

TALON INTERNATIONAL, INC.  
Form 424B3  
August 20, 2015

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**TALON INTERNATIONAL, INC.**

**Filed Pursuant to Rule 424(b)(3)**

**Registration No. 333-200417**

**PROSPECTUS SUPPLEMENT NO. 1**

**(To Prospectus dated March 20, 2015)**

This is a prospectus supplement to our prospectus dated March 20, 2015 relating to the resale from time to time by selling stockholders of up to 61,111,109 shares of our common stock. On August 14, 2015, we filed with the Securities and Exchange Commission a Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2015. The text of the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2015 is attached to and made a part of this prospectus supplement. The exhibits to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2015 are not included with this prospectus supplement and are not incorporated by reference herein.

This prospectus supplement should be read in conjunction with the prospectus and is qualified by reference to the prospectus except to the extent that the information provided by this prospectus supplement supersedes the information contained in the prospectus.

**The securities offered by the prospectus involve a high degree of risk. You should carefully consider the “Risk Factors” referenced on page 3 of the prospectus in determining whether to purchase shares of our common**

**stock offered thereunder.**

**The date of this prospectus supplement is August 20, 2015.**

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended June 30, 2015

OR

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

Commission file number 1-13669

**TALON INTERNATIONAL, INC.**

(Exact Name of Issuer as Specified in its Charter)

**Delaware** **95-4654481**  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

**21900 Burbank Boulevard, Suite 270**

**Woodland Hills, California 91367**

(Address of Principal Executive Offices)

**(818) 444-4100**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for 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 (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

At August 13, 2015, the issuer had 92,267,831 shares of Common Stock, \$.001 par value, issued and outstanding.

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**TALON INTERNATIONAL, INC.**

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**TALON INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEETS**

|   | <b>June 30,<br/>2015<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2014</b> |
|---|--|----------------------------------|
| <b>Assets</b>   |  |                                  |
| <b>Current assets:</b>  |  |                                  |
| Cash and cash equivalents   | \$3,291,851                              | \$2,603,138                      |
| Accounts receivable, net  | 5,462,842                                | 3,019,749                        |
| Inventories, net  | 519,661                                  | 506,272                          |
| Current deferred income tax assets, net   | 922,684                                  | 746,370                          |
| Prepaid expenses and other current assets   | 762,990                                  | 551,775                          |
| <b>Total current assets</b>   | <b>10,960,028</b>                        | <b>7,427,304</b>                 |
| Property and equipment, net   | 798,622                                  | 584,586                          |
| Intangible assets, net  | 4,313,979                                | 4,300,084                        |
| Deferred income tax assets, net   | 5,208,041                                | 5,374,468                        |
| Other assets  | 428,085                                  | 416,035                          |
| <b>Total assets</b>   | <b>\$21,708,755</b>                      | <b>\$18,102,477</b>              |
| <b>Liabilities and Stockholders' Equity</b>   |  |                                  |
| <b>Current liabilities:</b>   |  |                                  |
| Accounts payable  | \$8,935,184                              | \$6,191,954                      |
| Accrued expenses  | 3,051,493                                | 2,403,563                        |
| Revolving credit loan   | 2,200,000                                | 1,500,000                        |
| Current portion of term loan payable  | 284,722                                  | 1,816,667                        |
| Current portion of capital lease obligations  | 21,087                                   | -                                |
| <b>Total current liabilities</b>  | <b>14,492,486</b>                        | <b>11,912,184</b>                |
| Term loan payable, net of current portion   | 1,440,278                                | 1,016,667                        |
| Capital lease obligations, net of current portion   | 71,971                                   | -                                |
| Deferred income tax liabilities   | 9,054                                    | 13,961                           |
| Other liabilities   | 215,262                                  | 26,077                           |
| <b>Total liabilities</b>  | <b>16,229,051</b>                        | <b>12,968,889</b>                |
| <b>Commitments and contingencies (Note 11)</b>  |  |                                  |
| <b>Stockholders' Equity:</b>  |  |                                  |
| Common Stock, \$0.001 par value, 300,000,000 shares authorized; 92,267,831 shares issued and outstanding at June 30, 2015 and December 31, 2014 | 92,268                                   | 92,268                           |

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|  |              |              |
|--|--------------|--------------|
| Additional paid-in capital                 | 64,231,496   | 64,175,254   |
| Accumulated deficit                        | (58,960,825) | (59,250,109) |
| Accumulated other comprehensive income     | 116,765      | 116,175      |
| Total stockholders' equity                 | 5,479,704    | 5,133,588    |
| Total liabilities and stockholders' equity | \$21,708,755 | \$18,102,477 |

See accompanying notes to consolidated financial statements.



