LEATHER FACTORY INC
Form 10-Q/A
October 29, 2004

FORM 10-Q/A
AMENDMENT NO. 1
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 2004

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

THE 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 Number)

3847 EAST LOOP 820 SOUTH, FT. WORTH, TEXAS 76119
(Address of principal executive offices) (Zip code)

(817) 496-4414
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to by 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 is an accelerated filer.

Yes No x

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

Class	Shares outstanding as of May 10, 2004
Common Stock, par value $.0024 per share	10,555,661

THE LEATHER FACTORY, INC.

FORM 10-Q/A

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

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THE LEATHER FACTORY, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2004 (unaudited)
ASSETS	
CURRENT ASSETS:	

Cash	$ 1,678,607	$
Accounts receivable-trade, net of allowance for doubtful accounts of $63,000 and $31,000 in 2004 and 2003, respectively	3,055,545	
Inventory	11,392,312	
Prepaid income taxes	-	
Deferred income taxes	161,674	
Other current assets	1,054,036	
Total current assets	17,342,174	
PROPERTY AND EQUIPMENT, at cost	5,689,106	
Less-accumulated depreciation and amortization	(3,784,460)	
Property and equipment, net	1,904,646	
GOODWILL, net of accumulated amortization of $757,000 and $758,000 in 2004 and 2003, respectively	731,094	
OTHER INTANGIBLES, net of accumulated amortization of $178,000 and $164,000, in 2004 and 2003, respectively	439,493	
OTHER assets	322,107	
	$20,739,514	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 2,355,092	$
Accrued expenses and other liabilities	1,113,237	
Income taxes payable	229,631	
Notes payable and current maturities of long-term debt	-	
Total current liabilities	3,697,960	
DEFERRED INCOME TAXES	216,877	
NOTES PAYABLE AND LONG-TERM DEBT, net of current maturities	1,267,984	
COMMITMENTS AND CONTINGENCIES	-	
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.10 par value; 20,000,000 shares authorized, none issued or outstanding	-	
Common stock, $0.0024 par value; 25,000,000 shares authorized, 10,525,661 and 10,487,961 shares issued and outstanding at 2004 and 2003, respectively	25,261	
Paid-in capital	4,755,208	
Retained earnings	10,775,685	
Less: Notes receivable - secured by common stock	(15,000)	
Accumulated other comprehensive income	15,539	
Total stockholders' equity	15,556,693	
	$20,739,514	$

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

THE LEATHER FACTORY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2004 AND 2003

	2004	2003
NET SALES	$12,180,877	$10,560,085
COST OF SALES	5,455,964	4,914,581
Gross profit	6,724,913	5,645,504
OPERATING EXPENSES	5,277,778	4,529,832
INCOME FROM OPERATIONS	1,447,135	1,115,672
OTHER EXPENSE:		
Interest expense	13,638	63,352
Other, net	1,737	(30,818)
Total other expense	15,375	32,534
INCOME BEFORE INCOME TAXES	1,431,760	1,083,138
PROVISION FOR INCOME TAXES	460,794	308,620
NET INCOME	$ 970,966	$ 774,518
NET INCOME PER COMMON SHARE - BASIC	$ 0.09	$ 0.08
NET INCOME PER COMMON SHARE - DILUTED	$ 0.09	$ 0.07
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
Basic	10,506,995	10,177,433
Diluted	11,011,122	10,793,464

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

THE LEATHER FACTORY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 970,966	$ 774,51
Adjustments to reconcile net income to net		

