

TANDY LEATHER FACTORY INC
Form 10-Q
November 14, 2007

**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, 2007

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

75-2543540

(State or other jurisdiction of incorporate of organization) (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 9, 2007 |
|--------------------------------------------|--------------------------------------------------|
| Common Stock, par value \$0.0024 per share | 10,977,092 |

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

**Tandy Leather Factory, Inc.
Consolidated Balance Sheets**

| | September 30, 2007 (unaudited) | December 31, 2006 (audited) |
|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|-----------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash | \$3,757,534 | \$6,739,891 |
| Accounts receivable-trade, net of allowance for doubtful accounts of \$127,000 and \$149,000 in 2007 and 2006, respectively | 2,294,922 | 2,599,279 |
| Inventory | 20,721,612 | 17,169,358 |
| Prepaid income taxes | 520,826 | - |
| Deferred income taxes | 287,942 | 266,018 |
| Other current assets | 974,559 | 1,089,258 |
| Total current assets | 28,557,394 | 27,863,804 |
| PROPERTY AND EQUIPMENT, at cost | 11,709,818 | 6,865,946 |
| Less accumulated depreciation and amortization | (5,197,704) | (4,989,341) |
| | 6,512,114 | 1,876,605 |
| GOODWILL | 989,296 | 746,139 |
| OTHER INTANGIBLES, net of accumulated amortization of \$300,000 and \$262,000 in 2007 and 2006, respectively | 396,957 | 360,676 |
| OTHER assets | 1,189,678 | 1,069,411 |
| | \$37,645,440 | \$31,916,635 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable-trade | \$2,341,491 | \$1,776,646 |
| Accrued expenses and other liabilities | 2,431,130 | 3,424,010 |
| Income taxes payable | - | 59,392 |
| Current maturities of capital lease obligations | 11,172 | 111,723 |
| Current maturities of long-term debt | 84,375 | - |
| Total current liabilities | 4,868,168 | 5,371,771 |
| DEFERRED INCOME TAXES | 225,396 | 221,621 |
| LONG-TERM DEBT, less current maturities | 3,965,625 | - |
| 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;

10,974,951 and 10,885,068 shares issued at 2007 and 2006, respectively;

10,969,092 and 10,879,209 outstanding at 2007 and 2006, respectively

| | | |
|----------------------------------------|---------------------|---------------------|
| | 26,340 | 26,124 |
| Paid-in capital | 5,389,111 | 5,292,591 |
| Retained earnings | 22,864,188 | 20,949,540 |
| Treasury stock (5,859 shares at cost) | (25,487) | (25,487) |
| Accumulated other comprehensive income | 332,099 | 80,475 |
| Total stockholders' equity | 28,586,251 | 26,323,243 |
| | \$37,645,440 | \$31,916,635 |

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, 2007 and 2006

| | THREE MONTHS | | NINE MONTHS | |
|------------------------------------------------|--------------|--------------|--------------|--------------|
| | 2007 | 2006 | 2007 | 2006 |
| NET SALES | \$12,806,333 | \$12,559,593 | \$40,691,125 | \$40,366,325 |
| COST OF SALES | 5,864,699 | 5,488,179 | 17,465,869 | 17,458,476 |
| Gross profit | 6,941,634 | 7,071,414 | 23,225,256 | 22,907,849 |
| OPERATING EXPENSES | 6,836,357 | 5,807,442 | 20,460,848 | 17,903,337 |
| INCOME FROM OPERATIONS | 105,277 | 1,263,972 | 2,764,408 | 5,004,512 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (50,494) | - | (50,494) | - |
| Other, net | 272,658 | 37,422 | 349,172 | 84,951 |
| Total other income (expense) | 222,164 | 37,422 | 298,678 | 84,951 |
| INCOME BEFORE INCOME TAXES | 327,441 | 1,301,394 | 3,063,086 | 5,089,463 |
| PROVISION FOR INCOME TAXES | 155,835 | 410,975 | 1,148,438 | 1,720,288 |
| NET INCOME | \$171,606 | \$890,419 | \$1,914,648 | \$3,369,175 |
| NET INCOME PER COMMON SHARE-BASIC | | | | |
| | \$ 0.02 | \$ 0.08 | \$ 0.17 | \$ 0.31 |
| NET INCOME PER COMMON SHARE-DILUTED | | | | |
| | \$ 0.02 | \$ 0.08 | \$ 0.17 | \$ 0.30 |
| Weighted Average Number of Shares Outstanding: | | | | |
| Basic | 10,968,635 | 10,818,130 | 10,943,817 | 10,788,720 |
| Diluted | 11,152,731 | 11,102,383 | 11,157,013 | 11,105,903 |