## TALON INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited)

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 30,<br>2015   | 2014             | June 30,<br>2015 | 2014             |
| Net sales   | \$15,787,278       | \$15,959,169     | \$26,595,700     | \$27,302,287     |
| Cost of goods sold  | 10,754,319         | 10,553,709       | 17,998,834       | 18,161,871       |
| Gross profit  | 5,032,959          | 5,405,460        | 8,596,866        | 9,140,416        |
| Sales and marketing expenses                                      | 1,641,827          | 1,702,274        | 3,284,061        | 3,117,964        |
| General and administrative expenses                               | 2,618,291          | 2,221,622        | 4,685,783        | 4,398,693        |
| Total operating expenses  | 4,260,118          | 3,923,896        | 7,969,844        | 7,516,657        |
| Income from operations  | 772,841            | 1,481,564        | 627,022          | 1,623,759        |
| Interest expense, net   | 106,142            | 109,614          | 200,561          | 220,885          |
| Income before provision for income taxes                          | 666,699            | 1,371,950        | 426,461          | 1,402,874        |
| Provision for income taxes, net                                   | 218,192            | 557,475          | 137,177          | 571,134          |
| <b>Net income</b>   | <b>\$448,507</b>   | <b>\$814,475</b> | <b>\$289,284</b> | <b>\$831,740</b> |
| <b>Basic and diluted net income per share</b>                     | <b>\$0.00</b>      | <b>\$0.01</b>    | <b>\$0.00</b>    | <b>\$0.01</b>    |
| Weighted average number of common shares outstanding -<br>Basic   | 92,267,831         | 92,267,831       | 92,267,831       | 92,037,571       |
| Weighted average number of common shares outstanding -<br>Diluted | 93,516,492         | 93,702,693       | 93,608,931       | 93,566,946       |
| <b>Net income</b>   | <b>\$448,507</b>   | <b>\$814,475</b> | <b>\$289,284</b> | <b>\$831,740</b> |
| Other comprehensive income from foreign currency<br>translation   | 311                | 766              | 590              | 1,858            |
| <b>Total comprehensive income</b>                                 | <b>\$448,818</b>   | <b>\$815,241</b> | <b>\$289,874</b> | <b>\$833,598</b> |

See accompanying notes to consolidated financial statements.



## TALON INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|   | <b>Six Months Ended June</b> |             |
|---|------------------------------|-------------|
|   | <b>30,</b>                   |             |
|   | <b>2015</b>                  | <b>2014</b> |
| <i>Cash flows from operating activities:</i>                                      |                              |             |
| Net income  | \$289,284                    | \$831,740   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |             |
| Depreciation and amortization   | 124,687                      | 144,780     |
| Loss (gain) on disposal of property and equipment                                 | 281                          | (193 )      |
| Amortization of deferred financing cost   | 57,913                       | 45,139      |
| Stock based compensation  | 56,242                       | 122,923     |
| Deferred income taxes (benefits), net   | (14,789 )                    | 237,552     |
| Bad debt recoveries, net  | (14,857 )                    | (9,094 )    |
| Inventory valuation provisions, net   | 11,499                       | 17,952      |
| Changes in operating assets and liabilities:                                      |                              |             |
| Accounts receivable   | (2,425,230)                  | (193,336 )  |
| Inventories   | (24,848 )                    | 130,809     |
| Prepaid expenses and other current assets   | (210,641 )                   | 28,660      |
| Other assets.   | (12,882 )                    | (2,978 )    |
| Accounts payable and accrued expenses   | 3,384,251                    | 440,293     |
| Other liabilities   | 55,852                       | (6,923 )    |
| Net cash provided by operating activities   | 1,276,762                    | 1,787,324   |
| <i>Cash flows from investing activities:</i>                                      |                              |             |
| Proceeds from sale of equipment   | 350                          | 193         |
| Acquisitions of property and equipment  | (104,011 )                   | (143,773 )  |
| Acquisitions of intangibles   | (20,437 )                    | -           |
| Net cash used in investing activities   | (124,098 )                   | (143,580 )  |
| <i>Cash flows from financing activities:</i>                                      |                              |             |
| Payments of term loan payable   | (1,108,334)                  | (833,333 )  |
| Revolving credit loan borrowings  | 700,000                      | 500,000     |
| Payment of revolving credit loan  | -                            | (500,000 )  |
| Payment of financing costs associated with credit facilities                      | (56,915 )                    | -           |
| Payment of capital leases   | (1,683 )                     | -           |
| Payments related to taxes on the exercise of stock options and settlement of RSUs | -                            | (143,537 )  |
| Proceeds from exercise of stock options   | -                            | 29,709      |
| Net cash used in financing activities   | (466,932 )                   | (947,161 )  |

