STEPHAN CO
Form 10-K
May 05, 2006

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, 2005

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 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, 2005, the last business day of the Registrant's most recently completed second fiscal quarter was $12,871,299, based upon the reported sale price of $4.25 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 31, 2006

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

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THE STEPHAN CO. AND SUBSIDIARIES
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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, 2005; 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, Foxy Products, Inc., 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. and American Manicure, 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 2006. Retail brand sales of Stephan, including the Frances Denney product line, accounted for approximately $2,867,000 of the Company's 2005 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 2005. Private label production, which is the manufacturing of products marketed and sold under the brand names of customers of the Company, was not significant in 2005.

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. Its Tampa facility manufac- tures 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. The operations of Old 97 are included in the Manufacturing segment of our business.

WILLIAMSPORT BARBER AND BEAUTY CORP.

Williamsport Barber and Beauty Corp. ("Williamsport"), a wholly-owned subsidiary of the Company, is located in Williamsport, Pennsylvania.

Williamsport, a mail order beauty and barber supply company, with net sales of approximately $4,192,000 in 2005, accounted for approximately 18.8% 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 and spas. For the year ended December 31, 2005, Stephan & Co. had net sales of approximately $404,000.

SCIENTIFIC RESEARCH PRODUCTS, INC. OF DELAWARE.

Scientific Research Products, Inc. of Delaware ("Scientific") is a wholly-owned subsidiary, which accounted for 6.8% of our consolidated revenues in 2005, with net sales of approximately $1,524,000. 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 2005 were approximately $631,000, representing 2.8% of our consolidated revenues, and are included in the Professional business 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 professional brands acquired from New Image amounted to approximately 4.8% of consolidated revenues, or approximately $1,073,000 of net sales for the year ended December 31, 2005. 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. Sales for the year ended December 31, 2005 were approximately $11,227,000, accounting for approximately 50.4% of our consolidated revenues, and are included in the Professional segment of the Company's business.

AMERICAN MANICURE, INC.

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

"French" nail polish manicure kits to other distributors and

salons. The transaction was accounted for as a purchase, and included primarily inventory and accounts receivable amounting to approximately $150,000. The purchase transaction was closed on June 17, 2005 and no goodwill was recorded as a result of the acquisition. Sales for the year ended December 31, 2005 were not material.

SEGMENT INFORMATION

"Operating Segments and Related Information," which provides informa- tion 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, 2005 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, 2005, expenditures on Company sponsored research relating to the development of 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, 2005, in addition to its four executive officers, the Company and its subsidiaries employed 107 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.

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.

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.

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 $12,378,000 at December 31, 2005, and represented approximately 38% of total assets. For the year ended December 31, 2004, the Company incurred an impairment loss of $2,145,000 in connection with the valuation of intangible assets. Because of the 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 July 15, 2007. 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.

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 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. This facility replaced the North Powerline Road warehouse.

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. From time to time, and as inventory levels dictate, Old 97 leases temporary warehouse space, generally on a short-term basis. Old 97 is currently leasing a 44,000 square foot warehouse located in close proximity to the general office and warehouse facility.

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, 2007. Monthly rent in the amount of $2,100 is payable to the former owner of Williamsport Barber Supply and the Company has the right to terminate the lease upon 30-days notice.

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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.

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 2006 through 2010 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, 2005, 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 and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Events.

In the fourth quarter of 2003, Sorbie Acquisition Co. ("SAC"), a wholly-owned subsidiary of the Company, and Trevor Sorbie International, Plc. ("TSI") commenced arbitration proceedings before the American Arbitration Association in Pittsburgh, Pennsylvania. This arbitration proceeding arose from a lawsuit filed against SAC by TSI alleging causes of action for breach of contract, declaratory judgment and trademark infringement. On October 25, 2004,

the arbitration panel returned an award in favor of TSI with respect to certain royalties due, including interest, and in favor of SAC with respect to the infringement of SAC's rights to exclusive publicity in their territory. The panel did not affirm any of the other claims alleged by either of the parties to the proceeding. In Federal Court, SAC appealed the decision on certain grounds, including an improper computation of the interest due on additional royalties. In Pennsylvania State Court, SAC appealed the State Court's confirmation of the Arbitration award and was notified on March 29, 2006 that the appeal was denied.

The financial statements for the year ended December 31, 2005 reflect a liability of approximately $816,000 for payment of the award. Also, SAC may continue to incur additional interest. Due to the complexities of the issues involved, however, the Company is currently unable to predict the outcome of the appeal, including whether or not the appeal will be heard in Federal Court.

In 1997 the Company's wholly-owned subsidiary, Stephan Distributing, Inc., acquired several product lines from New Image Laboratories, Inc. ("New Image"). A portion of 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, among other things, a declaratory decree that the 125,000 shares of the Company's common stock held in escrow for the contingent payment of certain purchase price adjustments be released from escrow and turned over to New Image. 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. New Image's claim for diminution of the value of the shares held in escrow was heard before a special master in late October 2004 and on March 30, 2005, the special master recommended that judgment be entered in favor of the Company. The federal court then entered an order confirming the findings of the Special Master and entered judgment denying New Image's diminution claim. New Image has not appealed the judgment.

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

No matters were submitted to a vote of our security holders, through the solicitation of proxies or otherwise, during the quarter ended December 31, 2005.

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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 during each quarterly period within the two most recent fiscal years:

Quarter Ended	High Sales Price	Low Sales Price
March 31, 2004	$ 4.60	$ 4.32
June 30, 2004	4.88	4.41
September 30, 2004	6.80	3.30(1)
December 31, 2004	4.25(1)	3.45(1)
March 31, 2005	$ 5.10(1)	$ 3.87(1)
June 30, 2005	4.70(1)	3.45(1)
September 30, 2005	4.70(1)	3.85(1)
December 31, 2005	4.10(1)	3.14(1)

(1) Net of $2.00 per share special dividend paid September 15, 2004

(b) Holders

As of March 31, 2006, the Company's Common Stock was held of record by approximately 340 holders. The Company's Common Stock is believed to be held beneficially by approximately 1,000 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 2005. 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. As indicated above, 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

	2005	2004	2003	2002	2001
	(in thousands, except per share data)				
Net sales	$22,262	$23,951	$25,336	$25,067	$28,296
(Loss)/Income before income taxes and cumulative effect of change in accounting principle	(244)	(2,034)	1,487	1,400	746
(Loss)/Income before cumulative effect of change in accounting principle	(172)	(2,176)	760	503	608
Cumulative effect of change in accounting principle, net of tax	--	--	--	(6,762)	--
Net (loss)/income	(172)	(2,176)	760	(6,259)	608
Current assets	16,853	15,014	24,139	20,284	20,116
Total assets	32,778	34,719	48,063	47,655	57,062
Current liabilities	5,240	3,276	5,085	3,514	4,067
Long term debt	--	3,238	4,348	6,395	7,758
PER COMMON SHARE (Basic and Diluted): (a)					
(Loss)/Income before cumulative effect of change in accounting principle	(.04)	(.50)	.18	.12	.14
Cumulative effect of change in accounting principle	--	--	--	(1.58)	--
Net (loss)/income	(.04)	(.50)	.18	(1.46)	.14
Cash dividends	.08	2.08	.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 2005, 4,348,908 for 2004, 4,312,711 for 2003, 4,285,577 for 2002, and 4,285,577 for 2001. 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 3/31/05	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)

	Quarter Ended 3/31/04	Quarter Ended 6/30/04	Quarter Ended 9/30/04	Quarter Ended 12/31/04
Net sales	$ 5,959	$ 5,556	$ 7,305	$ 5,131
Gross profit	2,504	2,342	2,995	1,823
Net income/(loss)	78	312	29	(2,595)(a)
Net income/(loss) per share	.02	.07	.01	(.60)

(a) Includes an impairment loss on goodwill and trademarks in the amount of $2,145.

