

TANDY LEATHER FACTORY INC  
Form 10-Q  
May 14, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-12368

TANDY LEATHER FACTORY, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction of Incorporation or Organization)

75-2543540  
(I.R.S. Employer Identification No.)

1900 Southeast Loop 820, Fort Worth, Texas 76140  
(Address of Principal Executive Offices) (Zip Code)

(817) 872-3200  
(Registrant's Telephone Number, Including Area Code)

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 such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for a shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Edgar Filing: TANDY LEATHER FACTORY INC - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
[ ] No [X]

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

Class	Shares outstanding as of May 10, 2012
Common Stock, par value \$0.0024 per share	10,156,442

---

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2012

TABLE OF CONTENTS

	PAGE NO.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	1
<u>Consolidated Balance Sheets</u>	1
<u>Consolidated Statements of Income</u>	2
<u>Consolidated Statements of Comprehensive Income</u>	3
<u>Consolidated Statements of Cash Flows</u>	4
<u>Consolidated Statements of Stockholders' Equity</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	9
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	12
Item 4. <u>Controls and Procedures</u>	12
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	13
Item 6. <u>Exhibits</u>	13
SIGNATURES	13

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

Tandy Leather Factory, Inc.  
Consolidated Balance Sheets

	March 31, 2012 (unaudited)	December 31, 2011 (audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$6,431,259	\$10,765,591
Short-term available-for-sale investments, including certificates of deposit	87,893	423,893
Accounts receivable-trade, net of allowance for doubtful accounts of \$114,000 and \$81,000 in 2012 and 2011, respectively	1,449,157	1,328,579
Inventory	24,092,025	19,940,251
Deferred income taxes	314,574	281,251
Other current assets	1,402,828	948,459
Total current assets	33,777,736	33,688,024
PROPERTY AND EQUIPMENT, at cost	15,123,033	14,999,826
Less accumulated depreciation and amortization	(4,925,845)	(4,700,476)
	10,197,188	10,299,350
GOODWILL	989,945	987,009
OTHER INTANGIBLES, net of accumulated amortization of \$551,000 and \$539,000 in 2012 and 2011, respectively	176,127	187,292
OTHER assets	334,620	341,240
	\$45,475,616	\$45,502,915
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable-trade	\$2,347,811	\$1,622,697
Accrued expenses and other liabilities	4,669,916	4,641,191
Income taxes payable	796,666	638,897
Current maturities of long-term debt	202,500	202,500
Total current liabilities	8,016,893	7,105,285
DEFERRED INCOME TAXES	835,953	858,829
LONG-TERM DEBT, net of current maturities	3,054,375	3,105,000
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.10 par value; 20,000,000 shares authorized;		

Edgar Filing: TANDY LEATHER FACTORY INC - Form 10-Q

none issued or outstanding; attributes to be determined on issuance	-	-
Common stock, \$0.0024 par value; 25,000,000 shares authorized; 11,150,065 shares issued at 2012 and 2011; 10,156,442 shares outstanding at 2012 and 2011	26,760	26,760
Paid-in capital	5,741,543	5,736,543
Retained earnings	30,219,910	31,181,936
Treasury stock at cost (993,623 shares at 2012 and 2011)	(2,894,068)	(2,894,068)
Accumulated other comprehensive income	474,250	382,630
Total stockholders' equity	33,568,395	34,433,801
	\$45,475,616	\$45,502,915

The accompanying notes are an integral part of these financial statements.

TABLE OF CONTENTS

Tandy Leather Factory, Inc.  
 Consolidated Statements of Income  
 (Unaudited)  
 For the Three Months Ended March 31, 2012 and 2011

	2012	2011
NET SALES	\$18,177,078	\$15,879,040
COST OF SALES	6,811,445	6,354,192
Gross profit	11,365,633	9,524,848
OPERATING EXPENSES	8,811,458	7,612,360
INCOME FROM OPERATIONS	2,554,175	1,912,488
OTHER (INCOME) EXPENSE:		
Interest expense	58,392	62,003
Other, net	(19,814)	48,832
Total other (income) expense	38,578	110,835
INCOME BEFORE INCOME TAXES	2,515,597	1,801,653
PROVISION FOR INCOME TAXES	941,492	651,077
NET INCOME	\$1,574,105	\$1,150,576
NET INCOME PER COMMON SHARE:		
BASIC	\$0.15	\$0.11
DILUTED	\$0.15	\$0.11
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
BASIC	10,156,442	10,156,442
DILUTED	10,172,950	10,169,701

The accompanying notes are an integral part of these financial statements.

2

---

TABLE OF CONTENTS

Tandy Leather Factory, Inc.  
Consolidated Statements of Comprehensive Income  
(Unaudited)  
For the Three Months Ended March 31, 2012 and 2011

	2012	2011
NET INCOME	\$1,574,105	\$1,150,576
Foreign currency translation adjustments	91,620	110,826
COMPREHENSIVE INCOME	\$1,665,725	\$1,261,402

The accompanying notes are an integral part of these financial statements.



