TANDY LEATHER FACTORY INC
Form 10-Q
August 14, 2014

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 June 30, 2014

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 such 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 August 10, 2014
Common Stock, par value $0.0024 per share	10,233,334

TANDY LEATHER FACTORY, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Tandy Leather Factory, Inc.
Consolidated Balance Sheets

	June 30, 2014 (unaudited)	December 31, 2013 (audited)
ASSETS		
CURRENT ASSETS:		
Cash	$7,402,534	$11,082,679
Accounts receivable-trade, net of allowance for doubtful accounts of $0 and $1,000 in 2014 and 2013, respectively	796,106	762,405
Inventory	36,001,590	26,300,830
Prepaid income taxes	468,307	-
Deferred income taxes	369,978	309,533
Prepaid expenses	1,277,871	1,609,644
Other current assets	350,232	478,593
Total current assets	46,666,618	40,543,684
PROPERTY AND EQUIPMENT, at cost	21,156,669	20,290,990
Less accumulated depreciation and amortization	(6,484,259)	(5,863,280)
	14,672,410	14,427,710
GOODWILL	981,527	981,985
OTHER INTANGIBLES, net of accumulated amortization of approximately $645,000 and $622,000 in 2014 and 2013, respectively	80,582	103,228
OTHER assets	336,975	341,959
TOTAL ASSETS	$62,738,112	$56,398,566
LIABILITIES AND STOCKHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable-trade	$2,055,912	$1,884,637
Accrued expenses and other liabilities	6,697,117	5,808,882
Dividend payable	2,549,684	-
Income taxes payable	-	272,198
Current maturities of long-term debt	2,452,500	202,500
Total current liabilities	13,755,213	8,168,217
DEFERRED INCOME TAXES	1,129,589	1,212,557
LONG-TERM DEBT, net of current maturities	2,041,875	2,396,250
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;		
11,226,957 and 11,192,356 shares issued at 2014 and 2013, respectively;		
10,233,334 and 10,198,733 shares outstanding at 2014 and 2013, respectively	26,945	26,862
Paid-in capital	5,921,889	5,892,907
Retained earnings	42,577,805	41,507,592
Treasury stock at cost (993,623 shares at 2014 and 2013)	(2,894,068)	(2,894,068)
Accumulated other comprehensive income	178,864	88,249
Total stockholders' equity	45,811,435	44,621,542
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$62,738,112	$56,398,566

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 and Six Months Ended June 30, 2014 and 2013

	THREE MONTHS		SIX MONTHS	
	2014	2013	2014	2013
NET SALES	$19,703,607	$18,973,013	$39,542,073	$38,210,840
COST OF SALES	6,924,001	7,052,892	14,046,744	14,359,890
Gross profit	12,779,606	11,920,121	25,495,329	23,850,950
OPERATING EXPENSES	10,123,329	9,574,057	19,872,389	18,884,026
INCOME FROM OPERATIONS	2,656,277	2,346,064	5,622,940	4,966,924
OTHER INCOME (EXPENSE):				
Interest expense	(44,855)	(51,544)	(90,683)	(107,638)
Other, net	5,334	98,284	6,678	125,023
Total other income (expense)	(39,521)	46,740	(84,005)	17,385
INCOME BEFORE INCOME TAXES	2,616,756	2,392,804	5,538,935	4,984,309
PROVISION FOR INCOME TAXES	851,271	763,451	1,919,038	1,768,635
NET INCOME	$1,765,485	$1,629,353	$3,619,897	$3,215,674
NET INCOME PER COMMON SHARE:				
Basic	$0.17	$0.16	$0.35	$0.32
Diluted	$0.17	$0.16	$0.35	$0.32
Weighted Average Number of Shares Outstanding:				
Basic	10,198,733	10,167,649	10,198,733	10,165,060
Diluted	10,239,823	10,216,535	10,239,447	10,205,439

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 and Six Months Ended June 30, 2014 and 2013

	THREE MONTHS		SIX MONTHS	
	2014	2013	2014	2013
NET INCOME	$1,765,485	$1,629,353	$3,619,897	$3,215,674
Foreign currency translation adjustments	220,023	(173,142)	90,615	(361,493)
COMPREHENSIVE INCOME	$1,985,508	$1,456,211	$3,710,512	$2,854,181

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 Six Months Ended June 30, 2014 and 2013

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$3,619,897	$3,215,674
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	715,920	562,710
(Gain) loss on disposal or abandonment of assets	(1,409)	85,458
Non-cash stock-based compensation	29,065	11,686
Deferred income taxes	(143,413)	157,099
Other	84,854	(328,000)
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(33,701)	(315,451)
Inventory	(9,700,760)	(1,635,238)
Prepaid expenses	331,773	(365,277)
Other current assets	128,361	(611,980)
Accounts payable-trade	171,275	1,270,216
Accrued expenses and other liabilities	888,235	163,184
Income taxes payable	(740,505)	24,484
Total adjustments	(8,270,305)	(981,109)
Net cash provided by (used in) operating activities	(4,650,408)	2,234,565
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(949,082)	(1,962,700)
Proceeds from sale of assets	18,736	515
Decrease (increase) in other assets	4,984	91
Net cash used in investing activities	(925,362)	(1,962,094)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in revolving credit loans	2,250,000	-
Payments on notes payable and long-term debt	(354,375)	(405,000)
Net cash provided by (used in) financing activities	1,895,625	(405,000)
NET DECREASE IN CASH	(3,680,145)	(132,529)
CASH, beginning of period	11,082,679	7,705,182
CASH, end of period	$7,402,534	$7,572,653
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid during the period	$90,683	$107,638
Income tax paid during the period, net of (refunds)	$2,567,257	$1,584,223

