

TANDY LEATHER FACTORY INC
Form 10-K
March 31, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period _____ 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) 75-2543540
(IRS Employer Identification Number)

1900 Southeast Loop 820, Fort Worth, TX 76140
(Address of principal executive offices) 817/872-3200
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Title of Each Class Name of Each Exchange on Which Registered
Common Stock, par value \$0.0024 NYSE Amex

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

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 [X]

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$22,193,469 at June 30, 2008 (the last business day of its most recently completed second fiscal quarter). At March 10, 2009, there were 10,664,555 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 12, 2009, are incorporated by reference in Part III of this report.

TABLE OF CONTENTS

Item		Page
Part I		
1	<u>Business</u>	1
1A	<u>Risk Factors</u>	5
2	<u>Properties</u>	6
3	<u>Legal Proceedings</u>	7
4	<u>Submission of Matters to a Vote of Security Holders</u>	7
Part II		
5	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	7
6	<u>Selected Financial Data</u>	8
7	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	8
7A	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	12
8	<u>Financial Statement and Supplementary Data</u>	13
9	<u>Change in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	28
9A	<u>Controls and Procedures</u>	28
9B	<u>Other Information</u>	28
Part III		
10	<u>Directors, Executive Officers and Corporate Governance</u>	28
11	<u>Executive Compensation</u>	28
12	<u>Security Ownership of Certain Owners and Management and Related Stockholder Matters</u>	28
13	<u>Certain Relationships and Related Transactions and Director Independence</u>	28
14	<u>Principal Accountant Fees and Services</u>	28
Part IV		
15	<u>Exhibits, Financial Statement Schedules</u>	29

PART I

ITEM 1. BUSINESS

General

We are a retailer and wholesale distributor of a broad line of leather and related products, including leather, leatherworking tools, buckles and adornments for belts, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits. We also manufacture leather lacing and kits. During 2008, our consolidated sales totaled \$53.2 million of which approximately 13% were export sales. We maintain our principal offices at 1900 Southeast Loop 820, Fort Worth, Texas 76140. Our common stock trades on the NYSE Amex (formerly the American Stock Exchange) under the symbol "TLF."

Our company was founded in 1980 as Midas Leathercraft Tool Company, a Texas corporation. Midas' original business activity focused on the distribution of leathercraft tools. In addition, the founders of Midas entered into a consulting agreement with Brown Group, Inc., a major footwear retailer, as a result of their proposal to develop a multi-location chain of wholesale stores known as "The Leather Factory." In 1985, Midas purchased the assets of The Leather Factory from Brown Shoe Group, which then consisted of six wholesale stores.

In 1993, we changed our name to "The Leather Factory, Inc.", then reincorporated in the state of Delaware in 1994. In 2005, we changed our name to Tandy Leather Factory, Inc.

Our Development in Recent Years

We have expanded our wholesale chain by opening new stores and by numerous acquisitions of small businesses in strategic geographic locations including the acquisition of our Canadian distributor, The Leather Factory of Canada, Ltd., in 1996. By 2000, we had grown to 27 Leather Factory stores located in the United States and two Leather Factory stores in Canada. In November 2000, we acquired the operating assets of two subsidiaries of Tandy Leather Company, Inc. to form Tandy Leather Company. In 2002, we began opening retail stores under the "Tandy Leather" name. During that year, Tandy Leather purchased four independent leathercraft retail stores and opened another 10. We also opened our thirtieth Leather Factory store - our third in Canada. In 2003, we opened 12 Tandy Leather retail stores. In 2004, we purchased three independent leathercraft retail stores and opened an additional nine stores in the U.S. We also opened another store in Canada which is operating as a Tandy Leather retail store. In November 2004, we acquired all of the issued and outstanding shares of capital stock of Heritan Ltd. and its parent, our primary Canadian competitor, headquartered in Barrie, Ontario. The acquisition resulted in an additional three retail stores in Canada, bringing the total locations in Canada to seven - three Leather Factory stores and four Tandy Leather stores. In 2005, we opened eight Tandy Leather retail stores. In 2006, we opened 11 Tandy Leather retail stores and converted one wholesale store to a retail store. In 2007, we purchased one independent leathercraft store and opened an additional nine retail stores - eight in the U.S. and one in Canada. We also purchased Mid-Continent Leather Sales, Inc., a competitor located in Oklahoma, which became our thirtieth wholesale store. In 2008, we opened one retail store in the U.S. and one combination wholesale and retail store in Northampton, United Kingdom.

At December 31, 2008, we operated 30 wholesale stores - 29 operating under the Leather Factory name (26 in the U.S. and three in Canada) and one operating under the Mid-Continent Leather Sales name. We also operated 73 retail stores operating under the Tandy Leather name (67 in the U.S. and six in Canada) as well as one combination wholesale and retail store operating under the Tandy Leather Factory name in the United Kingdom. Finally, we also own and operate Roberts, Cushman and Company, Inc., a distributor of custom hat trims.

Our growth, measured both by our net sales and net income, occurs as a result of the increase in the number of stores we have and the increase from year to year of the sales in our existing stores. The following tables provide summary information concerning the additions of facilities for our Leather Factory wholesale stores and Tandy Leather retail stores in each of our fiscal years from 1999 to 2008.

STORE COUNT
YEARS ENDED DECEMBER 31, 1999 through 2008

Year Ended	Leather Factory wholesale stores			Tandy Leather retail stores		
	Opened	Conversions(1)	Total	Opened (2)	Closed	Total
Balance Fwd			22			N/A
1999	4	0	26			N/A
2000	2	0	28	1*	0	1
2001	2	0	30	0	0	1
2002	1	(1)	30	14	1*	14
2003	0	0	30	12	0	26
2004	0	0	30	16	0	42
2005	0	0	30	8	0	50
2006	0	(1)	29	12	0	62
2007	1^	0	30	10	0	72
2008	0	0	30	1	0	73

(1) Leather Factory wholesale store converted to a Tandy Leather retail store.

(2) Includes conversions of Leather Factory wholesale stores to Tandy Leather retail stores.

(*) The Tandy Leather operation began as a central mail-order fulfillment center in 2000 which was closed in 2002.

(^) Wholesale store operating as Mid-Continent Leather Sales

No single customer's purchases represent more than 5% of our total sales in 2008. Sales to our five largest customers combined to represent 6.2%, 8.3% and 9.5%, respectively, of consolidated sales in 2008, 2007 and 2006. While management does not believe the loss of one of these customers would have a significant negative impact on our operations, it does believe the loss of several of these customers simultaneously or a substantial reduction in sales generated by them could temporarily affect our operating results.

Our Operating Divisions

We service our customers primarily through the operation of four divisions. We identify those divisions based on management responsibility and customer focus. The Wholesale Leathercraft division consists of thirty wholesale stores of which 27 are located in the United States and three are located in Canada. As of March 1, 2009, the Retail Leathercraft division consists of 74 Tandy Leather retail stores of which 68 are located in the United States and six are located in Canada. Both of these divisions sell leather and leathercraft-related products. The International Leathercraft division consists of all stores, wholesale or retail, located outside of North America. Currently, we have one such store located in the United Kingdom. Our fourth business segment, referred to as "Other," consists of our hatband manufacturer, Roberts, Cushman & Company, Inc.

TABLE OF CONTENTS

Wholesale Leathercraft

The Wholesale Leathercraft operation distributes its broad product line of leather and leathercraft-related products in the United States and internationally through Leather Factory stores. This segment had net sales of \$26.4 million, \$29.6 million and \$31.0 million for 2008, 2007 and 2006, respectively. The wholesale stores operate under the name “The Leather Factory”, with the exception of the one store we acquired in February 2007 which operates under the name “Mid-Continent Leather Sales.”

General We operate wholesale stores in 20 states and three Canadian provinces. The centers range in size from 2,600 square feet to 19,800 square feet, with the average size of a store being approximately 6,000 square feet. The type of premises utilized for our wholesale stores is generally light industrial office/warehouse space in proximity to a major freeway or with other similar access. This type of location typically offers lower rents compared to other more retail-oriented locations.

Business Strategy The Leather Factory business concept centers around the wholesale distribution of leather and related accessories to retailers, manufacturers and end users. Our strategy is that a customer can purchase the leather, related accessories and supplies necessary to complete his project from one place. The size and layout of the centers are planned to allow large quantities of product to be displayed in an easily accessible and visually appealing manner. Leather is displayed by the pallet where the customer can see and touch it, assessing first-hand the numerous sizes, styles and grades offered. The location of the stores is selected based on the location of customers, so that delivery time to customers is minimized. A two-day maximum delivery time for phone, internet and mail orders is our goal.

Our wholesale stores serve customers through various means including walk-in traffic, phone and mail order. We also employ a distinctive marketing tactic in that we maintain an internally-developed target customer mailing list for use in our aggressive direct mail advertising campaigns. We staff our stores with experienced managers whose compensation is tied to the operating profit of the store they manage. Sales are generated by the selling efforts of the store personnel, our direct mail advertising, our website (www.tandy-leatherfactory.com), our participation at trade shows and, on a limited basis, the use of sales representative organizations. The sales representative organizations consist of companies located in specific geographic areas that represent numerous companies in a similar industry. These organizations call on customers and show multiple products from more than one vendor at a time.

Customers Our customer base consists of individuals, wholesale distributors, tack and saddle shops, institutions (prisons and prisoners, schools, hospitals), western stores, craft stores and craft store chains, other large volume purchasers, manufacturers and retailers dispersed geographically throughout the world. Wholesale sales constitute the majority of our business, although retail customers may purchase products from our wholesale stores. The Wholesale Leathercraft division’s sales generally do not reflect significant seasonal patterns.

Our Authorized Sales Center (“ASC”) program was developed to create a presence in geographical areas where we do not have a wholesale store. An unrelated person operating an existing business who desires to become an ASC must submit an application and upon approval, place a minimum initial order. There are also minimum annual purchase amounts to which the ASC must adhere in order to maintain ASC status. In exchange, the benefits to the ASC are free advertising in various sale flyers produced and distributed by us, price breaks on many products, advance notice of new products, and priority shipping and handling on all orders. Our wholesale stores service 151 ASC's: 87 located in the U.S., 42 located in Canada, and 22 located outside North America.