TABLE OF CONTENTS

Tandy Leather Factory, Inc.  
Consolidated Statements of Cash Flows  
(Unaudited)  
For the Three Months Ended March 31, 2012 and 2011

	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$1,574,105	\$1,150,576
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	259,536	245,004
(Gain) loss on disposal or abandonment of assets	624	(2,925)
Non-cash stock-based compensation	5,000	18,900
Deferred income taxes	(56,199)	165,664
Other	80,297	102,119
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(120,578)	(180,478)
Inventory	(4,151,774)	26,173
Income taxes	157,769	1,499
Other current assets	(454,369)	(613,680)
Accounts payable-trade	725,114	776,976
Accrued expenses and other liabilities	28,725	(2,185,751)
Total adjustments	(3,525,855)	(1,646,499)
Net cash used in operating activities	(1,951,750)	(495,923)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(139,841)	(169,186)
Proceeds from maturities of certificates of deposit	336,000	5,000
Proceeds from sale of assets	1,395	21,513
Decrease (increase) in other assets	6,620	664
Net cash provided by (used in) investing activities	204,174	(142,009)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on notes payable and long-term debt	(50,625)	(50,625)
Payment of cash dividend	(2,536,131)	-
Net cash used in financing activities	(2,586,756)	(50,625)
<b>NET DECREASE IN CASH</b>	<b>(4,334,332)</b>	<b>(688,557)</b>
CASH, beginning of period	10,765,591	4,293,746
CASH, end of period	\$6,431,259	\$3,605,189
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Interest paid during the period	\$58,392	\$62,003
Income tax paid during the period, net of (refunds)	860,843	411,721

The accompanying notes are an integral part of these financial statements.

4

---

TABLE OF CONTENTS

Tandy Leather Factory, Inc.  
 Consolidated Statements of Stockholders' Equity  
 (Unaudited)  
 For the Three Months Ended March 31, 2012 and 2011

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2010	10,156,442	\$26,760	\$5,703,387	\$(2,894,068)	\$26,429,335	\$496,180	\$29,761,594
Stock-based compensation	-	-	18,900	-	-	-	18,900
Net income	-	-	-	-	1,150,576	-	1,150,576
Translation adjustment	-	-	-	-	-	110,826	110,826
BALANCE, March 31, 2011	10,156,442	\$26,760	\$5,722,287	\$(2,894,068)	\$27,579,911	\$607,006	\$31,041,896

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2011	10,156,442	\$26,760	\$5,736,543	\$(2,894,068)	\$31,181,936	\$382,630	\$34,433,801
Stock-based compensation	-	-	5,000	-	-	-	5,000
Net income	-	-	-	-	1,574,105	-	1,574,105
Cash dividend	-	-	-	-	(2,536,131)	-	(2,536,131)
Translation adjustment	-	-	-	-	-	91,620	91,620
BALANCE, March 31, 2012	10,156,442	\$26,760	\$5,741,543	\$(2,894,068)	\$30,219,910	\$474,250	\$33,568,395

The accompanying notes are an integral part of these financial statements.



TABLE OF CONTENTS

TANDY LEATHER FACTORY, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

In the opinion of management, the accompanying consolidated financial statements for Tandy Leather Factory, Inc. and its consolidated subsidiaries contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly its financial position as of March 31, 2012 and December 31, 2011, and its results of operations and cash flows for the three-month periods ended March 31, 2012 and 2011. Operating results for the three-month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2011.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Inventory.** Inventory is stated at the lower of cost or market and is accounted for on the “first in, first out” method. Based on negotiations with vendors, title generally passes to us when merchandise is put on board. Merchandise to which we have title but which have not yet received is recorded as inventory in transit. In addition, the value of inventory is periodically reduced for slow-moving or obsolete inventory based on management’s review of items on hand compared to their estimated future demand.

The components of inventory consist of the following:

	As of	
	March 31, 2012	December 31, 2011
<b>Inventory on hand:</b>		
Finished goods held for sale	\$20,084,753	\$17,742,298
Raw materials and work in process	864,432	479,686
Inventory in transit	3,142,840	1,718,267
	<b>\$24,092,025</b>	<b>\$19,940,251</b>

**Goodwill and Other Intangibles.** Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is required to be evaluated for impairment on an annual basis, absent indicators of impairment during the interim. Application of the goodwill impairment test requires exercise of judgment, including the estimation of future cash flows, determination of appropriate discount rates and other important assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

A two-step process is used to test for goodwill impairment. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2011, management determined that the present value of the discounted estimated future cash flows of the stores associated with the goodwill is sufficient to support their

Edgar Filing: TANDY LEATHER FACTORY INC - Form 10-Q

respective goodwill balances. No indicators of impairment were identified during the first quarter of 2012.