NON-CASH INVESTING ACTIVITIES:		
Accrued dividend	$2,549,684	-

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 Six Months Ended June 30, 2014 and 2013

	Number of Shares	ParValue	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	9,291	22	11,664	-	-	-	11,686
Net income	-	-	-	-	3,215,674	-	3,215,674
Translation adjustment	-	-	-	-	-	(361,493)	(361,493)
BALANCE, June 30, 2013	10,171,733	$26,797	$5,779,172	$(2,894,068)	$37,457,549	$17,434	$40,386,884

	Number of Shares	Par Value	Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
BALANCE, December 31, 2013	10,198,733	$26,862	$5,892,907	$(2,894,068)	$41,507,592	$88,249	$44,621,542
Stock-based compensation	34,601	83	28,982	-	-	-	29,065
Net income	-	-	-	-	3,619,897	-	3,619,897
Dividend payable	-	-	-	-	(2,549,684)		(2,549,684)
Translation adjustment	-	-	-	-	-	90,615	90,615
BALANCE, June 30, 2014	10,233,334	$26,945	$5,921,889	$(2,894,068)	$42,577,805	$178,864	$45,811,435

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 June 30, 2014 and December 31, 2013, and its results of operations and cash flows for the three and six-month periods ended June 30, 2014 and 2013. Operating results for the three and six-month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. 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, 2013.

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 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	
	June 30, 2014	December 31, 2013
Inventory on hand:		
Finished goods held for sale	$31,335,255	$24,546,771
Raw materials and work in process	968,678	853,200
Inventory in transit	3,697,657	900,859
	$36,001,590	$26,300,830

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, 2013, 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 six months of 2014.

A summary of changes in our goodwill for the periods ended June 30, 2014 and 2013 is as follows:

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2012	$607,319	$383,406	$990,725
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(7,412)	-	(7,412)
Impairments	-	-	-
Balance, June 30, 2013	$599,907	$383,406	$983,313

	Leather Factory	Tandy Leather	Total
Balance, December 31, 2013	$598,579	$383,406	$981,985
Acquisitions and adjustments	-	-	-
Foreign exchange gain/loss	(458)	-	(458)
Impairments	-	-	-
Balance, June 30, 2014	$598,121	$383,406	$981,527

Other intangibles consist of the following:

	As of June 30, 2014			As of December 31, 2013		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Trademarks, Copyrights	$544,369	$503,204	$41,165	$544,369	$487,891	$56,478
Non-Compete Agreements	181,111	141,694	39,417	181,216	134,466	46,750
	$725,480	$644,898	$80,582	$725,585	$622,357	$103,228

We recorded amortization expense of $22,646 during the first six months of 2014 compared to $19,712 during the first half of 2013. All of our intangible assets 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
2014	$198	$45,004	$45,202
2015	108	$40,302	$40,410
2016	108	5,667	5,775
2017	90	1,000	1,090
2018	-	750	750

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.

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Recent Accounting Pronouncements. In July 2013, the Financial Accounting Standards Board ("FASB") issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists" to eliminate the diversity in practice associated with the presentation of unrecognized tax benefits in instances where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 generally requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except in certain circumstances. The amendments in ASU 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this standard did not have a material impact on our consolidated financial statements.

In April 2014, FASB issued Accounting Standards Update 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under the new guidance, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. This guidance also changes an entity's requirements when presenting, for each comparative period, the assets and liabilities of a disposal group that includes a discontinued operation. A discontinued operation may include a component of an entity, or a business or nonprofit activity. The guidance is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of the new requirements is not expected to have a material impact on our consolidated earnings, financial position or cash flows.

In May 2014, FASB issued Accounting Standards Update 2014-09 which creates a new topic in the Accounting Standards Codification ("ASC") Topic 606, "Revenue From Contracts With Customers." In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606 establishes a new control-based revenue recognition model; changes the basis for deciding when revenue is recognized over time or at a point in time; provides new and more detailed guidance on specific topics; and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, "Other Assets and Deferred Costs: Contracts with Customers," to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The guidance is effective for interim and annual reporting periods beginning after December 15, 2016. Companies are permitted to apply the guidance in ASC 606 using one of the following two methods: retrospectively to each prior period presented in accordance with ASC 250, subject to certain practical expedients; or retrospectively with a cumulative effect adjustment to opening retained earnings in the period of initial adoption. If applying this transition method, an entity should apply the new revenue recognition guidance only to contracts not completed under existing U.S. GAAP at the date of adoption. We are currently evaluating the adoption method to apply and the impact that the update will have on its financial position, results of operations, cash flows and financial statement disclosures.

