TANDY LEATHER FACTORY INC
Form 10-K
March 30, 2016

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

Form 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015

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 | 75-2543540 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 1900 Southeast Loop 820, Fort Worth, TX 76140 | 817/872-3200 |
| (Address of Principal Executive Offices and Zip Code) | (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 | NASDAQ Global Market |
| Preferred Share Purchase Rights | NASDAQ Global Market |

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 [X]

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 [X]

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 [X] No [ ]

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

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. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [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 $59,091,778 at June 30, 2015 (based on the price at which the common stock was last traded on the last business day of its most recently completed second fiscal quarter). At March 25, 2016, there were 9,486,978 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 June 7, 2016, are incorporated by reference in Part III of this report.

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# 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 some of our do-it-yourself kits. During 2015, our consolidated sales totaled $84.2 million of which approximately 14% were export sales. We maintain our principal offices at 1900 Southeast Loop 820, Fort Worth, Texas 76140. Our common stock trades on the NASDAQ Global Market 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 related to The Leather Factory stores from Brown Group, Inc., which then consisted of six wholesale stores.

In 1993, we changed our name to The Leather Factory, Inc. We 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 store chain by opening new stores and by making numerous acquisitions of small businesses in strategic geographic locations. In 1996, we expanded into Canada by acquiring our Canadian distributor, The Leather Factory of Canada, Ltd.

Our retail operations began in 2000, when we acquired the operating assets of two subsidiaries of Tandycrafts, Inc. to form Tandy Leather Company. In 2002, we opened our first retail store under the "Tandy Leather" name. Since 2002, we have acquired or opened 85 retail locations and closed three retail stores, for a net of 82 retail stores.

In 2008, we began expanding outside of North America by opening one combination wholesale and retail store in Northampton, United Kingdom. By 2009, we operated 30 wholesale stores, 75 retail stores, and one international combination wholesale and retail store. Since 2009, we have closed two wholesale stores, opened nine new retail stores, closed two retail stores, and opened two new international combination wholesale and retail stores.

At December 31, 2015, we operated 28 stores located in North America operating under the Leather Factory name and 82 stores located in North America operating under the Tandy Leather name, and four combination wholesale and retail stores operating under the Tandy Leather Factory name in the United Kingdom, Australia and Spain.

Tandy Leather Factory, Inc. wholly-owns eleven subsidiaries which create three operating segments as follows:

| Segment | Subsidiaries included: |
|---|---|
| Wholesale Leathercraft | The Leather Factory, LP (25 stores)<br>The Leather Factory of Canada, Ltd (3 stores) |
| Retail Leathercraft | Tandy Leather Company, LP (75 stores) |

| | |
|---|---|
| | The Leather Factory of Canada, Ltd (7 stores) |
| International Leathercraft | Tandy Leather Factory UK Ltd. (2 stores)<br>Tandy Leather Factory Australia Pty Ltd<br>Tandy Leather Factory Espana, SL |

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 store count information by segment in each of our fiscal years from 1999 to 2015.

STORE COUNT
YEARS ENDED DECEMBER 31, 1999 through 2015

| | Wholesale Leathercraft | | | | Retail Leathercraft | | | International Leathercraft | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year Ended | Opened | Conv. (1) | Closed | Total | Opened (2) | Closed | Total | Opened | Closed | Total |
| Balance Fwd | | | | 22 | | | N/A | | | N/A |
| 1999 | 4 | - | - | 26 | - | - | - | - | - | - |
| 2000 | 2 | - | - | 28 | 1* | - | 1 | - | - | - |
| 2001 | 2 | - | - | 30 | - | - | 1 | - | - | - |
| 2002 | 1 | (1) | - | 30 | 14 | 1* | 14 | - | - | - |
| 2003 | - | - | - | 30 | 12 | - | 26 | - | - | - |
| 2004 | - | - | - | 30 | 16 | - | 42 | - | - | - |
| 2005 | - | - | - | 30 | 8 | - | 50 | - | - | - |
| 2006 | - | (1) | - | 29 | 12 | - | 62 | - | - | - |
| 2007 | 1^ | - | - | 30 | 10 | - | 72 | - | - | - |
| 2008 | - | - | - | 30 | 1 | - | 73 | 1 | - | 1 |
| 2009 | - | - | - | 30 | 2 | - | 75 | - | - | 1 |
| 2010 | - | - | 1^ | 29 | 1 | - | 76 | - | - | 1 |
| 2011 | - | - | - | 29 | 1 | - | 77 | 1 | - | 2 |
| 2012 | - | - | - | 29 | 1 | - | 78 | 1 | - | 3 |
| 2013 | - | - | - | 29 | 3 | 2 | 79 | - | - | 3 |
| 2014 | - | - | 1 | 28 | 3 | - | 82 | - | - | 3 |
| 2015 | - | - | - | 28 | - | - | 82 | 1 | - | 4 |

(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 represented more than 1/2% of our total sales in 2015. Sales to our five largest customers represent 1.3%, 1.7% and 2.5% of consolidated sales in 2015, 2014, and 2013, respectively. Management does not believe the loss of one of these customers would have a significant negative impact on our consolidated operations.

Our Operating Segments

We service our customers primarily through the operation of three segments. We identify those segments based on management responsibility, customer focus, and store location. The Wholesale Leathercraft segment consists of 28 wholesale stores of which 25 are located in the United States and three are located in Canada. As of March 1, 2016, the Retail Leathercraft segment consists of 83 Tandy Leather retail stores, of which 76 are located in the United States and seven are located in Canada. Both of these segments sell leather and leathercraft-related products. The International Leathercraft segment consists of all stores, wholesale or retail, located outside of North America. As of March 1, 2016, we had four such stores, two located in the United Kingdom, one located in Australia, and one located in Spain.

Information regarding net sales, gross profit, operating income, and total assets, attributable to each of our segments, is included within Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and within Item 8. Financial Statements and Supplementary Data in Note 12, Segment Information, of our Notes to Consolidated Financial Statements.

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Wholesale Leathercraft

The Wholesale Leathercraft operation distributes its broad product line of leather and leathercraft-related products in the United States and Canada through wholesale stores operating under the name, "The Leather Factory". This segment had net sales of $26.8 million, $27.3 million and $27.4 million for 2015, 2014, and 2013, respectively.

General We operate wholesale stores in 18 states and three Canadian provinces. The stores range in size from 2,350 square feet to 22,000 square feet, with the average size of a store being approximately 5,000 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 Our business concept focuses on 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 a single source. The size and layout of the stores 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, Internet 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.tandyleather.com), and our participation at trade shows.

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. No single customer's purchases represented more than 2% of this segment's sales in 2015.

Merchandise Our products are generally organized into 12 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, Texas 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 TejasTM brand name. We also distribute product under the Tandy LeatherTM, Eco-FloTM, CraftoolTM, and Dr. Jackson'sTM brands. We develop new products through the ideas and referrals of customers and store personnel as well as the analysis 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 2015, 2014, and 2013, Wholesale Leathercraft division sales by product category were as follows:

| Product Category | 2015 Sales Mix | 2014 Sales Mix | 2013 Sales Mix |
|---|---|---|---|
| Belts strips and straps | 3% | 3% | 3% |
| Books, patterns, videos | 2% | 2% | 2% |
| Buckles | 3% | 3% | 4% |
| Conchos^ | 2% | 3% | 3% |
| Craft supplies | 2% | 2% | 2% |
| Dyes, finishes, glues | 7% | 7% | 7% |
| Hand tools | 16% | 16% | 16% |
| Hardware | 8% | 8% | 8% |
| Kits | 5% | 6% | 7% |
| Lace | 3% | 3% | 4% |
| Leather | 44% | 41% | 39% |
| Stamping tools | 5% | 6% | 5% |
| | 100% | 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 2015 and 2014, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Suppliers We purchase merchandise and raw materials from approximately 150 vendors dispersed throughout the United States and in approximately 20 foreign countries. In 2015, our 10 largest vendors accounted for approximately 79% 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. Because an occurrence of such an event 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, we do not believe that the loss of any of these principal suppliers would have a material impact on our operations.

