

TANDY LEATHER FACTORY INC
Form 10-Q
November 14, 2013

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 September 30, 2013

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. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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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 November 10, 2013
Common Stock, par value \$0.0024 per share	10,198,733

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013

TABLE OF CONTENTS

	PAGE NO.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<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>	
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	13
Item 4. <u>Controls and Procedures</u>	13
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	13
Item 5. <u>Other Information</u>	13
Item 6. <u>Exhibits</u>	14
SIGNATURES	14

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

	September 30, 2013 (unaudited)	December 31, 2012 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$6,289,550	\$7,705,182
Accounts receivable-trade, net of allowance for doubtful accounts of approximately \$30,000 and \$112,000 in 2013 and 2012, respectively	945,725	822,772
Inventory	29,492,488	25,862,784
Prepaid income taxes	6,106	
Deferred income taxes	340,426	349,478
Prepaid expenses	1,845,862	776,463
Other current assets	429,522	153,450
Total current assets	39,349,679	35,670,129
PROPERTY AND EQUIPMENT, at cost	19,042,844	17,574,895
Less accumulated depreciation and amortization	(5,645,113)	(5,630,305)
	13,397,731	11,944,590
GOODWILL	986,153	990,725
OTHER INTANGIBLES, net of accumulated amortization of approximately \$612,000 and \$582,000 in 2013 and 2012, respectively	114,643	145,533
Other assets	337,115	336,695
	\$54,185,321	\$49,087,672
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	\$2,299,450	\$1,612,627
Accrued expenses and other liabilities	5,913,564	5,928,798
Income taxes payable	-	113,705
Current maturities of long-term debt	202,500	202,500
Total current liabilities	8,415,514	7,857,630
DEFERRED INCOME TAXES	987,617	806,525
LONG-TERM DEBT, net of current maturities	2,446,875	2,902,500
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		

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Preferred stock, \$0.10 par value; 20,000,000 shares authorized; none issued or outstanding; attributes to be determined on issuance	-	-
Common stock, \$0.0024 par value; 25,000,000 shares authorized; 11,192,356 and 11,156,065 shares issued at 2013 and 2012, respectively; 10,198,733 and 10,162,442 shares outstanding at 2013 and 2012, respectively	26,862	26,775
Paid-in capital	5,892,907	5,767,508
Retained earnings	39,019,381	34,241,875
Treasury stock at cost (993,623 shares at 2013 and 2012)	(2,894,068)	(2,894,068)
Accumulated other comprehensive income	290,233	378,927
Total stockholders' equity	42,335,315	37,521,017
	\$54,185,321	\$49,087,672

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 and Nine Months Ended September 30, 2013 and 2012

	THREE MONTHS		NINE MONTHS	
	2013	2012	2013	2012
NET SALES	\$18,524,604	\$17,000,728	\$56,735,444	\$52,082,061
COST OF SALES	6,823,661	6,595,958	21,183,551	19,371,456
Gross profit	11,700,943	10,404,770	35,551,893	32,710,605
OPERATING EXPENSES	9,295,590	9,759,914	28,179,616	27,046,801
INCOME FROM OPERATIONS	2,405,353	644,856	7,372,277	5,663,804
OTHER INCOME (EXPENSE):				
Interest expense	(51,021)	(59,623)	(158,659)	(176,251)
Other, net	13,777	(2,787)	138,800	59,786
Total other income (expense)	(37,244)	(62,410)	(19,859)	(116,465)
INCOME BEFORE INCOME TAXES	2,368,109	582,446	7,352,418	5,547,339
PROVISION FOR INCOME TAXES	806,277	301,676	2,574,912	2,152,825
NET INCOME	\$1,561,832	\$280,770	\$4,777,506	\$3,394,514
NET INCOME PER COMMON SHARE:				
Basic	\$0.15	\$0.03	\$0.47	\$0.33
Diluted	\$0.15	\$0.03	\$0.47	\$0.33
Weighted Average Number of Shares Outstanding:				
Basic	10,176,744	10,156,790	10,163,490	10,156,559
Diluted	10,221,512	10,177,466	10,205,348	10,179,569

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 and Nine Months Ended September 30, 2013 and 2012

	THREE MONTHS		NINE MONTHS	
	2013	2012	2013	2012
NET INCOME	\$1,561,832	\$280,770	\$4,777,506	\$3,394,514
Foreign currency translation adjustments	272,799	174,633	(88,694)	74,266
COMPREHENSIVE INCOME	\$1,834,631	\$455,403	\$4,688,812	\$3,468,780

