

TANDY LEATHER FACTORY INC
Form 10-Q
November 16, 2009

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, 2009

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
(IRS Employer Identification Number)

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer

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 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, 2009 |
|--|--|
| Common Stock, par value \$0.0024 per share | 10,166,328 |

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

TABLE OF CONTENTS

| | PAGE NO. |
|--|----------|
| PART I. FINANCIAL INFORMATION | |
| <u>Item 1. Financial Statements</u> | |
| Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008 | 1 |
| Consolidated Statements of Income for the three and nine months ended 2 September 30, 2009 and 2008 | 2 |
| Consolidated Statements of Cash Flows for the nine months ended September 3 30, 2009 and 2008 | 3 |
| Consolidated Statements of Stockholders' Equity for the nine months ended 4 September 30, 2009 and 2008 | 4 |
| <u>Notes to Consolidated Financial Statements</u> | 5 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and 9 Results of Operations</u> | 9 |
| <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 2. . Unregistered Sales of Equity Securities and Use of Proceeds</u> | 14 |
| <u>Item 6. Exhibits</u> | 14 |
| SIGNATURES | 14 |

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

| | September 30, 2009 (unaudited) | December 31, 2008 (audited) |
|---|--------------------------------------|-----------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash | \$4,197,357 | \$7,810,298 |
| Short-term investments, including certificates of deposit | 5,409,000 | 3,011,000 |
| Accounts receivable-trade, net of allowance for doubtful accounts of \$51,000 and \$43,000 in 2009 and 2008, respectively | 1,694,732 | 1,180,349 |
| Inventory | 16,970,065 | 16,011,147 |
| Prepaid income taxes | 191,892 | - |
| Deferred income taxes | 241,688 | 229,501 |
| Other current assets | 1,043,510 | 777,550 |
| Total current assets | 29,748,244 | 29,019,845 |
| PROPERTY AND EQUIPMENT, at cost | 15,927,686 | 15,340,732 |
| Less accumulated depreciation and amortization | (5,704,551) | (5,019,885) |
| | 10,223,135 | 10,320,847 |
| GOODWILL | 981,170 | 966,655 |
| OTHER INTANGIBLES, net of accumulated amortization of \$405,000 and \$367,000 in 2009 and 2008, respectively | 320,069 | 355,492 |
| OTHER assets | 312,870 | 313,074 |
| | \$41,585,488 | \$40,975,913 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable-trade | \$1,614,303 | \$1,148,577 |
| Accrued expenses and other liabilities | 3,401,695 | 3,182,194 |
| Income taxes payable | - | 271,122 |
| Current maturities of capital lease obligation | - | 265,111 |
| Current maturities of long-term debt | 202,500 | 202,500 |
| Total current liabilities | 5,218,498 | 5,069,504 |
| DEFERRED INCOME TAXES | 679,571 | 600,309 |
| LONG-TERM DEBT, net of current maturities | 3,560,625 | 3,712,500 |
| CAPITAL LEASE OBLIGATION, net of current maturities | - | 328,838 |
| COMMITMENTS AND CONTINGENCIES | | |

STOCKHOLDERS' EQUITY:

| | | |
|--|--------------|--------------|
| 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; | | |
| 11,021,951 and 10,994,951 shares issued at 2009 and 2008; | | |
| 10,166,328 and 10,664,555 shares outstanding at 2009 and 2008, | 26,453 | 26,388 |
| Paid-in capital | 5,491,736 | 5,464,443 |
| Retained earnings | 28,653,986 | 26,641,853 |
| Treasury stock (855,623 and 330,396 shares at cost at 2009 and 2008) | (2,320,760) | (828,385) |
| Accumulated other comprehensive income | 275,379 | (39,537) |
| Total stockholders' equity | 32,126,794 | 31,264,762 |
| | \$41,585,488 | \$40,975,913 |

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, 2009 and 2008

| | THREE MONTHS | | NINE MONTHS | |
|---|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| NET SALES | \$12,787,264 | \$12,251,990 | \$39,363,194 | \$39,360,114 |
| COST OF SALES | 5,189,674 | 5,108,833 | 16,207,276 | 16,464,284 |
| Gross profit | 7,597,590 | 7,143,157 | 23,155,918 | 22,895,830 |
| OPERATING EXPENSES | 6,725,896 | 6,377,674 | 20,104,518 | 20,317,446 |
| INCOME FROM OPERATIONS | 871,694 | 765,483 | 3,051,400 | 2,578,384 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (68,895) | (80,072) | (229,879) | (249,725) |
| Other, net | (48,307) | 25,672 | 171,881 | 332,355 |
| Total other income (expense) | (117,202) | (54,400) | (57,998) | 82,630 |
| INCOME BEFORE INCOME TAXES | 754,492 | 711,083 | 2,993,402 | 2,661,014 |
| PROVISION FOR INCOME TAXES | 201,527 | 290,069 | 981,269 | 1,000,252 |
| NET INCOME | \$552,965 | \$421,014 | \$2,012,133 | \$1,660,762 |
| NET INCOME PER COMMON SHARE-BASIC | \$ 0.05 | \$ 0.04 | \$ 0.19 | \$ 0.15 |
| NET INCOME PER COMMON SHARE-DILUTED | \$ 0.05 | \$ 0.04 | \$ 0.19 | \$ 0.15 |
| Weighted Average Number of Shares Outstanding: | | | | |
| Basic | 10,387,462 | 10,988,092 | 10,575,904 | 10,982,209 |
| Diluted | 10,457,318 | 11,073,942 | 10,636,090 | 11,072,717 |

