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LEATHER FACTORY INC  
Form 10-Q/A  
November 10, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q/A  
-----  
Amendment No. 1  
-----

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

FOR THE QUARTER ENDED SEPTEMBER 30, 2003

COMMISSION FILE NUMBER 1-12368

THE LEATHER FACTORY, INC.  
A DELAWARE CORPORATION  
IRS EMPLOYER IDENTIFICATION NO. 75-2543540  
3847 EAST LOOP 820 SOUTH, FT. WORTH, TEXAS 76119  
(817) 496-4414

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes    X    No  
-----

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes            No    X  
-----        -----

Number of shares of Common Stock, Par Value \$0.0024, outstanding as of October 31, 2003:        10,470,461

EXPLANATORY NOTE: This Form 10-Q/A amends the Registrant's quarterly report on Form 10-Q for the quarter ended September 30, 2003 as filed on November 7, 2003 to correct the table containing the sales and operating income by segment for the nine months ended September 30, 2002 as presented in Part 1, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations under the caption "Results of Operations".

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FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets  
September 30, 2003 and December 31, 2002 -----

Consolidated Statements of Operations  
Three and nine months ended September 30, 2003 and 2002 -----

Consolidated Statements of Cash Flows  
Nine months ended September 30, 2003 and 2002 -----

Consolidated Statements of Stockholders' Equity  
Nine months ended September 30, 2003 and 2002 -----

Notes to Consolidated Financial Statements -----

Item 2. Management's Discussion and Analysis of Financial  
Condition and Results of Operations -----

Item 3. Quantitative and Qualitative Disclosures About Market Risk -----

PART II. OTHER INFORMATION

Item 4. Controls and Procedures -----

Item 6. Exhibits and Reports on Form 8-K -----

SIGNATURES -----

2

THE LEATHER FACTORY, INC.  
CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, D

2003

-----  
(unaudited)

ASSETS

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CURRENT ASSETS:			
Cash	\$	188,199	\$
Cash restricted for payment on revolving credit facility		510,155	
Accounts receivable-trade, net of allowance for doubtful accounts of \$45,000 and \$78,000, respectively		2,329,505	
Inventory		11,621,127	
Prepaid income taxes		52,707	
Deferred income taxes		148,111	
Other current assets		709,270	
		-----	-----
Total current assets		15,559,074	
		-----	-----
PROPERTY AND EQUIPMENT, at cost		5,517,844	
Less accumulated depreciation and amortization		(3,547,038)	
		-----	-----
Property and equipment, net		1,970,806	
GOODWILL, net of accumulated amortization of \$753,000 and \$734,000 in 2003 and 2002, respectively		700,262	
OTHER INTANGIBLES, net of accumulated amortization of \$151,000 and \$113,000 in 2003 and 2002, respectively		445,289	
OTHER ASSETS		331,776	
		-----	-----
	\$	19,007,207	\$
		=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable	\$	1,432,291	\$
Accrued expenses and other liabilities		964,989	
Notes payable and current maturities of long-term debt		2,671,929	
		-----	-----
Total current liabilities		5,069,209	
		-----	-----
DEFERRED INCOME TAXES		234,605	
NOTES PAYABLE AND LONG-TERM DEBT, net of current maturities		-	
COMMITMENTS AND CONTINGENCIES		-	
STOCKHOLDERS' EQUITY:			
Preferred stock, \$0.10 par value; 20,000 shares authorized, none issued or outstanding		-	
Common stock, \$0.0024 par value; 25,000,000 shares authorized, 10,470,461 and 10,149,961 shares issued		25,129	
Paid-in capital		4,488,819	
Retained earnings		9,219,247	
Less: notes receivable secured by common stock		(20,000)	
Accumulated other comprehensive loss		(9,802)	
		-----	-----
Total stockholders' equity		13,703,393	
		-----	-----
	\$	19,007,207	\$
		=====	=====

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

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THE LEATHER FACTORY, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)  
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