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, 2007 and 2006

| | 2007 | 2006 |
|---------------------------------------------------------------------------------------------|-------------|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$1,914,648 | \$3,369,175 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities- | | |
| Depreciation & amortization | 470,832 | 291,257 |
| Gain on disposal of assets | - | (1,750) |
| Non-cash stock-based compensation | 22,876 | 78,600 |
| Deferred income taxes | (18,149) | 56,975 |
| Other | 233,465 | 36,217 |
| Net changes in assets and liabilities: | | |
| Accounts receivable-trade, net | 360,709 | (248,942) |
| Inventory | (3,202,032) | (1,493,683) |
| Income taxes | (580,218) | (412,676) |
| Other current assets | 98,716 | (648,879) |
| Accounts payable | 516,201 | 1,924,072 |
| Accrued expenses and other liabilities | (992,879) | (830,874) |
| Total adjustments | (3,090,478) | (1,249,683) |
| Net cash provided by (used in) operating activities | (1,175,830) | 2,119,492 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (5,084,907) | (382,187) |
| Payments in connection with businesses acquired | (650,000) | - |
| Proceeds from sale of assets | 25,339 | 1,750 |
| Decrease (increase) in other assets | (120,267) | 9,407 |
| Net cash used in investing activities | (5,829,835) | (371,030) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from notes payable and long-term debt | 4,050,000 | - |
| Payments on capital lease obligations | (100,550) | (100,550) |
| Proceeds from issuance of common stock | 73,860 | 106,590 |
| Net cash provided by (used in) financing activities | 4,023,310 | 6,040 |
| NET CHANGE IN CASH | (2,982,355) | 1,754,502 |
| CASH, beginning of period | 6,739,891 | 3,215,727 |
| CASH, end of period | \$3,757,534 | \$4,970,229 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

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| | | |
|-------------------------------------------------------|-----------|-------------|
| Interest paid during the period | \$50,494 | - |
| Income taxes paid during the period, net of (refunds) | 1,758,519 | \$1,833,737 |

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

Tandy Leather Factory, Inc.
Consolidated Statements of Stockholders' Equity
(Unaudited)
For the Nine Months Ended September 30, 2007 and 2006

| | Number of Shares | Par Value | Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|-------------------------------------------------------------------|---------------------|--------------|--------------------|-------------------|----------------------|--------------------------------------------------------|--------------|--------------------------------|
| 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 |

| | | | | | | | | |
|------------------------------------------------------------------|------------|----------|-------------|------------|--------------|----------|--------------|-------------|
| BALANCE, December 31, 2006 | 10,879,209 | \$26,124 | \$5,292,591 | \$(25,487) | \$20,949,540 | \$80,475 | \$26,323,243 | |
| Shares issued - stock options and warrants exercised | 89,883 | 216 | 73,644 | - | - | - | 73,860 | |
| Stock-based compensation | - | - | 22,876 | - | - | - | 22,876 | |
| Net income | - | - | - | - | 1,914,648 | - | 1,914,648 | \$1,914,648 |

| | | | | | | | | |
|-------------------------------------------------------------------|------------|----------|-------------|------------|--------------|-----------|--------------|-------------|
| Translation adjustment | - | - | - | - | - | 251,624 | 251,622 | 251,624 |
| BALANCE, September 30, 2007 | 10,969,092 | \$26,340 | \$5,389,111 | \$(25,487) | \$22,864,188 | \$332,099 | \$28,586,251 | |
| Comprehensive income for the nine months ended September 30, 2007 | | | | | | | | \$2,166,272 |

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, 2007 and December 31, 2006, and its results of operations and cash flows for the three and/or nine-month periods ended September 30, 2007 and 2006. Operating results for the three and nine-month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. 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, 2006.

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, 2007 | December 31, 2006 |
| Inventory on hand: | | |
| Finished goods held for sale | \$19,127,786 | \$14,774,445 |
| Raw materials and work in process | 762,742 | 628,539 |
| Inventory in transit | 831,084 | 1,766,374 |
| | \$20,721,612 | \$17,169,358 |

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, 2006, 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 2007.

A summary of changes in our goodwill for the periods ended September 30, 2007 and 2006 is as follows:

| | Leather Factory | Tandy Leather | Total |
|----------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2005 | \$363,205 | \$383,406 | \$746,611 |

| | | | |
|------------------------------|-----------|-----------|-----------|
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain/loss | 4,471 | - | 4,471 |
| Impairments | - | - | - |
| Balance, September 30, 2006 | \$367,676 | \$383,406 | \$751,082 |

| | Leather Factory | Tandy Leather | Total |
|------------------------------|------------------------|----------------------|--------------|
| Balance, December 31, 2006 | \$362,733 | \$383,406 | \$746,139 |
| Acquisitions and adjustments | 225,000 | - | 225,000 |
| Foreign exchange gain/loss | 18,157 | - | 18,157 |
| Impairments | - | - | - |
| Balance, September 30, 2007 | \$605,890 | \$383,406 | \$989,296 |

