

TANDY LEATHER FACTORY INC
Form 10-Q
August 15, 2011

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 June 30, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-12368

TANDY LEATHER FACTORY, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

75-2543540
(I.R.S. Employer Identification No.)

1900 Southeast Loop 820, Fort Worth, Texas 76140
(Address of Principal Executive Offices) (Zip Code)

(817) 872-3200
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for a shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Shares outstanding as of August 10, 2011 |
|--|--|
| Common Stock, par value \$0.0024 per share | 10,156,442 |

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

| | June 30, 2011 (unaudited) | December 31, 2010 (audited) |
|--|---------------------------------|-----------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash | \$4,897,099 | \$4,293,746 |
| Short-term investments, including certificates of deposit | 976,341 | 1,621,593 |
| Accounts receivable-trade, net of allowance for doubtful accounts of \$72,000 and \$147,000 in 2011 and 2010, respectively | 1,353,624 | 1,253,639 |
| Inventory | 20,260,247 | 20,236,028 |
| Prepaid income taxes | 56,749 | - |
| Deferred income taxes | 287,239 | 307,509 |
| Other current assets | 1,354,223 | 1,056,201 |
| Total current assets | 29,185,522 | 28,768,716 |
| PROPERTY AND EQUIPMENT, at cost | 14,476,574 | 14,390,662 |
| Less accumulated depreciation and amortization | (4,269,432) | (4,106,121) |
| | 10,207,142 | 10,284,541 |
| GOODWILL | 994,669 | 990,368 |
| OTHER INTANGIBLES, net of accumulated amortization of \$518,000 and \$495,000 in 2011 and 2010, respectively | 210,784 | 232,416 |
| Other assets | 316,692 | 319,533 |
| | \$40,914,809 | \$40,595,574 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable-trade | \$1,498,195 | \$1,247,821 |
| Accrued expenses and other liabilities | 3,025,483 | 4,893,236 |
| Income taxes payable | - | 554,380 |
| Current maturities of long-term debt | 202,500 | 202,500 |
| Total current liabilities | 4,726,178 | 6,897,937 |
| DEFERRED INCOME TAXES | 840,392 | 628,543 |
| LONG-TERM DEBT, net of current maturities | 3,206,250 | 3,307,500 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$0.10 par value; 20,000,000 shares authorized; | | |

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| | | |
|---|--------------|--------------|
| none issued or outstanding; attributes to be determined on issuance | - | - |
| Common stock, \$0.0024 par value; 25,000,000 shares authorized; 11,150,065 shares issued at 2011 and 2010; | | |
| 10,156,442 shares outstanding at 2011 and 2010 | 26,760 | 26,760 |
| Paid-in capital | 5,729,417 | 5,703,387 |
| Retained earnings | 28,656,267 | 26,429,335 |
| Treasury stock at cost (993,623 shares at 2011 and 2010) | (2,894,068) | (2,894,068) |
| Accumulated other comprehensive income | 623,613 | 496,180 |
| Total stockholders' equity | 32,141,989 | 29,761,594 |
| | \$40,914,809 | \$40,595,574 |

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 Six Months Ended June 30, 2011 and 2010

| | THREE MONTHS | | SIX MONTHS | |
|---|--------------|--------------|--------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| NET SALES | \$15,933,921 | \$14,350,822 | \$31,812,961 | \$28,939,360 |
| COST OF SALES | 6,088,667 | 5,635,856 | 12,442,859 | 11,247,798 |
| Gross profit | 9,845,254 | 8,714,966 | 19,370,102 | 17,691,562 |
| OPERATING EXPENSES | 8,075,939 | 7,270,655 | 15,688,299 | 14,710,883 |
| INCOME FROM CONTINUING OPERATIONS | 1,769,315 | 1,444,311 | 3,681,803 | 2,980,679 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (62,132) | (65,615) | (124,135) | (131,219) |
| Other, net | (45,767) | 81,741 | (94,599) | 83,208 |
| Total other income (expense) | (107,899) | 16,126 | (218,734) | (48,011) |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 1,661,416 | 1,460,437 | 3,463,069 | 2,932,668 |
| PROVISION FOR INCOME TAXES | 585,060 | 399,327 | 1,236,137 | 923,981 |
| NET INCOME FROM CONTINUING OPERATIONS | 1,076,356 | 1,061,110 | 2,226,932 | 2,008,687 |
| INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX | - | - | - | 536 |
| NET INCOME | \$1,076,356 | \$1,061,110 | \$2,226,932 | \$2,009,223 |
| NET INCOME FROM CONTINUING OPERATIONS PER COMMON SHARE: | | | | |
| Basic | \$0.11 | \$0.10 | \$0.22 | \$0.20 |
| Diluted | \$0.11 | \$0.10 | \$0.22 | \$0.20 |
| NET INCOME FROM DISCONTINUED OPERATIONS PER COMMON SHARE: | | | | |
| Basic | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Diluted | \$0.00 | \$0.00 | \$0.00 | \$0.00 |

NET INCOME PER COMMON
SHARE:

| | | | | |
|---------|--------|--------|--------|--------|
| Basic | \$0.11 | \$0.10 | \$0.22 | \$0.20 |
| Diluted | \$0.11 | \$0.10 | \$0.22 | \$0.20 |

Weighted Average Number of Shares

Outstanding:

| | | | | |
|---------|------------|------------|------------|------------|
| Basic | 10,156,442 | 10,191,506 | 10,156,442 | 10,164,759 |
| Diluted | 10,168,098 | 10,238,217 | 10,175,561 | 10,226,015 |

