TANDY LEATHER FACTORY INC
Form 10-Q
May 14, 2013

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

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

or

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

For the transition period from _________ to __________

Commission File Number 1-12368

TANDY LEATHER FACTORY, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	75-2543540
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Check one: Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

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

Class	Shares outstanding as of May 10, 2013
Common Stock, par value $0.0024 per share	10,162,442

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

	March 31, 2013 (unaudited)	December 31, 2012 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	$7,164,181	$7,705,182
Accounts receivable-trade, net of allowance for doubtful accounts of $36,000 and $112,000 in 2013 and 2012, respectively	934,893	822,772
Inventory	25,358,992	25,862,784
Deferred income taxes	305,374	349,478
Prepaid expenses	1,390,761	776,463
Other current assets	416,734	153,450
Total current assets	35,570,935	35,670,129
PROPERTY AND EQUIPMENT, at cost	18,425,394	17,574,895
Less accumulated depreciation and amortization	(5,782,069)	(5,630,305)
	12,643,325	11,944,590
GOODWILL	987,539	990,725
OTHER INTANGIBLES, net of accumulated amortization of $590,000 and $582,000 in 2013 and 2012, respectively	137,006	145,533
OTHER assets	339,819	336,695
TOTAL ASSETS	$49,678,624	$49,087,672
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	$1,775,892	$1,612,627
Accrued expenses and other liabilities	4,481,271	5,928,798
Income taxes payable	633,962	113,705
Current maturities of long-term debt	202,500	202,500
Total current liabilities	7,093,625	7,857,630
DEFERRED INCOME TAXES	808,294	806,525
LONG-TERM DEBT, net of current maturities	2,851,875	2,902,500
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.10 par value; 20,000,000 shares authorized; none issued or outstanding; attributes to be determined on issuance	-	-

Common stock, $0.0024 par value; 25,000,000 shares authorized; 11,150,065 shares issued at 2013 and 2012; 10,162,442 shares outstanding at 2013 and 2012	26,775	26,775
Paid-in capital	5,773,351	5,767,508
Retained earnings	35,828,196	34,241,875
Treasury stock at cost (993,623 shares at 2013 and 2012)	(2,894,068)	(2,894,068)
Accumulated other comprehensive income	190,576	378,927
Total stockholders' equity	38,924,830	37,521,017
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$49,678,624	$49,087,672

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Income
(Unaudited)
For the Three Months Ended March 31, 2013 and 2012

	2013	2012
NET SALES	$19,237,827	$18,177,078
COST OF SALES	7,306,998	6,811,445
Gross profit	11,930,829	11,365,633
OPERATING EXPENSES	9,309,969	8,811,458
INCOME FROM OPERATIONS	2,620,860	2,554,175
OTHER (INCOME) EXPENSE:		
Interest expense	56,094	58,392
Other, net	(26,739)	(19,814)
Total other (income) expense	29,355	38,578
INCOME BEFORE INCOME TAXES	2,591,505	2,515,597
PROVISION FOR INCOME TAXES	1,005,184	941,492
NET INCOME	$1,586,321	$1,574,105
NET INCOME PER COMMON SHARE:		
BASIC	$0.16	$0.15
DILUTED	$0.16	$0.15
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
BASIC	10,162,442	10,156,442
DILUTED	10,194,219	10,172,950

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Comprehensive Income
(Unaudited)
For the Three Months Ended March 31, 2013 and 2012

	2013	2012
NET INCOME	$1,586,321	$1,574,105
Foreign currency translation adjustments, net of tax	(188,351)	91,620
COMPREHENSIVE INCOME	$1,397,970	$1,665,725

