

TANDY LEATHER FACTORY INC  
Form 10-K  
March 08, 2018

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

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-12368

Tandy Leather Factory, Inc.

(Exact name of registrant as specified in its charter)

Delaware

75-2543540

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1900 Southeast Loop 820, Fort Worth, TX 76140

817/872-3200

(Address of Principal Executive Offices and Zip Code)

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Name of each exchange on which registered

Common Stock, par value \$0.0024 NASDAQ Global Market

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act. Yes  No

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

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  No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$47,389,981 at June 30, 2017 (based on the price at which the common stock was last traded on the last business day of its most recently completed second fiscal quarter). At March 7, 2018, there were 9,270,862 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on June 5, 2018, are incorporated by reference in Part III of this report.

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PART I

ITEM 1. BUSINESS

The following discussion, as well as other portions of this Annual Report on Form 10-K (or statements otherwise made by the Company or on the Company's behalf from time to time in other reports, filings with the Securities and Exchange Commission ("SEC"), news releases, conferences, World Wide Web postings or otherwise), contains forward-looking statements that reflect our plans, estimates and beliefs. Any such forward-looking statements (including, but not limited to, statements to the effect that TLF or its management "anticipates", "plans", "estimates", "expects", "believes", "intends", and other similar expressions) that are not statements of historical fact should be considered forward-looking statements and should be read carefully because they involve risks and uncertainties. Any forward-looking statement speaks only as of the date on which such statement is made. We do not undertake any obligation to update or revise any forward-looking statements. Specific examples of forward-looking statements include, but are not limited to, statements regarding our forecasts of financial performance, share repurchases, store openings, capital expenditures and working capital requirements. Our actual results could materially differ from those discussed in such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this Annual Report on Form 10-K and particularly in "Item 1A. Risk Factors" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations". Unless the context otherwise indicates, references in this Annual Report on Form 10-K to "we", "our", "us", "our Company", "the Company", "Tandy", "Tandy Leather" or "TLF", mean Tandy Leather Factory, Inc, together with its subsidiaries.

General

With \$82.3 million of sales in 2017 (of which 14% were export sales), Tandy Leather is, to our knowledge, the world's largest specialty retailer of leather and leathercraft related items based on sales, offering a wide range of leather, quality tools, hardware, accessories, liquids, lace, kits and teaching materials. We sell our products through company-owned stores and through orders generated from our website, [www.tandyleather.com](http://www.tandyleather.com). We also manufacture the leather lace and some of our do-it-yourself kits that are sold in our stores and website. We maintain our principal offices at 1900 Southeast Loop 820, Fort Worth, Texas 76140. Our common stock trades on the NASDAQ Global Market under the symbol "TLF."

Our company was founded in 1980 as Midas Leathercraft Tool Company, a Texas corporation ("Midas"), which focused on the distribution of leathercraft tools. In addition, the founders of Midas entered into an agreement with Brown Group, Inc., a major footwear retailer, to develop a chain of wholesale stores known as "The Leather Factory." In 1985, Midas purchased the assets related to The Leather Factory stores from Brown Group, Inc., which then consisted of six stores. In 1993, we changed our name to The Leather Factory, Inc. We reincorporated in the state of Delaware in 1994. In 2005, we changed our name to Tandy Leather Factory, Inc.

Our Development in Recent Years

We have built our business by offering our customers quality products in one location at competitive prices. We have expanded our store footprint by opening new stores and by making numerous acquisitions of small businesses in strategic geographic locations. In 1996, we expanded into Canada by acquiring our Canadian distributor, The Leather Factory of Canada, Ltd. In 2000, we acquired the operating assets of two subsidiaries of Tandy Leathers, Inc. We began expanding outside of North America by opening a store in the United Kingdom in 2008, then Australia in 2011 and Spain in 2012. We opened another store in the United Kingdom in 2015. At December 31, 2017, we operated 115 stores located in North America and 4 stores in the United Kingdom, Australia and Spain.

The following tables provide store count and expansion information by segment for the last five years:

Year ended	<u>North America</u>			<u>International</u>		
	<u>Opened</u>	<u>Closed</u>	<u>Total</u>	<u>Opened</u>	<u>Closed</u>	<u>Total</u>
2013	3	2	108	-	-	3
2014	3	1	110	-	-	3
2015	-	-	110	1	-	4
2016	4	3*	111	-	-	4
2017	4*	-	115	-	-	4

\*1 store temporarily closed in April 2016 and reopened in January 2017

We believe that the key to our success is our ability to profitably grow our base business. We expect to grow that business by opening new stores and by increasing sales in our existing stores. Our initiatives to increase sales include new merchandising with an expanded product line intended to increase our retail customer base, a refocus on business development to our wholesale and manufacturer groups, improvements to our digital and e-commerce channels, as well as increasing our average ticket. We have also increased our training efforts with our store associates to strengthen their product knowledge. We believe that our store associates, armed with a solid knowledge of our extensive product line, can drive higher average tickets and traffic conversion.

Our mission is to teach and inspire the art of leathercrafting, one person, one class, one neighborhood, one community at a time. Our rich heritage began with Tandy Leather Company, which was originally established in 1919 as Hinkley-Tandy Leather Company, one of the oldest and one of the best-known suppliers of leather and related products used in the leathercraft industry. Tandy has long been known for its commitment to promoting and developing the craft through education and customer development. We continue to seek to broaden our customer base by opening new stores, working with various youth organizations and institutions where people are introduced to leathercraft, as well as hosting classes in our stores. In 2017, we began offering military and first responder appreciation programs which gives eligible customers discounted pricing.

We are also focusing on improving our customer experience, increasing our brand awareness, and strengthening our store performance. To help achieve those goals, in early 2017, we announced a district restructuring with our store footprint divided into fifteen districts (previously, our store footprint was divided into five regions). Each district contains six to ten stores, reporting to a district manager who is tasked with growing traffic and sales, as well as training store managers and associates to better serve our customers and succeed in today's retail environment. As of March 7, 2018, we have filled twelve of our fifteen district manager positions.

#### Customers

Our customer base is diverse, with individual retail customers as our largest customer group, representing approximately 60% of our 2017 sales. The remaining portion of our 2017 sales were to our wholesale, manufacturer and institutional groups (including horse and tack shops, Western wear, crafters, upholsterers, cobblers, auto repair, education, hospitals, prisons and other large businesses that use our products as raw materials to produce goods for resale). Generally, our retail customers provide a higher gross profit as compared to our wholesale and manufacturer groups.

We serve our customers through various means including walk-in traffic, phone, mail order, and orders generated from our website. We seek to minimize delivery time by locating our stores based on the location of customers. A two-day maximum delivery time for phone, web and mail orders is our goal. We also employ a distinctive marketing tactic in that we maintain an internally-developed target customer mailing list for use in our direct mail advertising campaigns. We staff our stores with experienced managers whose compensation is tied to the operating profit of the store they manage. Sales are generated by the selling efforts of the store personnel, combined with our marketing programs, including print, digital, direct mail, community events and trade shows.

No single customer's purchases represented more than 0.5% of our total sales in 2017. Sales to our five largest customers represented 1.2%, 1.4% and 1.3% of consolidated sales in 2017, 2016, and 2015, respectively. We do not believe the loss of any one of these customers would have a significant negative impact on our consolidated results.

