

TANDY LEATHER FACTORY INC
Form 10-Q
November 13, 2015

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, 2015

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)

(Former name, former address and former fiscal year, if changed since last report)

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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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 the definitions 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 [] (Do not check if a smaller reporting company) Smaller reporting company [X]

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, 2015
Common Stock, par value \$0.0024 per share	9,753,293

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

	September 30, 2015 (unaudited)	December 31, 2014 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$7,243,288	\$10,636,530
Accounts receivable-trade, net of allowance for doubtful accounts of \$1,492 and \$395 in 2015 and 2014, respectively	585,012	625,054
Inventory	35,058,012	32,875,492
Prepaid income taxes	868,582	336,828
Deferred income taxes	342,763	371,491
Prepaid expenses	1,659,052	1,348,652
Other current assets	249,089	157,758
Total current assets	46,005,798	46,351,805
PROPERTY AND EQUIPMENT, at cost	23,242,846	22,199,943
Less accumulated depreciation and amortization	(7,971,654)	(7,037,665)
	15,271,192	15,162,278
GOODWILL	956,584	971,786
OTHER INTANGIBLES, net of accumulated amortization of approximately \$696,000 and \$665,000 in 2015 and 2014, respectively	34,025	58,026
OTHER assets	332,881	329,979
TOTAL ASSETS	\$62,600,480	\$62,873,874
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	\$2,498,058	\$1,255,218
Accrued expenses and other liabilities	6,396,752	5,394,514
Current maturities of long-term debt	-	3,702,500
Total current liabilities	8,894,810	10,352,232
DEFERRED INCOME TAXES	1,361,631	1,458,005
LONG-TERM DEBT, net of current maturities	3,711,224	1,940,625
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;		

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11,275,641 and 11,239,157 shares issued at 2015 and 2014,
respectively;

9,753,293 and 10,245,534 shares outstanding at 2015 and 2014,
respectively

	27,062	26,984
Paid-in capital	6,129,736	6,013,325
Retained earnings	50,728,476	46,664,829
Treasury stock at cost (1,522,348 shares at 2015; 993,623 shares at 2014)	(6,602,930)	(2,894,068)
Accumulated other comprehensive income	(1,649,529)	(688,058)
Total stockholders' equity	48,632,815	49,123,012
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$62,600,480	\$62,873,874

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

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Tandy Leather Factory, Inc.
 Consolidated Statements of Income
 (Unaudited)
 For the Three and Nine Months Ended September 30, 2015 and 2014

	THREE MONTHS		NINE MONTHS	
	2015	2014	2015	2014
NET SALES	\$19,355,937	\$19,417,234	\$59,918,229	\$58,959,307
COST OF SALES	7,523,240	7,242,525	22,688,223	21,289,269
Gross profit	11,832,697	12,174,709	37,230,006	37,670,038
OPERATING EXPENSES	9,972,946	9,717,782	30,647,532	29,590,171
INCOME FROM OPERATIONS	1,859,751	2,456,927	6,582,474	8,079,867
OTHER INCOME (EXPENSE):				
Interest expense	(228,235)	(63,684)	(307,160)	(154,367)
Other, net	38,320	37,525	68,070	44,203
Total other income (expense)	(189,915)	(26,159)	(239,090)	(110,164)
INCOME BEFORE INCOME TAXES	1,669,836	2,430,768	6,343,384	7,969,703
PROVISION FOR INCOME TAXES	558,492	802,206	2,279,737	2,721,244
NET INCOME	\$1,111,344	\$1,628,562	\$4,063,647	\$5,248,459
NET INCOME PER COMMON SHARE:				
Basic	\$0.11	\$0.16	\$0.40	\$0.51
Diluted	\$0.11	\$0.16	\$0.40	\$0.51
Weighted Average Number of Shares Outstanding:				
Basic	10,175,650	10,203,711	10,199,841	10,200,411
Diluted	10,199,092	10,241,410	10,226,877	10,240,109

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

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Tandy Leather Factory, Inc.
 Consolidated Statements of Comprehensive Income
 (Unaudited)
 For the Three and Nine Months Ended September 30, 2015 and 2014