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

2

Table of Contents

Tandy Leather Factory, Inc.
 Consolidated Statements of Cash Flows
 (Unaudited)
 For the Nine Months Ended September 30, 2009 and 2008

| | 2009 | 2008 |
|--|--------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$2,012,133 | \$1,660,762 |
| Adjustments to reconcile net income to net cash provided by operating activities - | | |
| Depreciation & amortization | 852,943 | 758,364 |
| Loss on disposal of assets | 26,008 | 13,385 |
| Non-cash stock-based compensation | 2,540 | 22,875 |
| Deferred income taxes | 67,075 | 392,615 |
| Other | 284,258 | (131,157) |
| Net changes in assets and liabilities: | | |
| Accounts receivable-trade, net | (514,383) | 579,386 |
| Inventory | (958,918) | 434,531 |
| Income taxes | (463,014) | 760 |
| Other current assets | (265,960) | 128,174 |
| Accounts payable | 465,726 | 1,266,611 |
| Accrued expenses and other liabilities | 219,501 | 1,542,779 |
| Total adjustments | (284,224) | 5,008,323 |
| Net cash provided by operating activities | 1,727,909 | 6,669,085 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (731,763) | (3,272,993) |
| Purchase of certificates of deposit | (7,526,000) | (1,858,000) |
| Proceeds from maturities of certificates of deposit | 5,128,000 | - |
| Decrease in marketable securities | - | 100,000 |
| Proceeds from sale of assets | 2,090 | 39,556 |
| Decrease (increase) in other assets | 204 | 751,200 |
| Net cash used in investing activities | (3,127,469) | (4,240,237) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on long-term debt and notes payable | (151,875) | (84,375) |
| Payments on capital lease obligations | (593,949) | (145,795) |
| Repurchase of common stock (treasury stock) | (1,492,375) | - |
| Proceeds from issuance of common stock | 24,818 | 14,500 |
| Net cash used in financing activities | (2,213,381) | (215,670) |
| NET CHANGE IN CASH | (3,612,941) | 2,213,178 |
| CASH, beginning of period | 7,810,298 | 6,310,396 |

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

| | | |
|---------------------|-------------|-------------|
| CASH, end of period | \$4,197,357 | \$8,523,574 |
|---------------------|-------------|-------------|

SUPPLEMENTAL DISCLOSURES OF CASH FLOW
INFORMATION:

| | | |
|---|-----------|-----------|
| Interest paid during the period | \$229,879 | \$249,725 |
| Income taxes paid during the period, net of (refunds) | 1,304,838 | 634,749 |

NON-CASH INVESTING ACTIVITIES:

| | | |
|---|---|---------|
| Equipment acquired under capital lease financing arrangements | - | 803,713 |
|---|---|---------|

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

Table of Contents

Tandy Leather Factory, Inc.
 Consolidated Statements of Stockholders' Equity
 (Unaudited)
 For the Nine Months Ended September 30, 2009 and 2008

| | Number of Shares | Par Value | Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|--|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|--------------------------------|
| BALANCE, December 31, 2007 | 10,977,092 | \$26,359 | \$5,419,477 | \$(25,487) | \$24,037,672 | \$357,483 | \$29,815,504 | |
| Shares issued - stock options and warrants exercised 12,000 | | 29 | 14,471 | - | - | - | 14,500 | |
| Stock-based compensation | - | - | 22,875 | - | - | - | 22,875 | |
| Net income | - | - | - | - | 1,660,762 | - | 1,660,762 | \$1,660,762 |
| Translation adjustment | - | - | - | - | - | (139,789) | (139,789) | (139,789) |
| BALANCE, September 30, 2008 | 10,989,092 | \$26,388 | \$5,456,823 | \$(25,487) | \$25,698,434 | \$217,694 | \$31,373,852 | |
| Comprehensive income for the nine months ended September 30, 2008 | | | | | | | | \$1,520,973 |
| BALANCE, December 31, 2008 | 10,664,555 | \$26,388 | \$5,464,443 | \$(828,385) | \$26,641,853 | \$(39,537) | \$31,264,762 | |

| | | | | | | | | |
|---|------------|----------|-------------|---------------|--------------|-------------|--------------|-------------|
| Shares issued | - | | | | | | | |
| stock options exercised 27,000 | 65 | 24,753 | - | - | - | 24,818 | | |
| Purchase of treasury stock (525,227) | - | - | (1,492,375) | - | - | (1,492,375) | | |
| Stock-based compensation | - | 2,540 | - | - | - | 2,540 | | |
| Net income | - | - | - | 2,012,133 | - | 2,012,133 | \$2,012,133 | |
| Translation adjustment | - | - | - | - | - | 314,916 | 314,916 | 314,916 |
| BALANCE, September 30, 2009 | 10,166,328 | \$26,453 | \$5,491,736 | \$(2,320,760) | \$28,653,986 | \$275,379 | \$32,126,794 | |
| Comprehensive income for the nine months ended September 30, 2009 | | | | | | | | \$2,327,049 |

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

Table of Contents

TANDY LEATHER FACTORY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

These financial statements include the accounts of Tandy Leather Factory, Inc. and its subsidiaries. Unless the context indicates otherwise, references to “we”, “us”, and “our” refer to the consolidated operations of Tandy Leather Factory, Inc. and its subsidiaries. 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, 2009 and December 31, 2008, and its results of operations and cash flows for the three and/or nine-month periods ended September 30, 2009 and 2008, respectively. Operating results for the three and nine-month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2009. 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, 2008.

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 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, 2009 | December 31, 2008 |
| Inventory on hand: | | |
| Finished goods held for sale | \$15,234,087 | \$14,867,830 |
| Raw materials and work in process | 641,623 | 415,644 |
| Inventory in transit | 1,094,355 | 727,673 |
| | \$16,970,065 | \$16,011,147 |

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 tested 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, 2008, 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 respective goodwill balances. No indicators of impairment were identified during the first nine months of 2009.