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 Six Months Ended June 30, 2011 and 2010

| | 2011 | 2010 |
|---|----------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$2,226,932 | \$2,009,223 |
| Income from discontinued operations | - | 536 |
| | 2,226,932 | 2,008,687 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 497,351 | 471,410 |
| Loss on disposal or abandonment of assets | 79,035 | 8,553 |
| Non-cash stock-based compensation | 26,030 | 18,388 |
| Deferred income taxes | 232,119 | (82,823) |
| Other | 117,789 | (52,842) |
| Net changes in assets and liabilities, net of effect of business acquisitions: | | |
| Accounts receivable-trade, net | (99,985) | (195,779) |
| Inventory | (24,219) | (1,244,465) |
| Income taxes | (611,129) | (406,926) |
| Other current assets | (298,022) | (1,063,029) |
| Accounts payable-trade | 250,374 | 517,249 |
| Accrued expenses and other liabilities | (1,867,753) | 383,085 |
| Total adjustments | (1,698,410) | (1,647,179) |
| Net cash provided by continuing operating activities | 528,522 | 361,508 |
| Cash provided from discontinued operations | - | 6,831 |
| Net cash provided by operating activities | 528,522 | 368,339 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (497,485) | (238,756) |
| Purchase of certificates of deposit | - | (2,572,593) |
| Proceeds from maturities of certificates of deposit | 645,252 | 5,086,000 |
| Proceeds from sale of assets | 25,473 | 6,560 |
| Decrease (increase) in other assets | 2,841 | (1,612) |
| Net cash provided by investing activities | 176,081 | 2,279,599 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on notes payable and long-term debt | (101,250) | (101,250) |
| Repurchase of common stock (treasury stock) | - | (8,419) |
| Proceeds from issuance of common stock | - | 166,466 |
| Net cash (used in) provided by financing activities | (101,250) | 56,797 |
| NET INCREASE IN CASH | 603,353 | 2,704,735 |
| CASH, beginning of period | 4,293,746 | 7,891,962 |

| | | |
|---------------------|-----------|------------|
| CASH, end of period | 4,897,099 | 10,596,697 |
|---------------------|-----------|------------|

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

| | | |
|---|-------------|-------------|
| Interest paid during the period | \$124,135 | \$131,219 |
| Income tax paid during the period, net of (refunds) | \$1,471,101 | \$1,405,089 |

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 Six Months Ended June 30, 2011 and 2010

| | Number of Shares | Par Value | Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|----------------------------------|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|--------------------------------|
| BALANCE, December 31, 2009 | 10,130,628 | \$26,453 | \$5,491,736 | \$(2,452,649) | \$29,959,910 | \$334,205 | \$33,359,655 | |
| Shares issued | | | | | | | | |
| - stock options | 126,114 | 302 | 166,164 | - | - | - | 166,466 | |
| Stock-based compensation | - | - | 18,388 | - | - | - | 18,388 | |
| Purchase of treasury stock | (2,300) | - | - | (8,419) | - | - | (8,419) | |
| Net income | - | - | - | - | 2,009,223 | - | 2,009,223 | \$2,099,223 |
| Cash dividend | - | - | - | - | (7,690,832) | - | (7,690,832) | |
| Translation adjustment | - | - | - | - | - | (59,693) | (59,693) | (59,693) |
| BALANCE, June 30, 2010 | 10,254,442 | \$26,755 | \$5,676,288 | \$(2,461,068) | \$24,278,301 | \$274,512 | \$27,794,788 | |

Comprehensive income for the six months ended June 30, 2010 \$1,949,530

| | Number of Shares | Par Value | Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|----------------------------------|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|--------------------------------|
| BALANCE, December 31, 2010 | 10,156,442 | \$26,760 | \$5,703,387 | \$(2,894,068) | \$26,429,335 | \$496,180 | \$29,761,594 | |
| Stock-based compensation | - | - | 26,030 | - | - | - | 26,030 | |
| Net income | - | - | - | - | 2,226,932 | - | 2,226,932 | \$2,226,932 |
| Translation adjustment | - | - | - | - | - | 127,433 | 127,433 | 127,433 |
| BALANCE, June 30, 2011 | 10,156,442 | \$26,760 | \$5,729,417 | \$(2,894,068) | \$28,656,267 | \$623,613 | \$32,141,989 | |

Comprehensive income for the six months ended June 30, 2011 \$2,354,365

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 June 30, 2011 and December 31, 2010, and its results of operations and cash flows for the three and/or six-month periods ended June 30, 2011 and 2010. Operating results for the three and six-month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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, 2010.

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 | |
|-----------------------------------|---------------------|----------------------|
| | June 30, 2011 | December 31, 2010 |
| Inventory on hand: | | |
| Finished goods held for sale | \$18,815,401 | \$17,847,002 |
| Raw materials and work in process | 684,584 | 518,422 |
| Inventory in transit | 760,262 | 1,870,604 |
| | \$20,260,247 | \$20,236,028 |

Goodwill and Other Intangibles. Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is required to be tested for impairment on an annual basis, absent indicators of impairment during the interim. Application of the goodwill impairment test requires exercise of judgment, including the estimation of future cash flows, determination of appropriate discount rates and other important assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

A two-step process is used to test for goodwill impairment. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2010, 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 half of 2011.

A summary of changes in our goodwill for the periods ended June 30, 2011 and 2010 is as follows:

| | Leather Factory | Tandy Leather | Total |
|------------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2009 | \$600,417 | \$383,406 | \$983,823 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain/loss | (1,706) | - | (1,706) |
| Impairments | - | - | - |
| Balance, June 30, 2010 | \$598,711 | \$383,406 | \$982,117 |
| | Leather Factory | Tandy Leather | Total |
| Balance, December 31, 2010 | \$606,962 | \$383,406 | \$990,368 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain/loss | 4,301 | - | 4,301 |
| Impairments | - | - | - |
| Balance, June 30, 2011 | \$611,263 | \$383,406 | \$994,669 |

Other intangibles consist of the following:

| | As of June 30, 2011 | | | As of December 31, 2010 | | |
|------------------------|---------------------|------------------------------|-----------|-------------------------|------------------------------|-----------|
| | Gross | Accumulated Net Amortization | | Gross | Accumulated Net Amortization | |
| Trademarks, Copyrights | \$544,369 | \$408,551 | \$135,818 | \$544,369 | \$391,531 | \$152,838 |
| Non-Compete Agreements | 184,118 | 109,152 | 74,966 | 183,134 | 103,556 | 79,578 |
| | \$728,487 | \$517,703 | \$210,784 | \$727,503 | \$495,087 | \$232,416 |

We recorded amortization expense of \$22,139 during the first six months of 2011 compared to \$30,312 during the first half of 2010. 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 |
|------|------------------------|---------------------|----------|
| 2011 | \$13,918 | \$30,337 | \$44,255 |
| 2012 | 5,522 | 30,337 | 35,859 |
| 2013 | - | 30,337 | 30,337 |
| 2014 | - | 30,337 | 30,337 |
| 2015 | - | 25,635 | 25,635 |

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.