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. Under the terms of the Line of Credit Note, we could borrow from time to time until April 30, 2008, up to the lesser of $5,500,000 or 90% of the cost of the property and make monthly interest payments. Proceeds in the amount of $4,050,000 were used to fund the purchase of the property from Standard Motor Products, Inc. under an Agreement of Purchase and Sale, dated June 25, 2007, which closed on July 31, 2007. No further borrowings were drawn. On April 30, 2008, the principal balance was rolled into a 10-year term note with an interest rate of 7.10% per annum.

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% (2.16% at June 30, 2014) and was to mature on June 30, 2014. On June 23, 2014, we executed a Note Modification Agreement which increased the maximum amount available from $4 million to $6 million and extended the maturity date from June 30, 2014 to June 30, 2015. All other terms remain unchanged. Interest is paid monthly. The note was obtained for working capital purposes and is secured by the real estate and improvements located at 1900 Southeast Loop 820, Fort Worth Texas.

At June 30, 2014 and December 31, 2013, the amount outstanding under the above agreements consisted of the following:

	June 30, 2014	December 31, 2013
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	$2,244,375	$2,598,750
Line of Credit Note with JPMorgan Chase Bank – collateralized by real estate; payable as follows:		
Line of Credit Note dated July 12, 2012, as amended on June 23, 2014, in the maximum principal amount of $6,000,000 with revolving features as more fully described above – interest due monthly at LIBOR plus 2%; matures June 30, 2015	$2,250,000	-
	4,494,375	2,598,750
Less - Current maturities	(2,452,500)	(202,500)
	$2,041,875	$2,396,250

On August 5, 2014, we drew another $3 million on the line of credit to fund additional inventory purchases and pay the one-time special dividend, leaving $750,000 in availability on the line.

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 during the six months ended June 30, 2013, while no options were awarded during the six months ended June 30, 2014. The options vest and become exercisable six months from the option grant date. 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 $11,686 for the quarter and six months ended June 30, 2013, respectively, as a component of operating expenses. No share based compensation expense pertaining to stock options grants was recognized in 2014.

During the six months ended June 30, 2014 and 2013, the stock option activity under our stock option plans was as follows:

	Weighted Average Exercise	# of shares	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value

	Price		(in years)	
Outstanding, January 1, 2013	$4.53	121,600		
Granted	6.87	12,000		
Cancelled	-	-		
Exercised	4.24	(22,000)		
Outstanding, June 30, 2013	$4.84	111,600	5.72	$167,186
Exercisable, June 30, 2013	$4.60	99,600	5.24	$155,500
Outstanding, January 1, 2014	$5.04	84,600		
Granted	-	-		
Cancelled	-	-		
Exercised	-	-		
Outstanding, June 30, 2014	$5.04	84,600	6.47	$104,656
Exercisable, June 30, 2014	$5.04	84,600	6.47	$104,656

Other information pertaining to option activity during the six-month periods ended June 30, 2014 and 2013 are as follows:

	June 30, 2014	June 30, 2013
Weighted average grant-date fair value of stock options granted	N/A	$11,686
Total fair value of stock options vested	N/A	N/A
Total intrinsic value of stock options exercised	N/A	$51,260

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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:

	2014	2013
Volatility	N/A	19.1%
Expected option life	N/A	3 years
Interest rate (risk free)	N/A	0.80%
Dividends	None	None

There was no unrecognized compensation cost pertaining to stock option grants as of June 30, 2014 and 2013.

We have a restricted stock plan that was adopted by our Board of Directors in January 2013 and approved by our stockholders in June 2013. The plan reserves up to 300,000 shares of our common stock for restricted stock awards to our executive officers, non-employee directors and other key employees. Awards granted under the plan may be stock awards or performance awards, and may be subject to a graded vesting schedule with a minimum vesting period of four years.

In February 2014, our Chief Executive Officer, Chief Financial Officer and Senior Vice President were awarded restricted stock grants consisting of 9,375 shares each. In addition, four of our independent directors were awarded restricted stock grants consisting of 1,619 shares each. The grants will vest in equal annual amounts over a four-year period. The fair value of nonvested restricted common stock awards is the market value of our common stock on the date of grant. Compensation costs for these awards will be recognized on a straight-line basis over the four year vesting period.

A summary of the activity for nonvested restricted common stock awards as of June 30, 2014 is presented below:

	Shares	Grant Fair Value
Balance, January 1, 2014	-	-
Granted	34,601	$8.96
Forfeited	-	-
Vested	-	-
Balance, June 30, 2014	34,601	$8.96

Pertaining to restricted stock awards, we recognized share based compensation expense of $29,065 during the three and six months ended June 30, 2014 as a component of operating expenses. As of June 30, 2014, there was unrecognized compensation cost related to non-vested restricted stock awards of $280,960 to be recognized in equal amounts over a period of four years.