	THREE MONTHS		NINE MONTHS	
	2015	2014	2015	2014
NET INCOME	\$1,111,344	\$1,628,562	\$4,063,647	\$5,248,459
Foreign currency translation adjustments	(794,904)	(721,916)	(961,471)	(631,301)
COMPREHENSIVE INCOME	\$316,440	\$906,646	\$3,102,176	\$4,617,158

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, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$4,063,647	\$5,248,459
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,163,116	1,088,758
(Gain) loss on disposal or abandonment of assets	25,782	8,603
Non-cash stock-based compensation	106,569	48,441
Deferred income taxes	(67,646)	(227,486)
Net changes in assets and liabilities:		
Accounts receivable-trade, net	40,042	60,403
Inventory	(2,182,520)	(13,064,374)
Prepaid expenses	(310,400)	(11,683)
Other current assets	(91,331)	380,013
Accounts payable-trade	1,242,840	57,471
Accrued expenses and other liabilities	1,002,238	131,224
Income taxes payable	(531,754)	(735,527)
Total adjustments	396,936	(12,264,157)
Net cash provided by (used in) operating activities	4,460,583	(7,015,698)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(1,339,098)	(1,719,465)
Proceeds from sale of assets	11,372	19,935
Purchase of intangible assets	(10,000)	-
(Increase) decrease in other assets	(2,902)	6,968
Net cash used in investing activities	(1,340,628)	(1,692,562)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in revolving credit loans	(3,500,000)	6,000,000
Proceeds from notes payable and long-term debt	3,711,224	-
Payment of dividend	-	(2,549,683)
Payments on notes payable and long-term debt	(2,143,125)	(405,000)
Repurchase of common stock (treasury stock)	(3,708,862)	-
Proceeds from issuance of common stock	9,920	52,722
Net cash (used in) provided by financing activities	(5,630,843)	3,098,039
Effect of exchange rate changes on cash	(882,354)	(606,442)
NET CHANGE IN CASH	(3,393,242)	(6,216,663)
CASH, beginning of period	10,636,530	11,082,679
CASH, end of period	\$7,243,288	\$4,866,016

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Interest paid during the period	\$307,160	\$154,367
Income tax paid during the period, net of (refunds)	\$2,883,552	\$3,690,817

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

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Tandy Leather Factory, Inc.
 Consolidated Statements of Stockholders' Equity
 (Unaudited)
 For the Nine Months Ended September 30, 2015 and 2014

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2013	10,198,733	\$26,862	\$5,892,907	\$(2,894,068)	\$41,507,592	\$88,249	\$44,621,542
Shares issued – stock option exercise	12,200	29	52,693	-	-	-	52,722
Stock-based compensation	34,601	88	48,353	-	-	-	48,441
Net income	-	-	-	-	5,248,459	-	5,248,459
Cash dividend	-	-	-	-	(2,549,684)	-	(2,549,684)
Translation adjustment	-	-	-	-	-	(631,301)	(631,301)
BALANCE, September 30, 2014	10,245,534	\$26,979	\$5,993,953	\$(2,894,068)	\$44,206,367	\$(543,052)	\$46,790,179

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2014	10,245,534	\$26,984	\$6,013,325	\$(2,894,068)	\$46,664,829	\$(688,058)	\$49,123,012
Shares issued – stock option exercise	2,000	5	9,915	-	-	-	9,920
Stock-based compensation	34,484	73	106,496	-	-	-	106,569
Purchase of treasury stock	(528,725)	-	-	(3,708,862)	-	-	(3,708,862)
Net income	-	-	-	-	4,063,647	-	4,063,647
Translation adjustment	-	-	-	-	-	(961,471)	(961,471)
BALANCE, September 30, 2015	9,753,293	\$27,062	\$6,129,736	\$(6,602,930)	\$50,728,476	\$(1,649,529)	\$48,632,815

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

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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, 2015 and December 31, 2014, and its results of operations and cash flows for the three and nine-month periods ended September 30, 2015 and 2014. Operating results for the three and nine-month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. 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, 2014.