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Recent Accounting Pronouncements. In January 2010, FASB issued guidance titled “Improving Disclosures About Fair Value Measurements” that amended existing disclosure requirements by adding required disclosures about items transferring into and out of levels 1 and 2 in the fair value hierarchy; adding separate disclosures about purchase, sales, issuances, and settlements relative to level 3 measurements; and clarifying, among other things, the existing fair value disclosures about the level of disaggregation. Except for the separate level 3 disclosures, this guidance was effective for financial statements issued for interim or fiscal years beginning after December 15, 2009. The separate level 3 disclosure requirement was effective for financial statements issued for interim or fiscal years beginning after December 15, 2010. Our adoption did not have a material impact on our financial condition or results of operations.

In April 2010, FASB issued ASU 2010-13 "Compensation-Stock Compensation (Topic 718) Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades" (ASU 2010-13). Topic 718 is amended to clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades shall not be considered to contain a market, performance, or service condition. Therefore, such an award is not to be classified as a liability if it otherwise qualifies as equity classification. The amendments in this standard are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The guidance should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings for all outstanding awards as of the beginning of the fiscal year in which the amendments are initially applied. The adoption of the standard did not have a material impact on our consolidated results of operations and financial condition.

In December 2010, FASB issued ASU 2010-28 “Intangibles - Goodwill and Other (Topic 350)” (ASU 2010-28). Topic 350 is amended to clarify the requirement to test for impairment of goodwill. Topic 350 has required that goodwill be tested for impairment if the carrying amount of a reporting unit exceeds its fair value. Under ASU 2010-28, when the carrying amount of a reporting unit is zero or negative an entity must assume that it is more likely than not that a goodwill impairment exists, perform an additional test to determine whether goodwill has been impaired and calculate the amount of that impairment. The modifications to ASC Topic 350 resulting from the issuance of ASU 2010-28 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. The adoption of the standard did not have a material impact on our consolidated results of operations and financial condition.

In December 2010, FASB issued ASU 2010-29 “Business Combinations (Topic 805) - Disclosure of Supplementary Pro Forma Information for Business Combinations” (ASU 2010-29). This standard update clarifies that, when presenting comparative financial statements, SEC registrants should disclose revenue and earnings of the combined entity as though the current period business combinations had occurred as of the beginning of the comparable prior annual reporting period only. The update also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective prospectively for material (either on an individual or aggregate basis) business combinations entered into in fiscal years beginning on or after December 15, 2010. The adoption of the standard did not have a material impact on our consolidated financial statements.

In June 2011, FASB issued ASU 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income” (ASU 2011-05). This standard update requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of stockholders’ equity. ASU 2011-05 is effective for the interim and annual periods beginning after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements as it only requires a change in the format of presentation.

2. SHORT-TERM INVESTMENTS

All current fixed maturity securities are classified as “available for sale” and are reported at carrying value, which approximates fair value based on the discounted value of contractual cash flows. We have determined that our investment securities are available to support current operations and, accordingly, have classified such securities as current assets without regard to contractual maturities. Investments at June 30, 2011 and December 31, 2010 consisted of certificates of deposit. The contractual maturities of \$976,341 in certificates of deposit held as of June 30, 2011 are all due within one year.

We measure fair value as an exit price, which is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As a basis for considering such assumptions, accounting standards establish a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – include other inputs that are directly or indirectly observable in the marketplace.

Level 3 – unobservable inputs which are supported by little or no market activity.

Classification of the financial asset or liability within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. We classify our certificates of deposit as level 2 assets and have maintained consistency in valuation techniques during the period ended June 30, 2011.

3. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, 2007, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to \$5,500,000 to facilitate our purchase of real estate consisting of a 195,000 square foot building situated on 30 acres of land located at 1900 SE Loop 820 in Fort Worth, Texas. Proceeds in the amount of \$4,050,000 were used to fund the purchase of the property. On April 30, 2008, the principal balance was rolled into a 10-year term note with a 20-year amortization that accrues interest at a rate of 7.10% per annum.

On July 15, 2010, we entered into a Credit Agreement and Line of Credit Note with Comerica Bank, pursuant to which the bank agreed to provide us with a revolving credit facility of up to \$2,500,000. The agreement expired on June 29, 2011 and was not renewed.

At June 30, 2011 and December 31, 2010, the amount outstanding under the above agreements consisted of the following:

| | June 30, 2011 | December 31, 2010 |
|--|------------------|----------------------|
| Credit Agreement with JPMorgan Chase Bank – collateralized by real estate; payable as follows: | | |
| Line of Credit Note dated July 31, 2007, converted to a 10-year term note on April 30, 2008; \$16,875 monthly principal payments plus interest at 7.1% per annum; matures April 30, 2018 | \$ 3,408,750 | \$3,510,000 |

Credit Agreement with Comerica Bank – unsecured;
payable as follows:

| | | |
|---|-------------|-------------|
| Master Revolving Note dated June 30, 2010 in the maximum principal amount of \$2,500,000 – interest due monthly as LIBOR plus 2%; expired June 29, 2011 | - | - |
| | 3,408,750 | 3,510,000 |
| Less - Current maturities | (202,500) | (202,500) |
| | \$3,206,250 | \$3,307,500 |

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4. STOCK-BASED COMPENSATION

We have one stock option plan which provides for annual stock option grants to non-employee directors with an exercise price equal to the fair market value of the shares at the date of grant. Under this plan, 12,000 and 9,000 options were awarded to directors in the first half of 2011 and 2010, respectively. These options vest and become exercisable six months from the option grant date. We had two other stock option plans from 1995 which provided for stock option grants to officers, key employees and non-employee directors. These plans expired in 2005. The expiration of the plans has no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our common stock as of closing on the date the option was granted and no option has a term in excess of ten years. We recognized share based compensation expense of \$7,130 and \$18,388 for each of the quarters ended June 30, 2011 and 2010, respectively, and \$26,030 and \$18,388 for each of the six month periods ended June 30, 2011 and 2010, respectively, as a component of operating expenses.