A summary of changes in our goodwill for the periods ended March 31, 2012 and 2011 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2010	\$606,962	\$383,406	\$990,368
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	3,641	-	3,641
Impairments	-	-	-
Balance, March 31, 2011	\$610,603	\$383,406	\$994,009
Balance, December 31, 2011	\$603,603	\$383,406	\$987,009
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	2,936	-	2,936
Impairments	-	-	-
Balance, March 31, 2012	\$606,539	\$383,406	\$989,945

Other intangibles consist of the following:

	As of March 31, 2012			As of December 31, 2011		
	Accumulated			Accumulated		
	Gross	Amortization	Net	Gross	Amortization	Net
Trademarks,	\$544,369	\$433,498	\$110,871	\$544,369	\$425,418	\$118,951
Copyrights						
Non-Compete	183,037	117,781	65,256	182,365	114,024	68,341
Agreements						
	\$727,406	\$551,279	\$176,127	\$726,734	\$539,442	\$187,292

We recorded amortization expense of \$11,327 during the first quarter of 2012 compared to \$11,079 during the first quarter of 2011. All of our intangible assets, other than goodwill, are subject to amortization under U.S. GAAP. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding 5 years is as follows:

	Wholesale Leathercraft	Retail Leathercraft	Total
2012	\$1,477	\$37,634	\$39,111
2013	-	33,337	33,337
2014	-	33,337	33,337
2015	-	28,636	28,636
2016	-	2,000	2,000

Revenue Recognition. Our sales generally occur via two methods: (1) at the counter in our stores, and (2) shipment by common carrier. Sales at the counter are recorded and title passes as transactions occur. Otherwise, sales are recorded and title passes when the merchandise is shipped to the customer. Our shipping terms are FOB shipping point.

We offer an unconditional satisfaction guarantee to our customers and accept all product returns. Net sales represent gross sales less negotiated price allowances, product returns, and allowances for defective merchandise.



TABLE OF CONTENTS

Comprehensive Income (loss) and Accumulated Other Comprehensive Income (loss). Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-stockholder sources and includes all changes in equity during a period except those resulting from investments by and dividends to stockholders. Our comprehensive income (loss) consists of our net income and foreign currency translation adjustments from our international operations.

Recent Accounting Pronouncements. In June 2011, FASB issued ASU 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income” (ASU 2011-05). This standard update requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of stockholders’ equity. ASU 2011-05 is effective for the interim and annual periods beginning after December 15, 2011. The adoption of the standard did not have a material impact on our consolidated financial statements.

In September 2011, FASB issued ASU 2011-08, “Intangibles-Goodwill and Other (Topic 350) – Testing Goodwill for Impairment”. ASU 2011-08 provides companies with a new option to determine whether or not it is necessary to apply the traditional two-step quantitative goodwill impairment test in ASC 350, Intangibles – Goodwill and Other. Under ASU 2011-08 companies are no longer required to calculate the fair value of a reporting unit unless it determines, on the basis of qualitative information, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. ASU 2011-08 is effective for periods ending after December 15, 2011. The adoption of the standard did not have a material impact on our consolidated financial statements.

## 2. SHORT-TERM INVESTMENTS

All current fixed maturity securities are classified as “available for sale” and are reported at carrying value, which approximates fair value based on the discounted value of contractual cash flows. We have determined that our investment securities are available to support current operations and, accordingly, have classified such securities as current assets without regard to contractual maturities. Investments at March 31, 2012 and December 31, 2011 consisted of certificates of deposit. The contractual maturities of \$87,893 in certificates of deposit held as of March 31, 2012 are all due within one year.

## 3. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, 2007, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to \$5,500,000 to facilitate our purchase of real estate consisting of a 191,000 square foot building situated on 30 acres of land located at 1900 SE Loop 820 in Fort Worth, Texas. Proceeds in the amount of \$4,050,000 were used to fund the purchase of the property. On April 30, 2008, the principal balance was rolled into a 10-year term note with an interest rate of 7.10% per annum.

At March 31, 2012 and December 31, 2011, the amount outstanding under the above agreement consisted of the following:

	March 31, 2012	December 31, 2011
Credit Agreement with JPMorgan Chase Bank – collateralized by real estate; payable as follows:		
Line of Credit Note dated July 31, 2007, converted to a 10-year term note on April 30, 2008; \$16,875 monthly principal payments plus interest at 7.1% per annum;	\$ 3,256,875	\$3,307,500



matures April 30, 2018

	3,256,875	3,307,500
Less - Current maturities	(202,500)	(202,500)
	\$3,054,375	\$3,105,000

