

TANDY LEATHER FACTORY INC
Form 10-Q
November 13, 2006

**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 ACT OF 1934

For the quarterly period ended September 30, 2006

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 incorporate of organization)

75-2543540

(IRS Employer Identification Number)

3847 East Loop 820 South, Fort Worth, Texas 76119

(Address of principal executive offices) (Zip Code)

(817) 496-4414

(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 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

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

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 6, 2006
Common Stock, par value \$0.0024 per share	10,849,000

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006

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Tandy Leather Factory, Inc.
Consolidated Balance Sheets

	September 30, 2006 (unaudited)	December 31, 2005 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$4,970,230	\$3,215,727
Accounts receivable-trade, net of allowance for doubtful accounts of \$134,000 and \$138,000 in 2006 and 2005, respectively	2,427,790	2,178,848
Inventory	17,162,865	15,669,182
Prepaid income taxes	213,095	-
Deferred income taxes	229,015	273,872
Other current assets	1,006,938	358,058
Total current assets	26,009,933	21,695,687
PROPERTY AND EQUIPMENT, at cost	6,757,607	6,424,091
Less accumulated depreciation and amortization	(4,878,481)	(4,664,614)
	1,879,126	1,759,477
GOODWILL	751,082	746,611
OTHER INTANGIBLES, net of accumulated amortization of \$252,000 and \$223,000 in 2006 and 2005, respectively	370,248	398,967
OTHER assets	1,070,323	1,079,731
	\$30,080,712	\$25,680,473
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	\$3,144,495	\$1,220,420
Accrued expenses and other liabilities	1,719,699	2,550,573
Income taxes payable	-	199,581
Current maturities of capital lease obligations	134,067	134,067
Total current liabilities	4,998,261	4,104,641
DEFERRED INCOME TAXES	218,371	206,253
LONG-TERM DEBT, net of current maturities	-	-
CAPITAL LEASE OBLIGATIONS, net of current maturities	11,172	111,722
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.10 par value; 20,000,000 shares authorized; none issued or outstanding	-	-
Common stock, \$0.0024 par value; 25,000,000 shares authorized;		

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10,837,000 and 10,741,835 shares issued at 2006 and 2005,
respectively;

10,831,141 and 10,735,976 outstanding at 2006 and 2005,
respectively

	26,008	25,780
Paid-in capital	5,173,407	4,988,445
Retained earnings	19,541,650	16,172,475
Treasury stock	(25,487)	(25,487)
Accumulated other comprehensive income	137,330	96,644
Total stockholders' equity	24,852,908	21,257,857
	\$30,080,712	\$25,680,473

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

Tandy Leather Factory, Inc.
Consolidated Statements of Income
(Unaudited)
For the Three and Nine Months Ended September 30, 2006 and 2005

	THREE MONTHS		NINE MONTHS	
	2006	2005	2006	2005
NET SALES	\$12,559,593	\$11,777,133	\$40,366,325	\$36,666,348
COST OF SALES	5,488,179	5,013,331	17,458,476	15,845,392
Gross profit	7,071,414	6,763,802	22,907,849	20,820,956
OPERATING EXPENSES	5,807,442	5,865,676	17,903,337	17,031,669
INCOME FROM OPERATIONS	1,263,972	898,126	5,004,512	3,789,287
OTHER INCOME (EXPENSE):				
Interest expense	-	-	-	(3,188)
Other, net	37,422	80,185	84,951	104,404
Total other income (expense)	37,422	80,185	84,951	101,216
INCOME BEFORE INCOME TAXES	1,301,394	978,311	5,089,463	3,890,503
PROVISION FOR INCOME TAXES	410,975	282,221	1,720,288	1,357,522
NET INCOME	\$890,419	\$696,090	\$3,369,175	\$2,532,981
NET INCOME PER COMMON SHARE-BASIC	\$0.08	\$0.07	\$0.31	\$0.24
NET INCOME PER COMMON SHARE-DILUTED	\$0.08	\$0.06	\$0.30	\$0.23

**Weighted Average Number of Shares
Outstanding:**

Basic	10,818,130	10,679,389	10,788,720	10,626,857
Diluted	11,102,383	11,029,840	11,105,903	10,965,922

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Cash Flows
(Unaudited)
For the Nine Months Ended September 30, 2006 and 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$3,369,175	\$2,532,981
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation & amortization	291,257	346,217
Gain on disposal of assets	(1,750)	(9,145)
Non-cash stock-based compensation	78,600	-
Deferred income taxes	56,975	(173,744)
Other	36,215	35,123
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(248,942)	(375,163)
Inventory	(1,493,683)	(4,784,330)
Income taxes	(412,676)	(30,268)
Other current assets	(648,880)	(230,761)
Accounts payable	1,924,075	1,312,001
Accrued expenses and other liabilities	(830,874)	1,373,522
Total adjustments	(1,249,683)	(2,536,548)
Net cash provided by (used in) operating activities	2,119,492	(3,567)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(382,187)	(197,746)
Proceeds from sale of assets	1,750	9,145
Decrease (increase) in other assets	9,408	(168,567)
Net cash used in investing activities	(371,029)	(357,168)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in revolving credit loans	-	(505,154)
Payments on capital lease obligations	(100,550)	(100,551)
Proceeds from issuance of common stock	106,590	174,413
Net cash provided by (used in) financing activities	6,040	(431,292)
NET CHANGE IN CASH	1,754,503	(792,027)
CASH, beginning of period	3,215,727	2,560,202
CASH, end of period	\$4,970,230	\$1,768,175
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid during the period	-	\$3,188

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Income taxes paid during the period, net of (refunds)	\$1,833,737	1,541,134
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The accompanying notes are an integral part of these financial statements.

