

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

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 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> |          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>                            | 13       |
| <u>Item 4. Controls and Procedures</u>   | 13       |
| PART II. OTHER INFORMATION   |          |
| <u>Item 1. Legal Proceedings</u>   | 13       |
| <u>Item 5. Other Information</u>   | 13       |
| <u>Item 6. 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,<br>2013<br>(unaudited) | December<br>31,<br>2012<br>(audited) |
|--|--------------------------------------|--------------------------------------|
| <b>ASSETS</b>  |                                      |                                      |
| <b>CURRENT ASSETS:</b>   |                                      |                                      |
| Cash   | \$6,289,550                          | \$7,705,182                          |
| Accounts receivable-trade, net of allowance for doubtful accounts<br>of approximately \$30,000 and \$112,000 in 2013 and<br>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<br>\$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                         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                                      |
| <b>CURRENT LIABILITIES:</b>  |                                      |                                      |
| 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                            |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                                      |                                      |
| <b>STOCKHOLDERS' EQUITY:</b>   |                                      |                                      |

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

|   |              |              |
|---|--------------|--------------|
| Preferred stock, \$0.10 par value; 20,000,000 shares authorized;<br>none issued or outstanding; attributes to be determined on issuance   | -            | -            |
| Common stock, \$0.0024 par value; 25,000,000 shares authorized;<br>11,192,356 and 11,156,065 shares issued at 2013 and 2012,<br>respectively;<br>10,198,733 and 10,162,442 shares outstanding at 2013 and 2012,<br>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               |
|---|--------------------|--------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                    |                    |
| 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)        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                    |                    |
| 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)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                    |                    |
| 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)        |
| <b>NET CHANGE IN CASH</b>   | <b>(1,415,632)</b> | <b>(7,244,834)</b> |
| 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:

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

|   |             |             |
|---|-------------|-------------|
| 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<br>Shares | Par<br>Value | Paid-in<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total        |
|--|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|
| BALANCE, December<br>31, 2011              | 10,156,422          | \$26,760     | \$5,736,543        | \$(2,894,068)     | \$31,181,936         | \$382,630  | \$34,433,801 |
| Shares issued – stock<br>options exercised | 2,000               | 5            | 5,435              | -                 | -                    | -  | 5,440        |
| Stock-based<br>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<br>30, 2012             | 10,158,422          | \$26,765     | \$5,751,978        | \$(2,894,068)     | \$32,040,319         | \$456,896  | \$35,381,890 |

|  | Number of<br>Shares | Par<br>Value | Paid-in<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total        |
|--|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|
| BALANCE, December<br>31, 2012              | 10,162,442          | \$26,775     | \$5,767,508        | \$(2,894,068)     | \$34,241,875         | \$378,927  | \$37,521,017 |
| Shares issued – stock<br>options exercised | 36,291              | 87           | 113,713            | -                 | -                    | -  | 113,800      |
| Stock-based<br>compensation                | -                   | -            | 11,686             | -                 | -                    | -  | 11,686       |
| Net income                                 | -                   | -            | -                  | -                 | 4,777,506            | -  | 4,777,506    |
| Translation adjustment                     | -                   | -            | -                  | -                 | -                    | (88,694)   | (88,694)     |
| BALANCE, September<br>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,<br>2013 | December 31,<br>2012 |
| <b>Inventory on hand:</b>         |                       |                      |
| 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            |
|                                   | <b>\$29,492,488</b>   | <b>\$25,862,784</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, 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

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

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<br>30, 2013 | December 31,<br>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<br>Average | Weighted Average<br>Remaining | Aggregate<br>Intrinsic |
|---------------------------------|-------------------------------|------------------------|
|---------------------------------|-------------------------------|------------------------|



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

|                                 | 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<br>September 30, |           | Nine Months Ended<br>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:                                       |                                     |           |                                    |             |

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

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| 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.