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

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

The components of inventory consist of the following:

	As of	
	September 30, 2015	December 31, 2014
Inventory on hand:		
Finished goods held for sale	\$32,295,201	\$31,257,820
Raw materials and work in process	1,230,577	1,118,506
Inventory in transit	1,532,234	499,166
	\$35,058,012	\$32,875,492

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, 2014, 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 2015.

A summary of changes in our goodwill for the periods ended September 30, 2015 and 2014 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2013	\$598,579	\$383,406	\$981,985
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(6,328)	-	(6,328)
Impairments	-	-	-
Balance, September 30, 2014	\$592,251	\$383,406	\$975,657
	Leather Factory	Tandy Leather	Total
Balance, December 31, 2014	\$588,380	\$383,406	\$971,786
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(15,202)	-	(15,202)
Impairments	-	-	-
Balance, September 30, 2015	\$573,178	\$383,406	\$956,584

Other intangibles consist of the following:

	As of September 30, 2015			As of December 31, 2014		
	Gross	Accumulated		Gross	Accumulated	
		Amortization	Net		Amortization	Net
Trademarks, Copyrights	\$554,369	\$541,427	\$12,942	\$544,369	\$518,426	\$25,943
Non-Compete Agreements	175,403	154,320	21,083	178,882	146,799	32,083
	\$729,772	\$695,747	\$34,025	\$723,251	\$665,225	\$58,026

We recorded amortization expense of \$34,001 during the first nine months of 2015 compared to \$33,924 during the same period of 2014. 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
2015	\$27	\$6,549	\$6,576
2016	108	6,333	6,441
2017	90	1,667	1,757
2018	-	1,417	1,417
2019	-	667	667
2020	-	667	667
Thereafter	-	6,500	6,500

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

Recent Accounting Pronouncements. In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under the new guidance, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. This guidance also changes an entity's requirements when presenting, for each comparative period, the assets and liabilities of a disposal group that includes a discontinued operation. A discontinued operation may include a component of an entity, or a business or nonprofit activity. The guidance was effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of the new requirements did not have a material impact on our consolidated earnings, financial position or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, which amends ASC Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices and improve disclosure requirements. The amendments in this accounting standard update are effective for interim and annual reporting periods beginning after December 15, 2016. In April 2015, the FASB issued ASU No. 2015-24, Revenue from Contracts with Customers: Deferral of the Effective Date which proposed a deferral of the effective date by one year, and on July 7, 2015, the FASB decided to delay the effective date by one year. The deferral results in the new revenue standard being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. We are therefore required to apply the new revenue guidance beginning in our 2018 interim and annual financial statements. This ASU can be adopted either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Entities reporting under U.S. GAAP are not permitted to adopt this standard earlier than the original effective date for public entities (that is, no earlier than 2017 for calendar year-end entities.) We are evaluating what impact, if any, the adoption of this guidance will have on our financial condition, results of operations, cash flows or financial disclosures.

In June 2014, the FASB issued ASU No. 2014-12, which amends ASC Topic 718, Compensation—Stock Compensation. The guidance requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition and should not be reflected in the estimate of the grant-date fair value of the award. The guidance is effective for annual periods, and interim periods within those annual periods beginning after December 15, 2015. The guidance can be applied prospectively for all awards granted or modified after the effective date or retrospectively to all awards with performance targets outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. We do not expect that our adoption will have a material impact on our financial statements or disclosures in our financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements – Going Concern. This ASU codifies management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. The guidance is effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter, and early adoption is permitted. We do not expect that our adoption will have a material impact on our financial statements or disclosures in our financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement – Extraordinary and Unusual Items. This ASU simplifies income statement classification by removing the concept of extraordinary items from U.S. GAAP. As a result, items that are both unusual and infrequent will no longer be separately reported net of tax after continuing operations. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and early adoption is permitted. We do not expect that our adoption will have a material impact on our financial statements or disclosures in our financial statements.