During the six months ended June 30, 2011 and 2010, 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, 2010 | \$2.33 | 197,700 | | |
| Granted | 5.30 | 9,000 | | |
| Cancelled | - | - | | |
| Exercised | 1.644 | 134,700 | | |
| Outstanding, June 30, 2010 | \$4.27 | 72,000 | 4.23 | \$152,133 |
| Exercisable, June 30, 2010 | \$4.12 | 63,000 | 4.12 | \$133,745 |
| Outstanding, January 1, 2011 | \$4.35 | 103,600 | | |
| Granted | 1.19 | 12,000 | | |
| Cancelled | - | - | | |
| Exercised | - | - | | |
| Outstanding, June 30, 2011 | \$4.40 | 115,600 | 5.37 | \$206,332 |
| Exercisable, June 30, 2011 | \$4.35 | 103,600 | 5.44 | \$192,075 |

Other information pertaining to option activity during the six-month periods ended June 30, 2011 and 2010 are as follows:

| | June 30, 2011 | June 30, 2010 |
|---|---------------|---------------|
| Weighted average grant-date fair value of stock options granted | \$14,257 | \$18,388 |

| | | |
|--|----------|-----------|
| Total fair value of stock options vested | \$42,202 | N/A |
| Total intrinsic value of stock options exercised | N/A | \$112,343 |

As of June 30, 2011 and 2010 unrecognized compensation cost was \$7,129 and \$0, respectively.

5. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for the three and six months ended June 30, 2011 and 2010:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------|------------------|-------------|
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Numerator: | | | | |
| Net income | \$1,076,356 | \$1,061,110 | \$2,226,932 | \$2,009,223 |
| Numerator for basic and diluted earnings per share | 1,076,356 | 1,061,110 | 2,226,932 | 2,009,223 |
| Denominator: | | | | |
| Weighted-average shares outstanding-basic | 10,156,442 | 10,191,506 | 10,156,442 | 10,164,759 |
| Effect of dilutive securities: | | | | |
| Stock options | 11,656 | 46,711 | 19,119 | 61,256 |
| Dilutive potential common shares | 11,656 | 46,711 | 19,119 | 61,256 |
| Denominator for diluted earnings per share-weighted-average shares | 10,168,098 | 10,238,217 | 10,175,561 | 10,226,015 |
| Basic earnings per share | \$0.11 | \$0.10 | \$0.22 | \$0.20 |
| Diluted earnings per share | \$0.11 | \$0.10 | \$0.22 | \$0.20 |

The net effect of converting stock options and warrants to purchase 102,600 and 173,700 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the quarter ended June 30, 2011 and 2010, respectively.

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6. CASH DIVIDEND

In May 2010, our Board of Directors authorized a \$0.75 per share special one-time cash dividend that was paid to stockholders of record at the close of business on June 3, 2010. We released the funds used to pay for the special one-time cash dividend on July 1, 2010 and the dividend, totaling \$7.7 million, was paid to stockholders on July 5, 2010. 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.

7. SEGMENT INFORMATION

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

- a. Wholesale Leathercraft, which consists of a chain of wholesale stores operating under the name, The Leather Factory, located in North America;
- b. Retail Leathercraft, which consists of a chain of retail stores operating under the name, Tandy Leather Company, located in the North America; and
- c. International Leathercraft, which sells to both wholesale and retail customers. It carries the same products as North American stores. We started this operation in February 2008 and have one store located in Northampton, UK.

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 | Int'l Leathercraft | Discontinued Operations | Total |
|--|---------------------------|------------------------|-----------------------|----------------------------|---------------|
| For the quarter ended June 30, 2011 | | | | | |
| Net sales | \$6,471,072 | \$8,934,306 | \$528,543 | | \$15,933,921 |
| Gross profit | 4,106,707 | 5,383,078 | 355,469 | | 9,845,254 |
| Operating earnings | 608,385 | 1,038,301 | 122,629 | | 1,769,315 |
| Interest (expense) | (62,132) | - | - | | (62,132) |
| Other income (expense), net | (45,436) | - | (331) | | (45,767) |
| Income before income taxes | 500,817 | 1,038,301 | 122,298 | | 1,661,416 |
| Depreciation and amortization | 211,290 | 38,436 | 2,621 | | 252,347 |
| Fixed asset additions | 173,914 | 154,385 | - | | 328,299 |
| Total assets | \$33,191,853 | \$6,577,192 | \$1,145,764 | | -\$40,914,809 |

For the quarter ended June 30,
2010

| | | | | | |
|-----------------------------|-------------|-------------|-----------|--|--------------|
| Net sales | \$6,248,279 | \$7,706,679 | \$395,864 | | \$14,350,822 |
| Gross profit | 3,904,444 | 4,573,109 | 237,413 | | 8,714,966 |
| Operating earnings | 623,266 | 769,476 | 51,569 | | 1,444,311 |
| Interest (expense) | (65,615) | - | - | | (65,615) |
| Other income (expense), net | 76,813 | (2,610) | 7,538 | | 81,741 |
| Income before income taxes | 634,464 | 766,866 | 59,107 | | 1,460,437 |

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| | | | | |
|-------------------------------|--------------|-------------|-----------|---------------|
| Depreciation and amortization | 201,828 | 32,251 | 3,305 | 237,384 |
| Fixed asset additions | 130,670 | 8,969 | - | 139,639 |
| Total assets | \$39,239,711 | \$5,878,346 | \$675,839 | -\$45,793,896 |

| | Wholesale Leathercraft | Retail Leathercraft | Int'l Leathercraft | Discontinued Operations | Total |
|---|---------------------------|------------------------|-----------------------|----------------------------|---------------|
| For the six months ended June 30, 2011 | | | | | |
| Net sales | \$13,191,781 | \$17,583,458 | \$1,037,722 | | \$31,812,961 |
| Gross profit | 8,048,277 | 10,651,126 | 670,699 | | 19,370,102 |
| Operating earnings | 1,418,439 | 2,040,602 | 222,762 | | 3,681,803 |
| Interest (expense) | (124,135) | - | - | | (124,135) |
| Other income (expense), net | (111,782) | - | 17,183 | | (94,599) |
| Income before income taxes | 1,182,522 | 2,040,602 | 239,945 | | 3,463,069 |
| | | | | | |
| Depreciation and amortization | 419,478 | 72,761 | 5,112 | | 497,351 |
| Fixed asset additions | 281,328 | 214,657 | 1,500 | | 497,485 |
| Total assets | \$33,191,853 | \$6,577,192 | \$1,145,764 | | -\$40,914,809 |

