

TANDY LEATHER FACTORY INC
Form 10-Q
August 11, 2009

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

(Mark One)

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

For the quarterly period ended June 30, 2009

or

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

For the transition period from _____ to _____

Commission File Number 1-12368

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

Delaware
(State or other jurisdiction of
incorporation or organization)

75-2543540
(IRS Employer Identification Number)

1900 Southeast Loop 820, Fort Worth, Texas 76140
(Address of principal executive offices) (Zip Code)

(817) 872-3200
(Registrant's telephone number, including area code)

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

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

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

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

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

| Class | Shares outstanding as of August 10, 2009 |
|--|--|
| Common Stock, par value \$0.0024 per share | 10,664,328 |

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

| | June 30, 2009 (unaudited) | December 31, 2008 (audited) |
|---|---------------------------------|-----------------------------------|
| CURRENT ASSETS: | | |
| Cash | \$5,618,813 | \$7,810,298 |
| Short-term investments, including certificates of deposit | 5,572,000 | 3,011,000 |
| Accounts receivable-trade, net of allowance for doubtful accounts of \$35,000 and \$43,000 in 2009 and 2008, respectively | 1,657,816 | 1,180,349 |
| Inventory | 15,789,292 | 16,011,147 |
| Deferred income taxes | 229,162 | 229,501 |
| Other current assets | 1,072,512 | 777,550 |
| Total current assets | 29,939,595 | 29,019,845 |
| PROPERTY AND EQUIPMENT, at cost | 15,807,808 | 15,340,732 |
| Less accumulated depreciation and amortization | (5,570,565) | (5,019,885) |
| | 10,237,243 | 10,320,847 |
| GOODWILL | 971,464 | 966,655 |
| OTHER INTANGIBLES, net of accumulated amortization of \$392,000 and \$367,000 in 2009 and 2008, respectively | 330,856 | 355,492 |
| OTHER assets | 312,022 | 313,074 |
| | \$41,791,180 | \$40,975,913 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable-trade | \$1,514,288 | \$1,148,577 |
| Accrued expenses and other liabilities | 2,979,974 | 3,182,194 |
| Income taxes payable | 53,805 | 271,122 |
| Current maturities of capital lease obligation | - | 265,111 |
| Current maturities of long-term debt | 202,500 | 202,500 |
| Total current liabilities | 4,750,567 | 5,069,504 |
| DEFERRED INCOME TAXES | 644,896 | 600,309 |
| LONG-TERM DEBT, net of current maturities | 3,611,250 | 3,712,500 |
| CAPITAL LEASE OBLIGATION, net of current maturities | - | 328,838 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY: | | |

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| | | |
|---|---------------------|---------------------|
| 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; | | |
| 11,019,951 and 10,994,951 shares issued at 2009 and 2008; | | |
| 10,665,281 and 10,664,555 shares outstanding at 2009 and 2008, | 26,448 | 26,388 |
| Paid-in capital | 5,490,360 | 5,464,443 |
| Retained earnings | 28,101,021 | 26,641,853 |
| Treasury stock (354,670 and 330,396 shares at cost at 2009 and 2008)) | (893,282) | (828,385) |
| Accumulated other comprehensive income | 59,920 | (39,537) |
| Total stockholders' equity | 32,784,467 | 31,264,762 |
| | \$41,791,180 | \$40,975,913 |

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

Tandy Leather Factory, Inc.
Consolidated Statements of Income
(Unaudited)
For the Three and Six Months Ended June 30, 2009 and 2008

| | THREE MONTHS | | SIX MONTHS | |
|---|--------------|--------------|--------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| NET SALES | \$13,214,940 | \$13,847,964 | \$26,575,930 | \$27,108,124 |
| COST OF SALES | 5,473,058 | 5,836,312 | 11,017,602 | 11,355,450 |
| Gross profit | 7,741,882 | 8,011,652 | 15,558,328 | 15,752,674 |
| OPERATING EXPENSES | 6,599,484 | 6,920,134 | 13,378,621 | 13,939,773 |
| INCOME FROM OPERATIONS | 1,142,398 | 1,091,518 | 2,179,707 | 1,812,901 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (83,575) | (87,912) | (160,984) | (169,653) |
| Other, net | 142,915 | 26,293 | 220,187 | 306,683 |
| Total other income (expense) | 59,340 | (61,619) | 59,203 | 137,030 |
| INCOME BEFORE INCOME TAXES | 1,201,738 | 1,029,899 | 2,238,910 | 1,949,931 |
| PROVISION FOR INCOME TAXES | 440,487 | 374,649 | 779,742 | 710,183 |
| NET INCOME | \$761,251 | \$655,250 | \$1,459,168 | \$1,239,748 |
| NET INCOME PER COMMON SHARE-BASIC | \$ 0.07 | \$ 0.06 | \$ 0.14 | \$ 0.11 |
| NET INCOME PER COMMON SHARE-DILUTED | \$ 0.07 | \$ 0.06 | \$ 0.14 | \$ 0.11 |
| Weighted Average Number of Shares Outstanding: | | | | |
| Basic | 10,673,245 | 10,981,378 | 10,650,573 | 10,979,235 |
| Diluted | 10,731,998 | 11,076,340 | 10,705,871 | 11,072,102 |