Merchandise Our products are generally organized into thirteen categories. We carry a wide assortment of products including leather, lace, hand tools, kits and craft supplies. We operate a light manufacturing facility in Fort Worth whose processes generally involve cutting leather into various shapes and patterns using metal dies. The factory produces approximately 20% of our products and also assembles and repackages products as needed. Products

manufactured in our factory are distributed through our stores under the Tejas™ brand name. We also distribute product under the Tandy Leather™ and Dr. Jackson's™ brands. We develop new products through the ideas and referrals of customers and store personnel as well as the tracking of fads and trends of interest in the market.

We offer an unconditional satisfaction guarantee to our customers. Simply stated, we will accept product returns for any reason. We believe this liberal policy promotes customer loyalty. We offer credit terms to our non-retail customers, upon receipt of a credit application and approval by our credit manager. Generally, our open accounts are net 30 days.

During 2008 and 2007, Wholesale Leathercraft division sales by product category were as follows:

Product Category	2008 Sales Mix	2007 Sales Mix
Belts strips and straps	2%	3%
Books, patterns, videos	1%	2%
Buckles	4%	4%
Conchos [^]	5%	4%
Craft supplies	6%	4%
Custom tools and hardware	0%	0%
Dyes, finishes, glues	6%	5%
Hand tools	12%	12%
Hardware	7%	8%
Kits	8%	7%
Lace	9%	10%
Leather	36%	37%
Stamping tools	4%	4%
	100%	100%

[^]A concho is a metal adornment attached to clothing, belts, saddles, etc., usually made into a pattern of some southwestern or geometric object.

In addition to meeting ordinary operational requirements, our working capital demands are a product of the need to maintain a level of inventory sufficient to fill customer orders as they are received with minimal backorders and the time required to collect our accounts receivable. Because availability of merchandise and prompt delivery time are important competitive factors for us, we maintain higher levels of inventory than our smaller competitors. For additional information regarding our cash, inventory and accounts receivable at the end of 2008 and 2007, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Suppliers We purchase merchandise and raw materials from approximately 200 vendors dispersed throughout the United States and in approximately 15 foreign countries. In 2008, our ten largest vendors accounted for approximately 70% of our inventory purchases.

Because leather is sold internationally, market conditions abroad are likely to affect the price of leather in the United States. Outbreaks of mad cow and hoof-and-mouth disease (or foot-and-mouth disease) in any part of the world can influence the price of the leather we purchase. As such an occurrence is beyond our control, we cannot predict when and to what extent we could be affected in the future. Aside from increasing purchases when we anticipate price increases (or possibly delaying purchases if we foresee price declines), we do not attempt to hedge our inventory costs.

Overall, we believe that our relationships with suppliers are strong and do not anticipate any material changes in these supplier relationships. Due to the number of alternative sources of supply, the loss of any of these principal suppliers

would not have a material impact on our operations.

Operations Hours of operations vary by location, but generally range from 8:00 am to 6:00 pm Monday through Friday, and from 9:00 am to 4:00 pm on Saturdays. The stores maintain uniform prices, except where lower prices are necessary to meet local competition.

2

TABLE OF CONTENTS

Competition Most of our competition comes in the form of small, independently-owned retailers who in most cases are also our customers. We estimate that there are a few hundred of these small independent stores in the United States and Canada. We compete on price, availability of merchandise, and delivery time. While there is competition in connection with a number of our products, to our knowledge there is no direct competition affecting our entire product line. Our large size relative to most competitors gives us the advantage of being able to purchase large volumes and stock a full range of products.

Distribution The wholesale stores receive the majority of their inventory from our central warehouse located in Fort Worth, Texas, although occasionally, merchandise is shipped directly from the vendor. Inventory is shipped to the stores from our central warehouse once a week to meet customer demand without sacrificing inventory turns. Customer orders are filled as received, and we do not have backlogs.

We attempt to maintain the optimum number of items in our product line to minimize out-of-stock situations against carrying costs involved with such an inventory level. We generally maintain higher inventories of imported items to ensure a continuous supply. The number of products offered changes every year due to the introduction of new items and the discontinuance of others. We carry approximately 2,800 items in the current lines of leather and leather-related merchandise. All items are offered in all stores.

Expansion Our wholesale store expansion across the United States has been fairly consistent since we purchased the original six stores in 1985. We opened our thirtieth store in August 2002. We converted one wholesale (Leather Factory) store to a retail (Tandy Leather) store in 2006, reducing the number of wholesale stores to 29. We acquired Mid-Continent Leather Sales in 2007, a wholesale store located in Oklahoma, increasing the number of wholesale stores to 30. While we do not believe there is a significant and immediate opportunity for expansion of the Leather Factory distribution system in terms of opening additional locations, we do believe expansion could be achieved by acquiring companies in related areas/markets which offer collaborative advantages based on the local markets and/or the product lines of the businesses.

Retail Leathercraft

Our Retail Leathercraft division consists of a growing chain of retail stores operating under the name, Tandy Leather. Tandy Leather Company, established in 1919 as Hinkley-Tandy Leather Company, is the oldest and best-known supplier of leather and related supplies used in the leathercraft industry. We offer a product line of quality tools, leather, accessories, kits and teaching materials. This segment had net sales of \$25.2 million, \$24.7 million and \$22.5 million for 2008, 2007 and 2006, respectively.

General As of March 1, 2009, the Tandy Leather retail chain has 74 stores located in 35 states and five Canadian provinces with plans to reach 100 to 120 stores as opportunities arise over the next several years. The stores range in size from 1,200 square feet to 3,800 square feet, with the average size of a store being approximately 2,000 square feet. The type of premises utilized for a retail store is generally an older strip shopping center located at well-known crossroads, making the store easy to find.

Business Strategy Tandy Leather has long been known for its reputation in the leathercraft industry and its commitment to promoting and developing the craft through education and customer development. Our commitment to this strategy is evidenced by our re-establishment of the retail store chain throughout the United States following our acquisition of the assets of Tandy Leather in 2000. We continue to broaden our customer base by working with various youth organizations and institutions where people are introduced to leathercraft, as well as hosting classes in our stores.

The retail stores serve walk-in, mail and phone order customers as well as orders generated from our website, www.tandy-leatherfactory.com. Our retail stores are staffed by knowledgeable sales people whose compensation is based, in part, upon the profitability of their store. Sales by Tandy Leather are driven by the efforts of the store staff, trade shows, and our direct mail and e-mail marketing program.

Customers Individual retail customers are our largest customer group, representing more than 65% of Tandy Leather's 2008 sales. Youth groups, summer camps, schools and a limited number of wholesale customers complete our customer base. Like the wholesale stores, the retail stores fill orders as they are received, and there is no order backlog. The retail stores maintain reasonable amounts of inventory to fill these orders. Tandy Leather's retail store operations historically generate slightly more sales in the fourth quarter of each year (30-32%), while the other three quarters remain fairly even at 23-25% per quarter.

Merchandise Our products are generally organized into thirteen categories. We carry a wide assortment of products including leather, hand tools, kits, dyes & finishes and stamping tools. During 2008 and 2007, Retail Leathercraft division sales by product category were as follows:

Product Category	2008 Sales Mix	2007 Sales Mix
Belts strips and straps	4%	4%
Books, patterns, videos	3%	3%
Buckles	4%	4%
Conchos	4%	4%
Craft supplies	4%	3%
Dyes, finishes, glues	8%	8%
Hand tools	15%	16%
Hardware	6%	6%
Kits	11%	11%
Lace	4%	4%
Leather	31%	31%
Stamping tools	6%	6%
	100%	100%

As indicated above, the products sold in our retail stores are also sold in our wholesale stores. Therefore, the discussion above regarding products, their sources and the working capital requirements for the Wholesale Leathercraft division also apply to the Retail Leathercraft division. Sales at the retail stores are generally made through cash transactions or through national credit cards. We also sell on open account to selected wholesale customers including schools and other institutions and small retailers. Our terms are generally net 30 days. Like the wholesale stores, the retail stores have an unconditional return policy.

Operations Hours of operation are 9:00 am to 6:00 pm Monday through Friday, and from 9:00 am to 4:00 pm on Saturdays. In addition, most of the stores stay open late one night a week for leathercrafting classes taught in the stores. Selling prices are uniform throughout the retail store system.

Competition Our competitors are generally small local craft stores that carry a limited line of leathercraft products. Several national retail chains that are customers in our Wholesale Leathercraft division also carry leathercraft products on a very small scale relative to their overall product line. To our knowledge, our retail store chain is the only one in existence solely specializing in leathercraft.

Distribution The retail stores receive their inventory from our central warehouse located in Fort Worth, Texas. The stores generally restock their inventory once a week with a shipment from the warehouse. Retail Leathercraft's inventory turns are higher than Wholesale Leathercraft's because the Wholesale Leathercraft calculation includes the

central warehouse inventory whereas the Retail Leathercraft calculation includes only the inventory in the Tandy Leather retail stores.

Expansion We intend to expand the Tandy Leather retail store chain to between 100 and 120 stores throughout North America as it makes financial sense to do so. 14 stores were opened in 2002; 12 stores were opened in 2003; 16 were opened in 2004 (including four in Canada); eight were opened in 2005, 12 were opened in 2006, ten were opened in 2007 and one was opened in 2008. Of the 72 stores opened to date, 11 were independent leathercraft stores that we acquired. Separately, these acquisitions are not material. The other 62 stores have been de novo stores opened by us. In 2009, we plan to open four retail stores. We have already opened one and anticipate the remaining three to be opened in the middle to last half of the year.

TABLE OF CONTENTS

International Leathercraft

Our International Leathercraft division consists of company-owned stores located outside of North America. Currently, we have one wholesale and retail combination store located in Northampton, United Kingdom, which we opened in February 2008. It operates under the Tandy Leather Factory trade name. This segment had net sales of \$836,000 in 2008.