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

## Merchandise

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

Sales by product category were as follows:

<u>Product Category</u>	<u>2017 Sales Mix</u>	<u>2016 Sales Mix</u>	<u>2015 Sales Mix</u>
Belts strips and straps	4%	4%	4%
Books, patterns, videos	1%	1%	2%
Buckles	2%	3%	3%
Conchos <sup>^</sup>	2%	2%	2%
Craft supplies	2%	2%	2%
Dyes, finishes, glues	7%	7%	7%
Hand tools	20%	18%	16%
Hardware	8%	8%	8%
Kits	6%	6%	6%
Lace	3%	3%	3%
Leather	40%	41%	42%
Stamping tools	5%	5%	5%
	100%	100%	100%

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

## Our Operating Segments

We operate in two segments, based on management responsibility and store location: North America and International. Prior to January 1, 2017, we operated in three segments: Wholesale, Retail and International. To better reflect how management analyzes the business and allocates resources, we combined Wholesale and Retail into North America effective January 1, 2017, while International remains the same. All prior year data discussed throughout this Annual Report on Form 10K has been restated to conform to the new reporting segment structure. The new reporting segment structure did not result in any change to our consolidated financial position or results.

Information regarding net sales, gross profit, operating income, and total assets, attributable to each of our segments, is included within Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and within Item 8. Financial Statements and Supplementary Data in Note 12, Segment Information, of our Notes to Consolidated Financial Statements.

## North America Segment

As of March 7, 2018, the North America segment consists of 115 stores, of which 105 are in the United States across 42 US states and 10 are in Canada across 7 provinces. This segment had net sales of \$78.6 million, \$79.0 million and \$80.5 million for 2017, 2016, and 2015, respectively.

Our stores offer a broad selection of products combined with leathercraft expertise in a one-stop shop. Not only can customers purchase leather, related accessories and supplies necessary to complete his or her project from a single source, but many of our store associates are also leathercrafters themselves and can provide suggestions and advice on the customer's projects. The size and layout of the stores are planned to allow large quantities of product to be displayed in an easily accessible and visually appealing manner. For example, leather is displayed by the pallet where the customer can see and touch it, assessing first-hand the numerous sizes, styles, and grades offered. We also offer open workbenches where customers can try out tools and stamps.

From a physical standpoint, our stores range in size from 1,200 square feet to 22,000 square feet, with the average size of a store being approximately 4,000 square feet. The types of premises utilized for our stores are generally light industrial offices or warehouse spaces or older strip shopping centers in proximity to major freeways or well-known crossroads; these types of locations typically offer lower rents compared to other more retail-oriented locations. In 2016, we began opening new stores with an average footprint of 2,500 square feet in upgraded retail centers to seek to attract more retail customers.

Historically, we typically generate slightly more sales in the fourth quarter of each year due to the holiday shopping season (approximately 28-30% of annual sales), while the other three quarters remain fairly even at approximately 22-24 % of annual sales each quarter.

We plan to open two to four new stores in 2018, and we will evaluate the number of store relocations to seek to ensure that the benefits gained exceed the costs of relocation.

#### International Segment

The International segment consists of all stores located outside of North America. As of March 7, 2018, we had four such stores, two located in the United Kingdom, one located in Australia, and one located in Spain. This segment's net sales were approximately \$3.8 million, \$3.9 million and \$3.7 million in 2017, 2016, and 2015, respectively. We intend to open more stores internationally, as the opportunities present themselves, but we have not determined a specific time schedule for future store openings and we do not expect to open any international stores in 2018.

The business concept for our International segment is similar to our North America strategy, although the stores average 7,000 square feet and are generally located in light industrial areas. The customer base generally consists of individuals, wholesale distributors, equine-related shops, cobblers, dealers, and retailers dispersed geographically throughout Europe, Australia, and Asia. No single customer's purchases represented more than 4% of International Leathercraft's sales in 2017.

For more information about our business and our reportable segments, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".



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### Operations

Starting March 1, 2018, in the majority of our stores, our hours of operation were extended to allow for later closing times to seek to better accommodate our customer's schedules. Our stores now open at 10:00 am Monday through Saturday, and close at 6:00 pm on Monday, Wednesday, Friday and Saturday and close at 8 pm on Tuesday and Thursday. Previously, the hours of operation of our stores were 9:00 am to 6:00 pm Monday through Friday, and from 9:00 am to 4:00 pm on Saturdays. Our stores are closed on Sunday, but this is currently under evaluation. The stores maintain uniform prices, except where lower prices are necessary to meet local competition.

### Distribution

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

We attempt to maintain the optimum number of items in our product line in order to seek to minimize out-of-stock situations against carrying costs involved with such an inventory level. We generally maintain higher inventories of imported items to seek to ensure a continuous supply. The number of products offered changes every year due to the introduction of new items and the discontinuance of others. We carry approximately 2,600 items in the current lines of leather and leather-related merchandise. All items are offered in all stores, unless prohibited by local regulations.

### Competition

Most of our competition comes in the form of small, independently-owned businesses some of which are also our customers. These small businesses generally carry only a limited line of leathercraft products. We also compete with several national chains that also carry leathercraft products on a very small scale relative to their overall product line. We also compete with internet-based retailers that provide customers the ability to search and compare products and prices without having to visit a physical store. We compete on price, availability of merchandise, depth of our product line, and delivery time. While there is competition with a number of our products, to our knowledge, there is no direct competition affecting our entire product line. Further, to our knowledge, our store chain is the only one in existence solely specializing in leathercraft. As such, we believe that our large size relative to most competitors gives us the advantage of being able to purchase large volumes and stock a full range of products in our stores, as well as hire experienced store personnel that offer product expertise and project advice.

### Suppliers

We purchase merchandise and raw materials from approximately 150 vendors dispersed throughout the United States and in approximately 20 foreign countries. In 2017, our 10 largest vendors accounted for approximately 72% of our inventory purchases.

Because leather is sold internationally, market conditions abroad are likely to affect the price of leather in the United States. Aside from increasing purchases when we anticipate price increases (or possibly delaying purchases if we foresee price declines), we do not attempt to hedge our inventory costs.

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

### Compliance With Environmental Laws

Our compliance with federal, state and local environmental protection laws has not had, and is not expected to have, a material effect on our capital expenditures, earnings, or competitive position.

#### Employees

As of December 31, 2017, we employed 656 people, 550 of whom were employed on a full-time basis. We are not a party to any collective bargaining agreements. Overall, we believe that relations with employees are good.

#### Intellectual Property

We own approximately 120 registered trademarks, including federal trade name registrations for "Tandy Leather Factory," "The Leather Factory," "Tandy Leather Company," and "Tandy." We also own approximately 60 registered foreign trademarks worldwide. We own approximately 600 registered copyrights in the United States covering more than 800 individual works relating to various products. We also own several United States patents for specific belt buckles and leather-working equipment. These rights are valuable assets, and we defend them as necessary.

#### Foreign Sales

Information regarding our revenues from the United States and abroad and our long-lived assets are found in Note 12 to our Consolidated Financial Statements, Segment Information. For a description of some of the risks attendant to our foreign operations, see Item 1.A "Risk Factors".

#### Available Information

We file reports with the Securities and Exchange Commission ("SEC"). These reports include our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these filings. The public may read any of these filings at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549 on official business days during the hours of 10 a.m. and 3 p.m. In addition, the public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Further, the SEC maintains an Internet site that contains reports, proxy and information statements, and other information concerning us. You can connect to this site at [www.sec.gov](http://www.sec.gov).