2. NOTES PAYABLE AND LONG-TERM DEBT

On September 18, 2015, we executed a Promissory Note and Business Loan Agreement with BOKF, NA dba Bank of Texas (“BOKF”), pursuant to which BOKF agreed to provide us with a line of credit facility of up to \$6,000,000. It has a two-year term and is secured by our inventory. The Business Loan Agreement contains covenants that we will maintain a funded debt to EBITDA ratio of no greater than 1.5 to 1, and that we will maintain a Fixed Charge Coverage Ratio greater than or equal to 1.2 to 1. Both ratios are calculated quarterly and are based on a trailing four quarter basis.

Also on September 18, 2015, we executed a Promissory Note with BOKF, pursuant to which BOKF agreed to provide us with a line of credit facility of up to \$10,000,000 for the purpose of purchasing our common stock. Under the terms of the Promissory Note, we can borrow sums up to the lesser of \$10,000,000 or the purchase price of a maximum of 1.2 million shares of our common stock from the period September 18, 2015 and ending on the earlier of September 18, 2016 or the date on which the entire amount is drawn. During this time, we will make interest only payments monthly, at which time the principal balance will be rolled into a 4-year term note. This Promissory Note is secured by a Deed of Trust on the real estate located at 1900 SE Loop 820, Fort Worth, Texas. We drew approximately \$3.7 million on this line of credit in September 2015 which was used to purchase approximately 529,000 shares of our common stock.

Amounts drawn under either Promissory Note accrue interest at the London interbank Eurodollar market rate for U.S. dollars (commonly known as “LIBOR”) plus 1.85% (2.04% at September 30, 2015).

On July 31, 2007, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to \$5,500,000 to facilitate our purchase of real estate consisting of a 191,000 square foot building situated on 30 acres of land located at 1900 SE Loop 820 in Fort Worth, Texas. Proceeds in the amount of \$4,050,000 were used to fund the purchase of the property that is our corporate headquarters. On April 30, 2008, the principal balance was rolled into a 10-year term note with an interest rate of 7.10% per annum. We paid this note in full in September 2015. As a result of the early payoff, we incurred a prepayment penalty in the amount of \$200,000 which is included in interest expense.

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, which was subsequently increased to \$6 million. The note expired on September 30, 2015.

At September 30, 2015 and December 31, 2014, the amount outstanding under the above agreements consisted of the following:

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	September 30, 2015	December 31, 2014
Business Loan Agreement with BOKF, NA – collateralized by real estate; payable as follows:		
Line of Credit Note dated September 18, 2015, in the maximum principal amount of \$10,000,000 with features as more fully described above – interest due monthly at LIBOR \$3,711,224 plus 1.85%; matures September 18, 2020	-	-
Line of Credit Note dated September 18, 2015, in the maximum principal amount of \$6,000,000 with revolving features as more fully described above – interest due monthly at LIBOR plus 1.85%; matures September 18, 2017	-	-
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, retired	-	\$2,143,125
Line of Credit Note dated July 12, 2012, as amended on June 23, 2014, in the maximum principal amount of \$6,000,000 with revolving features as more fully described above – interest due monthly at LIBOR plus 2%; expired September 30, 2015	-	3,500,000
	\$3,711,224	\$5,643,125
Less current maturities	-	3,702,500
	\$3,711,224	\$1,940,625

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3. STOCK-BASED COMPENSATION

We have one stock option plan which permits 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. 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. Under this plan, no options were awarded to directors during the nine months ended September 30, 2015 and 2014 and therefore, no share based compensation expense was recorded for those periods.

During the nine months ended September 30, 2015 and 2014, 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, 2014	\$5.04	84,600		
Granted	-	-		
Cancelled	-	-		
Exercised	4.32	(12,200)		
Outstanding, September 30, 2014	\$5.78	72,400	6.42	\$89,840
Exercisable, September 30, 2014	\$5.78	72,400	6.42	\$89,840
Outstanding, January 1, 2015	\$5.16	72,400		
Granted	-	-		
Cancelled	(4.96)	(2,000)		
Exercised	(4.96)	(2,000)		
Outstanding, September 30, 2015	\$5.17	68,400	5.70	\$83,933
Exercisable, September 30, 2015	\$5.17	68,400	5.70	\$83,933

Other information pertaining to option activity during the nine-month periods ended September 30, 2015 and 2014 are as follows:

	September 30, 2015	September 30, 2014
Weighted average grant-date fair value of stock options granted	N/A	N/A
Total fair value of stock options vested	N/A	N/A
Total intrinsic value of stock options exercised	\$2,953	N/A

There was no unrecognized compensation cost pertaining to stock option grants as of September 30, 2015 and 2014.