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

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<br>Leathercraft | Retail<br>Leathercraft | Int'l<br>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      |

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

|                               |              |              |             |              |
|-------------------------------|--------------|--------------|-------------|--------------|
| 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<br>Leathercraft | Retail<br>Leathercraft | Int'l<br>Leathercraft | Total        |
|---|---------------------------|------------------------|-----------------------|--------------|
| For the nine months ended September 30,<br>2013 |                           |                        |                       |              |
| Net sales                                       | \$19,934,996              | \$33,930,587           | \$2,869,861           | \$56,735,444 |
| Gross profit                                    | 13,171,368                | 20,584,324             | 1,796,201             | 35,551,893   |
| Operating earnings                              | 2,853,219                 | 4,243,006              | 276,052               | 7,372,277    |
| Interest expense                                | (158,659)                 | -                      | -                     | (158,659)    |
| Other income (expense), net                     | 108,077                   | 26                     | 30,697                | 138,800      |
| Income before income taxes                      | 2,802,637                 | 4,243,032              | 306,749               | 7,352,418    |
| Depreciation and amortization                   | 655,022                   | 193,118                | 41,255                | 889,395      |
| Fixed asset additions                           | 1,858,985                 | 554,831                | 1,668                 | 2,415,484    |
| Total assets                                    | \$40,445,814              | \$11,150,004           | \$2,589,503           | \$54,185,321 |

For the nine months ended September 30,  
2012

|                               |              |              |             |              |
|-------------------------------|--------------|--------------|-------------|--------------|
| Net sales                     | \$19,678,009 | \$30,093,864 | \$2,310,188 | \$52,082,061 |
| Gross profit                  | 12,914,740   | 18,365,729   | 1,430,136   | 32,710,605   |
| Operating earnings            | 2,038,267    | 3,655,932    | (30,395)    | 5,663,804    |
| Interest expense              | (176,251)    | -            | -           | (176,251)    |
| Other income (expense), net   | 44,275       | 13           | 15,498      | 59,786       |
| Income before income taxes    | 1,906,291    | 3,655,945    | (14,897)    | 5,547,339    |
| Depreciation and amortization | 613,608      | 140,566      | 39,948      | 794,122      |
| Fixed asset additions         | 913,900      | 303,525      | 76,625      | 1,294,050    |
| Total assets                  | \$35,690,494 | \$10,719,659 | \$2,242,963 | \$48,653,116 |

Net sales for geographic areas were as follows for the three and nine months ended September 30, 2013 and 2012:

| Three months ended September<br>30, | 2013         | 2012         |
|-------------------------------------|--------------|--------------|
| United States                       | \$15,466,317 | \$14,221,642 |
| Canada                              | 1,889,696    | 1,761,960    |
| All other countries                 | 1,168,591    | 1,017,126    |
|                                     | \$18,524,604 | \$17,000,728 |

| Nine months ended September<br>30, | 2013         | 2012         |
|------------------------------------|--------------|--------------|
| United States                      | \$47,404,281 | \$43,861,288 |
| Canada                             | 5,728,405    | 5,214,782    |
| All other countries                | 3,602,758    | 3,005,991    |
|                                    | \$56,735,444 | \$52,082,061 |

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 or nine-month periods ended September 30, 2013 and 2012. 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 7 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 customers are only national craft chains.

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 37 states and six Canadian provinces. Tandy Leather Company, one of 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 August 1, 2013, we were operating 78 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 additional stores outside of North America in the future, although specific locations and 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, 2012.

Table of Contents

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, 2012 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 continuing financial uncertainty around the world.

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. Specialty retail, and retail in general, is 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. The United States and global economies have suffered from economic uncertainty for the past several years. Consumer spending in the United States appears to have stabilized recently, but could deteriorate in the future. As a result, our operating results may be adversely and materially affected by 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

### Three Months Ended September 30, 2013 and 2012

The following tables present selected financial data of each of our three segments for the quarters ended September 30, 2013 and 2012.

|                        | Quarter Ended September 30, 2013 |                  | Quarter Ended September 30, 2012 |                  |
|------------------------|----------------------------------|------------------|----------------------------------|------------------|
|                        | Sales                            | Operating Income | Sales                            | Operating Income |
| Wholesale Leathercraft | \$6,476,676                      | \$956,721        | \$6,242,602                      | \$(297,897)      |
| Retail Leathercraft    | 11,128,646                       | 1,351,062        | 9,947,911                        | 987,704          |
| Int'l Leathercraft     | 919,282                          | 97,570           | 810,215                          | (44,951)         |
| Total Operations       | \$18,524,604                     | \$2,405,353      | \$17,000,728                     | \$644,856        |

Consolidated net sales for the quarter ended September 30, 2013 increased \$1.5 million, or 9%, compared to the same period in 2012. All three segments contributed to the sales increase with gains ranging from 4% to 13%. Operating income on a consolidated basis for the quarter ended September 30, 2013 increased 273%, or \$1.8 million, compared to the third quarter of 2012. The primary reason for the significant increase in operating income was the one-time charge of \$994,000 related to the settlement of litigation that was recorded in the third quarter of 2012, but was not repeated in the third quarter of 2013. (See Note 6 to the consolidated financial statements included in Item 1 of this Report for additional information.)

