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LEATHER FACTORY INC
Form 8-K/A
February 13, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

Form 8-K/A

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

Date of report (Date of earliest event reported): November 30, 2000

The Leather Factory, Inc..

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation)

1-12368

75-2543540

(Commission File Number)

(IRS Employer Identification Number)

3847 East Loop 820 South, Fort Worth, Texas

76119

(Address of Principal Executive Offices)

(Zip Code)

(817) 496-4414

(Registrant's Telephone Number, Including Area Code)

(Former Name or Former Address, if Changed Since Last Report)

The Form 8-K filed by the Registrant on December 15, 2000 is amended by the supplemental filing of the information required by Items 7(a) and 7(b).

Item 7. Financial Statements, Pro Forma Financial Information and Exhibits.

(a) Financial Statements of Businesses Acquired.

The financial statements required by Item 7(a) are attached as Attachment A, along with the accountants' report of Hein and Associates LLP.

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(b) Pro Forma Financial Information.

The pro forma financial information required by Item 7(b) is attached as Attachment B.

This Report contains forward-looking statements based on current expectations that involve a number of uncertainties. Details on the factors that could affect The Leather Factory, Inc.'s financial results are included in The Leather Factory, Inc.'s Securities and Exchange Commission (SEC) filings, including the latest Annual Report on Form 10-K and on its Quarterly Reports on Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf of the undersigned hereunto duly authorized.

THE LEATHER FACTORY, INC.

Date: February 12, 2001

BY: /s/ Wray Thompson

Wray Thompson, Chairman of the Board and
Chief Executive Officer

ATTACHMENT A

INDEPENDENT AUDITOR'S REPORT

December 22, 2000

Board of Directors
TLC Direct, Inc.
Tandy Leather Dealer, Inc.
Fort Worth, Texas

We have audited the accompanying combined balance sheet of TLC Direct, Inc. and Tandy Leather Dealer, Inc. (collectively the "Tandy Leather Company") as of June 30, 2000, and the related combined statements of operations and changes in stockholder's equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to in the first

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paragraph present fairly, in all material respects, the combined financial position of Tandy Leather Company as of June 30, 2000, and the combined results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

HEIN + ASSOCIATES, LLP

Certified Public Accountants

TANDY LEATHER COMPANY
(wholly owned by Tandycrafts, Inc.)

COMBINED BALANCE SHEETS

| ASSETS ----- | SEPTEMBER 30, 2000 ----- | JUNE 30, 2000 ----- |
|---|--------------------------------|---------------------------|
| | (Unaudited) | |
| CURRENT ASSETS: | | |
| Trade accounts receivable, net of allowance for doubtful accounts of \$234,000 and \$226,000, respectively | \$ 310,327 | \$ 398,020 |
| Inventory | 2,280,072 | 2,237,333 |
| Prepaid expenses | 84,003 | 16,150 |
| | ----- | ----- |
| Total current assets | 2,674,402 | 2,651,503 |
| PROPERTY AND EQUIPMENT, net | 61,456 | 64,811 |
| | ----- | ----- |
| Total assets | \$ 2,735,858 ===== | \$ 2,716,314 ===== |
| LIABILITIES AND STOCKHOLDER'S EQUITY ----- | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 263,367 | \$ 314,177 |
| Accrued expenses and other liabilities | 191,132 | 115,356 |
| Due to Parent | 2,013,415 | 2,062,257 |
| | ----- | ----- |
| Total current liabilities | 2,467,914 | 2,491,790 |
| STOCKHOLDER'S EQUITY | | |
| Common stock | 20 | 20 |
| Paid-in capital | 1,980 | 1,980 |
| Retained earnings | 265,944 | 222,524 |
| | ----- | ----- |
| Total stockholder's equity | 267,944 | 224,524 |
| | ----- | ----- |
| Total stockholder's equity | \$ 2,735,858 ===== | \$ 2,716,314 ===== |

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See accompanying notes to these combined financial statements.

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TANDY LEATHER COMPANY
(wholly owned by Tandy crafts, Inc.)