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

Tandy Leather Factory, Inc.
Consolidated Statements of Cash Flows
(Unaudited)
For the Six Months Ended June 30, 2009 and 2008

| | 2009 | 2008 |
|---|-------------|-------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$1,459,168 | \$1,239,748 |
| Adjustments to reconcile net income to net cash provided by operating activities- | | |
| Depreciation & amortization | 561,253 | 509,324 |
| Loss on disposal of assets | - | 14,760 |
| Non-cash stock-based compensation | 2,540 | 15,250 |
| Deferred income taxes | 44,926 | 358,413 |
| Other | 84,037 | (36,354) |
| Net changes in assets and liabilities: | | |
| Accounts receivable-trade, net | (477,467) | 183,169 |
| Inventory | 221,855 | 2,162,406 |
| Income taxes | (217,317) | (184,140) |
| Other current assets | (294,962) | 262,063 |
| Accounts payable | 365,711 | 292,114 |
| Accrued expenses and other liabilities | (202,220) | 720,975 |
| Total adjustments | 88,356 | 4,297,980 |
| Net cash provided by operating activities | 1,547,524 | 5,537,728 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (442,402) | (3,098,638) |
| Purchase of certificates of deposit | (5,336,000) | (396,000) |
| Proceeds from maturities of certificates of deposit | 2,775,000 | - |
| Proceeds from sale of assets | - | 38,181 |
| Decrease (increase) in other assets | 1,052 | 721,907 |
| Net cash used in investing activities | (3,002,350) | (2,734,550) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on long-term debt and notes payable | (101,250) | (33,750) |
| Payments on capital lease obligations | (593,949) | (103,647) |
| Repurchase of common stock (treasury stock) | (64,897) | - |
| Proceeds from issuance of common stock | 23,437 | 13,500 |
| Net cash used in financing activities | (736,659) | (123,897) |
| NET CHANGE IN CASH | (2,191,485) | 2,679,281 |
| CASH, beginning of period | 7,810,298 | 6,310,396 |
| CASH, end of period | \$5,618,813 | \$8,989,677 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW
INFORMATION:

| | | |
|---|-----------|-----------|
| Interest paid during the period | \$160,487 | \$169,653 |
| Income taxes paid during the period, net of (refunds) | 884,425 | 534,957 |

NON-CASH INVESTING ACTIVITIES:

| | | |
|---|---|---------|
| Equipment acquired under capital lease financing arrangements | - | 803,712 |
|---|---|---------|

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

Tandy Leather Factory, Inc.
Consolidated Statements of Stockholders' Equity
(Unaudited)
For the Six Months Ended June 30, 2009 and 2008

| | Number of Shares | Par Value | Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|---|---------------------|--------------|--------------------|-------------------|----------------------|--|--------------|--------------------------------|
| BALANCE, December 31, 2007 | 10,977,092 | \$26,359 | \$5,419,477 | \$(25,487) | \$24,037,672 | \$357,483 | \$29,815,504 | |
| Shares issued - stock options and warrants exercised | 10,000 | 24 | 13,476 | - | - | - | 13,500 | |
| Stock-based compensation | - | - | 15,250 | - | - | - | 15,250 | |
| Net income | - | - | - | - | 1,239,748 | - | 1,239,748 | \$1,239,748 |
| Translation adjustment | - | - | - | - | - | (39,362) | (39,362) | (39,362) |
| BALANCE, June 30, 2008 | 10,987,092 | \$26,383 | \$5,448,203 | \$(25,487) | \$25,277,420 | \$318,121 | \$31,044,640 | |

Comprehensive income for the six months ended June 30, 2008 \$1,200,386

| | | | | | | | | |
|--|------------|----------|-------------|-------------|--------------|------------|--------------|-------------|
| BALANCE, December 31, 2008 | 10,664,555 | \$26,388 | \$5,464,443 | \$(828,385) | \$26,641,853 | \$(39,537) | \$31,264,762 | |
| Shares issued - stock options exercised | 25,000 | 60 | 23,377 | - | - | - | 23,437 | |
| Purchase of treasury stock | (24,274) | - | - | (64,897) | - | - | (64,897) | |
| Stock-based compensation | - | - | 2,540 | - | - | - | 2,540 | |
| Net income | - | - | - | - | 1,459,168 | - | 1,459,168 | \$1,459,168 |
| Translation adjustment | - | - | - | - | - | 99,457 | 99,457 | 99,457 |
| BALANCE, June 30, 2009 | 10,665,281 | \$26,448 | \$5,490,360 | \$(893,282) | \$28,101,021 | \$59,920 | \$32,784,467 | |

Comprehensive income for the six months ended June 30, 2009 \$1,558,625

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

These financial statements include the accounts of Tandy Leather Factory, Inc. and its subsidiaries. Unless the context indicates otherwise, references to “we”, “us”, and “our” refer to the consolidated operations of Tandy Leather Factory, Inc. and its subsidiaries. In the opinion of management, the accompanying consolidated financial statements for Tandy Leather Factory, Inc. and its consolidated subsidiaries contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly its financial position as of June 30, 2009 and December 31, 2008, and its results of operations and cash flows for the three and/or six-month periods ended June 30, 2009 and 2008. Operating results for the three and six-month periods ended June 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2009. 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, 2008.

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

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

The components of inventory consist of the following:

| | As of | |
|-----------------------------------|---------------------|---------------------|
| | June 30, 2009 | December 31, 2008 |
| Inventory on hand: | | |
| Finished goods held for sale | \$14,402,833 | \$14,867,830 |
| Raw materials and work in process | 591,329 | 415,644 |
| Inventory in transit | 795,130 | 727,673 |
| | \$15,789,292 | \$16,011,147 |

Goodwill and Other Intangibles. Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets, prescribes a two-phase process for impairment testing of goodwill, which is performed once annually, absent indicators of impairment during the interim. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. We have elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2008, management determined that the present value of the discounted estimated future cash flows of the stores associated with the goodwill is sufficient to support their respective goodwill balances. No indicators of impairment were identified during the first half of 2009.

