses were the significant reasons that recurring SG&A expenses declined approximately $564,000 in 2006 when compared to 2005.

The Professional segment experienced a sales decline of almost $1,000,000 in 2006. A large part of this decline was in "hard goods", due to a combination of factors including strong price consciousness by customers in addition to some contraction of the customer base. A positive growth in net sales was shown by our New Era and American Manicure brands which offset a decline in the "wet goods" level of sales in 2006. The Manufacturing segment showed increased sales, both from existing distribution channels in addition to new private label customers. The Company is optimistic that it can continue to provide quality products to it's private label sector and increase sales in this segment. As indicated above, while overall sales declined in 2006, this created a change in the sales mix, since the significant decline in the Professional segment was due to a decline in the sales of hard goods, which traditionally has a lower gross margin than other lines. As a result, gross profit increased $546,000 for the year ended December 31, 2006 when compared to the results achieved in 2005.

Selling, general and administrative expenses (SG&A) increased overall by approximately $4,731,000, from $8,766,000 in 2005 to $13,497,000 in 2006 as a result of the impairment charge discussed above. A large portion of this decline can be attributed to decreases in promotional expenses, rent expense as a result of consolidation of warehouse space, a decline in legal expenses and a reduction in overall payroll costs.

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Interest expense decreased slightly, as interest paid on actual outstanding debt decreased by approximately $19,000 while interest expense accrued on the Sorbie debt increased by approximately $16,000. The continuing accrual of interest with respect to the Sorbie arbitration award is more fully discussed in Item 3, above, however management believes we may ultimately prevail and/or settle for an amount substantially below the amount already accrued, but continues to accrue interest on the entire obligation because it cannot predict the outcome of the litigation.

Actual interest paid on the Company's outstanding bank debt obligation was $39,000 for the year ended December 31, 2006, compared to $58,000 in 2005. Interest income increased $106,000 due to higher interest rates and an increase in the level of invested cash. Interest income for the year ended December 31, 2006, was $233,000, compared to $127,000 earned in 2005.

The net loss per share for the year ended December 31, 2006 was ($.82), compared to a net loss per share in 2005 of ($.04), based upon an average number of shares outstanding of 4,389,805 in 2006 and 2005.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2005 AS COMPARED TO 2004

In 2005, the Company incurred a net loss of $172,000 as a result of reduced sales and gross profit, even though the Company experienced a decrease in selling, general and administrative expenses. Net sales for the year ended December 31, 2005 was $22,262,000, a decline of $1,689,000 from the previous year. Over 90% of this decline was due to a decrease in the net sales of the Company's Retail business segment. This decline was due, in part, to the continuing contraction in the ethnic hair care market, as major distributors realigned inventory levels to cope with softening demand. In addition, other retail brands, marketed mainly through general retail markets, also declined as the Company attempted to restructure it's distribution channels.

As a result of lower net sales, gross profit declined $1,169,000 for the year ended December 31, 2005, to $8,495,000, when compared to $9,664,000, the gross profit for the year ended December 31, 2004. The gross profit margin declined slightly, from 40.4% in 2004 to 38.2% in 2005.

This was due to the continuing change in the sales mix as retail brand net sales declined. The Morris Flamingo-Stephan and Williamsport subsidiaries (Professional business segment) accounted for approximately 69.3% of consolidated net sales, an increase of 7.8% over 2004 levels. These two subsidiaries have traditionally lower gross margins than other entities comprising the professional group.

In addition to the above, net sales of the Image and Sorbie brands of the professional segment declined over $275,000 in 2005 when compared to net sales in 2004. In mid-2005, the Company acquired a small manicure company that markets it's nail care sets to distributors. Net sales for this subsidiary, American Manicure, was approximately $135,000 for the period. Sales of hotel and spa amenities continued to improve in 2005, with net sales increasing almost 10% over the prior year.

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Selling, general and administrative expenses (SG&A) decreased overall by approximately $1,493,000, from $10,259,000 in 2004 to $8,766,000 in 2005. Approximately $907,000 of SG&A expenses in 2004 were of a non-recurring nature and were comprised of "non-cash" expenses, including an impairment loss on trademarks in the amount of $300,000, $415,000 of additional payroll costs associated with certain officers of the Company exercising stock options utilizing the "cashless method" of exercise and $192,000 of additional royalty expense to reflect the results of the Sorbie arbitration (see Item 3. Legal Proceedings, above). Other decreases in SG&A were the result of significantly reduced marketing expenditures, including reductions in payroll, shipping costs, commissions and advertising.

Interest expense increased by approximately $59,000, from $91,000 in 2004 to $150,000 in 2005, a result of the continuing accrual of interest with respect to the Sorbie arbitration award more fully discussed in Item 3 above. Actual interest paid on the Company's outstanding bank debt obligation was $58,000 for the year ended December 31, 2005, compared to $87,000 in 2004. Interest income declined $37,000 due to low interest rates and significantly lower cash investments due to the payment of a special $2.00 per share dividend in September 2004. Interest income for the year ended December 31, 2005, was $127,000, compared to $164,000 earned in 2004.

The net loss for the year ended December 31, 2005 was $172,000, compared to $2,176,000 for the year ended December 31, 2004. As indicated above, 2004 had several unusual expenses, in addition to legal settlements which resulted in other income of approximately $283,000. As was the case in 2004, in connection with the Frances Denney line, the Company received a $50,000 royalty payment in 2005. The net benefit for income taxes includes a net state income tax provision of approximately $77,000 and a deferred Federal income tax benefit of approximately $149,000.

Basic and diluted net loss per share for the year ended December 31, 2005 was $.04, compared to a net loss per share in 2004 of $.50, based upon an average number of shares outstanding of 4,389,805 in 2005 and 4,348,908 in 2004.

LIQUIDITY AND CAPITAL RESOURCES

Working capital increased $81,000 from December 31, 2005, and was approximately $11,693,000 at December 31, 2006. Cash and cash equivalents increased approximately $1,461,000, to $7,064,000 as compared to $5,603,000 as of December 31, 2005. The Company continues to secure its outstanding debt with restricted cash. In the third quarter of 2006, the Company and Wachovia Bank converted the balloon payment due in August 2006 to monthly principal payments under the same terms and conditions as the original obligation, payable through 2008.

The Company does not anticipate any significant capital expenditures in the near term and management believes that there is sufficient cash on hand, working capital and borrowing capacity to satisfy any upcoming requirements currently anticipated to occur within the next year.

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The Company does not have any off-balance sheet financing or similar arrangements.

Inventory levels declined as management sustained efforts to reduce the overall amount of inventory on hand through the use of effective inventory control techniques, controlled purchasing and a program of continued utilization of old or slow moving raw materials and components.

In addition, in 2006, there was an increase in the amount of inventory that the Company deemed to be non-current.