cash provided by operating activities-		
Depreciation & amortization	129,418	125,03
Loss on disposal of assets	-	9,37
Deferred income taxes	(19,774)	24,47
Other	(9,766)	10,60
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(1,226,807)	(829,10
Inventory	(267,966)	22,75
Income taxes	435,654	187,38
Other current assets	(351,800)	(352,03
Accounts payable	810,013	(90,54
Accrued expenses and other liabilities	112,810	(1,507,39
Total adjustments	(388,218)	(2,399,44
Net cash provided by (used in) operating activities	582,748	(1,624,92
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(82,115)	(93,97
Payments in connection with businesses acquired	(125,452)	
Proceeds from sale of assets	-	6,21
Increase in other assets	14,076	(17,19
Net cash used in investing activities	(193,491)	(104,95
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in revolving credit loans	(525,000)	1,597,06
Payments on notes payable and long-term debt	(1,134)	(1,60
Decrease in cash restricted for payment on revolving credit facility	-	90,18
Payments received on notes secured by common stock	5,000	
Proceeds from issuance of common stock	82,140	47,65
Net cash provided by (used in) financing activities	(438,994)	1,733,30
NET CHANGE IN CASH	(49,737)	3,43
CASH, beginning of period	1,728,344	101,55
CASH, end of period	$ 1,678,607	$ 104,98
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid during the period	$ 16,205	$ 59,93
Income taxes paid during the period, net of (refunds)	44,914	41,62

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

THE LEATHER FACTORY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2004 AND 2003

	NUMBER OF SHARES	PAR VALUE	PAID-IN CA
BALANCE, December 31, 2002	10,149,961	$ 24,360	$ 4,16

Payments on notes receivable-secured by common stock	-	-	
Shares issued - stock options exercised	62,500	150	4
Net Income	-	-	
Translation adjustment	-	-	
BALANCE, March 31, 2003	10,212,461	$ 24,510	$ 4,21
BALANCE, December 31, 2003	10,487,961	$ 25,171	$ 4,67
Payments on notes receivable-secured by common stock	-	-	
Shares issued - stock options exercised	37,700	90	8
Net Income	-	-	
Translation adjustment	-	-	
BALANCE, March 31, 2004	10,525,661	$ 25,261	$ 4,7

	NOTES RECEIVABLE SECURED BY COMMON STK	ACCUMULATED OTHE CUMULATIVE INC(L
BALANCE, December 31, 2002	$ (44,003)	$ (38,
Payments on notes receivable-secured by common stock	-	
Shares issued - stock options exercised	-	
Net Income	-	
Translation adjustment	-	10,
BALANCE, March 31, 2003	$ (44,003)	$ (27,
Comprehensive income for the three months ended March 31, 2003		

	NOTES RECEIVABLE SECURED BY COMMON STK	ACCUMULATED OTHE CUMULATIVE INC(L
BALANCE, December 31, 2003	$ (20,000)	$ 26,
Payments on notes receivable-secured by common stock	5,000	
Shares issued - stock options exercised	-	
Net Income	-	
Translation adjustment	-	(10,
BALANCE, March 31, 2004	$ (15,000)	$ 15,
Comprehensive income for the three months ended March 31, 2004		

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

THE 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 The Leather Factory, Inc. and its consolidated subsidiaries (TLF) contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly its financial position as of March 31, 2004 and December 31, 2003, and its results of operations and cash flows for the three-month periods ended March 31, 2004 and 2003. Operating results for the three-month period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. 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, 2003.

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.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FIN 46, "Consolidation of Variable Interest Entities (VIE's)," an Interpretation of Accounting Research Bulletin No. 51. FIN 46 requires certain variable interest entities (VIEs) to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN 46R (revised December 2003) which delayed the application of FIN 46 to TLF until the interim period ended March 31, 2004, and provides additional technical clarifications to implementation issues. The application of this interpretation did not have a material impact on the Company's consolidated financial statements for the quarter.

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.

Inventory

Inventory is stated at the lower of cost or market and is accounted for on the "first in, first out" method. In addition, the value of inventory is periodically reduced for slow-moving or obsolete inventory based on management's review of items on hand compared to their estimated future demand. The components of inventory consist of the following:

	AS OF MARCH 31, 2004	AS OF DECEMBER 31, 2003
Finished goods held for sale. . .	$10,323,322	$ 9,902,140
Raw materials and work in process	1,068,990	1,177,753
	$11,392,312	$11,079,893

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. The Company has elected to perform the annual analysis during the fourth calendar quarter of each year. As of December 31, 2003, management determined that the present value of the discounted estimated future cash flows of the stores associated with the goodwill is sufficient to support their respective goodwill balances. No indicators of impairment were identified during the first quarter of 2004.