4. 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, 2014 and 2013:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$1,765,485	$1,629,353	$3,619,897	$3,215,674
Numerator for basic and diluted earnings per share	1,765,485	1,629,353	3,619,897	3,215,674

Denominator:				
Weighted-average shares outstanding-basic	10,198,733	10,167,649	10,198,733	10,165,060
Effect of dilutive securities:				
Stock options	39,376	48,886	39,067	40,379
Restricted stock	1,714	-	1,647	-
Dilutive potential common shares	41,090	48,886	40,714	40,379
Denominator for diluted earnings per share-weighted-average shares	10,239,823	10,216,535	10,239,447	10,205,439
Basic earnings per share	$0.17	$0.16	$0.35	$0.32
Diluted earnings per share	$0.17	$0.16	$0.35	$0.32

The net effect of converting stock options and warrants to purchase 119,201 and 133,600 shares of common stock at exercise prices less than the average market prices has been included in the computations of diluted earnings per share for the quarters ended June 30, 2014 and 2013, respectively.

5. CASH DIVIDEND

On June 9, 2014, our Board of Directors authorized a $0.25 per share special one-time cash dividend to be paid to stockholders of record at the close of business on July 7, 2014. The cash dividend, totaling $2.5 million, will be paid to stockholders on August 8, 2014. 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 transferred to the United States District Court, Northern District of Texas, Fort Worth Division (“Court”), and an amended complaint was filed on May 9, 2011 by plaintiffs to add another former employee, Donna Cavota, as a third named plaintiff. The suit alleged that we violated requirements of the Fair Labor Standards Act (FLSA) as well as various state wage laws. Plaintiffs sought to represent themselves and all similarly situated U.S. current and former store managers of ours. A Settlement Agreement was reached between the parties, and on September 24, 2012, the Court issued an Order Preliminarily Approving the Settlement of all federal and state claims asserted by the plaintiffs in the litigation. We continue to deny any violation of any statute, law, rule or regulation, any liability or wrongdoing, and the truth of plaintiffs’ allegations. We 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 to put to rest the controversy underlying the litigation.

The Settlement Agreement preliminarily approved by the Court required us to establish a fund designated as a Qualified Settlement Fund (Escrow Account) in the amount of $993,386 to fund (1) settlement payments to the plaintiffs, (2) settlement payments to the other members of the settlement class who joined the case, (3) plaintiffs’ attorneys’ fees and expenses, and (4) and the claim administrator (Escrow Agent’s) fees and expenses. 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.

The deadline established by the Court for any persons employed by us as store managers between November 23, 2008 and September 24, 2012 to join the lawsuit as class members expired on May 24, 2013. On June 28, 2013, the Court issued two orders: (1) an Order Approving Class and Collective Action Settlement and Dismissing Case with Prejudice, and (2) a Final Judgment, Approving Class and Collective Action Settlement and Dismissing Case with Prejudice. Pursuant to the Court's June 28, 2013 orders, the claims administrator (Escrow Agent) was required to make payments to the plaintiffs and those existing and former store managers who joined the lawsuit by signing and returning Consent to Join Forms, which contained a release of us from the claims asserted in plaintiffs' lawsuit.

The settlement payments to the class members and the plaintiffs were made from the Escrow Account pursuant to the formula set forth in the Settlement Agreement by the claims administrator, as well as the payment of the plaintiffs' attorney's fees and the fees and expenses of the claims administrator (Escrow Agent). The total payment from the Escrow Account, including our required FICA payments based on the settlement payments, was $744,273 from the total Escrow Account of $993,386. All payments were made by the claims administrator and the balance of the Escrow Account (approximately $249,000) was returned to us in the first quarter of 2014.

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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, covered the full settlement of all claims of the plaintiffs and the class members, plaintiffs' attorneys' fees, and the fees and expenses of the claims administrator (Escrow Agent) in accordance with the terms of the Settlement Agreement. In the quarter ended June 30, 2013, we recorded a benefit of approximately $312,000, which was the expected remaining balance in the Escrow Account after all payments have been made. Payroll taxes associated with the payments to claimants of approximately $63,000 was recorded in the fourth quarter of 2013.

We are periodically involved in various other litigation matters that arise in the ordinary course of our business and operations. There are no such matters pending that we expect will 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.

7. 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, one in Sydney, Australia, and one in Jerez, Spain. 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 June 30, 2014				
Net sales	$6,457,467	$12,201,624	$1,044,516	$19,703,607
Gross profit	4,774,051	7,308,073	697,482	12,779,606
Operating earnings	1,106,942	1,427,913	121,422	2,656,277
Interest (expense)	(44,855)	-	-	(44,855)
Other income (expense), net	15,398	-	(10,064)	5,334
Income before income taxes	1,077,485	1,427,913	111,358	2,616,756
Depreciation and amortization	238,783	113,319	17,263	369,365
Fixed asset additions	160,847	145,768	1,185	307,800
Total assets	$45,455,609	$14,967,724	$2,314,779	$62,738,112
For the quarter ended June 30, 2013				
Net sales	$6,728,586	$11,242,080	$1,002,347	$18,973,013
Gross profit	4,648,116	6,670,357	601,648	11,920,121
Operating earnings	883,533	1,377,105	85,426	2,346,064
Interest (expense)	(51,544)	-	-	(51,544)
Other income (expense), net	60,212	16	38,056	98,284