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

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. The Company is optimistic that this will have a favorable impact on net sales starting in 2006.

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 new subsidiary, American Manicure, was approximately $135,000 and the Company expects that this brand will continue to enhance sales in 2006 and beyond. Sales of hotel and spa amenities continued to improve in 2005, with net sales increasing almost 10% over the prior year.

Selling, general and administrative expenses (SG&A) decreased overall by approximately $3,338,000, from $12,104,000 in 2004 to $8,766,000 in 2005. Approximately $2,752,000 of SG&A expenses in 2004 were of a non-recurring nature and were comprised of "non-cash" expenses, including an impairment loss on goodwill and trademarks in the amount of $2,145,000, $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.

YEAR ENDED DECEMBER 31, 2004 AS COMPARED TO 2003

Net sales for 2004 decreased primarily as a result of declines in the revenues from the Company's Retail business segment. The decline in net sales for the Retail segment was approximately $1,638,000, largely as a result of the return to a normal level of sales of Quinsana Medicated Talc to the military as a result of the stabilization of troops deployed to the Middle East. The Professional segment showed a small sales decrease, with an increase in hard goods sales offsetting most of the decline in wet goods sales.

Gross profit decreased $1,514,000, to $9,664,000 in 2004 when compared to 2003 levels. This decrease was due to an overall decline in net sales, increased write-downs of long-term inventory and a continuing change in the overall mix of business. The gross margin in 2004 was 40.4%, compared to 44.1% in 2003. The decrease, as indicated above, was due to an unfavorable sales mix. In 2004, as a result of lower than anticipated sales and slow inventory movement during the year, the Company recorded a charge reflected in cost of goods sold for $337,000 to reduce the carrying value of inventory. This contributed to the decline in gross profit as well as contributing to the overall decrease in the gross margin.

The Retail Personal Care Products operating segment experienced a significant decrease in net sales as a result of the decrease in military sales as explained above, in addition to a decline in net sales of the LeKair product line. Net retail sales in 2004 were $5,734,000, as compared to $7,373,000 in 2003. The Company continues to utilize discounting in an attempt to maintain market share, a practice which has an adverse effect on the overall gross profit of the Company.

Net sales of the Manufacturing segment declined as a result of the decline in wet goods sales, in addition to a decline in private label manufacturing; however, management's efforts to "re-launch" the amenities business showed favorable results, with net sales of $366,000 in 2004.

Selling, general and administrative expenses (SG&A) increased overall by approximately $2,352,000, from $9,752,000 in 2003 to $12,104,000 in 2004. Approximately $2,752,000 of SG&A expenses in 2004 were comprised of "non-cash"

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expenses, including an impairment loss on goodwill and trademarks in the amount of $2,145,000, $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. Other increases in SG&A were the result of the reimbursement of an additional $158,000 for expenses previously incurred by Eastchester Enterprises, in accordance with the terms of the Merger Agreement (Eastchester Enterprises was the entity created by the four Board members who were attempting to privatize the Company), $111,000 in additional legal expenses in connection with litigation and "going-private" matters and additional rent expense of $72,000. In 2003, SG&A included officers bonuses of $755,000; however no bonus was due or payable for the year ended December 31, 2004.

Interest expense declined by approximately $312,000, from $403,000 in 2003 to $91,000 in 2004, a result of the payoff of an obligation to Colgate-Palmolive in April 2004; interest income also declined $63,000 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, 2004, was $164,000, compared to $227,000 earned in 2003.

As indicated in previously filed reports, on April 7, 2004, the Company and Colgate-Palmolive mutually agreed to settle all outstanding claims and issues between them. The net result of this settlement was a reduction of the Company's outstanding obligation by approximately $418,000. This amount is reflected in other income. In addition to the Colgate-Palmolive settlement, other income was impacted by the settlement of two lawsuits. In one case, the Company received payment of $150,000 in connection with a customer's failure to perform on a purchase order issued by them to the Company, and in July 2004, the Company also settled a portion of the New Image litigation by agreeing to pay New Image $285,000. Other income also includes royalty payments from Color Me Beautiful in the amount of $50,000 in connection with the marketing of Frances Denney products.

The loss before income taxes for the year ended December 31, 2004 was $2,034,000, compared to income of $1,487,000 achieved for the corresponding period in 2003, due to a decline in net sales and gross profit as well as the increase in SG&A indicated above. The provision for income taxes of $142,000 includes a current benefit of $213,000 and a deferred tax expense of $355,000. The net loss for the year ended December 31, 2004 was $2,176,000, a decline of $2,936,000 from the corresponding period for 2003, however as mentioned above, approximately $2,752,000 of SG&A expenses were "non-cash" in nature.

Basic and diluted loss per share for the year ended December 31, 2004 was $.50, compared to earnings of $.18 for the year ended December 31, 2003, based upon an average number of shares outstanding of 4,348,908 in 2004 and 4,312,711 in 2003.

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LIQUIDITY AND CAPITAL RESOURCES

Working capital decreased $125,000 from December 31, 2004, and was approximately $11,613,000 at December 31, 2005. Cash and cash equivalents increased to $5,603,000 as compared to $4,402,000 as of December 31, 2004. The Company continues to secure its outstanding debt with restricted cash. In the first quarter of 2006, the Company and Wachovia Bank have agreed, in principle, to convert the balloon payment due in August 2006 to monthly principal payments under the same terms and conditions as the original obligation, through 2008.

The Company is currently engaged in the construction of additional warehouse facilities on the Tampa, Florida manufacturing property, estimated to cost approximately $1,000,000. The Company has reviewed construction designs and site plans, and has initiated procedures for obtaining the necessary permits. Other than the above, the Company does not anticipate any significant capital expenditures in the near term and management believes that there is sufficient cash on hand, working capital and borrowing capacity to satisfy upcoming requirements.

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.

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, 2005:

	Payments due by period (in thousands)		
Contractual obligation	Total	Less than 1 year	1-3 years
Bank debt payable	$ 3,238	$ 3,238	$ --
Employment contract	1,966	594	1,372
TOTAL OBLIGATIONS	$ 5,204	$ 3,832	$1,372

NEW FINANCIAL ACCOUNTING STANDARDS

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

In December 2004, the FASB issued a revised SFAS No. 123 impacting the accounting treatment for share-based payments. The revised statement requires companies to reflect in the income statement compensation expense related to the grant-date fair value of stock options and other equity-based compensation issued to employees over the period that such amounts are earned. The statement is effective for the Company's 2006 fiscal year.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4", effective for fiscal years beginning after June 15, 2005. SFAS No. 151 requires that the costs associated with certain abnormal expenditures be recognized in the current period. It also requires that the amount of fixed production overhead allocated to inventory be based upon normal capacity of production facilities. The effect this statement would have on the Company's consolidated financial statements is not expected to be material.

RECENT EVENTS

On April 18, 2006, the Company announced that Romella International AB, United Feature Syndicate, Inc., and The Stephan Company entered into a license agreement for the use of the Charles Schulz "Peanuts" characters in the United States and its possessions, with an initial licensing term extending through March 2009. The agreement gives The Stephan Company distribution rights to direct mail catalogs, Duty Free Shops, Department Stores, Home Shopping Channels, Mass Market Retailers, Department Stores and Super Market/Grocery Stores. The Company anticipates the lead line will be a fragrance geared towards the younger market, using the Snoopy logo, followed by additions to the line which would fall into the bath and body category. Cosmetic bags and other types of carry-on bags are also part of the license agreement, which the Company intends to market with its other fragrance and bath items.