A summary of changes in our goodwill for the six-month periods ended June 30, 2009 and 2008 is as follows:

| | Leather Factory | Tandy Leather | Total |
|------------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2007 | \$607,130 | \$383,406 | \$990,536 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain (loss) | (3,010) | - | (3,010) |
| Impairments | - | - | - |
| Balance, June 30, 2008 | \$604,120 | \$383,406 | \$987,526 |

| | Leather Factory | Tandy Leather | Total |
|------------------------------|-----------------|---------------|-----------|
| Balance, December 31, 2008 | \$583,259 | \$383,406 | \$966,665 |
| Acquisitions and adjustments | - | - | - |
| Foreign exchange gain (loss) | 4,799 | - | 4,799 |
| Impairments | - | - | - |
| Balance, June 30, 2009 | \$588,058 | \$383,406 | \$971,464 |

Other intangibles consist of the following:

| | As of June 30, 2009 | | | As of December 31, 2008 | | |
|------------------------|---------------------|------------------------------|-----------|-------------------------|------------------------------|-----------|
| | Gross | Accumulated Net Amortization | | Gross | Accumulated Net Amortization | |
| Trademarks, | \$544,369 | \$337,921 | \$206,448 | \$544,369 | \$319,776 | \$224,593 |
| Copyrights | | | | | | |
| Non-Compete Agreements | 178,808 | 54,400 | 124,408 | 177,708 | 46,809 | 130,899 |
| | \$723,177 | \$392,321 | \$330,856 | \$722,077 | \$366,585 | \$355,492 |

We recorded amortization expense of \$25,645 during the first six months of 2009 compared to \$25,645 during the first half of 2008. All of our intangible assets are subject to amortization under SFAS 142. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding five years is as follows:

| | Wholesale Leathercraft | Retail Leathercraft | Total |
|------|------------------------|---------------------|----------|
| 2009 | \$20,954 | \$30,337 | \$51,291 |
| 2010 | 20,954 | 30,337 | 51,291 |
| 2011 | 20,027 | 30,337 | 50,364 |
| 2012 | 1,250 | 30,337 | 31,587 |
| 2013 | - | 30,337 | 30,337 |

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

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

Recent Accounting Pronouncements. In December 2007, FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. Under SFAS 141R, all business combinations are accounted for by applying the acquisition method (previously referred to as the purchase method), under which the acquirer measures all identified assets acquired, liabilities assumed, and noncontrolling interests in the acquiree at their acquisition date fair values. Certain forms of contingent consideration and certain acquired contingencies are also recorded at their acquisition date fair values. SFAS 141R also requires that most acquisition related costs be expensed in the period incurred. SFAS 141R was effective for us in January 2009. SFAS 141R will change our accounting for business combinations on a prospective basis.

In December 2007, FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51 (SFAS 160). SFAS 160 requires a company to recognize noncontrolling interests (previously referred to as “minority interests”) as a separate component in the equity section of the consolidated statement of financial position. It also requires the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated statement of income. SFAS 160 also requires changes in ownership interest to be accounted for similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. SFAS 160 was effective for us in January 2009. The adoption of SFAS 160 did not have a material impact on our financial position, results of operations and cash flows.

In March 2008, FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 requires a company with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and how derivative instruments and related hedged items affect a company’s financial position, financial performance, and cash flows. SFAS 161 was effective for us in January 2009. The adoption of SFAS 161 did not have a material impact on our financial position, results of operations and cash flows.

In May 2009, FASB issued SFAS No. 165, Subsequent Events (SFAS 165), which modifies the subsequent event guidance in AICPA AU Section 560. The three modifications to the subsequent events guidance in AU Section 560 are: 1) To name the two types of subsequent events either as recognized or non-recognized subsequent events, 2) To modify the definition of subsequent events to refer to events or transactions that occur after the balance sheet date, but before the financial statement are issued or available to be issued and 3) To require entities to disclose the date through which an entity has evaluated subsequent events and the basis for that date, i.e. whether that date represents the date the financial statements were issued or were available to be issued. We adopted this standard, as required, for the period ended June 30, 2009. The adoption of SFAS 165 did not have a material impact on our financial position, results of operations and cash flows.

In July 2009, FASB issued SFAS No. 168, The FASB Accounting Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168). SFAS 168 supersedes Statement No. 162 issued in May 2008. SFAS 168 will establish the Financial Accounting Standards Board Accounting Standards Codification (the “Codification”) as the source of authoritative U.S. generally accepted accounting principles (“GAAP”) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases issued by the SEC are also sources of authoritative GAAP for SEC registrants. On the effective date of SFAS 168, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. SFAS 168 will not impact our financial statements other than references to authoritative accounting literature in future periods will be made in accordance with the Codification.

2. SHORT-TERM INVESTMENTS

All current fixed maturity securities are classified as “available for sale” and are reported at carrying value, which approximates fair value. We have determined that our investment securities are available to support current operations and, accordingly, have classified such securities as current assets without regard to contractual maturities. Investments at June 30, 2009 and December 31, 2008 consisted of certificates of deposit. The contractual maturities of the certificates of deposit as of June 30, 2009 are shown below. Actual maturities may differ from the contractual maturities because debtors may have the right to call obligations with or without call penalties.

| | |
|--------------------------------------|-------------|
| Due within one year | \$4,383,000 |
| Due between one and five years | 892,000 |
| Due between five and ten years | 99,000 |
| Due between ten and fifteen years | 99,000 |
| Due between fifteen and twenty years | 99,000 |
| | \$5,572,000 |

3. NOTES PAYABLE AND LONG-TERM DEBT

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

At June 30, 2009 and December 31, 2008, the amount outstanding under the above agreement consisted of the following:

| | June 30, 2009 | December 31, 2008 |
|---|------------------|----------------------|
| 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; | \$ 3,813,750 | \$3,915,000 |
| \$16,875 monthly principal payments plus interest at 7.1% per annum; matures April 30, 2018 | | |
| Capital lease secured by HVAC equipment – total monthly principal and interest payments of \$24,328 at approximately 5.7% interest per annum, matures February 2011; paid in full in May 2009 | - | 593,949 |
| | 3,813,750 | 4,508,949 |
| Less - Current maturities | (202,500) | (467,611) |
| | \$3,611,250 | \$4,041,338 |

4. STOCK-BASED COMPENSATION

We have one stock option plan which provides for stock option grants to non-employee directors. No options have been awarded as of June 30, 2009. 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. Additionally, options vest and become exercisable either six months from the option grant date or in equal installments over a five year period. Prior to fiscal 2006, we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations and provided the required pro forma disclosures of SFAS No. 123, Accounting for Stock-Based Compensation.