The Company has not experienced any material adverse impact from the effects of inflation in the last several years. Management maintains some flexibility to increase prices and does not have any binding contract pricing with either customers or vendors. Many of the Company's products, as well as the components used, are petroleum-based products, and as a result, the prices for raw materials are and will continue to be subject to oil prices which, in turn, are subject to various political or economic pressures. The Company does not presently foresee any material increase in the costs of raw materials or component costs, and our management believes it has the flexibility of calling upon multiple vendors and the ability to increase prices to offset any price changes, however, if this trend continues, it may adversely impact the Company's gross profit margin.

The following table sets forth certain information regarding future contractual obligations of the Company as of December 31, 2006:

		Payments due by period (in thousands)			
Contractual obligation	Total	Less than 1 year	1-3 years	3-5 years	over 5 years
Bank debt payable	$ 2,220	$ 1,110	$ 1,110	-	-
Employment contract	1,372	653	719	-	-
Office and Warehouse leases	3,003	519	756	663	1,065
TOTAL OBLIGATIONS	$ 6,595	$ 2,282	$ 2,585	$ 663	$ 1,065

NEW FINANCIAL ACCOUNTING STANDARDS

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159), which establishes a fair value option under which entities can elect to report certain financial assets and liabilities at fair value, with changes in fair value recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact SFAS 159 will have on the Company's financial statements.

In September 2006, the Securities and Exchange Commission staff published Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses quantifying the

financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 by our Company in the fourth quarter of 2006 did not have a material impact on our consolidated financial statements

In July 2006 the FASB issued FASB Interpretation No. 48, ("FIN 48") "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109". FIN 48 requires that we recognize in our financial statements the impact of a tax position taken or expected to be taken in a tax return, provided that that position is more likely than not of being sustained on audit. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not anticipate that FIN 48 will have any adverse effect on our financial statements.

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. In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140", effective for events occurring after the first fiscal year that begins after September 15, 2006. In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140", also effective for the first fiscal year that begins after September 15, 2006. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", effective for financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands required disclosures in connection therewith. Also in September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Retirement Plans", an amendment of FASB Statements No. 87, 88, 106, and 132(R). The effect of these statements on the Company's consolidated financial statements will be determined based upon the nature and significance of future events, if any, that would be subject to these statements.

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 could differ significantly from those estimates if different assumptions were used or different events ultimately transpire. We believe that the following are the most critical accounting policies that requires management to make difficult, subjective and/or complex judgments, often due to a need to make estimates about matters that are inherently uncertain:

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VALUATION OF ACCOUNTS RECEIVABLE: The ultimate amount of collections received against outstanding accounts receivable must take into account returns, allowances and deductions that may be made by our customers. Many retailers to whom we sell products take deductions for various forms of marketing expenses, as well as participating in nationwide reclamation cooperatives for processing damaged goods. Other expenses to which we are subject to, in addition to those experienced in the retail environment (but also with Professional products sold to distributors) include deductions for freight if the invoice is paid within specified terms, co-op advertising allowances, new store/warehouse allowances and, from time to time, limited rebate programs. We attempt to estimate these costs, as well as providing for anticipated bad debts, by recording allowances based upon our experience, economic conditions, normal customer inventory levels and/or competitive conditions. Actual returns, credits or allowances, as well as the condition of any product actually returned, may differ significantly from the estimates used by the Company.

INVENTORIES: Inventories are stated at the lower of cost, determined by the first-in, first-out (FIFO) method, or market. We periodically evaluate inventory levels, giving consideration to factors such as the physical condition of the goods, the sales patterns of finished goods and the useful life of particular packaging, componentry and finished goods and estimate a reasonable write-down amount to be provided for slow moving, obsolete or damaged inventory. These estimates could vary significantly, either favorably or unfavorably, from actual requirements based upon future economic conditions, customer inventory levels or competitive factors that were not foreseen or did not exist when the inventory write-downs were established.

IMPAIRMENT OF LONG-LIVED ASSETS AND GOODWILL: The Company periodically evaluates whether events or circumstances have occurred that would indicate that long-lived assets may not be recoverable or that the remaining useful life may be impaired. When such events or circumstances are present, the Company assesses the recoverability of long-lived assets determining whether the carrying value will be recovered through the expected future cash flows resulting from the use of the asset. If the results of this testing indicates an impairment of the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of its cash inflows and outflows several years into the future and only takes into consideration circumstances known at the time of the impairment test.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and other indefinite lived intangible assets are to be evaluated for impairment on an annual basis, and between annual tests, whenever events or circumstances indicate that the carrying value of an asset may exceed its fair value. The use of various acceptable and appropriate methods of valuation requires the use of long-term planning forecasts and assumptions regarding industry-specific economic conditions that are outside the control of the Company. As previously indicated, for the year ended December 31, 2006, the Company incurred an impairment loss of approximately $6,706,000.

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Item 7A. Quantitative and Qualitative Disclosure about Market Risk

The Company does not own or maintain an interest in derivative or other financial instruments for which fair value disclosure would be required under Statement of Financial Accounting Standards 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 Company has no interest rate risk on its fixed rate debt since the interest rate on the note payable to a bank resets annually upon the anniversary of the loan (August) at 50 basis points above the interest rate earned on the restricted cash that collateralizes the loan.

Item 8. Financial Statements and Supplementary Data

Reference is made to the consolidated financial statements and supplementary data contained elsewhere in this Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A: Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this annual 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 Annual Report in timely alerting them as to material information relating to our Company (including our consolidated subsidiaries) required to be included in this Annual Report.

The material weakness in our internal controls over financial reporting as of December 31, 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 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 still existed as of December 31, 2006.

(b) Change in Internal Control over Financial Reporting

No change in the Company's internal control over financial reporting occurred during the Company's fourth fiscal quarter 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 are inadequate and 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.

ITEM 9B. OTHER INFORMATION

None

PART III

The information required by Part III of this Form 10-K (Items 10-14) is incorporated herein by reference from the Company's proxy statement with respect to the Company's 2007 annual meeting of stockholders scheduled to be filed with the Securities and Exchange Commission no later than April 30, 2007.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Exhibits

10.1 Acquisition Agreement, dated December 31, 1995, between Colgate-Palmolive Company and The Stephan Co., with exhibits, including the Transition Agreement, included with the Form 8-K filed January 16, 1996, and as amended on January 22, 1996, is incorporated herein by reference.

10.2 Acquisition Agreement, dated December 31, 1995, between The Mennen Company and The Stephan Co., with exhibits, included with the Form 8-K filed January 16, 1996 and as amended on January 22, 1996, is incorporated herein by reference.

10.3 Letter agreement, dated December 31, 1995, between Colgate-Palmolive Company, The Mennen Company and The Stephan Co., included with the Form 8-K filed January 16, 1996 and as amended on January 22, 1996, is incorporated herein by reference.

10.4 Settlement Agreement and Amendment, dated December 5, 1996, between The Stephan Co., The Mennen Company and Colgate-Palmolive Company, included with the Form 10-K filed April 15, 1997, is incorporated herein by reference.