On August 18, 2005, the Company entered into a License Agreement with Simply Organic, Inc., for the exclusive rights to manufacture, market, and distribute the SIMPLY ORGANIC(R) line of personal care and wellness products in all retail and certain professional channels of distribution in the Western Hemisphere. Utilizing natural anti-viral, anti-bacterial, moisturizing and emulsifying ingredients, SIMPLY ORGANIC(R) products are currently sold in upscale salons and spas as a "wellness" alternative to main-stream beauty products. The Company believes that this new private label customer will enhance sales in the 2006 fiscal year.

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On August 1, 2005, the Company entered into a Brand License Agreement with The Quantum Beauty Company Limited (the "Licensor") for the exclusive rights to manufacture, market and distribute the "Lee Stafford" brand of hair care products in the Western Hemisphere (the "License Agreement"). The initial term of the License Agreement is 5 years, with a minimum 5 year renewal at the Licensor's option. The Company is subject to certain requirements, including satisfactory compliance with manufacturing and quality standards, reporting timeframes, payment of royalties, minimum marketing, advertising and promotional expenditures as well as targeted sales goals increasing on an annual basis. On the basis of targeted sales goals stipulated in the License Agreement, the Company believes that overall, accounts receivable and inventory levels will increase in the future and anticipates a positive impact on the sales and earnings of the Company over the term of the License Agreement.

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:

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 by 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.

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

In connection with the Company's change of auditors in 2005, the Form 8-K filed September 19, 2005 is incorporated herein by reference.

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, 2005 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 existed as of December 31, 2005.

(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 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

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CONTROL PERSONS OF THE COMPANY

Board of Directors

Directors are elected on a staggered basis, with each class generally standing for election for a three-year term. The Company's By-Laws provide that the number of directors shall be set from time to time by resolution of the Board of Directors and must be a minimum of one. The Board of Directors has set the size of the Board at seven members.

Set forth below is certain information with respect to the members of the Board of Directors:

	Age (as of 3/31/06)	Year first elected as a Company Director	Principal Occupation(s) During Past Five Years; Other Directorships
William M. Gross(2)(3)	82	2005	Certified Public Accountant and Attorney. For more than the previous five years, he has served as Authorized House Counsel for the Company on a part time basis.
Shouky A. Shaheen	75	1998	For more than the previous five years, President of Shaheen and Co. Mr. Shaheen is also the former Owner of Morris Flamingo, L.P., which was acquired by the Company in March 1998.
Curtis Carlson	52	1996	For more than the previous five years, partner in various law firms. Currently a partner in the Miami-based law firm of Carlson & Lewittes, PA.
Frank F. Ferola	62	1981	For more than the previous five years, Chairman of the Board, President and Chief Executive Officer of the Company.
Richard Barone (1)(2)(3)	64	2005	Chairman, CEO and Portfolio Manager for Ancora Advisors, an investment advisor based in Cleveland, OH. Additionally, Chairman of Ancora Capital and Ancora Securities, a holding company and broker/dealer based in Cleveland. Prior to founding Ancora Advisors, from 2001-2003, portfolio manager for Fifth Third Bank Invest Advisors. Prior to that, President and CEO for Maxus Investment Group.
David Pawl (1)(3)	57	2005	Retired. From 1997 to 2002 President of GE Quartz, Inc., a subsidiary of General Electric Company.
Elliot Ross (1)(2)	60	2005	Since 2000 co-founder of MFL Group, a corporate consulting firm. Prior to 2000,

President and Director of State Industrial Products.

(1) Member of the Audit Committee.
(2) Member of the Stock Option and Compensation Committee.
(3) Member of the Nominating Committee.

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Committees of the Board

The Board has established three standing committees, consisting of (1) an Audit Committee (2) a Stock Option & Compensation Committee and (3) a Nominating Committee.

The Audit Committee reviews the internal and external audit functions of the Company and makes recommendations to the Board of Directors with respect thereto. It also has primary responsibility for the formulation and development of the auditing policies and procedures of the Company, and for selecting the Company's independent auditing firm. The Audit Committee is governed by the Company's Audit Committee Charter. The Board of Directors of the Company has determined that the current composition of the Audit Committee satisfies the American Stock Exchange's requirements regarding the independence, financial literacy and experience. The Chairman and financial expert of the Audit Committee is Richard Barone, an independent director.

Executive Officers

The four executive officers of the Company consist of Frank F. Ferola, President, Chairman of the Board and Chief Executive Officer; David A. Spiegel, Chief Financial Officer, Vice President and Treasurer; Tyler Kiester, Assistant Secretary; and Curtis Carlson, Vice President and Secretary.

The following sets forth certain information with respect to the executive officers of the Company who are not also directors (based solely on information furnished by such persons):

Mr. David A. Spiegel, 57, was appointed as Chief Financial Officer in January 1994. For more than the five years prior to 1994, Mr. Spiegel was the independent public accountant for the Company.

Mr. Tyler Kiester, 38, was appointed Assistant Secretary in January 2003. For more than the previous five years, Mr. Kiester has been employed by the Company in various capacities.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors and persons owning more than 10% of the Company's common stock to file reports of ownership and changes in ownership with the Securities and Exchange Commission and to furnish copies of all such reports to the Company. The Company believes, based on the Company's stock transfer records and written representations from certain reporting persons, that, except as set forth below, all reports required under section 16(a) were timely filed during 2005.

Name	# of Late Reports	# of Late Transactions

John DePinto	1	1
Michael S. Cordaro	1	
Leonard Genovese	1	1
Richard A. Barone	2	1
Shouky Shaheen	1	1
Curtis Carlson	1	1
Frank F. Ferola	1	1
David Pawl	1	1
Elliot Ross	2	2
William M. Gross	1	1

Code of Ethics

The Company has adopted a Code of Ethics that applies to all officers, employees and directors. This Code requires continued observance of high ethical standards such as honesty, integrity and compliance with the law in the conduct of the business. The Code is posted on the Company website, (www.thestephanco.com).

ITEM 11. EXECUTIVE COMPENSATION

Compensation

The following table sets forth information for the fiscal years ended December 31, 2005, 2004 and 2003 as to the compensation earned by the Company's Chief Executive Officer and the other most highly compensated executive officers and/or other employees of the Company whose total annual salary and bonus exceeded $100,000 for services rendered by them in all capacities to the Company and its subsidiaries during fiscal year 2005.

Summary Compensation Table

	Annual Compensation				Long-Term Compensation	
Name and Principal Position(s)	Year	Salary	Bonus	Other Annual Compensation	Securities Underlying Options	All Other Compensatio
Frank F. Ferola	2005	$742,172	$ 0	$ 0	$50,000(1)	$ 0
Pres., CEO &	2004	$828,139	$ 0	$ 0	$50,000(1)	$ 0
Board Chair	2003	$752,853	$630,000(2)	$ 0	$50,000(1)	$60,80
David Spiegel, CFO	2005	$180,437	$ 0	$ 0	$ 0	$ 0
	2004	$188,781	$ 0	$ 0	$ 0	$ 0
	2003	$165,816	$ 0	$ 0	$ 0	$ 0
Jeff Lovelace,	2005	$103,133	$ 0	$ 0	$ 0	$ 0
Director of Sales	2004	$104,500	$ 0	$ 0	$ 0	$ 0
	2003	$ 83,326	$ 0	$ 0	$ 0	$ 0

(1) Reflects stock options granted pursuant to employment agreements.
(2) Bonus earned in 2003 and paid in 2004.

Stock Option Grants in Fiscal Year 2005

The following table sets forth certain information concerning stock options granted to those individuals named in the Summary Compensation Table who were granted stock options in fiscal year 2005.

Name	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Year	Exercise Price Per Share	Exp. Date	Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation (2)	
					5%	10%
Frank F. Ferola	50,000(1)	100%	$4.26	1/1/2010	$271,848	$343,039

(1) Reflects Stock Options granted pursuant to employment agreements.