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Cash Flows
(Unaudited)
For the Three Months Ended March 31, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,586,321	$1,574,105
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	263,102	259,536
Loss on disposal or abandonment of assets	21,003	624
Non-cash stock-based compensation	5,843	5,000
Deferred income taxes	45,873	(56,199)
Other	(176,925)	80,297
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(112,121)	(120,578)
Inventory	503,792	(4,151,774)
Prepaid expenses	(614,298)	(522,700)
Other current assets	(263,284)	68,331
Accounts payable-trade	163,265	725,114
Accrued expenses and other liabilities	(1,447,527)	28,725
Income taxes payable	520,257	157,769
Total adjustments	(1,091,020)	(3,525,855)
Net cash provided by (used in) operating activities	495,301	(1,951,750)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(982,553)	(139,841)
Proceeds from maturities of certificates of deposit	-	336,000
Proceeds from sale of assets	-	1,395
Decrease (increase) in other assets	(3,124)	6,620
Net cash provided by (used in) investing activities	(985,677)	204,174
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on notes payable and long-term debt	(50,625)	(50,625)
Payment of cash dividend	-	(2,536,131)
Net cash used in financing activities	(50,625)	(2,586,756)
NET DECREASE IN CASH	(541,001)	(4,334,332)
CASH, beginning of period	7,705,182	10,765,591
CASH, end of period	$7,164,181	$6,431,259
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid during the period	$56,094	$58,392
Income tax paid during the period, net of (refunds)	$384,652	$860,843

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

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Tandy Leather Factory, Inc.
Consolidated Statements of Stockholders' Equity
(Unaudited)
For the Three Months Ended March 31, 2013 and 2012

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2011	10,156,442	$26,760	$5,736,543	$(2,894,068)	$31,181,936	$382,630	$34,433,801
Stock-based compensation	-	-	5,000	-	-	-	5,000
Net income	-	-	-	-	1,574,105	-	1,574,105
Cash dividend	-	-	-	-	(2,536,131)	-	(2,536,131)
Translation adjustment	-	-	-	-	-	91,620	91,620
BALANCE, March 31, 2012	10,156,442	$26,760	$5,741,543	$(2,894,068)	$30,219,910	$474,250	$33,568,395

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2012	10,162,442	$26,775	$5,767,508	$(2,894,068)	$34,241,875	$378,927	$37,521,017
Stock-based compensation	-	-	5,843	-	-	-	5,843
Net income	-	-	-	-	1,586,321	-	1,586,321
Translation adjustment	-	-	-	-	-	(188,351)	(188,351)
BALANCE, March 31, 2013	10,162,442	$26,775	$5,773,351	$(2,894,068)	$35,828,196	$190,576	$38,924,830

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

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TANDY LEATHER FACTORY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

In the opinion of management, the accompanying consolidated financial statements for Tandy Leather Factory, Inc. and its consolidated subsidiaries contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly its financial position as of March 31, 2013 and December 31, 2012, and its results of operations and cash flows for the three-month periods ended March 31, 2013 and 2012. Operating results for the three-month period ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

Certain reclassifications have been made to the 2012 financial statements to conform to the 2013 presentation.

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

The components of inventory consist of the following:

	As of	
	March 31, 2013	December 31, 2012
Inventory on hand:		
Finished goods held for sale	$23,226,414	$24,039,846
Raw materials and work in process	678,696	495,182
Inventory in transit	1,453,882	1,327,756
	$25,358,992	$25,862,784

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

A two-step process is used to test for goodwill impairment. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2012, management determined that the present value of the discounted estimated future cash flows of the stores associated with the goodwill is sufficient to support their respective goodwill balances. No indicators of impairment were identified during the first quarter of 2013.

A summary of changes in our goodwill for the periods ended March 31, 2013 and 2012 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2011	$603,603	$383,406	$987,009
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	2,936	-	2,936
Impairments	-	-	-
Balance, March 31, 2012	$606,539	$383,406	$989,945
	Leather Factory	Tandy Leather	Total
Balance, December 31, 2012	$607,319	$383,406	$990,725
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(3,186)	-	(3,186)
Impairments	-	-	-
Balance, March 31, 2013	$604,133	$383,406	$987,539

Other intangibles consist of the following:

	As of March 31, 2013			As of December 31, 2012		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Trademarks, Copyrights	$544,369	$464,613	$79,756	$544,369	$456,836	$87,533
Non-Compete Agreements	182,487	125,237	57,250	183,216	125,216	58,000
	$726,856	$589,850	$137,006	$727,585	$582,052	$145,533

We recorded amortization expense of $8,526 during the first quarter of 2013 compared to $11,327 during the first quarter of 2012. All of our intangible assets, other than goodwill, are subject to amortization under U.S. GAAP. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding 5 years is as follows:

	Wholesale Leathercraft	Retail Leathercraft	Total
2013	$768	$33,337	$34,105
2014	455	33,337	33,792
2015	-	28,635	28,635
2016	-	2,000	2,000
2017	-	-	-

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

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

Comprehensive Income (loss) and Accumulated Other Comprehensive Income (loss). Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-stockholder sources and includes all changes in equity during a period except those resulting from investments by and dividends to stockholders. Our comprehensive income (loss) consists of our net income and foreign currency translation adjustments from our international operations.