|   |             |             |
|---|-------------|-------------|
| Net effect of foreign currency exchange translation on cash | 2,981       | (3,653 )    |
| Net increase in cash and cash equivalents                   | 688,713     | 692,930     |
| Cash and cash equivalents at beginning of period            | 2,603,138   | 3,779,508   |
| Cash and cash equivalents at end of period                  | \$3,291,851 | \$4,472,438 |

See accompanying notes to consolidated financial statements.

**TALON INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

Supplemental disclosures of cash flow information:

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         |             |
|   | <b>2015</b>             | <b>2014</b> |
| Cash received (paid) during the period for:                               |                         |             |
| Interest paid   | \$(143,588)             | \$(176,205) |
| Interest received   | \$976                   | \$1,336     |
| Income tax paid, net (principally foreign)                                | \$(29,081 )             | \$(42,684 ) |
| Non-cash financing activities:  |                         |             |
| Lease incentives  | \$133,333               | \$-         |
| Capital lease obligation  | \$94,741                | \$-         |
| Non-cash exercise of stock options and settlement of RSUs in common stock | \$-                     | \$649       |
| Effect of foreign currency translation on net assets                      | \$590                   | \$1,858     |

See accompanying notes to consolidated financial statements.

**Note 1. Presentation of Interim Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in comprehensive financial statements have been condensed or omitted pursuant to such rules and regulations, although the management of Talon International, Inc. and its consolidated subsidiaries (collectively, the “Company”) believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

**Note 2. Summary of Significant Accounting Policies**

A complete description of the Company’s Significant Accounting Policies is included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, and should be read in conjunction with these unaudited consolidated financial statements. The Significant Accounting Policies noted below are only those policies that have changed materially or have supplemental information included for the periods presented here.

***Allowance for Accounts Receivable Doubtful Accounts***

The Company is required to make judgments as to the collectibility of accounts receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful accounts represent allowances for customer trade accounts that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables to their net realizable value. The Company records these allowances based on estimates related to the following factors: (i) customer specific allowances; (ii) amounts based upon an aging schedule; and (iii) an estimated amount, based on the Company’s historical experience, for issues not yet identified. Bad debt recoveries, net for the three and six months ended June 30, 2015 were \$(9,810) and \$(14,857), respectively. Bad debt recoveries, net for the three and six months ended June 30, 2014 were \$(18,508) and \$(9,094), respectively.

***Fair Value Measurements***

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the guidance under Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820, “*Fair Value Measurements and Disclosures*”, establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Includes other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's financial instruments include cash and cash equivalents, accounts receivable, other assets, accounts payable, accrued expenses, revolving credit loan, term loan payable and other liabilities. The book value of the financial instruments is representative of their fair values. In accordance with this guidance, the Company measures its cash equivalents at fair value. The Company's cash equivalents are classified within Level 1. Cash equivalents are valued primarily using quoted market prices utilizing market observable inputs. At June 30, 2015 and December 31, 2014, cash equivalents consisted of money market funds measured at fair value on a recurring basis; fair value of the Company's money market funds was approximately \$493,000 and \$1,018,000, respectively.