(2) Potential realizable value is based on the assumption that the Common Stock appreciates at the annual rates shown (compounded annually) from the date of grant until the expiration of the option term. These numbers are calculated based on the requirements promulgated by the Commission and do not reflect any estimate or prediction by the Company of future Common Stock trading prices.

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Option Exercises and Year-End Option Values

The following table sets forth information with respect to the number of shares acquired upon exercise of stock options and the value realized upon exercise of such stock options by the individuals named in the Summary Compensation Table during 2005. The table also contains information regarding the number of shares covered by both exercisable and unexercisable stock options held by the same individuals as of December 31, 2005. Also reported are the values for "in-the-money" stock options that represent the positive spread between the respective exercise prices of outstanding stock options and the fair market value of our common stock as of December 31, 2005 ($3.42 per share).

Name	Shares Acquired On Exercise	$ Value Realized	Number of Securities Underlying Unexercised Options Held at December 31,2005		Value of Unexercised I Money Option December 31,	
			Exercisable	Unexercisable	Exercisable	Une
Frank F. Ferola	--	--	200,000	50,000	--	

Compensation of Directors

All directors of the Company are compensated for their services by payment of $300 for each Board meeting attended.

During fiscal year 2005, options to purchase an aggregate of 20,248 shares of Common Stock, at an exercise price of $4.82 per share, were granted by the Company to the four directors of the Company who were not employees or regularly retained consultants of the Company (each, an "Outside Director") pursuant to the Company's 1990 Outside Directors' Stock Option Plan.

Under the Plan, each Outside Director is automatically granted, upon such person's election or re-election to serve as a director of the Company, an option exercisable over five years, to purchase shares of Common Stock. Upon initial election to the Board of Directors, an Outside Director is granted an option to purchase 5,062 shares of Common Stock at an exercise price equal to the fair market value of the Common Stock on the date of grant. An option to purchase an additional 5,062 shares of Common Stock (at an exercise price equal to the fair market value of the Common Stock on the date of such grant) is granted to each incumbent Outside Director during each fiscal year of the Company thereafter on the earlier of (i) June 30 or (ii) the date on which the stockholders of the Company elect directors at an annual meeting of such stockholders or any adjournment thereof. The aggregate number of shares of Common Stock reserved for grant under the Outside Directors' Stock Option Plan is 202,500, of which options covering 91,116 shares are outstanding.

Employment and Termination Arrangements

Frank F. Ferola

On January 1, 1997, the Company entered into an employment agreement with Mr. Frank F. Ferola. The agreement provides for a three year term, which may be renewed for successive terms of three years if, at least thirty days prior to the end of each term, Mr. Ferola gives notice of his election to renew. Mr. Ferola renewed the agreement at the end of 1999, 2002, and, most recently on March 7, 2005, terminating December 31, 2008.

Under the agreement, Mr. Ferola receives an annual base salary which is increased annually by an amount equal to 10% of the previous years' base salary. For the year ending December 31, 2005, Mr. Ferola's annual base salary was $910,953. (However, by letter dated July 6, 2005, to the Company, Mr. Ferola unilaterally reduced his salary to $540,000 per annum. See discussion under Certain Relationships and Related Transactions.)

In addition, Mr. Ferola is entitled to receive an annual performance bonus based on increases of at least 10% in the Company's earnings per share, calculated by comparison to a base year (currently, 2002) and pursuant to a formula set forth in his employment agreement. For the year ending December 31, 2005, Mr. Ferola was not due a bonus.

Further, Mr. Ferola's employment agreement provides that he will receive stock options with five year terms, under the 1990 Key Employee Stock Incentive Plan or under a substitute plan directly from the Company, on each anniversary date of the agreement of not less than 50,000 shares based on the closing price of the stock on the last business day before the anniversary date.

Moreover, in the event of a "change in control" (as defined in the employment agreement) of the Company, Mr. Ferola is entitled to receive an amount equal to his base salary for the remaining term of his employment agreement plus an additional 24 months' salary, plus a lump-sum payment in an amount equal to the most recent annual bonus paid multiplied by the sum of the number of years (including any fraction thereof) remaining in the term of his agreement, plus two.

David Spiegel

Mr. Spiegel has an arrangement with the Company where the Company pays him a severance payment upon a "change in control" (as defined in a letter agreement dated April 29, 2004, by and between Mr. Spiegel and the Company) in an amount equal to his then-current monthly base salary, multiplied by twelve, plus a lump-sum payment equal to his most recent annual bonus.

Tyler Kiester

Finally, Mr. Kiester has an arrangement whereby the Company pays him a severance payment upon a "change in control" (as defined in a letter agreement dated May 19, 2003, by and between Mr. Kiester and the Company) in an amount equal to his then-current monthly base salary multiplied by twelve.

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Richard Barone, David Pawl and William Gross comprised the Compensation Committee in 2005.

Report of the Compensation Committee on Executive Compensation

The following Report on Executive Compensation does not constitute soliciting material and should not be deemed filed or incorporated by reference in any other filing by us under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that we specifically incorporate this report by reference therein.

The Compensation Committee is composed of a majority of independent directors. The Compensation Committee reviews the base salaries of our employees (as well as our executive officers) on an annual basis, considering factors such as corporate progress toward achieving objectives (without reference to any specific performance-related targets) and individual performance experience and expertise. The Compensation Committee has primary responsibility for the administration of the Company's 1990 Key Employee Stock Incentive Plan (the "Incentive Plan"), including principal responsibility for the granting of options thereunder. The Compensation Committee is also responsible for establishing the overall philosophy of the Company's executive compensation program and overseeing the executive compensation plan developed to execute the Company's compensation strategy.

Compensation Strategy

The Company's executive compensation program has been designed to (i) align executive compensation with stockholder interests, (ii) attract, retain and motivate a highly competent executive team, (iii) link compensation to individual and Company performance and (iv) achieve a balance between incentives for short-term and long-term performance and results. The Company's executive compensation package consists of the payment of base salary, potential annual bonus and stock options awarded through participation in the Incentive Plan. The Compensation Committee reviews annually the compensation to be paid to the Company's executive officers. In making such review, the Compensation Committee evaluates information supplied by management. The Compensation Committee also participates in the negotiation of employment contracts, including provisions for salary and bonuses, with the Company's executive officers. Currently, pursuant to the Company's employment agreement with its Chief Executive Officer, Mr. Ferola receives a fixed annual salary.

Base Salary

The Compensation Committee's policy is to negotiate salaries in relation to industry norms, the principal job duties and responsibilities undertaken by such executives, individual performance and other relevant criteria. A base salary comparison for the Company's Chief Executive Officer was made to a group of public companies that the Compensation Committee believes provides a meaningful comparison to the Company. Several of these companies are included in the custom composite of companies in the Standard & Poor's Midcap Consumer Products Index. The base salary paid to the Company's Chief Executive Officer for fiscal year 2005 was in the middle of the range of base salary paid by such companies.

Annual Bonus

Annual bonuses for the Chief Executive Officer is determined by a specific bonus formulae set forth in his written employment agreement. Other executives may be paid bonuses at the discretion of the Compensation Committee.

Stock Options

Long-term incentive compensation of executives is granted through participation in the Incentive Plan. The Incentive Plan permits the Company to grant stock options to executive officers at a price not less than 100% of the fair market value of the Common Stock on the date of the grant. In addition to any obligations pursuant to the Chief Executive Officers' employment agreement, stock options may be granted, in the Compensation Committee's discretion, to executive officers based upon its appraisal of the ability of such executive officers to influence the long-term growth and profitability of the Company. The Compensation Committee believes that providing a portion of the executive's compensation in the form of stock options encourages the officers to share with the Company's stockholders the goals of increasing the value of the Company's stock and contributing to the success of the Company.