| | | | | | |
|---|--------------|--------------|-----------|--|---------------|
| For the six months ended June 30, 2010 | | | | | |
| Net sales | \$12,836,083 | \$15,322,975 | \$780,302 | | \$28,939,360 |
| Gross profit | 7,792,346 | 9,410,403 | 488,813 | | 17,691,562 |
| Operating earnings | 1,157,462 | 1,692,214 | 131,003 | | 2,980,679 |
| Interest expense | (131,219) | - | - | | (131,219) |
| Other income (expense), net | 96,956 | (524) | (13,224) | | 83,208 |
| Income before income taxes | 1,123,199 | 1,691,690 | 117,779 | | 2,932,668 |
| | | | | | |
| Depreciation and amortization | 399,615 | 65,035 | 6,760 | | 471,410 |
| Fixed asset additions | 201,377 | 37,379 | - | | 238,756 |
| Total assets | \$39,239,711 | \$5,878,346 | \$675,839 | | -\$45,793,896 |

Net sales for geographic areas were as follows for the three and six months ended June 30, 2011 and 2010:

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| Three months ended June 30, | 2011 | 2010 |
|-----------------------------|--------------|--------------|
| United States | \$13,459,312 | \$12,570,039 |
| Canada | 1,685,746 | 1,377,127 |
| All other countries | 788,863 | 403,656 |
| | \$15,933,921 | \$14,350,822 |

| Six months ended June 30, | 2011 | 2010 |
|---------------------------|--------------|--------------|
| United States | \$26,978,244 | \$25,183,889 |
| Canada | 3,271,270 | 2,721,723 |
| All other countries | 1,563,447 | 1,033,748 |
| | \$31,812,961 | \$28,939,360 |

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 six-month periods ended June 30, 2011 and 2010. We do not have any significant long-lived assets outside of the United States.

8. LITIGATION

On March 16, 2011, two former employees of the Company filed a lawsuit, entitled Mark Barnes and Jerry Mercante on behalf of themselves and all other similarly situated v. Tandy Leather Company, Inc., Tandy Leather Factory, and Does 1-50, in the US District Court for the District of Nevada. The lawsuit was subsequently amended on May 9, 2011 to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleges that the Company violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs seek to represent themselves and all similarly situated U.S. current and former store managers of the Company. Plaintiffs seek reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, attorney's fees and costs. On May 17, 2011, the district court in Nevada granted the Company's request to transfer venue to the Northern District of Texas. Trial is currently set for the week of May 29, 2012. It is not possible at this time to predict whether the Company will incur any liability, or to estimate the ranges of damages, if any, which may be incurred in connection with the matter. The company intends to vigorously defend the lawsuit.

9. STORE CLOSING

On October 15, 2010, we announced the closing of Mid-Continent Leather Sales, a wholesale store located in Coweta, Oklahoma, due to its unsatisfactory sales and earnings performance. All related one-time expenses associated with the store closing were expensed in 2010 as part of operating expenses. The store closing did not result in an impairment of goodwill.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Our Business

We are the world's largest specialty retailer and wholesale distributor of leather and leathercraft related items. We market our products to our growing list of customers through company-owned retail and wholesale stores. We are a Delaware corporation, and our common stock trades on the NASDAQ Global Market under the symbol "TLF." We operate our business in three segments: Wholesale Leathercraft, which operates wholesale stores in North America under the trade name, The Leather Factory, Retail Leathercraft, which operates retail stores in North America under

the trade name, Tandy Leather Company, and International Leathercraft, which operates combination retail/wholesale stores outside of North America under the trade name, Tandy Leather Factory. See Note 7 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

Our Wholesale Leathercraft segment operates 29 company-owned wholesale stores in 19 states and three Canadian provinces. These stores are engaged in the wholesale distribution of leather and related items, including leatherworking tools, buckles and belt adornments, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits, to retailers, manufacturers, and end users. Our Wholesale Leathercraft segment also includes our National Account sales group, whose customers are only national craft chains.

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 35 states and six Canadian provinces. Tandy Leather Company, the oldest and one of the best-known suppliers of leather and related supplies used in the leathercraft industry, has been a primary leathercraft resource for decades. Tandy Leather Company's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather Company's industry presence by opening retail stores. As of August 1, 2011, we were operating 77 Tandy Leather Company retail stores located throughout the United States and Canada.

Our International Leathercraft segment operates one company-owned store in Northampton, United Kingdom. The store, which opened in February 2008, operates as a combination retail and wholesale store. In 2011, we intend to open a new store in Australia and one to two stores in Spain. While the opening dates have not been determined yet, we are estimating the Australia store to open in the third quarter and the Spain store(s) to open in the fourth quarter.

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, 2010.

Forward-Looking Statements

Certain statements contained in this report and other materials we file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made or to be made by us, other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally are accompanied by words such as "may," "will," "could," "should," "anticipate," "believe," "budgeted," "intend," "plan," "project," "potential," "estimate," "continue," or "future" variations thereof or other similar statements. There are certain important risks that could cause results to differ materially from those anticipated by some of the forward-looking statements. Some, but not all, of the important risks, including those described below, could cause actual results to differ materially from those suggested by the forward-looking statements. Please refer also to our Annual Report on Form 10-K for fiscal year ended December 31, 2010 for additional information concerning these and other uncertainties that could negatively impact the Company.

Ø Our business may be negatively impacted by general economic conditions and the current global financial crisis.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also small businesses and other retailers. The United States and global economies have suffered from a prolonged recession for the past several years and as a result consumer spending has remained depressed, and may be subject to further deterioration for the foreseeable future. Specialty retail, and retail in general, are heavily influenced by general economic cycles. Purchases of non-essential products tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. During

periods of economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, open and operate new stores, maintain sales levels at our existing stores, maintain or increase our international operations on a profitable basis, or maintain our earnings from operations as a percentage of net sales. As a result, our operating results may be adversely and materially affected by continued downward trends or uncertainty in the United States or global economies.