10.5 The Trademark License Agreement, dated December 5, 1996, between Colgate-Palmolive Canada, Inc. and The Stephan Co., included with the Form 10-K filed April 15, 1997, is incorporated herein by reference.

10.6 Trademark License and Supply Agreement, dated March 7, 1996, between Color Me Beautiful, Inc. and The Stephan Co., included with the Form 8-K filed March 20, 1996, is incorporated herein by reference.

10.7 Agreement, dated June 28, 1996, for the acquisition of Sorbie Acquisition Co. and Subsidiaries, with exhibits, included with the Form 8-K filed July 15, 1996, and as such was amended on August 21, September 16 and October 9, 1996, is incorporated herein by reference.

10.8 Amended and Restated Sorbie Products Agreement, dated June 27, 1996, among Sorbie Acquisition Co., Sorbie Trading Limited, Trevor Sorbie International, PLC and Trevor Sorbie, included with the Form 8-K/A filed August 21, 1996, is incorporated herein by reference.

10.9 Settlement Agreement and Amendment, dated December 5, 1996, between The Stephan Co., The Mennen Company and Colgate-Palmolive Company, included with the Form 10-K for the year ended December 31, 1996, filed April 15, 1997, is incorporated herein by reference.

10.10 Trademark License and Supply Agreement, dated March 7, 1996, between Color Me Beautiful, Inc. and The Stephan Co., included with the Form 8-K filed March 20, 1996, is incorporated herein by reference.

10.11 Acquisition Agreement, dated as of May 23, 1997, between New Image Laboratories, Inc., The Stephan Co. and Stephan Distributing, Inc., in connection with the acquisition of brands, included with the Form 10-Q for the period ended June 30, 1997, filed August 13, 1997, is incorporated herein by reference.

10.12 Acquisition Agreement, dated as of March 18, 1998, between Morris Flamingo-Stephan, Inc., The Stephan Co., Morris-Flamingo, L.P., Morris-Flamingo Beauty Products, Inc., Shaheen & Co., Inc. and Shouky A Shaheen, included with the Form 10-Q for the period ended June 30, 1998, filed May 15, 1998, is incorporated herein by reference.

10.13 1990 Key Employee Stock Incentive Plan, as amended, as set forth in the Definitive Proxy filed July 5, 2000, in connection with the Company's 2000 Annual Meeting of Stockholders.

10.14 1990 Non-Employee (Outside Directors) Plan, as amended, as set forth in the Definitive Proxy filed July 5, 2000, in connection with the Company's 2000 Annual Meeting of Stockholders.

10.15 Merger Agreement, dated April 30, 2003, by and among The Stephan Co., Gunhill Enterprises and Eastchester Enterprises, including exhibits, included with Form 8-K filed May 8, 2003, is incorporated herein by reference.

10.16 Working Capital Management Account agreement dated September 19, 2003 with Merrill Lynch Business Financial Services Inc., creating a line of credit not to exceed $5,000,000, included with Form 8-K filed October 3, 2003, and amended October 9, 2003, is incorporated herein by reference.

10.17 Second Amended and Restated Agreement and Plan of Merger, dated March 24, 2004, by and among The Stephan Co., Gunhill Enterprises and Eastchester Enterprises, including exhibits, included with Form 8-K filed March 30, 2004, is incorporated herein by reference.

10.18 Modification of employment agreement between the Company and Frank F. Ferola, President and Chief Operating Officer, dated July 6, 2005, included with Form 10-K for the year ended December 31, 2004, filed September 9, 2005, is incorporated herein by reference.

10.19 Brand License Agreement with The Quantum Beauty Company Limited for the exclusive rights to manufacture, market and distribute the "Lee Stafford" brand of hair care products included with the Form 8-K filed August 4, 2005, is incorporated herein by reference.

10.20 Loan Modification Agreement with Wachovia Bank, dated September 26, 2006, included with Form 10-Q for the nine months ended September 30, 2006, filed November 13, 2006, is incorporated herein by reference.

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

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31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 Certification of 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 of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Financial Statements and Financial Statement Schedules
(i) Financial Statements

Reports of Independent Registered Public Accounting Firms.

Consolidated Balance Sheets as of December 31, 2006 and 2005.

Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004.

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2006, 2005, and 2004.

Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004.

Notes to Consolidated Financial Statements.

(ii) Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
The Stephan Co.
Fort Lauderdale, FL

We have audited the accompanying consolidated balance sheets of The Stephan Co. and subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of The Stephan Co. and subsidiaries as of December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

GOLDSTEIN LEWIN & CO.
Certified Public Accountants

Boca Raton, Florida
April 17, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of The Stephan Co.
Fort Lauderdale, FL

We have audited the accompanying consolidated statements of operations, changes in stockholders' equity, and cash flows of The Stephan Co. and subsidiaries (the "Company") for the year ended December 31, 2004. Our audit also included the financial statement schedule for the year ended December 31, 2004 listed in the Index at Item 15. These financial statements and financial statement schedule for the year ended December 31, 2004, are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and the financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the Company's results of operations and cash flows for the year ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule for the year ended December 31, 2004, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP
Certified Public Accountants

Fort Lauderdale, Florida
September 8, 2005

(i) Financial Statements

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

ASSETS

	2006	2005
CURRENT ASSETS		
Cash and cash equivalents	$ 7,064,332	$ 5,602,762
Restricted cash	1,110,000	3,335,557
Accounts receivable, net	1,716,733	1,431,650
Inventories	4,792,357	6,148,267
Income taxes receivable	-	22,893
Prepaid expenses and other current assets	335,429	311,905
TOTAL CURRENT ASSETS	15,018,851	16,853,034
RESTRICTED CASH	1,206,392	-
PROPERTY, PLANT AND EQUIPMENT, net	1,573,560	1,682,951
DEFERRED INCOME TAXES, net	864,471	-
GOODWILL, net	2,602,802	4,013,458
TRADEMARKS, net	3,069,507	8,364,809
OTHER INTANGIBLE ASSETS, net	76,161	142,185

OTHER ASSETS	2,354,295	1,721,169
TOTAL ASSETS	$26,766,039	$32,777,606

See notes to consolidated financial statements.