Compensation Committee's Actions for Fiscal Year 2005

After various informal meetings during 2005, the Compensation Committee did not award any discretionary stock options to any key employees and did not grant any discretionary salary increases or award any bonuses. Options were granted only pursuant to Mr. Ferola's employment agreement.

The Chief Executive Officer Compensation

As set forth in more detail herein, the Compensation Committee approved an employment agreement on January 1, 1997 for Mr. Frank F. Ferola that was renewed for successive terms until December 31, 2008. Based on the earnings formula described therein, Mr. Ferola received annual bonus(es) and stock options as previously indicated in this Item 11.

Section 162(m) Compliance

Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), generally disallows a tax deduction to a public company for compensation over $1 million annually paid to its chief executive officer and four other most highly compensated executive officers. Qualifying performance-based compensation will not be subject to the deduction limitation if certain requirements are met. The Compensation Committee's current policy is to structure the performance-based portion of the compensation of the Company's executive officers (currently consisting of stock option grants and cash bonuses) in a manner that complies with Section 162(m) of the Code whenever practicable and appropriate in the judgment of the Compensation Committee.

COMPENSATION COMMITTEE:
Richard Barone, Chairman
David Pawl
William Gross

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ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Equity Compensation Plans

As of December 31, 2005, an aggregate of 512,700 options had been granted to executive officers under the 1990 Key Employee Stock Incentive Plan and an aggregate of 546,330 options had been granted to all employees under the Plan. Included in the above totals are options that have been granted and subsequently cancelled and/or expired.

Non-employee directors of the Company are not granted options under the 1990 Key Employee Stock Incentive Plan, but are granted options under the 1990 Outside Directors' Stock Option Plan, discussed above under "Compensation of Directors."

Stock Ownership by Certain Beneficial Owners

The following table sets forth, as of March 31, 2006, certain information as to the stockholders (other than directors and executive officers of the Company) known by the Company to own beneficially more than 5% of the Common Stock (based solely upon filings by said holders with the Securities and Exchange Commission on Schedule 13D, pursuant to the Securities Exchange Act of 1934, as amended).

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned *	Percent of Class
Merlin Partners, L.P., et al. 2000 Auburn Drive, Suite 420 Cleveland, OH 44122	321,921	7.3
Yorktown Avenue Capital, et al. 124 E. 4th Street Tulsa, OK 74103	573,513	13.1
David M. Knott, et al. 485 Underhill Blvd., Suite 205 Syosset, NY 11791	387,900	8.8
Richard L. Scott Boult Cummings Conners & Berry, PLC 414 Union Street, Suite 1600 Nashville, TN 37219	438,500	10.0

* Beneficial ownership, as reported in the above table, has been determined in accordance with Rule 13d-3 Under the Exchange Act. Unless otherwise indicated, beneficial ownership includes both sole voting and sole dispositive power.

Stock Ownership by Management and Directors

The following table sets forth, as of March 31, 2006, certain information concerning the beneficial ownership of Common Stock by each of the seven directors of the Company, the executive officers, and all current directors and executive officers of the Company as a group (based solely upon information furnished by such persons):

Name of Beneficial Owner (1)	Number of Shares Beneficially Owned(2)		Percent of Class
Curtis Carlson	20,248		(4)
William M. Gross	--		(4)
Frank F. Ferola	810,333	(3)	18.46%
John DePinto	128,452		2.93
Tyler Kiester	--		(4)
Shouky Shaheen	332,368		7.57%
David Spiegel	700		(4)
Richard Barone	321,921		7.33%
Elliot Ross	5,000		(4)
David Pawl	--		(4)
All executive officers and directors as a group	1,619,022		36.88%

(1) Beneficial ownership, as reported in the above table, has been determined in accordance with Rule 13d-3 under the Exchange Act. Unless otherwise indicated, beneficial ownership includes both sole voting and sole dispositive power. Unless otherwise indicated, the address of each person listed is c/o The Stephan Co., 1850 W. McNab Rd., Ft. Lauderdale, FL 33309.

(2) Includes the following shares that may be acquired upon the exercise of options held by the specified person within 60 days of the Record Date: Mr. John DePinto - 20,248; Mr. Frank Ferola - 200,000; Mr. Curtis Carlson - 20,248; Mr. Leonard Genovese - 20,248; Mr. Shouky Shaheen - 5,062; and all executive officers and directors as a group - 245,558.

(3) Includes 43,174 shares owned by Mr. Frank Ferola's personal Charitable foundation, of which Mr. Ferola is a co-trustee.

(4) Represents less than 1%.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In fiscal year 2005, the Company paid $191,384 to Payton & Carlson, P.A. and to Carlson & Associates, P.A., law firms of which Curtis Carlson is a partner, for legal services rendered by such firms to the Company. Further, commencing April 8, 2005, the Company began to pay Mr. Carlson $2,000. per month for his services as Vice-President and Secretary.

In fiscal year 2005, the Company paid $286,000 in rent to Shaheen & Co., Inc., a corporation in which Mr. Shaheen has an ownership interest, for a building the Company leases in Danville, Illinois. On May 4, 2005, the Company entered into a Second Amendment of Lease Agreement for the Danville facility which, among other things, increases the annual rental to $303,000.

By way of letter dated July 6, 2005, Frank F. Ferola, President, CEO and Chairman of the Board, unilaterally reduced, on a temporary basis, his salary from $910,953 in 2005 to $540,000 per annum, subject to the contractual annual 10% increase ($594,000 in 2006). In the event of a "change of control" in the Company (as defined in the July 6, 2005 letter) Mr. Ferola's salary, as set forth in his employment contract, shall automatically resume.

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ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Principal Accountant Fees and Services

The following table sets forth the fees billed to us by Goldstein Lewin & Co. and Deloitte & Touche, our independent registered accounting firms, as of and for the years ended December 31, 2005 and 2004.

	For the Years Ended December 31, 2005	For the Years Ended December 31, 2004
Audit fees(1)	$ 93,580	$190,400
Audit - related fees	$ --	$ --
Tax fees(2)	$ --	$ 1,062
All other fees	$ --	$ --
	$ 93,580	$191,462

(1) Audit fees billed by Goldstein Lewin & Co. in 2005 related to the review of our interim consolidated financial statements included in our Quarterly Reports on Form 10-Q for the periods ended March 31, June 30 and September 30, 2005. Audit fees billed by Deloitte & Touche, LLP in 2005 related to the audit of our annual consolidated financial statements for the year ended December 31, 2004 and services performed in connection with "comment letters" received from the Securities and Exchange Commission. Audit fees billed by Deloitte & Touche, LLP in 2004 related to the audit of our annual consolidated financial statements; the review of our interim consolidated financial statements included in our Quarterly Reports on Form 10-Q for the periods ended March 31, June 30 and September 30, 2004.

(2) Tax fees billed by Deloitte & Touche, LLP related to tax advice in connection with real estate and personal property tax statements.

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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.

10.14 1990 Non-Employee (Outside Directors) Plan, as amended.

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.

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.

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

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

32.1 Certification 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, 2005 and 2004.

Consolidated Statements of Operations for the years ended December 31, 2005, 2004, and 2003.

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2005, 2004, and 2003.

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004, and 2003.