Our corporate website is located at [www.tandyleather.com](http://www.tandyleather.com). We make copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and any amendments thereto filed with or furnished to the SEC available to investors on or through our website free of charge as soon as reasonably practicable after we electronically file them with or furnish them to the SEC. Our SEC filings can be found on the Investor Relations page of our website through the "SEC Filings" link. In addition, certain other corporate governance documents are available on our website through the "Corporate Governance" link.

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Executive Officers of the Registrant

The following table sets forth information concerning our executive officers as of March 7, 2018:

<u>Name and Age</u>	<u>Position</u>	<u>Served as Executive Officer Since</u>
Shannon L. Greene, 52	Chief Executive Officer	2000
Mark J. Angus, 57	President	2008
Tina L. Castillo, 48	Chief Financial Officer and Treasurer	2017
William M. Warren, 74	Secretary and Corporate Counsel	1993

Shannon L. Greene has served as Chief Executive Officer since February 2016 and a director since January 2001; Prior to her current role, Ms. Greene served as our Chief Financial Officer and Treasurer from May 2000 – February 2017. Ms. Greene, a certified public accountant, also serves on our 401(k) Plan committee.

Mark J. Angus has served as President since February 2016 and a director since June 2009; previously, Mr. Angus served as our Senior Vice President from June 2008 – February 2016 and as Vice President of Merchandising from January 1993 – June 2008.

Tina Castillo has served as Chief Financial Officer and Treasurer since February 2017; previously, Ms. Castillo served as Controller from February 2016 to January 2017. Ms. Castillo has served as Chief Financial Officer for several other public and private companies since 2009 and started her career at Ernst & Young in 1994. Ms. Castillo, a certified public accountant, also serves on our 401(k) Plan committee.

William M. Warren has served as Secretary and General Counsel since 1993. Since 1979, Mr. Warren has been President and Director of Loe, Warren, Rosenfield, Kaitcer, Hibbs, Windsor & Lawrence, P.C., a law firm located in Fort Worth, Texas.

All officers are elected annually by the Board of Directors to serve for the ensuing year.

ITEM 1A. RISK FACTORS

Risks to Our Industry

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

Our performance is subject to global 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, discretionary 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, maintain our earnings from operations as a percentage of net sales, or generate sufficient cash flows to fund our operational and liquidity needs. While consumer spending in the United States has stabilized recently, it 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.

Increases in the price of leather and other items we sell or a reduction in availability of those products could increase our cost of goods and decrease our profitability.

The prices we pay our suppliers for our products are dependent in part on the market price for leather, metals, and other products. The cost of these items may fluctuate substantially, depending on a variety of factors, including demand, supply conditions, transportation costs, government regulation, economic climates, political considerations, and other unpredictable factors. Leather prices world-wide have been relatively stable for the past several years although the outlook for future prices is uncertain. Increases in these costs, together with other factors, will make it difficult for us to sustain the gross margin level we have achieved in recent years and result in a decrease in our profitability unless we are able to pass higher prices on to our customers or reduce costs in other areas. Accordingly, such increases in costs could adversely affect our business and our results of operations.

Further, involvement by the United States in war and other military operations abroad could disrupt international trade and affect our inventory sources. Finally, livestock diseases, such as mad cow, could reduce the availability of hides and leathers or increase their cost. The occurrence of any of these events could adversely affect our business and our results of operations.

#### Risks Related to Our Business

We may be unable to sustain our financial performance or our past growth, which may have a material adverse effect on our future operating results.

In 2017, we experienced a decline in sales, primarily due to lower sales from our non-retail customers and a decline in operating income due to recent investments in our district manager program and new store growth strategy. Many other specialty retailers have experienced declining sales and losses due to the overall challenging retail environment. Our sales and profits may continue to be negatively affected in the future. We anticipate that our financial performance will depend on a number of factors, including consumer preferences, the strength and protection of our brand, the introduction of new products, and the success of our district manager program. Our future success will depend substantially on the ability of our management team to successfully execute on its business strategies. If we fail to successfully execute on these business strategies, our future operating results could be adversely affected.

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Our profitability may decline from increasing pressure on margins.

Our industry is subject to significant pricing pressure caused by many factors, including fluctuations in the cost of the leathers 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 whose costs have increased may prohibit us from passing those 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.

Our growth depends on our ability to open new stores and increase comparable store sales.

One of our key business strategies is to expand our base of retail stores. If we are unable to continue this strategy, our ability to increase our sales, profitability and cash flow could be impaired. To the extent we are unable to open new stores as we anticipate, our sales growth would come only from increases in comparable store sales. Growth in profitability in that case would depend significantly on our ability to improve gross margin. We may be unable to continue our store growth strategy if we cannot identify suitable sites for additional stores, negotiate acceptable leases, or hire and train a sufficient number of qualified team members.

Our success depends on the continued protection of our trademarks and other proprietary intellectual property rights.

Our trademarks and other intellectual property rights are important to our success and competitive position, and the loss of or inability to enforce our trademark and other proprietary intellectual property rights could harm our business. We devote substantial resources to the establishment and protection of our trademark and other proprietary intellectual property rights on a worldwide basis. Despite any precautions we may take to protect our intellectual property, policing unauthorized use of our intellectual property is difficult, expensive, and time consuming, and we may be unable to adequately protect our intellectual property or determine the extent of any unauthorized use. Our efforts to establish and protect our trademark and other proprietary intellectual property rights may not be adequate to prevent imitation or counterfeiting of our products by others, which may not only erode sales of our products but may also cause significant damage to our brand name. Further, we could incur substantial costs in legal actions relating to our use of intellectual property or the use of our intellectual property by others. Even if we are successful in these actions, the costs we incur could have a material adverse effect on us.

Foreign currency fluctuations could adversely impact our financial condition and results of operations.

We generally purchase our products in U.S. dollars. However, we source a large portion of our products from countries other than the United States. The cost of these products may be affected by changes in the value of the applicable currencies. Changes in currency exchange rates may also affect the U.S. dollar value of the foreign currency denominated prices at which our international business will sell products. Furthermore, the majority of our international sales are generally derived from sales in foreign countries. This revenue, when translated into U.S. dollars for consolidated reporting purposes, could be materially affected by fluctuations in the U.S. dollar, negatively impacting our results of operations and our ability to generate revenue growth.

Our business could be harmed if we are unable to maintain our brand image.

Tandy Leather is one of the most recognized brand names in our industry. Our success to date has been due in large part to the strength of that brand. If we are unable to provide quality products and exceptional customer service to our customers, including education, which Tandy Leather has traditionally been known for, our brand name may be impaired which could adversely affect our operating results.

We may be subject to information technology system failures or network disruptions, or our information systems may prove inadequate, resulting in damage to our reputation, business operations and financial condition.

We depend on our information systems for many aspects of our business, including in designing, manufacturing, marketing and distributing our products, as well as processing transactions, managing inventory and accounting for and reporting our results. Therefore, it is critical that we maintain uninterrupted operation of our information systems. Even with our preventative efforts, we may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, denial of service attacks, computer viruses, physical or electronic break ins, or similar events or disruptions. System redundancy may be ineffective or inadequate, and our disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could prevent access to our online services and preclude store transactions, as well as require a significant investment to repair or replace them. System failures and disruptions could also impede the manufacturing and shipping of products, transactions processing and financial reporting. Additionally, we may be materially adversely affected if we are unable to improve, upgrade, maintain, and expand our systems.

A significant data security or privacy breach of our information systems could affect our business.