On January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, and elected to adopt the standard using the modified prospective transition method. We recognized share based compensation expense of \$0 and \$7,625 for each of the quarters ended June 30, 2009 and 2008, respectively, and \$2,540 and \$15,250 for each of the six month periods ended June 30, 2009 and 2008, respectively, as a component of operating expenses.

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During the six months ended June 30, 2009 and 2008, 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, 2008 | \$2.11 | 236,700 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 1.35 | 10,000 | | |
| Outstanding, June 30, 2008 | \$2.15 | 226,700 | 3.70 | \$262,751 |
| Exercisable, June 30, 2008 | \$2.00 | 210,700 | 3.56 | \$229,711 |
| Outstanding, January 1, 2009 | \$2.16 | 224,700 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 0.94 | 25,000 | | |
| Outstanding, June 30, 2009 | \$2.31 | 199,700 | 2.77 | \$247,123 |
| Exercisable, June 30, 2009 | \$2.30 | 210,700 | 2.75 | \$244,583 |

Other information pertaining to option activity during the six month periods ended June 30, 2009 and 2008 are as follows:

| | June 30, 2009 | June 30, 2008 |
|---|---------------|---------------|
| Weighted average grant-date fair value of stock options granted | N/A | N/A |
| Total fair value of stock options vested | N/A | N/A |
| Total intrinsic value of stock options exercised | \$14,878 | \$8,029 |

As of June 30, 2009 and 2008, there was \$0 and \$18,000, respectively, of total unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a remaining weighted average vesting period of two years.

5. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for the three and six months ended June 30, 2009 and 2008:

| | Three Months Ended | | Six Months Ended | |
|------------|--------------------|-----------|------------------|-------------|
| | June 30, | | June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Numerator: | | | | |
| Net income | \$761,251 | \$655,250 | \$1,459,168 | \$1,239,748 |
| | 761,251 | 655,250 | 1,459,168 | 1,239,748 |

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Numerator for basic and diluted earnings per share

| Denominator: | | | | |
|--|------------|------------|------------|------------|
| Weighted-average shares outstanding-basic | 10,673,245 | 10,981,378 | 10,650,573 | 10,979,235 |
| Effect of dilutive securities: | | | | |
| Stock options | 58,753 | 94,962 | 55,298 | 92,867 |
| Dilutive potential common shares | 58,753 | 94,962 | 55,298 | 92,867 |
| Denominator for diluted earnings per share-weighted-average shares | 10,731,998 | 11,076,340 | 10,705,871 | 11,072,102 |
| Basic earnings per share | \$0.07 | \$0.06 | \$0.14 | \$0.11 |
| Diluted earnings per share | \$0.07 | \$0.06 | \$0.14 | \$0.11 |

The net effect of converting stock options to purchase 126,700 and 165,700 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted EPS for the quarter and six months ended June 30, 2009 and 2008, respectively.

6. SEGMENT INFORMATION

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

- a. Wholesale Leathercraft, which consists of a chain of warehouse distribution units operating under the name, The Leather Factory, located in North America;
- b. Retail Leathercraft, which consists of a chain of retail stores operating under the name, Tandy Leather Company, located in the North America;
- c. International Leathercraft, sells to both wholesale and retail customers. It carries the same products as our North American stores. This operation started in February 2008 with one store located in Northampton, United Kingdom; and
- d. Other, which consists of Roberts, Cushman & Co., a distributor of decorative hat trims sold directly to hat manufacturers.

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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 | International Leathercraft | Other | Total |
|-------------------------------------|---------------------------|------------------------|-------------------------------|-----------|--------------|
| For the quarter ended June 30, 2009 | | | | | |
| Net sales | \$6,112,421 | \$6,626,225 | \$307,852 | \$168,442 | \$13,214,940 |
| Gross profit | 3,502,921 | 4,026,569 | 146,551 | 65,841 | 7,741,882 |
| Operating earnings | 513,527 | 646,307 | (12,062) | (5,374) | 1,142,398 |
| Interest (expense) | (83,575) | - | - | - | (83,575) |
| Other income (expense), net | (6,877) | 1,081 | 148,711 | - | 142,915 |
| Income before income taxes | 423,075 | 647,388 | 136,649 | (5,374) | 1,201,738 |
| Depreciation and amortization | 250,296 | 27,848 | 3,401 | 209 | 281,754 |
| Fixed asset additions | 132,139 | 32,039 | - | - | 164,178 |
| Total assets | \$34,880,109 | \$5,499,948 | \$1,238,393 | \$172,730 | \$41,791,180 |

| | | | | | |
|-------------------------------------|--------------|-------------|-----------|-----------|--------------|
| For the quarter ended June 30, 2008 | | | | | |
| Net sales | \$7,218,197 | \$6,235,427 | \$193,822 | \$200,518 | \$13,847,964 |
| Gross profit | 3,901,648 | 3,898,022 | 112,284 | 99,698 | 8,011,652 |
| Operating earnings | 524,619 | 571,869 | (7,456) | 2,486 | 1,091,518 |
| Interest (expense) | (87,912) | - | - | - | (87,912) |
| Other income (expense), net | 33,420 | (134) | (6,993) | - | 26,293 |
| Income before income taxes | 470,127 | 571,735 | (14,449) | 2,486 | 1,029,899 |
| Depreciation and amortization | 248,425 | 31,732 | 3,744 | - | 283,901 |
| Fixed asset additions | 150,013 | 6,660 | 2,007 | - | 158,680 |
| Total assets | \$34,790,281 | \$5,423,423 | \$501,521 | \$132,470 | \$40,847,695 |