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 sheet of The Stephan Co. and subsidiaries (the "Company") as of December 31, 2005, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for year ended December 31, 2005. Our audit 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 the financial statements and 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 re-quire 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 financial position of The Stephan Co. and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for the year ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such 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, 2006

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 sheet of The Stephan Co. and subsidiaries (the "Company") as of December 31, 2004, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

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 financial position of The Stephan Co. and subsidiaries as of December 31, 2004, and the results of their operations and their cash flows for each of the two years in the period 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, 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

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 AND 2004

ASSETS

	2005	2004
CURRENT ASSETS		
Cash and cash equivalents	$ 5,602,762	$ 4,402,463

Restricted cash	3,335,557	1,110,000
Accounts receivable, net	1,431,650	1,753,250
Inventories	6,148,267	7,164,901
Income taxes receivable	22,893	209,203
Prepaid expenses and other current assets	311,905	374,079
TOTAL CURRENT ASSETS	16,853,034	15,013,896
RESTRICTED CASH	--	3,430,408
PROPERTY, PLANT AND EQUIPMENT, net	1,682,951	1,627,227
GOODWILL, net	4,013,458	4,013,458
TRADEMARKS, net	8,364,809	8,364,809
OTHER INTANGIBLE ASSETS, net	142,185	216,652
OTHER ASSETS	1,721,169	2,052,405
TOTAL ASSETS	$32,777,606	$34,718,855

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 AND 2004

LIABILITIES AND STOCKHOLDERS' EQUITY

	2005	2004
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 2,002,728	$ 2,165,751
Current portion of long-term debt	3,237,500	1,110,000
TOTAL CURRENT LIABILITIES	5,240,228	3,275,751
DEFERRED INCOME TAXES, net	1,343,257	1,488,116
LONG-TERM DEBT, less current maturities	--	3,237,500

TOTAL LIABILITIES	6,583,485	8,001,367
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, 2005 and 2004	43,898	43,898
Additional paid in capital	17,556,731	17,556,731
Retained earnings	8,593,492	9,116,859
TOTAL STOCKHOLDERS' EQUITY	26,194,121	26,717,488
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$32,777,606	$34,718,855

See notes to consolidated financial statements.

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THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

	2005	2004	2003
NET SALES	$ 22,262,423	$ 23,950,648	$ 25,336,017
COST OF GOODS SOLD	13,767,127	14,286,280	14,157,918
GROSS PROFIT	8,495,296	9,664,368	11,178,099
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	8,766,298	12,103,784	9,752,137
OPERATING (LOSS)/INCOME	(271,002)	(2,439,416)	1,425,962
OTHER INCOME(EXPENSE)			
Interest income	127,313	163,921	227,399
Interest expense	(150,173)	(91,237)	(403,028)
Royalty and other income	50,000	332,745	237,000
(LOSS)/INCOME BEFORE INCOME TAXES	(243,862)	(2,033,987)	1,487,333
INCOME TAX (BENEFIT)/EXPENSE	(71,679)	142,251	(726,874)
NET (LOSS)/INCOME	$ (172,183)	$ (2,176,238)	$ 760,459

BASIC AND DILUTED (LOSS)/ EARNINGS PER SHARE	$ (.04)	$ (.50)	$ .18
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	4,389,805	4,348,908	4,312,711

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

	Common Stock		Additional Paid in Capital	Retained Earnings	Contingently Returnable Shares
	Shares	Par Value			
Balances, Jan. 1, 2003	4,410,577	$ 44,106	$ 18,417,080	$ 19,979,819	$(1,351,563)
Dividends paid	--	--	--	(352,846)	--
Net income	--	--	--	760,459	--
Balances, Dec. 31,2003	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	$ --

See notes to consolidated financial statements.

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THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss)/income	$ (172,183)	$(2,176,238)	$ 760,459
Adjustments to reconcile net (loss)/ income to net cash flows provided by operating activities:			
Depreciation	143,509	136,712	287,978
Amortization of deferred acquisition costs	74,467	82,121	92,592
Write-down of inventories	--	337,215	92,670
Compensation expense resulting from exercise of stock options	--	415,430	--
Loss on disposal of property plant and equipment	--	--	34,422
Deferred income taxes	(144,859)	355,065	477,278
Provision for doubtful accounts	27,571	55,865	80,899
Impairment loss on goodwill and trademarks	--	2,144,522	--
Settlement of Colgate-Palmolive debt	--	(417,745)	--
Changes in operating assets and liabilities:			
Accounts receivable	294,029	(364,607)	(74,108)
Inventories	1,016,634	(4,854)	33,832
Income taxes receivable/payable	186,310	(237,473)	93,648
Prepaid expenses and other current assets	62,174	410,522	(426,772)
Other assets	331,236	815,553	831,699
Accounts payable and accrued expenses	(163,023)	(448,980)	596,495
Total adjustments	1,828,048	3,279,346	2,120,633
Net cash flows provided by operating activities	1,655,865	1,103,108	2,881,092

See notes to consolidated financial statements.

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THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

	2005	2004	2003
CASH FLOWS FROM INVESTING ACTIVITIES:			
Change in restricted cash	1,204,851	1,102,092	1,110,000
Purchase of property, plant and equipment	(199,233)	(61,608)	(20,265)
Net cash flows provided by investing activities	1,005,618	1,040,484	1,089,735
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayments of long-term debt	(1,110,000)	(2,024,528)	(1,101,817)
Proceeds from exercise of stock options	--	75,575	--
Dividends paid	(351,184)	(9,094,335)	(352,846)
Net cash flows used in financing activities	(1,461,184)	(11,043,288)	(1,454,663)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	1,200,299	(8,899,696)	2,516,164
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,402,463	13,302,159	10,785,995
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,602,762	$ 4,402,463	$13,302,159

See notes to consolidated financial statements.

THE STEPHAN CO. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

Supplemental Disclosures of Cash Flow Information:

	2005	2004	2003
Interest paid	$ 58,364	$ 190,214	$ 248,051
Income taxes paid	$ 69,526	$ 101,188	$ 122,255

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.

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THE STEPHAN CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

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. and American Manicure, Inc. (collectively, the "Company"). All significant intercompany 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 2005. 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 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. Periodic testing for impairment on an annual basis necessitated an impairment loss in 2004 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).

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

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: The Company adopted the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternate methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation and to require prominent disclosures in both annual and interim financial statements about the methods of accounting for stock-based compensation and the effect of the method used on reported results. As permitted by SFAS No. 148 and 123, the Company continues to apply the accounting provisions of APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations, with regard to the measurement of compensation cost for options granted under the Company's existing plans. No stock-based compensation cost, other than as discussed below, is reflected in net (loss)/income as all options granted under the plans had an exercise price not less than the market value of the underlying common stock on the date of grant. Had expense been recognized using the fair value method described in SFAS No. 123, using the Black-Scholes option-pricing model, the Company would have reported the following results of operations (in thousands, except per share amounts):

	Year ended December 31,		
	2005	2004	2003
Net (loss)/income, as reported	$ (172)	$ (2,176)	$ 760
Add: Stock-based compensation included in reported net income, net of related tax effects	--	272	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(88)	(400)	(165)
Pro forma net (loss)/income	$ (260)	$ (2,304)	$ 595
Net (loss)/income per share:			
As reported	$ (.04)	$ (.50)	$ .18
Pro forma	$ (.06)	$ (.53)	$ .14

In connection with the pro-forma information above, the pro-forma effect takes into consideration only options granted since January 1, 1997 and is likely to increase in future years as additional options are granted and amortized ratably over the vesting period. The average fair value of stock

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

options granted during 2005, 2004 and 2003 was $ 2.03, $2.37, and $1.58, respectively. The fair value of stock options granted was estimated using the Black-Scholes option-pricing model and included the following assumptions for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
Life expectancy	5 years	5 years	5 years
Risk-free interest rate	4%	3%	3%
Expected volatility	61%	69%	59%
Dividends per share	$.08	$.08	$.08

In the third quarter of 2004, 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.

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, 2005 and 2004 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 manufactured goods 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 $1,139,000, $1,227,000 and $1,183,000, in 2005, 2004 and 2003, respectively, and were included in Selling, General and Administrative Expenses in the Consolidated Statements of Operations.