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. Our stores are closed on Sunday. The stores maintain uniform prices, except where lower prices are necessary to meet local competition.

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 in our stores.

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 typically 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 2,600 items in the current lines of leather and leather-related merchandise. All items are offered in all stores.

Expansion We do not believe there is a significant and immediate opportunity for expansion of the Leather Factory wholesale store system in terms of opening additional locations.

Retail Leathercraft

Our Retail Leathercraft segment 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 one of the best-known suppliers of leather and related supplies used in the leathercraft industry. This retail segment offers a product line of quality tools, leather, accessories, kits, and teaching materials. It had net sales of $53.7 million, $51.8 million and $47.0 million for 2015, 2014, and 2013, respectively.

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General As of March 1, 2016, the Tandy Leather retail chain has 83 stores located in 37 states and six Canadian provinces. The stores range in size from 1,200 square feet to 9,000 square feet, with the average size of a store being approximately 3,300 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. In the past several years, we have relocated some of our smaller stores into larger spaces within the same cities as lease terms expire and appropriate larger space is available at acceptable rates. We expect to limit the number of store relocations in 2016 as we evaluate the benefits gained against the costs of such relocations.

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 and Canada 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.tandyleather.com. A two-day maximum delivery time for phone, Internet and mail orders is our goal. 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 approximately 60% of Tandy Leather's 2015 sales. Youth groups, summer camps, schools, and a limited number of wholesale customers complete our customer base. Like the wholesale stores, the retail stores typically 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 due to the holiday shopping season (28-29% of annual sales), while the other three quarters remain fairly even at 24-25 % of annual sales each quarter. No single customer’s purchases represented more than 1/2% of Retail Leathercraft’s sales in 2015.

Merchandise Our products are generally organized into 12 categories. We carry a wide assortment of products including leather, hand tools, kits, dyes, and finishes and stamping tools. During 2015, 2014 and 2013, Retail Leathercraft division sales by product category were as follows:

| Product Category | 2015 Sales Mix | 2014 Sales Mix | 2013 Sales Mix |
|---|---|---|---|
| Belts strips and straps | 5% | 4% | 5% |
| Books, patterns, videos | 1% | 2% | 2% |
| Buckles | 3% | 3% | 3% |
| Conchos | 2% | 3% | 3% |
| Craft supplies | 2% | 2% | 2% |
| Dyes, finishes, glues | 7% | 7% | 7% |
| Hand tools | 16% | 17% | 17% |
| Hardware | 8% | 8% | 8% |
| Kits | 7% | 7% | 8% |
| Lace | 3% | 3% | 3% |
| Leather | 41% | 39% | 37% |
| Stamping tools | 5% | 5% | 5% |
| | 100% | 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. The retail stores 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. Our stores are closed on Sunday. 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, including those that are customers in our Wholesale Leathercraft division, also carry leathercraft products on a very small scale relative to their overall product line. We compete on price, availability of merchandise, and depth of our product line. To our knowledge, our 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. Of the 82 stores opened as of December 31, 2015, 11 were independent leathercraft stores that we acquired. Separately, these acquisitions are not material. The other 71 stores have been new stores opened by us.

International Leathercraft

Our International Leathercraft segment consists of company-owned stores located outside of North America. The first store in this segment opened in the United Kingdom in 2008. As of December 31, 2015, the segment consisted of four wholesale/retail combination stores: two in the United Kingdom, (the newest one having been opened in October 2015), one in Australia and one in Spain. The stores operate under the Tandy Leather Factory trade name. This segment had net sales of approximately $3.7 million, $4.3 million and $3.9 million in 2015, 2014, and 2013, respectively. We intend to open more stores internationally, specifically in Europe, as the opportunities present themselves, but we have not determined a specific time schedule for said openings.

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 stores average 7,000 square feet and are located in light industrial areas. We seek to 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 our website, www.tandyleather.com. 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 Europe, Australia, and Asia. 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 North American stores, our international stores have an unconditional return policy.  No single customer's purchases represented more than 3% of International Leathercraft's sales in 2015.

Our Authorized Sales Center ("ASC") program was developed to create a presence in geographic areas where we do not have a company-owned store.  An unrelated person operating an existing business could become an ASC by submitting an application and upon approval, placing a minimum initial order and meeting minimum annual purchase amounts.  In exchange, the benefits to the ASC are free advertising in various sales flyers produced and distributed by us, preferred pricing on certain products, advance notice of new products, and priority shipping and handling of orders.  We currently have 6 ASC's located in Europe.

Merchandise   The products sold in our international stores are also sold in our North America 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 9:00 am to 6:00 pm Monday through Friday, and from 9:00 am to 4:00 pm on Saturdays.  Our stores are closed on Sunday.  Selling prices are consistent with our US pricing, adjusted for currency fluctuation.

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Competition Our competitors are generally small, independently-owned retailers who, in some cases, are also our customers. We compete on price, availability of merchandise, and delivery time. While there is competition in connection with a number of the products we carry, to our knowledge there is no direct competition affecting our entire product line. We believe our ability to stock a full range of products gives us an advantage over most local competitors.

Distribution The international stores receive the majority of 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 typically filled as received, and we typically do not have backlogs.

Expansion We intend to expand further internationally by opening additional stores, although the timing of any store openings has not been determined. We intend to grow our customer base throughout Europe as well as other parts of the world to support any such additional stores.

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, 2015, we employed 584 people, 488 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 120 registered trademarks, including federal trade name registrations for "Tandy Leather Factory,” “The Leather Factory," "Tandy Leather Company," and “Tandy.” We also own approximately 60 registered foreign trademarks worldwide. We own approximately 600 registered copyrights in the United States covering more than 800 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 12 to our Consolidated Financial Statements, Segment Information. For a description of some of the risks attendant to our foreign operations, see Item 1.A “Risk Factors” on page 5.

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 on official business days during the hours of 10 a.m. and 3 p.m. 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 www.sec.gov.

Our corporate website is located at www.tandyleather.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 thereto 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 our website through the "Corporate Governance" link.

Executive Officers of the Registrant

The following table sets forth information concerning our executive officers as of March 25, 2016:

| Name and Age | Position | Served as Executive Officer Since |
|---|---|---|
| Shannon L. Greene, 50 | Interim Chief Executive Officer since February 2016; Chief Financial Officer since May 2000; Treasurer and Chief Accounting Officer since 2001 | 2000 |
| Mark J. Angus, 55 | Interim President since February 2016; Senior Vice President and Assistant Secretary since June 2008; Operational Vice President of Merchandising since June 1993 | 2008 |
| William M. Warren, 72 | Secretary and Corporate Counsel | 1993 |

Shannon L. Greene has served as our interim Chief Executive Officer since February 2016, following the resignation of Jon Thompson, former Chief Executive Officer and President. Ms. Greene has also 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.

Mark J. Angus has served as interim President since February 2016, following the resignation of Jon Thompson, former Chief Executive Officer and President. Mr. Angus has also served as our Senior Vice President since June 2008 and as director since July 2009. He has served as Vice President of Merchandising since January 1993.

William M. Warren has served as Secretary and General Counsel since 1993. Since 1979, Mr. Warren has been President and Director of Loe, Warren, Rosenfield, Kaitcer, Hibbs, Windsor & Lawrence, P.C., a law firm located in Fort Worth, Texas.