Other intangibles consist of the following:

| | As of September 30, 2007 | | | As of December 31, 2006 | | |
|---------------------------|---------------------------------|---------------------|------------|--------------------------------|---------------------|------------|
| | Accumulated | | | Accumulated | | |
| | Gross | Amortization | Net | Gross | Amortization | Net |
| Trademarks, Copyrights | \$544,369 | \$274,412 | \$269,957 | \$544,369 | \$247,193 | \$297,176 |
| Non-Compete Agreements | 153,000 | 26,000 | 127,000 | 78,000 | 14,500 | 63,500 |
| | \$697,369 | \$300,412 | \$396,957 | \$622,369 | \$261,693 | \$360,676 |

We recorded amortization expense of \$38,718 during the first nine months of 2007 compared to \$28,718 during the first nine months of 2006. 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 |
|------|---------------------------|------------------------|--------|
| 2007 | 19,704 | 31,837 | 51,541 |
| 2008 | 20,954 | 30,337 | 51,291 |
| 2009 | 20,954 | 30,337 | 51,291 |
| 2010 | 20,954 | 30,337 | 51,291 |
| 2011 | 20,027 | 30,337 | 50,364 |

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 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 July 2006, the FASB issued Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109,” which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax provisions. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. We implemented FIN 48 as of January 1, 2007 and have determined that there was no material effect to our consolidated financial statements.

In September 2006, the FASB issued SFAS 157, “Fair Value Measurements” (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We must adopt these new requirements no later than the first quarter of 2008. We have not yet determined the effect on our consolidated financial statements, if any, upon adoption of SFAS 157, or if we will adopt the requirements prior to the first quarter of 2008.

2. STOCK-BASED COMPENSATION

We had two stock option plans which provide for stock option grants to officers, key employees and directors. The plans expired in 2005. The expiration of the plans has no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our Common Stock 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*.

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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 for the three and nine months ended September 30, 2007 and 2006 as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------------|-------------------------------------|----------|------------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| Share-based compensation expense | \$7,625 | \$33,640 | \$22,876 | \$78,600 |

The fair values of stock options granted were estimated on the grant dates using the Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.375%-3.5%, a dividend yield of 0%; volatility factor of .366-.780; and an expected life of the valued options of 3-5 years.

During the nine months ended September 30, 2007, 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, 2007 | \$2.050 | 296,200 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 1.466 | 51,500 | | |
| Outstanding, September 30, 2007 | \$2.180 | 244,700 | 4.35 | \$289,420 |
| Exercisable, September 30, 2007 | \$2.050 | 228,700 | 4.22 | \$256,380 |

Other information pertaining to option activity during the nine month periods ended September 30, 2007 and 2006 are as follows:

| | September 30, 2007 | September 30, 2006 |
|-----------------------------------------------------------------|-----------------------|-----------------------|
| Weighted average grant-date fair value of stock options granted | N/A | \$11,160 |
| Total fair value of stock options vested | \$30,500 | \$101,728 |
| Total intrinsic value of stock options exercised | \$43,640 | \$63,481 |

As of September 30, 2007, there was \$30,000 of total unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a remaining weighted average vesting period of 3 years.

3. 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, 2007 and 2006:

| | Three Months Ended | | Nine Months Ended | |
|--------------------------------------------------------------------|--------------------|------------|-------------------|-------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Numerator: | | | | |
| Net income | \$171,606 | \$890,419 | \$1,914,648 | \$3,369,175 |
| Numerator for basic and diluted earnings per share | 171,606 | 890,419 | 1,914,648 | 3,369,175 |
| Denominator: | | | | |
| Weighted-average shares outstanding-basic | 10,968,635 | 10,818,130 | 10,943,817 | 10,788,720 |
| Effect of dilutive securities: | | | | |
| Stock options | 170,874 | 241,192 | 187,064 | 266,034 |
| Warrants | 13,222 | 43,061 | 26,132 | 51,149 |
| Dilutive potential common shares | 184,096 | 284,253 | 213,196 | 317,183 |
| Denominator for diluted earnings per share-weighted-average shares | 11,152,731 | 11,102,383 | 11,157,013 | 11,105,903 |
| Basic earnings per share | \$0.02 | \$0.08 | \$0.18 | \$0.31 |
| Diluted earnings per share | \$0.02 | \$0.08 | \$0.17 | \$0.20 |

The net effect of converting stock options and warrants to purchase 289,000 and 478,300 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the three and nine months ended September 30, 2007 and 2006, respectively.