Business Strategy The business concept for our International Leathercraft division is a blending of our Leather Factory and Tandy Leather business strategies – the wholesale distribution of leather and related accessories to retailers, manufacturers and other businesses, as well as the promotion and continuance of leathercraft through education and development of the retail customers. The store is located in a 6,600 square foot building in a light industrial area. We maintain sufficient inventory so that our customers can purchase the leather, related accessories and supplies necessary to complete their projects from one supplier. The layout of the store is such that large quantities of product can be displayed in an easily accessible and visually appealing manner. The store services walk-in, mail and phone order customers as well as orders generated from its website, www.tandy-leatherfactory.co.uk. Sales are driven by the efforts of the store staff, trade shows, and our direct mail and e-mail marketing programs.

Customers The growing customer base consists of individuals, wholesale distributors, equine-related shops, cobblers, dealers, and retailers dispersed geographically throughout the UK and Europe. Retail sales generally occur via cash transactions or through national credits cards. We also sell on open account to selected wholesale customers including dealers, manufacturers, and retailers. Like our USA stores, our UK store has an unconditional return policy.

Merchandise The products sold in our UK store are also sold in our USA stores. Therefore, the discussion above regarding products, their sources and the working capital requirements for the Wholesale and Retail Leathercraft divisions also apply here.

Operations Hours of operation are 8:00 am to 5:00 pm Monday through Friday, and from 8:00 am to 2:00 pm on Saturdays. Selling prices are consistent with the USA store pricing, adjusted for currency fluctuation.

Distribution The UK store receives the majority of its inventory from our central warehouse located in Fort Worth, Texas, although occasionally, merchandise is shipped directly from the vendor. Inventory is shipped from our warehouse to the store several times per month to meet customer demand without sacrificing inventory turns. Customer orders are filled as received, and we do not have backlogs.

Expansion We intend to expand further internationally although have no specific plans or time frame at this time. We will continue to grow our customer base throughout Europe as well as other parts of the world so that we can support additional stores.

Other

Roberts, Cushman, founded in 1856, supplies made-to-order trimmings to the headwear industry. This segment had net sales of \$745,000, \$1.1 million, and \$1.7 million for 2008, 2007 and 2006, respectively. This segment is immaterial to our overall business strategy.

For more information about our business and our reportable segments, see Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” on page 8.

Additional Information

Compliance With Environmental Laws Our compliance with federal, state and local environmental protection laws has not had, and is not expected to have, a material effect on our capital expenditures, earnings or competitive position.

Employees As of December 31, 2008, we employed 458 people, 367 of whom were employed on a full-time basis. We are not a party to any collective bargaining agreements. Overall, we believe that relations with employees are good.

Intellectual Property We own approximately 20 registered trademarks, including federal trade name registrations for "The Leather Factory" and "Tandy Leather Company." We also own approximately 20 registered foreign trademarks worldwide.

We own approximately 500 registered copyrights in the United States covering more than 600 individual works relating to various products. We also own several United States patents for specific belt buckles and leather-working equipment. These rights are valuable assets, and we defend them as necessary.

International Operations Information regarding our revenues from the United States and abroad and our long-lived assets are found in Note 14 to our Consolidated Financial Statements, Segment Information.

Our Website and Availability of SEC Reports We file reports with the Securities and Exchange Commission ("SEC"). These reports include our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these filings. The public may read any of these filings at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. In addition, the public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Further, the SEC maintains an Internet site that contains reports, proxy and information statements and other information concerning us. You can connect to this site at <http://www.sec.gov>.

Our corporate website is located at <http://www.tandyleatherfactory.com>. We make copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and any amendments filed with or furnished to the SEC available to investors on or through our website free of charge as soon as reasonably practicable after we electronically file them with or furnish them to the SEC. Our SEC filings can be found on the Investor Relations page of our website through the "SEC Filings" link. In addition, certain other corporate governance documents are available on this website through the "Corporate Governance" link.

TABLE OF CONTENTS

Executive Officers of the Registrant

The following table sets forth information concerning our executive officers as of March 27, 2009:

Name and Age	Position and Business Experience During Past Five Years	Served as Officer Since
J. Wray Thompson, 77	Chairman of the Board since June 1993; Chief Executive Officer from June 1993 to December 2006	1993
Ronald C. Morgan, 61	Chief Executive Officer since January 2007; President since January 2001; Chief Operating Officer since June 1993	1993
Jon W. Thompson, 47	President since June 2008; Senior Vice President since June 1993	2008
Shannon L. Greene, 43	Chief Financial Officer since May 2000	2000
Mark J. Angus, 48	Senior Vice President since June 2008; Vice President of Merchandising since June 1993	2008
Robin L. Morgan, 58	Vice President of Administration since June 1993	1993

Wray Thompson has served as our Chairman of the Board since June 1993. He served as Chief Executive Officer from June 1993 to December 2006. He also served as President from June 1993 to January 2001. Mr. Thompson was a co-founder of the company.

Ronald C. Morgan has served as our Chief Executive Officer since January 2007. He has also served as President and Chief Operating Officer from January 2001 to June 2008 and director since June 1993. Mr. Morgan was also a co-founder of the company. Mr. Morgan is married to Robin L. Morgan, our Vice President.

Jon W. Thompson has served as President and Chief Operating Officer since June 2008, following the resignation of Ron Morgan. He served as Senior Vice President from June 1993 to June 2008. Mr. Thompson is the son of Wray Thompson, Chairman of the Board.

Shannon L. Greene has served as our Chief Financial Officer and Treasurer since May 2000 and director since January 2001. Ms. Greene is also our Chief Accounting Officer. Ms. Greene, a certified public accountant, also serves on our 401(k) Plan committee. Her professional affiliations include the American Institute of Certified Public Accountants, the Texas Society of Certified Public Accountants and its Fort Worth chapter, the Fort Worth Association for Financial Professionals, and the Financial Executives International. She also sits on the Board of Directors of the U.S. Chamber of Commerce.

Mark J. Angus has served as Senior Vice President since June 2008, following Jon Thompson's resignation. He served as Vice President of Merchandising since January 1993.

Robin L. Morgan has served as our Vice President of Administration and Assistant Secretary since June 1993. She serves as chairman of our 401(k) Plan committee. Ms. Morgan is married to Ronald C. Morgan, our CEO.

All officers are elected annually by the Board of Directors to serve for the ensuing year.

ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors together with all of the other information included in this annual report, including the financial statements and related notes, when deciding to invest in us. You should be aware that the occurrence of any of the events described in this Risk Factors section and elsewhere in this annual report could have a material adverse effect on our business, financial position, results of operations and cash flows. Some, but not all, of the important risks which could cause actual results to differ materially from those suggested by forward-looking statements made by us include the following:

- We might fail to realize the anticipated benefits of the opening of Tandy Leather retail stores or we might be unable to obtain sufficient new locations on acceptable terms to meet our growth plans. Further, we might fail to hire and train competent managers to oversee the stores opened.
- Continued weakness in the economy in the United States, as well as abroad, may cause our sales to decrease or not to increase or adversely affect the prices charged for our products. Also, hostilities, terrorism or other events could worsen this condition.
- Negative trends in general consumer-spending levels, including the impact of the availability and level of consumer debt and levels of consumer confidence could adversely affect our sales.
- Political considerations here and abroad could disrupt our sources of supplies from abroad or affect the prices we pay for goods.
- Continued involvement by the United States in war and other military operations in the Middle East and other areas abroad could disrupt international trade and affect our inventory sources.
- As a result of the on-going threat of terrorist attacks on the United States, consumer buying habits could change and decrease our sales.
- Livestock diseases such as mad cow could reduce the availability of hides and leathers or increase their cost. Also, the prices of hides and leathers fluctuate in normal times, and these fluctuations can affect us.
- If, for whatever reason, the costs of our raw materials and inventory increase, we may not be able to pass those costs on to our customers.
- Other factors could cause either fluctuations in buying patterns or possible negative trends in the craft and western retail markets. In addition, our customers may change their preferences to products other than ours, or they may not accept new products as we introduce them.
- Any change in the commercial banking environment may affect us and our ability to borrow capital as needed.

Other uncertainties, which are difficult to predict and many of which are beyond our control, may occur as well.

TABLE OF CONTENTS

ITEM 2. PROPERTIES

We lease all of our store locations premises, with the majority of our stores having initial lease terms of approximately five years. The leases are generally renewable, with increases in lease rental rates in some cases. We believe that all of our properties are adequately covered by insurance. The properties leased by our Wholesale Leathercraft (Leather Factory stores), Retail Leathercraft (Tandy Leather stores), and International Leathercraft divisions are described in Item 1 in the description of each segment. We also lease a 284 square-foot showroom in the Denver Merchandise Mart for \$5,908 per year. This lease will expire in October 2011.

We own our corporate headquarters, which includes our central warehouse and manufacturing facility, the sales, advertising, administrative, and executive offices, and the administrative offices of Roberts, Cushman. The facility consists of 191,000 square feet located on approximately 30 acres.