A summary of changes in our goodwill for the nine-month periods ended September 30, 2009 and 2008 is as follows:

| | Leather Factory | Tandy Leather | Total |
|------------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2007 | \$607,130 | \$383,406 | \$990,536 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain (loss) | (8,632) | - | (8,632) |
| Impairments | - | - | - |
| Balance, September 30, 2008 | \$598,498 | \$383,406 | \$981,904 |

| | Leather Factory | Tandy Leather | Total |
|------------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2008 | \$583,249 | \$383,406 | \$966,655 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain (loss) | 14,515 | - | 14,515 |
| Impairments | - | - | - |
| Balance, September 30, 2009 | \$597,764 | \$383,406 | \$981,170 |

Other intangibles consist of the following:

| | As of September 30, 2009 | | | As of December 31, 2008 | | |
|------------------------|--------------------------|------------------------------|-----------|-------------------------|------------------------------|-----------|
| | Gross | Accumulated Net Amortization | | Gross | Accumulated Net Amortization | |
| Trademarks, Copyrights | \$544,369 | \$346,994 | \$197,375 | \$544,369 | \$319,776 | \$224,593 |
| Non-Compete Agreements | 181,029 | 58,335 | 122,694 | 177,708 | 46,809 | 130,899 |
| | \$725,398 | \$405,329 | \$320,069 | \$722,077 | \$366,585 | \$355,492 |

We recorded amortization expense of \$34,587 during the first nine months of 2009, equal to that during the same period in 2008. All of our intangible assets are subject to amortization in accordance with U.S. GAAP. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding five years is as follows:

| | Wholesale Leathercraft | Retail Leathercraft | Total |
|------|------------------------|---------------------|----------|
| 2009 | \$20,954 | \$30,337 | \$51,291 |
| 2010 | 20,954 | 30,337 | 51,291 |
| 2011 | 20,027 | 30,337 | 50,364 |
| 2012 | 1,250 | 30,337 | 31,587 |
| 2013 | - | 30,337 | 30,337 |

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.

Subsequent Events. Management has evaluated subsequent events after the balance sheet date through November 16, 2009 for appropriate accounting and disclosure.

5

Table of Contents

Recently Adopted Accounting Guidance

In June 2009, the FASB issued The Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, which establishes the FASB Accounting Standards Codification (the “Codification”) as the single source of authoritative U.S. generally accepted accounting principles (“GAAP”) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases issued by the Securities and Exchange Commission (“SEC”) are also sources of authoritative GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification became nonauthoritative. The Codification was effective for us July 1, 2009 and its adoption did not have a material impact on our consolidated financial condition or results of operations.

In May 2009, the FASB issued accounting guidance on subsequent events which requires companies to address the accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, companies must name the two types of subsequent events either as recognized or non-recognized subsequent events and disclose the date through it has evaluated subsequent events and the basis for that date, i.e. whether that date represents the date the financial statements were issued or were available to be issued. We adopted this standard, as required, for the period ended June 30, 2009. The adoption of accounting guidance did not have a material impact on our financial position, results of operations and cash flows

In April 2009, the FASB issued accounting guidance requiring disclosure about the method and significant assumptions used to establish the fair value of financial instruments for interim reporting periods as well as annual statements. The adoption of this accounting guidance did not have a material impact on our consolidated financial condition or results of operations.

In December 2007, the FASB issued accounting guidance which requires all companies to recognize noncontrolling interests (previously referred to as “minority interests”) as a separate component in the equity section of the consolidated statement of financial position. It also requires changes in ownership interest to be accounted for similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. This guidance was effective for us in January 2009 and did not have a material impact on our financial position, results of operations and cash flows.

2. SHORT-TERM INVESTMENTS

All current fixed maturity securities are classified as “available for sale” and are reported at carrying value, which approximates fair value. We have determined that our investment securities are available to support current operations and, accordingly, have classified such securities as current assets without regard to contractual maturities. Investments at September 30, 2009 and December 31, 2008 consisted of certificates of deposit. The contractual maturities of the certificates of deposit as of September 30, 2009 are shown below. Actual maturities may differ from the contractual maturities because debtors may have the right to call obligations with or without call penalties.

| | |
|--------------------------------------|-------------|
| Due within one year | \$2,629,000 |
| Due between one and five years | 2,582,000 |
| Due between five and ten years | - |
| Due between ten and fifteen years | 99,000 |
| Due between fifteen and twenty years | 99,000 |
| | \$5,409,000 |

3. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, 2007, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to \$5,500,000 to facilitate our purchase of real estate consisting of a 195,000 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 and accrues interest at a rate of 7.10% per annum.

At September 30, 2009 and December 31, 2008, the amount outstanding under the above agreement consisted of the following:

| | September 30, 2009 | December 31, 2008 |
|---|-----------------------|----------------------|
| 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 | \$ 3,763,125 | \$3,915,000 |
| Capital lease secured by HVAC equipment – total monthly principal and interest payments of \$24,328 at approximately 5.7% interest per annum, matures February 2011; paid in full in May 2009 | - | 593,949 |
| | 3,763,125 | 4,508,949 |
| Less - Current maturities | (202,500) | (467,611) |
| | \$3,560,625 | \$4,041,338 |

Table of Contents

4. STOCK-BASED COMPENSATION

We have one stock option plan which provides for stock option grants to non-employee directors. No options have been awarded as of September 30, 2009. 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 had no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our common stock on the date the option was granted and no option has a term in excess of ten years. Additionally, options vest and become exercisable either six months from the option grant date or in equal installments over a five year period.