4. SEGMENT INFORMATION

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

- a. Wholesale Leathercraft*, which consists of a chain of warehouse distribution units operating under the name, *The Leather Factory*, located in the United States and Canada;
- b. Retail Leathercraft*, which consists of a chain of retail stores operating under the name, *Tandy Leather Company*, located in the United States and Canada; and
- c. Other*, which is a manufacturer 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 | Other | Total |
|-------------------------------------------------|---------------------------|------------------------|-----------|--------------|
| For the quarter ended September 30, 2007 | | | | |
| Net sales | \$6,940,484 | \$5,657,198 | \$208,651 | \$12,806,333 |
| Gross profit | 3,608,272 | 3,254,075 | 79,287 | 6,941,634 |
| Operating earnings | 32,686 | 58,780 | 13,811 | 105,277 |
| Interest expense | 50,494 | - | - | 50,494 |
| Other, net | (264,792) | (7,866) | - | (272,658) |
| Income before income taxes | 246,984 | 66,646 | 13,811 | 327,441 |
| Depreciation and amortization | 181,113 | 35,050 | 2,477 | 218,640 |
| Fixed asset additions | 4,657,769 | 74,257 | - | \$4,732,026 |
| Total assets | \$31,929,070 | \$5,548,815 | \$167,555 | \$37,645,440 |

| | | | | |
|-------------------------------------------------|--------------|-------------|-----------|--------------|
| For the quarter ended September 30, 2006 | | | | |
| Net sales | \$7,113,181 | \$5,121,556 | \$324,856 | \$12,559,593 |
| Gross profit | 3,847,911 | 3,095,207 | 128,296 | 7,071,414 |
| Operating earnings | 910,942 | 362,744 | (9,714) | 1,263,972 |
| Interest expense | - | - | - | - |
| Other, net | 37,805 | (1,664) | 1,281 | 37,422 |
| Income before income taxes | 948,747 | 361,080 | (8,433) | 1,301,394 |
| Depreciation and amortization | 60,975 | 37,112 | 1,697 | 99,784 |
| Fixed asset additions | 100,403 | 52,009 | - | 152,412 |
| Total assets | \$24,558,634 | \$5,192,664 | \$329,414 | \$30,080,712 |

| | Wholesale Leathercraft | Retail Leathercraft | Other | Total |
|-----------------------------------------------------|---------------------------|------------------------|-----------|--------------|
| For the nine months ended September 30, 2007 | | | | |
| Net sales | \$22,057,123 | \$17,753,614 | \$880,388 | \$40,691,125 |
| Gross profit | 12,378,185 | 10,482,976 | 364,095 | 23,225,256 |
| Operating earnings | 1,790,257 | 878,492 | 95,659 | 2,764,408 |
| Interest expense | 50,494 | - | - | 50,494 |

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| | | | | |
|----------------------------|-----------|----------|--------|-----------|
| Other, net | (336,641) | (12,531) | - | (349,172) |
| Income before income taxes | 2,076,404 | 891,023 | 95,659 | 3,063,086 |

| | | | | |
|-------------------------------|--------------|-------------|-----------|--------------|
| Depreciation and amortization | 341,974 | 127,862 | 996 | 470,832 |
| Fixed asset additions | 4,892,019 | 192,687 | 200 | \$5,084,906 |
| Total assets | \$31,929,070 | \$5,548,815 | \$167,555 | \$37,645,440 |

For the nine months ended September 30, 2006

| | | | | |
|----------------------------|--------------|--------------|-------------|--------------|
| Net sales | \$23,250,338 | \$15,858,835 | \$1,257,152 | \$40,366,325 |
| Gross profit | 12,930,486 | 9,634,035 | 343,328 | 22,907,849 |
| Operating earnings | 3,675,658 | 1,323,105 | 5,749 | 5,004,512 |
| Interest expense | - | - | - | - |
| Other, net | 102,089 | (18,419) | 1,281 | 84,951 |
| Income before income taxes | 3,777,747 | 1,304,686 | 7,030 | 5,089,463 |

| | | | | |
|-------------------------------|--------------|-------------|-----------|--------------|
| Depreciation and amortization | 180,289 | 106,651 | 4,317 | 291,257 |
| Fixed asset additions | 228,880 | 153,146 | 162 | 382,188 |
| Total assets | \$24,558,634 | \$5,192,664 | \$329,414 | \$30,080,712 |

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Net sales for geographic areas for the three and nine months ended September 30, 2007 and 2006 were as follows:

| Three months ended September 30, | 2007 | 2006 |
|---------------------------------------------|---------------------|---------------------|
| United States | \$11,423,156 | \$11,151,670 |
| Canada | 1,072,842 | 953,224 |
| All other countries | 310,335 | 454,699 |
| | \$12,806,333 | \$12,559,593 |

| Nine months ended September 30, | 2007 | 2006 |
|--------------------------------------------|---------------------|---------------------|
| United States | \$36,194,509 | \$35,981,135 |
| Canada | 3,274,464 | 3,098,839 |
| All other countries | 1,222,152 | 1,286,351 |
| | \$40,691,125 | \$40,366,325 |

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, 2007 or 2006. We do not have any significant long-lived assets outside of the United States.

5. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, 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. Under the terms of the Line of Credit Note, we may borrow from time to time until April 30, 2008, up to the lesser of \$5,500,000 or 90% of the cost of the property. We will make only monthly interest payments until April 30, 2008, at which time the principal balance will be rolled into a 10-year term note. Amounts drawn under the Credit Agreement accrue interest at a rate of 7.10% per annum.

Proceeds in the amount of \$4,050,000 were used to fund the purchase of the property from Standard Motor Products, Inc. under an Agreement of Purchase and Sale, dated June 25, 2007, which closed on July 31, 2007. The remaining credit line available will be used to remodel portions of the building. We expect to move our corporate headquarters, central warehouse and other support units into the acquired building during the first quarter of 2008.

At September 30, 2007, the amount outstanding under the above agreement consisted of the following:

| | 2007 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| Credit Agreement with JPMorgan Chase Bank - collateralized by real estate; payable as follows: | |
| Line of Credit Note dated July 31, 2007 in the maximum principal amount of \$5,500,000 with revolving features as more fully \$ 4,050,000 described above - interest due monthly at 7.10%; matures April 30, 2018 | 4,050,000 |
| Less - Current maturities | 84,375 |
| | \$3,965,625 |

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 stores and wholesale distribution centers. We are a Delaware corporation and our common stock trades on the American Stock Exchange under the symbol "TLF." We operate our business in three segments: **Wholesale Leathercraft**, which operates under the trade name, *The Leather Factory*, **Retail Leathercraft**, which operates under the trade name, *Tandy Leather Company*, and **Other**. See Note 4 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.

Tandy Leather, 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, 2007, we were operating 72 Tandy Leather retail stores located throughout the United States and Canada.

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 year ended December 31, 2006.

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. The 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 2006 for additional information concerning these and other uncertainties that could negatively impact us.

Ø We believe that the continued 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 their increased costs on to us. We are unsure how much of this increase we will be able to pass on to our customers.

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, 2007 and 2006

The following tables present selected financial data of each of our three segments for the quarters ended September 30, 2007 and 2006. Certain prior year amounts have been reclassified to conform to the current year presentation.

| | Quarter Ended September 30, 2007 | | Quarter Ended September 30, 2006 | |
|------------------------|-------------------------------------|---------------------|-------------------------------------|---------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$6,940,484 | \$32,686 | \$7,088,181 | \$910,942 |
| Retail Leathercraft | 5,657,198 | 58,780 | 5,121,556 | 362,744 |
| Other | 208,651 | 13,811 | 349,856 | (9,714) |
| Total Operations | \$12,806,333 | \$105,277 | \$12,559,593 | \$1,263,972 |

Consolidated net sales for the quarter ended September 30, 2007 increased 2%, compared to the same period in 2006. Retail Leathercraft contributed \$535,000 of additional sales, offset by a combined sales decrease of \$289,000 in Wholesale Leathercraft and Other. Operating income on a consolidated basis for the quarter ended September 30, 2007 was down 92% or \$1.1 million over the third quarter of 2006.

The following table shows in comparative form our consolidated net income for the third quarters of 2007 and 2006:

| | 2007 | 2006 | % Change |
|------------|-----------|-----------|----------|
| Net income | \$171,606 | \$890,419 | (80.7)% |

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, 2007 and 2006:

| Customer Group | Quarter ended | |
|-------------------------------------------------------------------------------------|---------------|----------|
| | 09/30/07 | 09/30/06 |
| RETAIL (end users, consumers, individuals) | 21% | 23% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 8% | 7% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 43% | 39% |
| MANUFACTURERS | 13% | 11% |
| NATIONAL ACCOUNTS | 15% | 20% |
| | 100% | 100% |

Net sales decreased 2%, or \$148,000, for the third quarter of 2007 as follows:

| | Quarter Ended 09/30/07 | Quarter Ended 09/30/06 | \$ change | % change |
|------------------------|------------------------------|------------------------------|--------------|-------------|
| Same store sales (29) | \$5,992,707 | \$5,968,100 | \$24,607 | 0.4% |
| New store (1) | 164,314 | - | 164,314 | N/A |
| National account group | 783,462 | 1,120,081 | (336,619) | (30.1)% |
| | \$6,940,483 | \$7,088,181 | \$(147,698) | (2.1)% |

The customer sales mix for the third quarter indicates a decline in sales to retail customers and our national account customers. We achieved gains in sales to our Institution (specifically prisons and prisoners) and Wholesale customers. Sales to our national account customers were down 30% for the quarter compared to the same quarter last year. Approximately 25% of the sales decline is attributable to one customer which intends to stop purchasing from us in the second quarter of 2008 due to its vendor consolidation policy. We believe the sales mix speaks to several issues: (1) the craft industry overall has weakened in recent years and (2) the retail customer is more cautious in discretionary spending due to the concerns about the economy overall.