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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, unless otherwise determined by the committee that administers the plan.

In February 2014, our Chief Executive Officer, Chief Financial Officer and Senior Vice President were awarded restricted stock grants consisting of 9,375 shares each. In addition, four of our independent directors were awarded restricted stock grants consisting of 1,619 shares each. The grants will vest in equal annual amounts over a four-year period. The fair value of non-vested restricted common stock awards is the market value of our common stock on the date of grant. Compensation costs for these awards will be recognized on a straight-line basis over the four year vesting period.

In February 2015, our Chief Executive Officer, Chief Financial Officer and Senior Vice President were awarded restricted stock grants consisting of 9,344 shares each. In addition, four of our independent directors were awarded restricted stock grants consisting of 1,613 shares each. The grants will vest in equal annual amounts over a four-year period. The fair value of non-vested restricted common stock awards is the market value of our common stock on the date of grant. Compensation costs for these awards will be recognized on a straight-line basis over the four year vesting period.

A summary of the activity for non-vested restricted common stock awards as of September 30, 2015 and 2014 is presented below:

	Shares	Award Fair Value
Balance, January 1, 2014	-	-
Granted	34,601	\$8.96
Forfeited	-	-
Vested	-	-
Unvested Balance, September 30, 2014	34,601	\$8.96
Balance, January 1, 2015	34,601	\$8.96
Granted	34,484	\$8.99
Forfeited		
Vested	(8,652)	\$8.96
Unvested Balance, September 30, 2015	60,433	\$8.97

Pertaining to restricted stock awards, we recognized share based compensation expense of \$106,569 and \$48,441, respectively, during the nine months ended September 30, 2015 and 2014 as a component of operating expenses.

Total unrecognized compensation expense for the non-vested restricted stock awards as of September 30, 2015 and 2014 totals \$445,650 and \$261,584, respectively. As of September 30, 2015, compensation expense is expected to be recognized in equal annual amounts over a period of four years as follows:

	2015 Award	2014 Award	Total
2015	\$19,376	\$19,377	\$38,753
2016	\$77,503	\$77,506	\$155,009
2017	\$77,503	\$77,506	\$155,009
2018	\$77,503	\$9,688	\$87,191
2019	\$9,688	-	\$9,688

\$261,573

\$184,077

\$445,650

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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, 2015 and 2014:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Numerator:				
Net income	\$1,111,344	\$1,628,562	\$4,063,647	\$5,248,459
Numerator for basic and diluted earnings per share	1,111,344	1,628,562	4,063,647	5,248,459
Denominator:				
Weighted-average shares outstanding-basic	10,175,650	10,203,711	10,199,841	10,200,411
Effect of dilutive securities:				
Stock options	23,442	36,294	27,036	38,133
Restricted stock	-	1,405	-	1,565
Dilutive potential common shares	23,442	37,699	27,036	39,698
Denominator for diluted earnings per share-weighted-average shares	10,199,092	10,241,410	10,226,877	10,240,109
Basic earnings per share	\$0.11	\$0.16	\$0.40	\$0.51
Diluted earnings per share	\$0.11	\$0.16	\$0.40	\$0.51

The net effect of converting stock options and restricted stock awards of 128,833 and 119,201 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 quarters ended September 30, 2015 and 2014, respectively.