	Wholesale Leathercraft	Retail Leathercraft	Int'l Leathercraft	Total
Income before income taxes	892,201	1,377,121	123,482	2,392,804
Depreciation and amortization	221,625	64,193	13,790	299,608
Fixed asset additions	830,162	149,985	-	980,147
Total assets	$39,552,986	$10,815,721	$2,787,275	$53,155,982

	Wholesale Leathercraft	Retail Leathercraft	Int'l Leathercraft	Total
For the six months ended June 30, 2014				
Net sales	$13,281,435	$24,157,978	$2,102,660	$39,542,073
Gross profit	9,304,260	14,806,489	1,384,580	25,495,329
Operating earnings	2,479,579	2,900,616	242,745	5,622,940
Interest (expense)	(90,683)	-	-	(90,683)
Other income (expense), net	25,174	-	(18,496)	6,678
Income before income taxes	2,414,070	2,900,616	224,249	5,538,935
Depreciation and amortization	464,639	217,760	33,521	715,920
Fixed asset additions	397,057	501,967	50,058	949,082
Total assets	$45,455,609	$14,967,724	$2,314,779	$62,738,112
For the six months ended June 30, 2013				
Net sales	$13,458,320	$22,801,941	$1,950,579	$38,210,840
Gross profit	8,813,271	13,831,585	1,206,094	23,850,950
Operating earnings	1,896,498	2,891,944	178,482	4,966,924
Interest expense	(107,638)	-	-	(107,638)
Other income (expense), net	74,705	26	50,292	125,023
Income before income taxes	1,863,565	2,891,970	228,774	4,984,309
Depreciation and amortization	413,158	121,622	27,930	562,710
Fixed asset additions	1,568,898	392,134	1,668	1,962,700
Total assets	$39,552,986	$10,815,721	$2,787,275	$53,155,982

Net sales for geographic areas were as follows for the three and six months ended June 30, 2014 and 2013:

Three months ended June 30,	2014	2013
United States	$16,432,956	$15,741,570
Canada	2,030,752	1,918,986
All other countries	1,239,899	1,312,457
	$19,703,607	$18,973,013

Six months ended June 30,	2014	2013
United States	$33,078,842	$31,937,964
Canada	3,926,810	3,838,709
All other countries	2,536,421	2,434,167
	$39,542,073	$38,210,840

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 and six-month periods ended June 30, 2014 and 2013. We do not have any significant long-lived assets outside of the United States.

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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 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, 2014, we were operating 80 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 international stores in 2014.

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, 2013.

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, without limitation, 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, 2013 for additional information concerning these and other uncertainties that could negatively impact the Company.

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

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also small businesses and other retailers. Specialty retail, and retail in general, is heavily influenced by general economic cycles. Purchases of non-essential 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.

- 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. Changes in consumers' product preferences or lack of acceptance of our products with respect to which costs have increased 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.

- 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 operations.

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

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

We 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, 2014 and 2013

The following tables present selected financial data of each of our three segments for the quarters ended June 30, 2014 and 2013.

	Quarter Ended June 30, 2014		Quarter Ended June 30, 2013	
	Sales	Income from Operations	Sales	Income from Operations
Wholesale Leathercraft	$6,457,467	$1,106,942	$6,728,586	$883,533
Retail Leathercraft	12,201,624	1,427,913	11,242,080	1,377,105
Int'l Leathercraft	1,044,516	121,422	1,002,347	85,426
Total Operations	$19,703,607	$2,656,277	$18,973,013	$2,346,064

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Consolidated net sales for the quarter ended June 30, 2014 increased approximately $730,000, or 3.9%, compared to the same period in 2013. Retail Leathercraft reported the largest percentage sales gain of 8.5%, followed by International Leathercraft, reporting a sales gain of 4.2%. Wholesale Leathercraft reported a sales decrease of 4%. Income from operations on a consolidated basis for the quarter ended June 30, 2014 increased 13.2%, or approximately $310,000, from the second quarter of 2013 due to the improvement in gross profit margin.

The following table shows in comparative form our consolidated net income for the second quarters of 2014 and 2013:

	2014	2013	% change
Net income	$1,765,485	$1,629,353	8.4%

All segments contributed to our 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 June 30, 2014 and 2013:

	Quarter ended	
Customer Group	06/30/14	06/30/13
RETAIL (end users, consumers, individuals)	43%	38%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	5%	5%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	44%	45%
MANUFACTURERS	6%	6%
NATIONAL ACCOUNTS	2%	6%
	100%	100%

Net sales decreased 4.0%, or approximately $271,000, for the second quarter of 2014 compared to the second quarter of 2013 as follows:

	# Stores	Qtr Ended 06/30/14	# Stores	Qtr Ended 06/30/13	$ Change	% Change
Same store sales	29	$6,451,664	29	$6,347,666	$103,998	1.6%
National account group		5,803		380,920	(375,117)	(98.5)%
Total sales	29	$6,457,467	29	$6,728,586	$(271,119)	(4.0)%

Sales to our retail and manufacturing customers increased in the second quarter of 2014 compared to the second quarter of 2013, while sales to our wholesale and institution group customers were down slightly. Sales to our national account customers ended in April – the result of a decision we made to eliminate certain products from our product line that these customers were buying. These products were eliminated due to unacceptable gross profit margins. Income from operations for Wholesale Leathercraft during the current quarter increased by $223,000 from the comparative 2013 quarter, an increase of 25%.