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THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

LIABILITIES AND STOCKHOLDERS' EQUITY

	2006	2005
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,215,449	$2,002,728
Current portion of long-term debt	1,110,000	3,237,500
TOTAL CURRENT LIABILITIES	3,325,449	5,240,228
DEFERRED INCOME TAXES, net	-	1,343,257
LONG-TERM DEBT, less current maturities	1,110,000	-
TOTAL LIABILITIES	4,435,449	6,583,485
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value; 25,000,000 shares authorized; 4,389,805 shares issued at December 31, 2006 and 2005	43,898	43,898
Additional paid in capital	17,646,069	17,556,731
Retained earnings	4,640,623	8,593,492
TOTAL STOCKHOLDERS' EQUITY	22,330,590	26,194,121
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$26,766,039	$32,777,606

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

	2006	2005	2004
NET SALES	$21,836,315	$22,262,423	$23,950,648
COST OF GOODS SOLD	12,795,314	13,767,127	14,286,280
GROSS PROFIT	9,041,001	8,495,296	9,664,368
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	13,497,397	8,766,298	10,259,262
IMPAIRMENT OF GOODWILL	1,410,655	-	1,844,522
OPERATING LOSS	(5,867,051)	(271,002)	(2,439,416)
OTHER INCOME(EXPENSE)			
Interest income	233,192	127,313	163,921
Interest expense	(147,313)	(150,173)	(91,237)
Royalty and other income	50,000	50,000	332,745
LOSS BEFORE INCOME TAXES	(5,731,172)	(243,862)	(2,033,987)
INCOME TAX (BENEFIT)/EXPENSE	(2,129,487)	(71,679)	142,251
NET LOSS	$(3,601,685)	$ (172,183)	$(2,176,238)
BASIC AND DILUTED LOSS PER SHARE	$ (.82)	$ (.04)	$ (.50)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,389,805	4,389,805	4,348,908

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

	Common Stock		Additional Paid in Capital	Retained Earnings	Contingently Returnable Shares
	Shares	Par Value			
Balances, Jan. 1, 2004	4,410,577	$ 44,106	$18,417,080	$20,387,432	(1,351,563)
Stock options exercised	104,228	1,042	489,964	-	-
Contingently returnable shares retired	(125,000)	(1,250)	(1,350,313)	-	1,351,563
Dividends paid	-	-	-	(9,094,335	-
Net loss	-	-	-	(2,176,238)	-
Balances, Dec. 31,2004	4,389,805	43,898	17,556,731	9,116,859	-
Dividends paid	-	-	-	(351,184)	-
Net loss	-	-	-	(172,183)	-
Balances, Dec. 31, 2005	4,389,805	43,898	17,556,731	8,593,492	-
Stock options granted	-	-	89,338	-	-
Dividends paid	-	-	-	(351,184)	-
Net loss	-	-	-	(3,601,685)	-
Balances, Dec. 31, 2006	4,389,805	$ 43,898	$17,646,069	$4,640,623	-

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$(3,601,685)	$ (172,183)	$(2,176,238)
Adjustments to reconcile net loss to net cash flows provided by operating activities:			
Depreciation	143,062	143,509	136,712
Stock option compensation	89,338	-	-
Amortization of deferred acquisition costs	66,024	74,467	82,121
Write-down of inventories	-	-	337,215
Compensation expense resulting from exercise of stock options	-	-	415,430
Deferred income taxes	(2,207,728)	(144,859)	355,065
Provision for doubtful accounts	40,455	27,571	55,865
Impairment loss on goodwill and trademarks	6,705,958	-	2,144,522
Settlement of Colgate-Palmolive debt	-	-	(417,745)
Changes in operating assets and liabilities:			
Accounts receivable	(325,538)	294,029	(364,607)
Inventories	1,355,910	1,016,634	(4,854)
Income taxes receivable/payable	22,893	186,310	(237,473)
Prepaid expenses and other current assets	(23,524)	62,174	410,522
Other assets	(633,126)	331,236	815,553
Accounts payable and accrued expenses	212,721	(163,023)	(448,980)
Total adjustments	5,446,445	1,828,048	3,279,346
Net cash flows provided by operating activities	1,844,760	1,655,865	1,103,108

See notes to consolidated financial statements.

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THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

	2006	2005	2004

CASH FLOWS FROM INVESTING ACTIVITIES:			
Change in restricted cash	1,019,165	1,204,851	1,102,092
Purchase of property, plant and equipment	(33,671)	(199,233)	(61,608)
Net cash flows provided by investing activities	985,494	1,005,618	1,040,484
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayments of long-term debt	(1,017,500)	(1,110,000)	(2,024,528)
Proceeds from exercise of stock options	-	-	75,575
Dividends paid	(351,184)	(351,184)	(9,094,335)
Net cash flows used in financing activities	(1,368,684)	(1,461,184)	(11,043,288)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	1,461,570	1,200,299	(8,899,696)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	5,602,762	4,402,463	13,302,159
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 7,064,332	$ 5,602,762	$ 4,402,463

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

Supplemental Disclosures of Cash Flow Information:

	2006	2005	2004

Interest paid	$ 38,950	$ 58,364	$ 190,214
Income taxes paid	$ 54,868	$ 69,526	$ 101,188

Supplemental Disclosure of Non-Cash Investing and Financing Activities:

On August 20, 2004, 125,000 contingently returnable shares, carried at $1,351,563, were retired and Common Stock and Additional Paid in Capital were reduced by the same amount in the aggregate.

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

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

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, and as more fully explained in Note 9, 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.

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of The Stephan Co. and its wholly-owned subsidiaries, Foxy Products, Inc., Old 97 Company, Williamsport Barber and Beauty Supply Corp., Stephan & Co., Scientific Research Products, Inc. of Delaware, Sorbie Distributing Corporation, Stephan Distributing, Inc., Morris Flamingo-Stephan, Inc., American Manicure, Inc. and Lee Stafford Beauty Group, Inc. (collectively, the "Company"). All significant inter-company balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES: 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 could differ from those estimates and the differences could be material.

MAJOR CUSTOMERS: There were no sales to any single customer in excess of 10% of net sales in 2006. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral. The Company does not believe that its customers' credit risk represents a material risk of loss to the Company. However, the loss of a large customer could have an adverse effect on the Company.

GOODWILL and OTHER INTANGIBLE ASSETS: Goodwill and trademarks represent the excess of the purchase price over the fair value of identifiable assets of businesses or brands acquired, respectively, in transactions accounted for as a purchase. Goodwill and trademarks having indefinite lives are no longer being amortized and in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), are now subject to periodic testing for impairment. Deferred acquisition costs that have definite lives are continuing to be amortized over their estimated useful lives of 10 years. Goodwill and trademarks of a reporting unit (as defined in SFAS No. 142) are tested for impairment on an annual basis at a minimum, or as circumstances dictate. Based upon a valuation analysis of intangible assets for the year ended December 31, 2006, prepared with the assistance of an independent valuation firm, an impairment loss was recognized amounting to approximately $6,706,000. The Company reduced all of the goodwill attributed to the

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

acquisition of Scientific Research Products, Inc., by approximately $1,411,000 and all of the trademarks associated with the brands LeKair, New Era and Frances Denney, in addition to substantially all of the value assigned to the brands acquired from the Colgate-Palmolive Company, totaling approximately $5,295,000. The impairment of the trademarks has been included in Selling, General and Administrative expenses, in accordance with SFAS No. 142. In 2004, an impairment loss was recorded in the amount of $2,145,000 in connection with goodwill arising from the purchase of Trevor Sorbie and trademarks associated with the Stephan Distributing subsidiary. As a result of the impairment loss, all goodwill associated with the Sorbie brand was written off (See Note 5).