### *Intangible Assets*

Intangible assets consist of the *Talon* trade name acquired in a purchase business combination, patents, licenses, intellectual property rights and technology. Intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of ASC 350, "*Intangibles - Goodwill and Other*". Intangible assets with estimable useful lives are amortized over their respective estimated useful lives using the straight-line method, and are reviewed for impairment in accordance with the provisions of ASC 360, "*Property, Plant and Equipment*". Costs incurred to renew or extend the term of recognized intangible assets are capitalized and amortized over the useful life of the asset.

The Company applies Accounting Standards Update ("ASU") 2012-02, "*Intangibles – Goodwill and Other - Testing Indefinite-lived Intangible Assets for Impairment*" to determine whether an impairment is required. The guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then the company is required to estimate the fair value of the indefinite-lived intangible assets and perform a quantitative impairment test in accordance with ASU 350-30. The Company completed the required assessment as of June 30, 2015 and December 31, 2014, and noted no impairment.

From time to time the Company makes investments in product and technical opportunities that are complimentary to or enhancements to its apparel accessories business. During the quarter and six months ended June 30, 2015, the Company invested \$14,672 and \$20,437, respectively in the acquisition of intellectual property rights complimentary to the Company's *Talon Zipper* products. There was no acquisition of intellectual property rights for the quarter ended June 30, 2014. At June 30, 2015 and December 31, 2014 the Company invested \$66,494 and \$46,057, respectively, for intellectual property rights complimentary to the Company's *Talon Zipper* products, which are not yet in service.



Intangible assets as of June 30, 2015 and December 31, 2014 are as follows:

|   | <b>June 30,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---|--------------------------|----------------------------------|
| Tradenname - Talon trademark                    | \$4,110,751              | \$4,110,751                      |
| Intellectual property rights                    | 245,216                  | 224,779                          |
| Less: Accumulated amortization (10 to 17 years) | (41,988 )                | (35,446 )                        |
| Intellectual property rights, net               | 203,228                  | 189,333                          |
| Intangible assets, net                          | \$4,313,979              | \$4,300,084                      |

Amortization expense for intangible assets was \$3,271 and \$6,542, respectively for the three and six months ended June 30, 2015 and 2014.

### ***Classification of Expenses***

*Costs of Goods Sold* – Cost of goods sold primarily includes expenses related to inventory purchases, customs, duty, freight, overhead expenses and reserves for obsolete inventory. Overhead expenses primarily consist of quality assurance costs, warehouse and operations salaries, and other warehouse expense.

*Sales and Marketing Expenses* – Sales and marketing expenses primarily include sales salaries and commissions, travel and entertainment, marketing, advertising and other sales and product development related costs. Marketing and advertising efforts are expensed as incurred.

*General and Administrative Expenses* – General and administrative expenses primarily include administrative salaries, employee benefits, professional service fees, facility expenses, information technology costs, investor relations, travel and entertainment, depreciation and amortization, bad debts and other general corporate expenses.

*Interest Expense, net* – Interest expense reflects the cost of borrowings and amortization of deferred financing costs. Interest expense for the three and six months ended June 30, 2015 totaled \$106,700 and \$201,537, respectively.

Interest expense for the three and six months ended June 30, 2014 totaled \$110,457 and \$222,221, respectively. Interest income consists of earnings from cash held in interest bearing accounts. Interest income for each of the three months ended June 30, 2015 and 2014 represented less than \$1,000. Interest income for the six months ended June 30, 2015 and 2014 was \$976 and \$1,336, respectively.

***Foreign Currency Translation***

The Company has operations and holds assets in various foreign countries. The local currency is the functional currency for the Company's subsidiaries in China and India. Assets and liabilities are translated at end-of-period exchange rates while revenues and expenses are translated at the average exchange rates in effect during the period. Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income until the translation adjustments are realized. Included in accumulated other comprehensive income was a cumulative foreign currency translation gain of \$116,765 and \$116,175 as of June 30, 2015 and December 31, 2014, respectively.

### ***Comprehensive Income***

Comprehensive income consists of net income and unrealized income on foreign currency translation adjustments. The foreign currency translation adjustment represents the net currency translation gains and losses related to our China and India subsidiaries, which have not been reflected in the net income for the periods presented.