An increase in gross profit of approximately $126,000, along with a reduction in operating expenses of approximately $97,000, contributed to the improvement in income from operations compared to last year's second quarter. Gross profit as a percentage of sales increased from 69.1% in the second quarter of 2013 to 73.9% in the second quarter of 2014, due to an increase in sales to our retail customers, which generally brings higher gross profit margins as compared to other customer groups, and more sales of non-leather products, which also brings higher gross profit margins than that of leather sales. Operating expenses increased slightly as a percentage of sales due to the decrease in sales this quarter compared to last year's comparable quarter, but decreased in dollars. Expense decreases occurred in legal and professional fees, repairs/maintenance, and supplies. This was partially offset by an increase in employee compensation.

Retail Leathercraft

Our Retail Leathercraft operation consists of 80 Tandy Leather Company retail stores at June 30, 2014 compared to 78 stores at June 30, 2013. Net sales increased 8.5% for the second quarter of 2014 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 06/30/14	# Stores	Qtr Ended 06/30/13	$ Change	% Change
Same store sales	76	$11,811,841	76	$11,077,281	$734,560	6.6%
New store sales	4	389,783	-	-	389,783	N/A
Closed store sales	2	-	2	164,799	(164,799)	N/A
Total sales	80	$12,201,624	78	$11,242,080	$959,544	8.5%

The following table presents sales mix by customer categories for the quarters ended June 30, 2014 and 2013 for our Retail Leathercraft operation:

	Quarter ended	
Customer Group	06/30/14	06/30/13
RETAIL (end users, consumers, individuals)	57%	57%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%	5%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	36%	35%
MANUFACTURERS	3%	3%
	100%	100%

Sales to retail and wholesale customer groups increased over the second quarter of 2013, while sales to our institution and manufacturers customer groups declined slightly over the same period.

Income from operations increased approximately $51,000, in the quarter ended June 30, 2014, or 3.7%, from the comparative 2013 quarter due to an increase in gross profit offset partially by an increase in operating expenses. Our gross profit increased by approximately $638,000 from the comparable 2013 quarter primarily due to higher sales. Operating expenses as a percentage of sales rose from 47.1% in the second quarter of 2013 to 59.9% in the second quarter of 2014. The increase in operating expenses of approximately $587,000 in the second quarter of 2014 compared to the second quarter of 2013 was caused by increases in employee compensation and benefits (approximately $208,000), rent and utilities expense (approximately $137,000), and depreciation (approximately $49,000), and advertising expenses (approximately $125,000). A portion of these expense increases were attributable to the four new stores opened since November 2013.

International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of June 30, 2014 and 2013, the segment contained three stores, with one each located in United Kingdom, Australia, and Spain. This segment's sales totaled approximately $1,044,000 for the second quarter of 2014, compared to approximately $1,002,000 in the second quarter of 2013, an improvement of 4.2%. Operating expenses totaled approximately $576,000 in the second quarter of 2014, up from approximately $516,000 in last year's second quarter. Employee compensation is this segment's largest expense, followed by advertising and marketing expenses, rent, travel, and shipping costs to customers.

Other Expenses

We paid approximately $45,000 in interest on our bank debt in the second quarter of 2014, compared to approximately $51,000 in the second quarter of 2013. We recorded an expense of approximately $10,000 for currency fluctuations in the second quarter of 2014. Comparatively, in the second quarter of 2013, we recorded income of approximately $38,000 for currency fluctuations.

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Six Months Ended June 30, 2014 and 2013

The following table presents selected financial data of each of our three segments for the six months ended June 30, 2014 and 2013:

	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
	Sales	Operating Income	Sales	Operating Income
Wholesale Leathercraft	$13,281,435	$2,479,579	$13,458,320	$1,896,498
Retail Leathercraft	24,157,978	2,900,616	22,801,941	2,891,944
International Leathercraft	2,102,660	242,745	1,950,579	178,482
Total Operations	$39,542,073	$5,622,940	$38,210,840	$4,966,924

Consolidated net sales for the six months ended June 30, 2014 were up 3% compared to the same period in 2013, increasing approximately $1.3 million. Retail Leathercraft contributed the largest sales increase of approximately $1.4 million, followed by International Leathercraft reporting an increase of approximately $152,000. Wholesale Leathercraft reported a decrease of approximately $177,000. The increase in inventory at the stores, coupled with strong advertising efforts, contributed to the overall sales increase. Operating income on a consolidated basis for the six months ended June 30, 2014 was up 13.0% compared to the first half of 2013, increasing approximately $656,000.