Operating income for Wholesale Leathercraft during the current quarter decreased by \$878,000 from the comparative 2006 quarter, a decline of 96%. Operating expenses as a percentage of sales were 51.5%, up \$653,000 from the third quarter of 2006. Employee compensation increased \$250,000 as our headcount is up 10% compared to the third quarter of 2006. At September 30, 2007, there are 7 manager trainees in the Leather Factory stores. We are analyzing the headcount increase at the support units and will be making adjustments as necessary to reduce this expense. Employee benefits, specifically health insurance and 401(k) plan contributions, are up \$115,000 as well. Advertising expenses increased \$200,000 over last year's third quarter in an effort to improve sales. Legal and professional fees are up \$115,000 as we've incurred fees related to our recent real estate purchase and the defense of our intellectual property.

Retail Leathercraft

Our Retail Leathercraft operation consists of 71 Tandy Leather retail stores at September 30, 2007, compared to 61 stores at September 30, 2006. Net sales were up approximately 10% for the third quarter of 2007 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 09/30/07 | Qtr Ended 09/30/06 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|-------------|-----------------------|-----------------------|-------------------|------------------|
| Same (existing) store sales | 61 | \$5,319,336 | \$5,084,332 | \$235,004 | 4.6% |
| New store sales | 10 | 337,862 | 37,224 | 300,638 | N/A |
| Total sales | 71 | \$5,657,198 | \$5,121,556 | \$535,642 | 10.5% |

The following table presents sales mix by customer categories for the quarters ended September 30, 2007 and 2006 for our Retail Leathercraft operation:

| Customer Group | Quarter Ended | |
|-------------------------------------------------------------------------------------|---------------|----------|
| | 09/30/07 | 09/30/06 |
| RETAIL (end users, consumers, individuals) | 62% | 62% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7 | 8 |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 28 | 30 |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 3 | - |
| | 100% | 100% |

Sales to our Retail customer group increased 7% compared to the third quarter of 2006. Sales to the Wholesale and Manufacturers customer groups increased 3% each as more stores are beginning to develop these types of customers in their local markets. The retail stores opened prior to July 1, 2007 averaged approximately \$28,000 in sales per month for the third quarter of 2007.

Operating income decreased \$304,000 from the comparative 2006 quarter to 1.0% of sales, compared to 7.1% of sales in the third quarter of 2006. Our gross margin fell from 60.4% to 57.5% due to cost increases that we were unable to pass on to customers and the increase in sales to wholesale customers. Operating expenses increased \$460,000 in the third quarter of 2007 over the third quarter of 2006, and as a percentage of sales increased from 53.4% to 56.5%. The operating expenses at the new stores opened since October 1, 2006 totaled \$350,000. The remainder of the increase consisted of \$50,000 in additional advertising and a \$50,000 increase in employee benefits (health insurance, etc.).

Other (Roberts, Cushman)

Sales decreased \$141,000 or 40.4% for the third quarter of 2007. Gross profit margins decreased by \$55,000 while operating income increased by \$23,000. We expected sales to decline as we increased the minimum order quantities due to the change in operations as we converted from a manufacturer to a distributor. However, we also expected gross profit margins and operating margins to improve as we eliminated substantial labor and direct manufacturing expenses by outsourcing that function.

Other Expenses

We paid interest in the third quarter of 2007 of \$50,000 as a result of the bank debt incurred to purchase a building in July 2007. We also recorded \$97,000 in rent income on this building in August and September. In addition, we recorded \$106,000 in other income, representing an oil and gas lease bonus related to the property. We earned \$27,000

during the quarter in interest income. We recorded \$6,000 in income during the quarter for currency fluctuations from our Canadian operation.

Nine Months Ended September 30, 2007 and 2006

The following table presents selected financial data of each of our three segments for the nine months ended September 30, 2007 and 2006:

| | Nine Months Ended September 30, 2007 | | Nine Months Ended September 30, 2006 | |
|------------------------|-----------------------------------------|---------------------|-----------------------------------------|---------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$22,057,123 | \$1,790,257 | \$22,880,119 | \$3,675,658 |
| Retail Leathercraft | 17,753,614 | 878,492 | 15,858,836 | 1,323,105 |
| Other | 880,388 | 95,659 | 1,627,370 | 5,749 |
| Total Operations | \$40,691,125 | \$2,764,408 | \$40,366,325 | \$5,004,512 |

Consolidated net sales for the nine months ended September 30, 2007 were up almost 1%, increasing \$325,000, compared to the same period in 2006. Retail Leathercraft contributed additional sales of \$1.9 million, offset by a combined sales decrease of \$1.6 million from Wholesale Leathercraft and Other. Operating income on a consolidated basis for the nine months ended September 30, 2007 was down 44.8% or \$2.2 million over the first nine months of 2006.