IMPAIRMENT OF LONG-LIVED ASSETS: Long-lived assets are reviewed for impairment whenever events or changes in circumstances warrant, which may be an indication that the carrying value of the asset may ultimately be unrecoverable. The Company uses fair value methods to determine the amount of impairment, if any. If necessary, an impairment loss equal to the difference between the asset's fair value and its carrying value is recognized.

STOCK-BASED COMPENSATION: Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised), "Share-Based Payment" ("SFAS 123R"), and chose to utilize the modified prospective transition method. Under this method, compensation costs recognized at December 31, 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 SFAS 123R. Prior to the adoption of SFAS 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 using the intrinsic value of the grant and had elected the disclosure only provisions of SFAS 123. In accordance with the provisions of SFAS 123R, options granted prior to January 1, 2006 have not been restated to reflect the adoption of SFAS 123R. The required services for awards prior to January 1, 2006 had been rendered prior to December 31, 2005.

As a result of adopting SFAS 123R on January 1, 2006, the Company's net income for the year ended December 31, 2006 was reduced as a result of the Company's recognition of approximately $89,000 of compensation expense (included in Selling, General and Administrative Expenses). The impact on basic and diluted earnings per share for the year ended December 31, 2006 amounted to approximately $.01 per share. The Company has used the Black-Scholes option pricing model to estimate the fair value of stock options using the following assumptions as of the respective date of grant during 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.

FAIR VALUE OF FINANCIAL INSTRUMENTS: The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and recognized valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market sale of such instruments.

The following methods and assumptions were used to estimate fair value:

- the carrying amounts of cash and cash equivalents, receivables and accounts payable approximate fair value due to their short term nature;

- discounted cash flows using current interest rates for financial instruments with similar characteristics and maturity were used to determine the fair value of notes payable and debt.

As of December 31, 2006 and 2005 there were no significant differences in the carrying values and fair market values of financial instruments.

REVENUE RECOGNITION: Revenue is recognized when all significant contractual obligations have been satisfied, which involves the delivery of the products sold and reasonable assurance as to the collectability of the resulting account receivable.

SHIPPING AND HANDLING FEES AND COSTS: Expenses for the shipping and delivery of products sold to customers are recorded as a component of selling expenses and were $1,141,000, $1,139,000 and $1,227,000, in 2006, 2005 and 2004, respectively, and were included in Selling, General and Administrative Expenses in the Consolidated Statements of Operations.

PROMOTIONAL AND SALES RETURNS ALLOWANCES: The Company participates in various promotional activities in conjunction with its retailers

and distributors, primarily through the use of discounts, new warehouse allowances, slotting allowances, co-op advertising and periodic price reduction programs. All such costs are netted against sales and amounted to approximately $211,000, $289,000 and $417,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The allowances for sales returns and consumer and trade promotion liabilities are established based on the Company's best estimate of the amounts necessary to settle future and existing obligations for such items on products sold as of the balance sheet date. While the Company believes that promotional allowances are adequate and that the judgment applied is appropriate, amounts estimated to be due and payable could differ materially from actual costs incurred in the future.

CASH AND CASH EQUIVALENTS: Cash and cash equivalents include cash, certificates of deposit, U. S. Government issues, and municipal bonds having maturities of 90 days or less when acquired. The Company maintains cash deposits at certain financial institutions in amounts in excess of federally insured limits of $100,000. Cash and cash equivalents held in interest-bearing accounts as of December 31, 2006 and 2005 were approximately $6,242,000 and $5,095,000, respectively. At December 31, 2006 and 2005, the Company excluded restricted cash in the amount of approximately $2,316,000 and $3,336,000, respectively, from the above as they are pledged as collateral for a bank loan.

INVENTORIES: Inventories are stated at the lower of cost (determined on the first-in, first-out basis) or market. Direct labor and overhead costs charged to inventories for the years ended December 31, 2006 and 2005 were approximately $2,574,000 and $2,622,000, respectively. Direct labor and overhead costs capitalized in inventories as of December 31, 2006 and 2005 were approximately $884,000 and $587,000, respectively.

PROPERTY, PLANT AND EQUIPMENT: Property, plant and equipment are recorded at cost. Routine repairs and maintenance are expensed as incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	15-30 years
Machinery and equipment	5-10 years
Furniture and office equipment	3-5 years

INCOME TAXES: Income taxes are calculated under the asset and liability method of accounting. Deferred income taxes are recognized by applying the enacted statutory rates applicable to future year differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. A valuation allowance is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

BASIC AND DILUTED EARNINGS PER SHARE: Basic and diluted earnings per share are computed by dividing net (loss)/income by the weighted average number of shares of common stock outstanding. For the years ended

December 31, 2006, 2005 and 2004, the Company had 346,178, 341,116 and 291,822 outstanding stock options, respectively. For the years ended December 31, 2006, 2005 and 2004, no options were used in the calculation of net loss per share because their inclusion would be anti-dilutive, and as such, 4,389,805 shares were used for the calculation of basic and diluted loss per share for 2006 and 2005 and 4,348,908 shares were used for 2004.

NEW FINANCIAL ACCOUNTING STANDARDS: In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159), which establishes a fair value option under which entities can elect to report certain financial assets and liabilities at fair value, with changes in fair value recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact SFAS 159 will have on the Company's financial statements.

In September 2006, the Securities and Exchange Commission staff published Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 by our Company in the fourth quarter of 2006 did not have a material impact on our consolidated financial statements

In July 2006 the FASB issued FASB Interpretation No. 48, ("FIN 48") "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109". FIN 48 requires that we recognize in our financial statements the impact of a tax position taken or expected to be taken in a tax return, provided that that position is more likely than not of being sustained on audit. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not anticipate that FIN 48 will have any adverse effect on our financial statements.

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. In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140", effective for events occurring after the first fiscal year that begins after September 15, 2006. In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140", also effective for the first fiscal year that begins after September 15, 2006. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", effective for financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands required disclosures in connection therewith. Also in

September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Retirement Plans", an amendment of FASB Statements No. 87, 88, 106, and 132(R). The effect of these statements on the Company's consolidated financial statements will be determined based upon the nature and significance of future events, if any, that would be subject to these statements.

NOTE 2. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2006 and 2005 consisted of the following:

	2006	2005
Trade accounts receivable	$1,856,128	$1,540,303
Less: Allowance for doubtful accounts	(139,395)	(108,653)
Accounts receivable, net	$1,716,733	$1,431,650

The following is an analysis of the allowance for doubtful accounts for the year ended December 31:

	2006	2005	2004
Balance, beginning of year	$ 108,653	$ 91,848	$ 112,924
Provision for doubtful accounts	40,455	27,571	55,865
Uncollectible accounts written off, net of recoveries	(9,713)	(10,766)	(76,941)
Balance, end of year	$ 139,395	$ 108,653	$ 91,848

NOTE 3. INVENTORIES

Inventories at December 31, 2006 and 2005 consisted of the following:

	2006	2005
Raw materials	$ 1,457,575	$ 1,692,277
Packaging and components	2,138,017	2,238,763
Work in progress	605,848	454,217
Finished goods	2,872,305	3,402,742
	7,073,745	7,787,999
Less: Amount included in other assets	(2,281,388)	(1,639,732)
Balance, end of year	$ 4,792,357	$ 6,148,267

NOTE 3. INVENTORIES (Continued)

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 bottles or containers (plastic or glass), jars, caps, pumps and similar materials that will become part of the finished product. Finished goods also 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.