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

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## ITEM 1A. RISK FACTORS

### Risks to Our Industry

Our business may be negatively impacted by general economic conditions in the United States and abroad.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also small businesses and other retailers. Specialty retail, and retail in general, is heavily influenced by general economic cycles. Purchases of non-essential, discretionary products tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. During periods of economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, open and operate new stores, maintain sales levels at our existing stores, maintain or increase our international operations on a profitable basis, maintain our earnings from operations as a percentage of net sales, or generate sufficient cash flows to fund our operational and liquidity needs. The United States and global economies have suffered from economic uncertainty for the past several years, and there continues to be global concern that we may be entering into another recessionary period. While consumer spending in the United States has stabilized recently, it could deteriorate in the future. As a result, our operating results may be adversely and materially affected by downward trends or uncertainty in the United States or global economies.

Increases in the price of leather and other items we sell or a reduction in availability of those products could increase our cost of goods and decrease our profitability.

The prices we pay our suppliers for our products are dependent in part on the market price for leather, metals, and other products. The cost of these items may fluctuate substantially, depending on a variety of factors, including demand, supply conditions, transportation costs, government regulation, economic climates, political considerations, and other unpredictable factors. Leather prices world-wide have been on the rise for the past several years and the outlook for future prices is uncertain. Increases in these costs, together with other factors, will make it difficult for us to sustain the gross margin level we have achieved in recent years and result in a decrease in our profitability unless we are able to pass higher prices on to our customers or reduce costs in other areas. Accordingly, such increases in costs could adversely affect our business and our results of operations.

Further, 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. Finally, livestock diseases such as mad cow could reduce the availability of hides and leathers or increase their cost. The occurrence of any of these events could adversely affect our business and our results of operations.

### Risks Related to Our Business

We may be unable to sustain our past growth or manage our future growth, which may have a material adverse effect on our future operating results.

We have experienced modest sales and earnings growth recently. Many specialty retailers have experienced periods of growth in sales and earnings followed by periods of declining sales and losses. Our business may be similarly affected in the future. We anticipate that our future growth will depend on a number of factors, including consumer preferences, the strength and protection of our brand, the market success of our current and future products, the success of our growth strategies, and our ability to manage our future growth. Further, our future success will depend substantially on the ability of our management team to manage our growth effectively, optimizing our operational, administrative, financial, and legal procedures in order to maximize profitability. If we fail to manage our growth effectively, our future operating results could be adversely affected.

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

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

We may be unsuccessful in implementing our planned international expansion, which could impair the value of our brand, harm our business and negatively affect our results of operation.

We plan to grow our net sales and net earnings from our International Leathercraft segment by opening stores in various international markets. As we expand outside of North America, we may incur significant costs relating to starting up, maintaining, and expanding foreign operations. Such costs may include, but are not limited to, obtaining locations for stores, hiring personnel, and travel expenses. We may be unable to open and operate new stores successfully and as a result, our growth may be limited, unless we are able to identify desirable sites for store locations, negotiate acceptable lease terms, hire, train, and retain competent store personnel; manage inventory effectively to meet the needs and demands of customers on a timely basis, manage foreign currency risk effectively, and achieve acceptable operating margins from the new stores. We may not successfully open new stores or our new stores may not be profitable. If we are unable to successfully open new stores or our new stores are not profitable, our business and our results of operations could be adversely affected.

As we continue to increase our international operations, we face the possibility of greater losses from a number of risks inherent in doing business in international markets and from a number of factors which are beyond our control, such as political instability or acts of terrorism, which disrupt trade with the countries in which our suppliers or customers are located; local business practices that do not conform to legal or ethical guidelines; restrictions or regulations relating to imports or exports; additional or increased customs duties, tariffs, taxes, and other charges on imports; significant fluctuations in the value of the dollar against foreign currencies; social, legal or economic instability in the foreign markets in which we do business, which could influence our ability to sell our products in these markets; and restrictions on the transfer of funds between the United States and foreign jurisdictions. The occurrence of any of these events could adversely affect our business and our results of operations.

We may fail to realize the anticipated benefits of the opening of additional stores in North America or we may be unable to obtain sufficient new locations on acceptable terms to meet our growth plans. Further, we may fail to hire and train qualified managers to oversee the stores opened.

Our strategy to grow our business partially depends on continuing to successfully open new stores in North America. The success of this strategy will depend largely upon our ability to find a sufficient number of suitable locations and our ability to recruit, hire, and train qualified personnel to operate our new stores.

Our long-term expansion plans in North America call for us to open new stores both in new geographic areas and in or near the areas where we have existing stores. To the extent that we open stores in markets where we already have existing stores, we may experience reduced net sales at those existing stores. Also, if we expand into new geographic areas, those stores may not be received as well as, or achieve net sales or profitability levels comparable to those of, our existing stores in our estimated time periods, or at all. If our stores fail to achieve, or are unable to sustain, acceptable net sales and profitability levels, our business may be materially harmed and we may incur costs associated with closing or relocating stores. In addition, our current expansion plans are only estimates, and the actual number of stores we open each year and in total and the actual number of suitable locations for our new stores could differ significantly from these estimates. If we are unable to successfully open new stores or our new stores are not profitable, our business and our results of operations could be adversely affected.

Our success depends on the continued protection of our trademarks and other proprietary intellectual property rights.

Our trademarks and other intellectual property rights are important to our success and competitive position, and the loss of or inability to enforce our trademark and other proprietary intellectual property rights could harm our business. We devote substantial resources to the establishment and protection of our trademark and other proprietary intellectual property rights on a worldwide basis. Despite any precautions we may take to protect our intellectual property, policing unauthorized use of our intellectual property is difficult, expensive, and time consuming, and we may be unable to adequately protect our intellectual property or determine the extent of any unauthorized use. Our efforts to establish and protect our trademark and other proprietary intellectual property rights may not be adequate to prevent imitation or counterfeiting of our products by others, which may not only erode sales of our products but may also cause significant damage to our brand name. Further, we could incur substantial costs in legal actions relating to our use of intellectual property or the use of our intellectual property by others. Even if we are successful in these actions, the costs we incur could have a material adverse effect on us.

Foreign currency fluctuations could adversely impact our financial condition and results of operations.

We generally purchase our products in U.S. dollars. However, we source a large portion of our products from countries other than the United States. The cost of these products may be affected by changes in the value of the applicable currencies. Changes in currency exchange rates may also affect the U.S. dollar value of the foreign currency denominated prices at which our international business will sell products. Furthermore, the majority of our international sales are generally derived from sales in foreign countries. This revenue, when translated into U.S. dollars for consolidated reporting purposes, could be materially affected by fluctuations in the U.S. dollar, negatively impacting our results of operations and our ability to generate revenue growth.

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Our business could be harmed if we are unable to maintain our brand image.

Tandy Leather is one of the most recognized brand names in our industry. Our success to date has been due in large part to the strength of that brand. If we are unable to provide quality products and exceptional customer service to our customers, including education, which Tandy Leather has traditionally been known for, our brand name may be impaired which could adversely affect our operating results.