The protection of our customer, employee and other data is important to us, and our customers and employees expect that their personal information will be adequately protected. In addition, the regulatory environment surrounding information security and privacy is becoming increasingly demanding, with evolving requirements in the various jurisdictions in which we do business. Although we have developed and implemented systems and processes that are designed to protect personal and Company information and prevent data loss and other security breaches, such measures cannot provide absolute security. Additionally, our increased use and reliance on web-based hosted (i.e., cloud computing) applications and systems for the storage, processing and transmission of information, including customer and employee information, could expose us, our employees and our customers to a risk of loss or misuse of such information. Our efforts to protect personal and Company information may also be adversely impacted by data security or privacy breaches that occur at our third-party vendors. We cannot control these vendors and therefore cannot guarantee that a data security or privacy breach of their systems will not occur in the future. A significant breach of customer, employee or Company data could damage our reputation, relationships with customers, and our brand and could result in lost sales, sizable fines, significant breach-notification costs and lawsuits as well as adversely affect results of operations. We may also incur additional costs in the future related to the implementation of additional security measures to protect against new or enhanced data security and privacy threats, to comply with state, federal and international laws that may be enacted to address those threats or to investigate or address potential or actual data security or privacy breaches.

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The loss or a prolonged disruption in the operation of our centralized distribution center could adversely affect its business and operations.

We maintain a distribution center in Fort Worth, Texas dedicated to warehousing merchandise to handle worldwide store replenishment and process some direct-to-customer orders. Although we believe that we have appropriate contingency plans, unforeseen disruptions impacting our centralized distribution center for a prolonged period of time may result in delays in the delivery of merchandise to stores or in fulfilling customer orders.

Other uncertainties, which are difficult to predict and many of which are beyond our control, may occur as well and may adversely affect our business and our results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We lease our store locations, with the exception of our flagship store located in Fort Worth, Texas. The majority of our stores have initial lease terms of at least five years. The leases are generally renewable, with increases in lease rental rates in some cases. We believe that all of our properties are adequately covered by insurance. The properties leased by us are described in Item 1 in the description of each of our two operating segments. We own the 22,000 square foot building that houses our flagship store. Further, we own our corporate headquarters, which includes our central warehouse and manufacturing facility, sales, advertising, administrative, and executive offices. The facility consists of 191,000 square feet located on approximately 30 acres.

The following table summarizes the locations of our leased premises as of December 31, 2017:

U.S. Locations

Alabama	1	Montana	1
Alaska	1	Nebraska	1
Arizona	4	Nevada	2
Arkansas	1	New Mexico	2
California	11	New York	2
Colorado	4	New Jersey	1
Connecticut	1	North Carolina	2
Florida	5	Ohio	3
Georgia	1	Oklahoma	2
Idaho	1	Oregon	3
Illinois	2	Pennsylvania	3
Indiana	2	Rhode Island	1
Iowa	1	South Carolina	1
Kansas	1	South Dakota	1
Kentucky	1	Tennessee	3
Louisiana	2	Texas	18
Maryland	1	Utah	4
Massachusetts	1	Virginia	1
Michigan	2	Washington	3
Minnesota	2	Wisconsin	1
Missouri	3	Wyoming	1

Canadian  
locations:

Alberta	1
British Columbia	1
Manitoba	1
Nova Scotia	1
Ontario	3
Quebec	1
Saskatchewan	1

International  
locations:

United Kingdom	2
Australia	1
Spain	1

ITEM 3. LEGAL PROCEEDINGS

See discussion of Legal Proceedings in Note 9 to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.



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## PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Market using the symbol "TLF." The high and low trading prices for each calendar quarter during the last two fiscal years are as follows:

<u>2016</u>	<u>High</u>	<u>Low</u>	<u>2017</u>	<u>High</u>	<u>Low</u>
4 <sup>th</sup> quarter	\$8.25	\$6.85	4 <sup>th</sup> quarter	\$8.45	\$7.25
3 <sup>rd</sup> quarter	\$7.90	\$6.96	3 <sup>rd</sup> quarter	\$9.00	\$7.85
2 <sup>nd</sup> quarter	\$7.69	\$6.73	2 <sup>nd</sup> quarter	\$8.99	\$7.85
1 <sup>st</sup> quarter	\$7.75	\$6.75	1 <sup>st</sup> quarter	\$8.20	\$7.15

There were approximately 299 stockholders of record on March 7, 2018.

We did not sell any shares of our equity securities during our fiscal year ended December 31, 2017 that were not registered under the Securities Act.

We did not purchase any shares of our common stock in 2017, although we are authorized to do so through a stock purchase program permitting us to repurchase up to 2.2 million shares of our common stock at prevailing market prices. We announced the program on August 10, 2015, and it was amended on June 6, 2017 to extend the termination date to August 9, 2018. See Note 11 to our Financial Statements included in Item 8 of this report.

Our Board of Directors did not authorize any dividends during the fiscal years ended December 31, 2017 or 2016. Our Board of Directors determines future cash dividends after giving consideration to our profitability, cash flow, capital requirements, current and forecasted liquidity, as well as financial and other business conditions existing at the time. This policy is subject to change based on future industry and market conditions, as well as other factors.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below are derived from and should be read in conjunction with our Consolidated Financial Statements and related notes. This information should also be read in conjunction with "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations."

Income Statement Data, Years ended December 31,	2017	2016	2015	2014	2013
Net sales	\$82,321,268	\$82,923,992	\$84,161,200	\$83,430,912	\$78,284,585
Gross profit	52,113,829	51,713,242	52,071,060	52,124,757	49,328,024
Income from operations	7,241,822	10,300,731	10,474,700	11,958,029	11,266,790
Net income	\$4,451,751	\$6,402,259	\$6,402,405	\$7,706,921	\$7,265,717
Net income per share					
Basic	\$0.48	\$0.69	\$0.64	\$0.76	\$0.71
Diluted	\$0.48	\$0.69	\$0.63	\$0.75	\$0.71
Weighted average common shares outstanding for:					
Basic EPS	9,242,092	9,301,867	10,077,506	10,203,063	10,176,492
Diluted EPS	9,256,810	9,321,558	10,102,760	10,241,121	10,216,438

Cash dividend declared per common share	-	-	-	\$0.25	-
Balance Sheet Data, as of December 31,	2017	2016	2015	2014	2013
Cash and certificates of deposit	\$18,337,258	\$16,862,304	\$10,962,615	\$10,636,530	\$11,082,679
Total assets	74,914,596	70,652,720	64,611,076	62,873,874	56,398,566
Long-term debt, including current portion	7,371,730	7,444,416	3,863,307	5,643,125	2,598,750
Total Stockholders' Equity	\$59,538,981	\$53,693,201	\$50,972,176	\$49,123,012	\$44,621,542

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We intend for the following discussion to provide you with information that will assist you in understanding our financial statements, the changes in key items in those financial statements from year to year and the primary factors that accounted for those changes, as well as how particular accounting principles affect our financial statements. This discussion also provides information about the financial results of the various segments of our business so you may better understand how those segments and their results affect our financial condition and results of operations as a whole. Finally, we have identified and discussed trends known to management that we believe are likely to have a material effect on our results of operations and financial condition.

This discussion should be read in conjunction with our financial statements and the notes accompanying those financial statements included elsewhere in this Annual Report on Form 10-K. You are also urged to consider the information under the caption "Summary of Critical Accounting Policies." In addition to historical financial information, the following management's discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our results and the timing of selected events may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those discussed under "Item 1A. Risk Factors" and elsewhere in this Annual Report on Form 10-K.