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 Nine Months Ended September 30, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$4,777,506	\$3,394,514
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	889,395	794,122
Loss on disposal or abandonment of assets	89,531	16,977
Non-cash stock-based compensation	11,686	10,000
Deferred income taxes	190,144	(180,237)
Other	(70,330)	63,559
Net changes in assets and liabilities, net of effect of business acquisitions:		
Accounts receivable-trade, net	(122,953)	253,702
Inventory	(3,629,704)	(9,754,553)
Income taxes	(119,811)	(1,183,816)
Prepaid expenses	(1,069,399)	1,624,011
Other current assets	(276,072)	(1,765,227)
Accounts payable-trade	686,823	929,847
Accrued expenses and other liabilities	(15,234)	1,097,165
Total adjustments	(3,435,924)	(8,094,450)
Net cash provided by (used in) operating activities	1,341,582	(4,699,936)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(2,415,484)	(1,294,050)
Proceeds from sale or maturities of certificates of deposit	-	423,893
Proceeds from sale of assets	515	1,150
Decrease (increase) in other assets	(420)	6,675
Net cash used in investing activities	(2,415,389)	(862,332)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and long-term debt	-	1,000,000
Payments on notes payable and long-term debt	(455,625)	(151,875)
Proceeds from issuance of common stock	113,800	5,440
Payment of cash dividend	-	(2,536,131)
Net cash used in financing activities	(341,825)	(1,682,566)
NET CHANGE IN CASH	(1,415,632)	(7,244,834)
CASH, beginning of period	7,705,182	10,765,591
CASH, end of period	\$6,289,550	\$3,520,757

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

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Interest paid during the period	\$158,659	\$176,251
Income tax paid during the period, net of (refunds)	\$2,507,842	\$3,524,962

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 Nine Months Ended September 30, 2013 and 2012

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, December 31, 2011	10,156,422	\$26,760	\$5,736,543	\$(2,894,068)	\$31,181,936	\$382,630	\$34,433,801
Shares issued – stock options exercised	2,000	5	5,435	-	-	-	5,440
Stock-based compensation	-	-	10,000	-	-	-	10,000
Cash dividend	-	-	-	-	(2,536,131)	-	(2,536,131)
Net income	-	-	-	-	3,394,514	-	3,394,514
Translation adjustment	-	-	-	-	-	74,266	74,266
BALANCE, September 30, 2012	10,158,422	\$26,765	\$5,751,978	\$(2,894,068)	\$32,040,319	\$456,896	\$35,381,890

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, December 31, 2012	10,162,442	\$26,775	\$5,767,508	\$(2,894,068)	\$34,241,875	\$378,927	\$37,521,017
Shares issued – stock options exercised	36,291	87	113,713	-	-	-	113,800
Stock-based compensation	-	-	11,686	-	-	-	11,686
Net income	-	-	-	-	4,777,506	-	4,777,506
Translation adjustment	-	-	-	-	-	(88,694)	(88,694)
BALANCE, September 30, 2013	10,198,733	\$26,862	\$5,892,907	\$(2,894,068)	\$39,019,381	\$290,233	\$42,335,315

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

5

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 September 30, 2013 and December 31, 2012, and its results of operations and cash flows for the three and/or nine-month periods ended September 30, 2013 and 2012. Operating results for the three and nine-month periods ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. 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, 2012.

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 we 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	
	September 30, 2013	December 31, 2012
Inventory on hand:		
Finished goods held for sale	\$27,213,820	\$24,039,846
Raw materials and work in process	1,227,130	495,182
Inventory in transit	1,051,538	1,327,756
	\$29,492,488	\$25,862,784

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, 2012, 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

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respective goodwill balances. No indicators of impairment were identified during the first three quarters of 2013. In accordance with recent guidance from the FASB, beginning in 2012, we are permitted to first assess qualitative factors in testing goodwill for impairment prior to performing a quantitative assessment.

A summary of changes in our goodwill for the periods ended September 30, 2013 and 2012 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2011	\$603,603	\$383,406	\$987,009
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	5,018	-	5,018
Impairments	-	-	-
Balance, September 30, 2012	\$608,621	\$383,406	\$992,027

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2012	\$607,319	\$383,406	\$990,725
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(4,572)	-	(4,572)
Impairments	-	-	-
Balance, September 30, 2013	\$602,747	\$383,406	\$986,153

Other intangibles consist of the following:

	As of September 30, 2013			As of December 31, 2012		
	Gross	Accumulated Net Amortization		Gross	Accumulated Net Amortization	
Trademarks, Copyrights	\$544,369	\$480,143	\$64,226	\$544,369	\$456,836	\$87,533
Non-Compete Agreements	182,170	131,753	50,417	183,216	125,216	58,000
	\$726,539	\$611,896	\$114,643	\$727,585	\$582,052	\$145,533

We recorded amortization expense of \$30,890 during the first nine months of 2013 compared to \$33,378 during the same period of 2012. All of our intangible assets 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
2013	\$732	\$41,337	\$42,069
2014	492	44,004	44,496
2015	-	39,302	39,302
2016	-	4,666	4,666
2017	-	-	-

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.