5. CASH DIVIDEND

On June 9, 2014, our Board of Directors authorized a \$0.25 per share special one-time cash dividend to be paid to stockholders of record at the close of business on July 7, 2014. The cash dividend, totaling \$2.5 million, was paid to stockholders on August 8, 2014. 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 transferred to the United States District Court, Northern District of Texas, Fort Worth Division (“Court”), and an amended complaint was filed on May 9, 2011 by plaintiffs to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleged that we violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs sought 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 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 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 underlying the 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 joined the case, (3) plaintiffs' attorneys' fees and expenses, and (4) 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 persons employed by us as store managers between November 23, 2008 and September 24, 2012 to join the lawsuit as class members 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) was required to make payments to the plaintiffs and those existing and former store managers 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 were made from the Escrow Account pursuant to the formula set forth in the Settlement Agreement by the claims administrator, 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, including our required FICA payments based on the settlement payments, was \$744,273 from the total Escrow Account of \$993,386. All payments were made by the claims administrator and the balance of the Escrow Account (approximately \$249,000) was returned to us in the first quarter of 2014.

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 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, one in Sydney, Australia, and one in Jerez, Spain. 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.

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	Wholesale Leathercraft	Retail Leathercraft	International Leathercraft	Total
For the quarter ended September 30, 2015				
Net sales	\$6,114,793	\$12,328,599	\$912,545	\$19,355,937
Gross profit	4,180,181	7,118,111	534,405	11,832,697
Operating earnings	682,461	1,122,222	55,068	1,859,751
Interest (expense)	(228,235)	-	-	(228,235)
Other income (expense), net	9,408	-	28,912	38,320
Income before income taxes	463,634	1,122,222	83,980	1,669,836
Depreciation and amortization	200,147	141,582	11,931	353,660
Fixed asset additions	122,549	124,502	3,816	250,867
Total assets	\$40,209,669	\$18,113,696	\$4,277,115	\$62,600,480

For the quarter ended September 30, 2014				
Net sales	\$6,294,745	\$12,068,832	\$1,053,657	\$19,417,234
Gross profit	4,283,949	7,167,486	723,274	12,174,709
Operating earnings	1,000,329	1,270,884	185,714	2,456,927
Interest expense	(63,684)	-	-	(63,684)
Other income (expense), net	19,556	-	17,969	37,525
Income before income taxes	956,201	1,270,884	203,683	2,430,768
Depreciation and amortization	241,264	114,516	17,058	372,838
Fixed asset additions	489,660	279,829	893	770,382
Total assets	\$44,943,519	\$16,439,542	\$2,578,444	\$63,961,505

	Wholesale Leathercraft	Retail Leathercraft	International Leathercraft	Total
For the nine months ended September 30, 2015				
Net sales	\$19,234,375	\$37,970,423	\$2,713,431	\$59,918,229
Gross profit	13,076,723	22,512,736	1,640,547	37,230,006
Operating earnings	2,602,868	3,862,343	117,263	6,582,474
Interest (expense)	(307,160)	-	-	(307,160)
Other income (expense), net	46,570	-	21,500	68,070
Income before income taxes	2,342,278	3,862,343	138,763	6,343,384
Depreciation and amortization	714,401	412,179	36,536	1,163,116
Fixed asset additions	706,995	608,817	23,286	1,339,098
Total assets	\$40,209,669	\$18,113,696	\$4,277,115	\$62,600,480

For the nine months ended September 30, 2014				
Net sales	\$19,576,180	\$36,226,810	\$3,156,317	\$58,959,307
Gross profit	13,588,209	21,973,975	2,107,854	37,670,038
Operating earnings	3,479,908	4,171,500	428,459	8,079,867
Interest expense	(154,367)	-	-	(154,367)
Other income (expense), net	44,730	-	(527)	44,203
Income before income taxes	3,370,271	4,171,500	427,932	7,969,703

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Depreciation and amortization	705,902	332,276	50,580	1,088,758
Fixed asset additions	886,719	781,795	50,951	1,719,465
Total assets	\$44,943,519	\$16,439,542	\$2,578,444	\$63,961,505

Net sales for geographic areas were as follows for the three and nine months ended September 30, 2015 and 2014:

Three months ended September 30,	2015	2014
United States	\$16,558,873	\$16,219,193
Canada	1,693,958	1,908,966
All other countries	1,103,106	1,289,075
	\$19,355,937	\$19,417,234

Nine months ended September 30,	2015	2014
United States	\$51,144,236	\$49,298,035
Canada	5,432,724	5,835,776
All other countries	3,341,269	3,825,496
	\$59,918,229	\$58,959,307

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 and nine-month periods ended September 30, 2015 and 2014. We do not have any significant long-lived assets outside of the United States.