The Company reports comprehensive income in accordance with Topic 220 “*Comprehensive Income*”, and uses the option provided under ASU 2011-05 “*Presentation of Comprehensive Income*” to present the total of comprehensive income, the components of net income and the components of other comprehensive income in a single continuous statement.

### ***Use of Estimates***

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. The accounting estimates that require the Company’s most significant, difficult and subjective judgments include the valuation allowance for accounts receivable and inventory, the assessment of recoverability of long-lived assets and intangible assets, stock-based compensation and the recognition and measurement of current and deferred income taxes (including the measurement of uncertain tax positions). Actual results could differ materially from the Company’s estimates.

### ***Presentation***

In order to facilitate the comparison of financial information, certain amounts reported in the prior year have been reclassified to conform to the current year presentation.

### **Note 3. New Accounting Pronouncements**

In April 2015, the FASB issued ASU No. 2015-03, “*Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*” (“ASU 2015-03”). The amendment simplifies debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction of the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendment. ASU 2015-03 is effective for fiscal years, and interim reporting periods within those fiscal years, beginning December 15, 2015. Other than reclassification of debt issuance costs net of amortization from assets to liabilities, no other effect is expected to be included on the Company’s financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. ASU 2014-15 explicitly requires management to evaluate, at each annual or interim reporting period, whether there are conditions or events that exist which raise substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and annual and interim periods thereafter, with early adoption permitted. The Company does not expect that the adoption of this pronouncement will have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard is effective as of the first interim period within annual reporting periods beginning on or after December 15, 2016, and will replace most existing revenue recognition guidance in U.S. GAAP. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company does not expect that the adoption of this pronouncement will have a material impact on its consolidated financial statements.

#### Note 4. Net Income Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations:

|   | Net<br>income | Shares     | Per<br>Share<br>Amount |
|---|---------------|------------|------------------------|
| <b><u>Three months ended June 30, 2015:</u></b> |               |            |                        |
| Basic net income:                               |               |            |                        |
| Net income                                      | \$448,507     | 92,267,831 | \$ 0.00                |
| Effect of Dilutive Securities -                 |               |            |                        |
| Options   | -             | 1,248,661  | 0.00                   |
| Diluted net income                              | \$448,507     | 93,516,492 | \$ 0.00                |
| <b><u>Three months ended June 30, 2014:</u></b> |               |            |                        |
| Basic net income:                               |               |            |                        |
| Net income                                      | \$814,475     | 92,267,831 | \$ 0.01                |
| Effect of Dilutive Securities -                 |               |            |                        |
| Options   | -             | 1,434,862  | 0.00                   |
| Diluted net income                              | \$814,475     | 93,702,693 | \$ 0.01                |

|   | Net<br>income | Shares     | Per<br>Share<br><br>Amount |
|---|---------------|------------|----------------------------|
| <b><u>Six months ended June 30, 2015:</u></b> |               |            |                            |
| Basic net income:                             |               |            |                            |
| Net income                                    | \$289,284     | 92,267,831 | \$ 0.00                    |
| Effect of Dilutive Securities -               |               |            |                            |
| Options                                       | -             | 1,341,100  | 0.00                       |
| Diluted net income                            | \$289,284     | 93,608,931 | \$ 0.00                    |
| <b><u>Six months ended June 30, 2014:</u></b> |               |            |                            |
| Basic net income:                             |               |            |                            |
| Net income                                    | \$831,740     | 92,037,571 | \$ 0.01                    |
| Effect of Dilutive Securities -               |               |            |                            |
| Options                                       | -             | 1,529,375  | 0.00                       |
| Diluted net income                            | \$831,740     | 93,566,946 | \$ 0.01                    |

For the three and six months ended June 30, 2015, options to purchase 2,691,667 shares of common stock exercisable between \$0.04 and \$0.11 per share were included in the computation of diluted net income per share; and options to purchase 5,623,600 shares of common stock exercisable between \$0.16 and \$1.33 per share, were outstanding but were not included in the computation of diluted net income per share because they would have an antidilutive effect on the net income per share.