| | Wholesale Leathercraft | Retail Leathercraft | International Leathercraft | Other | Total |
|--|---------------------------|------------------------|-------------------------------|-----------|--------------|
| For the six months ended June 30, 2009 | | | | | |
| Net sales | \$12,399,123 | \$13,229,746 | \$600,724 | \$346,337 | \$26,575,930 |
| Gross profit | 7,070,843 | 7,976,733 | 368,911 | 141,841 | 15,558,328 |
| Operating earnings | 879,774 | 1,196,475 | 69,054 | 34,404 | 2,179,707 |
| Interest (expense) | (160,984) | - | - | - | (160,984) |
| Other income (expense), net | 87,132 | 889 | 132,166 | - | 220,187 |
| Income before income taxes | 805,922 | 1,197,364 | 201,220 | 34,404 | 2,238,910 |
| Depreciation and amortization | 497,398 | 56,872 | 6,565 | 418 | 561,253 |
| Fixed asset additions | 383,179 | 59,223 | - | - | 442,402 |
| Total assets | \$34,880,109 | \$5,499,948 | \$1,238,393 | \$172,730 | \$41,791,180 |

| | | | | | |
|--|--------------|--------------|-----------|-----------|--------------|
| For the six months ended June 30, 2008 | | | | | |
| Net sales | \$13,956,408 | \$12,506,201 | \$235,559 | \$409,956 | \$27,108,124 |
| Gross profit | 7,620,702 | 7,806,491 | 142,008 | 183,473 | 15,752,674 |
| Operating earnings | 648,574 | 1,186,321 | (48,917) | 26,923 | 1,812,901 |

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| | | | | | |
|-------------------------------|--------------|-------------|-----------|-----------|--------------|
| Interest expense | (169,653) | - | - | - | (169,653) |
| Other income (expense), net | 314,028 | (401) | (6,944) | - | 306,683 |
| Income before income taxes | 792,949 | 1,185,920 | (55,861) | 26,923 | 1,949,931 |
| Depreciation and amortization | 438,114 | 63,757 | 6,391 | 1,062 | 509,324 |
| Fixed asset additions | 3,006,764 | 21,920 | - | 69,954 | 3,098,638 |
| Total assets | \$34,790,281 | \$5,423,423 | \$501,521 | \$132,470 | \$40,847,695 |

Net sales for geographic areas for the three and six months ended June 30, 2009 and 2008 were as follows:

| Three months ended June 30, | 2009 | 2008 |
|-----------------------------|--------------|--------------|
| United States | \$11,526,193 | \$12,081,267 |
| Canada | 1,080,061 | 1,229,723 |
| All other countries | 608,686 | 536,974 |
| | \$13,214,940 | \$13,847,964 |

| Six months ended June 30, | 2009 | 2008 |
|---------------------------|--------------|--------------|
| United States | \$23,261,903 | \$23,613,163 |
| Canada | 2,131,135 | 2,472,207 |
| All other countries | 1,182,892 | 1,022,754 |
| | \$26,575,930 | \$27,108,124 |

Geographic sales information is based on the location of the customer. No single foreign country, except for Canada, accounted for any material amount of our consolidated net sales for the three or six-month periods ended June 30, 2009 or 2008. 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 NYSE Amex (formerly the American Stock Exchange) under the symbol "TLF." We operate our business in four 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, International Leathercraft, which operates combination retail/wholesale stores outside of North America under the trade name, Tandy Leather Factory, and Other. See Note 6 to the Consolidated Financial Statements for additional information concerning our segments, as well as our foreign operations.

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

Our Retail Leathercraft segment operates company-owned Tandy Leather Company retail stores in 35 states and five Canadian provinces. Tandy Leather, the oldest and best-known supplier of leather and related supplies used in the leathercraft industry, has been the primary leathercraft resource for decades. Tandy Leather's products include quality tools, leather, accessories, kits and teaching materials. In 2002, we began expanding Tandy Leather's industry presence by opening retail stores. As of August 1, 2009, we were operating 75 Tandy Leather retail stores located throughout the United States and Canada.

Our International Leathercraft segment operates one company-owned store in Northampton, United Kingdom. The store, which opened in February 2008, operates as a combination retail and wholesale store.

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

Critical Accounting Policies

A description of our critical accounting policies appears in Item 7 "Management's Discussions and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Forward-Looking Statements

Certain statements contained in this report and other materials we file with the Securities and Exchange Commission, as well as information included in oral statements or other written statements made or to be made by us, other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally are accompanied by words such as "may," "will," "could," "should," "anticipate," "believe," "budgeted," "intend," "plan," "project," "potential," "estimate," "continue," or "future" variations thereof or other similar statements. There are certain important risks that could cause results to differ materially from those anticipated by some of the forward-looking statements. Some, but not all, of the important risks, including those described below, could cause actual results to differ materially from those suggested by the forward-looking statements. Please refer also to our annual report on Form 10-K for fiscal year ended December 31, 2008 for additional information concerning these and

other uncertainties that could negatively impact the Company.

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

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

Ø Continued weakness in the economy in the United States, as well as abroad, may cause our sales to decrease or not to increase or adversely affect the prices charged for our products. Furthermore, negative trends in general consumer-spending levels, including the impact of the availability and level of consumer debt and levels of consumer confidence could adversely affect our sales.

General economic factors that are beyond our control impact our forecasts and actual performance. These factors include interest rates, recession, inflation, deflation, consumer credit availability, consumer debt levels, tax rates and policy, unemployment trends and other matters that influence consumer confidence and spending.

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

Results of Operations

Three Months Ended June 30, 2009 and 2008

The following tables present selected financial data of each of our four segments for the quarters ended June 30, 2009 and 2008.

| | Quarter Ended June 30, 2009 | | Quarter Ended June 30, 2008 | |
|----------------------------|-----------------------------|--------------------|-----------------------------|--------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$6,112,421 | \$513,527 | \$7,218,197 | \$524,619 |
| Retail Leathercraft | 6,626,225 | 646,307 | 6,235,427 | 571,869 |
| International Leathercraft | 307,852 | (12,064) | 193,822 | (7,456) |
| Other | 168,442 | (5,374) | 200,518 | 2,486 |
| Total Operations | \$13,214,940 | \$1,142,398 | \$13,847,964 | \$1,091,518 |

Consolidated net sales for the quarter ended June 30, 2009 decreased \$633,000 or 5%, compared to the same period in 2008. Retail and International Leathercraft contributed \$391,000 and \$114,000 of additional sales, offset by a sales decrease of \$1.1 million and \$32,000 in Wholesale Leathercraft and Other, respectively. Operating income on a consolidated basis for the quarter ended June 30, 2009 was up 5% or \$51,000 over the second quarter of 2008.