	THREE MONTHS	
	2003	2002
NET SALES	\$ 10,119,070	\$ 9,484,730
COST OF SALES	4,529,258	4,396,332
Gross profit	5,589,812	5,088,398
OPERATING EXPENSES	4,672,820	4,246,873
INCOME FROM OPERATIONS	916,992	841,525
OTHER INCOME (EXPENSE):		
Interest expense	(40,735)	(54,108)
Other, net	(6,089)	(18,578)
Total other income (expense)	(46,824)	(72,686)
INCOME BEFORE INCOME TAXES and CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE.	870,168	768,839
PROVISION FOR INCOME TAXES	268,488	234,747
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	601,680	534,092
CUMULATIVE EFFECT OF CHANGE IN ACCTG PRINCIPLE, net of income taxes	-	-
NET INCOME (LOSS)	\$ 601,680	\$ 534,092

NET INCOME (LOSS) PER COMMON SHARE - BASIC:

INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	\$0.06	\$0.05	\$0.21	\$ 0.21
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET. . . . .	-	-	-	(0.37)
NET INCOME (LOSS) PER COMMON SHARE-BASIC . . . . .	\$0.06	\$0.05	\$0.21	\$(0.19)

NET INCOME (LOSS) PER COMMON SHARE - DILUTED:

INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	\$0.06	\$0.05	\$0.20	\$ 0.19
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET. . . . .	-	-	-	(0.37)

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NET INCOME (LOSS) PER COMMON SHARE-DILUTED. . . . . \$0.06 \$0.05 \$0.20 \$(0.18)  
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The accompanying notes are an integral part of these financial statements.

4

THE LEATHER FACTORY, INC.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)  
 NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

	2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 2,154,902	\$(1,923,38
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities-		
Depreciation & amortization	397,959	370,23
Loss on disposal of assets	9,372	
Amortization of deferred financing costs	-	37,03
Deferred income taxes	59,508	(42,71
Other	14,960	(3,11
Cumulative effect of change in accounting principle	-	4,008,83
Net changes in assets and liabilities:		
Accounts receivable-trade, net	(390,808)	(102,45
Inventory	1,074,217	(1,222,30
Income taxes	2,936	(94,69
Other current assets	(37,153)	(343,10
Accounts payable	(162,618)	321,88
Accrued expenses and other liabilities	(1,538,342)	244,92
	-----	-----
Total adjustments	(569,969)	3,174,52
	-----	-----
Net cash provided by operating activities	1,584,933	1,251,13
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(326,284)	(429,25
Payments in connection with businesses acquired	-	(227,74
Proceeds from sale of assets	6,217	
Increase in other assets	(22,305)	(415,80
	-----	-----
Net cash used in investing activities	(342,372)	(1,072,80
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in revolving credit loans	(1,544,417)	(601,04
Payments on notes payable and long-term debt	(4,878)	(25,90
Decrease in cash restricted for payment on revolving credit facility	43,685	5,09
Payments received on notes secured by common stock	24,003	26,28
Proceeds from issuance of common stock	325,688	120,30
	-----	-----
Net cash used in financing activities	(1,155,919)	(475,27
	-----	-----
NET CHANGE IN CASH	86,642	(296,94

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CASH, beginning of period	101,557	409,04
CASH, end of period	\$ 188,199	\$ 112,10
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid during the period	\$ 178,558	\$ 157,91
Income taxes paid during the period, net of (refunds)	819,602	1,076,31

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

5

THE LEATHER FACTORY, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(UNAUDITED)  
NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

	Common Stock		
	Number of shares	Par value	Paid-in capital
BALANCE, December 30, 2001	9,991,161	\$ 23,979	\$ 4,030,508
Payments on notes receivable - secured by common stock	-	-	-
Shares issued - warrants and employee stock options exercised	73,000	175	76,320
Net loss	-	-	-
Translation adjustment	-	-	-
BALANCE, September 30, 2002	10,064,161	\$ 24,154	\$ 4,106,828

	Notes receivable - secured by common stock	Accumulated other comprehensive loss	Tota
BALANCE, December 30, 2001	\$ (71,939)	\$ (37,064)	\$ 12,42
Payments on notes receivable - secured by common stock	24,636	-	2
Shares issued - warrants and employee stock options exercised	-	-	7
Net loss	-	-	(2,45
Translation adjustment	-	3,197	

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BALANCE, September 30, 2002	\$ (47,303)	\$ (33,867)	\$ 10,07
-----------------------------	-------------	-------------	----------