Other uncertainties, which are difficult to predict and many of which are beyond our control, may occur as well and may adversely affect our business and our results of operations.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

## ITEM 2. PROPERTIES

We lease our store locations, with the exception of our flagship store located in Fort Worth, Texas. The majority of our stores have initial lease terms of at least 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 us are described in Item 1 in the description of each of our three operating segments. We own the 22,000 square foot building that houses our flagship store. Further, we own our corporate headquarters, which includes our central warehouse and manufacturing facility, sales, advertising, administrative, and executive offices. 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, 2015:

| State | Wholesale Leathercraft | Retail Leathercraft | International |
|---|---|---|---|
| Alabama | - | 1 | n/a |
| Alaska | - | 1 | n/a |
| Arizona | 2 | 3 | n/a |
| Arkansas | - | 1 | n/a |
| California | 3 | 8 | n/a |
| Colorado | 1 | 3 | n/a |
| Connecticut | - | 1 | n/a |
| Florida | 1 | 3 | n/a |
| Georgia | - | 1 | n/a |
| Idaho | - | 1 | n/a |
| Illinois | 1 | 1 | n/a |
| Indiana | - | 2 | n/a |
| Iowa | 1 | - | n/a |
| Kansas | 1 | - | n/a |
| Kentucky | - | 1 | n/a |
| Louisiana | 1 | 1 | n/a |
| Maryland | - | 1 | n/a |
| Massachusetts | - | 1 | n/a |
| Michigan | 1 | 1 | n/a |
| Minnesota | - | 2 | n/a |
| Missouri | 1 | 2 | n/a |

| | | | |
|---|---|---|---|
| Montana | 1 | - | n/a |
| Nebraska | - | 1 | n/a |
| Nevada | - | 2 | n/a |
| New Mexico | 1 | 1 | n/a |
| New York | - | 1 | n/a |
| North Carolina | - | 2 | n/a |
| Ohio | 1 | 2 | n/a |
| Oklahoma | - | 2 | n/a |
| Oregon | 1 | 2 | n/a |
| Pennsylvania | 1 | 2 | n/a |
| South Carolina | - | 1 | n/a |
| South Dakota | - | 1 | n/a |
| Tennessee | - | 3 | n/a |
| Texas | 5 | 12 | n/a |
| Utah | 1 | 3 | n/a |
| Virginia | - | 1 | n/a |
| Washington | 1 | 2 | n/a |
| Wisconsin | - | 1 | n/a |
| Wyoming | - | 1 | n/a |
| | | | |
| Canadian locations: | | | |
| Alberta | 1 | 1 | n/a |
| British Columbia | - | 1 | n/a |
| Manitoba | 1 | - | n/a |
| Nova Scotia | - | 1 | n/a |
| Ontario | 1 | 2 | n/a |
| Quebec | - | 1 | n/a |
| Saskatchewan | - | 1 | n/a |
| | | | |
| International locations: | | | |
| United Kingdom | n/a | n/a | 2 |
| Australia | n/a | n/a | 1 |
| Spain | n/a | n/a | 1 |

ITEM 3. LEGAL PROCEEDINGS

See discussion of Legal Proceedings in Note 9 to the consolidated financial statements included in Item 8 of this Report.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

| 2015 | High | Low | 2014 | High | Low |
|---|---|---|---|---|---|
| 4th quarter | $7.88 | $6.85 | 4th quarter | $9.70 | $8.61 |
| 3rd quarter | $8.63 | $6.76 | 3rd quarter | $9.59 | $8.96 |
| 2nd quarter | $8.90 | $8.39 | 2nd quarter | $9.80 | $8.74 |
| 1st quarter | $9.03 | $7.89 | 1st quarter | $9.95 | $8.42 |

There were approximately 326 stockholders of record on March 25, 2016.

We did not sell any shares of our equity securities during our fiscal year ended December 31, 2015 that were not registered under the Securities Act.

We did not purchase any shares of our common stock during the fourth quarter of 2015, although we are authorized to do so through a stock purchase program permitting us to repurchase up to 1.2 million shares of our common stock at prevailing market prices. We announced the program on August 10, 2015. Purchases under the program commenced on August 24, 2015 and will terminate on August 9, 2016. See Note 11 to our Financial Statements included in Item 8 of this report.

On June 9, 2014, our Board of Directors authorized a $0.25 per share special one-time cash dividend that was paid to our stockholders of record at the close of business on July 7, 2014. The dividend, totaling $2.5 million, was paid to our stockholders on August 8, 2014. Our Board of Directors will determine future cash dividends after giving consideration to our then existing levels of profit and cash flow, capital requirements, current and forecasted liquidity, as well as financial and other business conditions existing at the time. This policy is subject to change based on future industry and market conditions, as well as other factors.

The following table sets forth information regarding our equity compensation plans (including individual compensation arrangements) that authorize the issuance of shares of our common stock. The information is aggregated in two categories: plans previously approved by our stockholders and plans not approved by our stockholders. The table includes information for officers, directors, employees, and non-employees. All information is as of December 31, 2015.

| Plan Category | Column (a)<br>Number of Securities to be issued upon exercise of outstanding options, warrants and rights | Column (b)<br>Weighted-average exercise price of outstanding options, warrants and rights | Column (c)<br>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in Column (a)) |
|---|---|---|---|
| Equity compensation plans approved by stockholders | 128,833 | $7.08 | 252,315 |
| | | | |

| | | | |
|---|---|---|---|
| Equity compensation plans not approved by stockholders | - | - | - |
| TOTAL | 128,833 | $7.08 | 252,315 |

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, which occurred in subsequent years.

| Income Statement Data, Years ended December 31, | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Net sales | $84,161,200 | $83,430,912 | $78,284,585 | $72,720,624 | $66,102,947 |
| Gross profit | 52,071,060 | 52,124,757 | 49,328,024 | 45,905,674 | 40,337,159 |
| Income from operations | 10,474,700 | 11,958,029 | 11,266,790 | 9,144,005 | 7,706,650 |
| Net income from continuing operations | 6,402,405 | 7,706,921 | 7,265,717 | 5,596,070 | 4,753,969 |
| Income from discontinued operations, net of tax | - | - | - | - | (1,368) |
| Net income | $6,402,405 | $7,706,921 | $7,265,717 | $5,596,070 | $4,752,601 |
| Net income per share from continuing operations | | | | | |
| Basic | $0.64 | $0.76 | $0.71 | $0.55 | $0.47 |
| Diluted | $0.63 | $0.75 | $0.71 | $0.55 | $0.47 |
| Net income per share including discontinued operations | | | | | |
| Basic | $0.64 | $0.76 | $0.71 | $0.55 | $0.47 |
| Diluted | $0.63 | $0.75 | $0.71 | $0.55 | $0.47 |
| Weighted average common shares outstanding for: | | | | | |
| Basic EPS | 10,077,506 | 10,203,063 | 10,176,492 | 10,157,395 | 10,156,442 |
| Diluted EPS | 10,102,760 | 10,241,121 | 10,216,438 | 10,175,346 | 10,182,098 |
| | | | | | |
| Cash dividend declared per common share | - | $0.25 | - | $0.25 | - |

| Balance Sheet Data, as of December 31, | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Cash and certificates of deposit | $10,962,615 | $10,636,530 | $11,082,679 | $7,705,182 | $11,189,484 |
| Total assets | 64,566,926 | 62,873,874 | 56,398,566 | 49,087,672 | 45,502,915 |
| Long-term debt, including current portion | 3,863,307 | 5,643,125 | 2,598,750 | 3,105,000 | 3,307,500 |
| Total Stockholders' Equity | $50,972,176 | $49,123,012 | $44,621,542 | $37,521,017 | $34,433,801 |

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## 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 on our results of operations and financial condition.

This discussion should be read in conjunction with our financial statements and the notes accompanying those financial statements included elsewhere in this Annual Report on Form 10-K. 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 and internationally.

We operate in three segments. Wholesale Leathercraft, consisting of our Leather Factory-branded stores, is our oldest segment with sales of $26.8 million in 2015. Historically, in normal economic conditions, this division has generally offered steady but very modest increases in sales. Sales in 2015 declined 2% compared to 2014, with the same stores' sales increasing 1%. Sales to our national account customer group, which consisted of large national store chains, ended in April 2014 as the result of our intentional decision to discontinue certain products from our product line that these customers purchased due to unsatisfactory gross profit margins. Sales at our stores are showing signs of growth as consumer confidence slowly improves, despite the flat to modest growth of the U.S. economy. We closed one Leather Factory store in 2014.