The following table shows in comparative form our consolidated net income for the third quarters of 2013 and 2012:

|            | 2013        | 2012      | % change |
|------------|-------------|-----------|----------|
| Net income | \$1,561,832 | \$280,770 | 456%     |

All segments contributed to our increased consolidated net income. Additional information appears below for each segment.

### Wholesale Leathercraft

Our Wholesale Leathercraft segment consists of 29 wholesale stores and our National Account sales group. The National Account sales group's customers consist of only national craft chains. The following table presents the combined sales mix by customer categories for the quarters ended September 30, 2013 and 2012:

|  | Quarter Ended |
|--|---------------|
|--|---------------|

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

| Customer Group  | 09/30/13 | 09/30/12 |
|---|----------|----------|
| RETAIL (end users, consumers, individuals)  | 38%      | 33%      |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)     | 5%       | 6%       |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 43%      | 44%      |
| MANUFACTURERS   | 7%       | 8%       |
| NATIONAL ACCOUNTS   | 7%       | 9%       |
|   | 100%     | 100%     |

Net sales increased 3.8%, or \$234,000, for the third quarter of 2013 as follows:

|                        | #      | Qtr Ended   | Qtr Ended   | \$        | %       |
|------------------------|--------|-------------|-------------|-----------|---------|
|                        | Stores | 09/30/13    | 09/30/12    | Change    | Change  |
| Same store sales       | 29     | \$6,105,137 | \$5,821,208 | \$283,929 | 4.9%    |
| National account group |        | 371,539     | 421,394     | (49,855)  | (11.8)% |
| Total sales            |        | \$6,476,676 | \$6,242,602 | \$234,074 | 3.8%    |

Table of Contents

Our same store sales increased 4.9% in the third quarter of 2013, as compared with the same period in 2012. Compared to the third quarter of 2012, we achieved sales dollar increases in our retail and wholesale customer categories, which were offset somewhat by minimal decreases in our institution, manufacturing, and national account customer categories. We continue to see strength from our retail customer group, while our other customer groups appear to be less stable. Sales to summer camps and youth programs, as well as inmates and prisons, which are all included in our institution customer group, declined compared to last year's third quarter due to a reduction in funding of programs. Sales to our National Account customers were down 12% for the quarter, compared to the same quarter last year. As discussed in our previous filings, we expect sales to our National Accounts customers to continue to decline year over year due to our decision to stop supplying certain products with unacceptable gross profit margins that these customers were previously buying. Therefore, it is likely we will experience further sales declines to our National Account group if the products we stock are not what these customers want to purchase. Our primary focus is on sales through our stores, rather than National Accounts, as we believe our stores represent the greatest potential for continued and consistent sales growth.

Operating income for Wholesale Leathercraft during the quarter ended September 30, 2013 increased \$1.2 million, or 421%, from the comparative 2012 quarter. Our gross profit margin increased from 65.9% to 67.3% as our sales to retail customers increased. Those sales bring higher margins than sales to wholesale customers. Operating expenses as a percentage of sales were 53%, down \$1.0 million from the third quarter of 2012. The primary reason for the operating expense decrease was the one-time charge of \$994,000 related to the settlement of litigation that was recorded in the third quarter of 2012, but was not repeated in the third quarter of 2013. (See Note 6 to the consolidated financial statements included in Item 1 of this Report for additional information.) Significant expense increases occurred in employee compensation (\$274,000), legal and professional fees (\$178,000), which were offset by decreases in bad debts (\$87,000), dues and subscriptions (\$23,000), health insurance costs (\$116,000), rents (\$49,000), and supplies (\$65,000). The increase in employee compensation is due to an increase in employee count that is attributable to an increase in the size of certain stores. The increase in legal fees is attributable to one time fees incurred for new trademark filings.