Ø Our profitability may decline as a result of increasing pressure on margins.

Our industry is subject to significant pricing pressure caused by many factors, including fluctuations in the cost of the leathers and metal products that we purchase and changes in consumer spending patterns and acceptance of our products. These factors may prohibit us from passing cost increases on to customers which could cause our gross margin to decline. If our product costs increase and our sale prices do not, our future operating results could be adversely affected unless we are able to offset such gross margin declines with comparable reductions in operating costs.

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.

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Results of Operations

Three Months Ended June 30, 2011 and 2010

The following tables present selected financial data of each of our three segments for the quarters ended June 30, 2011 and 2010.

| | Quarter Ended June 30, 2011 | | Quarter Ended June 30, 2010 | |
|------------------------|-----------------------------|------------------|-----------------------------|------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$6,471,072 | \$608,385 | \$6,248,279 | \$623,266 |
| Retail Leathercraft | 8,934,306 | 1,038,301 | 7,706,679 | 769,476 |
| Int'l Leathercraft | 528,543 | 122,629 | 395,864 | 51,569 |
| Total Operations | \$15,933,921 | \$1,769,315 | \$14,350,822 | \$1,444,311 |

Consolidated net sales for the quarter ended June 30, 2011 increased \$1.6 million, or 11.0%, compared to the same period in 2010. All three segments achieved sales gains, ranging from 4% to 34%. Operating income on a consolidated basis for the quarter ended June 30, 2011 was up 22.5%, or \$325,000, from the second quarter of 2010.

The following table shows in comparative form our consolidated net income for the second quarters of 2011 and 2010:

| | 2011 | 2010 | % change |
|------------|-------------|-------------|----------|
| Net income | \$1,076,356 | \$1,061,110 | 1.4% |

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

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 29 wholesale stores and our National Account sales group. The National Account sales group's customers consist of only national craft chains. The following table presents the combined sales mix by customer categories for the quarters ended June 30, 2011 and 2010:

| Customer Group | Quarter Ended | |
|---|---------------|----------|
| | 06/30/11 | 06/30/10 |
| RETAIL (end users, consumers, individuals) | 31% | 30% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 6% | 7% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 45% | 42% |
| MANUFACTURERS | 7% | 8% |
| NATIONAL ACCOUNTS | 11% | 13% |
| | 100% | 100% |

Net sales increased 3.6%, or \$223,000, for the second quarter of 2011 as follows:

| | # Stores | Qtr Ended 06/30/11 | Qtr Ended 06/30/10 | \$ Change | % Change |
|------------------|----------|-----------------------|-----------------------|-----------|-------------|
| Same store sales | 29 | \$5,838,551 | \$5,485,026 | \$353,525 | 6.4% |
| Closed store | 1 | - | 83,203 | (83,203) | N/A |

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| | | | | |
|------------------------|-------------|-------------|-----------|--------|
| National account group | 632,521 | 680,050 | (47,529) | (7.5)% |
| Total sales | \$6,471,072 | \$6,248,279 | \$222,793 | 3.6% |

Our same store sales increased 6.4% in the second quarter of 2011, as compared with the same period in 2010. Compared to the second quarter of 2010, we achieved sales increases in our retail and wholesale customer categories, which were offset somewhat by decreases in our manufacturing and national account customer categories. We believe our wholesale customers are beginning to stabilize which has resulted in an increase in purchases. However, it is too early to tell whether this trend will continue. We have lowered our discounts to our manufacturer customer group in an attempt to protect gross margins, which has affected sales to this group somewhat. Sales to our National Account customers were down 7.5% for the quarter, compared to the same quarter last year. Our sales to these customers will depend on products we develop specifically for this group and the level of inventory we are willing to house in anticipation of orders. Therefore, it is possible we will experience further sales declines to our National Account group if the product we stock is not what these customers want to purchase. Our primary focus is on sales through our stores, rather than National Accounts, as we believe our stores represent the greatest potential for continued and consistent sales growth.

Operating income for Wholesale Leathercraft during the quarter ended June 30, 2011 decreased by \$15,000 from the comparative 2010 quarter, a decrease of 2.4%. Operating expenses as a percentage of sales were 54.0%, up \$217,000 from the second quarter of 2010. Increases in legal fees of \$266,000 and employee compensation and benefits of \$108,000, offset by a decrease in advertising and marketing expenses of \$107,000, accounted for the operating expense increase.

Retail Leathercraft

Our Retail Leathercraft operation consists of 77 and 76 Tandy Leather Company retail stores at June 30, 2011 and 2010, respectively. Net sales increased 15.9% for the second quarter of 2011 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 06/30/11 | Qtr Ended 06/30/10 | \$ Change | % Change |
|------------------|----------|-----------------------|-----------------------|-------------|-------------|
| Same store sales | 76 | \$8,924,874 | \$7,706,679 | \$1,218,195 | 15.8% |
| New store sales | 1 | 9,432 | - | 9,432 | N/A |
| Total sales | | \$8,934,306 | \$7,706,679 | \$1,227,627 | 15.9% |

The following table presents sales mix by customer categories for the quarters ended June 30, 2011 and 2010 for our Retail Leathercraft operation:

| Customer Group | Quarter Ended | |
|---|---------------|----------|
| | 06/30/11 | 06/30/10 |
| RETAIL (end users, consumers, individuals) | 60% | 63% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7% | 8% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 31% | 28% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 2% | 1% |
| | 100% | 100% |

The retail stores averaged approximately \$39,000 in sales per month for the second quarter of 2011.

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Sales to each customer group increased slightly over the second quarter of 2010. Operating income increased \$269,000, or 34.9%, from the comparative 2010 quarter. Operating income as a percentage of sales also increased from 10.0% in the second quarter of 2010 to 11.6% in the second quarter of 2011. Our gross profit margin improved slightly from 59.3% to 60.3%. Operating expenses as a percentage of sales decreased from 49.4% to 48.6% as sales grew at a faster rate than that of expenses during the quarter. Operating expenses increased \$541,000 over the second quarter of 2010. The new store opened in June 2011 accounted for additional operating expenses of \$19,000. Employee compensation and benefits increased \$241,000. Advertising and marketing expenses increased \$86,000. Expenses associated with store moves added \$50,000 this quarter.