The following table summarizes the locations of our leased premises as of December 31, 2008:

State	Wholesale Leathercraft	Retail Leathercraft	International
Alabama	-	1	-
Alaska	-	1	-
Arizona	2	2	-
Arkansas	-	1	-
California	3	7	-
Colorado	1	3	-
Connecticut	-	1	-
Florida	1	3	-
Georgia	-	1	-
Idaho	-	1	-
Illinois	1	1	-
Indiana	-	2	-
Iowa	1	-	-
Kansas	1	-	-
Kentucky	-	1	-
Louisiana	1	-	-
Maryland	-	1	-
Massachusetts	-	1	-
Michigan	1	1	-
Minnesota	-	2	-
Missouri	1	2	-
Montana	1	-	-
Nebraska	-	1	-
Nevada	-	2	-
New Mexico	1	2	-
New York	-	1	-
North Carolina	-	2	-
Ohio	1	2	-
Oklahoma	1	2	-
Oregon	1	-	-
Pennsylvania	1	2	-
South Carolina	-	1	-
South Dakota	-	1	-
Tennessee	1	3	-

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

Texas	5	9	-
Utah	1	2	-
Virginia	-	1	-
Washington	1	2	-
Wisconsin	-	1	-
Wyoming	-	1	-
Canadian locations:			
Alberta	1	1	-
British Columbia	-	1	-
Manitoba	1	-	-
Nova Scotia	-	1	-
Ontario	1	2	-
Quebec	-	1	-
International locations:			
United Kingdom	-	-	1

TABLE OF CONTENTS

ITEM 3. LEGAL PROCEEDINGS

We are involved in litigation in the ordinary course of business but are not currently a party to any material pending legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of our security holders during the fourth quarter of our fiscal year ended December 31, 2008.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the NYSE Amex using the symbol "TLF". The high and low trading prices for each calendar quarter during the last two fiscal years are as follows:

2008	High	Low	2007	High	Low
4th quarter	\$2.75	\$1.72	4th quarter	\$7.15	\$2.70
3rd quarter	\$3.07	\$2.49	3rd quarter	\$7.55	\$5.80
2nd quarter	\$3.37	\$2.63	2nd quarter	\$7.50	\$6.85
1st quarter	\$3.32	\$2.30	1st quarter	\$8.25	\$6.81

There were approximately 526 stockholders of record on March 1, 2009.

We have never declared or paid any cash dividends on the shares of our common stock. Our Board of Directors has historically followed a policy of reinvesting our earnings in the expansion of our business. This policy is subject to change based on future industry and market conditions, as well as other factors.

We did not sell any shares of our equity securities during our fiscal year ended December 31, 2008 that were not registered under the Securities Act.

The following table provides information about purchases we have made of our common stock during the quarter ended December 31, 2008:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 through October 31	194,610	\$2.67	194,610	292,180
November 1 through November 30	73,332	\$2.35	73,332	218,848
December 1 through December 31	56,595	\$1.96	56,595	-0-
Total	324,537(1)	\$2.47	324,537	-0-

- (1) On September 9, 2008, our Board of Directors approved a limited stock repurchase plan whereby all non-officer participants in The Leather Factory, Inc. Stock Ownership Plan (the “ESOP”) would have the option of selling the shares of our common stock distributed to them upon termination of the ESOP back to us. The option remained open to the non-officer participants for a period of sixty days beginning on September 26, 2008 and ending on November 25, 2008. The purchase price of the shares was calculated at a price-per-share equal to the closing price of a share of our common stock on the American Stock Exchange on the business day each non-officer participant notified the ESOP administrator of his or her intent to sell his or her shares to us. All of the 324,537 shares we repurchased between October 1 and December 31, 2008 were repurchased in connection with the termination of the ESOP.

Stockholder Return Performance Graph

The line graph below compares the yearly percentage change in our cumulative five-year total stockholder return on our common stock with the Standard & Poor’s SmallCap 600 Index and the S&P Specialty Stores Index. The graph assumes that \$100 was invested on December 31, 2003 in our common stock, the Standard & Poor’s SmallCap 600 Index, and the S&P Specialty Stores Index, and that all dividends were reinvested. The returns shown on the graph are not necessarily indicative of future performance.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURNS Tandy Leather Factory, Inc.

Company Name / Index	Dec 03	Dec 04	Dec 05	Dec 06	Dec 07	Dec 08
TANDY LEATHER FACTORY	100	73.35	141.53	166.74	67.56	44.42
S&P SMALLCAP 600 INDEX	100	122.65	132.07	152.04	151.58	104.48
S&P SPECIALTY STORES	100	105.20	124.25	151.04	110.87	70.30

Data Source: Research Data Group, Inc., San Francisco, CA

TABLE OF CONTENTS

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below are derived from and should be read in conjunction with our Consolidated Financial Statements and related notes. This information should also be read in conjunction with "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations." Data in prior years has not been restated to reflect acquisitions, if any, that occurred in subsequent years.

Income Statement Data,

Years ended December 31,	2008	2007	2006	2005	2004
Net sales	\$53,237,094	\$55,317,002	\$55,199,021	\$50,719,574	\$46,146,284
Cost of sales	21,857,800	23,644,599	23,566,251	21,964,530	20,706,239
Gross profit	31,379,294	31,672,403	31,632,770	28,755,044	25,440,045
Operating expenses	27,200,150	27,161,402	24,565,056	23,181,633	21,181,599
Operating income	4,179,144	4,511,001	7,067,714	5,573,411	4,258,446
Operating income per share - basic	\$0.38	\$0.41	\$0.65	\$0.52	\$0.40
Operating income per shares - diluted	\$0.38	\$0.40	\$0.64	\$0.51	\$0.39
Other (income) expense	67,072	(316,831)	(98,391)	(134,502)	44,800
Income (loss) before income taxes	4,112,072	4,827,832	7,166,105	5,707,913	4,213,646
Income tax provision (benefit)	1,507,891	1,739,701	2,389,039	1,994,199	1,559,605
Net income (loss)	\$2,604,181	\$3,088,131	\$4,777,066	\$3,713,714	\$2,654,041
Earnings (loss) per share	\$0.24	\$0.28	\$0.44	\$0.35	\$0.25
Earnings (loss) per share-assuming dilution	\$0.24	\$0.28	\$0.43	\$0.34	\$0.24
Weighted average common shares outstanding for:					
Basic EPS	10,931,306	10,951,481	10,643,004	10,643,004	10,543,994
Diluted EPS	11,015,657	11,157,775	10,976,240	10,976,240	10,957,518

Balance Sheet Data, as of December 31,

	2008	2007	2006	2005	2004
Cash and certificates of deposit	\$10,821,298	\$6,810,396	\$6,739,981	\$3,215,727	\$2,560,202
Total assets	40,975,913	37,651,506	31,916,635	25,680,473	22,167,163
Capital lease obligation, including current portion	593,949	-	111,723	245,789	379,857
Long-term debt, including current portion	3,915,000	4,050,000	-	-	505,154
Total Stockholders' Equity	\$31,264,762	\$29,815,504	\$26,323,243	\$21,257,857	\$17,310,233

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We intend for the following discussion to provide you with information that will assist you in understanding our financial statements, the changes in key items in those financial statements from year to year and the primary factors that accounted for those changes, as well as how particular accounting principles affect our financial statements. This discussion also provides information about the financial results of the various segments of our business so you may better understand how those segments and their results affect our financial condition and results of operations as a whole. Finally, we have identified and discussed trends known to management that we believe are likely to have a material effect.

This discussion should be read in conjunction with our financial statements as of December 31, 2008 and 2007 and the two years then ended and the notes accompanying those financial statements. You are also urged to consider the information under the caption "Summary of Critical Accounting Policies."

Summary

We are the world's largest specialty retailer and wholesale distributor of leather and leathercraft-related items. Our operations are centered on operating retail and wholesale stores. We have built our business by offering our customers quality products in one location at competitive prices. The key to our success is our ability to grow our base business. We grow that business by opening new locations and by increasing sales in our existing locations. We intend to continue to expand both domestically, in the short-term, and internationally, in the long-term.

We operate in four segments. First, Wholesale Leathercraft, consisting of our Leather Factory stores and our national account group, is the largest source of our revenues (\$26.4 million in 2008). This division has generally offered steady but modest increases in sales. Sales in 2008 declined 10.6%. The wholesale stores' sales declined 10% compared to 2007 and national account sales were down 12%. Much of the sales decline at the stores is attributed to an overall weakness in consumer spending, which results in fewer purchases of our products by small businesses. The decline in national account sales is related to weaker consumer spending as well as the expected decline in sales to one customer who stopped purchasing from us in the first quarter of 2008.

Since acquiring its assets in 2000, we have focused on re-establishing Tandy Leather as the operator of retail leathercraft stores. These retail stores comprise our second segment, Retail Leathercraft. Because of growth here, this segment has experienced the greatest increases in sales (\$25.2 million in 2008, up from \$24.6 million in 2007). Our business plan calls for opening an average of 10-12 stores annually as we work toward a goal of 100+ stores from 73 stores at the end of 2008. We have slowed down our new store openings in recent years due to the general economic conditions in the U.S. We plan to open 4 new stores in 2009, one of which was opened in the first quarter.

Our third segment is International Leathercraft, which consists of stores located outside of North America. Currently, we have one retail/wholesale combination store located in the United Kingdom, which was opened in February 2008. It is our intention to add more stores to this segment once we have a large enough customer base to support additional stores.

We refer to our fourth segment as "Other". It consists of Roberts, Cushman, a supplier of trimmings for headwear. Its operations are not material to us.

On a consolidated basis, a key indicator of costs, gross margin as a percent of total net sales, held steady in 2007 and increased in 2008. Operating expenses as a percent of total net sales in 2008 increased 2.0% from 2007. Operating expenses increased 4.6% as a percentage of total net sales in 2007 when compared with 2006. The increase in operating expenses in 2007 was due to our delayed response to cut expenses on weaker than expected sales, particularly in the second and third quarters. We were much more successful in our control of operating expenses in 2008, given the continued weak sales environment.

We reported consolidated net income for 2008 of \$2.6 million. Consolidated net income for 2007 and 2006 was \$3.1 million and \$4.8 million, respectively. We have used our cash flow to fund our operations, to fund the opening of new Tandy Leather stores, to purchase necessary property and equipment and make acquisitions of small competitors in the retail and wholesale market. In 2007, we incurred \$4.0 million in bank debt to purchase a 191,000 square foot building to house our corporate headquarters and central support units. We moved into that facility in the first quarter of 2008. At the end of 2009, our stockholders' equity had increased to \$31.3 million from \$29.8 million the previous year.

Comparing the December 31, 2008 balance sheet with the prior year's balance sheet, we reduced our investment in inventory from \$17.5 million to \$16.0 million, while total cash (including certificates of deposit and other short-term investments) increased from \$6.8 million from \$10.8 million.