Comprehensive Income and Accumulated Other Comprehensive Income. Comprehensive income 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 consists of our net income and foreign currency translation adjustments from our international operations.

Recent Accounting Pronouncements. In February 2013, FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The objective of ASU No. 2013-02 is to improve reporting by requiring entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the statement of operations. The amendments in ASU No. 2013-02 are required to be applied retrospectively and are effective for reporting periods beginning after December 15, 2012. The adoption of the standard did not have any impact on our consolidated financial statements.

Table of Contents

2. 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 \$5.5 million 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 a 20-year amortization that accrues interest at a rate of 7.10% per annum.

At September 30, 2013 and December 31, 2012, the amount outstanding under the above agreements consisted of the following:

	September 30, 2013	December 31, 2012
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; matures April 30, 2018	\$ 2,649,375	\$3,105,000
	2,649,375	3,105,000
Less - Current maturities	(202,500)	(202,500)
	\$2,446,875	\$2,902,500

On July 12, 2012, we executed a Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a revolving credit facility of up to \$4 million. The note was obtained for working capital purposes. The revolver bears interest at LIBOR plus 2% (2.25% at September 30, 2013) and was to mature on June 30, 2013. On June 25, 2013, we executed a Note Modification Agreement which extends the maturity date of the Line of Credit Note to June 30, 2014. All other terms remain unchanged. Interest is paid monthly. The unused amount at September 30, 2013 was \$4 million.

3. 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 in each of the first nine months of 2013 and 2012. 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 as of closing on the date the option was granted and no option has a term in excess of ten years. No share based compensation expense was recognized in each of the quarters ended September 30, 2013 and 2012. Share based compensation expense of \$11,686 and \$10,000 was recognized for the nine month periods ended September 30, 2013 and 2012, respectively, as a component of operating expenses.

During the nine months ended September 30, 2013 and 2012, the stock option activity under our stock option plans was as follows:

Weighted # of shares Average	Weighted Average Remaining	Aggregate Intrinsic
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	Exercise Price		Contractual Term Value (in years)	
Outstanding, January 1, 2012	\$4.40	115,600		
Granted	5.27	12,000		
Cancelled	-	-		
Exercised	2.72	(2,000)		
Outstanding, September 30, 2012	\$4.51	125,600	4.93	\$213,256
Exercisable, September 30, 2012	\$4.51	125,600	4.93	\$213,256
Outstanding, January 1, 2013	\$4.53	121,600		
Granted	6.87	12,000		
Cancelled	-	-		
Exercised	4.23	(49,000)		
Outstanding, September 30, 2013	\$5.04	84,600	7.22	\$104,656
Exercisable, September 30, 2013	\$5.04	84,600	7.22	\$104,656

Other information pertaining to option activity during the nine-month periods ended September 30, 2013 and 2012 are as follows:

	September 30, 2013	September 30, 2012
Weighted average grant-date fair value of stock options granted	\$0.97	\$0.83
Total fair value of stock options vested	\$11,686	\$10,000
Total intrinsic value of stock options exercised	\$113,790	\$3,077

There was no unrecognized compensation cost as of September 30, 2013 and 2012.

We have a restricted stock plan that was adopted by our Board of Directors in January 2013 and approved by our stockholders in June 2013. The plan reserves up to 300,000 shares of our common stock for restricted stock awards to our executive officers, non-employee directors and other key employees. Awards granted under the plan may be stock awards or performance awards, and may be subject to a graded vesting schedule with a minimum vesting period of four years. No awards have been made to date.

4. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net income	\$1,561,832	\$280,770	\$4,777,506	\$3,394,514
Numerator for basic and diluted earnings per share	1,561,832	280,770	4,777,506	3,394,514
Denominator:				

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Weighted-average shares outstanding-basic	10,176,744	10,156,790	10,163,490	10,156,559
Effect of dilutive securities:				
Stock options	44,768	20,676	41,858	23,010
Dilutive potential common shares	44,768	20,676	41,858	23,010
Denominator for diluted earnings per share-weighted-average shares	10,221,512	10,177,466	10,205,348	10,179,569
Basic earnings per share	\$0.15	\$0.03	\$0.47	\$0.33
Diluted earnings per share	\$0.15	\$0.03	\$0.47	\$0.33

The net effect of converting stock options to purchase 111,600 and 127,600 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted earnings per share for the quarter ended September 30, 2013 and 2012, respectively.

Table of Contents

5. 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.