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING

POLICIES (Continued)

PROMOTIONAL AND SALES RETURNS ALLOWANCES: The Company partici- pates 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 $289,000, $417,000 and $345,000 for the years ended December 31, 2005, 2004 and 2003, 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, 2005 and 2004 were approximately $5,095,000 and $3,824,000, respectively. At December 31, 2005 and 2004, the Company excluded restricted cash in the amount of approximately $3,336,000 and $4,540,000, 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, 2005 and 2004 were approximately $2,622,000 and $3,166,000, respectively. Direct labor and overhead costs capitalized in inventories as of December 31, 2005 and 2004 were approximately $587,000 and $783,000, 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.

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

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, 2005, 2004 and 2003, the Company had 341,116, 291,822 and 547,570 outstanding stock options, respectively. At December 31, 2003, 27,134 options were included in the calculation of basic and diluted earnings per share. For the years ended

December 31, 2005 and 2004, none were used because their inclusion would be anti-dilutive, and as such, 4,389,805 and 4,348,908 shares, respectively, were used for the calculation of basic and diluted earnings per share.

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

In December 2004, the FASB issued a revised SFAS No. 123 impacting the accounting treatment for share-based payments. The revised statement requires companies to reflect in the income statement compensation expense related to the grant-date fair value of stock options and other equity-based compensation issued to employees over the period that such amounts are earned. The statement is effective for the Company's 2006 fiscal year.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4", effective for fiscal years beginning after June 15, 2005. SFAS No. 151 requires that the costs associated with certain abnormal expenditures be recognized in the current period. It also requires that the amount of fixed production overhead allocated to inventory be based upon normal capacity of production facilities. The effect this statement would have on the Company's consolidated financial statements is not expected to be material.

NOTE 2. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2005 and 2004 consisted of the following:

	2005	2004
Trade accounts receivable	$ 1,540,303	$ 1,845,098
Less: Allowance for doubtful accounts	(108,653)	(91,848)
Accounts receivable, net	$ 1,431,650	$ 1,753,250

NOTE 2. ACCOUNTS RECEIVABLE (Continued)

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

	2005	2004	2003
Balance, beginning of year	$ 91,848	$ 112,924	$ 163,281
Provision for doubtful accounts	27,571	55,865	80,899
Uncollectible accounts written off, net of recoveries	(10,766)	(76,941)	(131,256)
Balance, end of year	$ 108,653	$ 91,848	$ 112,924

NOTE 3. INVENTORIES

Inventories at December 31, 2005 and 2004 consisted of the following:

	2005	2004
Raw materials	$ 1,692,277	$ 1,827,553
Packaging and components	2,238,763	2,187,901
Work in progress	454,217	429,552
Finished goods	3,402,742	4,651,422
	7,787,999	9,096,428
Less: Amount included in other assets	(1,639,732)	(1,931,527)
Balance, end of year	$ 6,148,267	$ 7,164,901

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, 2005 and 2004 consisted of the following:

	2005	2004
Land	$ 379,627	$ 379,627
Buildings and improvements	2,251,894	2,159,046
Machinery and equipment	1,947,080	1,852,551
Furniture and office equipment	583,566	571,710
	5,162,167	4,962,934
Less: accumulated depreciation	(3,479,216)	(3,335,707)
Balance, end of year	$ 1,682,951	$ 1,627,227

NOTE 5. GOODWILL, TRADEMARKS AND OTHER INTANGIBLE ASSETS

Since implementing SFAS No. 142, the Company performs annual im- pairment tests. For the year ended December 31, 2004, it was determined that an additional impairment loss of approximately $2.15 million was necessary.

Approximately $1.85 million 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 $.3 million was related to the trademarks associated with the Stephan Distributing 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 and included in selling, general and administrative expenses in the statement of operations.

Other intangible assets can be summarized as follows:

	2005	2004
Deferred acquisition costs	$ 934,544	$ 934,544
Less: Accumulated amortization	(792,359)	(717,892)
Balance, end of year	$ 142,185	$ 216,652

Amortization expense of other intangible assets for 2005, 2004 and 2003 was $74,000, $82,000 and $93,000, respectively. Amortization expense of other intangible assets, recorded as of December 31, 2005, for the years ended December 31, 2006 through 2008 is anticipated to be as follows: 2006: $66,000; 2007: $66,000; 2008: $10,000.

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NOTE 6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2005 and 2004 consisted of the following:

	2005	2004
Accounts payable	$ 254,863	$ 384,831
Accrued marketing expenses	133,469	146,744
Accrued royalty and related interest payable (Note 10)	815,711	723,902
Accrued payroll, bonuses and related costs	410,149	324,783
Accrued "privatization" expenses	--	158,279
Accrued legal and professional fees	240,691	251,039
Other accrued expenses	147,845	176,173
Balance, end of year	$2,002,728	$2,165,751

Accrued "privatization" expenses shown above were due to Eastchester Enterprises, an entity created by the four Board members who attempted to take the Company private.

NOTE 7. LONG-TERM DEBT

Long-term debt at December 31, 2005 and 2004 consisted of the following:

	2005	2004
1.50% note payable to bank, principal of $92,500 plus interest due monthly through August 2, 2006; 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	$ 3,237,500	$ 4,347,500
	3,237,500	4,347,500
Less: current portion	(3,237,500)	(1,110,000)
Long-term debt	$ --	$ 3,237,500

In the first quarter of 2006, the Company and Wachovia Bank have agreed, in principle, to convert the balloon payment due in August 2006 to monthly principal payments under the same terms and conditions as the original obligation, through 2008.

Assuming the conversion of the outstanding obligation was in effect as of December 31, 2005, the approximate maturities of long-term debt would be $1,110,000 in 2006, $1,110,000 in 2007 and 1,017,500 in 2008.

NOTE 8. INCOME TAXES

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

	2005	2004	2003
Current tax:			
Federal	$ --	$(105,047)	$117,021
State	77,128	(107,767)	132,575
Total current provision/(benefit)	77,128	(212,814)	249,596
Deferred tax:			
Federal	(135,767)	220,766	433,266
State	(13,040)	134,299	44,012
Total deferred (benefit)/provision	(148,807)	355,065	477,278
Total (benefit)/provision for income taxes	$ (71,679)	$ 142,251	$726,874

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.

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

	2005	2004
Accounts receivable allowances	$ (40,886)	$ (36,280)
Inventory allowance	(126,894)	(141,063)
Property, plant and equipment	46,728	68,800
Amortization of intangibles	2,559,360	2,085,642
Charitable contribution carryforward	(652)	(122,546)
State income taxes	(101,467)	(91,679)
Net operating loss carryover	(954,285)	(391,736)
Accrued liabilities and other	(38,647)	(5,568)
	1,343,257	1,365,570
Less: Valuation allowance	--	122,546
Deferred income tax liability, net	$ 1,343,257	$ 1,488,116

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:

NOTE 8. INCOME TAXES (Continued)

	2005	2004	2003
Amount computed on pretax income	(34.0%)	(34.0%)	35.0%
Increase(decrease) in taxes:			
State income taxes, net of federal tax benefit	(3.5)	.8	7.8
Goodwill impairment	--	30.8	--
Goodwill/Trademarks	1.3	.2	.2
Benefit of graduated rates	--	--	(1.0)
Compensation limitations	--	8.1	--
Privatization transaction costs	--	2.7	6.7
Tax exempt interest	(2.4)	(1.0)	(1.6)
Other	9.3	(.6)	1.8
Total income tax	(29.3%)	7.0%	48.9%

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 $2,535,969 for Federal income tax purposes which expire beginning in 2025 if not utilized.