Tandy Leather has long been known for its retail leathercraft store chain. These retail stores comprise our Retail Leathercraft segment. This segment has experienced the greatest increases in sales ($53.7 million in 2015, up from $51.8 million in 2014) and is our largest source of revenues. We expect to grow the number of stores to approximately 100 in the future from 82 stores in operation at the end of 2015. Our pace of store openings has slowed in the last five years due to the general economic conditions in the U.S. and because of the lack of personnel qualified for store manager positions. We expect to continue to open stores domestically but have not committed to a specific time frame. While the store opening schedule has slowed, we have relocated some existing stores as current lease terms near expiration into larger spaces so that a larger amount of product is available to customers. While we believe the store relocation strategy has been somewhat successful, it has not achieved the return on investment that we were expecting, although there are a number of factors beyond the store size that contributed to that lack of return. While we are not opposed to the occasional store relocation when warranted, we believe that opening new stores is a more effective strategy to grow our sales. While we do not expect a significant number of store openings to occur in 2016, we will focus on personnel training and development in order to increase the rate at which stores are opened in 2017 and beyond.

Our International Leathercraft segment consists of company-owned stores located outside of North America. At December 31, 2015, four combination retail/wholesale stores, with two located in the United Kingdom, and one each in Australia and Spain, comprised this segment. It is our intention to open more stores in this segment once we have a sufficient customer base to support additional stores.

On a consolidated basis, gross profit margin as a percent of total net sales, a key indicator of costs, decreased minimally in 2015 compared to 2014. Operating expenses increased at a faster pace than that of sales in 2015, increasing by 4% from 2014. Operating expenses increased at a slower pace than that of sales in 2014, increasing 6% from 2013.

We reported consolidated net income for 2015 of $6.4 million. Consolidated net income for 2014 and 2013 was $7.7 million and $7.3 million, respectively. We use our cash flow to fund our operations, to fund the opening of new stores and to purchase necessary property and equipment. We paid one-time dividends in 2014 and 2012 to our stockholders, totaling $2.5 million each year. At the end of 2015, our stockholders' equity had increased to $51.0 million from $49.1 million the previous year.

Comparing the December 31, 2015 balance sheet with the prior year's balance sheet, we increased our investment in inventory from $32.9 million to $33.6 million while total cash increased from $10.6 million to $11.0 million.

Net Sales

Net sales for the three years ended December 31, 2015 were as follows:

| Year | Wholesale Leathercraft | Retail Leathercraft | International Leathercraft | Total Company | Increase from Prior Year |
|---|---|---|---|---|---|
| 2015 | $26,754,165 | $53,714,432 | $3,692,603 | $84,161,200 | 0.9% |
| 2014 | $27,285,884 | $51,805,944 | $4,339,084 | $83,430,912 | 6.6% |
| 2013 | $27,384,614 | $46,995,902 | $3,904,069 | $78,284,585 | 7.7% |

Our net sales increased by 0.9% in 2015 when compared with 2014 and increased by 6.6% in 2014 when compared with 2013. In 2015, our Retail Leathercraft segment reported a sales increase compared to the prior year while our Wholesale Leathercraft and International Leathercraft segments reported sales declines. The decline in sales in our Wholesale Leathercraft segment was due to the elimination of our national account customer group and the closing of one store, impacting sales for a portion of 2014 but all of 2015. The decline in sales in our International Leathercraft segment was primarily due to the change in foreign currency rates between 2015 and 2014. In 2014, our Retail and International Leathercraft segments reported sales increases compared to the prior year while our Wholesale Leathercraft segment reported a sales decrease due to the elimination of our national account customer group.

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 2015, our cost of sales increased slightly as a percentage of total net sales when compared to 2014, resulting in a decrease in consolidated gross profit margin from 62.5% to 61.9%. Our 2014 cost of sales as a percentage of our total net sales increased slightly as a percentage of total net sales when compared to 2013, resulting in a decrease in consolidated gross profit margin from 63.0% to 62.5%. Fluctuations in gross margin are primarily due to customer mix and product mix. Wholesale sales are at a lower gross margin than that of retail sales. Leather sales are at a lower gross margin than that of non-leather sales. Therefore, as wholesale sales increase at a faster pace than that of retail sales, or we sell a higher percentage of leather compared to non-leather, our gross margin decreases accordingly.

Our gross margins for the three years ended December 31, 2015 were as follows:

| Year | Wholesale Leathercraft | Retail Leathercraft | International Leathercraft | Total Company |
|---|---|---|---|---|
| 2015 | 69.5% | 58.2% | 60.5% | 61.9% |
| 2014 | 67.4% | 59.6% | 65.7% | 62.5% |
| 2013 | 67.3% | 60.5% | 63.3% | 63.0% |

Our operating expenses increased as a percentage of total net sales to 49.4% in 2015 when compared with 48.2% in 2014. This increase indicates that our operating expenses grew faster than our sales during this period. 2015 operating expenses were $1.4 million higher than those of 2014. Significant expense fluctuations in 2015 compared to 2014 are as follows:

| Expense | 2015 amount | Incr (Decr) over 2014 |
|---|---|---|
| Employee compensation and benefits | $20.1 million | $216,000 |
| Advertising and marketing | $5.8 million | $660,000 |
| Rent and utilities | $5.7 million | $181,000 |
| Legal, professional and other outside fees | $1.1 million | 156,000 |
| Depreciation | $1.5 million | 130,000 |

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The increase in employee compensation is due primarily to an increase in the cost of employee benefits and an increase in employee headcount at the stores. Advertising and marketing expenses rose due to an increase in trade shows attended. The increase in rent and utilities expense is the result of the relocations of selected stores into larger space.

Our operating expenses decreased as a percentage of total net sales to 48.3% in 2014 when compared with 48.6% in 2013. This decrease indicates that our operating expenses grew slower than our sales during this period. 2014 operating expenses were $2.2 million higher than those of 2013. Significant expense fluctuations in 2014 compared to 2013 are as follows:

| Expense | 2014 amount | Incr (Decr) over 2013 |
|---|---|---|
| Employee compensation and benefits | $20.0 million | $1.1 million |
| Advertising and marketing | $5.7 million | $739,000 |
| Rent and utilities | $4.8 million | $476,000 |
| Legal and professional fees | $747,000 | ($447,000) |
| Depreciation | $1.4 million | $241,000 |

The increase in employee compensation is due to an increase in employee headcount and an increase in store manager base salary. In addition, our store managers are paid a percentage of the operating profit generated by the store they manage as additional compensation, so as store profits increase, manager compensation increases. Advertising and marketing expenses rose due to an increase in trade shows attended. The increase in rent and utilities expense is the result of the relocations of selected stores into larger space.

Other Income/Expense (net)

Other Income/Expense consists primarily of currency exchange fluctuations, interest income, and interest expense. In 2015, we incurred other expenses (net) of approximately $256,000 compared to other expenses (net) of approximately $150,000 in 2014. In 2015, we received approximately $7,000 in gas royalties, earned approximately $3,000 in interest income on our cash and paid approximately $330,000 in interest expense on our bank debt. We had a currency exchange loss of approximately $24,000 in 2015 compared to a currency exchange loss of approximately $13,000 in 2014.