Other intangibles consist of the following:

	AS OF MARCH 31, 2004 GROSS	ACCUMULATED AMORTIZATION	NET	AS OF DECEMBER 31, 2003 GROSS	ACCUMULATED AMORTIZATION
Trademarks, Copyrights	$ 544,369	$ 147,393	$ 396,976	$ 544,369	$ 138,320
Non-Compete Agreements	73,000	30,483	42,517	52,000	25,500
	$ 617,369	$ 177,876	$ 439,493	$ 596,369	$ 163,820

The Company recorded amortization expense of $14,056 during the first quarter of 2004 compared to $12,740 during the first quarter of 2003. The Company has no intangible assets not 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 5 years is as follows:

	LEATHER FACTORY	TANDY LEATHER	ROBERTS, CUSHMAN	TOTAL
2004	$ 5,954	$ 54,004	$ 0	$59,958
2005	5,954	38,004	0	43,958
2006	5,954	37,337	0	43,291
2007	5,954	36,504	0	42,458
2008	5,954	33,337	0	39,291

2. STOCK-BASED COMPENSATION

The Company accounts for stock options granted to its directors and employees using the intrinsic value method prescribed by APB No. 25 which requires compensation expense be recognized for stock options when the quoted market price of the Company's common stock on the date of grant exceeds the option's exercise price. No compensation cost has been reflected in net income for the granting of director and employee stock options as all options granted had an exercise price equal to the quoted market price of the Company's common stock on the date the options were granted.

Had compensation cost for the Company's stock options been determined consistent with the SFAS 123 fair value approach, the Company's net income and net income per common share for the three months ended March 31, 2004 and 2003, on a pro forma basis, would have been as follows:

	2004	2003
Net income, as reported	$970,966	$774,518
Add: Stock-based compensation expense included in reported net income	-	-
Deduct: Stock-based compensation expense determined under fair value method	27,145	20,266
Net income, pro forma	$943,821	$754,252
Net income per share:		
Basic - as reported	$ 0.09	$ 0.08
Basic - pro forma	$ 0.09	$ 0.07
Diluted - as reported	$ 0.09	$ 0.07
Diluted - pro forma	$ 0.09	$ 0.07

The fair values of stock options granted were estimated on the dates of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.125% and 3.00% for 2004 and 2003, respectively; dividend yields of 0% for both periods; volatility factors of .696 for 2004 and .725 for 2003; and an expected life of the valued options of 5 years.

3. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS"):

	TH
Net income	$
Numerator for basic and diluted earnings per share	
Denominator for basic earnings per share - weighted-average shares	1

Effect of dilutive securities:	
Stock options	
Warrants	
	--
Dilutive potential common shares	
	--
Denominator for diluted earnings per share - weighted-average shares	1
	==
Basic earnings per share	$
	==
Diluted earnings per share	$
	==

The net effect of converting stock options and warrants to purchase 825,200 and 747,200 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 ended March 31, 2004 and 2003, respectively.

4. SEGMENT INFORMATION

The Company identifies its segments based on the activities of three distinct businesses:

A. THE LEATHER FACTORY, which sells primarily to wholesale customers through a chain of 30 outlet stores located in the United States and Canada;

B. TANDY LEATHER COMPANY, which sells primarily to retail customers through a chain of retail stores located in the United States; and

C. ROBERTS, CUSHMAN & COMPANY, manufacturer of decorative hat trims sold directly to hat manufacturers and distributors.

The Company's reportable operating segments have been determined as separately identifiable business units. The Company measures segment earnings as operating earnings, defined as income before interest and income taxes.