COMBINED STATEMENTS OF OPERATIONS

| | THREE MONTHS ENDED SEPTEMBER 30, | | YEAR ENDED JUNE 30, |
|--|-------------------------------------|--------------|------------------------|
| | 2000 | 1999 | 2000 |
| | (Unaudited) | (Unaudited) | |
| NET SALES | \$ 1,562,421 | \$ 1,496,574 | \$ 7,124,176 |
| COST OF SALES | 828,451 | 764,321 | 3,628,003 |
| Gross profit | 733,970 | 732,253 | 3,496,173 |
| OPERATING EXPENSES: | | | |
| Selling, general and administrative expenses | 661,216 | 1,169,496 | 3,128,481 |
| Depreciation | 3,355 | 2,289 | 10,899 |
| Income (loss) before income taxes | 69,399 | (439,532) | 356,793 |
| PROVISION FOR INCOME TAXES | 25,979 | -- | 134,269 |
| NET INCOME (LOSS) | \$ 43,420 | \$ (439,532) | \$ 222,524 |

See accompanying notes to these combined financial statements.

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TANDY LEATHER COMPANY
(wholly owned by Tandy crafts, Inc.)

COMBINED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY

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FOR THE PERIOD FROM JULY 1, 1999 TO SEPTEMBER 30, 2000

| | COMMON STOCK AMOUNT | PAID-IN CAPITAL | RETAINED EARNINGS | TOTAL STOCKHOLDER'S EQUITY |
|---|---------------------------|--------------------|----------------------|----------------------------------|
| BALANCES, July 1, 1999 | \$ -- | \$ -- | \$ -- | \$ -- |
| Common stock issued for cash | 20 | 1,980 | -- | 2,000 |
| Net income | -- | -- | 222,524 | 222,524 |
| <hr style="border-top: 1px dashed black;"/> | | | | |
| BALANCES, June 30, 2000 | 20 | 1,980 | 222,524 | 224,524 |
| Net income (Unaudited) | -- | -- | 43,420 | 43,420 |
| <hr style="border-top: 1px dashed black;"/> | | | | |
| BALANCES, September 30, 2000 (Unaudited) | \$ 20 ===== | \$ 1,980 ===== | \$265,944 ===== | \$267,944 ===== |

See accompanying notes to these combined financial statements.

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TANDY LEATHER COMPANY
(wholly owned by Tandy crafts, Inc.)

COMBINED STATEMENTS OF CASH FLOWS

| | THREE MONTHS ENDED SEPTEMBER 30, | | YEAR ENDING JUNE 30, |
|---|---|---|---|
| | 2000 | 1999 | 2000 |
| | (Unaudited) | (Unaudited) | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income (loss) | \$ 43,420 | \$ (439,532) | \$ |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation | 3,355 | 2,289 | |
| Changes in operating assets and liabilities: | | | |
| Trade accounts receivable | 87,693 | 133,388 | |
| Inventory | (42,739) | 297,229 | (|
| Prepaid expenses | (67,853) | (7,213) | |
| Accounts payable | (50,810) | 174,058 | |
| Accrued expenses and other liabilities | 75,776 | 29,583 | |
| | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> |

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| | | | |
|--|----------|-------------|-------|
| Net cash provided (used) by operating activities | 48,842 | 189,802 | |
| CASH FLOWS FROM INVESTING ACTIVITIES - | | | |
| Purchases of property and equipment | -- | (2,800) | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net advances (repayments) from Parent | (48,842) | (189,002) | |
| Common stock issued for cash | -- | 2,000 | |
| | ----- | ----- | |
| Net cash used in financing activities | (48,842) | (187,002) | |
| | ----- | ----- | |
| NET CHANGE IN CASH | -- | -- | |
| CASH, beginning of period | -- | -- | |
| | ----- | ----- | |
| CASH, end of period | \$ -- | \$ -- | \$ |
| | ===== | ===== | ===== |
| NON-CASH ACTIVITY: | | | |
| Transfer of assets and liabilities from Parent: | | | |
| Trade accounts receivable, net | -- | 364,437 | |
| Inventory | -- | 1,735,830 | 1, |
| Prepays | -- | 23,907 | |
| Property and equipment, net | -- | 51,293 | |
| Accounts payable and accrued liabilities | -- | (149,779) | (|
| Due to Parent | -- | (2,025,688) | (2, |

See accompanying notes to these combined financial statements.

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TANDY LEATHER COMPANY
(wholly owned by Tandy crafts, Inc.)

NOTES TO COMBINED FINANCIAL STATEMENTS
(the three-month periods ended September 30, 2000 and 1999 are unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

The Company markets and distributes leather and leather craft products sold throughout the United States via the Internet and mail order, and internationally through authorized dealers.