NOTE 4. PROPERTY, PLANT, AND EQUIPMENT

Property, plant and equipment at December 31, 2006 and 2005 consisted of the following:

	2006	2005
Land	$ 379,627	$ 379,627
Buildings and improvements	2,230,025	2,251,894
Machinery and equipment	1,984,087	1,947,080
Furniture and office equipment	602,099	583,566
	5,195,838	5,162,167
Less: accumulated depreciation	(3,622,278)	(3,479,216)
Balance, end of year	$1,573,560	$1,682,951

NOTE 5. GOODWILL, TRADEMARKS AND OTHER INTANGIBLE ASSETS

Since implementing SFAS No. 142, the Company performs annual impairment tests. Based upon a valuation analysis of intangible assets for the year ended December 31, 2006, prepared with the assistance of an independent valuation firm, an impairment loss was recognized amounting to approximately $6,706,000. The Company reduced all of the goodwill attributed to the acquisition of Scientific Research Products, Inc., by approximately $1,411,000 and all of the trademarks associated with the brands LeKair, New Era and Frances Denney, in addition to substantially all of the value assigned to the brands acquired from the Colgate-Palmolive

Company, totaling approximately $5,295,000. The impairment of the trademarks has been included in Selling, General and Administrative expenses. This impairment was due to a decline in sales attributable to the Retail reporting unit as well as a more conservative approach to forecasted future sales used in the valuation analysis, particularly as it relates to the slow acceptance of new products the Company introduced in the market place.

For the year ended December 31, 2004, it was determined that an

impairment loss of approximately $2,145,000 was necessary. Approximately $1,845,000 of this impairment was in connection with goodwill arising from the purchase of the Trevor Sorbie of America line in June 1996 and the remaining $300,000 was related to the trademarks associated with the Stephan Distributing ("SDI") subsidiary. This charge was primarily based on management's estimated fair value of each reporting unit using discounted present value of cash flows and valuation models as of the test date. The impairment was a result of the declining sales and an adverse outcome of litigation within the reporting unit, including the operations of Trevor Sorbie of America. As a result of the impairment loss, all goodwill associated with the Trevor Sorbie brand has been written off. Included in selling, general and administrative expenses in the statement of operations. is the $300,000 impairment loss related to the SDI trademarks

Other intangible assets can be summarized as follows:

	2006	2005
Deferred acquisition costs	$ 780,182	$ 934,544
Less: Accumulated amortization	(704,021)	(792,359)
Balance, end of year	$ 76,161	$ 142,185

Amortization expense of other intangible assets for 2006, 2005 and 2004 was $66,000, $74,000 and $82,000, respectively. Amortization expense for the years ended December 31, 2007 and 2008 is anticipated to be as follows: 2007: $66,000; 2008: $10,000.

NOTE 6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2006 and 2005 consisted of the following:

	2006	2005
Accounts payable	$ 515,638	$ 254,863
Accrued marketing expenses	113,768	133,469
Accrued royalty and related interest payable (Note 10)	931,052	815,711
Accrued payroll and related costs	244,479	410,149
Accrued legal and professional fees	132,067	240,691
Accrued rent and property taxes	140,282	88,299
Other accrued expenses	138,163	59,546
Balance, end of year	$ 2,215,449	$ 2,002,728

NOTE 7. LONG-TERM DEBT

Long-term debt at December 31, 2006 and 2005 consisted of the following:

NOTE 7. LONG-TERM DEBT (Continued)

	2006	2005
1.50% note payable to bank, principal of $92,500 plus interest due monthly through December 2, 2008; collateralized by a security interest in a restricted cash account of like amount, which bears interest at 50 basis points below the interest charged on the note. The interest rate on the note and the cash collateral resets annually.	$ 2,220,000	$ 3,237,500
	2,220,000	3,237,500
Less: current portion	(1,110,000)	(3,237,500)
Long-term debt	$ 1,110,000	$ -

At December 31, 2006, the approximate maturities of long-term debt are $1,110,000 in 2007 and $1,110,000 in 2008.

NOTE 8. INCOME TAXES

The provision/(benefit) for income taxes is comprised of the following for the years ended December 31:

	2006	2005	2004
Current tax:			
Federal	$ -	$ -	$ (105,047)
State	75,494	77,128	(107,767)
Total current provision/(benefit)	75,494	77,128	(212,814)
Deferred tax:			
Federal	(2,009,198)	(135,767)	220,766
State	(195,783)	(13,040)	134,299
Total deferred (benefit)/provision	(2,204,981)	(148,807)	355,065
Total (benefit)/provision for income taxes	$(2,129,487)	$ (71,679)	$ 142,251

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

NOTE 8. INCOME TAXES (Continued)

The net deferred income tax asset/liability in the accompanying consolidated balance sheets includes deferred tax assets and liabilities attributable to the following items:

	2006	2005
Accounts receivable allowances	$ (29,318)	$ (40,886)
Inventory allowance	(126,894)	(126,894)
Property, plant and equipment	76,099	46,728
Amortization of intangibles	(648,199)	2,559,360
State income taxes	(96,560)	(101,467)
Net operating loss carryover	(1,162,039)	(954,285)
Interest expense on Sorbie debt	(77,950)	-
Accrued liabilities and other	(39,599)	(39,299)
	(2,104,460)	1,343,257
Less: Valuation allowance	1,239,989	-
Deferred income tax (asset)/liability, net	$ (864,471)	$ 1,343,257

The provision for Federal and state income taxes differs from statutory tax expense (computed by applying the U.S. Federal corporate tax rate to income before taxes) as follows:

	2006	2005	2004
Amount computed on pretax income	(34.0%)	(34.0%)	(34.0%)
Increase(decrease) in taxes:			
State income taxes, net of federal tax benefit	(3.6)	(3.5)	.8
Goodwill impairment	26.7	-	30.8
Goodwill/Trademarks	-	1.3	.2
Change in valuation allowance	(.3)	-	-
Compensation limitations	-	-	8.1
Privatization transaction costs	-	-	2.7
Tax exempt interest	-	(2.4)	(1.0)
Other	.8	9.3	(.6)
Total income tax	(11.2%)	(29.3%)	7.0%

For the year ended December 31, 2006, the Company had an income tax valuation allowance of $1,239,989 to provide for the likelihood that the utilization of the deferred tax asset may not be realized. For the year ended December 31, 2004, the Company had an income tax valuation allowance of $122,546 in order to provide for the likelihood that the Company's charitable contribution carryforward will expire unused. The Company has net operating loss carryforwards of approximately $3,088,000 for Federal income tax purposes which expire beginning in 2026 if not utilized.

