

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

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES ACT OF 1934

For the quarterly period ended September 30, 2007

or

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

For the transition period from _____ to _____

Commission File Number 1-12368

TANDY LEATHER FACTORY, INC.

(Exact name of registrant as specified in its charter)

Delaware

75-2543540

(State or other jurisdiction of incorporate of organization) (IRS Employer Identification Number)

3847 East Loop 820 South, Fort Worth, Texas 76119

(Address of principal executive offices) (Zip Code)

(817) 496-4414

(Registrant's telephone number, including area code)

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

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

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

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

Class	Shares outstanding as of November 9, 2007
Common Stock, par value \$0.0024 per share	10,977,092

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2007 (unaudited)	December 31, 2006 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	\$3,757,534	\$6,739,891
Accounts receivable-trade, net of allowance for doubtful accounts of \$127,000 and \$149,000 in 2007 and 2006, respectively	2,294,922	2,599,279
Inventory	20,721,612	17,169,358
Prepaid income taxes	520,826	-
Deferred income taxes	287,942	266,018
Other current assets	974,559	1,089,258
Total current assets	28,557,394	27,863,804
PROPERTY AND EQUIPMENT, at cost	11,709,818	6,865,946
Less accumulated depreciation and amortization	(5,197,704)	(4,989,341)
	6,512,114	1,876,605
GOODWILL	989,296	746,139
OTHER INTANGIBLES, net of accumulated amortization of \$300,000 and \$262,000 in 2007 and 2006, respectively	396,957	360,676
OTHER assets	1,189,678	1,069,411
	\$37,645,440	\$31,916,635
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	\$2,341,491	\$1,776,646
Accrued expenses and other liabilities	2,431,130	3,424,010
Income taxes payable	-	59,392
Current maturities of capital lease obligations	11,172	111,723
Current maturities of long-term debt	84,375	-
Total current liabilities	4,868,168	5,371,771
DEFERRED INCOME TAXES	225,396	221,621
LONG-TERM DEBT, less current maturities	3,965,625	-
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.10 par value; 20,000,000 shares authorized;	-	-

none issued or outstanding; attributes to be determined on issuance

Common stock, \$0.0024 par value; 25,000,000 shares authorized;

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

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

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

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

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

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

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

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

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

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

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

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

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

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
BALANCE, December 31, 2005	10,741,835	\$25,780	\$4,988,445	\$(25,487)	\$16,172,475	\$96,644	\$21,257,857	
Shares issued - stock options and warrants exercised	95,165	228	106,362	-	-	-	106,590	
Stock-based compensation	-	-	78,600	-	-	-	78,600	
Net income	-	-	-	-	3,369,175	-	3,369,175	\$3,369,175
Translation adjustment	-	-	-	-	-	40,686	40,686	40,686
BALANCE, September 30, 2006	10,837,000	\$26,008	\$5,173,407	\$(25,487)	\$19,541,650	\$137,330	\$24,852,908	
Comprehensive income for the nine months ended September 30, 2006								\$3,409,861

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

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

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

TANDY LEATHER FACTORY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

In the opinion of management, the accompanying consolidated financial statements for Tandy Leather Factory, Inc. and its consolidated subsidiaries contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly its financial position as of September 30, 2007 and December 31, 2006, and its results of operations and cash flows for the three and/or nine-month periods ended September 30, 2007 and 2006. Operating results for the three and nine-month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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

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

The components of inventory consist of the following:

	As of	
	September 30, 2007	December 31, 2006
Inventory on hand:		
Finished goods held for sale	\$19,127,786	\$14,774,445
Raw materials and work in process	762,742	628,539
Inventory in transit	831,084	1,766,374
	\$20,721,612	\$17,169,358

Goodwill and Other Intangibles. Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," prescribes a two-phase process for impairment testing of goodwill, which is performed once annually, absent indicators of impairment during the interim. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2006, management determined that the present value of the discounted estimated future cash flows of the stores associated with the goodwill is sufficient to support their respective goodwill balances. No indicators of impairment were identified during the first nine months of 2007.