## Retail Leathercraft

Our Retail Leathercraft segment consists of 78 and 77 Tandy Leather Company retail stores at September 30, 2013 and 2012, respectively. Net sales increased 12% for the third quarter of 2013 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.

|                  | #<br>Stores | Qtr Ended<br>09/30/13 | Qtr Ended<br>09/30/12 | \$<br>Change | %<br>Change |
|------------------|-------------|-----------------------|-----------------------|--------------|-------------|
| Same store sales | 77          | \$11,004,898          | \$9,947,911           | \$1,056,987  | 10.6%       |
| New store sales  | 1           | 123,748               | -                     | 123,748      | N/A         |
| Total sales      |             | \$11,128,646          | \$9,947,911           | \$1,180,735  | 11.9%       |

The following table presents sales mix by customer categories for the quarters ended September 30, 2013 and 2012 for our Retail Leathercraft operation:

| Customer Group  | Quarter Ended |          |
|---|---------------|----------|
|   | 09/30/13      | 09/30/12 |
| RETAIL (end users, consumers, individuals)  | 57%           | 60%      |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)     | 4%            | 5%       |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 36%           | 33%      |

|                   |      |      |
|-------------------|------|------|
| NATIONAL ACCOUNTS | -    | -    |
| MANUFACTURERS     | 3%   | 2%   |
|                   | 100% | 100% |

The retail stores averaged approximately \$48,000 in sales per store per month for the third quarter of 2013.

Sales to each customer group increased solidly over the third quarter of 2012, with the exception of our institution customer group. Sales to summer camps and youth programs, which are part of our institution customer group, declined compared to last year's third quarter due to a decrease in participation and funding of these programs. Our gross profit margin increased from 58.8% to 60.7% due to the strength in sales to our retail customers. Sales to our retail customer group bring higher margins compared to our other customer groups as our retail selling prices are higher than our other selling prices. Operating income increased \$363,000, or 37%, from the comparative 2012 quarter. Operating income as a percentage of sales improved from 9.9% in the third quarter of 2012 to 12.1% in the third quarter of 2013 due to the increase in gross profit margin, partially offset by the increase in operating expenses. Operating expenses as a percentage of sales decreased from 48.9% to 48.5% as expenses grew at a slightly slower rate than that of sales during the quarter. Operating expenses increased \$541,000 over the third quarter of 2012. Compared to last year's third quarter, manager bonuses increased \$160,000 due to an increase in store profit. Advertising and marketing expenses increased \$87,000, due to special advertising related to store relocations, credit card fees and freight out (shipping to customers) increased \$62,000 as a result of the increase in sales, rent and utilities expense increased \$43,000 as we continue to move stores into larger locations, and supplies expense was up \$12,000.

#### International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of September 30, 2013 and 2012, the segment contained three stores, with one each located in United Kingdom, Australia, and Spain. Net sales increased 13.5% for the third quarter of 2013 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.

|                  | #<br>Stores | Qtr Ended<br>09/30/13 | Qtr Ended<br>09/30/12 | \$<br>Change | %<br>Change |
|------------------|-------------|-----------------------|-----------------------|--------------|-------------|
| Same store sales | 3           | \$919,282             | \$810,215             | \$109,067    | 13.5%       |
| New store sales  | -           | -                     | -                     | -            | N/A         |
| Total sales      |             | \$919,282             | \$810,215             | \$109,067    | 13.5%       |

Gross profit margin as a percentage of sales increased from 55.0% in the third quarter of 2012 to 64.2% in the third quarter of 2013. We determine selling prices taking into consideration the currency conversion between the U.S. dollar and the local currency, as well as local market conditions. Further, the mix of products sold has a direct impact on gross margins. A larger ratio of non-leather items sold to leather sold will raise margins as non-leather items bring higher margins. Similarly, a larger ratio of leather sold to non-leather items sold will lower margins as leather brings lower margins. Operating expenses totaled \$492,000 in the third quarter of 2013, up \$2,000 from \$490,000 in the third quarter of 2012. Compared to last year's third quarter, advertising and marketing expenses were up \$27,000 and employee compensation was down \$15,000. Advertising and marketing expenses were this segment's largest expense in the quarter, followed by employee compensation, freight out, legal and professional fees, and rent.

#### Other Expenses

We paid \$51,000 in interest expense in the third quarter of 2013 on our bank debt, which is related to our building purchase, compared to \$59,000 in interest expense in the third quarter last year. We recorded other income, consisting of gas royalties and miscellaneous non-operating income, of \$33,000 in the current quarter compared to \$17,000 in last year's comparable quarter. We recorded an expense of \$20,000 during the third quarter of 2013 related to currency

fluctuations from our international operations. Comparatively, in the third quarter of 2012, we recorded an expense of \$18,000 for currency fluctuations.