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Summary

To our knowledge, we are the world's largest specialty retailer of leather and leathercraft related items (based on sales), offering a wide range of leather, quality tools, hardware, accessories, liquids, lace, kits and teaching materials. We sell our products through company-owned stores and through orders generated from our website, [www.tandyleather.com](http://www.tandyleather.com). We have built our business by offering our customers a broad selection of quality products combined with knowledgeable store associates, in one location, at competitive prices.

We believe that the key to our success is our ability to profitably grow our base business. We expect to grow that business by opening new stores and by increasing sales in our existing stores. In 2017, we reopened one store in Harrisburg, PA and opened new stores in Allen, TX; Miami, FL; and McAllen, TX.

We operate in two segments, based on management responsibility and store location: North America and International. Prior to January 1, 2017, we operated in three segments: Wholesale, Retail and International. To better reflect how management analyzes the business and allocates resources, we combined Wholesale and Retail into North America effective January 1, 2017, while International remains the same.

As of March 7, 2018, our North America segment operates 115 company-owned stores located in 42 U.S. states and 7 Canadian provinces. We expect to grow the number of stores in North America to approximately 150 in the future. Our pace of store openings has recently picked up due to a change in strategy with a focus on growth.

Our International segment operates four company-owned stores with one located in each of Northampton, United Kingdom; Manchester, United Kingdom; Sydney, Australia; and Jerez, Spain. We expect to continue opening international stores in the future, but do not intend to open any new international stores in 2018.

Prior to 2015, we had experienced stable to steady increases in revenue and net income. In 2016, our net sales declined by 1.5%, although through cost controls, net income was relatively flat. To address the weakness in sales, we began focusing on improving our customer experience, increasing our brand awareness, and strengthening our store performance. To help achieve those goals, in early 2017, we announced a district restructuring with our store footprint divided into fifteen districts (previously, our store footprint was divided into five regions). Each district contains six to ten stores, reporting to a district manager who is tasked with growing traffic and sales, as well as training store managers and associates to better serve our customers and succeed in today's retail environment. As of March 7, 2018, we have filled twelve of our fifteen district manager positions.

In addition to the district manager program, our store manager base compensation was increased by 40% in December 2016 to comply with the then expected FLSA minimum salaries. While that requirement was delayed and is still being evaluated by the Department of Labor, we maintained the increased base salaries as our store managers are essential to our mission and vision. With a higher base salary, we believe we are better equipped to attract and recruit these key employees, particularly in a tightening labor market.

Also, in 2017, to expand our customer base and increase our brand awareness, we committed to be the national sponsor of the Pinner's Conference & Expo ("Pinner's"), which hosted 2-day events across four U.S. cities focused on crafting classes and shopping, with thousands of women and DIY's in attendance. We hosted four leathercrafting classes at each of the four conferences with over 1,500 participants. Given our success with the Pinner's collaboration, in 2018, we committed again to be the national sponsor of Pinner's, which will grow to six U.S. cities.

In 2017, our overall net sales continued to be weak with a 0.7% decrease compared to 2016, despite contributions from new stores and the investments in our store manager base compensation, the new district manager program and Pinner's sponsorship. Our long-term strategy to drive sustainable growth in traffic and sales and achieve our 2020 financial targets of \$87 - \$90 million in net sales and greater than 10% operating income margins include the

following priorities:

- Grow sales by increasing the average ticket, expanding store hours and providing more incentive-based compensation to associates;
- Improve our stores' financial performance with an initial focus on correcting underperforming stores;
- Upgrade our technology platform to provide more insightful data and analytics;
- Attract, motivate and retain associates through a pay for performance culture and enhanced training;
- Focus on product innovation including new classes and formats, as well as adding higher ticket products;
- Maximize channels, including print, digital and e-commerce to attract new customers while retaining our established customers; and
- Evaluate the District Manager program's effectiveness to improve the overall return on investment.

Our strategy has required, and is expected to continue to require, investments in our new stores, expanded inventory and merchandising, as well as operating costs for additional headcount, travel, training and marketing expenses. We believe we are investing in areas that will drive sustainable long-term growth.

### Results of Operations

#### Net Sales

Our net sales for the three years ended December 31, 2017, 2016 and 2015 were as follows:

				<u>(Decr)</u>
				<u>Incr</u>
				<u>from</u>
				<u>Prior</u>
<u>North</u>				<u>Year</u>
<u>Year</u>	<u>America</u>	<u>International</u>	<u>Total</u>	
2017	\$78,568,219	\$3,753,049	\$82,321,268	(0.7 %)
2016	\$79,041,920	\$3,882,072	\$82,923,992	(1.5 %)
2015	\$80,468,597	\$3,692,603	\$84,161,200	0.9 %

Consolidated sales for 2017 decreased 0.7% compared to 2016. North America reported a sales decline of 0.6% while International reported a 3.3% decline. In North America, same store sales declined by 2.3%, while new stores added \$1.3 million of sales. The decline in same store sales can be attributed to a 9% decrease in purchases from our non-retail customers, offset by a 6% increase in sales to our retail customers. For our International stores, the sales decline was mostly attributable to weakness in our Australia operation as overall foreign currency impacts mostly offset one another.

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In 2016, our International segment reported a sales increase compared to 2015 while our North America segment reported a sales decline due to a decline in same store sales and loss of sales from closed stores. The increase in sales for our International segment was primarily due to the full year impact of the UK store that opened in October 2015, offset by the change in UK foreign currency rates between 2016 and 2015.

## Gross Profit

On a consolidated basis, gross profit margins were 63.3% in 2017, 62.4% in 2016, and 61.9% in 2015. In general, our gross profit margin fluctuates based on the mix of customers we serve, the mix of products we sell, and our ability to source products globally. Our negotiations with suppliers for lower pricing are an on-going process, for which we have varying degrees of success. Sales to retail customers tend to produce higher gross margins than sales to non-retail customers due to the difference in pricing levels. Therefore, as retail sales increase in the overall sales mix, higher gross margins tend to follow, which is the main reason our gross profit margins have shown steady improvement over the last two years. Finally, there is also significant fluctuation in gross margins between the various merchandise categories we offer. As a result, our gross margins can also vary depending on the mix of products sold during any given time period.

## Operating Expenses

Our consolidated operating expenses for the three years ended December 31, 2017, 2016 and 2015 were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>	
Operating expenses	\$44,872,007	\$41,412,511	\$41,596,360	
As a % of sales	54.5	% 49.9	% 49.4	%

The \$3.4 million increase in operating expenses in 2017 compared to 2016 was primarily due to \$1.3 million in costs related to the seven new stores that have opened / reopened since October 2016, \$1.1 million related to the district manager program, \$0.2 million for the increased base salary for our store managers, \$0.2 million in increased advertising and marketing related to our national sponsorship of the Pinners program, with the remaining increase related to increases in credit card processing fees, occupancy costs across our store footprint, and home office wages.

The \$184,000 decrease in operating expenses in 2016 compared to 2015 primarily related to \$0.5 million savings in store moves (fewer store relocations in 2016 as compared to 2015), \$0.3 million decrease in employee compensation and benefits (decrease in store manager bonus, partially offset by increases in headcount), \$0.1 million lower advertising and marketing expenses, offset by \$0.7 million higher occupancy costs.