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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 28 company-owned wholesale stores in 18 states and three Canadian provinces. These stores are engaged primarily in the wholesale distribution and retail sales 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 previously included our National Account sales group, whose only customers were national craft chains. We ended sales through this group in April 2014.

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 38 states and six Canadian provinces. Tandy Leather Company, 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 our industry presence by opening retail stores. As of November 1, 2015, we were operating 82 Tandy Leather Company retail stores located throughout North America.

Our International Leathercraft segment operates company-owned stores located outside of North America, which operate as combination retail / wholesale stores. As of November 1, 2015, we were operating 4 international stores with two located in the United Kingdom, one located in Australia, and one located in Spain. We expect to continue opening international stores in the future, but do not have a specific timeline.

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, 2014.

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, without limitation, 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, 2014 for additional information concerning these and other uncertainties that could negatively impact the Company. Potential factors, which could cause our actual results of operations to differ materially from those in the forward-looking statements include, among others:

- Ø General economic conditions in the United States and abroad;
 - Ø Increased pressure on margins;
- Ø Increases in the cost of the products we sell or a reduction in availability of those products;
 - Ø Challenges in implementing our planned international expansion;
 - Ø Failure to open additional stores in North America;
 - Ø Failure to hire and train qualified personnel to operate new and existing stores;
 - Ø Failure to protect our trademarks and other proprietary intellectual property rights;
- Ø Negative impact of foreign currency fluctuations on our financial condition and results of operations; and
 - Ø Damage to our brand image.

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, 2015 and 2014

The following tables present selected financial data of each of our three segments for the quarters ended September 30, 2015 and 2014.

	Quarter Ended September 30, 2015		Quarter Ended September 30, 2014	
	Sales	Income from Operations	Sales	Income from Operations
Wholesale Leathercraft	\$6,114,793	\$682,461	\$6,294,745	\$1,000,329
Retail Leathercraft	12,328,599	1,122,222	12,068,832	1,270,884
Int'l Leathercraft	912,545	55,068	1,053,657	185,714
Total Operations	\$19,355,937	\$1,859,751	\$19,417,234	\$2,456,927

Consolidated net sales for the quarter ended September 30, 2015 decreased approximately \$61,000, or 0.3%, compared to the same period in 2014. Retail Leathercraft reported a 2.2% sales gain. Wholesale Leathercraft and International Leathercraft reported sales decreases of 3% and 13%, respectively. Income from operations on a consolidated basis for the quarter ended September 30, 2015 decreased 24%, or approximately \$597,000, from the third quarter of 2014 due to an decrease in gross profit margin and an increase in operating expenses.

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The following table shows in comparative form our consolidated net income for the third quarters of 2015 and 2014:

	2015	2014	% change
Net income	\$1,111,344	\$1,628,562	(31.8)%

All segments were profitable in the third quarter of 2015 and therefore, contributed to our consolidated net income. Additional information appears below for each segment.

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 28 stores. The following table presents the combined sales mix by customer categories for the quarters ended September 30, 2015 and 2014:

Customer Group	Quarter ended	
	09/30/15	09/30/14
RETAIL (end users, consumers, individuals)	46%	41%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	3%	4%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	44%	48%
MANUFACTURERS	7%	7%
	100%	100%

Net sales decreased 3%, or approximately \$180,000, for the third quarter of 2015 compared to the third quarter of 2014 as follows:

	# Stores	Qtr Ended	# Stores	Qtr Ended	\$ Change	%
		09/30/15		09/30/14		Change
Same store sales	28	\$6,114,793	28	\$6,172,348	\$(57,555)	(1.0)%
Closed store sales	-	-	1			