The Company's combined financial statements include the accounts of TLC Direct, Inc. ("TLC") and Tandy Leather Dealer, Inc. ("TLD"), which were incorporated in July 1999 as wholly-owned subsidiaries of Tandy crafts, Inc. ("the Parent"). All significant intercompany accounts and transactions have been eliminated in the combination. TLC and TLD are referred to collectively as Tandy Leather Company ("the Company").

On August 1, 1999, the Parent contributed certain assets and liabilities to the Company that had previously comprised its leather and crafts operating

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division. The assets and liabilities were recorded at the Parent's book value.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Inventory

Inventory consists of finished goods held for resale, valued at the lower of average cost or market.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives, generally three to seven years, of the underlying assets. Accumulated depreciation is \$26,522 at June 30, 2000.

Expenditures for maintenance, repairs, renewals and betterments which do not materially prolong the useful lives of the assets are charged to income as incurred. The cost of property retired or sold, and the related accumulated depreciation, is removed from the accounts and any gain or loss, after taking into consideration proceeds from sales, is reflected in income.

Revenue Recognition

Sales are recorded when goods are shipped to customers.

Allocated Corporate Expenses

The accompanying statements of operations include certain expenses incurred by the Parent on the Company's behalf. These corporate expenses consist primarily of rent and labor, associated with the use of the Parent's warehouse facility, and other general and administrative expenses. The Parent charges rent expense at rates that it believes would be incurred for similar facilities. The Parent has established performance budgets for the Company and allocates labor costs relative to budgeted operating results. The Parent allocates general and administrative expenses in proportion to the Company's use of corporate services. The Parent believes these methods are reasonable.

Advertising Costs

With the exception of catalog costs, advertising costs are expensed as incurred. Catalog costs are capitalized and expensed when the catalog is released. Total advertising expense was \$900,166 for the year ended June 30, 2000 and \$127,034 and \$544,199 for the three month periods ended September 30, 2000 and 1999, respectively.

TANDY LEATHER COMPANY
(wholly owned by Tandycrafts, Inc.)

NOTES TO COMBINED FINANCIAL STATEMENTS
(the three-month periods ended September 30, 2000 and 1999 are unaudited)

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Income Taxes

Income taxes are calculated in accordance with the liability method, which requires that deferred tax assets and liabilities be recognized based on differences between the financial statement and tax bases of assets and liabilities using presently enacted rates.

The Company is included in the consolidated federal income tax return of the Parent. However, the Company records income taxes for financial reporting purposes as if it filed a separate tax return. Current and deferred income tax assets and liabilities are included in Due to Parent on the balance sheet.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates and those differences could be material. Significant estimates made by the Company include the net realizable values of accounts receivable and inventory.

Unaudited Information

The combined financial statements as of September 30, 2000 and for the three-month periods ended September 30, 2000 and 1999 were taken from the Company's books and records without audit. However, in the opinion of management, such information includes all adjustments (consisting only of normal recurring accruals) which are necessary to properly reflect the financial position and results of operations for the applicable periods.

3. RELATED PARTY TRANSACTIONS

Net amounts advanced to the Company by the Parent for working capital and other operating purposes, including net assets transferred at inception, totaled \$2,013,415 and \$2,062,257 at September 30, 2000 and June 30, 2000, respectively. Such advances are non-interest bearing and contain no specific terms of repayment. Expenses allocated by the Parent are described in Note 2.

The Company's assets are included as collateral for the Parent's bank debt along with other assets of the Parent. Funds from the sale of the Company's assets described in Note 7 were used to reduce the Parent's debt.

4. STOCKHOLDER'S EQUITY

TLC and TLD have each authorized 1,000 shares of common stock, \$.01 par value, for a total of 2,000 shares, all of which were issued and outstanding as of June 30, 2000.

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(the three-month periods ended September 30, 2000 and 1999 are unaudited)

5. INCOME TAXES

The provision for income taxes for the year ended June 30, 2000 consisted primarily of current tax expense. The difference between the tax expense and the amount expected based on the statutory tax rate is primarily due to the effect of state taxes.

As of June 30, 2000, the income tax effects of temporary differences that give rise to significant portions of the Company's deferred tax assets and liabilities were as set forth below. As described in Note 2, the deferred tax asset balance is included in Due to Parent in the balance sheet.