## Other Income/Expense (net)

Other Income/Expense consists primarily of currency exchange fluctuations, interest income, and interest expense. In 2017, we incurred other expenses (net) of approximately \$79,000 compared to other expenses (net) of approximately \$98,000 in 2016. In 2017, we earned approximately \$7,000 in interest income on our cash and paid approximately \$205,000 in interest expense on our bank debt. We had a currency exchange gain of approximately \$30,000 in 2017 compared to a currency exchange gain of approximately \$19,000 in 2016.

In 2016, we incurred other expenses (net) of approximately \$98,000 compared to other expenses (net) of approximately \$256,000 in 2015. In 2016, we earned approximately \$4,000 in interest income on our cash and paid approximately \$155,000 in interest expense on our bank debt. We had a currency exchange gain of approximately \$19,000 in 2016 compared to a currency exchange gain of approximately \$24,000 in 2015.

## Provision for Income Taxes

Our effective tax rate was 38%, 37%, and 37% for the years ended December 31, 2017, 2016 and 2015, respectively. The difference between our statutory rates and our effective rate are primarily due to the domestic production activities deduction that we receive for our light manufacturing facility in Fort Worth, Texas and the country mix of earnings.

On December 22, 2017, Tax Cuts and Jobs Act (the "Tax Act") was enacted. Except for certain provisions, the Tax Act is effective for tax years beginning on or after January 1, 2018. As a fiscal year U.S. taxpayer, the majority of the provisions will apply in 2018, such as the lowering of the U.S. federal corporate income tax rate to 21%, eliminating the domestic manufacturing deduction, creating new taxes on certain foreign sourced income and introducing new limitations on certain business deductions. Additionally, because the Tax Act was enacted in 2017, we were required to record an additional \$340,782 of net income tax expense in the fourth quarter of 2017 as follows:

Transition tax on deemed repatriation of certain foreign earnings	\$514,454
Foreign Withholding Taxes	290,128
Remeasuring deferred tax position at the lowered income tax rate	(463,800)
	\$340,782

The above amounts were recorded based on reasonable estimates and our current interpretation of the Tax Act. We are still accumulating and processing data to finalize the underlying calculations and expect regulators to issue further guidance. As such, our estimates may subsequently change.

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Segment Information

Results of operations by segment follows:

North America

The table below reports our net sales by store category for our North America segment for the year ended December 31, 2017 compared to the prior year:

	#		#	\$	%	
	Stores	2017	Stores	2016	Change	Change
Same stores	107	\$75,698,765	107	\$77,449,960	\$ (1,751,195)	(2.3 %)
New stores	7	2,374,044	4	1,034,142	1,339,902	129.6 %
Closed/temp closed stores	1	495,410	3	557,818	(62,408 )	(11.2 %)
Total net sales	115	\$78,568,219	111	\$79,041,920	\$ (473,701 )	(0.6 %)

North America consisted of 115 stores at December 31, 2017 and 111 stores at December 31, 2016. In 2017, we opened stores in Allen, TX (April 2017); Miami, FL (May 2017); and McAllen, TX (May 2017). Our Harrisburg, PA store was temporarily closed from April 2016 through December 2016. In 2016, we opened stores in Nyack, NY (March 2016); Philadelphia, PA (October 2016); Lyndhurst, NJ (November 2016); and Johnston, RI (December 2016). We closed stores in Tucson, AZ (March 2016) and Allentown, PA (April 2016). A store is categorized as “new” until it is operating for the full comparable period in the prior year.

The decline in same store sales was primarily due to a 9% decrease in sales to our non-retail customers, offset by a 6% increase to our retail customers. Specifically, ticket counts to our non-retail customers were relatively flat, decreasing by 0.1%, while the average ticket decreased 10%, from \$130.25 in 2016 to \$117.01. Our non-retail customers are still buying, just not as much.

For our retail customers, we believe the initiatives to improve our customer experience and increase our brand awareness have been successful. Further, our military and first responder appreciation programs (eligible customers receive discounted pricing) have also been well accepted, as enrollments continue to increase from 9,085 members at December 31, 2016 to 43,895 members at December 31, 2017. Sales to this customer group increased 6% in 2017 compared to 2016. Specifically, ticket counts increased 15%, while the average ticket was \$63.12 in 2017 compared to \$68.34 in 2016.

The table below reports our net sales by store category for the year ended December 31, 2016 compared to the prior year:

	#		#	\$	%	
	Stores	2016	Stores	2015	Change	Change
Same stores	107	\$77,449,960	107	\$78,265,681	\$ (815,721 )	(1.04 %)
New stores	4	1,034,142	-	-	1,034,142	NA
Closed/temp closed stores	3	557,818	3	2,202,916	(1,645,098)	(74.68 %)
Total net sales	111	\$79,041,920	107	\$80,468,597	\$ (1,426,677)	(1.77 %)

In 2015, there were no changes in our store footprint (no store openings or closures). The overall sales decline in 2016 compared to 2015 was due to lower sales to our non-retail customer group, while sales to retail customers experienced an increase.

Our sales mix by customer group for the three years ended December 31, 2017, 2016 and 2015 was as follows:

<u>Customer Group</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Retail	60%	57%	55%
Institution	2%	2%	3%
Wholesale	34%	36%	38%
Manufacturers	4%	5%	4%
	100%	100%	100%

In 2017, North America's operating expenses increased \$3.3 million to \$42.4 million compared to \$39.1 million in 2016 due to \$1.3 million in costs related to the seven new stores that have opened / reopened since October 2016, \$1.1 million related to the district manager program, \$0.2 million for the increased base salary for our store managers, \$0.2 million in increased advertising and marketing related to our national sponsorship of the Pinners program, while the remaining increases related to increases in credit card processing fees, occupancy costs across our store footprint and home office wages,.

In 2016, North America's operating expenses decreased \$0.4 million primarily due to \$0.5 million savings in store moves (fewer store relocations in 2016 than 2015), \$0.3 million decrease in employee compensation and benefits (decrease in store manager bonus, partially offset by increases in headcount), \$0.1 million lower advertising and marketing expenses, offset by \$0.5 million higher occupancy costs.

#### International

Our International segment consists of all stores located outside of North America. As of December 31, 2017 and 2016, that represents four retail/wholesale combination stores with two located in the United Kingdom, one located in Australia, and one located in Spain. International accounted for 4.6%, 4.7%, and 4.4% of our total sales in 2017, 2016, and 2015, respectively. We opened the second store in the United Kingdom in October 2015.



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The increases (or decreases) in net sales, operating income and operating income as a percentage of sales from our International stores for the years ended December 31, 2017, 2016 and 2015 were as follows:

	Net Sales		Operating		Operating		
	Increase		Income		Income as		
	(Decrease)		(Decrease)		a		
	from Prior		from Prior		Percentage		
<u>Year</u>	<u>Yr</u>	<u>Operating</u>	<u>Income</u>	<u>Income</u>	<u>as</u>	<u>Percentage</u>	
		<u>(Loss)</u>	<u>Year</u>	<u>Year</u>	<u>of Sales</u>		
2017	(3.3	%)	\$ (256,995)	(438.3	)%	(6.8	%)
2016	5.1	%	\$ 75,958	(37.4	)%	2.0	%
2015	(14.9	)%	\$ 121,296	(79.1	)%	3.3	%

International's sales totaled approximately \$3.8 million in 2017, compared to approximately \$3.9 million in 2016, a decrease of \$129,000, primarily due to lower sales in our Australia unit and unfavorable foreign currency exchange rates in the UK, offset by favorable exchange rates in Spain. Gross profit for International decreased to 59.3% in 2017 compared to 61.8% in 2016, due to customer and product mix. International's operating expenses increased by \$159,000 due to higher personnel, rent and advertising costs. Specifically, International's operating expenses totaled approximately \$2.5 million in 2017, compared to \$2.3 million in 2016. Overall, advertising and marketing expenses are this segment's largest expense, followed by employee compensation, rent, travel, and shipping costs to customers.