#### 4. STOCK-BASED COMPENSATION

We have one stock option plan which provides for annual stock option grants to non-employee directors with an exercise price equal to the fair market value of the shares at the date of grant. Under this plan, 12,000 options were awarded to directors for each of the three month periods ended March 31, 2012 and 2011. These options vest and become exercisable six months from the option grant date. We had two other stock option plans from 1995 which provided for stock option grants to officers, key employees and non-employee directors. These plans expired in 2005. The expiration of the plans has no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our common stock on the date the option was granted and no option has a term in excess of ten years. We recognized share based compensation expense of approximately \$5,000 and \$18,900 for the quarters ended March 31, 2012 and 2011, respectively, as a component of operating expenses. During the three months ended March 31, 2012 and 2011, the stock option activity under our stock option plans was as follows:

	Weighted Average Exercise Price	# of shares	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, January 1, 2011	\$4.35	103,600		
Granted	-	-		
Cancelled	-	-		
Exercised	-	-		
Outstanding, March 31, 2011	\$4.35	103,600	5.44	\$192,075
Exercisable, March 31, 2011	\$4.35	103,000	5.44	\$192,075
Outstanding, January 1, 2012	\$4.40	115,600		
Granted	5.27	12,000		
Cancelled	-	-		
Exercised	-	-		
Outstanding, March 31, 2012	\$4.48	127,600	5.38	\$216,332
Exercisable, March 31, 2012	\$4.40	115,600	4.90	\$206,332

Other information pertaining to option activity during the three-month periods ended March 31, 2012 and 2011 are as follows:

	March 31, 2012	March 31, 2011
Weighted average grant-date fair value of stock options granted	\$10,000	\$14,257
Total fair value of stock options vested	N/A	\$18,900

Total intrinsic value of stock options exercised	N/A	N/A
--	-----	-----

As of March 31, 2012 and 2011, there was unrecognized compensation cost related to non-vested stock options of \$5,000 and \$0, respectively.

7

---

TABLE OF CONTENTS

## 5. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (“EPS”) for the three months ended March 31, 2012 and 2011:

	2012	2011
Net income	\$1,574,105	\$1,150,576
Numerator for basic and diluted earnings per share	\$1,574,105	\$1,150,576
Denominator for basic earnings per share – weighted-average shares	10,156,442	10,156,442
Effect of dilutive securities:		
Stock options	16,508	13,259
Warrants	-	-
Dilutive potential common shares	16,508	13,259
Denominator for diluted earnings per share – weighted-average shares	10,172,950	10,169,701
Basic earnings per share	\$0.15	\$0.11
Diluted earnings per share	\$0.15	\$0.11

The net effect of converting stock options and warrants to purchase 106,600 and 90,600 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the quarters ended March 31, 2012 and 2011, respectively.

## 6. CASH DIVIDEND

In February 2012, our Board of Directors authorized a \$0.25 per share special one-time cash dividend that was paid to stockholders of record at the close of business on March 1, 2012. We released the funds used to pay for the special one-time cash dividend on March 29, 2012 and the dividend, totaling \$2.5 million, was paid to stockholders on April 2, 2012. Our Board will determine future cash dividends after giving consideration to our then existing levels of profit and cash flow, capital requirements, current and forecasted liquidity, as well as financial and other business conditions existing at the time.

## 7. COMMITMENTS AND CONTINGENCIES

**Legal Proceedings.** On March 16, 2011, two former employees of ours filed a lawsuit, entitled Mark Barnes and Jerry Mercante on behalf of themselves and all other similarly situated v. Tandy Leather Company, Inc., Tandy Leather Factory, and Does 1-50, in the US District Court for the District of Nevada. The lawsuit was subsequently amended on May 9, 2011 to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleges that we violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs seek to represent themselves and all similarly situated U.S. current and former store managers of ours. Plaintiffs seek reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, attorneys’ fees and costs. On May 17, 2011, the district court in Nevada granted our request to transfer venue to the Northern District of Texas. Trial is currently set for the week of May 29, 2012.

A Proposed Settlement Agreement was signed by the parties in January 2012 and submitted to the US District Court for the Northern District of Texas (Fort Worth Division) on January 24, 2012. The Proposed Settlement Agreement is

contingent on the Court's approval of its terms of the proposed Agreement as well as the Court's consent to certify the proposed class and collective action class described by the parties. The Court has not yet ruled on the Proposed Settlement Agreement or the proposed class descriptions, and could either approve, reject, or suggest modifications to the Proposed Settlement Agreement. In the event the Proposed Settlement Agreement is not approved in its entirety by the Court, either party has the right to withdraw from the Proposed Settlement Agreement, in which event the litigation between the parties would proceed.

In the event the Proposed Settlement Agreement and proposed class descriptions are approved by the Court, any payments pursuant to the Proposed Settlement Agreement are conditioned on the members of the proposed class submitting a claims form approved by the Court. The total amount of payments under the Proposed Settlement Agreement to the members of the proposed class who have submitted Claims forms is conditioned further on the number of claims submitted.

At this time, it is not possible to predict whether we will incur any liability, or to estimate the ranges of damages, if any, which may be incurred in connection with the matter. We intend to vigorously defend the lawsuit.