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)/INCOME BEFORE INCOME TAXES		
	2005	2004	2003	2005	2004	2003
Professional	$17,254	$17,538	$17,573	$ 1,012	$(1,801)	$ 1,449
Retail	4,178	5,734	7,373	(79)	486	873
Manufacturing	5,132	5,689	6,713	(989)	(292)	(112)
Total	26,564	28,961	31,659	(56)	(1,607)	2,210

NOTE 9. SEGMENT INFORMATION (Continued)

	NET SALES			(LOSS)/INCOME BEFORE INCOME TAXES		
	2005	2004	2003	2005	2004	2003
Intercompany Manufacturing	(4,302)	(5,010)	(6,323)	(188)	(427)	(723)
Consolidated	$22,262	$23,951	$25,336	$(244)	$(2,034)	$1,487

	INTEREST INCOME			INTEREST EXPENSE		
	2005	2004	2003	2005	2004	2003
Professional	$ 52	$ 104	$ 174	$ 127	$ 56	$ 90
Retail	66	53	47	18	33	304
Manufacturing	9	7	6	5	2	9
Total	$ 127	$ 164	$ 227	$ 150	$ 91	$ 403

	DEPRECIATION AND AMORTIZATION			TOTAL ASSETS	
	2005	2004	2003	2005	2004
Professional	$ 87	$ 78	$ 89	$11,774	$10,985
Retail	37	43	43	14,353	16,003
Manufacturing	94	98	249	6,651	7,731
Total	$ 218	$ 219	$ 381	$32,778	$34,719

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 entered into employment agreements with certain officers. These agreements, which expire on various dates through December 2008, provide for incentive bonuses based on consolidated earnings per share in excess of the applicable base year, as defined in the employment agreements. No bonuses were payable for the years ended December 31, 2005 and 2004. For the year ended December 31, 2003, management bonuses included in selling, general and administrative expenses were $755,000. In July 2005, the President of the

Company took a voluntary, unilateral reduction in compensation to $540,000 per year. In accordance with the terms of the waiver of compensation, the President retains the right to his original contractual compensation level upon 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 were determined that said change in control existed, the Company would be contingently liable for additional compensation of approximately $371,000 for the year ended December 31, 2005.

The Company was not a party to any non-cancelable operating leases at December 31, 2005. Annual rent expense for each of the last three years is as follows:

2005	$628,600
2004	692,800
2003	620,800

Included in rent expense above for the years ended December 31, 2005, 2004 and 2003 is $ 286,000, $273,000 and $213,000, 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 $302,780. 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 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 2006 through 2010 and approximately $1,360,000 thereafter.

In fiscal year 2005, the Company paid $191,384 to Payton & Carlson, P.A. and to Carlson & Associates, P.A., law firms of which Curtis Carlson is a partner, for legal services rendered by such firms to the Company. Further, commencing April 8, 2005, the Company began to pay Mr. Carlson $2,000. per month for his services as Vice-President and Secretary.

NOTE 10. COMMITMENTS AND CONTINGENCIES (Continued)

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, 2005, would likely, if adversely determined, have a material adverse effect on the Company's financial position, results of operations or cash flows.

In the fourth quarter of 2003, Sorbie Acquisition Co. ("SAC"), a wholly-owned subsidiary of the Company, and Trevor Sorbie International, Plc. ("TSI") commenced arbitration proceedings before the American Arbitration Association in Pittsburgh, Pennsylvania. This arbitration proceeding arose from a lawsuit filed against SAC by TSI alleging causes of action for breach of contract, declaratory judgment and trademark infringement. On October 25, 2004, the arbitration panel returned an award in favor of TSI with respect to certain royalties due, including interest, and in favor of SAC with respect to the infringement of SAC's rights to exclusive publicity in their territory. The panel did not affirm any of the other claims alleged by either of the parties to the proceeding. In Federal Court, SAC appealed the decision on certain grounds, including an improper computation of the interest due on additional royalties. In Pennsylvania State Court, SAC appealed the State Court's confirmation of the Arbitration award and was notified on March 29, 2006 that the appeal was denied.

The financial statements for the year ended December 31, 2005 reflect a liability of approximately $816,000 for payment of the award. Also, SAC may continue to incur additional interest. Due to the complexities of the issues involved, however, the Company is currently unable to predict the outcome of the appeal, including whether or not the appeal will be heard in Federal Court.

In 1997 the Company's wholly-owned subsidiary, Stephan Distributing, Inc., acquired several product lines from New Image Laboratories, Inc. ("New Image"). A portion of 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, among other things, a declaratory decree that the 125,000 shares of the Company's common stock held in escrow for the contingent payment of certain purchase price adjustments be released from escrow and turned over to New Image. 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

NOTE 10. COMMITMENTS AND CONTINGENCIES (Continued)

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. New Image's claim for diminution of the value of the shares held in escrow was heard before a special master in late October 2004 and on March 30, 2005, the special master recommended that judgment be entered in favor of the Company. The federal court then entered an order confirming the findings of the Special Master and entered judgment denying New Image's diminution claim. New Image has not appealed the judgment.

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.

Stock options are granted at the discretion of the Compensation Committee of the Board of Directors. The options become exercisable one year from the grant date and are exercisable within a maximum of 5-10 years from the date of grant. Stock option activity for 2005, 2004, and 2003 is set forth below:

NOTE 11. CAPITAL STOCK AND STOCK OPTIONS (Continued)

	Key Employee Incentive Plan	Avg. Price	Outside Directors Plan	Avg. Price
Outstanding at December 31, 2002	570,880	$7.68	101,240	$5.72
Granted	60,000	3.44	20,248	3.71
Canceled	(184,550)	9.38	(20,248)	13.21
Exercised	--		--	
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

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, 2005, 2004 and 2003 were 200,000 shares at $10.19, 160,830 shares at $11.59, and 396,330 shares at $6.79, respectively, for the 1990 Key Employee Stock Incentive Plan and 65,806 at $3.89, 60,744 at $3.73, and 80,992 at $3.85, respectively, for the Outside Directors Plan. At December 31, 2005 and 2004, 620,000 and 373,670 respectively, were available for future grants under the terms of the 1990 Key Employee Stock Incentive Plan and 111,384 shares and 81,012 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, 2005 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:

	Outstanding			Exercisable	
Exercise Price Range	Number of shares	Average Life	Average Price	Number of shares	Average Price
$ 3.00 - $ 5.00	191,116	3.18	$ 4.12	115,806	$ 4.08
$10.00 - $13.50	150,000	2.00	$12.15	150,000	$12.15
	341,116			265,806	

(ii) Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts

ADVERTISING, PROMOTION and RETURNS ALLOWANCES

	2005	2004	2003
Balance, beginning of year	$104,659	$152,906	$152,708
Additions	288,742	417,152	344,621
Utilizations	291,971	465,399	344,423
Balance, end of year	$101,430	$104,659	$152,906

DEFERRED TAX VALUATION ALLOWANCE

	2005	2004	2003
Balance, beginning of year	$122,546	$121,747	$268,359
Additions	--	799	1,579
Utilizations/Expirations	122,546	--	148,191
Balance, end of year	$ --	$122,546	$121,747

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
May 5, 2006

By: /s/ David A. Spiegel

David A. Spiegel
Principal Financial Officer

Principal Accounting Officer
May 5, 2006

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: May 5, 2006

By: /s/ Shouky Shaheen

Shouky Shaheen, Director
Date: May 5, 2006

By: /s/ Curtis Carlson

Curtis Carlson, Director
Date: May 5, 2006

By: /s/ Richard A. Barone

Richard A. Barone, Director
Date: May 5, 2006

By: /s/ William Gross

William Gross, Director
Date: May 5, 2006

By: /s/ David Pawl

David Pawl, Director
Date: May 5, 2006

By: /s/ Elliot Ross

Elliot Ross, Director
Date: May 5, 2006