The following table shows in comparative form our consolidated net income for the first half of 2014 and 2013:

	2014	2013	% change
Net income	$3,619,897	$3,215,674	12.6%

Wholesale Leathercraft

Net sales decreased 1.3%, or approximately $177,000, for the first half of 2014 as follows:

	# Stores	Six Months Ended 06/30/14	Six Months Ended 06/30/13	$ Change	% Change
Same store sales	29	$12,932,785	$12,791,987	$140,798	1.1%
National account group	-	348,650	666,333	(317,683)	(47.7)%
Total sales	29	$13,281,435	$13,458,320	$(176,885)	(1.3)%

Sales to our national account customers have been declining over time due to the elimination of certain products from our product line that these customers were buying (as these products have not historically provided an acceptable gross profit margin). Our final sale to this customer group occurred in April 2014.

The following table presents the combined sales mix by customer categories for the six months ended June 30, 2014 and 2013:

	Six Months Ended	
Customer Group	06/30/14	06/30/13
RETAIL (end users, consumers, individuals)	44%	39%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%	4%

WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	42%	44%
MANUFACTURERS	6%	6%
NATIONAL ACCOUNTS	4%	7%
	100%	100%

Operating income for Wholesale Leathercraft for the first half of 2014 increased by approximately $583,000 from the comparative 2013 period, a 31% improvement, due to an increase in gross profit and a reduction in operating expenses. Compared to the first six months of 2013, operating expenses decreased approximately $92,000 for the first half of 2014, holding steady as a percentage of sales at 51.4%.

Retail Leathercraft

Net sales were up 5.9% for the first half of 2014 over the same period last year.

	# Stores	Six Months Ended 06/30/14	Six Months Ended 06/30/13	$ Change	% Change
Same (existing) store sales	76	$23,421,926	$22,471,947	$949,979	4.2%
New store sales	4	736,052	-	736,052	N/A
Closed store sales	2	-	329,994	(329,994)	N/A
Total sales	80	$24,157,978	$22,801,941	$1,356,037	5.9%

The following table presents sales mix by customer categories for the six months ended June 30, 2014 and 2013 for our Retail Leathercraft operation:

	Six Months Ended	
Customer Group	06/30/14	06/30/13
RETAIL (end users, consumers, individuals)	59%	60%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%	4%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	35%	34%
NATIONAL ACCOUNTS	-	-
MANUFACTURERS	2%	2%
	100%	100%

The retail stores averaged approximately $50,000 in sales per month for the first half of 2014. By comparison, these stores averaged $49,000 in sales per month for the first half of 2013.

Operating income for the first six months of 2014 increased approximately $9,000 from the comparative 2013 period, decreasing as a percentage of sales from 12.7% in the first half of 2013 to 12.0% in the first half of 2014. Gross margin increased from 60.7% to 61.3% due to the customer and product mix. The ratio of retail sales, which brings a higher margin, to non-retail sales, which brings a lower margin, can affect gross profit margin positively or negatively. During the first six months of 2014, retail sales increased faster than non-retail sales, resulting in an improvement in gross profit margin. Operating expenses as a percentage of sales were 49.3% for the first half of 2014, increasing from 48.0% for the first half of 2013, as consolidated expenses grew faster than sales.

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International Leathercraft

International Leathercraft consists of all stores located outside of North America. As of June 30, 2014 and 2013, the segment contained three stores with one each located in United Kingdom, Australia, and Spain. Net sales increased 7.8% for the first half of 2014 over the same period last year. A store is categorized as "new" until it is operating for the full comparable period in the prior year.

	# Stores	Six Months Ended 06/30/14	Six Months Ended 06/30/13	$ Change	% Change
Same store sales	3	$2,102,660	$1,950,579	$152,081	7.8%
New store sales	-	-	-	-	-
Total sales	3	$2,102,660	$1,950,579	$152,081	7.8%

Gross profit margin as a percentage of sales increased from 61.8% in the first half of 2013 to 65.6% in the first half of 2014. Selling prices are determined based on the currency conversion between the U.S. dollar and the local currency. In addition, gross profit margin is affected by sales mix – the ratio of higher margin products (tools, supplies, etc.) to lower margin products (leather). Operating expenses totaled approximately $1.1 million in the first half of 2014, up approximately $114,000 from approximately $1.0 million in the first half of 2013. Advertising expenses increased approximately $64,000 compared to the comparable period last year, while employee compensation increased approximately $18,000 and travel expenses increased approximately $20,000. Employee compensation is this segment's largest expense, followed by advertising and marketing expenses, shipping costs to customers, and rent.

Other Expenses

We paid approximately $91,000 in interest on our bank debt in the first six months of 2014, compared to approximately $108,000 in the first six months of 2013. We recorded approximately $3,000 in interest income on our cash balances in the six months ended June 30, 2014 compared to approximaely $1,600 in the six months ended June 30, 2013. We recorded an expense of approximately $18,000 for currency fluctuations in the first half of 2014. Comparatively, in the first half of 2013, we recorded income of approximately $50,000 for currency fluctuations.

Capital Resources, Liquidity and Financial Condition

On our consolidated balance sheet, total assets increased from approximately $56.4 million at year-end 2013 to approximately $62.7 million at June 30, 2014. Total stockholders' equity increased from approximately $44.6 million at December 31, 2013 to approximately $45.8 million at June 30, 2014, the increase being attributable to our net income earned in the first half of 2014, partially offset by the special, one-time dividend of approximately $2.5 million that was approved by our Board of Directors in June. Our current ratio decreased from 5.0 at December 31, 2013 to 3.4 at June 30, 2014 due primarily to the approximately $2.2 million borrowings on our line of credit in the second quarter of 2014 and the accrued dividend that will be paid in August.