	THE LEATHER FACTORY	TANDY LEATHER COMPANY	ROBERTS, CU
FOR THE QUARTER ENDED MARCH 31, 2004			
Net sales	$ 8,443,091	$ 3,166,738	$
Gross profit	4,575,838	1,926,649	
Operating earnings	1,078,409	301,567	
Interest expense	(13,638)	-	
Other, net	(1,803)	66	
Income before income taxes	1,062,968	301,633	
Depreciation and amortization	102,028	25,153	
Fixed asset additions	39,737	38,043	
Total assets	$ 16,731,246	$ 3,079,605	$
FOR THE QUARTER ENDED MARCH 31, 2003			
Net sales	$ 8,201,258	$ 1,864,539	$
Gross profit	4,297,502	1,181,332	
Operating earnings	923,637	146,993	

Interest expense	(63,352)	-	
Other, net	31,290	(472)	
Income before income taxes	891,575	146,521	
Depreciation and amortization	106,367	15,839	
Fixed asset additions	39,497	54,475	
Total assets	$ 17,364,513	$ 2,447,611	$

Net sales for geographic areas were as follows:

	THREE MONTHS ENDED	
	MARCH 31, 2004	MARCH 31, 2003
United States	$ 11,285,857	$ 9,870,636
All other countries	895,020	689,449
	$ 12,180,877	$ 10,560,085

Geographic sales information is based on the location of the customer. No single foreign country accounted for any material amount of the Company's consolidated net sales for the three-month periods ended March 31, 2004 and 2003. The Company does 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.

The Leather Factory, Inc. ("TLF" or the "Company") is a Delaware corporation whose common stock trades on the American Stock Exchange under the symbol "TLF". The Company is managed on a business entity basis, with those businesses being The Leather Factory ("Leather Factory"), Tandy Leather Company ("Tandy" or "Tandy Leather"), and Roberts, Cushman & Company, Inc. ("Cushman"). See Note 4 to the Consolidated Financial Statements for additional information concerning the Company's segments, as well as its foreign operations.

Leather Factory, founded in 1980 by Wray Thompson and Ron Morgan, distributes leather and related products, including leatherworking tools, buckles and adornments for belts, leather dyes and finishes, saddle and tack hardware, and do-it-yourself kits. The products are sold primarily through 30 company-owned outlets located throughout the United States and Canada.

Tandy Leather is the oldest and best-known supplier of leather and related supplies used in the leathercraft industry. From its founding in 1919, Tandy has been the primary leathercraft resource worldwide. Products include quality tools, leather, accessories, kits and teaching materials. In early 2002, we initiated a plan to expand Tandy Leather by opening retail stores. As of April 15, 2004, we have opened 30 Tandy Leather retail stores located throughout the United States.

Cushman, whose origins date back to the mid-1800's, custom designs and manufactures a product line of decorative hat trims for headwear manufacturers.

CRITICAL ACCOUNTING POLICIES

A description of the Company's critical accounting policies appears in "Item 2. Management's Discussions and Analysis of Financial Condition and Results of

Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

RESULTS OF OPERATIONS

The following tables present selected financial data of each of the Company's three segments for the quarters ended March 31, 2004 and 2003:

	QUARTER ENDED MARCH 31, 2004		QUARTER ENDED MARCH 31, 2003	
	SALES	OPERATING INCOME	SALES	OPERATING INCOME
Leather Factory.	$ 8,443,091	$ 1,078,409	$ 8,201,258	$ 923,637
Tandy	3,166,738	301,567	1,864,539	146,993
Cushman	571,048	67,160	494,288	45,042
Total Operations	$ 12,180,877	$ 1,447,135	$ 10,560,085	$ 1,115,672

Consolidated net sales for the quarter ended March 31, 2004 increased $1.6 million, or 15.4%, compared to the same period in 2003. Leather Factory contributed $242,000 to the increase, Tandy contributed $1.3 million and Cushman recorded a sales increase of $77,000. Operating income on a consolidated basis for the quarter ended March 31, 2004 was up 29.7% or $331,000 over the first quarter of 2003.

The following table shows in comparative form our consolidated net income for the first quarters of 2004 and 2003:

	2004	2003	% CHANGE
Net income	$970,966	$774,518	25.4%

While our Leather Factory operation recorded 69.3% of our sales in the quarter, the continued growth and expansion of the Tandy Leather retail operation is responsible for the majority of the improvement in our consolidated net income.

LEATHER FACTORY OPERATIONS

Net sales from Leather Factory's 30 wholesale centers increased 2.95%, or $242,000, for the first quarter of 2004.