International's sales increased by 5.1% in 2016 compared to 2015, primarily due to the full year impact of the Manchester, UK store that opened in October 2015. Gross margin increased from 60.5% in 2015 to 61.8% in 2016. Operating expenses as a percentage of sales in 2016 increased from 57.2% in 2015 to 59.8% in 2016 as operating expenses grew at a faster pace in 2016 than sales, due to the addition of the Manchester, UK store. As a result, International's operating income as a percentage of sales decreased to 2.0% for 2016 compared to 3.3% for 2015. The change in foreign currency exchange rates from 2015 to 2016, primarily in the UK, and the performance our stores in Europe were the primary causes of the decline in this segment.

Capital Resources, Liquidity and Financial Condition

We require cash principally for day-to-day operations, to purchase inventory, to finance capital investments, and to service our outstanding debt. We expect to fund our operating and liquidity needs as well as our store growth from a combination of current cash balances and internally generated funds. Our cash balances at December 31, 2017 totaled \$18.3 million. In addition, we have available a \$6 million line of credit, as more fully described below.

In August 2015, our Board of Directors authorized a share repurchase program pursuant to which we are authorized to repurchase up to 1.2 million shares of our common stock at prevailing market rates through August 2016. Subsequently, the program was amended to increase the number of shares available for repurchase to 2.2 million and to extend the program through August 2018. In 2017, no shares were repurchased, while 520,500 shares were repurchased during in 2016. At December 31, 2017, there are 1,150,793 shares available for repurchase under the plan.

On September 18, 2015, we executed a Promissory Note and Business Loan Agreement with BOKF, NA d/b/a Bank of Texas ("BOKF") which provided us with a line of credit facility of up to \$10,000,000 for the purpose of repurchasing shares of our common stock pursuant to our stock repurchase program. On August 25, 2016, this line of credit was amended to increase the availability from \$10,000,000 to \$15,000,000 for the repurchase of shares of our common stock pursuant to our stock repurchase program through the earlier of August 25, 2017 or the date on which the entire amount is drawn. On August 10, 2017, this line of credit was further amended to extend the drawdown period and

conversion date from August 25, 2017 to August 18, 2018 to align with our stock repurchase program. During this time period, we are required to make monthly interest-only payments. At the end of this time period, we expect that the principal balance will be rolled into a 4-year term note. This Promissory Note is secured by a Deed of Trust on the real estate located at 1900 SE Loop 820, Fort Worth, Texas. There were no amounts drawn on this line in 2017. In 2016, we drew approximately \$3.7 million on this line which was used to repurchase approximately 520,500 shares of our common stock pursuant to our stock repurchase program. At December 31, 2017, the unused portion of the line of credit was approximately \$7.6 million.

Also, on September 18, 2015, we executed a Promissory Note and Business Loan Agreement with BOKF which provides us with a line of credit facility of up to \$6,000,000 and is secured by our inventory. On August 10, 2017, this line of credit was amended to extend the maturity to September 18, 2019. The Business Loan Agreement contains covenants that require us to maintain a funded debt to EBITDA ratio of no greater than 1.5 to 1 and a Fixed Charge Coverage Ratio greater than or equal to 1.2 to 1. Both ratios are calculated quarterly on a trailing four quarter basis. For the years ended December 31, 2017 and 2016, there were no amounts drawn on this line and we were fully in compliance with the required covenants.

Amounts drawn under either facility accrue interest at the London interbank Eurodollar market rate for U.S. dollars (commonly known as "LIBOR") plus 1.85% (3.351% and 2.557% at December 31, 2017 and 2016, respectively).

On our consolidated balance sheet, total assets increased to \$74.9 million at December 31, 2017 from \$70.7 million at year-end 2016. Total stockholders' equity increased to \$59.5 million at December 31, 2017 from \$53.7 million at year-end 2016, primarily due to net income earned during 2017, the exercise of stock options and the impact of foreign currency translation. Our current ratio increased to 8.3 at December 31, 2017 from 6.5 at year-end 2016 due primarily to an increase in cash and inventory and a decrease in accrued liabilities.

As of December 31, 2017, our investment in inventory increased by \$4.1 million from year-end 2016, as we invested in the four new stores that opened/reopened since December 31, 2016 and expanded our product line to support new marketing and merchandising initiatives. Inventory turnover reached an annualized rate of 2.3 times in 2017, decreasing from 2.5 times in 2016. We compute our inventory turns as sales divided by average inventory (calculated as the average of the beginning of the year and end of the year balances). At December 31, 2017, average inventory per store was \$176,000, an increase of 9% compared to \$161,000 at year-end 2016. This increase is a result of new merchandise in an effort to appeal to an expanded and diverse customer base, as well as stocking higher end leathers and luxury do-it-yourself kits in an effort to appeal to our legacy customer base. In general, our products are not perishable or seasonal and because we don't sell finished goods, our products can have a long shelf life.

Accounts payable decreased approximately \$0.2 million to \$1.4 million at December 31, 2017 compared to year-end 2016 due to timing of payments. Accrued expenses decreased by \$1.0 million from year-end 2016 to \$5.0 million at December 31, 2017 due to lower accrued bonus and lower levels of inventory in transit.

In 2017, cash flow provided by operating activities was \$3.0 million, composed of net income of \$4.5 million, plus \$1.9 million of depreciation and amortization, plus \$0.9 million of foreign currency translation, offset by changes in working capital including purchases of inventory and payments of accrued expenses.

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By comparison, in 2016, cash flow provided by operating activities was approximately \$7.5 million, composed of net income of \$6.4 million, plus \$1.7 million of depreciation and amortization.

Cash flow used in investing activities totaled approximately \$1.7 million and \$1.5 million in 2017 and 2016, respectively, consisting primarily of the purchase of fixtures for new stores, store moves and remodels and computer equipment, and in 2017, vehicles and computer equipment for our new district managers.

There was \$151,000 of cash provided by financing activities in 2017, related to proceeds from the exercise of stock options, offset by the final payment on our capital lease, compared to \$95,000 used in financing activities in 2016. In 2016, we repurchased \$3.7 million of treasury stock, funded primarily through drawdowns on our line of credit with BOKF, as well as made a scheduled payment on our capital lease obligation of \$80,710.

We believe that cash flow from operations will be adequate to fund our operations in 2018, while also funding our growth plans and strategic initiatives. At this time, we know of no trends or demands, commitments, events, or uncertainties that will or are likely to materially affect our liquidity, capital resources or results of operations. In addition, we anticipate that this cash flow will enable us to meet our contractual obligations and commercial commitments. We could defer expansion plans if required by unanticipated drops in cash flow. In particular, because of the relatively small investment required by each new store, we have flexibility in when we make most expansion expenditures.

### Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements during 2017, 2016, or 2015, and we do not currently have any such arrangements.

### Summary of Critical Accounting Policies

We strive to report our financial results in a clear and understandable manner, although in some cases accounting and disclosure rules are complex and require us to use technical terminology. We follow generally accepted accounting principles in the U.S. in preparing our consolidated financial statements which require us to make estimates and assumptions that affect our financial position and results of operations. We continually review our accounting policies, how they are applied, and how they are reported and disclosed in our financial statements. Following is a summary of our more significant accounting policies.