As of June 30, 2014, our investment in inventory increased by approximately $9.7 million from year-end 2013. The majority of the increase was caused by the arrival in the second quarter of a large portion of the new products that we will introduce in our annual catalog later this year. Historically, the majority of that product arrives in the third quarter. Inventory turnover reached an annualized rate of 2.5 times during the first half of 2014, decreasing from 2.9 times for the first half of 2013. Inventory turnover was 3.0 times for all of 2013. We compute our inventory turns as sales divided by average inventory.

Trade accounts receivable was approximately $796,000 at June 30, 2014, up approximately $34,000 from approximately $762,000 at year-end 2013. The average days to collect accounts for the first half of 2014 were 38 days, improving from 45 days for the first half of 2013. We monitor our customer accounts very closely in an effort to minimize the risk of uncollectible accounts in the current economic environment. Our allowance for doubtful accounts decreased from year-end 2013 to June 30, 2014 as a result of our collecting a number of various older accounts, which also contributed to the reduction in the days outstanding.

Accounts payable increased approximately $171,000 to approximately $2.1 million at June 30, 2014 compared to $1.9 million at year-end 2013 due to the increase in inventory during the quarter. Accrued expenses increased from approximately $5.8 million at December 31, 2013 to approximately $6.7 million at June 30, 2014. The increase in the inventory in transit at June 30, 2014 compared to that at December 31, 2013, offset by the payment of the 2013 manager bonuses in March 2014 accounted for the increase.

During the first half of 2014, cash flow used by operating activities was approximately $4.6 million. The increase in inventory of approximately $9.7 million, offset by net income of approximately $3.6 million and the increase in accounts payable and accrued expenses of approximately $1.1 million accounted for the use of operating cash during the first half of 2014.

By comparison, during the first six months of 2013, cash flow provided by operating activities was approximately $2.2 million. Net income of approximately $3.2 million and the increase in accounts payable of approximately $1.3 million, offset by the increase in inventory of approximately $1.6 million accounted for the operating cash provided in the first six months of 2013.

Cash flow used by investing activities totaled approximately $925,000 in the first six months of 2014, consisting primarily of the purchase of store fixtures, factory equipment, and computer equipment. In the first six months of 2013, cash flow used in investing activities totaled approximately $2.0 million, consisting primarily of the building constructed to house our flagship store, which opened in June 2013, and purchases of store fixtures and computer equipment.

Cash flow provided by financing activities totaled approximately $1.9 million in the first half of 2014, consisting of borrowing against our line of credit totaling approximately $2.2 million, partially offset by debt repayments of approximately $354,000. Cash flows used by financial activities totaled approximately $405,000 in the first half of 2013, consisting entirely of debt repayments.

We expect to fund our operating and liquidity needs as well as our store growth from a combination of current cash balances, internally generated funds, and occasional borrowings on our line of credit with JPMorgan Chase Bank.

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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, 2013. We believe that our exposure to market risks has not changed significantly since December 31, 2013. We expect that our exposure to foreign currency exchange risk will increase as our international presence increases.

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, 2014. 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, 2014, 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, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The information contained in Note 6 to the consolidated financial statements included in Item 1 of this Report is hereby incorporated into this Item 1 by reference.

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 Tandy Leather Factory, Inc.'s Form 10-Q filed with the Securities and Exchange Commission on August 12, 2005 and incorporated by reference herein.
3.2	Bylaws of The Leather Factory, Inc. (n/k/a Tandy Leather Factory, Inc.), filed as Exhibit 3.5 to the Current Report on Form 8-K filed by Tandy Leather Factory, Inc (f/k/a The Leather Factory, Inc.) with

	the Securities and Exchange Commission on July 14, 2004 and incorporated by reference herein.
3.3	Certificate of Designations of Series A Junior Participating Preferred Stock of Tandy Leather Factory, Inc. filed as Exhibit 3.1 to Tandy Leather Factory's Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 10, 2013 and incorporated by reference herein.
10.1	Note Modification Agreement dated as of June 19, 2014 between Tandy Leather Factory, Inc. and JPMorgan Chase Bank, N.A., filed as Exhibit 10.1 to Tandy Leather Factory, Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on June 25, 2014 and incorporated by reference herein.
*31.1	13a-14(a) or 15d-14(a) Certification by Jon Thompson, Chief Executive Officer and President.
*31.2	13a-14(a) or 15d-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.
101.INS^	XBRL Instance Document.
101.SCH^	XBRL Taxonomy Extension Schema Document.
101.CAL^	XBRL Taxonomy Extension Calculation Document.
101.DEF^	XBRL Taxonomy Extension Definition Document.
101.LAB^	XBRL Taxonomy Extension Labels Document.
101.PRE^	XBRL Taxonomy Extension Presentation Document.

*Filed herewith.

^ XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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 14, 2014

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

Date: August 14, 2014

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