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Tandy Leather Factory, Inc.
Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30, 2006 and 2005

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
BALANCE,								
December 31, 2004	10,560,661	\$25,345	\$4,796,999	\$(25,487)	\$12,458,760	\$54,616	\$17,310,233	
Shares issued - stock options exercised								
	159,674	384	174,029	-	-	-	174,413	
Net income								
	-	-	-	-	2,532,981	-	2,532,981	\$2,532,981
Translation adjustment								
	-	-	-	-	-	38,756	38,756	38,756
BALANCE,								
September 30, 2005	10,720,335	\$25,729	\$4,971,028	\$(25,487)	\$14,991,741	\$93,372	\$20,056,383	
Comprehensive income for the nine months ended September 30, 2005								\$2,571,737
BALANCE,								
December 31, 2005	10,741,835	\$25,780	\$4,988,445	\$(25,487)	\$16,172,475	\$96,644	\$21,257,857	
Shares issued - stock options and warrants exercised								
	95,165	228	106,362	-	-	-	106,590	
Stock-based compensation								
	-	-	78,600	-	-	-	78,600	
Net income								
	-	-	-	-	3,369,175	-	3,369,175	\$3,369,175
Translation adjustment								
	-	-	-	-	-	40,686	40,686	40,686
BALANCE,								
September 30, 2006	10,837,000	\$26,008	\$5,173,407	\$(25,487)	\$19,541,650	\$137,330	\$24,852,908	

Comprehensive income for the nine months ended September 30, 2006	\$3,409,861
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The accompanying notes are an integral part of these financial statements.

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, 2006 and December 31, 2005, and its results of operations and cash flows for the three- and/or nine-month periods ended September 30, 2006 and 2005. Operating results for the three and nine-month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. 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, 2005.

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, 2006	December 31, 2005
Inventory on hand:		
Finished goods held for sale	\$16,164,887	\$14,035,384
Raw materials and work in process	661,493	984,878
Inventory in transit	336,485	648,920
	\$17,162,865	\$15,669,182

Goodwill and Other Intangibles. Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," prescribes a two-phase process for impairment testing of goodwill, which is performed once annually, absent indicators of impairment during the interim. 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, 2005, 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 2006.

Other intangibles consist of the following:

As of September 30, 2006			As of December 31, 2005		
Accumulated			Accumulated		
Gross	Amortization	Net	Gross	Amortization	Net
\$544,369	\$238,121	\$306,248	\$544,369	\$210,902	\$333,467

Trademarks, Copyrights Non-Compete Agreements	78,000	14,000	64,000	78,000	12,500	65,500
	\$622,369	\$252,121	\$370,248	\$622,369	\$223,402	\$398,967

We recorded amortization expense of \$28,719 during the first nine months of 2006 compared to \$29,218 during the first half of 2005. All of our intangible assets are subject to amortization under SFAS 142. 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
2006	\$5,954	\$32,337	\$38,291
2007	5,954	31,837	37,791
2008	5,954	30,337	36,291
2009	5,954	30,337	36,291
2010	5,954	30,337	36,291

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.

Recent Accounting Pronouncements. In December 2004, the FASB issued SFAS No. 153, “Exchanges of Nonmonetary Assets, an Amendment of APB Opinion No. 29” (“SFAS No. 153”), which is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets. The adoption of SFAS No. 153 did not have a material impact on our financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154 “Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and Statement No. 3” (“SFAS No. 154”). Previously, APB Opinion No. 20 “Accounting Changes” and SFAS No. 3 “Reporting Accounting Changes in Interim Financial Statements” required the inclusion of the cumulative effect of changes in accounting principle in net income of the period of the change. SFAS No. 154, which is effective January 1, 2006, requires companies to recognize a change in accounting principle, including a change required in a new accounting pronouncement when the pronouncement does not include specific transition provisions, retrospectively to prior periods’ financial statements. We will assess the impact of a change in accounting principle in accordance with SFAS No. 154 when such a change arises.

In June 2006 the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes,” (“FIN No. 48”) which becomes effective for fiscal years beginning after December 15, 2006. While we have not fully assessed the potential impact on our financial statements of adopting the interpretation in 2007, we do not believe the impact will be material. FIN 48 clarifies the accounting in accordance with SFAS No. 109, “Accounting for Income Taxes,” by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

2. STOCK-BASED COMPENSATION

We have two stock option plans which provide for stock option grants to officers, key employees and directors. Under the plans, 38,000 shares of our Common Stock are available for issuance. 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. Prior to fiscal 2006, we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation*.

On January 1, 2006, we adopted SFAS No. 123(R), "Share-Based Payment," and elected to adopt the standard using the modified prospective transition method. Under this transition method, compensation cost associated with stock options recognized in 2006 includes: (1) amortization related to the remaining unvested portion of all share based payments granted prior to, but not vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original pro forma footnote disclosure provisions of FASB Statement No. 123 and (2) amortization related to all share based payments granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of FASB Statement No. 123(R). Accordingly, stock compensation award expense is recognized over the requisite service period using the straight-line attribution method. Previously reported amounts have not been restated.

We recognized share-based compensation expense of approximately \$34,000 and \$79,000, respectively, for the three and nine months ended September 30, 2006, as a component of operating expenses. Had compensation expense for our stock option plans been based upon the projected fair values at the grant dates for awards under those plans in accordance with SFAS No. 123, our pro forma net earnings, basic and diluted earnings per common share for the three and nine months ended September 30, 2005 would have been as follows:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	\$696,090	\$2,532,981
Add: Stock-based compensation expense included in reported net income	-	-
Deduct: Stock-based compensation expense determined under fair value method	30,734	92,201
Net income, pro forma	\$665,356	\$2,440,780
Net income per share:		