Recent Accounting Pronouncements. In February 2013, FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The objective of ASU 2013-02 is to improve reporting by requiring entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the statement of operations. The amendments in ASU 2013-02 are required to be applied retrospectively and are effective for reporting periods beginning after December 15, 2012. The adoption of the standard did not have any impact on our consolidated financial statements.

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2. NOTES PAYABLE AND LONG-TERM DEBT

On July 31, 2007, we entered into a Credit Agreement and Line of Credit Note with JPMorgan Chase Bank, N.A., pursuant to which the bank agreed to provide us with a credit facility of up to $5,500,000 to facilitate our purchase of real estate consisting of a 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. On April 30, 2008, the principal balance was rolled into a 10-year term note with an interest rate of 7.10% per annum.

At March 31, 2013 and December 31, 2012, the amount outstanding under the above agreement consisted of the following:

	March 31, 2013	December 31, 2012
Credit Agreement with JPMorgan Chase Bank – collateralized by real estate; payable as follows:		
Line of Credit Note dated July 31, 2007, converted to a 10-year term note on April 30, 2008; $16,875 monthly principal payments plus interest at 7.1% per annum; matures April 30, 2018	$ 3,054,375	$3,105,000
	3,054,375	3,105,000
Less - Current maturities	(202,500)	(202,500)
	$2,851,875	$2,902,500

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. The revolver bears interest at LIBOR plus 2% (2.20% at March 31, 2013) and matures on June 30, 2013. Interest is paid monthly. The note was obtained for working capital purposes. The unused amount is March 31, 2013 is $4 million.

3. STOCK-BASED COMPENSATION

We have one stock option plan which provides for annual stock option grants to non-employee directors with an exercise price equal to the fair market value of the shares at the date of grant. Under this plan, 12,000 options were awarded to directors for each of the three month periods ended March 31, 2013 and 2012. These options vest and become exercisable six months from the option grant date. We had two other stock option plans from 1995 which provided for stock option grants to officers, key employees and non-employee directors. These plans expired in 2005. The expiration of the plans has no effect on the options previously granted. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our common stock on the date the option was granted and no option has a term in excess of ten years. We recognized share based compensation expense of $5,843 and $5,000 for the quarters ended March 31, 2013 and 2012, respectively, as a component of operating expenses. During the three months ended March 31, 2013 and 2012, the stock option activity under our stock option plans was as follows:

	Weighted Average Exercise Price	# of shares	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding, January 1, 2012	$4.40	115,600		

Granted	5.27	12,000		
Cancelled	-	-		
Exercised	-	-		
Outstanding, March 31, 2012	$4.48	127,600	5.38	$216,332
Exercisable, March 31, 2012	$4.40	115,600	4.90	$206,332
Outstanding, January 1, 2013	$4.53	121,600		
Granted	6.87	12,000		
Cancelled	-	-		
Exercised	-	-		
Outstanding, March 31, 2013	$4.74	133,600	4.97	$218,446
Exercisable, March 31, 2013	$4.53	121,600	4.83	$206,760

Other information pertaining to option activity during the three-month periods ended March 31, 2013 and 2012 are as follows:

	March 31, 2013	March 31, 2012
Weighted average grant-date fair value of stock options granted	$11,686	$10,000
Total fair value of stock options vested	N/A	N/A
Total intrinsic value of stock options exercised	N/A	N/A

The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2013	2012
Volatility	19.1%	21.4%
Expected option life	3 years	3 years
Interest rate (risk free)	0.80%	0.875%
Dividends	None	None

As of March 31, 2013 and 2012, there was unrecognized compensation cost related to non-vested stock options of $5,843 and $5,000, respectively.

4. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for the three months ended March 31, 2013 and 2012:

	2013	2012
Net income	$1,586,321	$1,574,105
Numerator for basic and diluted earnings per share	$1,586,321	$1,574,105
Denominator for basic earnings per share – weighted-average shares	10,162,442	10,156,442

Effect of dilutive securities:		
Stock options	31,777	16,508
Warrants	-	-
Dilutive potential common shares	31,777	16,508
Denominator for diluted earnings per share – weighted-average shares	10,194,219	10,172,950
Basic earnings per share	$0.16	$0.15
Diluted earnings per share	$0.16	$0.15

The net effect of converting stock options and warrants to purchase 121,600 and 115,600 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the quarters ended March 31, 2013 and 2012, respectively.

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5. CASH DIVIDEND

In February 2012, our Board of Directors authorized a $0.25 per share special one-time cash dividend that was paid to stockholders of record at the close of business on March 1, 2012. We released the funds used to pay for the special one-time cash dividend on March 29, 2012 and the dividend, totaling $2.5 million, was paid to stockholders on April 2, 2012. Our Board will determine future cash dividends after giving consideration to our then existing levels of profit and cash flow, capital requirements, current and forecasted liquidity, as well as financial and other business conditions existing at the time.

6. COMMITMENTS AND CONTINGENCIES

Legal Proceedings. On March 16, 2011, two former employees of ours filed a lawsuit, entitled Mark Barnes and Jerry Mercante on behalf of themselves and all other similarly situated v. Tandy Leather Company, Inc., Tandy Leather Factory, and Does 1-50, in the US District Court for the District of Nevada. The lawsuit was subsequently amended on May 9, 2011 to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleges that we violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs seek to represent themselves and all similarly situated U.S. current and former store managers of ours. Plaintiffs seek reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, attorneys' fees and costs. On May 17, 2011, the district court in Nevada granted our request to transfer venue to the Northern District of Texas.

On September 24, 2012, an agreement was reached and preliminarily approved by the United States District Court, Northern District of Texas, Fort Worth Division, to settle all federal and state claims asserted by the plaintiffs (the "Settlement Agreement"). At all times during the pendency of this litigation, we have vigorously denied all of the plaintiffs' allegations. As part of the settlement, we continue to deny any violation of any statute, law, rule or regulation, any liability or wrongdoing, and the truth of all of the plaintiffs' allegations. We have agreed to enter into the Settlement Agreement to avoid further expense and inconvenience, end the disruption and burden of the litigation, avoid any other present or future litigation arising out of the facts that gave rise to the litigation, avoid the risk inherent in uncertain complex litigation, and put to rest the controversy underlying the litigation.

The Settlement Agreement required us to establish a $993,386 escrow account to fund (1) settlement payments to the plaintiffs, (2) settlement payments to the other members of the settlement class who join the class action, (3) attorneys' fees and expenses, and (4) escrow agent fees and expenses. The plaintiffs and each other member of the settlement class who joins the class action release any and all claims against us related to the conduct alleged by the plaintiffs in the class action suit. The Settlement Agreement includes a formula to determine the amount of settlement payments payable to each claimant. If the aggregate amount of settlement payments determined by such formula exceeds the remaining balance in the escrow fund, we will have no further liability. Instead, the amount of settlement payments payable to the claimants will be reduced proportionately. To the extent that any funds remain in the escrow fund after payment of all required claims, fees and expenses, the remaining funds will be returned to us. The foregoing description is not complete and is qualified in its entirety by reference to the full text of the Settlement Agreement which was attached as Exhibit 10.1 to a Current Report on Form 8-K, as filed with the Securities and Exchange Commission on October 1, 2012.