The following table presents TLF's sales mix by customer categories for the quarters ended March 31, 2004 and 2003:

	QUARTER
CUSTOMER GROUP	3/31/04
RETAIL (end users, consumers, individuals)	23%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	7%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	45%
NATIONAL ACCOUNTS	19%

MANUFACTURERS	6%
	100%

Our biggest sales gains were in our WHOLESALE and MANUFACTURER customer groups. We believe that in both cases, new advertising programs begun in the second half of 2003 contributed to these gains. Sales to our small business customers (part of our WHOLESALE group) were up approximately 30% over sales to that same customer group a year ago. Sales to small manufacturers were up 11% from last year. Although the percent of national account sales decreased in the first quarter of 2004 compared to that same quarter in 2003, we renewed two of our large accounts during the first quarter. We anticipate that these renewals will produce increased sales for our NATIONAL ACCOUNT customer group later in 2004.

Operating income for Leather Factory increased $155,000 for the current quarter compared to 2003, an improvement of 16.7%. Operating expenses as a percentage of sales were 41.4%, slightly higher ($120,000) than our target of 40% of sales. Advertising and marketing expenses were up slightly this quarter ($55,000) due to expanding direct mail programs in an attempt to increase market awareness and target new customer sub-groups. We also increased our bad debt reserve by $32,000 to $63,000 at the end of the first quarter, as a result of a few customer accounts whose collectability appears questionable.

TANDY LEATHER OPERATIONS

The Tandy Leather retail store chain has grown from 19 stores at March 31, 2003 to 29 a year later. Net sales for Tandy Leather were up approximately 70% for the first quarter of 2004 over the same quarter last year.

	QTR ENDED 3/31/04	QTR ENDED 3/31/03	$ INCR (DECR)	% INCR (DECR)
Same (existing) store sales	$1,832,591	$1,806,293	$ 26,298	1.46%
New store sales	1,334,147	57,187	1,276,960	N/A
Order fulfillment house - closed	-	1,059	(1,059)	(100.00)
Total sales	$3,166,738	$1,864,539	$1,302,199	69.84%

A store is categorized as "new" if it was operating less than half of the comparable period in the prior year. In the above table, the sales amount for "new store sales" for the quarter ended March 31, 2003 represents the sales from the four stores opened in February and March 2003.

Sales in the current quarter were solid - although as the table above indicates, our existing stores did not produce as strongly as we expected. The results are uneven, with existing stores reporting sales gains ranging from 4% to 48% for the quarter. We produced and mailed a sales flyer in a new format during the quarter that failed to produce the sales that we expected. We have gone back to our more traditional format for sales flyers, expecting it to produce more customer interest. The retail stores that are at least three months old are averaging approximately $38,000 in sales per month.

The following table presents Tandy Leather's sales mix by customer categories for the quarters ended March 31, 2004 and 2003:

CUSTOMER GROUP	QUARTER 3/31/04
RETAIL (end users, consumers, individuals)	74%
INSTITUTION (prisons, prisoners, hospitals, schools, youth organizations, etc.)	4%
WHOLESALE (resellers & distributors, saddle & tack shops, authorized dealers, etc.)	20%
NATIONAL ACCOUNTS	-
MANUFACTURERS	2%
	100%

Operating income as a percentage of sales increased from 7.9% in the first quarter of 2003 to 9.5% in the first quarter of 2004. Our gross margin decreased from 63.4% to 60.8% due to an increase in leather sales at the Tandy stores during the current quarter. As discussed in previous filings, leather is our lowest gross margin category. We offset that low margin by the other products that we sell. Operating expenses as a percentage of sales decreased from 55.5% to 51.3% due primarily to the increase in leverage obtained as a result of the significant sales increase.

ROBERTS, CUSHMAN OPERATIONS

Net sales for Cushman increased $77,000 or 15.5% for the first quarter of 2004, and improved its gross profit margin from 34% to 39%. Operating income for Cushman increased $22,000 or 49.1%. We eliminated one management position in the operation at the beginning of 2004, which contributed to the improvement in operating income.