Deferred tax assets:

| | | |
|---------------------------------|----|----------|
| Allowance for doubtful accounts | \$ | 76,000 |
| Reserve for obsolete inventory | | 10,000 |
| | | ----- |
| Total deferred tax asset | | 86,000 |
| Deferred tax liability | | - |
| | | ----- |
| | | 86,000 |
| Valuation allowance | | (86,000) |
| | | ----- |
| | \$ | - |
| | | ===== |

6. MAJOR CUSTOMERS, CREDIT RISK AND GEOGRAPHIC AREA INFORMATION

The Company's revenues are derived from a diverse group of customers principally located in the United States and Canada. Approximately 11% of the Company's sales were to customers outside the United States. No single customer accounted for more than 10% of the Company's revenues for the periods presented.

Credit risk with respect to accounts receivable is considered to be limited due to the diversity of the Company's customer base and their geographic dispersion. The Company does not generally require collateral for accounts receivable. The Company performs periodic credit evaluations of its customers' financial condition and believes the allowance for doubtful accounts is adequate. At June 30, 2000, amounts due from an authorized dealer located in Canada represented approximately 28% of total accounts receivable, net of allowance for doubtful accounts.

7. SEGMENT INFORMATION

The Company markets and distributes leather and leather craft products via the Internet and mail order ("Direct") and to authorized dealers ("Dealer").

Management evaluates the performance of its reportable segments based on segment profit or loss, defined as segment revenue less segment cost of sales, excluding selling, general and administrative expenses, depreciation and taxes on income. Segment assets are those assets that are used in each reportable segment.

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TANDY LEATHER COMPANY
(wholly owned by TandyCrafts, Inc.)

NOTES TO COMBINED FINANCIAL STATEMENTS
(the three-month periods ended September 30, 2000 and 1999 are unaudited)

| | THREE MONTHS ENDED SEPTEMBER 30, | | YEAR ENDED JUNE 30, |
|--|-------------------------------------|--------------|------------------------|
| | 2000 | 1999 | 2000 |
| | (Unaudited) | (Unaudited) | |
| SEGMENT REVENUES: | | | |
| Direct | \$ 1,159,000 | \$ 1,279,000 | \$ 5,419,000 |
| Dealer | 403,000 | 218,000 | 1,705,000 |
| Total segment revenues | \$ 1,562,000 | \$ 1,497,000 | \$ 7,124,000 |
| SEGMENT PROFIT (LOSS): | | | |
| Direct | \$ 613,000 | \$ 670,000 | \$ 3,032,000 |
| Dealer | 120,000 | 61,000 | 464,000 |
| Total segment profit | 733,000 | 731,000 | 3,496,000 |
| Selling, general and administrative expenses | 661,000 | 1,169,000 | 3,128,000 |
| Depreciation | 3,000 | 2,000 | 11,000 |
| Income (loss) before income taxes | \$ 69,000 | \$ (440,000) | \$ 357,000 |
| | SEPTEMBER 30, | JUNE 30, | |
| | 2000 | 2000 | |
| | (Unaudited) | | |
| SEGMENT ASSETS: | | | |
| Direct | \$ 2,510,000 | \$ 2,495,000 | |
| Dealer | 226,000 | 221,000 | |
| Total segment assets | \$ 2,736,000 | \$ 2,716,000 | |

8. SUBSEQUENT EVENT

Effective November 30, 2000, the Company entered into an asset purchase agreement with The Leather Factory, Inc., whereby the Company's ongoing operations were sold for cash consideration of \$2,850,000, subject to adjustment.

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ATTACHMENT B

The Leather Factory, Inc.
Unaudited Pro Forma Combined Financial Statements

The accompanying unaudited pro forma combined financial statements have been prepared to reflect the acquisition of TLC Direct, Inc. and Tandy Leather Dealer, Inc. (collectively the "Tandy Leather Company") by The Leather Factory, Inc. ("TLF"). TLF acquired the Tandy Leather Company on November 30, 2000 for cash consideration of \$2,850,000, subject to certain adjustments specified in the Agreement.