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

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

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

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

Other intangibles consist of the following:

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

We recorded amortization expense of \$38,718 during the first nine months of 2007 compared to \$28,718 during the first nine months of 2006. All of our intangible assets are subject to amortization under SFAS 142. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding 5 years is as follows:

	Wholesale Leathercraft	Retail Leathercraft	Total
2007	19,704	31,837	51,541
2008	20,954	30,337	51,291
2009	20,954	30,337	51,291
2010	20,954	30,337	51,291
2011	20,027	30,337	50,364

Revenue Recognition. Our sales generally occur via two methods: (1) at the counter in our stores, and (2) shipment by common carrier. Sales at the counter are recorded and title passes as transactions occur. Otherwise, sales are recorded and title passes when the merchandise is shipped to the customer. Our shipping terms are FOB shipping point.

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

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

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

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

2. STOCK-BASED COMPENSATION

We had two stock option plans which provide for stock option grants to officers, key employees and directors. The plans expired in 2005. The expiration of the plans has no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our Common Stock on the date the option was granted and no option has a term in excess of ten years. Additionally, options vest and become exercisable either six months from the option grant date or in equal installments over a five year period. Prior to fiscal 2006, we accounted for stock-based compensation using the intrinsic value method prescribed in

Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation*.

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

We recognized share based compensation expense for the three and nine months ended September 30, 2007 and 2006 as follows:

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

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

During the nine months ended September 30, 2007, the stock option activity under our stock option plans was as follows:

	Weighted Average Exercise Price	# of Shares	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, January 1, 2007	\$2.050	296,200		
Granted	-	-		
Cancelled	-	-		
Exercised	1.466	51,500		
Outstanding, September 30, 2007	\$2.180	244,700	4.35	\$289,420
Exercisable, September 30, 2007	\$2.050	228,700	4.22	\$256,380

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

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

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

3. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for the three and nine months ended September 30, 2007 and 2006:

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

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

4. SEGMENT INFORMATION

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

- a. Wholesale Leathercraft*, which consists of a chain of warehouse distribution units operating under the name, *The Leather Factory*, located in the United States and Canada;
- b. Retail Leathercraft*, which consists of a chain of retail stores operating under the name, *Tandy Leather Company*, located in the United States and Canada; and
- c. Other*, which is a manufacturer of decorative hat trims sold directly to hat manufacturers.

Our reportable operating segments have been determined as separately identifiable business units and we measure segment earnings as operating earnings, defined as income before interest and income taxes.

	Wholesale Leathercraft	Retail Leathercraft	Other	Total
For the quarter ended September 30, 2007				
Net sales	\$6,940,484	\$5,657,198	\$208,651	\$12,806,333
Gross profit	3,608,272	3,254,075	79,287	6,941,634
Operating earnings	32,686	58,780	13,811	105,277
Interest expense	50,494	-	-	50,494
Other, net	(264,792)	(7,866)	-	(272,658)
Income before income taxes	246,984	66,646	13,811	327,441
Depreciation and amortization	181,113	35,050	2,477	218,640
Fixed asset additions	4,657,769	74,257	-	\$4,732,026
Total assets	\$31,929,070	\$5,548,815	\$167,555	\$37,645,440

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

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

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

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

For the nine months ended September 30, 2006

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

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

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

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

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

Geographic sales information is based on the location of the customer. No single foreign country, except for Canada, accounted for any material amount of our consolidated net sales for the three or nine-month periods ended September 30, 2007 or 2006. We do not have any significant long-lived assets outside of the United States.

5. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to \$5,500,000 to facilitate our purchase of real estate consisting of a 195,000 square foot building situated on 30 acres of land located at 1900 SE Loop 820 in Fort Worth, Texas. Under the terms of the Line of Credit Note, we may borrow from time to time until April 30, 2008, up to the lesser of \$5,500,000 or 90% of the cost of the property. We will make only monthly interest payments until April 30, 2008, at which time the principal balance will be rolled into a 10-year term note. Amounts drawn under the Credit Agreement accrue interest at a rate of 7.10% per annum.