The following table shows in comparative form our consolidated net income for the second quarters of 2009 and 2008:

| | 2009 | 2008 | % Change |
|------------|-----------|-----------|----------|
| Net income | \$761,251 | \$655,250 | 16.2% |

Wholesale Leathercraft

Our Wholesale Leathercraft operation consists of 30 wholesale stores and our National Account group. The following table presents the combined sales mix by customer categories for the quarters ended June 30, 2009 and 2008:

| Customer Group | Quarter ended | |
|---|---------------|----------|
| | 06/30/09 | 06/30/08 |
| RETAIL (end users, consumers, individuals) | 27% | 25% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 8% | 10% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 43% | 41% |
| MANUFACTURERS | 8% | 9% |
| NATIONAL ACCOUNTS | 14% | 15% |
| | 100% | 100% |

Net sales were down 15% for the second quarter of 2009 as follows:

| | Quarter Ended 06/30/09 | Quarter Ended 06/30/08 | \$ change | % change |
|------------------------|------------------------|------------------------|---------------|----------|
| Same store sales (30) | \$5,327,001 | \$6,069,076 | \$(742,075) | (12.2%) |
| National account group | 785,420 | 1,149,121 | (363,701) | (31.7%) |
| | \$6,112,421 | \$7,218,197 | \$(1,105,776) | (15.3%) |

Our same store sales declined 12% in the second quarter of 2009, as compared with the same period in 2008. Compared to the second quarter of 2008, sales decreased in all customer categories, which we attribute to general economic conditions. Sales to our national account customers were down 32% for the quarter, compared to the same quarter last year. The sales decline was the result of some one-time sales of discontinued merchandise in last year's second quarter that did not occur in this year's second quarter.

Operating income for Wholesale Leathercraft during the quarter ended June 30, 2009 declined by \$11,000 from the comparative 2008 quarter, a decrease of 2%. Operating expenses as a percentage of sales were 48.9%, down \$387,000 from the second quarter of 2008. Advertising expenses decreased \$178,000 as we continue to produce more electronic advertising programs which save printing and postage costs. Employee benefits decreased \$90,000. Professional fees and outside services decreased \$78,000 and \$65,000, respectively, due to the elimination of various consulting services. These reductions in operating expenses were partially offset by increases in property insurance of \$15,000 and property taxes of \$30,000.

Retail Leathercraft

Our Retail Leathercraft operation consists of 75 Tandy Leather retail stores at June 30, 2009, compared to 72 stores at June 30, 2008. Net sales were up approximately 6% for the second quarter of 2009 over the same quarter last year. A store is categorized as "new" until it is operating for the full comparable period in the prior year.

| | # Stores | Qtr Ended 06/30/09 | Qtr Ended 06/30/08 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|----------|--------------------|--------------------|----------------|---------------|
| Same (existing) store sales | 72 | \$6,501,086 | \$6,235,427 | \$265,659 | 4.3% |
| New store sales | 3 | 125,139 | - | 125,139 | N/A |
| Total sales | 75 | \$6,626,225 | \$6,235,427 | \$390,798 | 6.3% |

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The following table presents sales mix by customer categories for the quarters ended June 30, 2009 and 2008 for our Retail Leathercraft operation:

| Customer Group | Quarter Ended | |
|---|---------------|----------|
| | 06/30/09 | 06/30/08 |
| RETAIL (end users, consumers, individuals) | 60% | 60% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 11% | 11% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 28% | 28% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 1% | 1% |
| | 100% | 100% |

Sales to our Retail, Institution, and Wholesale customer groups in the second quarter of 2009 increased compared to the second quarter of 2008, while sales to our Manufacturer customer group declined. These sales trends are consistent throughout the company – that is, our retail business appears to be holding fairly steady while our wholesale business has declined. We believe the weak economy is the primary reason for these sales trends. The retail stores averaged approximately \$29,000 in sales per month for the second quarter of 2009.

Operating income in the second quarter of 2009 increased \$74,000 from the comparative 2008 quarter to 9.8% of sales, compared to 9.2% of sales in the second quarter of 2008. Our gross margin slipped from 62.5% to 60.8% due to aggressive pricing of product in order to motivate sales. Operating expenses as a percentage of sales decreased from 53.3% to 51.0% as sales grew at a faster rate than that of expenses during the quarter.

International Leathercraft

Sales totaled \$308,000 for the second quarter of 2009, compared to \$194,000 in the second quarter of 2008. Gross profit margin fell from 57.9% in last year's second quarter to 47.6% in the current quarter. The decline is due primarily to the fluctuation in inventory value between the U.S. dollar and the British pound. Operating expenses totaled \$159,000, with the largest contributors being employee compensation, advertising, shipping to customers, and rent.

Other (Roberts, Cushman)

Sales decreased \$32,000 or 16.0% for the second quarter of 2009. Gross profit margin declined to 39.1% compared to 49.7% in the comparable quarter in 2008 due to the write-off of selected inventory. Operating income decreased \$8,000 due to the reduction in sales and gross profit, offset somewhat by the reduction of various operating expenses.

Other Expenses

We paid \$84,000 in interest expense in the second quarter of 2009 on our bank debt and capital lease, which are both related to the building purchase, compared to \$88,000 in interest expense in the second quarter last year. We earned \$32,000 in interest income during the second quarter of 2009, equal to that of last year's second quarter interest income earned of \$32,000. We recorded \$78,000 in income during the second quarter of 2009 related to currency fluctuations from our Canadian and UK operations. Comparatively, in the second quarter of 2008, we recorded income of \$6,000 for currency fluctuations.