In 2014, we incurred other expenses (net) of approximately $150,000 compared to other expenses (net) of approximately $46,000 in 2013. In 2014, we received approximately $24,000 in gas royalties, earned approximately $3,000 in interest income on our cash and paid approximately $225,000 in interest expense on our bank debt. We had a currency exchange loss of approximately $13,000 in 2014 compared to a currency exchange gain of approximately $41,000 in 2013.

Net Income

During 2015, we earned net income of $6.4 million, a 17% decrease from our net income of $7.7 million earned during 2014. The decrease in net income was the result of the increase in cost of goods sold and operating expenses, partially offset by the increase in sales.

During 2014, we earned net income of $7.7 million, a 7% increase over our net income of $7.3 million earned during 2013. The increase in net income was the result of the increase in sales and gross profit, partially offset by the increase in operating expenses.

Wholesale Leathercraft

The increases (or decreases) 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, 2015 were as follows:

| Year | Net Sales Increase (Decrease) from Prior Year | Operating Income | Operating Income Increase (Decrease) from Prior Year | Operating Income as a Percentage of Sales |
|---|---|---|---|---|
| 2015 | (2.0)% | $4,663,590 | (12.0)% | 17.4% |
| 2014 | (0.4)% | $5,300,413 | 9.5% | 19.4% |
| 2013 | 2.0% | $4,840,416 | 29.8% | 17.7% |

Wholesale Leathercraft, consisting of 28 wholesale stores in 2015 accounted for 31.8% of our consolidated net sales in 2015, which compares to 33% in 2014 and 35% in 2013. The decrease in this division's contribution to our total net sales is the result of the growth in Retail Leathercraft and the elimination of sales to our national account customer group within this segment. We expect this trend to continue as we intend to open additional stores in our Retail Leathercraft segment.

Sales in the wholesale stores increased 0.8% in 2015 compared to sales in 2014. By customer group, sales in the wholesale stores to our retail customers increased while sales to our other customer groups declined from 2014. Our sales mix by customer group in the Wholesale Leathercraft division was as follows:

| Customer Group | 2015 | 2014 | 2013 |
|---|---|---|---|
| Retail | 47% | 45% | 41% |
| Institution | 3% | 4% | 4% |
| Wholesale | 43% | 42% | 44% |
| National Accounts | - | 3% | 5% |
| Manufacturers | 7% | 6% | 6% |
| | 100% | 100% | 100% |

In 2015, operating income as a percentage of sales declined from the prior year of 19.1% to 17.4%. Operating expenses increased approximately $822,000 in 2015 compared to 2014. The primary reason for the operating expense increase was the increase in the cost associated with our employee health benefit program and advertising and marketing expenses.

In 2014, operating income as a percentage of divisional sales improved from the prior year of 17.7% to 19.1%. Operating expenses decreased approximately $391,000 in 2014 compared to 2013. The primary reason for the operating expense decrease was the reduction in legal and professional fees, which is the result of new trademark filing fees incurred last year not repeated this year.

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, 2015 were as follows:

| Year | Net Sales Increase from Prior Year | Operating Income | Operating Income Increase (Decrease) from Prior Year | Operating Income as a Percentage of Sales |
|---|---|---|---|---|
| 2015 | 3.7% | $5,689,814 | (6.4)% | 10.6% |
| 2014 | 10.2% | $6,077,345 | 1.0% | 11.7% |
| 2013 | 10.3% | $6,026,731 | 10.9% | 12.8% |

Reflecting the growth previously discussed, Retail Leathercraft accounted for 63.8% of our total net sales in 2015, up from 62.1% in 2014 and 60.0% in 2013.  Growth in net sales for our Retail Leathercraft division in 2015 resulted from an increase in same store sales and new stores opened in late 2014.

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

| Customer Group | 2015 | 2014 | 2013 |
|---|---|---|---|
| Retail | 59% | 60% | 59% |
| Institution | 3% | 3% | 4% |
| Wholesale | 35% | 34% | 34% |
| National Accounts | 0% | 0% | 0% |
| Manufacturers | 3% | 3% | 3% |
| | 100% | 100% | 100% |

Operating income as a percentage of sales in 2015 decreased to 10.6% compared to 11.7% for 2014 due to an increase in operating expenses, partially offset by an increase in gross profit margin. Gross margin decreased from 59.6% in 2014 to 58.2% in 2015. Operating expenses as a percentage of sales decreased minimally from 47.9% in 2014 to 47.6% in 2015 as operating expenses grew at a slightly slower pace in 2015 than that of sales.

Operating income as a percentage of sales in 2014 decreased to 11.7% compared to 12.8% for 2013 due to the slight decline in gross profit margin and the increase in operating expenses. Gross margin decreased from 60.5% in 2013 to 59.6% in 2014. Operating expenses as a percentage of sales increased minimally from 47.7% in 2013 to 47.9% in 2014 as operating expenses grew at a slightly faster pace in 2014 than that of sales.

We intend to continue the slow expansion of our store chain over the next several years, with plans to open two to three stores in 2016 in North America. We remain committed to a conservative expansion plan for this division that is intended to minimize risks to our profits and maintain our financial stability. In the current economic environment in the United States, it is possible that we will change our plans for store openings in 2016 and beyond if we determine that the feasibility of additional successful openings is likely.

International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of December 31, 2015, that represents four retail/wholesale combination stores with two located in the United Kingdom, one located in Australia, and one located in Spain. International Leathercraft accounted for 4.4%, 5.2%, and 5.0% of our total sales in 2015, 2014, and 2013, respectively. We opened the second store in the United Kingdom in October 2015 and expect this segment to become a larger part of our total operations as our international customer base continues to grow.

The increases (or decreases) in net sales, operating income, operating income increases (or decreases), and operating income as a percentage of sales from our International Leathercraft stores for the three years ended December 31, 2015 were as follows:

| Year | Net Sales Increase (Decrease) from Prior Yr | Operating Income | Operating Income Increase (Decrease) from Prior Year | Operating Income as a Percentage of Sales |
|---|---|---|---|---|
| 2015 | (14.9)% | $121,296 | (79.1)% | 3.3% |
| 2014 | 11.1% | $580,271 | 45.2% | 13.4% |
| 2013 | 20.0% | $399,643 | 1806.6% | 10.2% |

Operating income as a percentage of sales decreased to 3.3% for 2015 compared to 13.4% for 2014. Gross margin decreased from 65.7% in 2014 to 60.5% in 2015. Operating expenses as a percentage of sales in 2015 increased from 52.3% in 2014 to 57.2% in 2015 as operating expenses grew at a faster pace in 2015 than that of sales. The change in foreign currency exchange rates from 2014 to 2015 and the expenses associated with the opening of the new store in the fourth quarter of 2015 was the primary cause of the significant decline in performance of this segment.

Operating income as a percentage of sales in 2014 increased to 13.4% for 2014 compared to 10.2% for 2013. Gross margin increased from 63.3% in 2013 to 65.7% in 2014. Operating expenses as a percentage of sales in 2014 decreased from 53.1% in 2013 to 52.3% in 2014 as operating expenses grew at a slower pace in 2014 than that of sales.

We intend to expand our International Leathercraft segment by opening new stores once the current stores have sufficiently built their customer bases to a level that will adequately support additional stores.

Financial Condition

At December 31, 2015, we held $11.0 million of cash, $33.6 million of inventory, accounts receivable of approximately $553,000, and $15.7 million of property and equipment. Goodwill and other intangibles (net of amortization and depreciation) were approximately $953,000 and $27,000, respectively. Net total assets were $64.6 million. Current liabilities were $8.3 million (including approximately $305,000 of current maturities of long-term debt and capital lease obligations), while long-term debt was $3.6 million. Total stockholders' equity at the end of 2015 was $51.0 million.