We recognized share based compensation expense of \$0 and \$7,625 for each of the quarters ended September 30, 2009 and 2008, respectively, and \$2,540 and \$22,875 for each of the nine month periods ended September 30, 2009 and 2008, respectively, as a component of operating expenses.

During the nine months ended September 30, 2009 and 2008, the stock option activity under our stock option plans was as follows:

| | Weighted Average Exercise Price | # of shares | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---------------------------------|---------------------------------------|----------------|---|---------------------------------|
| Outstanding, January 1, 2008 | \$2.11 | 236,700 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 1.21 | 12,000 | | |
| Outstanding, September 30, 2008 | \$2.16 | 224,700 | 3.46 | \$262,001 |
| Exercisable, September 30, 2008 | \$2.15 | 222,700 | 3.44 | \$259,461 |
| Outstanding, January 1, 2009 | \$2.16 | 224,700 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 0.92 | 27,000 | | |
| Outstanding, September 30, 2009 | \$2.33 | 197,700 | 2.55 | \$246,088 |
| Exercisable, September 30, 2009 | \$2.33 | 197,700 | 2.55 | \$246,088 |

Other information pertaining to option activity during the nine month periods ended September 30, 2009 and 2008 is as follows:

| | September 30, 2009 | September 30, 2008 |
|---|--------------------|--------------------|
| Weighted average grant-date fair value of stock options granted | N/A | N/A |
| Total fair value of stock options vested | \$2,540 | \$30,500 |
| Total intrinsic value of stock options exercised | \$1,035 | \$8,779 |

As of September 30, 2009 and 2008, there was \$0 and \$10,000, respectively, of total unrecognized compensation cost related to nonvested stock options.

5. 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, 2009 and 2008:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------|-------------------|-------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Numerator: | | | | |
| Net income | \$552,965 | \$421,014 | \$2,012,133 | \$1,660,762 |
| Numerator for basic and diluted earnings per share | 552,965 | 421,014 | 2,012,133 | 1,660,762 |
| Denominator: | | | | |
| Weighted-average shares outstanding-basic | 10,387,462 | 10,988,092 | 10,575,904 | 10,982,209 |
| Effect of dilutive securities: | | | | |
| Stock options | 69,856 | 85,850 | 60,186 | 90,508 |
| Dilutive potential common shares | 69,856 | 85,850 | 60,186 | 90,508 |
| Denominator for diluted earnings per share-weighted-average shares | 10,457,318 | 11,073,942 | 10,636,090 | 11,072,717 |
| Basic earnings per share | \$0.05 | \$0.04 | \$0.19 | \$0.15 |
| Diluted earnings per share | \$0.05 | \$0.04 | \$0.19 | \$0.15 |

The net effect of converting stock options to purchase 71,000 and 155,700 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the quarter and nine months ended September 30, 2009 and 2008, respectively.

Table of Contents

6. SEGMENT INFORMATION

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

- a. Wholesale Leathercraft, which consists of a chain of warehouse distribution units 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 North America;
- c. International Leathercraft, sells to both wholesale and retail customers. It carries the same products as our North American stores. This operation started in February 2008 with one store located in Northampton, United Kingdom; and
- d. Other, which consists of Roberts, Cushman & Co., a distributor of decorative hat trims sold directly to hat manufacturers.

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 | International Leathercraft | Other | Total |
|--|---------------------------|------------------------|-------------------------------|-----------|--------------|
| For the quarter ended September 30, 2009 | | | | | |
| Net sales | \$5,877,153 | \$6,444,179 | \$342,272 | \$123,660 | \$12,787,264 |
| Gross profit | 3,377,777 | 3,951,290 | 230,083 | 38,440 | 7,597,590 |
| Operating earnings | 348,567 | 472,653 | 52,446 | (1,972) | 871,694 |
| Interest (expense) | (68,895) | - | - | - | (68,895) |
| Other income (expense), net | (5,095) | (2,822) | (36,302) | (4,088) | (48,307) |
| Income before income taxes | 274,577 | 469,831 | 16,144 | (6,060) | 754,492 |
| Depreciation and amortization | 253,246 | 34,677 | 3,627 | 140 | 291,690 |
| Fixed asset additions | 228,397 | 60,577 | 387 | - | 289,361 |
| Total assets | \$34,344,104 | \$5,740,148 | \$1,381,151 | \$120,085 | \$41,585,488 |

| | | | | | |
|--|--------------|-------------|-----------|-----------|--------------|
| For the quarter ended September 30, 2008 | | | | | |
| Net sales | \$5,997,550 | \$5,726,164 | \$324,081 | \$204,195 | \$12,251,990 |
| Gross profit | 3,377,119 | 3,453,759 | 224,563 | 87,716 | 7,143,157 |
| Operating earnings | 435,790 | 234,743 | 55,008 | 39,942 | 765,483 |
| Interest expense | (80,072) | - | - | - | (80,072) |
| Other income (expense), net | 86,999 | 2,887 | (64,214) | - | 25,672 |
| Income before income taxes | 442,717 | 237,630 | (9,206) | 39,942 | 711,083 |
| Depreciation and amortization | 228,936 | 30,644 | 3,684 | 209 | 263,473 |
| Fixed asset additions | 148,597 | 27,404 | 19,018 | - | 195,019 |
| Total assets | \$36,495,134 | \$5,603,759 | \$695,395 | \$184,210 | \$42,978,498 |

Wholesale Retail International
Leathercraft Leathercraft Leathercraft Other Total