We are periodically involved in other various litigation that arises in the ordinary course of business and operations. There are no such matters pending that we expect to have a material impact on our financial position and operating results. Legal costs associated with the resolution of claims, lawsuits and other contingencies are expensed as incurred.

TABLE OF CONTENTS

## 8. SEGMENT INFORMATION

We identify our segments based on the activities of three distinct operations:

- a. Wholesale Leathercraft, which consists of a chain of wholesale stores operating under the name, The Leather Factory, located in North America;
- b. Retail Leathercraft, which consists of a chain of retail stores operating under the name, Tandy Leather Company, located in the North America; and
- c. International Leathercraft, which sells to both wholesale and retail customers. We have three stores operating in this segment: one in Northampton, United Kingdom which opened in February 2008, one in Sydney, Australia which opened in October 2011, and one in Jerez, Spain, which opened in January 2012. These stores carry the same products as our North American stores.

Our reportable operating segments have been determined as separately identifiable business units, and we measure segment earnings as operating earnings, defined as income before interest and income taxes.

	Wholesale Leathercraft	Retail Leathercraft	Int'l Leathercraft	Total
For the quarter ended March 31, 2012				
Net sales	\$7,152,417	\$10,282,814	\$741,847	\$18,177,078
Gross profit	4,529,683	6,372,144	463,806	11,365,633
Operating earnings	1,232,852	1,358,725	(37,402)	2,554,175
Interest expense	58,392	-	-	58,392
Other, net	(16,048)	(13)	(3,753)	(19,814)
Income before income taxes	1,190,508	1,358,738	(33,649)	2,515,597
Depreciation and amortization	203,690	43,451	12,395	259,536
Fixed asset additions	31,626	54,754	53,461	139,841
Total assets	\$34,422,385	\$8,509,506	\$2,543,725	\$45,475,616
For the quarter ended March 31, 2011				
Net sales	\$6,720,709	\$8,649,152	\$509,179	\$15,879,040
Gross profit	3,941,571	5,268,048	315,229	9,524,848
Operating earnings	808,314	1,004,042	100,132	1,912,488
Interest expense	62,003	-	-	62,003
Other, net	64,606	1,741	(17,515)	48,832
Income before income taxes	681,705	1,002,301	117,647	1,801,653
Depreciation and amortization	208,188	34,325	2,491	245,004
Fixed asset additions	107,414	60,272	1,500	169,186
Total assets	\$32,970,795	\$6,475,780	\$1,131,676	\$40,578,251

Net sales for geographic areas were as follows for the three months ended March 31, 2012 and 2011:

	2012	2011
United States	\$15,527,455	\$13,518,932
Canada	1,719,840	1,585,524

All other countries	929,783	774,584
	\$18,177,078	\$15,879,040

Geographic sales information is based on the location of the customer. No single foreign country, except for Canada, accounted for any material amount of our consolidated net sales for the three-month periods ended March 31, 2012 and 2011. We do not have any significant long-lived assets outside of the United States.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Our Business

We are the world's largest specialty retailer and wholesale distributor of leather and leathercraft related items. We market our products to our growing list of customers through company-owned retail and wholesale stores. We are a Delaware corporation, and our common stock trades on the NASDAQ Global Market under the symbol "TLF." We operate our business in three segments: Wholesale Leathercraft, which operates wholesale stores in North America under the trade name, The Leather Factory, Retail Leathercraft, which operates retail stores in North America under the trade name, Tandy Leather Company, and International Leathercraft, which operates combination retail/wholesale stores outside of North America under the trade name, Tandy Leather Factory. See Note 8 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

Our Wholesale Leathercraft segment operates 29 company-owned wholesale stores in 19 states and three Canadian provinces. These stores are engaged in the wholesale distribution of leather and related items, including leatherworking tools, buckles and belt adornments, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits, to retailers, manufacturers, and end users. Our Wholesale Leathercraft segment also includes our National Account sales group, whose only customers are national craft chains.

## TABLE OF CONTENTS

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 36 states and six Canadian provinces. Tandy Leather Company, the oldest and one of the best-known suppliers of leather and related supplies used in the leathercraft industry, has been a primary leathercraft resource for decades. Tandy Leather Company's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather Company's industry presence by opening retail stores. As of May 1, 2012, we were operating 77 Tandy Leather Company retail stores located throughout the United States and Canada.

Our International Leathercraft segment operates 3 company-owned stores, all located outside of North America. These stores operate as combination retail / wholesale stores and consist of one store in Northampton, United Kingdom, one store in Sydney, Australia, and one store in Jerez, Spain. We expect to open another one to two international stores during 2012, although specific locations or opening dates have not yet been determined.