TABLE OF CONTENTS

Net Sales

Net sales for the three years ended December 31, 2008 were as follows:

Year	Wholesale Leathercraft	Retail Leathercraft	International Leathercraft	Other	Total Company	Incr (Decr) from Prior Year
2008	\$26,423,858	\$25,231,145	\$836,535	\$745,556	\$53,237,094	(3.8)%
2007	\$29,555,978	\$24,663,750		- \$1,097,274	\$55,317,002	0.2%
2006	\$31,068,188	\$22,520,461		- \$1,610,372	\$55,199,021	8.8%

Our net sales fell by 3.8% in 2008 when compared with 2007 and grew by 0.2% in 2007 when compared with 2006. The 2008 sales decline resulted primarily from our Wholesale Leathercraft segment, offset somewhat by an increase in Retail Leathercraft sales and the sales from our new International Leathercraft segment, although sales at our retail stores have slowed down somewhat due to an overall slowdown in consumer spending in 2007 and 2008. The reduction in sales in our wholesale stores is also the result of the overall economic slowdown in the U.S.

Costs and Expenses

In general, our gross profit as a percentage of sales (our gross margin) fluctuates based on the mix of customers we serve, the mix of products we sell and our ability to source products globally. Our negotiations with suppliers for lower pricing are an on-going process, and we have varying degrees of success in those endeavors. Sales to retail customers tend to produce higher gross margins than sales to wholesale customers due to the difference in pricing levels. Therefore, as retail sales increase in the overall sales mix, higher gross margins tend to follow. Finally, there is significant fluctuation in gross margins between the various merchandise categories we offer. As a result, our gross margins can vary depending on the mix of products sold during any given time period.

For 2008, our cost of sales decreased as a percentage of total net sales when compared to 2007, resulting in an increase in consolidated gross profit margin from 57.3% to 58.9%. Our total cost of sales as a percentage of our total net sales held steady from 2006 to 2007, resulting in a consolidated gross profit margin at 57.3% in both years. Increases in gross margin are primarily due to increased retail sales from year to year.

Our gross margins for the three years ended December 31, 2008 were as follows:

Year	Wholesale Leathercraft	Retail Leathercraft	International Leathercraft	Other	Total Company
2008	56.5%	61.6%	68.4%	44.1%	58.9%
2007	55.7%	59.7%	-	44.8%	57.3%
2006	56.1%	60.8%	-	32.1%	57.3%

Our operating expenses increased 2.0% as a percentage of total net sales to 51.1% in 2008 when compared with 49.1% in 2007. This increase indicates that our operating expenses grew faster than our sales during this period. However, 2008 operating expenses were only \$38,000 higher than those of 2007. Significant expense fluctuations in 2008 compared to 2007 are as follows:

Expense	2008 amount	Incr (decr) over 2007
Employee compensation & benefits	\$14.0 million	\$(160,000)
Rent & utilities	4.1 million	323,000
Depreciation and amortization	985,000	350,000
Advertising	3.0 million	(400,000)
	1.5 million	(140,000)

Freight out – shipping product to customers

Property taxes	260,000	135,000
Outside services	260,000	(240,000)

Our operating expenses increased 4.6% as a percentage of total net sales to 49.1% in 2007 when compared with 44.5% in 2006. Significant expense fluctuations in 2007 compared to 2006 are as follows:

Expense	2007 amount	Incr (decr) over 2006
Employee compensation & benefits	\$14.1 million	\$800,000
Rent & utilities	3.8 million	300,000
Depreciation and amortization	635,000	240,000
Advertising	3.4 million	400,000
Legal & professional fees	650,000	350,000

Other Income/Expense (net)

Other Income/Expense consists primarily of currency exchange fluctuations, interest income and interest expense. In 2008, we had other expense (net) of \$67,000 compared to other income (net) of \$317,000 in 2007. We received \$230,000 for surface damage and additional access related to the oil and gas lease associated with a portion of the land surrounding our corporate facility. We earned \$141,000 in interest income on our cash and paid \$332,000 in interest expense on our bank debt. We had a currency exchange loss of \$114,000 in 2008 compared to income of \$9,000 in 2007.

In 2007, we had other income (net) of \$317,000 compared to other income (net) of \$98,000 in 2006. We received rental income of \$150,000 from our new building as we leased the building to the sellers for 90 days after purchase. We also received \$100,000 as a signing bonus on an oil and gas lease we signed related to a portion of the land we purchased. We earned \$140,000 in interest income on our cash and paid \$122,000 in interest expense on our bank debt. We had a currency exchange gain of \$9,000 in 2007 compared to \$52,000 in 2006.

Net Income

During 2008, we earned net income of \$2.6 million, a 16% decline over our net income of \$3.1 million earned during 2007. The decline in net income was the result of the decrease in gross profit and the decrease in other income, partially offset by the reduction in income tax expense.

During 2007, we earned net income of \$3.1 million, a 35% decline from our net income of \$4.8 million earned during 2006. The decline in net income was the result of the increase in operating expenses at a higher rate than that of our sales, partially offset by the reduction in income tax expense.

TABLE OF CONTENTS

Wholesale Leathercraft

The increases in net sales, operating income, operating income increases (or decreases) and operating income as a percentage of sales from our Wholesale Leathercraft stores for the three years ended December 31, 2008 were as follows:

Year	Net Sales Incr (Decr) from Prior Yr	Operating Income	Operating Income Incr (Decr) from Prior Year	Operating Income as a Percentage of Sales
2008	(10.6)%	\$1,842,526	(34.8)%	6.9%
2007	(3.7)%	\$2,826,710	(41.3)%	9.6%
2006	(0.1)%	\$4,814,240	29.4%	15.5%

Wholesale Leathercraft, consisting of our 30 wholesale stores and our national account group, accounted for 49.6% of our consolidated net sales in 2008, which compares to 53.4% in 2007 and 56.2% in 2006. The decrease in this division's contribution to our total net sales is the result of the growth in Retail Leathercraft and we expect this trend to continue.

Sales in the wholesale stores decreased 10.4% in 2008 compared to sales in 2007 while the sales decline in our national account group was 12.2%. By customer group, we had sales declines in all groups. The most significant decreases were in our wholesale and manufacturer groups. The customers of these groups are small businesses and have been significantly affected by the weakness in our economy. Our sales mix by customer group in the Wholesale Leathercraft division was as follows:

Customer Group	2008	2007	2006
Retail	26%	23%	25%
Institution	8%	8%	7%
Wholesale	41%	42%	39%
National Accounts	17%	15%	19%
Manufacturers	8%	12%	10%
	100%	100%	100%

The 2008 decrease in operating income as a percentage of divisional sales resulted from a decrease of 9.2% in gross margin (as a percentage of sales) compared with 2007, offset partially by a decrease of 3.9% in operating expenses as a percent of sales. Significant operating expense decreases occurred in employee compensation and benefits (\$670,000), outside services (\$235,000) and freight out (\$200,000). These decreases were partially offset by increases in depreciation expense (\$400,000) and property taxes (\$230,000), both due to the purchase of our corporate facility.

The 2007 increase in operating income as a percentage of divisional sales resulted from a decrease of 0.6% in gross margin (as a percentage of sales) compared with 2006, and an increase of 6.6% in operating expenses as a percent of sales. Significant operating expense increases occurred in employee compensation and benefits (\$500,000), depreciation expense (\$200,000), legal and professional fees (\$300,000) and advertising costs (\$200,000). These increases were partially offset by decreases in various insurance expenses (\$100,000) and general supplies (\$75,000).

Retail Leathercraft

The increases in net sales, operating income, operating income increases (or decreases) and operating income as a percentage of sales from our Retail Leathercraft stores for the three years ended December 31, 2008 were as follows:

Year	Operating	Operating Income
------	-----------	------------------

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

	Net Sales Increase from Prior Yr	Income	Incr (Decr) from Prior Year	Operating Income as a Percentage of Sales
2008	2.3%	\$2,188,282	41.7%	8.7%
2007	9.5%	\$1,544,320	(33.2)%	6.3%
2006	25.0%	\$2,310,073	30.7%	10.3%

Reflecting the growth previously discussed, Retail Leathercraft accounted for 47.4% of our total net sales in 2008, up from 44.6% in 2007 and 40.8% in 2006.

Growth in net sales for Retail Leathercraft division in 2008 and 2007 resulted primarily from our expansion program. Expansion during 2008 and 2007 consisted of the opening of 1 and 10 new stores, respectively.

Our sales mix by customer group in the Retail Leathercraft division was as follows:

Customer Group	2008	2007	2006
Retail	65%	63%	65%
Institution	9%	8%	8%
Wholesale	25%	27%	26%
National Accounts	0%	0%	0%
Manufacturers	1%	2%	1%
	100%	100%	100%

Operating income as a percentage of sales increased to 8.7% for 2008 compared to 6.3% for 2007. Gross margin improved to 61.6% in 2008 from 59.7% in 2007. Operating expenses as a percent of sales in 2008 decreased by 0.6%, from 53.5% for 2007 to 52.9% for 2008 as operating expenses grew at a slower pace than that of sales and gross margin.

Operating income as a percentage of sales decreased to 6.3% for 2007 compared to 10.3% for 2006. Gross margin fell to 59.7% in 2007 from 60.8% in 2006. Operating expenses as a percent of sales in 2007 decreased by 3.0%, from 50.5% for 2006 to 53.5% for 2007 as operating expenses grew at a faster pace than that of sales and gross margin.

We intend to continue the expansion of Tandy Leather's retail store chain in 2009 by opening approximately 4 new stores, one of which was opened in the first quarter. We remain committed to a conservative expansion plan for this division that minimizes risks to our profits and maintains financial stability. In the current economic environment in the U.S., it is possible that we will change our plans for store openings in 2009 if we determine that the U.S. retail sector can not support additional store openings at that time.

International Leathercraft

International Leathercraft consists of all stores located outside of North America. Currently, that represents one retail/wholesale combination store located in the United Kingdom. International Leathercraft accounted for 1.6% of our total sales in 2008. Operating income was \$54,000 in 2008. We expect this segment to become a larger part of our total operations as time progresses.