International Leathercraft

Consisting of one store located in the UK, this division's sales totaled \$529,000 for the second quarter of 2011, compared to \$396,000 in the second quarter of 2010, an improvement of 34%. Gross profit margin as a percentage of sales increased significantly from the second quarter of 2010. We determine UK selling prices taking into consideration the currency conversion between the U.S. dollar and the Great Britain pound. Even so, our UK store generates higher profit margins than that of a comparable U.S. store due to a beneficial product mix, selling more higher margin tools and supplies and less lower margin leather. Operating expenses totaled \$233,000 in the second quarter of 2011, up from \$186,000 in the second quarter of 2010 for our UK store. Advertising expense is this division's largest expense, followed by employee compensation, shipping costs to customers, and rent.

Other Expenses

We paid \$62,000 in interest expense in the second quarter of 2011 on our bank debt, which is related to our building purchase, compared to \$66,000 in interest expense in the second quarter last year. Due to the reduction in cash on hand compared to last year, we earned \$10,000 in interest income during the second quarter of 2011, down from last year's second quarter interest income earned of \$23,000. We recorded a \$66,000 loss during the second quarter of 2011 related to currency fluctuations from our Canadian and UK operations. Comparatively, in the second quarter of 2010, we recorded income of \$18,000 for currency fluctuations.

Six Months Ended June 30, 2011 and 2010

The following table presents selected financial data of each of our three segments for the six months ended June 30, 2011 and 2010:

| | Six Months Ended June 30, 2011 | | Six Months Ended June 30, 2010 | |
|----------------------------|--------------------------------|------------------|--------------------------------|------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$13,191,781 | \$1,418,439 | \$12,836,083 | \$1,157,462 |
| Retail Leathercraft | 17,583,458 | 2,040,602 | 15,322,975 | 1,692,214 |
| International Leathercraft | 1,037,722 | 222,762 | 780,302 | 131,003 |
| Total Operations | \$31,812,961 | \$3,681,803 | \$28,939,360 | \$2,980,679 |

Consolidated net sales for the six months ended June 30, 2011 were up 10% compared to the same period in 2010, increasing \$2.9 million. All three reporting segments contributed to the sales increase. Retail Leathercraft contributed the largest sales increase of \$2.3 million, followed by Wholesale Leathercraft reporting an increase of \$356,000 and International Leathercraft reporting an increase of \$257,000. Operating income on a consolidated basis for the six months ended June 30, 2011 was up 23.5% compared to the first half of 2010, increasing \$701,000.

The following table shows in comparative form our consolidated net income for the first half of 2011 and 2010:

| | 2011 | 2010 | % change |
|------------|-------------|-------------|----------|
| Net income | \$2,226,932 | \$2,009,223 | 10.8% |

Wholesale Leathercraft

Net sales increased 2.8%, or \$356,000, for the first half of 2011 as follows:

| | # Stores | Six Months Ended 06/30/11 | Six Months Ended 06/30/10 | \$ Change | % Change |
|------------------------|----------|---------------------------------|---------------------------------|-----------|-------------|
| Same store sales | 29 | \$11,771,831 | \$11,179,307 | \$592,524 | 5.3% |
| Closed store | 1 | - | 172,099 | (172,099) | N/A |
| National account group | | 1,419,950 | 1,484,677 | (64,727) | (4.4)% |
| Total sales | | \$13,191,781 | \$12,836,083 | \$355,698 | 2.8% |

The following table presents the combined sales mix by customer categories for the six months ended June 30, 2011 and 2010:

| Customer Group | Six Months Ended | |
|---|------------------|----------|
| | 06/30/11 | 06/30/10 |
| RETAIL (end users, consumers, individuals) | 31% | 31% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 6% | 7% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 44% | 41% |
| MANUFACTURERS | 7% | 7% |
| NATIONAL ACCOUNTS | 12% | 14% |
| | 100% | 100% |

Operating income for Wholesale Leathercraft for the first half of 2011 increased by \$261,000 from the comparative 2010 period, an improvement of 22.6%. Compared to the first six months of 2010, operating expenses decreased \$5,000 for the first half of 2011, decreasing as a percentage of sales from 51.7% to 50.3%.

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Retail Leathercraft

Net sales were up 14.8% for the first half of 2011 over the same period last year.

| | # Stores | Six Months Ended 06/30/11 | Six Months Ended 06/30/10 | \$ Change | % Change |
|-----------------------------|----------|------------------------------|------------------------------|-------------|-------------|
| Same (existing) store sales | 75 | \$17,405,991 | \$15,227,973 | \$2,178,018 | 14.3% |
| New store sales | 2 | 177,467 | 95,002 | 82,465 | 86.8% |
| Total sales | | \$17,583,458 | \$15,322,975 | \$2,260,483 | 14.8% |

The following table presents sales mix by customer categories for the six months ended June 30, 2011 and 2010 for our Retail Leathercraft operation:

| Customer Group | Six Months Ended | |
|---|------------------|----------|
| | 06/30/11 | 06/30/10 |
| RETAIL (end users, consumers, individuals) | 62% | 64% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 6% | 7% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 30% | 28% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 2% | 1% |
| | 100% | 100% |

The retail stores averaged approximately \$38,000 in sales per month for the first half of 2011.

Operating income for the first six months of 2011 increased \$348,000 from the comparative 2010, improving as a percentage of sales from 11.0% in the first half of 2010 to 11.6% in the first half of 2011. Gross margin decreased slightly from 61.4% to 60.6%. Operating expenses decreased as a percentage of sales from 50.4% during the first half of 2010 to 48.9% during the first half of 2011, indicating that sales grew faster than expenses.