The following table shows in comparative form our consolidated net income for the first nine months of 2007 and 2006:

| | 2007 | 2006 | % change |
|------------|-------------|-------------|----------|
| Net income | \$1,914,648 | \$3,369,175 | (43.2)% |

Wholesale Leathercraft

Net sales decreased 3.6%, or \$823,000, for the first nine months of 2007 as follows:

| | Nine Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 | \$ Change | % Change |
|------------------------|---------------------------------------------------------|-------------------------------------------------|------------------|-----------------|
| Same store sales (29) | \$18,729,902 | \$19,521,828 | \$(791,926) | (4.1)% |
| New store (1) | 553,451 | - | 553,451 | N/A |
| National account group | 2,773,770 | 3,358,291 | (584,521) | (17.4)% |
| | \$22,057,123 | \$22,880,119 | \$(822,996) | (3.6)% |

The following table presents the combined sales mix by customer categories for the nine months ended September 30, 2007 and 2006:

| Customer Group | Nine Months Ended | |
|-------------------------------------------------------------------------------------|--------------------------|-----------------|
| | 09/30/07 | 09/30/06 |
| RETAIL (end users, consumers, individuals) | 22% | 23% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 8% | 7% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 43% | 39% |
| MANUFACTURERS | 15% | 11% |
| NATIONAL ACCOUNTS | 12% | 20% |
| | 100% | 100% |

Operating income for Wholesale Leathercraft for the nine months ended September 30, 2007 decreased by \$1.9 million from the comparative 2006 period, a decline of 51.3%. Operating expenses as a percentage of sales were 48.0%, up \$1.5 million from the first nine months of 2006.

Retail Leathercraft

Net sales were up approximately 12% for the first nine months of 2007 over the same period last year.

| | # Stores | Nine Months Ended 09/30/07 | Nine Months Ended 09/30/06 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|---------------------|-------------------------------------------|-------------------------------------------|---------------------------|--------------------------|
| Same (existing) store sales | 52 | \$15,247,415 | \$14,856,541 | \$390,874 | 2.6% |
| New store sales | 19 | 2,506,199 | 1,002,294 | 1,503,905 | N/A |
| Total sales | 71 | \$17,753,614 | \$15,858,835 | \$1,894,779 | 11.9% |

The following table presents sales mix by customer categories for the nine months ended September 30, 2007 and 2006 for our Retail Leathercraft operation:

| Customer Group | Nine Months Ended | |
|---------------------------------------------------------------------------------|--------------------------|-----------------|
| | 09/30/07 | 09/30/06 |
| RETAIL (end users, consumers, individuals) | 63% | 65% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 8 | 9 |

| | | |
|-------------------------------------------------------------------------------------|------|------|
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 26 | 25 |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 3 | 1 |
| | 100% | 100% |

The retail stores opened prior to January 1, 2007 averaged approximately \$31,000 in sales per month for the first nine months of 2007.

Operating income for the first nine months of 2007 decreased \$444,000 from the comparative 2006 period and as a percentage of sales, from 8.3% in the first nine months of 2006 to 4.9% in the first nine months of 2007. Gross margin fell from 60.7% to 59.1% due to the increase in sales to wholesale customers and cost increases in various products and our inability to pass those cost increases on to our customers. We publish our retail selling prices in our annual catalog which is distributed in October of each year. Selling prices are set based on our estimate of the cost of the items for the coming year. As costs fluctuate during the year, our gross margins can be affected positively or negatively. Operating expenses as a percentage of sales increased from 52.4% to 54.1%.

Other (Roberts, Cushman)

Sales decreased \$747,000 in the first nine months of 2007 compared to the same period in 2006. Gross profit margins decreased by \$68,000 while operating margin increased by \$89,000. Operating expenses decreased by \$158,000 in the first nine months of 2007 compared to 2006.

Other Expenses

We paid interest of \$50,000 as a result of the bank debt incurred to purchase a building in July 2007. We earned \$108,000 in interest income. We recorded \$1,000 in income during the year for currency fluctuations from our Canadian operation. Comparatively, in the first nine months of 2006, we recorded income of \$56,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets increased from \$31.9 million at year-end 2006 to \$37.6 million at September 30, 2007. The increase in inventory and fixed assets, offset partially by the decrease in cash, accounted for the increase. Total stockholders' equity increased from \$26.3 million at December 31, 2006 to \$28.6 million at September 30, 2007. Most of the increase was attributable to earnings in the first nine months of this year. Our current ratio rose from 5.2 at December 31, 2006 to 5.9 at September 30, 2007.