6. 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. A Settlement Agreement was reached between the parties, and on September 24, 2012, the United States District Court, Northern District of Texas, Fort Worth Division (“Court”) issued an Order Preliminarily Approving the Settlement of all federal and state claims asserted by the plaintiffs in the litigation. We continue to deny any violation of any statute, law, rule or regulation, any liability or wrongdoing, and the truth of any or all of the plaintiffs’ allegations. We agreed to enter into the Settlement Agreement to avoid further expense and inconvenience, end the disruption and burden of the litigation, avoid any other present or future litigation arising out of the facts that gave rise to the litigation, avoid the risk inherent in uncertain complex litigation, and to put to rest the controversy set forth in the plaintiff’s litigation.

The Settlement Agreement preliminarily approved by the Court required us to establish a fund designated as a Qualified Settlement Fund (Escrow Account) in the amount of \$993,386 to fund (1) settlement payments to the plaintiffs, (2) settlement payments to the other members of the settlement class who join the case, (3) plaintiffs’ attorneys’ fees and expenses, and (4) and the claim administrator (Escrow Agent’s) fees and expenses. The foregoing description is not complete and is qualified in its entirety by reference to the full text of the Settlement Agreement which was attached as Exhibit 10.1 to a Current Report on Form 8-K, as filed with the Securities and Exchange Commission on October 1, 2012.

The deadline established by the Court for any existing or former persons employed by us as store managers between November 23, 2008 and September 24, 2012 to join the lawsuit as a class member expired on May 24, 2013. On June 28, 2013, the Court issued two orders: (1) an Order Approving Class and Collective Action Settlement and Dismissing Case with Prejudice, and (2) a Final Judgment, Approving Class and Collective Action Settlement and Dismissing Case with Prejudice. Pursuant to the Court’s June 28, 2013 Orders, the claims administrator (Escrow Agent) is required to make payments to those existing and former store managers and the plaintiffs who joined the lawsuit by signing and returning Consent to Join Forms, which contained a release of us from the claims asserted in plaintiffs’ lawsuit. The settlement payments to the class members and the plaintiffs will be made from the Escrow Account pursuant to the formula set forth in the Settlement Agreement, as well as the payment of the plaintiffs’ attorney’s fees and the fees and expenses of the claims administrator (Escrow Agent). The total payment from the Escrow Account, to include our required FICA payments based on the settlement payments, is expected to be \$680,867 from the total Escrow Account of \$993,385. After all payments have been made from the Escrow Account, the claims administrator (Escrow Agent) will terminate the Escrow Account within 120 days from the date the settlement checks have been mailed, and the balance of the Escrow Account (approximately \$312,000) is expected to be returned to us before year end 2013.

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In connection with the settlement, we recorded a charge to operations of \$993,386 during the quarter ended September 30, 2012 as this amount, as ordered by the Court, covered the full settlement of all claims of opt in claimants, class counsels' attorneys' fees, and class administration costs in accordance with the terms of the agreement. In the quarter ended June 30, 2013, we recorded a benefit of approximately \$312,000, which is the expected remaining balance in the Escrow Account after all payments have been made.

We are periodically involved in various other litigation matters that arise in the ordinary course of our business and operations. There are no such matters pending that we expect will 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.

7. 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 September 30, 2013				
Net sales	\$6,476,676	\$11,128,646	\$919,282	\$18,524,604
Gross profit	4,358,097	6,752,739	590,107	11,700,943
Operating earnings	956,721	1,351,062	97,570	2,405,353
Interest expense	(51,021)	-	-	(51,021)
Other income (expense), net	33,372	-	(19,595)	13,777
Income before income taxes	939,072	1,351,062	77,975	2,368,109
Depreciation and amortization	241,864	71,496	13,325	326,685
Fixed asset additions	290,087	162,697	-	452,784
Total assets	\$40,445,814	\$11,150,004	\$2,589,503	\$54,185,321
For the quarter ended September 30, 2012				
Net sales	\$6,242,602	\$9,947,911	\$810,215	\$17,000,728
Gross profit	4,111,067	5,848,397	445,306	10,404,770
Operating earnings	(297,897)	987,704	(44,951)	644,856
Interest expense	(59,623)	-	-	(59,623)
Other income (expense), net	15,926	-	(18,713)	(2,787)
Income before income taxes	(341,594)	987,704	(63,664)	582,446

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Depreciation and amortization	205,991	50,650	13,428	270,069
Fixed asset additions	779,676	107,234	3,529	890,439
Total assets	\$35,690,494	\$10,719,659	\$2,242,963	\$48,653,116

8

Table of Contents

	Wholesale Leathercraft	Retail Leathercraft	Int'l Leathercraft	Total
For the nine months ended September 30, 2013				
Net sales	\$19,934,996			