Nine Months Ended September 30, 2013 and 2012

The following table presents selected financial data of each of our three segments for the nine months ended September 30, 2013 and 2012:

|                            | Nine Months Ended September 30,<br>2013 |                     | Nine Months Ended September 30,<br>2012 |                     |
|----------------------------|---|---------------------|---|---------------------|
|                            | Sales                                   | Operating<br>Income | Sales                                   | Operating<br>Income |
| Wholesale Leathercraft     | \$19,934,996                            | \$2,853,219         | \$19,678,009                            | \$2,038,267         |
| Retail Leathercraft        | 33,930,587                              | 4,243,006           | 30,093,864                              | 3,655,932           |
| International Leathercraft | 2,869,861                               | 276,052             | 2,310,188                               | (30,395)            |
| Total Operations           | \$56,735,444                            | \$7,372,277         | \$52,082,061                            | \$5,663,804         |

Table of Contents

Consolidated net sales for the nine months ended September 30, 2013 were up 9% compared to the same period in 2012, increasing \$4.7 million. All three reporting segments contributed to the sales increase. Retail Leathercraft contributed the largest sales increase of \$3.8 million, followed by International Leathercraft reporting an increase of \$560,000 and Wholesale Leathercraft reporting an increase of \$257,000. The increase in inventory at the stores, coupled with targeted advertising efforts, contributed to the sales increase. Operating income on a consolidated basis for the nine months ended September 30, 2013 increased 30%, or \$1.7 million, compared to the first three quarters of 2012.

The following table shows in comparative form our consolidated net income for the first three quarters of 2013 and 2012:

|            | 2013        | 2012        | % change |
|------------|-------------|-------------|----------|
| Net income | \$4,777,506 | \$3,394,514 | 40.7%    |

## Wholesale Leathercraft

Net sales increased 1.3%, or \$257,000, for the first nine months of 2013 as follows:

|                        | #<br>Stores | Nine Months<br>Ended<br>09/30/13 | Nine<br>Months<br>Ended<br>09/30/12 | \$<br>Change | %<br>Change |
|------------------------|-------------|----------------------------------|-------------------------------------|--------------|-------------|
| Same store sales       | 29          | \$18,897,124                     | \$18,232,337                        | \$664,787    | 3.7%        |
| National account group |             | 1,037,872                        | 1,445,672                           | (407,800)    | (28.2)%     |
| Total sales            |             | \$19,934,996                     | \$19,678,009                        | \$256,987    | 1.3%        |

The following table presents the combined sales mix by customer categories for the nine months ended September 30, 2013 and 2012:

|   | Nine Months Ended |          |
|---|-------------------|----------|
| Customer Group  | 09/30/13          | 09/30/12 |
| RETAIL (end users, consumers, individuals)  | 38%               | 34%      |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)     | 4%                | 5%       |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 44%               | 43%      |
| MANUFACTURERS   | 7%                | 8%       |
| NATIONAL ACCOUNTS   | 7%                | 10%      |
|   | 100%              | 100%     |

Operating income for Wholesale Leathercraft for the first nine months of 2013 increased by \$815,000 from the comparative 2012 period, a 40% improvement. Compared to the first nine months of 2012, operating expenses decreased \$558,000 for the first nine months of 2013, decreasing as a percentage of sales from 55.3% to 51.8%. The primary reason for the operating expense decrease was the one-time charge of \$994,000 related to the settlement of litigation that was recorded in the third quarter of 2012, but was not repeated in the third quarter of 2013. (See Note 6 to the consolidated financial statements included in Item 1 of this Report for additional information.)

## Retail Leathercraft

Net sales were up 12.8% for the first nine months of 2013 over the same period last year.