A Fairness Hearing was held on February 11, 2013, to make final determinations as to whether the settlement described in the Settlement Agreement is fair, reasonable and adequate, whether it should be finally approved by the Court, and whether an Order and Final Judgment should be issued dismissing the lawsuit with prejudice. At the hearing, the Court expressed concern regarding certain aspects of communications to the potential opt in class members, and therefore, delayed ruling on the final approval of the settlement and dismissal of the case. The Court directed class counsel to prepare correspondence to be submitted and approved by the Court and then to be resubmitted to the remaining potential opt in class members before the Court makes a final ruling on the fairness of the settlement and issuance of an order of final dismissal. Said correspondence was mailed to the remaining potential opt in class members on April 23, 2013. Based on the Court's earlier Order Preliminarily Approving the Settlement, we are optimistic that the Court will ultimately issue a Final Order approving the settlement and dismissing the case with prejudice.

In connection with the settlement, we recorded a charge to operations of $993,386 during the quarter ended September 30, 2012 as this amount, as ordered by the court, will cover the full settlement of all claims of opt in claimants, class counsels' attorneys' fees, and class administration costs in accordance with the terms of the agreement.

We are periodically involved in various other litigation that arises in the ordinary course of business and operations. There are no such matters pending that we expect to have a material impact on our financial position and operating results. Legal costs associated with the resolution of claims, lawsuits and other contingencies are expensed as incurred.

8. SEGMENT INFORMATION

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

a. Wholesale Leathercraft, which consists of a chain of wholesale stores operating under the name, The Leather Factory, located in North America;

b. Retail Leathercraft, which consists of a chain of retail stores operating under the name, Tandy Leather Company, located in North America; and

c. International Leathercraft, which sells to both wholesale and retail customers. We have three stores operating in this segment: one in Northampton, United Kingdom which opened in February 2008, one in Sydney, Australia which opened in October 2011, and one in Jerez, Spain, which opened in January 2012. These stores carry the same products as our North American stores.

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

	Wholesale Leathercraft	Retail Leathercraft	Int'l Leathercraft	Total
For the quarter ended March 31, 2013				
Net sales	$6,729,734	$11,559,861	$948,232	$19,237,827
Gross profit	4,165,155	7,161,228	604,446	11,930,829
Income from operations	1,012,965	1,514,839	93,056	2,620,860
Interest expense	56,094	-	-	56,094
Other, net	(14,493)	(10)	(12,236)	(26,739)
Income before income taxes	971,364	1,514,849	105,292	2,591,505
Depreciation and amortization	191,533	57,429	14,140	263,102
Fixed asset additions	738,736	242,149	1,668	982,553
Total assets	$36,244,560	$10,474,588	$2,959,476	$49,678,624
For the quarter ended March 31, 2012				
Net sales	$7,152,417	$10,282,814	$741,847	$18,177,078
Gross profit	4,529,683	6,372,144	463,806	11,365,633
Income from operations	1,232,852	1,358,725	(37,402)	2,554,175

Interest expense	58,392	-	-	58,392
Other, net	(16,048)	(13)	(3,753)	(19,814)
Income before income taxes	1,190,508	1,358,738	(33,649)	2,515,597
Depreciation and amortization	203,690	43,451	12,395	259,536
Fixed asset additions	31,626	54,754	53,461	139,841
Total assets	$34,422,385	$8,509,506	$2,543,725	$45,475,616

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Net sales for geographic areas were as follows for the three months ended March 31, 2013 and 2012:

	2013	2012
United States	$16,196,394	$15,527,455
Canada	1,919,723	1,719,840
All other countries	1,121,710	929,783
	$19,237,827	$18,177,078

Geographic sales information is based on the location of the customer. No single foreign country, except for Canada, accounted for any material amount of our consolidated net sales for the three-month periods ended March 31, 2013 and 2012. We do not have any significant long-lived assets outside of the United States.

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

Our Business

We are the world's largest specialty retailer and wholesale distributor of leather and leathercraft related items. We market our products to our growing list of customers through company-owned retail and wholesale stores. We are a Delaware corporation, and our common stock trades on the NASDAQ Global Market under the symbol "TLF." We operate our business in three segments: Wholesale Leathercraft, which operates wholesale stores in North America under the trade name, The Leather Factory, Retail Leathercraft, which operates retail stores in North America under the trade name, Tandy Leather Company, and International Leathercraft, which operates combination retail/wholesale stores outside of North America under the trade name, Tandy Leather Factory. See Note 7 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

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

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 37 states and six Canadian provinces. Tandy Leather Company, one of the oldest and one of the best-known suppliers of leather and related supplies used in the leathercraft industry, has been a primary leathercraft resource for decades. Tandy Leather Company's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather Company's industry presence by opening retail stores. As of May 1, 2013, we were operating 78 Tandy Leather Company retail stores located throughout the United States and Canada.