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Six Months Ended June 30, 2009 and 2008

The following table presents selected financial data of each of our four segments for the six months ended June 30, 2009 and 2008:

| | Six Months Ended June 30, 2009 | | Six Months Ended June 30, 2008 | |
|----------------------------|--------------------------------|--------------------|--------------------------------|--------------------|
| | Sales | Operating Income | Sales | Operating Income |
| Wholesale Leathercraft | \$12,399,123 | \$879,774 | \$13,956,408 | \$648,574 |
| Retail Leathercraft | 13,229,746 | 1,196,475 | 12,506,201 | 1,186,321 |
| International Leathercraft | 600,724 | 69,054 | 235,559 | (48,917) |
| Other | 346,337 | 34,404 | 409,956 | 26,923 |
| Total Operations | \$26,575,930 | \$2,179,707 | \$27,108,124 | \$1,812,901 |

Consolidated net sales for the six months ended June 30, 2009 were down 2%, decreasing \$532,000, compared to the same period in 2008. Retail and International Leathercraft contributed additional sales of \$723,000 and \$365,000, respectively, offset by a combined sales decrease of \$1.6 million from Wholesale Leathercraft and Other. Operating income on a consolidated basis for the six months ended June 30, 2009 increased 20.2% or \$367,000 compared to the first half of 2008.

The following table shows in comparative form our consolidated net income for the first half of 2009 and 2008:

| | 2009 | 2008 | % change |
|------------|-------------|-------------|----------|
| Net income | \$1,459,168 | \$1,239,748 | 17.7% |

Wholesale Leathercraft

Net sales decreased 11.2%, or \$1.6 million, for the first half of 2009 as follows:

| | Six Months Ended 06/30/09 | Six Months Ended 06/30/08 | \$ Change | % Change |
|------------------------|---------------------------|---------------------------|-------------|----------|
| Same store sales (29) | \$10,741,998 | \$12,061,028 | (1,319,030) | (10.9%) |
| National account group | 1,657,125 | 1,895,380 | (238,255) | (12.6%) |
| | \$12,399,123 | \$13,956,408 | (1,557,285) | (11.2%) |

The following table presents the combined sales mix by customer categories for the six months ended June 30, 2009 and 2008:

| Customer Group | Six Months Ended | |
|---|------------------|----------|
| | 06/30/09 | 06/30/08 |
| RETAIL (end users, consumers, individuals) | 30% | 27% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 7% | 8% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 41% | 44% |
| MANUFACTURERS | 7% | 9% |
| NATIONAL ACCOUNTS | 15% | 12% |
| | 100% | 100% |

Operating income for Wholesale Leathercraft for the first half of 2009 increased by \$231,000 from the comparative 2008 period, an improvement of 35.6%. Compared to the first six months of 2008, operating expenses decreased \$781,000 for the first half of 2009, but were flat as a percentage of sales at 49.9% due to the decrease in sales.

Retail Leathercraft

Net sales were up approximately 6% for the first half of 2009 over the same period last year.

| | # Stores | Six Months Ended 06/30/09 | Six Months Ended 06/30/08 | \$ Incr (Decr) | % Incr (Decr) |
|-----------------------------|-------------|---------------------------------|---------------------------------|-------------------|------------------|
| Same (existing) store sales | 72 | \$12,969,259 | \$12,506,201 | \$463,058 | 3.7% |
| New store sales | 3 | 260,487 | - | 260,487 | N/A |
| Total sales | 75 | \$13,229,746 | \$12,506,201 | \$723,545 | 5.8% |

The following table presents sales mix by customer categories for the six months ended June 30, 2009 and 2008 for our Retail Leathercraft operation:

| Customer Group | Six Months Ended | |
|---|------------------|----------|
| | 06/30/09 | 06/30/08 |
| RETAIL (end users, consumers, individuals) | 63% | 62% |
| INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.) | 9% | 9% |
| WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.) | 27% | 28% |
| NATIONAL ACCOUNTS | - | - |
| MANUFACTURERS | 1% | 1% |
| | 100% | 100% |

The retail stores averaged approximately \$29,000 in sales per month for the first half of 2009.

Operating income for the first six months of 2009 increased \$10,000 from the comparative 2008 period but decreased as a percentage of sales, from 9.5% in the first half of 2008 to 9.0% in the first half of 2009. Gross margin declined from 62.4% to 60.3% due to aggressive pricing of product in order to maintain sales as we are competing for consumer spending. Operating expenses as a percentage of sales declined from 52.9% during the first half of 2008 to 51.3% during the first half of 2009.

International Leathercraft

Sales totaled \$601,000 for the first six months of 2009, an increase of 155% from sales of \$236,000 from the first six months of 2008. These sales are generated from our one store located in the UK, which opened in February 2008. Gross profit margin was 61.4% for the first half of 2008, an improvement over the 2008 comparable period's gross profit margin of 60.3%. 2009 year-to-date operating expenses totaled \$300,000 compared to 2008 year-to-date operating expenses of \$191,000, an increase of \$109,000. Advertising, rent, and shipping costs to customers accounted for the majority of the increase over the prior year. Operating income in 2009 totaled \$69,000 compared to an operating loss of \$49,000 last year.

Other (Roberts, Cushman)

Sales decreased \$64,000 in the first six months of 2009 compared to the same period in 2008. Gross profit margins decreased by \$42,000 while operating margin increased by \$7,000. Operating expenses decreased by \$49,000 in the first half of 2009 compared to 2008.

Other Expenses

We paid \$161,000 in interest expense in the first six months of 2009 on our debt related to our building purchase compared to \$170,000 in interest expense in the first half of 2008. We earned \$61,000 in interest income in the six months ended June 30, 2009, down from last year's interest income of \$73,000, due to a drop in interest rates earned on our cash investments. We recorded \$107,000 in income during the six months ended June 30, 2009 for currency fluctuations from our Canadian and UK operations. Comparatively, in the first half of 2008, we recorded income of \$21,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets increased from \$40.9 million at year-end 2008 to \$41.8 million at June 30, 2009. The increase in short-term investments and accounts receivable, offset partially by the decrease in inventory, accounted for the increase. Total stockholders' equity increased from \$31.3 million at December 31, 2008 to \$32.8 million at June 30, 2009. Most of the increase was attributable to earnings in the first half of this year. Our current ratio improved from 5.7 at December 31, 2008 to 6.3 at June 30, 2009.