International Leathercraft

Consisting of one store located in the UK, this division's sales totaled \$1,038,000 for the first six months of 2011, compared to \$780,000 in the first six months of 2010, an improvement of 33.0%. Gross profit margin was 64.6% for the first half of this year, an increase of two percentage points from 62.6% in the second half of 2010. UK selling prices are determined based on the currency conversion between the U.S. dollar and the Great Britain pound. Even so, the store generates higher profit margins than that of a comparable U.S. store as it sells a heavier mix of higher margin tools and supplies and less lower margin leather. Operating expenses totaled \$448,000 in the first half of 2011, up from \$358,000 in the first half of 2010. Employee compensation is this segment's largest expense, followed by advertising and marketing expenses, shipping costs to customers, and rent.

Other Expenses

We paid \$124,000 in interest on our bank debt in the first six months of 2011, compared to \$131,000 in the first six months of 2010. Due to the reduction in cash on hand compared to last year, we recorded \$17,000 in interest income on our cash balances in the six months ended June 30, 2011 compared to \$58,000 a year ago. We recorded an expense of \$138,000 for currency fluctuations in the first half of 2011. Comparatively, in the first half of 2010, we recorded an expense of \$74,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets were \$40.9 million at June 30, 2011, up \$300,000 from \$40.6 million at year-end 2010. Total stockholders' equity increased from \$29.8 million at December 31, 2010 to \$32.1 million at June 30, 2011, the increase being attributable to earnings in the first half of this year. Our current ratio increased from 4.2 at December 31, 2010 to 6.2 at June 30, 2011 due primarily to a decrease in accrued expenses and income taxes payable during the first half of 2011.

Our investment in inventory increased by \$24,000 from year-end 2010 to June 30, 2011. While total inventory only increased minimally from year end, we held approximately \$1 million in extra inventory in anticipation of our new stores to be opened overseas. Inventory turnover reached an annualized rate of 3.14 times during the first half of 2011, slightly less than 3.31 times for the first half of 2010. Inventory turnover was 3.23 times for all of 2010. We compute our inventory turns as sales divided by average inventory. As of June 30, 2011, our total inventory on hand was approximately 14% over our internal targets for optimal inventory levels. The inventory held for our anticipated new stores at the end of the period accounted for half of what would be considered excess inventory. Further, while sales remain strong and leather prices remain high, we will continue to buy large quantities of our stock leathers at special prices as those opportunities present themselves in order to relieve pressure on our gross margins.

Trade accounts receivable was \$1.3 million at June 30, 2011, up \$100,000 from \$1.2 million at year-end 2010. The average days to collect accounts for the first half of 2011 were 48 days, up slightly from the first half quarter of 2010 of 47 days. We are monitoring our customer accounts very closely in order to minimize the risk of uncollectible accounts in the current economic environment.

Accounts payable increased to \$1.5 million at June 30, 2011 compared to \$1.2 million at year-end 2010, primarily due to the increase in inventory purchases during the first half of 2011 in response to our sales increase. Accrued expenses decreased \$1.9 million from December 31, 2010 to June 30, 2011 due to the semi-annual payment of manager bonuses and a reduction in inventory in transit compared to year-end 2010.

During the first six months of 2011, cash flow provided by operating activities was \$529,000. Net income of \$2.2 million was offset by a reduction in accrued liabilities of \$1.9 million and accounted for the majority of the operating cash provided in the first six months. Accrued liabilities decreased from December 31, 2010 to June 30, 2011 due to the payment of manager bonuses and the reduction in inventory in transit.

By comparison, during the first six months of 2010, cash flow provided by operating activities was \$368,000. Net income of \$2.0 million and an increase in accounts payable of \$517,000, offset by the increase in inventory of \$1.2 million and other current assets of \$1.1 million, accounted for the majority of the operating cash provided.

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Cash flow provided by investing activities totaled \$176,000 in the first half of 2011, consisting primarily of maturities of certificates of deposit, offset by purchases of store fixtures and computer equipment. In the first half of 2010, cash provided by investing activities totaled \$2.3 million, consisting primarily of maturities of certificates of deposit.

Cash flow used by financing activities totaled \$101,000 in the first six months of 2011, consisting of debt repayments. In the first six months of 2010, cash flow provided by financial activities totaled \$57,000, consisting of proceeds from issuance of common stock of \$166,000, offset by debt repayments of \$101,000 and the purchase of treasury stock of \$8,000.

We expect to fund our operating and liquidity needs as well as our store growth 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, 2010. We believe that our exposure to market risks has not changed significantly since December 31, 2010.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management team, under the supervision and with the participation of our principal executive officer and our principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the last day of the fiscal period covered by this report, June 30, 2011. The term disclosure controls and procedures means our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to management, including our principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of June 30, 2011, our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On March 16, 2011, two former employees of the Company filed a lawsuit, entitled Mark Barnes and Jerry Mercante on behalf of themselves and all other similarly situated v. Tandy Leather Company, Inc., Tandy Leather Factory, and Does 1-50, in the US District Court for the District of Nevada. The lawsuit was subsequently amended on May 9, 2011 to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleges that the Company

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violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs seek to represent themselves and all similarly situated U.S. current and former store managers of the Company. Plaintiffs seek reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, attorney's fees and costs. On May 17, 2011, the district court in Nevada granted the Company's request to transfer venue to the Northern District of Texas. Trial is currently set for the week of May 29, 2012.

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 3.5 to the Current Report on Form 8-K (Commission File No. 001-12368) filed by Tandy Leather Factory, Inc (f/k/a The Leather Factory, Inc.) with the Securities and Exchange Commission on July 14, 2004 and incorporated by reference herein. |
| *31.1 | 13a-14(a) or 15d-14(a) Certification by Jon Thompson, Chief Executive Officer and President. |
| *31.2 | 13a-14(a) or 15d-14(a) Certification by Shannon Greene, Chief Financial Officer and Treasurer. |
| *32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS^ | XBRL Instance Document. |
| 101.SCH^ | XBRL Taxonomy Extension Schema Document. |
| 101.CAL^ | XBRL Taxonomy Extension Calculation Document. |
| 101.DEF^ | XBRL Taxonomy Extension Definition Document. |
| 101.LAB^ | XBRL Taxonomy Extension Labels Document. |
| 101.PRE^ | XBRL Taxonomy Extension Presentation Document. |

*Filed herewith.

^ XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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TANDY LEATHER FACTORY, INC.
(Registrant)

Date: August 12, 2011

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

Date: August 12, 2011

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