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

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

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

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

Our Business

We are the world's largest specialty retailer and wholesale distributor of leather and leathercraft related items. We market our products to our growing list of customers through company-owned retail stores and wholesale distribution centers. We are a Delaware corporation and our common stock trades on the American Stock Exchange under the symbol "TLF." We operate our business in three segments: **Wholesale Leathercraft**, which operates under the trade name, *The Leather Factory*, **Retail Leathercraft**, which operates under the trade name, *Tandy Leather Company*, and **Other**. See Note 4 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

Our Wholesale Leathercraft segment operates 30 company-owned wholesale stores in 20 states and three Canadian provinces. These stores are engaged in the wholesale distribution of leather and related items, including leatherworking tools, buckles and belt adornments, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits, to retailers, manufacturers, and end users. Our Wholesale Leathercraft segment also includes our National Account sales group.

Tandy Leather, the oldest and best-known supplier of leather and related supplies used in the leathercraft industry, has been the primary leathercraft resource for decades. Tandy Leather's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather's industry presence by opening retail stores. As of November 1, 2007, we were operating 72 Tandy Leather retail stores located throughout the United States and Canada.

Our "Other" segment consists of Roberts, Cushman and Co., a wholly-owned subsidiary that custom designs and distributes decorative hat trims for headwear manufacturers.

Critical Accounting Policies

A description of our critical accounting policies appears in "Item 7. Management's Discussions and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2006.

Forward-Looking Statements

Certain statements contained in this report and other materials we file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made or to be made by us, other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally are accompanied by words such as "may," "will," "could," "should," "anticipate," "believe," "budgeted," "intend," "plan," "project," "potential," "estimate," "continue," or "future" variations thereof or other similar statements. The important risks that could cause results to differ materially from those anticipated by some of the forward-looking statements. Some, but not all, of the important risks, including those described below, could cause actual results to differ materially from those suggested by the forward-looking statements. Please refer also to our annual report on Form 10-K for fiscal year 2006 for additional information concerning these and other uncertainties that could negatively impact us.

Ø We believe that the continued rise in oil and natural gas prices will increase the costs of the goods that we sell, including the costs of shipping those goods from the manufacturer to our stores and customers.

Various oils used to manufacture certain leather and leathercrafts are derived from petroleum and natural gas. Also, the carriers who transport our goods rely on petroleum-based fuels to power their ships, trucks and trains. They are likely to pass their increased costs on to us. We are unsure how much of this increase we will be able to pass on to our customers.

We assume no obligation to update or otherwise revise our forward-looking statements even if experience or future changes make it clear that any projected results, express or implied, will not be realized.

Results of Operations

Three Months Ended September 30, 2007 and 2006

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

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

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

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

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

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 30 wholesale stores and our National Account group. The following table presents the combined sales mix by customer categories for the quarters ended September 30, 2007 and 2006:

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

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

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

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

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

Retail Leathercraft

Our Retail Leathercraft operation consists of 71 Tandy Leather retail stores at September 30, 2007, compared to 61 stores at September 30, 2006. Net sales were up approximately 10% for the third quarter of 2007 over the same quarter last year. A store is categorized as "new" until it is operating for the full comparable period in the prior year.

	# Stores	Qtr Ended 09/30/07	Qtr Ended 09/30/06	\$ Incr (Decr)	% Incr (Decr)
Same (existing) store sales	61	\$5,319,336	\$5,084,332	\$235,004	4.6%
New store sales	10	337,862	37,224	300,638	N/A
Total sales	71	\$5,657,198	\$5,121,556	\$535,642	10.5%

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

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

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

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

Other (Roberts, Cushman)

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

Other Expenses

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

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

Nine Months Ended September 30, 2007 and 2006

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

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

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

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

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

Wholesale Leathercraft

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

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

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