Our International Leathercraft segment operates 3 company-owned stores, all located outside of North America. These stores operate as combination retail / wholesale stores and consist of one store in Northampton, United Kingdom, one store in Sydney, Australia, and one store in Jerez, Spain. We expect to continue opening international stores in the future, but do not intend to open any new stores in 2013.

Critical Accounting Policies

A description of our critical accounting policies appears in Item 7 "Management's Discussions and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Forward-Looking Statements

Certain statements contained in this report and other materials we file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made or to be made by us, other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally are accompanied by words such as “may,” “will,” “could,” “should,” “anticipate,” “believe,” “budgeted,” “intend,” “plan,” “project,” “potential,” “estimate,” “continue,” or “future” variations thereof or other similar statements. Th certain important risks that could cause results to differ materially from those anticipated by some of the forward-looking statements. Some, but not all, of the important risks, including those described below, could cause actual results to differ materially from those suggested by the forward-looking statements. Please refer also to our Annual Report on Form 10-K for fiscal year ended December 31, 2012 for additional information concerning these and other uncertainties that could negatively impact the Company.

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

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also small businesses and other retailers. Specialty retail, and retail in general, is heavily influenced by general economic cycles. Purchases of non-essential products tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. During periods of economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, open and operate new stores, maintain sales levels at our existing stores, maintain or increase our international operations on a profitable basis, or maintain our earnings from operations as a percentage of net sales. The United States and global economies have suffered from economic uncertainty for the past several years. Consumer spending in the United States appears to have stabilized recently, but 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.

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

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

Ø 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 segment by opening store 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. 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 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 cannot be sure that we can successfully open new stores or that our new stores will be profitable.

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.

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

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Results of Operations

The following tables present selected financial data of each of our three segments for the quarters ended March 31, 2013 and 2012.

	Quarter Ended March 31, 2013		Quarter Ended March 31, 2012	
	Sales	Income from Operations	Sales	Income from Operations
Wholesale Leathercraft	$6,729,734	$1,012,965	$7,152,417	$1,232,852
Retail Leathercraft	11,559,861	1,514,839	10,282,814	1,358,725
Int'l Leathercraft	948,232	93,056	741,847	(37,402)
Total Operations	$19,237,827	$2,620,860	$18,177,078	$2,554,175

Consolidated net sales for the quarter ended March 31, 2013 increased $1.1 million, or 5.8%, compared to the same period in 2012. International Leathercraft reported the largest sales gain of 27.8%, followed by Retail Leathercraft, reporting a sales gain of 12.4%. Wholesale Leathercraft reported a sales decrease of 5.9% due to the continued decline in sales to our National Account customers as a result of the elimination of certain products that have not historically produced an acceptable gross profit margin. Income from operations on a consolidated basis for the quarter ended March 31, 2013 was up 2.6%, or $67,000, from the first quarter of 2012.

The following table shows in comparative form our consolidated net income for the first quarters of 2013 and 2012:

	2013	2012	% change
Net income	$1,586,321	$1,574,105	0.8%

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

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 29 wholesale stores and our National Account sales group. The National Account sales group's customers consist of national craft chains only. The following table presents the combined sales mix by customer categories for the quarters ended March 31, 2013 and 2012:

	Quarter ended	
Customer Group	03/31/13	03/31/12
RETAIL (end users, consumers, individuals)	35%	30%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	6%	4%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	46%	45%
MANUFACTURERS	7%	7%
NATIONAL ACCOUNTS	6%	14%
	100%	100%

Net sales decreased 5.9%, or $423,000, for the first quarter of 2013 compared to the first quarter of 2012 as follows:

	# Stores	Qtr Ended 03/31/13	# Stores	Qtr Ended 03/31/12	$ Change	% Change
Same store sales	29	$6,444,321	29	$6,340,785	$103,536	1.6%

National account group	285,413	811,632	(526,219)	(64.8)%