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

For the nine months ended
September 30, 2009

| | | | | | |
|-----------------------------|--------------|--------------|-----------|-----------|--------------|
| Net sales | \$18,276,276 | \$19,673,925 | \$942,996 | \$469,997 | \$39,363,194 |
| Gross profit | 10,448,620 | 11,928,023 | 598,993 | 180,282 | 23,155,918 |
| Operating earnings | 1,243,341 | 1,669,129 | 106,499 | 32,431 | 3,051,400 |
| Interest (expense) | (229,879) | - | - | - | (229,879) |
| Other income (expense), net | 82,438 | (1,933) | 95,864 | (4,488) | 171,881 |
| Income before income taxes | 1,095,900 | 1,667,196 | 202,363 | 27,943 | 2,993,402 |

| | | | | | |
|-------------------------------|--------------|-------------|-------------|-----------|--------------|
| Depreciation and amortization | 750,644 | 91,549 | 10,192 | 558 | 852,943 |
| Fixed asset additions | 611,576 | 119,800 | 387 | - | 731,763 |
| Total assets | \$34,344,104 | \$5,740,148 | \$1,381,151 | \$120,085 | \$41,585,488 |

For the nine months ended
September 30, 2008

| | | | | | |
|-----------------------------|--------------|--------------|-----------|-----------|--------------|
| Net sales | \$19,953,958 | \$18,232,364 | \$559,641 | \$614,151 | \$39,360,114 |
| Gross profit | 10,997,820 | 11,260,249 | 366,572 | 271,190 | 22,895,830 |
| Operating earnings | 1,084,364 | 1,421,064 | 6,090 | 66,866 | 2,578,384 |
| Interest expense | (249,725) | - | - | - | (249,725) |
| Other income (expense), net | 401,027 | 2,486 | (71,158) | - | 332,355 |
| Income before income taxes | 1,235,666 | 1,423,550 | (65,068) | 66,866 | 2,661,014 |

| | | | | | |
|-------------------------------|--------------|-------------|-----------|-----------|--------------|
| Depreciation and amortization | 660,311 | 94,401 | 10,081 | 1,266 | 766,058 |
| Fixed asset additions | 3,155,361 | 91,161 | 25,409 | 1,062 | 3,272,993 |
| Total assets | \$36,495,134 | \$5,603,759 | \$695,395 | \$184,210 | \$42,978,498 |

Table of Contents

Net sales for geographic areas for the three and nine months ended September 30, 2009 and 2008 were as follows:

| Three months ended September 30, | 2009 | 2008 |
|----------------------------------|--------------|--------------|
| United States | \$11,012,136 | \$10,511,250 |
| Canada | 1,097,646 | 1,078,747 |
| All other countries | 677,482 | 661,993 |
| | \$12,787,264 | \$12,251,990 |

| Nine months ended September 30, | 2009 | 2008 |
|---------------------------------|--------------|--------------|
| United States | \$34,274,040 | \$34,124,413 |
| Canada | 3,228,780 | 3,550,955 |
| All other countries | 1,860,374 | 1,684,746 |
| | \$39,363,194 | \$39,360,114 |

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, 2009 or 2008. 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 NYSE Amex (formerly the American Stock Exchange) under the symbol, "TLF." We operate our business in four 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, International Leathercraft, which operates combination retail/wholesale stores outside of North America under the trade name, Tandy Leather Factory, and Other. See Note 6 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

Our Wholesale Leathercraft segment operates 30 company-owned wholesale stores in 20 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.

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 35 states and five Canadian provinces. Tandy Leather Company, the oldest and best-known supplier of leather and related supplies used in the leathercraft industry, has been the primary leathercraft resource for decades. Tandy Leather's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather's industry presence by opening retail stores. As of November 1, 2009, we were operating 75 Tandy Leather retail stores located throughout the United States and Canada.

Our International Leathercraft segment operates one company-owned store in Northampton, United Kingdom. The store, which opened in February 2008, operates as a combination retail and wholesale store.

Our “Other” segment consists of Roberts, Cushman and Co., a wholly-owned subsidiary that custom designs and distributes decorative hat trims for headwear manufacturers.

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, 2008.

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, 2008 for additional information concerning these and other uncertainties that could negatively impact the Company.

Ø We believe that a rise in oil and natural gas prices will increase the costs of the goods that we sell, including the costs of shipping those goods from the manufacturer to our stores and customers.

Various oils used to manufacture certain leather and leathercrafts are derived from petroleum and natural gas. Also, the carriers who transport our goods rely on petroleum-based fuels to power their ships, trucks and trains. They are likely to pass any incurred cost increases on to us. We are unsure how much of this increase we will be able to pass on to our customers.

Ø Continued weakness in the economy in the United States, as well as abroad, may cause our sales to decrease or not to increase or adversely affect the prices charged for our products. Furthermore, negative trends in general consumer-spending levels, including the impact of the availability and level of consumer debt and levels of consumer confidence could adversely affect our sales.

General economic factors that are beyond our control impact our forecasts and actual performance. These factors include interest rates, recession, inflation, deflation, consumer credit availability, consumer debt levels, tax rates and policy, unemployment trends and other matters that influence consumer confidence and spending.

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, 2009 and 2008

The following tables present selected financial data of each of our four segments for the quarters ended September 30, 2009 and 2008.

| | Quarter Ended September 30, 2009 | | Quarter Ended September 30, 2008 | |
|----------------------------|----------------------------------|------------------|----------------------------------|------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$5,877,153 | \$348,567 | \$5,997,550 | \$435,791 |
| Retail Leathercraft | 6,444,179 | 472,653 | 5,726,164 | 234,743 |
| International Leathercraft | 342,272 | 52,446 | 324,081 | 55,008 |
| Other | 123,660 | (1,972) | 204,195 | 39,941 |
| Total Operations | \$12,787,264 | \$871,694 | \$12,251,990 | \$765,483 |

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

Consolidated net sales for the quarter ended September 30, 2009 increased \$535,000 or 4%, compared to the same period in 2008. Retail and International Leathercraft contributed \$718,000 and \$18,000 of additional sales, respectively, offset by a sales decrease of \$120,000 and \$81,000 in Wholesale Leathercraft and Other, respectively. Operating income on a consolidated basis for the quarter ended September 30, 2009 was up 14% or \$106,000 over the third quarter of 2008.