At December 31, 2014, we held $10.6 million of cash, $32.9 million of inventory, accounts receivable of approximately $625,000, and $15.2 million of property and equipment. Goodwill and other intangibles (net of amortization and depreciation) were approximately $972,000 and $58,000, respectively. Net total assets were $62.9 million. Current liabilities were $10.4 million (including approximately $3.7 million of current maturities of long-term debt), while long-term debt was $1.9 million. Total stockholders' equity at the end of 2014 was $49.1 million.

Specific ratios on a consolidated basis at December 31 were as follows:

| | | 2015 | 2014 | 2013 |
|---|---|---|---|---|
| Solvency Ratios: | | | | |
| Quick Ratio | (Cash+Accts Rec)/Total Current Liabilities | 1.38 | 1.09 | 1.45 |
| Current Ratio | Total Current Assets/Total Current Liabilities | 5.71 | 4.48 | 4.96 |
| Current Liabilities to Net Worth | Total Current Liabilities/Net Worth | 0.16 | 0.21 | 0.18 |
| Current Liabilities to Inventory | Total Current Liabilities/Inventory | 0.25 | 0.32 | 0.31 |
| Total Liabilities to Net Worth | Total Liabilities/Net Worth | 0.27 | 0.28 | 0.26 |
| Fixed Assets to Net Worth | Fixed Assets/Net Worth | 0.31 | 0.31 | 0.32 |
| | | | | |
| Efficiency Ratios: | | | | |
| Collection Period (Days Outstanding) | Accounts Receivable/Credit Sales x 365 | 32.2 | 32.79 | 32.87 |
| Inventory Turnover | Sales/Average Inventory | 2.53 | 2.82 | 3.00 |
| Assets to Sales | Total Assets/Sales | 0.77 | 0.75 | 0.72 |
| Sales to Net Working Capital | Sales/Current Assets - Current Liabilities | 2.15 | 2.32 | 2.42 |

| | | | | |
|---|---|---|---|---|
| Accounts Payable to Sales | Accounts Payable/Sales | 0.02 | 0.02 | 0.02 |
| | | | | |
| Profitability Ratios: | | | | |
| Return on Sales (Profit Margin) | Net Profit After Taxes/Sales | 0.08 | 0.09 | 0.09 |
| Return on Assets | Net Profit After Taxes/Total Assets | 0.10 | 0.12 | 0.13 |
| Return on Net Worth (Return on Equity) | Net Profit After Taxes/Net Worth | 0.13 | 0.16 | 0.16 |

Capital Resources and Liquidity

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

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

Amounts drawn under either Promissory Note accrue interest at the London interbank Eurodollar market rate for U.S. dollars (commonly known as “LIBOR”) plus 1.85% (2.263% at December 31, 2015).

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

On July 12, 2012, we executed a Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a revolving credit facility of up to $4 million, which was subsequently increased to $6 million. The note expired on September 30, 2015.

Our primary source of liquidity and capital resources during 2015 was cash flow provided by operating activities. Net cash flow from operations for 2015, 2014, and 2013 was approximately $8.2 million, $1.2 million, and $7.5 million, respectively. The decrease in operating cash flow in 2014 was due to an intentional increase in inventory which is discussed further below.

Consolidated accounts receivable decreased approximately $72,000 to approximately $553,000 at December 31, 2015 compared to approximately $625,000 at December 31, 2014. Average days to collect in 2015 and 2014 were 32 and 33 days, respectively, on a consolidated basis. We maintain a tight credit policy and have aggressively accelerated our collection efforts to ensure collectability of all customer accounts.

Inventory increased from $32.9 million at the end of 2014 to $33.6 million at December 31, 2015. 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 expansion. We ended the year with our total inventory on hand matching that of our internal targets for optimal inventory.

Consolidated inventory turned 2.5 times during 2015, a slight slowdown from the 2014 turns at 2.8 times. We compute our inventory turnover rates as sales divided by average inventory.

By operating division, inventory turns are as follows:

| Segment | 2015 | 2014 | 2013 |
|---|---|---|---|
| Wholesale Leathercraft | 1.66 | 1.85 | 1.97 |
| Retail Leathercraft | 3.75 | 4.27 | 4.92 |
| International Leathercraft | 3.00 | 4.27 | 3.70 |

| | | | |
|---|---|---|---|
| Wholesale Leathercraft stores only | 4.04 | 4.52 | 4.79 |

Retail and International Leathercraft inventory turns are significantly higher than that of Wholesale Leathercraft because their inventories consist only of the inventories at the stores. These segments have no warehouse (back stock) inventory to include in the turnover computation as all stores get their product from the central warehouse, which is included in the Wholesale Leathercraft segment. Wholesale Leathercraft's turns are expected to be slower because the central warehouse inventory is part of this segment, and its inventory is held as the back stock for all of the stores.

Accounts payable totaled $2.0 million at the end of 2015, an increase of $728,000 from $1.3 million at the end of 2014, primarily due to timing of check disbursements.

Capital expenditures totaled $2.2 million in 2015 and 2014, primarily related to store fixtures and computer equipment for new, moved or remodeled stores. In 2015, we opened one new store in Manchester, United Kingdom and moved/remodeled 12 stores in North America. In 2014, we opened 3 new U.S. stores and moved/remodeled 8 other stores in North America.

In 2013, our capital expenditures totaled $3.8 million of which $1.0 million was directly related to the completion of our flagship store, $1.9 million for 13 moved/remodeled stores, $0.5 million for new stores opened, with the remaining amounts related to computer equipment, factory machines and dies, and some International stores' fixture and equipment.

For 2016, we intend to suspend the relocation plans for our smaller stores, with a few possible exceptions, which will reduce the amount of capital expenditures, namely fixtures, to be made. Computer equipment replacements will continue on an as-needed basis as the existing equipment becomes obsolete. Other plans for 2016 include the roll out of a new telecommunication platform between stores and a new payment system. Both are intended to improve the customer service experience and security. Despite those enhancements, we expect our 2016 capital expenditures to be less than our 2015 capital expenditures.

As described previously, we have repurchased approximately 529,000 shares of our stock, at an average price of $7.01, totaling $3.7 million for 2015. There were no stock repurchases in 2014 or 2013.

We believe that cash flow from operations will be adequate to fund our operations in 2016, while also funding our 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 our 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 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 2015, 2014, or 2013, and we do not currently have any such arrangements.

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Contractual Obligations

The following table summarizes by years our contractual obligations and commercial commitments as of December 31, 2015 (not including related interest expense):

| | Payments Due by Periods | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 Year | 1 – 3 Years | 3 -5 Years | More than 5 Years |
| Long-Term Debt(1) | $3,711,224 | $231,952 | $1,855,612 | $1,623,660 | $ - |
| Revolving Line of Credit(2) | - | - | - | - | - |
| Capital Lease Obligation(3) | 152,083 | 71,686 | 79,397 | - | - |
| Operating Leases(4) | 12,930,366 | 3,685,292 | 5,066,778 | 2,993,286 | 1,185,010 |
| Total Contractual Obligations | $16,793,673 | $3,988,930 | $7,001,787 | $4,616,946 | $1,185,010 |

(1) Our stock purchase loan from Bank of Texas matures September 2020.
(2) Our line of credit from Bank of Texas matures September 2017.
(3) Our capital lease obligation with Cisco Systems Capital Corporation matures January 2017.
(4) These are our leased store 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 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 carrying value. As of December 31, 2015, we determined that the present value of the discounted estimated future cash flows of the operating divisions associated with the goodwill is sufficient to support their respective goodwill balances. If actual financial performance of these divisions differs 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," "e "intend," "plan," "estimate," "anticipate," "believe," "project," "budget," "potential," or "continue," and similar expressions 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. Factors that could cause our actual results to differ materially from the results contemplated by such forward-looking statements include, but are not limited to, 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 currency 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 foreign subsidiaries as those subsidiaries have local currency revenue and local currency operating expenses. Changes in the foreign currency exchange rates impact the U.S. dollar amount of revenue and expenses. See Note 12 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 our outstanding debt at December 31, 2015 which accrue interest at a rate that changes with fluctuations in the LIBOR rate. Based on the Company's level of debt at December 31, 2015, increase of one percent in the LIBOR rate would result in additional interest expense of approximately $38,000 during a twelve-month period.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Tandy Leather Factory, Inc.
Consolidated Balance Sheets
December 31, 2015 and 2014