The unaudited pro forma combined balance sheet at September 30, 2000 is presented as if the acquisition had occurred on that date. The unaudited pro forma statements of income are presented for the three months ended September 30, 2000 and the year ended June 30, 2000. TLF has a December 31 calendar year-end and Tandy Leather Company has a June 30 fiscal year end. The pro forma statements of income are presented on a June 30 fiscal year basis because that presentation is believed to be more meaningful as Tandy Leather Company was not formed until July 1999. The pro forma statement of income of TLF for the year ended June 30, 2000 combines the statements of income of TLF for the six month period ended December 31, 1999 and the six month period ended June 30, 2000. The unaudited pro forma combined statement of income for the year ended June 30, 2000 is presented as if the acquisition had occurred on July 1, 1999. The unaudited pro forma combined statement of income for the three months ended September 30, 2000 is presented as if the acquisition had occurred on July 1, 2000.

The unaudited pro forma combined financial statements should be read in conjunction with the historical financial statements of TLF included in its most recent Forms 10-K and 10-Q, and the historical financial statements of the Tandy Leather Company included herein. These pro forma financial statements are not indicative of the financial position or results of operations that would actually have occurred if the transactions described above had occurred at the dates presented or which may be obtained in the future.

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THE LEATHER FACTORY, INC. AND TANDY LEATHER COMPANY

UNAUDITED PRO FORMA COMBINED BALANCE SHEET

AS OF SEPTEMBER 30, 2000

| THE LEATHER FACTORY, INC. | TANDY LEATHER COMPANY | PRO F ADJUST |
|------------------------------|-----------------------------|-----------------|
|------------------------------|-----------------------------|-----------------|

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CURRENT ASSETS:

| | | | | | | |
|-----------------------------|----|------------|----|-----------|----|-------|
| Cash | \$ | 337,991 | \$ | -- | \$ | (|
| Accounts receivable, net | | 2,270,329 | | 310,327 | | |
| Inventories | | 7,759,946 | | 2,280,072 | | |
| Deferred income taxes | | 138,416 | | -- | | |
| Other current assets | | 508,602 | | 84,003 | | |
| | | ----- | | ----- | | ----- |
| Total current assets | | 11,015,284 | | 2,674,402 | | (|
| PROPERTY AND EQUIPMENT, net | | 880,134 | | 61,456 | | |
| GOODWILL, net | | 4,606,540 | | -- | | |
| OTHER INTANGIBLES, net | | 175,777 | | -- | | |
| OTHER ASSETS | | 29,415 | \$ | -- | | |
| | | ----- | | ----- | | ----- |
| Total assets | \$ | 16,707,150 | \$ | 2,735,858 | \$ | |
| | | ===== | | ===== | | ===== |

CURRENT LIABILITIES:

| | | | | | | |
|--|--|-----------|----|-----------|----|-------|
| Accounts payable | | 1,047,635 | \$ | 263,367 | \$ | |
| Accrued expenses and other liabilities | | 1,258,151 | | 191,132 | | |
| Due to Parent | | -- | | 2,013,415 | | (2, |
| Notes payable and current maturities of long-term debt | | 4,330,630 | | -- | | 2, |
| | | ----- | | ----- | | ----- |
| Total current liabilities | | 6,636,416 | | 2,467,914 | | |

DEFERRED INCOME TAXES

| | | | | | | |
|--|--|--------|--|----|--|--|
| | | 73,173 | | -- | | |
|--|--|--------|--|----|--|--|

NOTES PAYABLE AND LONG-TERM DEBT, net of current portion

| | | | | | | |
|--|--|---------|--|----|--|--|
| | | 103,992 | | -- | | |
|--|--|---------|--|----|--|--|

STOCKHOLDERS' EQUITY:

| | | | | | | |
|--|----|------------|----|-----------|----|-------|
| Preferred stock | | -- | | -- | | |
| Common stock | | 23,720 | | 20 | | |
| Paid-in capital | | 3,918,543 | | 1,980 | | |
| Retained earnings | | 6,122,869 | | 265,944 | | (|
| Other stockholders' equity | | (171,563) | | -- | | |
| | | ----- | | ----- | | ----- |
| Total stockholders equity | | 9,893,569 | | 267,944 | | (|
| | | ----- | | ----- | | ----- |
| Total liabilities and stockholders' equity | \$ | 16,707,150 | \$ | 2,735,858 | \$ | |
| | | ===== | | ===== | | ===== |