The following table shows in comparative form our consolidated net income for the third quarters of 2009 and 2008:

| | 2009 | 2008 | % Change |
|------------|-----------|-----------|----------|
| Net income | \$552,965 | \$421,014 | 31.3% |

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 30 wholesale stores and our National Account group. The following table presents the combined sales mix by customer categories for the quarters ended September 30, 2009 and 2008:

| Customer Group | Quarter ended | |
|---|---------------|----------|
| | 09/30/09 | 09/30/08 |
| RETAIL (end users, consumers, individuals) | 22% | 19% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7% | 6% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 45% | 39% |
| MANUFACTURERS | 9% | 10% |
| NATIONAL ACCOUNTS | 17% | 26% |
| | 100% | 100% |

Net sales were down 2% for the third quarter of 2009 as follows:

| | Quarter Ended 09/30/09 | Quarter Ended 09/30/08 | \$ change | % change |
|------------------------|------------------------|------------------------|-------------|----------|
| Same store sales (30) | \$5,056,473 | \$5,289,155 | \$(232,682) | (4.4%) |
| National account group | 820,680 | 708,395 | 112,285 | 15.8% |
| | \$5,877,153 | \$5,997,550 | \$(120,397) | (2.0%) |

Our same store sales declined 4% in the third quarter of 2009, as compared with the same period in 2008. Compared to the third quarter of 2008, sales to our Retail and Wholesale customers increased minimally while sales to our Institution and Manufacturer customers decreased. We attribute the weakness in our sales overall to general economic conditions. Sales to our national account customers were up 16% for the quarter, compared to the same quarter last year. The sales increase was due to the timing of receipts of orders.

Operating income for Wholesale Leathercraft during the quarter ended September 30, 2009 decreased by \$88,000 from the comparative 2008 quarter, a decline of 20%. Operating expenses as a percentage of sales were 51.5%, up \$88,000 from the third quarter of 2008. Employee benefits increased \$110,000, utilities increased \$58,000, and advertising increased \$65,000. These increases were partially offset with decreases in employee compensation (\$46,000), customer freight costs (\$25,000), professional/consulting services (\$14,000) and miscellaneous administrative expenses (\$60,000).

Table of Contents

Retail Leathercraft

Our Retail Leathercraft operation consists of 75 Tandy Leather retail stores at September 30, 2009, compared to 72 stores at September 30, 2008. Net sales were up approximately 13% for the third quarter of 2009 over the same quarter last year. A store is categorized as "new" until it is operating for the full comparable period in the prior year.

| | # Stores | Qtr Ended 09/30/09 | Qtr Ended 09/30/08 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|----------|-----------------------|-----------------------|-------------------|------------------|
| Same (existing) store sales | 72 | \$6,273,553 | \$5,716,139 | \$557,414 | 9.8% |
| New store sales | 3 | 170,626 | 10,025 | 160,601 | N/A |
| Total sales | 75 | \$6,444,179 | \$5,726,164 | \$718,015 | 12.5% |

The following table presents sales mix by customer categories for the quarters ended September 30, 2009 and 2008 for our Retail Leathercraft operation:

| Customer Group | Quarter Ended | |
|---|---------------|----------|
| | 09/30/09 | 09/30/08 |
| RETAIL (end users, consumers, individuals) | 62% | 61% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7% | 9% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 30% | 29% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 1% | 1% |
| | 100% | 100% |

Sales to our Retail and Wholesale customer groups in the third quarter of 2009 increased compared to the third quarter of 2008, while sales to our Institution and Manufacturer customer group declined. These sales trends are consistent throughout the company – that is, our retail business appears to be holding fairly steady while our wholesale business has declined. We believe the weak economy is the primary reason for these sales trends. The retail stores averaged approximately \$29,000 in sales per store per month for the third quarter of 2009.

Operating income in the third quarter of 2009 increased \$238,000 from the comparative 2008 quarter to 7.3% of sales, compared to 4.1% of sales in the third quarter of 2008. Our gross margin improved from 60.3% to 61.3%. Operating expenses as a percentage of sales decreased from 56.2% to 53.9% as sales grew at a faster rate than that of expenses during the quarter.

International Leathercraft

Sales totaled \$342,000 for the third quarter of 2009, compared to \$324,000 in the third quarter of 2008. Gross profit margin fell from 69.3% in last year's third quarter to 67.2% in the current quarter. The decline is due primarily to the fluctuation in inventory value between the U.S. dollar and the British pound. Operating expenses totaled \$178,000, an increase of \$8,000 over the third quarter of 2008. The largest expense contributors were employee compensation, advertising, shipping to customers, and rent.

Other (Roberts, Cushman)

Sales decreased \$80,000 or 39% for the third quarter of 2009. Gross profit margin declined to 31.1% compared to 42.9% in the comparable quarter in 2008 due to the write-off of selected inventory. Operating income decreased \$42,000 due to the reduction in sales and gross profit, offset somewhat by the reduction of various operating expenses.