Other

Roberts, Cushman accounted for 1.4% of our total sales in 2008 compared with 2.0% and 2.9% in 2007 and 2006, respectively. Operating income was \$94,000 in 2008 compared to operating income of \$140,000 in 2007 and an operating loss of \$57,000 in 2006. Roberts, Cushman's sales and profits are immaterial to us as a whole.

TABLE OF CONTENTS

Financial Condition

At December 31, 2008, we held \$10.8 million of cash and certificates of deposit, \$16.0 million of inventory, accounts receivable of \$1.2 million, and \$10.3 million of property and equipment. Goodwill and other intangibles (net of amortization and depreciation) were \$966,000 and \$355,000, respectively. Net total assets were \$40.9 million. Current liabilities were \$5.1 million (including \$468,000 of current maturities of long-term debt), while long-term debt was \$4.0 million. Total stockholders' equity at the end of 2008 was \$31.2 million.

At December 31, 2007, we held \$6.8 million of cash, \$17.5 million of inventory, accounts receivable of \$2.5 million, and \$7.0 million of property and equipment. Goodwill and other intangibles (net of amortization and depreciation) were \$990,000 and \$384,000, respectively. Net total assets were \$37.6 million. Current liabilities were \$3.8 million (including \$135,000 of current maturities of long-term debt), while long-term debt was \$3.9 million. Total stockholders' equity at the end of 2007 was \$29.8 million.

Specific ratios on a consolidated basis at the end of each year ended December 31 were as follows:

		2008	2007	2006
Solvency Ratios:				
Quick Ratio	Cash+Accts Rec/Total Current Liabilities	2.37	2.48	1.74
Current Ratio	Total Current Assets/Total Current Liabilities	5.72	7.47	5.19
Current Liabilities to Net Worth	Total Current Liabilities/Net Worth	0.16	0.13	0.20
Current Liabilities to Inventory	Total Current Liabilities/Inventory	0.32	0.22	0.31
Total Liabilities to Net Worth	Total Liabilities/Net Worth	0.31	0.26	0.21
Fixed Assets to Net Worth	Fixed Assets/Net Worth	0.33	0.23	0.07
Efficiency Ratios:				
Collection Period (Days Outstanding)	Accounts Receivable/Credit Sales x 365	54.89	63.42	53.43
Inventory Turnover	Sales/Average Inventory	3.18	3.19	3.36
Assets to Sales	Total Assets/Sales	0.77	0.68	0.58
Sales to Net Working Capital	Sales/Current Assets - Current Liabilities	2.22	2.27	2.45
Accounts Payable to Sales	Accounts Payable/Sales	0.02	0.03	0.03
Profitability Ratios:				
Return on Sales (Profit Margin)	Net Profit After Taxes/Sales	0.05	0.06	0.09
Return on Assets	Net Profit After Taxes/Total Assets	0.06	0.08	0.15
Return on Net Worth (Return on Equity)	Net Profit After Taxes/Net Worth	0.08	0.10	0.18

Capital Resources and Liquidity

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 and remodel 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 initial purchase of the property. On April 30, 2008, that amount was rolled into a ten-year term note, and we began making monthly debt service payments in May 2008.

We are currently in compliance with all covenants and conditions contained in the JPMorgan Chase Credit Agreement and have no reason to believe that we will not continue to operate in compliance with the provisions of these financing arrangements. The principal terms and conditions of the Credit Agreement are described in further detail in Note 6 to the Consolidated Financial Statements, Notes Payable and Long-Term Debt.

Reflecting the borrowing and reduction of bank indebtedness during the periods, our financing activities for 2008, 2007 and 2006 provided (required) net cash of \$1.1 million, \$4.0 million, and \$69,000, respectively.

Our primary source of liquidity and capital resources during 2008 was cash flow provided by operating activities. Cash flow from operations for 2008 and 2007 was \$7.8 million and \$2.5 million, respectively, the largest portion being generated from net income. This net income was partially offset by the decrease in accrued expenses in 2007 and the decrease of accounts receivable and inventory in 2008. Cash flow from operations in 2006 was \$3.9 million.

Consolidated accounts receivable decreased significantly to \$1.2 million at December 31, 2008 compared to \$2.5 million at December 31, 2007. Average days to collect accounts improved from 63.4 days in 2007 to 54.9 days in 2008 on a consolidated basis. As evidenced by the significant reduction in our accounts receivable at the end of 2008, we have tightened our credit policy and are aggressively monitoring our customer accounts to ensure collectibility. We believe the trend in our collections is the result of the overall slowdown in the U.S. economy. Many of our customers with open accounts are very small businesses, and they tend to feel the effects of an economic slowdown more severely than larger businesses.

Inventory decreased from \$17.5 million at the end of 2007 to \$16.0 million at December 31, 2008. We expect our inventory to slowly trend upward as we continue our expansion of the Tandy Leather store chain. In 2009, we expect minimal increases in our inventory due to the expected weaknesses in our sales and the limited number of retail stores we plan to open. We attempt to manage our inventory levels to avoid tying up excessive capital while maintaining sufficient inventory in order to service our current customer demand as well as plan for our expected store growth and expansion. We believe our investment in inventory at the end of 2008 was at a very reasonable level given our expansion plans as it was in line with our internal targets of optimum inventory levels.

Consolidated inventory turned 3.18 times during 2008, virtually the same as in 2007 at 3.19 times. We compute our inventory turnover rates as sales divided by average inventory.

By operating division, inventory turns are as follows:

Segment	2008	2007	2006
Wholesale Leathercraft	2.14	2.37	2.40
Retail Leathercraft	6.05	5.87	6.99
International Leathercraft	4.61	n/a	n/a
Roberts, Cushman	17.75	25.88	7.15
Wholesale Leathercraft stores only	7.14	6.87	7.48

Retail Leathercraft inventory turns are significantly higher than that of Wholesale Leathercraft because its inventory consists only of the inventory at the stores. The retail stores have no warehouse (backstock) inventory to include in the turnover computation as the stores get their product from the central warehouse. Wholesale Leathercraft's turns are expected to be slower because the central warehouse inventory is part of this division and its inventory is held as the

backstock for all of the stores.

Accounts payable decreased slightly to \$1.1 million at the end of 2008 compared to \$1.5 million at the end of 2007.

As discussed above, the largest use of operating cash in 2008 was in the reduction of accounts payable. Cash paid for capital expenditures totaled \$2.8 million and \$1.7 million for the years ended December 31, 2008 and 2007, respectively. Total capital expenditures (both cash and non-cash) totaled \$3.6 million and \$5.8 million for the years ended December 31, 2008 and 2007, respectively. In 2007, the primary capital expenditure was the purchase of the land and building to house our corporate offices and central support departments for \$4.5 million. Other capital expenditures were factory machines and dies (\$110,000); fixtures and equipment for the new Tandy Leather retail stores (\$105,000), various store fixtures and computer equipment at existing stores (\$85,000), computer system upgrade for advertising department (\$100,000), computer equipment for future stores (\$125,000); and miscellaneous computer and other office equipment (\$250,000). In 2008, the primary capital expenditure was the remodel and retrofit of the building for \$3.2 million. Other capital expenditures were factory machines and dies (\$55,000) and computer equipment (\$415,000). Although we intend to continue opening or acquiring new Tandy Leather retail stores and therefore expenditures related to this expansion should continue into 2009, we do expect our 2009 capital expenditures to be substantially less than that of 2008 as the expenditures related to our building have been completed.

TABLE OF CONTENTS

Cash applied toward stock repurchases in 2008 totaled \$802,898.

We believe that cash flow from operations will be adequate to fund our operations in 2009, while also funding our limited expansion plans. At this time, we know of no trends or demands, commitments events or uncertainties that will or are likely to materially affect our liquidity, capital resources or results of operations. In addition, we anticipate that this cash flow will enable us to meet the contractual obligations and commercial commitments. We could defer expansion plans if required by unanticipated drops in cash flow. In particular, because of the relatively small investment required by each new retail store, we have flexibility in when we make most expansion expenditures.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements during 2008, 2007 and 2006, and we do not currently have any such arrangements.

Contractual Obligations

The following table summarizes by years our contractual obligations and commercial commitments as of December 31, 2008 (not including related interest expense):

Contractual Obligations	Total	Payments Due by Periods			
		Less than 1 Year	2 - 3 Years	4 -5 Years	More than 5 Years
Long-Term Debt(1)	\$3,915,000	\$202,500	\$405,000	\$405,000	\$2,902,500
Capital Lease Obligations	593,949	265,111	328,838	--	--
Operating Leases(2)	7,480,217	2,468,217	3,602,368	1,303,148	106,484
Total Contractual Obligations	\$11,989,166	\$2,935,828	\$4,336,206	\$1,708,148	\$3,008,984

(1) Our loan from JPMorgan Chase matures in May 2018.

(2) These are our leased facilities.

Summary of Critical Accounting Policies

We strive to report our financial results in a clear and understandable manner, although in some cases accounting and disclosure rules are complex and require us to use technical terminology. We follow generally accepted accounting principles in the U.S. in preparing our consolidated financial statements. These principles require us to make estimates and apply judgments that affect our financial position and results of operations. We continually review our accounting policies, how they are applied and how they are reported and disclosed in our financial statements. Following is a summary of our more significant accounting policies and how they are applied in preparation of the financial statements.

Basis of Consolidation. We report our financial information on a consolidated basis. Therefore, unless there is an indication to the contrary, financial information is provided for the parent company, Tandy Leather Factory, Inc., and its subsidiaries as a whole. Transactions between the parent company and any subsidiaries are eliminated for this purpose. We own all of the capital stock of our subsidiaries, and we do not have any subsidiaries that are not consolidated. None of our subsidiaries are "off balance sheet."

Revenue Recognition. We recognize revenue for retail (over the counter) sales as transactions occur and other sales upon shipment of our products, provided that there are no significant post-delivery obligations to the customer and collection is reasonably assured, which generally occurs upon shipment. Net sales represent gross sales less negotiated price allowances, product returns, and allowances for defective merchandise.