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NOTE 9. SEGMENT INFORMATION

The Company has identified three reportable operating segments based upon how 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 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 is mass merchandisers, chain drug stores and supermarkets that sell the product to the end user. The Manufacturing segment manufactures products for subsidiaries of the Company, and manufactures private label brands for customers.

The Company conducts operations primarily in the United States and sales to international customers are not material to consolidated revenues. The following tables, in thousands, summarize significant accounts and balances by reportable segment:

	NET SALES			LOSS BEFORE INCOME TAXES		
	2006	2005	2004	2006	2005	2004
Professional	$16,415	$17,254	$17,538	$ 1,177	$ 1,012	$(1,801)
Retail	4,281	4,178	5,734	(6,095)	(79)	486
Manufacturing	4,670	5,132	5,689	(653)	(989)	(292)
Total	$25,366	$26,564	$28,961	$(5,571)	$ (56)	$(1,607)
Intercompany Manufacturing	(3,530)	(4,302)	(5,010)	(160)	(188)	(427)
Consolidated	$21,836	$22,262	$23,951	$(5,731)	$ (244)	$(2,034)

	INTEREST INCOME			INTEREST EXPENSE		
	2006	2005	2004	2006	2005	2004
Professional	$ 117	$ 52	$ 104	$ 131	$ 127	$ 56
Retail	109	66	53	16	18	33
Manufacturing	7	9	7	-	5	2
Total	$ 233	$ 127	$ 164	$ 147	$ 150	$ 91

	DEPRECIATION AND AMORTIZATION			TOTAL ASSETS	
	2006	2005	2004	2006	2005
Professional	$ 88	$ 87	$ 78	$12,345	$11,774
Retail	55	37	43	6,513	14,353
Manufacturing	66	94	98	7,908	6,651
Total	$ 209	$ 218	$ 219	$26,766	$32,778

NOTE 9. SEGMENT INFORMATION (Continued)

The accounting policies used for each of the segments are the same as those used for the Company and are described in the summary of significant accounting policies in Note 1. Included in Manufacturing net sales are intercompany sales to related segments, which are generally recorded at cost plus 10%. Management of the Company evaluates the performance of each segment based upon results of operations before income taxes, intercompany allocations, interest and amortization.

NOTE 10. COMMITMENTS AND CONTINGENCIES

The Company has an employment agreement with its' Chief Executive Officer ("CEO"). The agreement expires on December 31, 2008, but provides for the unilateral renewal by the CEO. The contract includes an incentive bonus award based on consolidated earnings per share in excess of the applicable base year, as defined in the employment agreement. No bonuses were payable for the years ended December 31, 2006 and 2005. In July 2005, the CEO took a voluntary, unilateral reduction in compensation to $540,000. In accordance with the terms of the employment agreement, this amended base compensation level is subject to an annual increase of 10% in each of the remaining years of the contract.

Also, the terms of the waiver of compensation allows the CEO to retain the right to his original contractual compensation level at the time of the occurrence of certain specified events relating to a change in control, or reasonable likelihood of a change in control of the Company, as defined in the waiver. If it was determined that said change in control existed, the CEO would be entitled to a payment of approximately $635,000.

The Company was not a party to any non-cancelable operating leases at December 31, 2006, except for a warehouse lease in Tampa, FL that expires on July 31, 2008. The minimum annual rental due under this lease is $158,400 for 2007 and $92,400 for 2008.

Annual rent expense for each of the last three years is as follows:

2006	$599,000
2005	628,600
2004	692,800

Included in rent expense above for the years ended December 31, 2006, 2005 and 2004 is $ 321,000, $229,000 and $273,000, respectively, paid to Shaheen & Co., Inc., the former owner of Morris Flamingo. Shouky A. Shaheen, a minority owner of Shaheen & Co., Inc., who owns the building the Company leases in Danville, Illinois, is currently a member of the Board of Directors and a significant shareholder of the Company. On May 4, 2005, the Company entered into a Second Amendment of Lease Agreement (the "Amendment") for the Danville facility. The Amendment extends the term of the lease to June 30, 2015, with a five year renewal option, and increases the annual rental to approximately $303,000. The base rent is adjustable annually, in accordance with the existing master lease, whose terms, including a 90-day right of termination by the Company, remain in full force and effect. In addition, the Company has a purchase option, during

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NOTE 10. COMMITMENTS AND CONTINGENCIES (Continued)

the term of the lease, to purchase the premises at the then fair market value of the building, or to match any bona fide third-party offer to purchase the premises.

On July 6, 2005, the landlord notified the Company that its interpretation of the Amendment differs from that of the Company as to the existence of the 90-day right of termination. In October 2005, the landlord filed a lawsuit in the Circuit Court for the 17th Circuit of Florida in and for Broward County, styled Shaheen & Co., Inc. (Plaintiff) v The Stephan Co., Case number 05-15175 seeking a declaratory judgment with respect to the validity of the 90-day right of termination. In addition, the lawsuit alleges damages with respect to costs incurred and the weakening of the marketability of the property. This matter is currently unresolved and the Company is unable, at this time, to determine the outcome of the litigation. However, if it is ultimately determined that the early termination provision has been eliminated with the Amendment, the Company's minimum lease obligation would amount to $303,000 in each of the years 2007 through 2011 and approximately $1,360,000 thereafter.

In fiscal year 2006, the Company paid $35,500 to Carlson & Lewittes, P.A. a law firm of which Curtis Carlson, an officer and director of the Company, is a partner, for legal services rendered to the Company. Additionally, the Company paid Mr. Carlson $2,000 per month for his services as Vice-President and Secretary.

In addition to the matters set forth below, the Company is involved in other litigation arising in the normal course of business. It is the opinion of management that none of such matters, at December 31, 2006, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

In March 2006, in a case styled Trevor Sorbie International, Plc. v. Sorbie Acquisition Co. (CASE NO. 05-14908-09), filed in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, Trevor Sorbie International, Plc. ("TSI") instituted efforts to collect on a judgment it has against Sorbie Acquisition Co. ("SAC"). The judgment derives from an October 25, 2004, Pennsylvania arbitration award in favor of TSI and against SAC with respect to certain royalties and interest due. The financial statements for the Company for the year ended December 31, 2006, reflect a liability of approximately $931,000, including interest, for payment of this judgment. Among other things, the Florida lawsuit alleges fraud and names as additional defendants The Stephan Co., Trevor Sorbie of America, Inc. and Sorbie Distributing Corporation. The Company is vigorously defending this legal action against TSI. The Company continues to accrue interest on the entire obligation because, due to the limited discovery taken and the complexities of the issues involved, the Company cannot predict the outcome of the litigation.