Comprehensive loss for the nine months ended September 30, 2002

	Common Stock		Paid-in capital
	Number of shares	Par value	
BALANCE, December 31, 2002	10,149,961	\$24,360	\$4,163,90
Payments on notes receivable - secured by common stock	-	-	
Shares issued - warrants and employee stock options exercised	320,500	769	198,53
Warrants to acquire 100,000 shares of common stock issued	-	-	126,38
Net income	-	-	
Translation adjustment	-	-	
BALANCE, September 30, 2003	10,470,461	\$25,129	\$4,488,81

	Notes receivable - secured by common stock	Accumulated other comprehensive loss	Total
BALANCE, December 31, 2002	\$ (44,003)	\$ (38,541)	\$ 11,170,062
Payments on notes receivable - secured by common stock	24,003	-	24,003
Shares issued - warrants and employee stock options exercised	-	-	199,306
Warrants to acquire 100,000 shares of common stock issued	-	-	126,381
Net income	-	-	2,154,902
Translation adjustment	-	28,739	28,739
BALANCE, September 30, 2003	\$ (20,000)	\$ (9,802)	\$ 13,703,393

Comprehensive income for the nine months ended September 30, 2003

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

6

### 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 necessary to present fairly its financial position as of September 30, 2003 and December 31, 2002, and its results of operations and cash flows for the three and nine month periods ended September 30, 2003 and 2002. Certain reclassifications have been made to prior year amounts in order to conform to the current year presentation. Operating results for the three and nine month periods ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. These consolidated financial statements should be read in conjunction with the audited consolidated financial and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2002.

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 December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement 123, ("SFAS 148"). SFAS 148 amends SFAS No.123, Accounting for Stock-Based Compensation, ("SFAS 123"), to provide alternative transition methods for an entity's voluntary change in their accounting for stock-based compensation from the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ("APB No. 25") and related interpretations to the fair value method under SFAS 123. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require disclosure of the pro forma effects of using the fair value method of accounting for stock-based compensation in interim as well as annual financial statements. The Company currently accounts for its stock-based compensation using the intrinsic value method as prescribed by APB No. 25. The disclosure provisions of SFAS No. 148 were adopted on December 31, 2002 and are discussed in Note 2.

#### Revenue Recognition

The Company recognizes revenue for over-the-counter sales as transactions occur and other sales upon shipment of product 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 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



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review of items on hand compared to their estimated future demand. The components of inventory consist of the following as of:

	SEPTEMBER 30, 2003	DECEMBER 31, 2002
	-----	-----
Finished goods held for sale	\$ 10,457,893	\$ 11,693,868
Raw materials and work in process	1,163,234	1,001,476
	-----	-----
	\$ 11,621,127	\$ 12,695,344
	=====	=====

7

### 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. The first phase screens for impairment, while the second phase (if necessary) measures the impairment. As a result of SFAS 142, we incurred an impairment write-down in the first quarter of 2002 of our investment in our subsidiary, Roberts, Cushman & Company, Inc., in the amount of \$4.0 million. The remaining goodwill on our balance sheet is analyzed by management periodically to determine the appropriateness of its carrying value. We have elected to perform our annual analysis during the fourth calendar quarter of each year. As of December 31, 2002, 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 nine months of 2003.

Other intangibles consist of the following:

	AS OF SEPTEMBER 30, 2003			AS OF DECEMBER 31, 2002		
	-----	-----	-----	-----	-----	-----
	GROSS	ACCUMULATED AMORTIZATION	NET	GROSS	ACCUMULATED AMORTIZATION	NET
	-----	-----	-----	-----	-----	-----
Trademarks, Copyrights	\$ 544,369	\$ 129,247	\$415,122	\$544,369	\$ 102,029	\$442,340
Non-Compete Agreements	52,000	21,833	30,167	52,000	10,833	41,167
	-----	-----	-----	-----	-----	-----
	\$ 596,369	\$ 151,080	\$445,289	\$596,369	\$ 112,862	\$483,507
	=====	=====	=====	=====	=====	=====

The Company recorded amortization expense of \$39,161 during the first nine months of 2003 compared to \$35,401 during the first nine months of 2002. 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 are as follows:

ROBERTS

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	LEATHER FACTORY.	TANDY LEATHER	CUSHMAN	TOTAL
	-----	-----	-----	-----
2003	\$ 5,918	\$ 45,004	\$ 0	\$50,922
2004	5,918	45,004	0	50,922
2005	5,918	35,004	0	40,922
2006	5,918	34,337	0	40,255
2007	5,918	33,504	0	39,422

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 and nine months ended September 30, 2003 and 2002, on a pro forma basis, would have been as follows:

	THREE MONTH
	-----
	SEPTEMBER 30,
	2003
	-----
Net income (loss), as reported	\$ 601,680
Add: Stock-based compensation expense included in reported net income (loss)	-
Deduct: Stock-based compensation expense determined under fair value method	24,546
Net income (loss), pro forma	\$ 577,134
Net income (loss) per share:	
Basic - as reported	\$ 0.06
Basic - pro forma	\$ 0.06
Diluted - as reported	\$ 0.06
Diluted - pro forma	0.05
	NINE MONTH
	-----
	SEPTEMBER 30,
	2003
	-----
Net income (loss), as reported	\$ 2,154,902
Add: Stock-based compensation expense included in reported net income (loss)	-
Deduct: Stock-based compensation expense determined under fair value method	73,639
Net income (loss), pro forma	\$ 2,081,263

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Net income (loss) per share:		
Basic - as reported	\$	0.21
Basic - pro forma	\$	0.20
Diluted - as reported	\$	0.20
Diluted - pro forma	\$	0.19

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% for 2003 and 3.00% for 2002; dividend yields of 0% for both periods; volatility factors of .706 for 2003 and .736 for 2002; and an expected life of the valued options of 4 years.

8

### 3. EARNINGS PER SHARE

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

	THREE MONTHS ENDED SEPTEMBER 30,		NI
	2003	2002	
<b>Numerator:</b>			
Net income (loss)	\$ 601,680	\$ 534,092	\$ 2,15
Numerator for basic and diluted earnings per share	601,680	534,092	2,15
<b>Denominator:</b>			
Weighted-average shares outstanding-basic	10,394,374	10,064,249	10,26
<b>Effect of dilutive securities:</b>			
Stock options	422,000	448,836	42
Warrants	86,420	210,318	14
Dilutive potential common shares	508,420	659,154	57
Denominator for diluted earnings per share- weighted-average shares	10,902,794	10,723,403	10,84
Basic earnings (loss) per share	\$ 0.06	\$ 0.05	\$
Diluted earnings (loss) per share	\$ 0.06	\$ 0.05	\$

The net effect of converting stock options to purchase 924,700 and 1,081,000 shares of common stock at option prices less than the average market prices has been included in the computations of diluted EPS for the three and nine months ended September 30, 2003 and 2002, respectively.

### 4. SEGMENT INFORMATION

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

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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.

	LEATHER FACTORY	TANDY LEATHER	ROBERTS, CUSHMAN	
FOR THE QUARTER ENDED SEPTEMBER 30, 2003				
Net sales	\$ 7,372,159	\$ 2,334,127	\$ 412,784	\$10
Gross profit	3,996,866	1,475,312	117,634	5
Operating earnings	784,322	117,514	15,156	
Interest expense	(40,735)	-	-	
Other, net	(6,315)	226	-	
Income before income taxes	737,272	117,740	15,156	
Depreciation and amortization	99,489	20,978	2,365	
Fixed asset additions	33,230	21,300	1,377	
Total assets	\$ 15,300,407	\$ 2,802,218	\$ 904,582	\$19
FOR THE QUARTER ENDED SEPTEMBER 30, 2002				
Net sales	7,244,610	1,727,925	512,195	\$ 9
Gross profit	3,848,893	1,026,681	212,824	5
Operating earnings	631,125	76,231	134,169	
Interest expense	(53,995)	(113)	-	
Other, net	(18,578)	-	-	
Income before income taxes	558,552	76,118	134,169	
Depreciation and amortization	94,369	29,612	3,399	
Fixed asset additions	139,454	55,050	1,936	
Total assets	\$ 14,528,938	\$ 2,241,064	\$ 921,378	\$17

9

	LEATHER FACTORY	TANDY LEATHER	ROBERTS, CUSHMAN	
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003				
Net sales	\$ 23,375,158	\$ 6,312,145	\$1,452,527	\$31
Gross profit	12,477,180	3,981,715	497,475	16
Operating earnings	2,626,394	430,737	129,998	3
Interest expense	(174,555)	-	-	
Other, net	68,064	369	-	