Allowance for Accounts Receivable. We reduce accounts receivable by an allowance for amounts that may become uncollectible in the future. This allowance is an estimate based primarily on our evaluation of the customer's financial condition, past collection history, and the aging of the account. If the financial condition of any of our customers deteriorates, resulting in an impairment or inability to make payments, additional allowances may be required.

Inventory. Inventory is stated at the lower of cost or market and is accounted for on the "first in, first out" method. This means that sales of inventory treat the oldest item of identical inventory as being the first sold. In addition, we regularly reduce the value of our inventory for slow-moving or obsolete inventory. This reduction is based on our review of items on hand compared to their estimated future demand. If actual future demand is less favorable than what we project, additional write-downs may be necessary. Goods shipped to us are recorded as inventory owned by us when the risk of loss shifts to us from the supplier.

Goodwill. We periodically analyze the remaining goodwill on our balance sheet to determine the appropriateness of its carry value. As of December 31, 2008, we 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. If actual results of these stores differ significantly from our projections, such difference could affect the present value calculation in the future resulting in an impairment of all or part of the goodwill currently carried on our balance sheet.

Forward-Looking Statements

Certain statements contained in this annual report and other materials we file with the SEC, or in other written or oral statements made or to be made by us, other than statements of historical fact, are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements give our current expectations or forecasts of future events. Words such as "may," "assume," "forecast," "position," "predict," "strategy," "expect," "intend," "plan," "estimate," "anticipate," "believe," "project," "budget," "potential," or "continue," and similar expressions are used to identify forward-looking statements. They can be affected by assumptions used or by known or unknown risks or uncertainties. Consequently, no forward-looking statements can be guaranteed. Actual results may vary materially. You are cautioned not to place undue reliance on any forward-looking statements. You should also understand that it is not possible to predict or identify all such factors and should not consider the following list to be a complete statement of all potential risks and uncertainties. Factors that could cause our actual results to differ materially from the results contemplated by such forward-looking statements including the risk factors described in Item 1A, "Risk Factors," of this Annual Report on Form 10-K. Management cautions that forward-looking statements are not guarantees, and our actual results could differ materially from those expressed or implied in the forward-looking statements. We do not intend to update forward-looking statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We face exposure to financial market risks, including adverse movement in foreign current exchange rates and changes in interest rates. These exposures may change over time and could have a material impact on our financial results. We do not use or invest in market risk sensitive instruments to hedge any of these risks or for any other purpose.

Foreign Currency Exchange Rate Risk

Our primary foreign currency exposure is related to our subsidiaries in Canada and the United Kingdom as those subsidiaries have local currency revenue and local currency operating expenses. Changes in the currency exchange rates impact the U.S. dollar amount of revenue and expenses. See Note 14 to the Consolidated Financial Statements, Segment Information, for financial information concerning our foreign activities.

Interest Rate Risk

We are subject to market risk associated with interest rate movements on certain outstanding debt. However, our current credit agreement with JPMorgan Chase includes a fixed interest rate. Therefore, changes in the prime rate do not impact us in this area.

TABLE OF CONTENTS

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Tandy Leather Factory, Inc.
 Consolidated Balance Sheets
 December 31, 2008 and 2007

	December 31, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash	\$7,810,298	\$6,310,396
Short-term investments, including certificates of deposit	3,011,000	500,000
Accounts receivable-trade, net of allowance for doubtful accounts of \$43,000 and \$104,000 in 2008 and 2007, respectively	1,180,349	2,538,816
Inventory	16,011,147	17,473,352
Deferred income taxes	229,501	256,938
Other current assets	777,550	1,102,836
Total current assets	29,019,845	28,182,338
PROPERTY AND EQUIPMENT, at cost	15,340,732	11,793,317
Less accumulated depreciation and amortization	(5,019,885)	(4,794,505)
	10,320,847	6,998,812
GOODWILL	966,655	990,536
OTHER INTANGIBLES, net of accumulated amortization of \$367,000 and \$313,000 in 2008 and 2007, respectively	355,492	384,134
OTHER assets	313,074	1,095,686
	\$40,975,913	\$37,651,506
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	\$1,148,577	\$1,497,564
Accrued expenses and other liabilities	3,182,194	2,072,640
Income taxes payable	271,122	67,150
Current maturities of capital lease obligation	265,111	-
Current maturities of long-term debt	202,500	135,000
Total current liabilities	5,069,504	3,772,354
DEFERRED INCOME TAXES	600,309	148,648
CAPITAL LEASE OBLIGATION, net of current maturities	328,838	-
LONG-TERM DEBT, net of current maturities	3,712,500	3,915,000
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.10 par value; 20,000,000 shares		

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

authorized, none issued or outstanding	-	-
Common stock, \$0.0024 par value; 25,000,000 shares		
authorized, 10,994,951 and 10,982,951 shares issued at 2008 and 2007,		
10,664,555 and 10,977,092 outstanding at 2008 and 2007, respectively	26,388	26,359
Paid-in capital	5,464,443	5,419,477
Retained earnings	26,641,853	24,037,672
Treasury stock at cost (330,396 shares at 2008; 5,859 shares at 2007)	(828,385)	(25,487)
Accumulated other comprehensive income	(39,537)	357,483
Total stockholders' equity	31,264,762	29,815,504
	\$40,975,913	\$37,651,506

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

TABLE OF CONTENTS

Tandy Leather Factory, Inc.
 Consolidated Statements of Income
 For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
NET SALES	\$53,237,094	\$55,317,002	\$55,199,021
COST OF SALES	21,857,800	23,644,599	23,566,251
Gross Profit	31,379,294	31,672,403	31,632,770
OPERATING EXPENSES	27,200,150	27,161,402	24,565,056
INCOME FROM OPERATIONS	4,179,144	4,511,001	7,067,714
OTHER (INCOME) EXPENSE:			
Interest expense	332,107	122,209	-
Other, net	(265,035)	(439,040)	(98,391)
Total other expense	67,072	(316,831)	(98,391)
INCOME BEFORE INCOME TAXES	4,112,072	4,827,832	7,166,105
PROVISION FOR INCOME TAXES	1,507,891	1,739,701	2,389,039
NET INCOME	\$2,604,181	\$3,088,131	\$4,777,066
NET INCOME PER COMMON SHARE – BASIC	\$0.24	\$0.28	\$0.44
NET INCOME PER COMMON SHARE – DILUTED	\$0.24	\$0.28	\$0.43
Weighted Average Number of Shares Outstanding:			
Basic	10,931,306	10,951,481	10,807,316
Diluted	11,015,657	11,157,775	11,113,855

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

TABLE OF CONTENTS

Tandy Leather Factory, Inc.
 Consolidated Statements of Cash Flows
 For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$2,604,181	\$3,088,131	\$4,777,066
Adjustments to reconcile net income to net cash provided by operating activities -			
Depreciation and amortization	985,549	634,291	392,915
Loss (Gain) on disposal of assets	13,385	50,114	(3,750)
Non-cash stock-based compensation	30,495	19,340	101,080
Deferred income taxes	479,098	(63,893)	23,222
Other	(373,139)	241,182	(15,696)
Net changes in assets and liabilities, net of effect of business acquisitions:			
Accounts receivable-trade, net	1,358,467	119,293	(420,431)
Inventory	1,462,205	156,052	(1,500,176)
Income taxes	203,972	7,758	(140,189)
Other current assets	325,286	(27,946)	(731,200)
Accounts payable-trade	(348,987)	(327,726)	556,226
Accrued expenses and other liabilities	1,109,554	(1,351,369)	873,437
Total adjustments	5,245,885	(542,904)	(864,562)
Net cash provided by operating activities	7,850,066	2,545,227	3,912,504
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(2,845,548)	(1,705,367)	(471,753)
Payments in connection with businesses acquired	-	(771,417)	-
Purchases of certificates of deposit	(3,109,000)	-	-
Proceeds from maturities of certificates of deposit	98,000	-	-
Purchases of marketable securities	-	(500,000)	-
Proceeds from sale of marketable securities	500,000	-	-
Proceeds from sale of assets	42,114	32,281	3,750
Purchase of intangible assets	(24,708)	-	-
Decrease (increase) in other assets	122,140	(26,276)	10,320
Net cash used in investing activities	(5,217,002)	(2,970,779)	(457,683)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on notes payable and long-term debt	(135,000)	-	-
Payments on capital lease obligations	(209,764)	(111,723)	(134,067)
Repurchase of common stock (treasury stock)	(802,898)	-	-
Proceeds from issuance of common stock and warrants	14,500	107,780	203,410
Net cash provided by (used in) financing activities	(1,133,162)	(3,943)	69,343
NET INCREASE IN CASH	1,499,902	(429,495)	3,524,164

CASH, beginning of period	6,310,396	6,739,891	3,215,727
CASH, end of period	\$7,810,298	\$6,310,396	\$6,739,891

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Interest paid during the period	\$332,107	\$122,209	\$ -
Income tax paid during the period, net of (refunds)	878,110	1,830,688	2,282,113

NON-CASH INVESTING ACTIVITIES:

Equipment acquired under capital lease financing arrangements	\$803,713	-	-
Land and building acquired with long-term debt	-	\$4,050,000	-