**Revenue Recognition.** We recognize revenue for over the counter sales as transactions occur and other sales upon shipment of our products, provided that there are no significant post-delivery obligations to the customer and collection is reasonably assured, which generally occurs upon shipment. 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 net realizable value and is accounted for on the “first in, first out” method. This means that sales of inventory treat the oldest item of identical inventory as being the first sold. In addition, we regularly reduce the value of our inventory for slow-moving or obsolete inventory. This reduction is based on our review of items on hand compared to their estimated future demand. If actual future demand is less favorable than what we project, additional write-downs may be necessary. Goods shipped to us are recorded as inventory owned by us when the risk of loss shifts to us from the supplier.

**Impairment of Long-Lived Assets.** We evaluate long-lived assets for indicators of impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. Additionally, for store assets, we evaluate the performance of individual stores for indicators of impairment and underperforming stores are selected for further evaluation of the recoverability of the carrying amounts. The evaluation of long-lived assets is performed at

the lowest level of identifiable cash flows, which is at the individual store level. Impairment is determined when estimated future undiscounted cash flows associated with an asset are less than the asset's carrying value. To date, we have not recognized any impairment of our long-lived assets.

**Income Taxes.** Income taxes are estimated for each jurisdiction in which we operate. This involves assessing current tax exposure together with temporary differences resulting from differing treatment of items for tax and financial statement accounting purposes. Any resulting deferred tax assets are evaluated for recoverability based on estimated future taxable income. To the extent recovery is deemed not likely, a valuation allowance is recorded. Our evaluation regarding whether a valuation allowance is required or should be adjusted also considers, among other things, the nature, frequency, and severity of recent losses, forecasts of future profitability and the duration of statutory carryforward periods.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We face exposure to financial market risks, as described below. These exposures may change over time and could have a material impact on our financial results. We do not use or invest in market risk sensitive instruments to hedge any of these risks or for any other purpose.

**Foreign Currency Risk.** Our primary foreign currency exposure is related to our foreign subsidiaries as those subsidiaries have local currency revenue and local currency operating expenses. Changes in the foreign currency exchange rates impact the U.S. dollar amount of revenue and expenses. See Note 12 to the Consolidated Financial Statements, Segment Information, for financial information concerning our foreign activities.

**Interest Rate Risk.** We are subject to market risk associated with interest rate movements on our outstanding debt which accrue interest at a rate that changes with fluctuations in the LIBOR rate. Based on the Company's level of debt at December 31, 2017, increase of one percent in the LIBOR rate would result in additional interest expense of approximately \$74,000 during a twelve-month period.

Table of ContentsITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATATandy Leather Factory, Inc.  
Consolidated Balance Sheets

	December 31, 2017	December 31, 2016
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$18,337,258	\$16,862,304
Accounts receivable-trade, net of allowance for doubtful accounts of \$22,642 and \$2,404 as of December 31, 2017 and 2016, respectively	461,212	560,984
Inventory	37,311,197	33,177,539
Prepaid income taxes	41,307	964,323
Prepaid expenses	1,473,147	1,608,860
Other current assets	189,029	140,232
Total current assets	57,813,150	53,314,242
<b>PROPERTY AND EQUIPMENT, at cost</b>	27,218,481	25,536,352
Less accumulated depreciation and amortization	(11,750,639)	(9,884,559 )
Property and equipment, net	15,467,842	15,651,793
<b>DEFERRED INCOME TAXES</b>	271,738	375,236
<b>GOODWILL</b>	962,949	956,201
<b>OTHER INTANGIBLES, net of accumulated amortization of \$710,000 and \$708,000 as of December 31, 2017 and 2016, respectively</b>	19,222	20,840
<b>OTHER assets</b>	379,695	334,408
<b>Total Assets</b>	<b>\$74,914,596</b>	<b>\$70,652,720</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable-trade	\$1,413,450	\$1,621,884
Accrued expenses and other liabilities	4,953,477	5,937,187
Current maturities of capital lease obligations	-	72,686
Current maturities of long-term debt	614,311	614,311
Total current liabilities	6,981,238	8,246,068
<b>DEFERRED INCOME TAXES</b>	1,636,958	1,956,032
<b>LONG-TERM DEBT, net of current maturities</b>	6,757,419	6,757,419
<b>COMMITMENTS AND CONTINGENCIES</b>	-	-
<b>STOCKHOLDERS' EQUITY:</b>		
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		

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authorized; 11,313,692 and 11,235,992 shares issued at December 31, 2017 and 2016, respectively; 9,270,862 and 9,193,162 shares outstanding at December 31, 2017 and 2016, respectively	27,153	26,966
Paid-in capital	6,831,271	6,368,455
Retained earnings	63,921,244	59,469,493
Treasury stock at cost (2,042,830 shares each of 2017 and 2016, respectively)	(10,278,584)	(10,278,584)
Accumulated other comprehensive income	(962,103 )	(1,893,129 )
Total stockholders' equity	59,538,981	53,693,201
Total Liabilities and Stockholders' Equity	\$74,914,596	\$70,652,720

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

Table of ContentsTandy Leather Factory, Inc.  
Consolidated Statements of Comprehensive Income  
For the Years Ended December 31

	2017	2016	2015
NET SALES	\$82,321,268	\$82,923,992	\$84,161,200
COST OF SALES	30,207,439	31,210,750	32,090,140
Gross Profit	52,113,829	51,713,242	52,071,060
OPERATING EXPENSES	44,872,007	41,412,511	41,596,360
INCOME FROM OPERATIONS	7,241,822	10,300,731	10,474,700
OTHER (INCOME) EXPENSE:			
Interest expense	205,555	155,189	330,004
Other, net	(126,857 )	(57,287 )	(74,357 )
Total other expense	78,698	97,902	255,647
INCOME BEFORE INCOME TAXES	7,163,124	10,202,829	10,219,053
PROVISION FOR INCOME TAXES	2,711,373	3,800,570	3,816,648
NET INCOME	\$4,451,751	\$6,402,259	\$6,402,405
Foreign currency translation adjustments	931,026	(205,450 )	(999,621 )
COMPREHENSIVE INCOME	\$5,382,777	\$6,196,809	\$5,402,784
NET INCOME PER COMMON SHARE:			
BASIC	\$0.48	\$0.69	\$0.64
DILUTED	\$0.48	\$0.69	\$0.63
Weighted Average Number of Shares Outstanding:			
Basic	9,242,092	9,301,867	10,077,506
Diluted	9,256,810	9,321,558	10,102,760

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

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Tandy Leather Factory, Inc.  
 Consolidated Statements of Cash Flows  
 For the Years Ended December 31

	2017	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$4,451,751	\$6,402,259	\$6,402,405
Adjustments to reconcile net income to net cash provided by operating activities -			
Depreciation and amortization	1,875,102	1,719,154	1,567,172
Loss on disposal or abandonment of assets	3,139	16,985	31,064
Non-cash share-based compensation	239,599	199,870	145,322
Deferred income taxes	(215,576 )	205,111	289,171
Foreign currency translation	883,670	(163,292 )	(896,928 )
Net changes in assets and liabilities, net of effect of business acquisitions:			
Accounts receivable-trade	99,772	(7,778 )	71,848
Inventory	(4,133,658)	407,000	(709,047 )
Prepaid expenses	135,713	(284,788 )	43,585
Other current assets	(48,797 )		