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Income before income taxes	2,519,903	431,106	129,998	3
Depreciation and amortization	335,184	55,064	7,711	---
Fixed asset additions	201,862	122,189	2,233	---
Total assets	\$ 15,300,407	\$ 2,802,218	\$ 904,582	\$19
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002				
Net sales	\$ 22,769,549	\$ 5,420,108	\$1,551,060	\$29
Gross profit	12,151,507	3,179,498	561,614	15
Operating earnings	2,625,651	315,268	305,214	3
Interest expense	(190,903)	(516)	-	---
Other, net	(44,566)	(633)	-	---
Income before income taxes	2,390,182	314,119	305,214	3
Depreciation and amortization	279,033	81,256	9,945	---
Fixed asset additions	267,823	157,953	3,474	---
Total assets	\$ 14,528,938	\$ 2,241,064	\$ 921,378	\$17

Net sales for geographic areas were as follows:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
United States	\$ 9,456,440	\$ 8,941,654	\$29,038,861	\$28,052,774
All other countries	662,630	543,076	2,100,969	1,687,943
	\$ 10,119,070	\$ 9,484,730	\$31,139,830	\$29,740,717
	=====	=====	=====	=====

Geographic sales information is based on the location of the customer. Net sales from no single foreign country was material to the Company's consolidated net sales for the three and nine month periods ended September 30, 2003 and 2002. The Company does not have any significant long-lived assets outside of the United States.

10

### 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.

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Tandy Leather is the 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 world wide. Products include quality tools, leather, accessories, kits and teaching materials. In early 2002, we initiated a plan to expand Tandy by opening retail stores. As of October 31, 2003, we have opened 26 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, 2002.

### RESULTS OF OPERATIONS

The following tables present selected financial data of each of the Company's three segments for the quarters and nine months ended September 30, 2003 and 2002:

	QUARTER ENDED SEPTEMBER 30, 2003		QUARTER ENDED SEPTEMBER 30, 2002	
	SALES	OPERATING INCOME	SALES	OPERATING INCOME
Leather Factory	\$ 7,372,159	\$ 784,322	\$ 7,244,610	\$ 631,125
Tandy	2,334,127	117,514	1,727,925	76,231
Cushman	412,784	15,156	512,195	134,169
Total Operations	\$ 10,119,070	\$ 916,992	\$ 9,484,730	\$ 841,525
	=====	=====	=====	=====

	NINE MONTHS ENDED SEPTEMBER 30, 2003		NINE MONTHS ENDED SEPTEMBER 30, 2002	
	SALES	OPERATING INCOME	SALES	OPERATING INCOME
Leather Factory	\$ 23,375,158	\$ 784,322	\$ 22,769,549	\$ 2,625,651
Tandy	6,312,145	117,514	5,420,108	315,268
Cushman	1,452,527	15,156	1,551,060	305,214
Total Operations	\$ 31,139,830	\$ 916,992	\$ 29,740,717	\$ 3,246,133
	=====	=====	=====	=====

Consolidated net sales for the quarter ended September 30, 2003 increased \$634,000, or 6.7%, compared to the same period in 2002. Leather Factory's sales increase was \$127,000; Tandy contributed \$606,000 while Cushman recorded a sales

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reduction of \$99,000. Operating income on a consolidated basis for the quarter ended September 30, 2003 increased 9.0% or \$75,000 over the third quarter of 2002.

Total consolidated net sales for the nine months ended September 30, 2003 increased \$1.4 million, or 4.7%, compared to the same period in 2002. Leather Factory contributed \$606,000 of the sales gain while Tandy added \$892,000. Cushman's 2003 sales were down \$98,000 compared to a year ago. Operating income on a consolidated basis for the nine months ended September 30, 2003 was down 1.8% or \$59,000 over last year.

The following table shows in comparative form our consolidated net income (loss) for the third quarters of 2003 and 2002 and the first nine months of the two years, both before and after the cumulative effect of a previously reporting change in accounting principle in 2002:

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		
	2003	2002	% CHANGE
Income before cumulative effect of change in accounting principle	\$601,680	\$534,092	12.6%
Cumulative effect of change in accounting principle*	-	-	-
	-----	-----	-----
Net income (loss)	\$601,680	\$534,092	12.6%
	=====	=====	=====

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,		
	2003	2002	% C
Income before cumulative effect of change in accounting principle	\$2,154,902	\$ 2,085,444	
Cumulative effect of change in accounting principle*	-	(4,008,831)	
	-----	-----	-----
Net income (loss)	\$2,154,902	\$ (1,923,387)	
	=====	=====	=====