COSTS AND EXPENSES

Our consolidated gross profit as a percent of net sales increased to 55.2% for the first quarter of 2004, compared with 53.5% for the same period in 2003. Operating expenses ($5.3 million) were 43.3% of net sales in the first quarter of 2004, compared with $4.5 million, or 42.9% of net sales in the first three months of 2003.

Interest expense in the first quarter of 2004 ($14,000) was down 78.5% from the first quarter of 2003 ($63,000) due to the decrease in the outstanding debt balance.

CAPITAL RESOURCES, LIQUIDITY AND FINANCIAL CONDITION

There was a slight change (approximately 9%) in our consolidated total assets from December 31, 2003 to March 31, 2004, increasing from $19.0 million at year-end to $20.7 million at March 31. Our accounts receivable accounted for the majority of the increase. Total stockholders' equity increased from $14.5 million at December 31, 2003 to $15.5 million at March 31, 2004. Most of the increase was from earnings in the first quarter of this year. The Company's current ratio fell slightly from 6.16 at December 31, 2003 to 4.69 at March 31, 2004.

Inventory increased by $312,000 at March 31, 2004 from year-end 2003. Inventory turnover increased to an annualized rate of 4.34 times during the first quarter of 2004, from 3.47 times for the first quarter of 2003 and 3.51 times for all of 2003. We compute our inventory turns as sales divided by average inventory. Inventory management is a significant factor in our financial position. We strive to maintain the optimal amount of inventory throughout the system in order to fill customer orders timely without tying up too much working capital. We are pleased with our achievement in this area as of the end of the quarter and continue to monitor our inventory levels in order to maximize optimum availability.

The Company's investment in accounts receivable was $3.1 million at March 31, 2004, up $1.2 million from $1.8 million at year-end 2003. This is a result of an increase in credit sales to our national accounts during the quarter ended March 31, 2004 as compared to that of the quarter ended December 31, 2003. The average days to collect accounts slowed slightly over the first quarter of 2003 from 45.0 days to 47.2 days. Cushman posted the most improvement in average days to collect accounts, from 66.7 days in 2003 to 50.1 days for the first quarter of 2004, respectively. Leather Factory and Tandy Leather's days to collect were 44.7 and 39.0 days in the first quarter of 2004 compared to 41.1 and 39.6 days in the first quarter of 2003, respectively.

Accounts payable increased $810,000 to $2.4 million at the end of the first quarter, due primarily to the increase in inventory purchases to support the increased sales and the negotiations with some vendors for longer payment terms. Accrued expenses and other liabilities increased $113,000.

During the first quarter of 2004, cash flow provided by operating activities was $583,000. The net income generated for the quarter and the increase in accounts payable contributed to the cash flow, offset somewhat by the increase in accounts receivable. Cash flow used in investing activities totaled $193,000. $125,000 of this was for the assets purchases of the Syracuse, NY and St. Louis, MO Tandy Leather retail stores. Equipment purchased during the quarter totaled $82,000. Most of the equipment purchased was for the new Tandy Leather stores. Cash flow used by financing activities was $439,000, consisting of payments on our revolving credit facility during the quarter totaling $525,000, offset primarily by stock option exercises by employees.

At March 31, 2003, our bank debt totaled $5.8 million. At March 31, 2004, the balance was $1.3 million, a decrease of 77%.

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, internally generated funds and our revolving credit facility with Wells Fargo, which is based upon the level of the our accounts receivable and inventory. At March 31, 2004, the available and unused portion of the credit facility was approximately $3.7 million.

FORWARD-LOOKING STATEMENTS

This report (particularly this Item 2) contains forward-looking statements of management. In general, these are predictions or suggestions of future events and statements or expectations of future trends or occurrences. 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 that could cause actual results to differ materially from those suggested by the forward-looking statements include, among other things:

- We might fail to realize the anticipated benefits of the opening of Tandy Leather retail stores or we might be unable to obtain sufficient new locations on acceptable terms to meet our growth plans. Also, other retail initiatives might not be successful.

- Political considerations here and abroad could disrupt our sources of supplies from abroad or affect the prices we pay for goods.

