

TANDY LEATHER FACTORY INC
Form 10-K
March 30, 2012

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

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period _____ to _____

Commission File Number 1-12368
Tandy Leather Factory, Inc.
(Exact Name of Registrant as Specified in its Charter)

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

1900 Southeast Loop 820, Fort Worth, TX 76140
(Address of Principal Executive Offices and Zip Code) 817/872-3200
(Registrant's telephone number, including area code)

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

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

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

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

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

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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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No (The registrant is not yet required to submit Interactive Data)

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

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$43,549,114 at June 30, 2011 (based on the price at which the common stock was last traded on the last business day of its most recently completed second fiscal quarter). At March 26, 2012, there were 10,156,442 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on June 5, 2012, are incorporated by reference in Part III of this report.

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PART I

ITEM 1. BUSINESS

General

We are a retailer and wholesale distributor of a broad line of leather and related products, including leather, leatherworking tools, buckles and adornments for belts, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits. We also manufacture leather lacing and some of our do-it-yourself kits. During 2011, our consolidated sales totaled \$66.1 million of which approximately 15% were export sales. We maintain our principal offices at 1900 Southeast Loop 820, Fort Worth, Texas 76140. Our common stock trades on the NASDAQ Global Market under the symbol "TLF."

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

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

Our Development in Recent Years

We have expanded our wholesale store chain by opening new stores and by making numerous acquisitions of small businesses in strategic geographic locations including the acquisition of our Canadian distributor, The Leather Factory of Canada, Ltd., in 1996. By 2000, our wholesale chain we had grown to 27 Leather Factory stores located in the United States and two Leather Factory stores in Canada. In November 2000, we acquired the operating assets of two subsidiaries of Tandycrafts, Inc. to form Tandy Leather Company. In 2002, we began opening retail stores under the "Tandy Leather" name and also opened our thirtieth wholesale store – our third in Canada. From 2002 to 2009, we purchased eleven independent leathercraft retail stores, including Heritan Ltd. and its parent, our primary Canadian competitor, and opened another 64 retail stores. In 2007, we purchased Mid-Continent Leather Sales, Inc., a competitor located in Oklahoma, a wholesale store. In 2008, we opened one combination wholesale and retail store in Northampton, United Kingdom. In 2010, we opened one retail store in Canada. In 2011, we opened one combination wholesale and retail store in Sydney, Australia and one retail store in the U.S.

At December 31, 2011, we operated 29 wholesale stores operating under the Leather Factory name (26 in the U.S. and three in Canada). We also operated 77 retail stores operating under the Tandy Leather name (70 in the U.S. and seven in Canada) as well as two combination wholesale and retail stores operating under the Tandy Leather Factory name in the United Kingdom and Australia. We closed Mid-Continent Leather Sales, a wholesale store, in October 2010.

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

Segment	Subsidiaries included:
Wholesale Leathercraft	The Leather Factory, LP; The Leather Factory of Canada, Ltd (3 stores)
Retail Leathercraft	Tandy Leather Company, LP;

The Leather Factory of Canada, Ltd (7 stores)

International	Tandy Leather Factory UK Ltd.
Leathercraft	Tandy Leather Factory Australia Pty Ltd
	Tandy Leather Factory Espana, SL

Our growth, measured both by our net sales and net income, occurs as a result of the increase in the number of stores we have and the increase from year to year of the sales in our existing stores. The following tables provide summary store count information by segment in each of our fiscal years from 1999 to 2011.

STORE COUNT
YEARS ENDED DECEMBER 31, 1999 through 2011

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

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

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

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

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

No single customer's purchases represented more than 3% of our total sales in 2011, although two customers' purchases totaled 10% of Wholesale Leathercraft's sales in 2011. Retail Leathercraft and International Leathercraft segments did not have any customers whose purchases represented a significant portion of their sales. Sales to our five largest customers represent 5.5%, 5.5% and 6.3% of consolidated sales in 2011, 2010 and 2009, respectively. While management does not believe the loss of one of these customers would have a significant negative impact on our consolidated operations, it does believe the loss of several of these customers simultaneously or a substantial reduction in sales generated by them could temporarily affect our operating results.

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Our Operating Segments

We service our customers primarily through the operation of three segments. We identify those segments based on management responsibility, customer focus, and store location. The Wholesale Leathercraft segment consists of 29 wholesale stores of which 26 are located in the United States and three are located in Canada. As of March 1, 2012, the Retail Leathercraft segment consists of 77 Tandy Leather retail stores of which 70 are located in the United States and seven are located in Canada. Both of these segments sell leather and leathercraft-related products. The International Leathercraft segment consists of all stores, wholesale or retail, located outside of North America. As of March 1, 2012, we had three such stores, one located in the United Kingdom, one located in Australia, and one located in Spain.

Information regarding net sales, gross profit, operating income and total assets, attributable to each of our segments, is included within Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and within Item 8. Financial Statements and Supplementary Data in Note 14, Segment Information, of our Notes to Consolidated Financial Statements, which are incorporated herein by reference.