Our investment in inventory decreased by \$222,000 at June 30, 2009 from year-end 2008. We continue to closely manage our inventory levels to follow our sales trends. Inventory turnover decreased slightly to an annualized rate of 3.34 times during the first half of 2009, from 3.66 times for the first half of 2008. Inventory turnover was 3.18 times for all of 2008. We compute our inventory turns as sales divided by average inventory. At the end of the second quarter of 2009, our total inventory on hand was 2% below our internal targets for optimal inventory levels. We plan to increase our inventory slightly in our central warehouse during the remainder of the year in order to maintain a sufficient inventory to support the stores' needs.

Trade accounts receivable was \$1.7 million at June 30, 2009, down \$478,000 from \$1.2 million at year-end 2008. The average days to collect accounts for the first half of 2009 were 43.4 days, down considerably from 59.2 days for the first half of 2008. We have tightened our credit policy given the current economic environment and are closely monitoring our customers with open accounts to ensure collectability of the accounts.

Accounts payable increased \$366,000 to \$1.5 million at the end of the June 2009, due to an intentional slowdown of payments to vendors, taking full advantage of the payment terms. Accrued expenses and other liabilities decreased \$202,000, the majority of which is a reduction in manager bonus payable, partially offset by an increase in inventory in transit to us at June 30, 2009 compared to December 31, 2008.

During the first half of 2009, cash flow provided by operating activities was \$1.5 million. Net income accounted for the majority of the cash provided. Cash flow used in investing activities totaled \$3.0 million, consisting of \$2.7 million in net certificate of deposit purchases and \$442,000 in fixed asset purchases, \$130,000 of which was parking lot repaving at our building. The remaining fixed asset purchases consisted primarily of computer equipment. Cash flow used by financing activities totaled \$737,000, consisting of payments on our capital lease of \$594,000, payments on our building debt of \$101,000, and purchases of treasury stock of \$65,000, offset partially by proceeds from employee stock option exercises totaling \$23,000.

We expect to fund our operating and liquidity needs as well as our current expansion of Tandy Leather's retail store chain from a combination of current cash balances and internally generated funds.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

For disclosures about market risk affecting us, see Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for fiscal year ended December 31, 2008. Our exposure to market risks has not changed significantly since December 31, 2008.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management team, under the supervision and with the participation of our principal executive officer and our principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the last day of the fiscal period covered by this report, June 30, 2009. The term disclosure controls and procedures means our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to management, including our principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of June 30, 2009, our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2009 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchase of Equity Securities

Our Board of Directors authorized a stock repurchase program, permitting us to repurchase up to one million shares of our common stock at prevailing market prices not to exceed \$2.85. The program commenced April 1, 2009 and will terminate on March 10, 2010.

The following table sets forth the monthly repurchases of common stock for the period covered by this report:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs |
|------------------|----------------------------------|------------------------------|--|--|
| April 1-30, 2009 | 14,837 | \$2.73 | 14,837 | 985,163 |
| May 1-31, 2009 | 6,937 | \$2.66 | 21,774 | 978,226 |
| June 1-30, 2009 | 2,500 | \$2.38 | 24,274 | 975,726 |

Item 4. Submission of Matters to a Vote of Security Holders.

We held our Annual Meeting of Stockholders on May 12, 2009. At the meeting, stockholders elected seven directors to serve for the ensuing year. Out of the 10,689,555 eligible votes, 8,249,777 were cast at the meeting either by proxies solicited in accordance with Regulation 14A under the Securities Act of 1934, or by security voting in person. The tabulation of votes of the matters submitted to a vote of security holders is set forth below:

To elect members of the Board of Directors:

| | For | Against | Abstaining |
|----------------------|-----------|---------|------------|
| Shannon L. Greene | 7,824,236 | 425,541 | - |
| T. Field Lange | 7,837,913 | 411,864 | - |
| Joseph R. Mannes | 7,825,326 | 424,451 | - |
| L. Edward Martin III | 8,128,470 | 121,307 | - |
| Michael A. Nery | 8,017,483 | 232,294 | - |
| Jon Thompson | 8,126,470 | 123,307 | - |
| Wray Thompson | 7,970,112 | 279,665 | - |

Item 6. Exhibits

| Exhibit Number | Description |
|----------------|--|
| 3.1 | Certificate of Incorporation of The Leather Factory, Inc., and Certificate of Amendment to Certificate of Incorporation of The Leather Factory, Inc. filed as Exhibit 3.1 to Form 10-Q filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on August 12, 2005 and incorporated by reference herein. |
| 3.2 | Bylaws of The Leather Factory, Inc., filed as Exhibit 3.2 to the Registration Statement on Form SB-2 of The Leather Factory, Inc. (Commission File No. 33-81132), filed with the Securities and Exchange Commission on July 5, 1994 and incorporated by reference herein. |
| 10.1 | Consulting Agreement, dated January 1, 2009, by and between Tandy Leather Factory, Inc. and J. Wray Thompson, filed as Exhibit 10.1 to Form 8-K filed by Tandy Leather Factory, Inc. with the Securities and Exchange Commission on February 17, 2009 and incorporated by reference herein. |
| *31.1 | 13a-14(a) Certification by Jon Thompson, Chief Executive Officer and President. |

*31.2 13a-14(a) Certification by Shannon Greene, Chief Financial Officer and Treasurer.

*32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Filed herewith.

SIGNATURES

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

TANDY LEATHER FACTORY, INC.
(Registrant)

Date: August 11, 2009

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

Date: August 11, 2009

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