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash | $10,962,615 | $10,636,530 |
| Accounts receivable-trade, net of allowance for doubtful accounts | | |
| of $1,746 and $395 in 2015 and 2014, respectively | 553,206 | 625,054 |
| Inventory | 33,584,539 | 32,875,492 |
| Prepaid income taxes | 549,277 | 336,828 |
| Deferred income taxes | 326,830 | 371,491 |
| Prepaid expenses | 1,514,887 | 1,348,652 |
| Other current assets | 70,197 | 157,758 |
| Total current assets | 47,561,551 | 46,351,805 |
| | | |
| PROPERTY AND EQUIPMENT, at cost | 23,992,208 | 22,199,943 |
| Less accumulated depreciation and amortization | (8,297,155) | (7,037,665) |
| | 15,695,053 | 15,162,278 |
| | | |
| GOODWILL | 953,356 | 971,786 |
| OTHER INTANGIBLES, net of accumulated amortization of | | |
| $702,000 and $665,000 in 2015 and 2014, respectively | 27,282 | 58,026 |
| OTHER assets | 329,684 | 329,979 |
| Total Assets | $64,566,926 | $62,873,874 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable-trade | $1,983,376 | $1,255,218 |
| Accrued expenses and other liabilities | 6,045,552 | 5,394,514 |
| Current maturities of capital lease obligations | 72,686 | - |
| Current maturities of long-term debt | 231,952 | 3,702,500 |
| Total current liabilities | 8,333,566 | 10,352,232 |
| | | |
| DEFERRED INCOME TAXES | 1,702,515 | 1,458,005 |
| | | |
| LONG-TERM DEBT, net of current maturities | 3,479,273 | 1,940,625 |
| CAPITAL LEASE OBLIGATIONS, net of current maturities | 79,396 | - |
| COMMITMENTS AND CONTINGENCIES | - | - |
| | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, $0.10 par value; 20,000,000 shares | | |

| | | |
|---|---|---|
| authorized, none issued or outstanding | - | - |
| Common stock, $0.0024 par value; 25,000,000 shares authorized; 11,275,641 and 11,239,157 shares issued at 2015 and 2014, respectively; 9,753,293 and 10,245,534 shares outstanding at 2015 and 2014, respectively | 27,062 | 26,984 |
| Paid-in capital | 6,168,489 | 6,013,325 |
| Retained earnings | 53,067,234 | 46,664,829 |
| Treasury stock at cost (1,522,348 and 993,623 shares at 2015 and 2014, respectively) | (6,602,930) | (2,894,068) |
| Accumulated other comprehensive income | (1,687,679) | (688,058) |
| Total stockholders' equity | 50,972,176 | 49,123,012 |
| Total Liabilities and Stockholders' Equity | $64,566,926 | $62,873,874 |

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Income
For the Years Ended December 31, 2015, 2014, and 2013

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| NET SALES | $84,161,200 | $83,430,912 | $78,284,585 |
| COST OF SALES | 32,090,140 | 31,306,155 | 28,956,561 |
| Gross Profit | 52,071,060 | 52,124,757 | 49,328,024 |
| | | | |
| OPERATING EXPENSES | 41,596,360 | 40,166,728 | 38,061,234 |
| INCOME FROM OPERATIONS | 10,474,700 | 11,958,029 | 11,266,790 |
| | | | |
| OTHER (INCOME) EXPENSE: | | | |
| Interest expense | 330,004 | 225,584 | 206,763 |
| Other, net | (74,357) | (75,165) | (160,732) |
| Total other expense | 255,647 | 150,419 | 46,031 |
| | | | |
| INCOME BEFORE NCOME TAXES | 10,219,053 | 11,807,610 | 11,220,759 |
| | | | |
| PROVISION FOR INCOME TAXES | 3,816,648 | 4,100,689 | 3,955,042 |
| | | | |
| NET INCOME | $6,402,405 | $7,706,921 | $7,265,717 |
| | | | |
| NET INCOME PER COMMON SHARE: | | | |
| BASIC | $0.64 | $0.76 | $0.71 |
| DILUTED | $0.63 | $0.75 | $0.71 |
| | | | |
| Weighted Average Number of Shares Outstanding: | | | |
| Basic | 10,177,506 | 10,203,063 | 10,176,492 |
| Diluted | 10,102,760 | 10,241,121 | 10,216,438 |

Tandy Leather Factory, Inc.
Consolidated Statements of Comprehensive Income
For the Years Ended December 31, 2015, 2014, and 2013

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| NET INCOME | $6,402,405 | $7,706,921 | $7,265,717 |
| Foreign currency translation adjustments | (999,621) | (776,307) | (290,678) |
| COMPREHENSIVE INCOME | $5,402,784 | $6,930,614 | $6,975,039 |

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2015, 2014, and 2013

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $6,402,405 | $7,706,921 | $7,265,717 |
| Adjustments to reconcile net income to net cash provided by operating activities - | | | |
| Depreciation and amortization | 1,567,172 | 1,436,624 | 1,194,612 |
| Loss on disposal or abandonment of assets | 31,064 | 18,820 | 109,222 |
| Non-cash stock-based compensation | 145,322 | 67,818 | 11,686 |
| Deferred income taxes | 289,171 | 183,490 | 445,977 |
| Foreign currency translation | (896,928) | (727,664) | (261,908) |
| Net changes in assets and liabilities, net of effect of business acquisitions: | | | |
| Accounts receivable-trade | 71,848 | 137,351 | 60,367 |
| Inventory | (709,047) | (6,574,662) | (438,046) |
| Prepaid expenses | 43,585 | 260,992 | (833,181) |
| Other current assets | 87,561 | 320,835 | (325,143) |
| Accounts payable-trade | 728,158 | (629,419) | 272,010 |
| Accrued expenses and other liabilities | 651,038 | (414,368) | (119,916) |
| Income taxes | (212,449) | (609,026) | 158,493 |
| Total adjustments | 1,796,495 | (6,529,209) | 274,173 |
| Net cash provided by operating activities | 8,198,900 | 1,177,712 | 7,539,890 |
| | | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of property and equipment | (2,164,040) | (2,204,190) | (3,770,022) |
| Purchase of intangible property | (10,000) | - | - |
| Proceeds from sale of assets | 11,662 | 20,936 | 5,343 |
| Decrease (increase) in other assets | 295 | 11,980 | (5,264) |
| Net cash used in investing activities | (2,162,083) | (2,171,274) | (3,769,943) |
| | | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net increase (decrease) in revolving credit loans | (3,500,000) | 3,500,000 | - |
| Proceeds from notes payable and long term debt | 3,711,225 | - | - |
| Payments on notes payable and long-term debt | (2,143,125) | (455,625) | (506,250) |
| Payments on capital lease obligations | (79,890) | - | - |
| Repurchase of common stock (treasury stock) | (3,708,862) | - | - |
| Payment of cash dividend | - | (2,549,684) | - |
| Proceeds from issuance of common stock | 9,920 | 52,722 | 113,800 |
| Net cash provided by (used in) financing activities | (5,710,732) | 547,413 | |