In 1997, the Company's wholly-owned subsidiary, Stephan Distributing, Inc., acquired several product lines from New Image Laboratories, Inc. ("New Image"). The purchase price included a contingent payment of 125,000 shares of the Company's common stock payable upon the achievement of

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NOTE 10. COMMITMENTS AND CONTINGENCIES (Continued)

certain earnings levels. New Image commenced litigation against the Company seeking certain purchase price adjustments. The parties reached a settlement pursuant to a stipulation of settlement and amendments thereto which provided, among other things, as follows: (i) New Image relinquished title to 65,000 of the 125,000 shares of the Company's common stock held in escrow and received 60,000 shares, (subsequently, New Image elected to sell the Company its 60,000 shares for $285,000), (ii) Stephan was awarded $44,000 in damages from New Image, (iii) dividends, and interest accrued thereon, held in the escrow account (approximately $72,000) were distributed with Stephan receiving 52% of such funds and New Image receiving 48% of such funds, which was used to satisfy, in part, the award under (ii) above. As a result of this settlement, the Company recorded an expense of approximately $285,000 and the amount is reflected as a reduction of royalty and other income on the consolidated statement of operations for the year ended December 31, 2004. Also in 2004, the amount of the contingently returnable shares recorded in the financial statements of the Company was offset against additional paid in capital when the shares were retired.

On November 4, 2003, in connection with a "going-private" transaction, the Company filed a Preliminary Proxy with the Securities and Exchange Commission. On August 25, 2004, the Merger Agreement was terminated and the Acquisition Group withdrew its offer to acquire the shares of the Company's common stock not owned by it and informed the Company that it had decided not to pursue such an acquisition. As a result of the above, the Company incurred termination expenses in the amount of $158,000 in accordance with the terms of the Merger Agreement, payable to the Acquisition Group and the amount is included in selling, general and administrative expenses in the statement of operations for the year ended December 31, 2004.

NOTE 11. CAPITAL STOCK AND STOCK OPTIONS

1,000,000 shares of preferred stock, $0.01 par value are authorized; however, no shares have been issued.

In 1990, the shareholders of the Company approved the 1990 Key Employee Stock Incentive Plan, as amended, and the 1990 Non-Employee (Outside Directors) Plan, as amended, and in 2000, the shareholders approved a ten-year extension of both plans. The aggregate number of shares currently authorized pursuant to the Key Employee Plan, as adjusted for stock splits and shareholder-approved increases in 1994 and 1997, is 870,000 shares. The number of shares and terms of each grant is determined by the Compensation Committee of the Board of Directors, in accordance with the 1990 Key Employee Plan, as amended.

The Outside Directors Plan provides for annual grants, as adjusted for stock splits, of 5,062 shares to non-employee directors. Such grants are granted on the earlier of June 30 or the date of the Company's Annual Meeting of Shareholders, at the fair market value at the date of grant. The aggregate number of shares reserved for granting under this plan, as adjusted for stock splits, is 202,500.

NOTE 11. CAPITAL STOCK AND STOCK OPTIONS (Continued)

Stock options are granted at the discretion of the Compensation Committee of the Board of Directors. The options become exercisable one year from the date of grant and are exercisable within a maximum of 5-10 years from the date of grant. Stock option activity for 2006, 2005, and 2004 is set forth below:

	Key Employee Incentive Plan	Avg. Price	Outside Directors Plan	Avg. Price
Outstanding at December 31, 2003..	446,330	$ 6.41	101,240	$ 3.82
Granted..........................	50,000	4.32	20,248	4.82
Canceled.........................	-		(20,248)	4.18
Exercised........................	(285,500)	3.49	(20,248)	3.73
Outstanding at December 31, 2004..	210,830	9.87	80,992	3.43
Granted..........................	50,000	4.26	25,310	4.71
Canceled.........................	(10,830)	3.94	(15,186)	4.25
Exercised........................	-		-	

Outstanding at December 31, 2005..	250,000	9.00	91,116	3.93
Granted..........................	50,000	3.54	25,310	3.15
Canceled.........................	-		(5,062)	3.99
Expired..........................	(50,000)	12.88	(15,186)	3.15
Outstanding at December 31, 2006..	250,000	$ 7.14	96,178	$ 3.86

In the third quarter of 2004, certain officers of the Company exercised stock options utilizing the "cashless method" of exercise. As such, the Company recorded compensation expense in the amount of $415,430, included in selling, general and administrative expenses in the statement of operations for the year ended December 31, 2004.

The number of shares and average exercise price of options exercisable at December 31, 2006, 2005 and 2004 were 200,000 shares at $8.04, 200,000 shares at $10.19, and 160,830 shares at $11.59, respectively, for the 1990 Key Employee Stock Incentive Plan and 70,868 at $4.12, 65,806 at $3.89, and 60,744 at $3.73, respectively, for the Outside Directors Plan. At December 31, 2006 and 2005, 620,000 were available for future grants under the terms of the 1990 Key Employee Stock Incentive Plan and 106,322 shares and 111,384 shares, respectively, were available for future grants under the terms of the Outside Directors Plan.

The exercise price range of options outstanding and exercisable as of December 31, 2006 for both the Key Employee Stock Incentive and Outside Directors plans, the weighted average contractual lives remaining (in years) and the weighted average exercise price are as follows:

NOTE 11. CAPITAL STOCK AND STOCK OPTIONS (Continued)

	Outstanding			Exercisable	
Exercise Price Range	Number of shares	Average Life	Average Price	Number of shares	Average Price
$ 3.00 - $ 5.00	246,178	5.97	$ 3.97	170,868	$ 4.22
$10.00 - $13.50	100,000	1.50	$11.78	100,000	$11.78
	346,178			270,868	

(ii) Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts

ADVERTISING, PROMOTION and RETURNS ALLOWANCES

	2006	2005	2004
Balance, beginning of year	$ 101,430	$ 104,659	$ 152,906
Additions	211,380	288,742	417,152
Utilizations	211,542	291,971	465,399
Balance, end of year	$ 101,268	$ 101,430	$ 104,659

DEFERRED TAX VALUATION ALLOWANCE

	2006	2005	2004
Balance, beginning of year	$ -	$ 122,546	$ 121,747
Additions	1,239,989	-	799

Utilizations/Expirations	-	122,546	-
Balance, end of year	$1,239,989	$ -	$ 122,546

SIGNATURES

Pursuant to the requirements of Section 13 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.

By: /s/ Frank F. Ferola

Frank F. Ferola
President and Chairman of the Board
April 17, 2007

By: /s/ David A. Spiegel

David A. Spiegel
Principal Financial Officer
Principal Accounting Officer
April 17, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

By: /s/ Frank F. Ferola

Frank F. Ferola, Principal
Executive Officer and Director
Date: April 17, 2007

By: /s/ Shouky Shaheen

Shouky Shaheen, Director
Date: April 17, 2007

By: /s/ Curtis Carlson
Curtis Carlson, Director
Date: April 17, 2007

By: /s/ Richard A. Barone
Richard A. Barone, Director
Date: April 17, 2007

By: /s/ William Gross
William Gross, Director
Date: April 17, 2007

By: /s/ Elliot Ross
Elliot Ross, Director
Date: April 17, 2007