### Critical Accounting Policies

A description of our critical accounting policies appears in Item 7 "Management's Discussions and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

### Forward-Looking Statements

Certain statements contained in this report and other materials we file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made or to be made by us, other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally are accompanied by words such as "may," "will," "could," "should," "anticipate," "believe," "budgeted," "intend," "plan," "project," "potential," "estimate," "continue," or "future" variations thereof or other similar statements. There are certain important risks that could cause results to differ materially from those anticipated by some of the forward-looking statements. Some, but not all, of the important risks, including those described below, could cause actual results to differ materially from those suggested by the forward-looking statements. Please refer also to our Annual Report on Form 10-K for fiscal year ended December 31, 2011 for additional information concerning these and other uncertainties that could negatively impact the Company.

Ø Our business may be negatively impacted by general economic conditions and the current global financial crisis.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also small businesses and other retailers. The United States and global economies have suffered from a prolonged recession for the past several years and as a result, consumer spending has remained depressed, and may be subject to further deterioration for the foreseeable future. Specialty retail, and retail in general, are heavily influenced by general economic cycles. Purchases of non-essential products tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. During periods of economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, open and operate new stores, maintain sales levels at our existing stores, maintain or increase our international operations on a profitable basis, or maintain our earnings from operations as a percentage of net sales. As a result, our operating results may be adversely and materially affected by continued downward trends or uncertainty in the United States or global economies.

Ø Our profitability may decline as a result of increasing pressure on margins.

Our industry is subject to significant pricing pressure caused by many factors, including fluctuations in the cost of the leather and metal products that we purchase and changes in consumer spending patterns and acceptance of our products. These factors may prohibit us from passing cost increases on to customers which could cause our gross margin to decline. If our product costs increase and our sale prices do not, our future operating results could be adversely affected unless we are able to offset such gross margin declines with comparable reductions in operating costs.

Ø We may be unsuccessful in implementing our planned international expansion, which could impair the value of our brand, harm our business and negatively affect our results of operation.

We plan to grow our net sales and net earnings from our International segment by opening store in various international markets. As we expand outside of North America, we may incur significant costs relating to starting up, maintaining and expanding foreign operations. Costs may include, but are not limited to, obtaining locations for stores, hiring personnel, and travel expenses. We may be unable to open and operate new stores successfully and our growth may be limited, unless we are able to identify desirable sites for store locations, negotiate acceptable lease terms, hire, train and retain competent store personnel; manage inventory effectively to meet the needs and demands of customers on a timely basis, manage foreign currency risk effectively, and achieve acceptable operating margins from the new stores. We cannot be sure that we can successfully open new stores or that our new stores will be profitable.

As we continue to increase our international operations, we face the possibility of greater losses from a number of risks inherent in doing business in international markets and from a number of factors which are beyond our control, such as political instability or acts of terrorism, which disrupt trade with the countries in which our suppliers or customers are located; local business practices that do not conform to legal or ethical guidelines; restrictions or regulations relating to imports or exports; additional or increased customs duties, tariffs, taxes and other charges on imports; significant fluctuations in the value of the dollar against foreign currencies; social, legal or economic instability in the foreign markets in which we do business, which could influence our ability to sell our products in these markets; and restrictions on the transfer of funds between the United States and foreign jurisdictions.

We assume no obligation to update or otherwise revise our forward-looking statements even if experience or future changes make it clear that any projected results, express or implied, will not be realized.

#### Results of Operations

The following tables present selected financial data of each of our three segments for the quarters ended March 31, 2012 and 2011.

	Quarter Ended March 31, 2012		Quarter Ended March 31, 2011	
	Sales	Operating Income	Sales	Operating Income
Wholesale Leathercraft	\$7,152,417	\$1,232,852	\$6,720,709	\$808,314
Retail Leathercraft	10,282,814	1,358,725	8,649,152	1,004,042
Int'l Leathercraft	741,847	(37,402)	509,179	100,132
Total Operations	\$18,177,078	\$2,554,175	\$15,879,040	\$1,912,488

Consolidated net sales for the quarter ended March 31, 2012 increased \$2.3 million, or 14.5%, compared to the same period in 2011. All three segments achieved sales gains, ranging from 6% to 46%. Operating income on a consolidated basis for the quarter ended March 31, 2012 was up 33.6%, or \$642,000, from the first quarter of 2011.

The following table shows in comparative form our consolidated net income for the first quarters of 2012 and 2011:



	2012	2011	% change
Net income	\$1,574,105	\$1,150,576	36.8%

All segments except International Leathercraft contributed to our increased consolidated net income. The net loss in the International Leathercraft segment was caused by the lack of profitability at the Australia and Spain stores opened within the last six months. Additional information appears below for each segment.