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

|                  | # Stores | Nine Months Ended 09/30/13 | Nine Months Ended 09/30/12 | \$ Change   | % Change |
|------------------|----------|----------------------------|----------------------------|-------------|----------|
| Same store sales | 77       | \$33,563,875               | \$30,093,864               | \$3,470,011 | 11.5%    |
| New store sales  | 1        | 366,712                    | -                          | 366,712     | N/A      |
| Total sales      |          | \$33,930,587               | \$30,093,864               | \$3,836,723 | 12.8%    |

The following table presents sales mix by customer categories for the nine months ended September 30, 2013 and 2012 for our Retail Leathercraft operation:

| Customer Group  | Nine Months Ended |          |
|---|-------------------|----------|
|   | 09/30/13          | 09/30/12 |
| RETAIL (end users, consumers, individuals)  | 57%               | 59%      |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)     | 4%                | 5%       |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 36%               | 33%      |
| NATIONAL ACCOUNTS   | -                 | -        |
| MANUFACTURERS   | 3%                | 3%       |
|   | 100%              | 100%     |

The retail stores averaged approximately \$48,000 in sales per store per month for the first three quarters of 2013.

Operating income for the first nine months of 2013 increased \$587,000, or 16%, from the comparative 2012, and increased slightly as a percentage of sales from 12.2% in the first nine months of 2012 to 12.5% in the first nine months of 2013 due to sales growing faster than expenses. Gross margin decreased slightly from 61.0% to 60.7% due to the customer mix. The ratio of retail sales, which brings a higher margin, to non-retail sales, which brings a lower margin, can effect gross profit margin positively or negatively. During the first nine months of 2013, non-retail sales increased faster than retail sales, resulting in a slight decline in gross profit margin. Operating expenses as a percentage of sales were 48.2% for the first nine months of 2013, a slight improvement over 48.9% for the first nine months of 2012.

#### International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of September 30, 2013 and 2012, the segment contained three stores with one each located in United Kingdom, Australia, and Spain. Net sales increased 24.2% for the first three quarters of 2013 over the same period last year. A store is categorized as “new” until it is operating for the full comparable period in the prior year.

|                  | # Stores | Nine Months Ended 09/30/13 | Nine Months Ended 09/30/12 | \$ Change | % Change |
|------------------|----------|----------------------------|----------------------------|-----------|----------|
| Same store sales | 3        | \$2,869,861                | \$2,310,188                | \$559,673 | 24.2%    |
| New store sales  | -        | -                          | -                          | -         | -        |
| Total sales      |          | \$2,869,861                | \$2,310,188                | \$559,673 | 24.2%    |

Gross profit margin as a percentage of sales increased from 61.9% in the first nine months of 2012 to 62.6% in the first nine months of 2013. Selling prices are determined based on the currency conversion between the U.S. dollar and the local currency. In addition, gross profit margin is affected by sales mix – the ratio of higher margin products (tools, supplies, etc.) to lower margin products (leather). Operating expenses totaled \$1.5 million in the first nine

months of 2013, up \$60,000 from \$1.4 million in the first nine months of 2012. Freight out (shipping to customers) increased \$51,000 compared to the comparable period last year, while legal and professional fees increased \$27,000. Employee compensation is this segment's largest expense, followed by advertising and marketing expenses, shipping costs to customers, and rent.



Table of Contents

Other Expenses

We paid \$159,000 in interest on our bank debt in the first nine months of 2013, compared to \$176,000 in the first nine months of 2012. We recorded \$2,300 in interest income in the nine months ended September 30, 2013 compared to \$6,800 in last year's comparable period. We recorded income of \$31,000 for currency fluctuations in the first three quarters of 2013. Comparatively, in the same period of 2012, we recorded income of \$16,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets were \$54.2 million at September 30, 2013, up \$5.1 million from \$49.1 million at year-end 2012. Total stockholders' equity increased from \$37.5 million at December 31, 2012 to \$42.3 million at September 30, 2013, the increase being attributable to earnings in the first three quarters of this year. Our current ratio increased slightly from 4.5 at December 31, 2012 to 4.7 at September 30, 2013 as current assets grew faster than current liabilities.

Our investment in inventory increased by \$3.6 million from year-end 2012 to September 30, 2013. Inventory turnover reached an annualized rate of 2.7 times during the first nine months of 2013, slowing slightly from 2.8 times for the first nine months of 2012. Inventory turnover was 3.2 times for all of 2012. We compute our inventory turns as sales divided by average inventory. As of September 30, 2013, our total inventory on hand was approximately 20% over our internal targets for optimal inventory levels. 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. Further, an increase in inventory during the third quarter is a normal occurrence as we anticipate fourth quarter demand.

Trade accounts receivable were \$945,000 at September 30, 2013, up \$123,000 from \$823,000 at year-end 2012. The average days to collect accounts for the first nine months of 2013 were 39 days, improving from 47 days for the first nine months of 2012. We monitor our customer accounts very closely in order to minimize the risk of uncollectible accounts.