Notes

- (1) Adjustment to record preliminary value assigned to certain non-current and identifiable intangible assets acquired
- (2) Adjustment to record increase in accrued expenses relating to transaction costs incurred.
- (3) Elimination of intercompany debt with Parent of Tandy Leather Company.
- (4) Adjustment to reflect cash paid and additional borrowing incurred for purchase of Tandy Leather Company operations. The total purchase price of \$2,850,000 is subject to certain adjustments specified in the agreement.
- (5) Adjustment to remove equity accounts of Tandy Leather Company

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THE LEATHER FACTORY, INC. AND TANDY LEATHER COMPANY

UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME

FOR THE YEAR ENDED JUNE 30, 2000

| | THE LEATHER FACTORY, INC. | TANDY LEATHER COMPANY | PRO FORMA ADJUSTMENTS | PRO FORMA BALANCES |
|----------------------------------|------------------------------|-----------------------------|--------------------------|-----------------------|
| | ----- | ----- | ----- | ----- |
| Net sales | \$ 30,119,411 | \$ 7,124,176 | \$ -- | \$ 37,243,587 |
| Cost of goods sold | 15,663,814 | 3,628,003 | -- | 19,291,817 |
| Gross profit | 14,455,597 | 3,496,173 | -- | 17,951,770 |
| Operating expenses | 11,121,161 | 3,139,380 | 33,000 (1) | 14,293,541 |
| Income from operations | 3,334,436 | 356,793 | (33,000) | 3,658,229 |
| Other expense | 847,097 | -- | 250,000 (2) | 1,097,097 |
| Income before income taxes | 2,487,339 | 356,793 | (283,000) | 2,561,132 |
| Provision for income taxes | 1,193,923 | 134,269 | (96,000) (3) | 1,232,192 |
| Net income | \$ 1,293,416 | \$ 222,524 | \$ (187,000) | \$ 1,328,940 |
| Net income per share, basic | \$.13 | | | \$.13 |
| Net income per share, diluted | \$.13 | | | \$.13 |
| Weighted average shares, basic | 9,860,000 | | | 9,860,000 |
| Weighted average shares, diluted | 10,033,000 | | | 10,033,000 |

Notes

- (1) Adjustment to record increase of \$13,000 and \$20,000, respectively, in depreciation and amortization of certain non-current assets and identifiable intangible assets acquired, which are depreciated/amortized over a five and fifteen year period, respectively.
- (2) Adjustment to record increase in interest expenses for the additional borrowings incurred, at an average annual rate of 9%, to purchase the Tandy Leather Company operations.
- (3) Adjustment to record decrease in income taxes, provided at a 34% tax rate, on the aggregate pro forma reduction in pre-tax income.

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THE LEATHER FACTORY, INC. AND TANDY LEATHER COMPANY

UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2000

| | THE LEATHER FACTORY, INC. | TANDY LEATHER COMPANY | PRO FORMA ADJUSTMENT |
|----------------------------------|------------------------------|-----------------------------|-------------------------|
| | ----- | ----- | ----- |
| Net sales | \$ 7,374,556 | \$ 1,562,421 | \$ -- |
| Cost of goods sold | 3,660,995 | 828,451 | -- |
| Gross profit | ----- 3,713,561 | ----- 733,970 | ----- -- |
| Operating expenses | 3,012,409 | 664,571 | 8,000 |
| Income from operations | ----- 701,152 | ----- 69,399 | ----- (8,000) |
| Other expense | 149,863 | - | 69,000 |
| Income before income taxes | ----- 551,289 | ----- 69,399 | ----- (77,000) |
| Provision for income taxes | 236,190 | 25,979 | (26,000) |
| Net income | ----- \$ 315,099 | ----- \$ 43,420 | ----- \$ (51,000) |
| Net income per share, basic | \$.03 | | |
| Net income per share, diluted | \$.03 | | |
| Weighted average shares, basic | ----- 9,876,000 | | |
| Weighted average shares, diluted | ----- 10,199,000 | | |

Notes

- (1) Adjustment to record increase of \$3,000 and \$5,000, respectively, in depreciation and amortization of certain non-current assets and identifiable intangible assets acquired, which are depreciated/amortized over a five and fifteen year period, respectively.
- (2) Adjustment to record increase in interest expenses for the additional borrowings incurred, at an average annual rate of 10%, to purchase the Tandy Leather Company operations.
- (3) Adjustment to record decrease in income taxes, provided at a 34% rate, on the aggregate pro forma reduction in pre-tax income.