**TABLE OF CONTENTS**

## Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 29 wholesale stores and our National Account sales group. The National Account sales group's customers consist of national craft chains only. The following table presents the combined sales mix by customer categories for the quarters ended March 31, 2012 and 2011:

Customer Group	Quarter ended	
	03/31/12	03/31/11
RETAIL (end users, consumers, individuals)	30%	31%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%	5%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	45%	42%
MANUFACTURERS	7%	8%
NATIONAL ACCOUNTS	14%	14%
	100%	100%

Net sales increased 6.4%, or \$432,000, for the first quarter of 2012 compared to the first quarter of 2011 as follows:

	# Stores	Qtr Ended 03/31/12	# Stores	Qtr Ended 03/31/11	\$ Change	% Change
Same store sales	29	\$6,340,785	29	\$5,933,280	\$407,505	6.9%
National account group	n/a	811,632	n/a	787,429	24,203	3.1%
Total sales	29	\$7,152,417	29	\$6,720,709	\$431,708	6.4%

Sales to our retail and wholesale customers were up in the first quarter of 2012 compared to the first quarter of 2011, while sales to our institution and manufacturer account group customers were down slightly. Operating income for Wholesale Leathercraft during the current quarter increased by \$425,000 from the comparative 2011 quarter, an improvement of 53%.

The increase in gross profit of \$588,000 was the primary contributor to the improvement in operating income. Gross profit as a percentage of sales increased from 58.7% in the first quarter of 2011 to 63.3% in the first quarter of 2012, due primarily to the increased retail sales. Operating expenses remained consistent as a percentage of sales, increasing \$160,000 compared to last year's comparable period, despite an increase in employee compensation and benefits of \$284,000. This was offset somewhat by decreases in utilities (\$23,000), outside services (\$27,000) and bank fees (\$25,000).

## Retail Leathercraft

Our Retail Leathercraft operation consists of 77 Tandy Leather Company retail stores at March 31, 2012, versus 76 stores as of March 31, 2011. Net sales increased 18.9% for the first quarter of 2012 over the same quarter last year. A store is categorized as "new" until it is operating for the full comparable period in the prior year.

	# Stores	Qtr Ended 03/31/12	# Stores	Qtr Ended 03/31/11	\$ Change	% Change
Same store sales	76	\$10,177,523	76	\$8,649,152	\$1,528,371	17.7%
New store sales	1	105,291	-	-	105,291	N/A
Total sales	77	\$10,282,814	76	\$8,649,152	\$1,633,662	18.9%

Edgar Filing: TANDY LEATHER FACTORY INC - Form 10-Q

The following table presents sales mix by customer categories for the quarters ended March 31, 2012 and 2011 for our Retail Leathercraft operation:

Customer Group	Quarter ended	
	03/31/12	03/31/11
RETAIL (end users, consumers, individuals)	62%	64%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%	5%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	31%	30%
NATIONAL ACCOUNTS	-	-
MANUFACTURERS	3%	1%
	100%	100%

Sales to retail, wholesale and manufacturer customer groups increased over the first quarter of 2011, while sales to institution customer groups declined over the same period.

Operating income increased \$355,000, or 35%, from the comparative 2011 quarter due to an increase in gross profit partially offset by an increase in operating expenses. Our gross profit increased by \$1.1 million from the prior period primarily due to higher sales. Operating expenses as a percentage of sales remained virtually unchanged at 49% from the first quarter of 2011. The increase in operating expenses of \$749,000 compared to the first quarter of 2011 was caused by increases in employee compensation and benefits (\$452,000), rent expense (\$40,000), supplies (\$10,000), freight out (\$14,000) and advertising and marketing expenses (\$121,000).

#### International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of March 31, 2012, the segment contained three stores located in United Kingdom, Australia, and Spain. As of March 31, 2011, the segment consisted of the one store located in the United Kingdom. This segment's sales totaled \$742,000 for the first quarter of 2012, compared to \$509,000 in the first quarter of 2011, an improvement of 46%. Same store sales were \$530,000 as of March 31, 2012 and \$509,000 as of March 31, 2011, a 4% increase. Operating expenses totaled \$501,000 in the first quarter of 2012, up from \$215,000 in the first quarter of 2011. The operating expenses associated with the two new stores in Australia and Spain account for the increase in operating expenses. Employee compensation is this segment's largest expense, followed by advertising and marketing expenses, rent, travel, and shipping costs to customers.

#### Other Expenses

We paid \$58,000 in interest on our bank debt in the first quarter of 2012, compared to \$62,000 in the first quarter of 2011. Due to the reduction in short-term investments compared to last year, we recorded \$5,000 in interest income on our cash balances during the quarter compared to \$8,000 a year ago. We recorded income of \$4,000 for currency fluctuations in the first quarter of 2012. Comparatively, in the first quarter of 2011, we recorded an expense of \$72,000 for currency fluctuations.

TABLE OF CONTENTS

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets remained steady at \$45.5 million at year-end 2011 and March 31, 2012. Total stockholders' equity decreased from \$34.4 million at December 31, 2011 to \$33.6 million at March 31, 2012, the decrease being attributable to the cash dividend of \$2.5 million being released in the first quarter of this year for payment to stockholders as of April 2, 2012. Our current ratio decreased from 4.7 at December 31, 2011 to 4.2 at March 31, 2012 due primarily to an increase in accounts payable during the first quarter of 2012.