Other Expenses

We paid \$69,000 in interest expense in the third quarter of 2009 on our bank debt, which is related to the building purchase, compared to \$80,000 in interest expense in the third quarter last year. We earned \$42,000 in interest income during the third quarter of 2009, an \$11,000 increase over last year's third quarter interest income earned of \$31,000. We recorded \$115,000 in expense during the third quarter of 2009 related to currency fluctuations from our Canadian and UK operations. Comparatively, in the third quarter of 2008, we recorded an expense of \$30,000 for currency fluctuations.

Table of Contents

Nine Months Ended September 30, 2009 and 2008

The following table presents selected financial data of each of our four segments for the nine months ended September 30, 2009 and 2008:

| | Nine Months Ended September 30, 2009 | | Nine Months Ended September 30, 2008 | |
|----------------------------|--------------------------------------|------------------|--------------------------------------|------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$18,276,276 | \$1,243,341 | \$19,953,958 | \$1,084,364 |
| Retail Leathercraft | 19,673,925 | 1,669,129 | 18,232,364 | 1,421,064 |
| International Leathercraft | 942,996 | 106,499 | 559,641 | 6,091 |
| Other | 469,997 | 32,431 | 614,151 | 66,865 |
| Total Operations | \$39,363,194 | \$3,051,400 | \$39,360,114 | \$2,578,384 |

Consolidated net sales for the nine months ended September 30, 2009 were virtually unchanged from sales for the first nine months of 2008. Retail and International Leathercraft contributed additional sales of \$1.4 million and \$383,000, respectively, offset by a combined sales decrease of \$1.8 million from Wholesale Leathercraft and Other. Operating income on a consolidated basis for the nine months ended September 30, 2009 increased 18.4% or \$473,000 compared to the first nine months of 2008.

The following table shows in comparative form our consolidated net income for the first three quarters of 2009 and 2008:

| | 2009 | 2008 | % change |
|------------|-------------|-------------|----------|
| Net income | \$2,012,133 | \$1,660,762 | 21.2% |

Wholesale Leathercraft

Net sales decreased 8.4%, or \$1.7 million, for the first three quarters of 2009 as follows:

| | Nine Months Ended 09/30/09 | Nine Months Ended 09/30/08 | \$ Change | % Change |
|------------------------|----------------------------|----------------------------|-------------|----------|
| Same store sales (29) | \$15,798,472 | \$17,350,183 | (1,551,711) | (8.9%) |
| National account group | 2,477,804 | 2,603,775 | (125,971) | (4.8%) |
| | \$18,276,276 | \$19,953,958 | (1,677,682) | (8.4%) |

The following table presents the combined sales mix by customer categories for the nine months ended September 30, 2009 and 2008:

| Customer Group | Nine Months Ended | |
|---|-------------------|----------|
| | 09/30/09 | 09/30/08 |
| RETAIL (end users, consumers, individuals) | 27% | 25% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7% | 8% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 42% | 41% |
| MANUFACTURERS | 8% | 8% |

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

| | | |
|-------------------|------|------|
| NATIONAL ACCOUNTS | 16% | 18% |
| | 100% | 100% |

Operating income for Wholesale Leathercraft for the first three quarters of 2009 increased by \$159,000 from the comparative 2008 period, an improvement of 14.7%. Compared to the first nine months of 2008, operating expenses decreased \$708,000 for the first three quarters of 2009, but increased slightly as a percentage of sales from 49.7% for the nine months ended September 30, 2008 to 50.4% for the nine months ended September 30, 2009.

Retail Leathercraft

Net sales were up approximately 8% for the first three quarters of 2009 over the same period last year.

| | # Stores | Nine Months Ended 09/30/09 | Nine Months Ended 09/30/08 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|----------|----------------------------|----------------------------|----------------|---------------|
| Same (existing) store sales | 72 | \$19,242,812 | \$18,222,339 | \$1,020,473 | 5.6% |
| New store sales | 3 | 431,113 | 10,025 | 421,088 | N/A |
| Total sales | 75 | \$19,673,925 | \$18,232,364 | \$1,441,561 | 7.9% |

The following table presents sales mix by customer categories for the nine months ended September 30, 2009 and 2008 for our Retail Leathercraft operation:

| Customer Group | Nine Months Ended | |
|---|-------------------|----------|
| | 09/30/09 | 09/30/08 |
| RETAIL (end users, consumers, individuals) | 63% | 63% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 8% | 8% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 29% | 28% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | - | 1% |
| | 100% | 100% |

The retail stores averaged approximately \$29,000 in sales per month for the first three quarters of 2009.

Operating income for the first nine months of 2009 increased \$248,000 from the comparative 2008 period, improving as a percentage of sales, from 7.8% in the first nine months of 2008 to 8.5% in the first nine months of 2009. Gross margin declined slightly from 61.8% to 60.6%. Operating expenses as a percentage of sales declined from 53.9% during the first three quarters of 2008 to 52.1% during the first three quarters of 2009.

Table of Contents

International Leathercraft

Sales totaled \$943,000 for the first nine months of 2009, an increase of 69% from sales of \$560,000 from the same period of 2008. These sales are generated from our one store located in the UK, which opened in February 2008. Gross profit margin was 63.5% for the first three quarters of 2009, a decline from the 2008 comparable period's gross profit margin of 65.5%. 2009 year-to-date operating expenses totaled \$492,000 compared to 2008 year-to-date operating expenses of \$360,000, an increase of \$132,000. Advertising, rent, and shipping costs to customers accounted for the majority of the increase over the prior year. Operating income in 2009 totaled \$106,000 compared to 2008 year-to-date operating income of \$6,000.

Other (Roberts, Cushman)

Sales decreased \$144,000 in the first nine months of 2009 compared to the same period in 2008. Gross profit margin decreased by \$91,000 and operating margin decreased by \$34,000. Operating expenses decreased by \$56,000 in the first three quarters of 2009 compared to 2008.