Our investment in inventory increased by \$3.5 million at September 30, 2007 from year-end 2006. The increase is attributable to weaker than expected sales and not decreasing our purchases to match the sales trend. Inventory turnover decreased to an annualized rate of 2.86 times during the first nine months of 2007, from 3.28 times for the first nine months of 2006. Inventory turnover was 3.36 times for all of 2006. We compute our inventory turns as sales divided by average inventory. At the end of the third quarter, our total inventory on hand was 25% over our internal targets for optimal inventory levels. We are reducing our inventory purchases during the remainder of the year in an attempt to reduce our inventory on hand by year-end.

Trade accounts receivable was \$2.3 million at September 30, 2007, down \$304,000 from \$2.6 million at year-end 2006. The average days to collect accounts for the first nine months of 2007 were 54.9 days, up from the first nine months of 2006 of 47.5 days. We are tightening our credit policy and analyzing our customers with open accounts to ensure collectability of the accounts and will make adjustments as needed.

Accounts payable increased \$565,000 to \$2.3 million at the end of the September 2007, due primarily to the increases in inventory purchases. Accrued expenses and other liabilities decreased \$993,000 due to the decrease in inventory in transit at September 30, 2007.

During the first three quarters of 2007, cash flow used by operating activities was \$1.2 million. The increase in inventory and decrease in accrued expenses accounted for the majority of the cash used, offset by net income. Cash flow used in investing activities totaled \$5.8 million, consisting of \$5.1 million in fixed asset purchases, including \$4.5 million for the purchase of building for our corporate headquarters, and \$650,000 for the acquisition of Mid-Continent Leather Sales, Inc., a wholesale distributor of leather and leathercraft supplies located in Coweta, Oklahoma. Cash flow provided by financing activities totaled \$4.0 million, consisting of borrowings on a note payable related to the building purchase.

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, 2006. We believe that our exposure to market risks has not changed significantly since December 31, 2006.

Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed

by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at a reasonable assurance level.

We maintain certain internal controls over financial reporting that are appropriate, in management's judgment with similar cost-benefit considerations, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. No change in our internal control over financial reporting occurred during the fiscal quarter ended September 30, 2007 that has materially affected, or is reasonably likely to affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

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 with the Securities and Exchange Commission on July 5, 1994 and incorporated by reference herein. |
| 10.1 | 2007 Director Non-qualified Stock Option Plan of Tandy Leather Factory, Inc. dated March 22, 2007, filed as an Exhibit to Tandy Leather Factory, Inc.'s Definitive Proxy Statement filed with the Securities and Exchange Commission on April 18, 2007 and incorporated by reference herein. |
| 10.2 | Agreement of Purchase and Sale, dated June 25, 2007, by and between Standard Motor Products, Inc. and Tandy Leather Factory, L.P., filed as Exhibit 10.4 to Form 8-K filed with the Securities and Exchange Commission on August 6, 2007 and incorporated by reference herein. |
| *31.1 | 13a-14(a) Certification by Ronald C. Morgan, 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 14, 2007

By: /s/ Ronald C. Morgan
Ronald C. Morgan
Chief Executive Officer and President

Date: November 14, 2007

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

EXHIBIT 31.1

RULE 13a-14(a) CERTIFICATION

I, **Ronald C. Morgan**, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tandy Leather Factory, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [*language intentionally omitted SEC Rel. 33-8238 and 33-8618*] for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) [*Left blank intentionally SEC Rel. No. 33-8238 and 33-8618*];
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's third fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 14, 2007

/s/ Ronald C. Morgan
Ronald C. Morgan
Chief Executive Officer and President
(principal executive officer)

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EXHIBIT 31.2

RULE 13a-14(a) CERTIFICATION

I, **Shannon L. Greene**, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tandy Leather Factory, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) *[language intentionally omitted SEC Rel. 33-8238 and 33-8618]* for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) *[Left blank intentionally SEC Rel. No. 33-8238 and 33-8618];*
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's third fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 14, 2007

/s/ Shannon L. Greene
Shannon L. Greene

Chief Financial Officer and Treasurer
(principal financial and accounting officer)

EXHIBIT 32.1

**Certification Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Tandy Leather Factory, Inc. for the quarter ended September 30, 2007 as filed with the United States Securities and Exchange Commission on the date hereof (the "Report"), Ronald C. Morgan, as Chief Executive Officer and President, and Shannon L. Greene, as Treasurer and Chief Financial Officer, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- i. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- ii. The information contained in the Report fully presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

November 14, 2007

/s/ Ronald C. Morgan
Ronald C. Morgan
Chief Executive Officer and President

November 14, 2007

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