As of March 31, 2012, our investment in inventory increased by \$4.1 million from year-end 2011. We have increased the amount of inventory carried in our stores to provide our customers with greater product selection and to promote continued sales growth. We are also stocking additional inventory to support our growing International Leathercraft segment. Further, product was purchased in March in anticipation of our second annual national "Open House" event held in April 2012. Finally, while sales remain strong, we will continue to buy large quantities of our stock leathers at special prices as those opportunities present themselves in order to minimize pressure on our gross margins. Inventory turnover reached an annualized rate of 3.30 times during the first quarter of 2012, slightly more than 3.14 times for the first quarter of 2011. Inventory turnover was 3.29 times for all of 2011. We compute our inventory turns as sales divided by average inventory.

Trade accounts receivable was \$1.4 million at March 31, 2012, up \$121,000 from \$1.3 million at year-end 2011. The average days to collect accounts remain unchanged at 48 days for the first quarter of 2012 and the first quarter of 2011. We are constantly monitoring our customer accounts very closely in order to minimize the risk of uncollectible accounts in the current economic environment.

Accounts payable increased to \$2.3 million at March 31, 2012 compared to \$1.6 million at year-end 2011, primarily due to the increase in inventory purchases during the first quarter in response to our sales increase. Accrued expenses increased slightly to \$4.7 million at March 31, 2012 compared to \$4.6 million at year-end 2011.

During the first quarter of 2012, cash flow used by operating activities was \$2.0 million. The increase in inventory of \$4.2 million offset by net income of \$1.6 million and the increase in accounts payable of \$725,000, accounted for the majority of the operating cash used in the first quarter.

By comparison, during the first quarter of 2011, cash flow used by operating activities was \$496,000. The reduction in accrued liabilities of \$2.2 million and increase in other current assets of \$614,000, offset by net income of \$1.2 million, accounted for the majority of the operating cash used in the first quarter.

Cash flow provided by investing activities totaled \$204,000 in the first quarter of 2012, consisting primarily of certificate of deposit maturities of \$336,000 being offset somewhat by purchases of store fixtures and computer equipment of \$140,000. In the first quarter of 2011, cash used in investing activities totaled \$142,000 which was primarily purchases of store fixtures and computer equipment.

Cash flow used by financing activities totaled \$2.6 million in the first quarter of 2012, consisting of a special one-time cash dividend of \$2.5 million and debt repayments of \$51,000. In the first quarter of 2011, cash flow used by financial activities consisted entirely of debt repayments of \$51,000.

We expect to fund our operating and liquidity needs as well as our store growth from a combination of current cash balances and internally generated funds.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For disclosures about market risk affecting us, see Item 7A “Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for fiscal year ended December 31, 2011. We believe that our exposure to market risks has not changed significantly since December 31, 2011. We expect that our exposure to foreign currency exchange risk will increase as our international presence increases.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our management team, under the supervision and with the participation of our principal executive officer and our principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the last day of the fiscal period covered by this report, March 31, 2012. The term disclosure controls and procedures means our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to management, including our principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of March 31, 2012, our disclosure controls and procedures were effective at a reasonable assurance level.

TABLE OF CONTENTS

## Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the fiscal quarter ended March 31, 2012 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

The information contained in Note 7 to the consolidated financial statements included in Item 1 of this Report is hereby incorporated into this Item 1 by reference.

## Item 6. Exhibits

Exhibit Number	Description
3.1	Certificate of Incorporation of The Leather Factory, Inc., and Certificate of Amendment to Certificate of Incorporation of The Leather Factory, Inc. filed as Exhibit 3.1 to Form 10-Q filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on August 12, 2005 and incorporated by reference herein.
3.2	Bylaws of The Leather Factory, Inc., filed as Exhibit 3.5 to the Current Report on Form 8-K (Commission File No. 001-12368) filed by Tandy Leather Factory, Inc (f/k/a The Leather Factory, Inc.) with the Securities and Exchange Commission on July 14, 2004 and incorporated by reference herein.
*31.1	13a-14(a) or 15d-14(a) Certification by Jon Thompson, Chief Executive Officer and President.
*31.2	13a-14(a) or 15d-14(a) Certification by Shannon Greene, Chief Financial Officer and Treasurer.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS^	XBRL Instance Document.
101.SCH^	XBRL Taxonomy Extension Schema Document.
101.CAL^	XBRL Taxonomy Extension Calculation Document.
101.DEF^	XBRL Taxonomy Extension Definition Document.
101.LAB^	XBRL Taxonomy Extension Labels Document.
101.PRE^	XBRL Taxonomy Extension Presentation Document.

\*Filed herewith.

^ XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TANDY LEATHER FACTORY, INC.  
(Registrant)

Date: May 14, 2012 By: /s/ Jon Thompson  
Jon Thompson  
Chief Executive Officer and President

Date: May 14, 2012 By: /s/ Shannon L. Greene  
Shannon L. Greene  
Chief Financial Officer and Treasurer (Chief Accounting Officer)