Accounts payable increased to \$2.3 million at September 30, 2013 compared to \$1.6 million at year-end 2012, primarily due to the increase in inventory purchases during the third quarter of 2013 compared to the fourth quarter of 2012. Accrued expenses decreased \$15,000 from December 31, 2012 to September 30, 2013.

During the first nine months of 2013, cash flow provided by operating activities was \$1.3 million. Net income of \$4.8 million, offset by the increase in inventory of \$3.6 million accounted for the operating cash provided. By comparison, during the first nine months of 2012, cash flow used by operating activities was \$4.7 million. The increase in inventory of \$9.8 million, offset by net income of \$3.4 million, and the increase in accrued liabilities of \$1.1 million accounted for the majority of the operating cash used in the nine months ended September 30, 2012.

Cash flow used in investing activities totaled \$2.4 million in the first nine months of 2013, consisting primarily of the building constructed to house our flagship store, which opened in June 2013, and purchases of store fixtures and computer equipment. In the first three quarters of 2012, cash flow used in investing activities totaled \$862,000 in the first nine months of 2012, consisting primarily of purchases of store fixtures and computer equipment and building construction in progress, partially offset by maturities of certificates of deposit.

Cash flow used in financing activities totaled \$342,000 in the first nine months of 2013, consisting of bank debt repayments totaling \$456,000, partially offset by the proceeds received from the exercise of stock options of \$114,000. In the first nine months of 2012, cash flow used in financing activities totaled \$1.7 million in the first nine months of 2012, consisting of a special one-time cash dividend of \$2.5 million, partially offset by borrowings against the line of credit of \$1 million less debt repayments of \$152,000.

We expect to fund our operating and liquidity needs as well as our store growth from a combination of current cash balances, internally generated funds, and our revolving credit facility with JPMorgan Chase Bank.

### 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, 2012. We believe that our exposure to market risks has not changed significantly since December 31, 2012. 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, September 30, 2013. 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 September 30, 2013, our disclosure controls and procedures were effective at a reasonable assurance level.

#### Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the fiscal quarter ended September 30, 2013 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 6 to the consolidated financial statements included in Item 1 of this Report is hereby incorporated into this Item 1 by reference.

### Item 5. Other Information.

On June 10, 2013, we filed a Current Report on Form 8-K with the Securities and Exchange Commission reporting the results of the votes conducted at our annual meeting of stockholders held on June 6, 2013. Such Current Report on Form 8-K reported, among other things, the approval of the Tandy Leather Factory, Inc. 2013 Restricted Stock Plan by our stockholders at such annual meeting. A copy of the Tandy Leather Factory, Inc. 2013 Restricted Stock Plan was not filed as an exhibit to such Current Report on Form 8-K. Accordingly, a copy of the Tandy Leather Factory, Inc. 2013 Restricted Stock Plan is attached hereto as Exhibit 10.1. The description of the Tandy Leather Factory, Inc.

2013 Restricted Stock Plan contained herein is qualified in its entirety by reference to the full text of the Tandy Leather Factory, Inc. 2013 Restricted Stock Plan attached hereto and incorporated by reference herein.

Table of Contents

## 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 Tandy Leather Factory, Inc.'s Quarterly Report on Form 10-Q filed 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.   |
| 3.3            | Certificate of Designations of Series A Junior Participating Preferred Stock of Tandy Leather Factory, Inc. filed as Exhibit 3.1 to Tandy Leather Factory's Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 10, 2013.   |
| 4.1            | Rights Agreement dated as of June 6, 2013 between Tandy Leather Factory, Inc. and Broadridge Corporate Issuer Solutions, Inc., as Rights Agent (including the form of Certificate of Designations of Series A Junior Preferred Stock attached thereto as Exhibit A, the form of Right Certificate attached thereto as Exhibit B and the Summary of Rights attached thereto as Exhibit C) filed as Exhibit 4.1 to Tandy Leather Factory, Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 10, 2013. |
| *10.1          | Tandy Leather Factory, Inc. 2013 Restricted Stock Plan  |
| *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: November 14, 2013

By: /s/ Jon Thompson  
Jon Thompson  
Chief Executive Officer and President

Date: November 14, 2013

By: /s/ Shannon L. Greene  
Shannon L. Greene  
Chief Financial Officer and Treasurer (Chief Accounting Officer)