- Continued involvement by the United States in war and other military operations in the Middle East and other areas abroad could disrupt international trade and affect the Company's inventory sources.

- The recent slump 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. Also, hostilities, terrorism or other events could worsen this condition.
- As a result of the on-going threat of terrorist attacks on the United States, consumer buying habits could change and decrease our sales.
- Livestock diseases such as mad cow could reduce the availability of hides and leathers or increase their cost. Also, the prices of hides and leathers fluctuate in normal times, and these fluctuations can affect the Company.
- If, for whatever reason, the costs of our raw materials and inventory increase, we may not be able to pass those costs on to our customers, particularly if the economy has not recovered from its downturn.
- Other factors could cause either fluctuations in buying patterns or possible negative trends in the craft and western retail markets. In addition, our customers may change their preferences to products other than ours, or they may not accept new products as we introduce them.
- Tax or interest rates might increase. In particular, interest rates are likely to increase at some point from their present low levels. These increases will increase our costs of borrowing funds as needed in our business.

- Any change in the commercial banking environment may affect us and our ability to borrow capital as needed.

- Other uncertainties, which are difficult to predict and many of which are beyond the control of the Company, may occur as well.

The Company does not intend to update forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For disclosures about market risk affecting the Company, see Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for our fiscal year ended December 31, 2003. The Company believes that its exposure to market risks has not changed significantly since December 31, 2003.

ITEM 4. CONTROLS AND PROCEDURES

At the end of the first quarter of 2004, our President, Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"). Based upon this evaluation and notwithstanding the limitations contained in the final paragraph of this Item 4, they concluded that, as of March 31, 2004, the Company's disclosure controls and procedures offer reasonable assurance that the information required to be disclosed by the Company in the reports it files under the Exchange Act is recorded, processed, summarized, and reported within the time period specified in the results and forms adopted by the Securities and Exchange Commission.

During the period covered by this report, there has been no change in the Company's internal controls over financial reporting that materially affected, or is reasonably likely to materially affect, these controls.

Limitations on the Effectiveness of Controls. Our management, including the President, Chief Executive Officer and Chief Financial Officer, does not expect that the Company's disclosure controls and procedures or the Company's internal controls will prevent all error and all fraud. A well conceived and operating control system is based in part upon certain assumptions about the likelihood of future events and can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

PART II. OTHER INFORMATION

ITEM 5. CHANGES IN SECURITIES

On February 24, 2004, the Company entered into a Capital Markets Services Engagement Agreement ("Services Agreement") with Westminster Securities Corporation ("Westminster"), a member firm of the New York Stock Exchange. Under the Services Agreement, Westminster agreed to provide the Company with capital market services, including corporate finance advisory services, research services, and sales and trading services.

For the services to be provided during the two-year term of the Services Agreement, the Company agreed to pay $4,000 per month during the contract's term. Also, the Company issued to Westminster and certain named employees warrants to purchase 50,000 shares of the Company's common stock at an exercise price of $5.00 per share, subject to adjustment for certain issuances at a per share price below $5.00 that might occur during the five-year term of the warrants.

The issuance of the warrants was exempt from the registration requirements of the Securities Act of 1933 pursuant to Section 4(2) of that act. The related Financial Advisor's Warrant Agreement, dated as of February 24, 2004, contained representations as to investment intent and restrictions on transfer. Also the warrant certificates contain prominent legends stating the restrictions on transfer.

In addition, the Financial Advisor's Warrant Agreement grants demand and piggyback registration rights to the holders of the warrants to facilitate resale of the Company's common stock upon exercise of the warrants.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

EXHIBIT NUMBER	EXHIBIT
4.1*	Financial Advisor's Warrant Agreement, dated February 24, 2004, between The Leather Fact Securities Corporation
4.2*	Capital Markets Services Engagement Agreement, dated February 24, 2004, between The Leat Securities Corporation
31.1**	13a-14(a) Certification by Wray Thompson, Chairman of the Board and Chief Executive Offi
31.2**	13a-14(a) Certification by Shannon L. Greene, Chief Financial Officer and Treasurer
32.1*	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of