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

TABLE OF CONTENTS

Tandy Leather Factory, Inc.
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2008, 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	10,735,976	\$25,780	\$4,988,445	\$(25,487)	\$16,172,475	\$96,645	\$21,257,857	
Shares issued - stock options and warrants exercised	143,233	344	203,066	-	-	-	203,410	
Stock-based compensation	-	-	101,080	-	-	-	101,080	
Net income	-	-	-	-	4,777,066	-	4,777,066	\$4,777,066
Translation adjustment	-	-	-	-	-	(16,170)	(16,170)	(16,170)
BALANCE, December 31, 2006	10,879,209	\$26,124	\$5,292,591	\$(25,487)	\$20,949,541	\$80,475	\$26,323,243	
Comprehensive income for the year ended December 31, 2006								\$4,760,896
Shares issued - stock options and warrants exercised	97,883	235	107,545	-	-	-	107,780	
Stock-based compensation	-	-	19,341	-	-	-	19,341	
Net income	-	-	-	-	3,088,131	-	3,088,131	\$3,088,131
Translation adjustment	-	-	-	-	-	277,009	277,009	277,009
BALANCE, December 31, 2007	10,977,092	\$26,359	\$5,419,477	\$(25,487)	\$24,037,672	\$357,484	\$29,815,504	
Comprehensive income for the year ended December 31, 2007								\$3,365,140
Shares issued - stock options exercised	12,000	29	14,471	-	-	-	14,500	
Stock-based compensation	-	-	30,495	-	-	-	30,495	
Purchase of treasury stock	(324,537)	-	-	(802,898)	-	-	(802,898)	
Net income	-	-	-	-	2,604,181	-	2,604,181	\$2,604,181

Translation adjustment	-	-	-	-	-	(397,021)	(397,021)	(397,021)
BALANCE, December 31, 2008	10,664,555	\$26,388	\$5,464,443	\$(828,385)	\$26,641,853	\$(39,537)	\$31,264,762	
Comprehensive income for the year ended December 31, 2008								\$2,207,160

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

TABLE OF CONTENTS

TANDY LEATHER FACTORY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2008, 2007, and 2006

1. DESCRIPTION OF BUSINESS

Our primary line of business is the sale of leather, leather crafts and related supplies. We sell our products via company-owned stores throughout the United States, Canada, and the United Kingdom. Numerous customers including retailers, wholesalers, assemblers, distributors and other manufacturers are geographically disbursed throughout the world. We also have light manufacturing facilities in Texas.

2. SIGNIFICANT ACCOUNTING POLICIES

- Management estimates and reporting

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the periods presented. Actual results could differ from those estimates. Assets and liabilities with reported amounts based on significant estimates include trade accounts receivables, inventory (slow-moving), and deferred income taxes.

- Principles of consolidation

Our consolidated financial statements include the accounts of Tandy Leather Factory, Inc. and its wholly owned subsidiaries, The Leather Factory, L.P. (a Texas limited partnership) and its corporate partners, Tandy Leather Company, L.P. (a Texas limited partnership) and its corporate partners, Mid-Continent Leather Sales, Inc. (an Oklahoma corporation), Roberts, Cushman & Company, Inc. (a Texas corporation), The Leather Factory of Canada, Ltd. (a Canadian corporation), and Tandy Leather Factory UK Limited (a UK corporation). All intercompany accounts and transactions have been eliminated in consolidation.

- Foreign currency translation

Foreign currency translation adjustments arise from activities of our Canadian and United Kingdom operations. Results of operations are translated into U.S. dollars using the average exchange rates during the period, while assets and liabilities are translated using period-end exchange rates. Foreign currency translation adjustments of assets and liabilities are recorded in stockholders' equity. Gains and losses resulting from foreign currency translations are reported in the statements of income under the caption "Other (Income) Expense", net, for all periods presented. We recognized a foreign currency translation loss of \$114,000 in 2008 and transaction gains of \$9,000 and \$52,000 in 2007 and 2006, respectively.

- Revenue recognition

Our sales generally occur via two methods: (1) at the store counter, 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. Shipping terms are normally FOB shipping point. Sales tax is excluded from revenue.

We offer an unconditional satisfaction guarantee to all customers and accept all product returns. Net sales represent gross sales less negotiated price allowances, product returns, and allowances for defective merchandise.

- Discounts

We maintain four price levels on a consistent basis: retail, wholesale, business, and distributor. Gross sales are reported after deduction of discounts. We do not pay slotting fees or make other payments to resellers. Several customers require us to participate in their cooperative advertising programs. These programs are a negotiated percentage of their purchases and are accounted for as a reduction of sales.

- Expense categories

Cost of goods sold includes inbound freight and duty charges from vendors to our central warehouse, freight and handling charges to move merchandise from our central warehouse to our stores, and manufacturing overhead, as appropriate.

Operating expenses include all selling, general and administrative costs including wages and related employee expenses (payroll taxes, health benefits, savings plans, etc.), advertising, outbound freight charges (to ship merchandise to customers), rent, and utilities.

- Property and equipment, net of accumulated depreciation and amortization

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are five to ten years for equipment, five to seven years for furniture and fixtures, five years for vehicles, and forty years for buildings and related improvements. Leasehold improvements are amortized over the lesser of the life of the lease or the useful life of the asset. Repairs and maintenance costs are expensed as incurred.

- Inventory

Inventory is valued at the lower of first-in, first-out cost or market. 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.

- Impairment of long-lived assets

Potential impairments of long-lived assets are reviewed annually or when events and circumstances warrant an earlier review. In accordance with SFAS No. 144, impairment is determined when estimated future undiscounted cash flows associated with an asset are less than the asset's carrying value.

TABLE OF CONTENTS

- Earnings per share

Basic earnings per share are computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share includes, to the extent inclusion of such shares would be dilutive to earnings per share, the effect of outstanding options and warrants, computed using the treasury stock method.

BASIC	2008	2007	2006
Net income (loss)	\$2,604,181	\$3,088,131	\$4,777,066
Weighted average common shares outstanding	10,931,306	10,951,481	10,807,316
Earnings per share – basic	\$0.24	\$0.28	\$ 0.44
DILUTED			
Net income (loss)	2,604,181	3,088,131	\$ 4,777,066
Weighted average common shares outstanding	10,931,306	10,951,481	10,807,316
Effect of assumed exercise of stock options and warrants	84,351	206,294	306,539
Weighted average common shares outstanding, assuming dilution	11,015,657	11,157,775	11,113,855
Earnings per share - diluted	\$0.24	\$0.28	\$ 0.43
Outstanding options and warrants excluded as anti-dilutive	80,500	11,500	-

For additional disclosures regarding the employee stock options and the warrants, see Note 12. The net effect of converting stock options and warrants to purchase 232,200, 275,200 and 446,500 shares of common stock at option prices less than the average market prices has been included in the computations of diluted EPS for the years ended December 31, 2008, 2007 and 2006, respectively.

- 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. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We periodically analyze goodwill remaining on the balance sheet to determine the appropriateness of its carrying value and have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2008, we 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. Under SFAS 142, goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. Our reporting units are generally the same as the operating segments identified in Note 14 – Segment Information.

A summary of changes in our goodwill for the years ended December 31, 2008 and 2007 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2006	\$362,733	\$383,406	\$746,139

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

Acquisitions and adjustments	225,000	-	225,000
Foreign exchange gain/loss	19,397	-	19,397
Impairments	-	-	-
Balance, December 31, 2007	\$607,130	\$383,406	\$990,536
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(23,871)	-	(23,871)
Impairments	-	-	-
Balance, December 31, 2008	583,259	\$383,406	966,655

As of December 31, 2008 and 2007, our intangible assets and related accumulated amortization consisted of the following:

	As of December 31, 2008		
	Gross	Accumulated Amortization	Net
Trademarks, Copyrights	\$544,369	\$319,776	\$224,593
Non-Compete Agreements	177,708	46,809	130,899
	\$722,077	366,585	\$355,492

	As of December 31, 2007		
	Gross	Accumulated Amortization	Net
Trademarks, Copyrights	\$544,369	\$283,485	\$260,884
Non-Compete Agreements	153,000	29,750	123,250
	\$697,369	\$313,235	\$384,134

Excluding goodwill, we have no intangible assets not subject to amortization under SFAS 142. Amortization of intangible assets of \$53,350 in 2008, \$51,542 in 2007, and \$38,291 in 2006 was recorded in operating expenses. The weighted average amortization period is 15 years for trademarks and copyrights, and 4.22 years from non-compete agreements. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding 5 years are as follows:

	Leather Factory	Tandy Leather	Total
2009	\$29,190	\$30,337	\$59,527
2010	29,190	30,337	59,527
2011	26,204	30,337	56,541
2012	1,250	30,337	31,587
2013	-	30,337	30,337

During 2007 and 2008, we acquired non-compete agreements in the amounts of \$75,000 and \$24,708, respectively.

- Fair value of financial Instruments

The principal financial instruments held consist of accounts receivable, accounts payable, notes payable and long-term debt. The carrying value of accounts receivable and accounts payable approximate their fair value due to the relatively short-term nature of the accounts. The terms of the long-term debt are considered reasonable for this type of financing; therefore, the carrying amount approximates fair value.

TABLE OF CONTENTS

- Deferred taxes

Deferred income taxes result from temporary differences in the basis of our assets and liabilities reported for book and tax purposes.

- Stock-based compensation – Change in Accounting Principle

We had two stock option plans which provided for stock option grants to officers, key employees and directors. Both plans expired in the 4th quarter of 2005. The expiration of the plans have 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.

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

We recognized share based compensation expense of approximately \$30,000, \$19,000, and \$101,000 for the years ended December 31, 2008, 2007 and 2006, respectively, as a component of operating expenses.

During the years ended December 31, 2008 and 2007, the stock option activity under our stock option plans was as follows:

	Weighted # of Average shares Exercise Price		Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, January 1, 2007	\$2.05	296,200		
Granted	-	-		
Cancelled	-	-		
Exercised	1.81	(59,500)		
Outstanding, December 31, 2007	\$2.11	236,700	4.23	\$270,780
Exercisable, December 31, 2007	\$1.97	220,770	4.11	\$237,740

	Weighted # of Average shares Exercise Price		Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
--	--	--	--	---------------------------------

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

Outstanding, January 1, 2008	\$2.11	236,700		
Granted	-	-		
Cancelled	-	-		
Exercised	1.21	(12,000)		
Outstanding, December 31, 2008	\$2.16	224,700	3.09	\$262,001
Exercisable, December 31, 2008	\$215	220,770	3.07	\$259,461

Other information pertaining to option activity during the twelve month periods ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Weighted average grant-date fair value of stock options granted	N/A	N/A	N/A