Other Expenses

We paid \$230,000 in interest expense in the first nine months of 2009 on our debt related to our building purchase compared to \$250,000 in interest expense in the first nine months of 2008. We earned \$103,000 in interest income in the nine months ended September 30, 2009, the same as last year's interest income year to date. We recorded \$8,000 in expense during the nine months ended September 30, 2009 for currency fluctuations from our Canadian and UK operations. Comparatively, in the first three quarters of 2008, we recorded an expense of \$9,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets increased from \$40.9 million at year-end 2008 to \$41.6 million at September 30, 2009. The increase in short-term investments, accounts receivable and inventory, offset partially by the decrease in cash, accounted for the increase. Total stockholders' equity increased from \$31.3 million at December 31, 2008 to \$32.1 million at September 30, 2009. The increase was attributable to earnings in the first three quarters of the year, partially offset by the purchase of treasury stock. Our current ratio was unchanged at 5.7 at December 31, 2008 and September 30, 2009.

Our investment in inventory increased by \$959,000 at September 30, 2009 from year-end 2008. We continue to closely manage our inventory levels to follow our sales trends. In addition, the increase in inventory is consistent with prior periods at this time of year as we stock for the fourth quarter and Christmas shopping season. Inventory turnover remained virtually unchanged for the first nine months of 2009 compared to the same period of 2008, as the year-to-date 2009 rate was 3.05 and the year-to-date 2008 rate of 3.04. Inventory turnover was 3.18 times for all of 2008. We compute our inventory turns as sales divided by average inventory. At the end of the third quarter of 2009, our total inventory on hand was within 4% of our internal targets for optimal inventory levels.

Trade accounts receivable was \$1.7 million at September 30, 2009, up \$514,000 from \$1.2 million at year-end 2008. The average days to collect accounts for the first three quarters of 2009 were 44 days, down considerably from 56 days for the first three quarters of 2008. We have tightened our credit policy given the current economic environment and are closely monitoring our customers with open accounts to ensure collectability of the accounts.

Accounts payable increased \$466,000 to \$1.6 million at the end of the September 2009, due to an intentional slowdown of payments to vendors, taking full advantage of the payment terms, and a slight increase in purchases in the latter part of the quarter. Accrued expenses and other liabilities increased \$220,000, the majority of which is the

increase in inventory in transit to us at September 30, 2009 compared to December 31, 2008, partially offset by the reduction in accrued payroll at September 30, 2009.

During the first three quarters of 2009, cash flow provided by operating activities was \$1.7 million. Net income accounted for the majority of the cash provided. Cash flow used in investing activities totaled \$3.1 million, consisting of \$2.4 million in net certificate of deposit purchases and \$731,000 in fixed asset purchases, \$130,000 of which was parking lot repaving at our building. The remaining fixed asset purchases consisted primarily of computer equipment. Cash flow used by financing activities totaled \$2.2 million, consisting of payments on our capital lease of \$594,000, payments on our building debt of \$152,000, and purchases of treasury stock of \$1.5 million, offset partially by proceeds from employee stock option exercises totaling \$25,000.

We expect to fund our operating and liquidity needs as well as our current expansion of Tandy Leather's retail store chain from a combination of current cash balances and internally generated funds.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

For disclosures about market risk affecting us, see Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for fiscal year ended December 31, 2008. Our exposure to market risks has not changed significantly since December 31, 2008.

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, 2009. 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, 2009, 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, 2009 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth the monthly repurchases of common stock for the period covered by this report:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs |
|----------------------|----------------------------------|------------------------------|--|--|
| July 1-31, 2009 | 953 (1) | \$2.60 | 953 | 974,773 |
| August 1-31, 2009 | 500,000 (2) | \$2.85 | 500,000 | 974,773 |
| September 1-30, 2009 | - | - | - | 974,773 |

(1) Represents shares purchased through a stock repurchase program permitting us to repurchase up to one million shares of our common stock at prevailing market prices not to exceed \$2.85. We announced the program on February 27, 2009. Purchases under the program commenced on April 1, 2009 and will terminate on March 10, 2010.

(2) Represents shares purchased in August 2009 pursuant to an agreement we entered into with our founder, Ronald C. Morgan and his wife, Robin L. Morgan, on August 10, 2009. We announced the purchase of these shares on August 11, 2009. The shares repurchased in this transaction did not affect the number of shares to be purchased under the stock repurchase program discussed in footnote (1) above.

We have not repurchased any shares of our common stock since August 2009 because the market price of our common stock has been above the maximum price allowed under the stock repurchase program described in footnote (1) above.

Item 6. Exhibits

| Exhibit Number | Description |
|----------------|--|
| 3.1 | Certificate of Incorporation of The Leather Factory, Inc., and Certificate of Amendment to Certificate of Incorporation of The Leather Factory, Inc. filed as Exhibit 3.1 to Form 10-Q filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on August 12, 2005 and incorporated by reference herein. |
| 3.2 | Bylaws of The Leather Factory, Inc., filed as Exhibit 3.2 to the Registration Statement on Form SB-2 of The Leather Factory, Inc. (Commission File No. 33-81132), filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on July 5, 1994 and incorporated by reference herein. |
| 10.1 | Stock Purchase Agreement, dated August 10, 2009, by and among Ronald C. Morgan, Robin L. Morgan and Tandy Leather Factory, Inc., filed as Exhibit 1.02 to Form 8-K filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on August 11, 2009 and incorporated by reference herein |
| *31.1 | 13a-14(a) Certification by Jon Thompson, Chief Executive Officer and President. |

*31.2 13a-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.

*Filed herewith.

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 16, 2009

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

Date: November 16, 2009

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

Table of Contents