Wholesale Leathercraft

The Wholesale Leathercraft operation distributes its broad product line of leather and leathercraft-related products in the United States and Canada through wholesale stores operating under the name, "The Leather Factory". This segment had net sales of \$26.5 million, \$25.9 million and \$25.1 million for 2011, 2010 and 2009, respectively.

General We operate wholesale stores in 20 states and three Canadian provinces. The stores range in size from 2,350 square feet to 15,500 square feet, with the average size of a store being approximately 5,000 square feet. The type of premises utilized for our wholesale stores is generally light industrial office/warehouse space in proximity to a major freeway or with other similar access. This type of location typically offers lower rents compared to other more retail-oriented locations.

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

Our wholesale stores serve customers through various means including walk-in traffic, phone, internet and mail order. We also employ a distinctive marketing tactic in that we maintain an internally-developed target customer mailing list for use in our aggressive direct mail advertising campaigns. We staff our stores with experienced managers whose compensation is tied to the operating profit of the store they manage. Sales are generated by the selling efforts of the store personnel, our direct mail advertising, our website (www.tandyleatherfactory.com), and our participation at trade shows.

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

Our Authorized Sales Center (“ASC”) program was developed to create a presence in geographic areas where we do not have a company-owned store. An unrelated person operating an existing business could become an ASC by submitting an application and upon approval, placing a minimum initial order and meeting minimum annual purchase amounts. In exchange, the benefits to the ASC are free advertising in various sales flyers produced and distributed by us, preferred pricing on certain products, advance notice of new products, and priority shipping and handling of orders. In 2011, the ASC program was eliminated in North America as the number and location of our stores were deemed sufficient to represent each geographic area. We currently have 8 ASC’s located outside of North America.

We have two customers whose purchases total 10% of our Wholesale Leathercraft segment’s sales. While management believes that the loss of these customers would be noticeable and could temporarily affect this segment’s operating results, the impact would not be so significant as to bring into question the segment’s ability to generate operating profit.

Merchandise Our products are generally organized into 12 categories. We carry a wide assortment of products including leather, lace, hand tools, kits and craft supplies. We operate a light manufacturing facility in Fort Worth, Texas whose processes generally involve cutting leather into various shapes and patterns using metal dies. The factory produces approximately 20% of our products and also assembles and repackages products as needed. Products manufactured in our factory are distributed through our stores under the Tejas™ brand name. We also distribute product under the Tandy Leather™, Eco-Flo™, Craftool™ and Dr. Jackson's™ brands. We develop new products through the ideas and referrals of customers and store personnel as well as the analysis of fads and trends of interest in the market.

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

During 2011, 2010, and 2009, Wholesale Leathercraft division sales by product category were as follows:

Product Category	2011 Sales Mix	2010 Sales Mix	2009 Sales Mix
Belts strips and straps	3%	3%	2%
Books, patterns, videos	2%	2%	2%
Buckles	4%	4%	4%
Conchos [^]	4%	4%	4%
Craft supplies	5%	5%	6%
Dyes, finishes, glues	6%	6%	6%
Hand tools	15%	14%	13%
Hardware	7%	7%	7%
Kits	7%	8%	8%
Lace	7%	7%	9%
Leather	35%	36%	35%
Stamping tools	5%	4%	4%
	100%	100%	100%

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

In addition to meeting ordinary operational requirements, our working capital demands are a product of the need to maintain a level of inventory sufficient to fill customer orders as they are received with minimal backorders and the time required to collect our accounts receivable. Because availability of merchandise and prompt delivery time are important competitive factors for us, we maintain higher levels of inventory than our smaller competitors. For

additional information regarding our cash, inventory and accounts receivable at the end of 2011 and 2010, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

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Suppliers We purchase merchandise and raw materials from approximately 200 vendors dispersed throughout the United States and in approximately 15 foreign countries. In 2011, our 10 largest vendors accounted for approximately 67% of our inventory purchases.

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

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

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

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

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

We attempt to maintain the optimum number of items in our product line to minimize out-of-stock situations against carrying costs involved with such an inventory level. We generally maintain higher inventories of imported items to ensure a continuous supply. The number of products offered changes every year due to the introduction of new items and the discontinuance of others. We carry approximately 2,700 items in the current lines of leather and leather-related merchandise. All items are offered in all stores.

Expansion Our wholesale store expansion across the United States has been fairly consistent since we purchased the original six stores in 1985. We opened our thirtieth store in August 2002. We converted one wholesale (Leather Factory) store to a retail (Tandy Leather) store in 2006, reducing the number of wholesale stores to 29. We acquired Mid-Continent Leather Sales in 2007, a wholesale store located in Oklahoma, increasing the number of wholesale stores to 30, but subsequently closed it in 2010, reducing the number of wholesale stores again to 29. While we do not believe there is a significant and immediate opportunity for expansion of the Leather Factory store system in terms of opening additional locations, we do believe expansion could be achieved by acqu