For the three months ended June 30, 2014, options to purchase 5,066,667 shares of common stock exercisable between \$0.04 and \$0.20 per share were included in the computation of diluted net income per share. For the six months ended June 30, 2014, options to purchase 5,466,667 shares of common stock exercisable between \$0.04 and \$0.26 per share were included in the computation of diluted net income per share. Options to purchase 1,038,600 and 638,600 shares of common stock exercisable between \$0.26 and \$5.23 per share were outstanding but were not included in the computation of diluted net income per share because they would have an antidilutive effect on the net income per share.

#### **Note 5. Accounts Receivable**

Accounts receivable are included on the consolidated balance sheets net of the allowance for doubtful accounts. The allowance for doubtful accounts at June 30, 2015 and December 31, 2014 was \$34,117 and \$50,563, respectively.

**Note 6. Inventories**

Inventories are stated at the lower of cost, determined using the first-in, first-out basis, or market value and are all categorized as finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory valuation reserves are recorded for damaged, obsolete, excess and slow-moving inventory. The Company uses estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved depending on the type of product and the length of time the product has been included in inventory. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this inventory.

Inventories consist of the following:

|                   | <b>June 30,</b> | <b>December</b> |
|-------------------|-----------------|-----------------|
|                   | <b>2015</b>     | <b>31,</b>      |
|                   |                 | <b>2014</b>     |
| Finished goods    | \$585,538       | \$705,368       |
| Less: Reserves    | (65,877 )       | (199,096 )      |
| Total inventories | \$519,661       | \$506,272       |

**Note 7. Bank Credit Facilities**

On December 31, 2013, the Company entered into a Commercial Credit Agreement (the “Credit Agreement”) with MUFG Union Bank, N.A. (formerly Union Bank, N.A., “Union Bank”). The Credit Agreement provides for a 24 month revolving loan commitment and a 36 month term loan. The revolving loan commitment includes available borrowings of up to \$3,500,000 (the “Revolving Credit Loan”), consisting of revolving loans and a sublimit of letters of credit not to exceed a maximum aggregate principal amount of \$1,000,000. Borrowings under the Revolving Credit Loan initially carried interest at a per annum rate of two and one-half percent (2.50%) in excess of a reference rate (“Reference Rate”), which is an index rate determined by Union Bank from time to time as a means of pricing certain extensions of credit. The Reference Rate was 3.25% as of June 30, 2015 and December 31, 2014.



The Credit Agreement provides for a term loan in the amount of \$5,000,000 (the “Term Loan Payable” and together with the Revolving Credit Loan, the “Credit Facilities”). The Term Loan Payable was originally payable in 36 monthly payments of \$138,889 beginning January 31, 2014 with interest payable at a per annum rate of two and three-quarters percent (2.75%) in excess of the Reference Rate. The Company paid \$250,000 in financing costs associated with the Credit Agreement and used all of the proceeds of the Term Loan and \$827,490 of the proceeds of the Revolving Credit Loan to repay in full at December 31, 2013, a promissory note entered into in July 2013 with CVC California, LLC in the principal amount of \$5,800,000 plus accrued interest.

The Credit Agreement contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for Credit Facilities of this type including maintaining a Fixed Charge Coverage Ratio between Adjusted EBITDA and principal and interest payments (as defined in the Credit Agreement) of not less than 1.25:1.00 as of the close of each fiscal quarter and an EBITDA (as defined in the Credit Agreement) of at least \$2,750,000 as of the close of each fiscal quarter, for the 12-month period ended as of the last day of the quarter. The Company did not satisfy the previous minimum Fixed Charge Coverage Ratio requirement (1.25:1.00) and the previous minimum EBITDA requirement of \$2,750,000 for the 12-month periods ended September 30, 2014 and December 31, 2014, and in connection therewith obtained waivers of such non-compliance from Union Bank for those periods. In exchange for the waivers, the Company paid Union Bank a waiver fee of \$10,000, and at December 31, 2014 a prepayment in the amount of \$500,000 was made and applied to the principal of the Term Loan Payable and certain provisions of the Credit Agreement were amended.

On March 3, 2015, the Company signed an amendment to the Credit Agreement with Union Bank, changing various contractual terms as follows: the Fixed Charge Coverage Ratio requirement was reduced for the periods ended March 31, 2015 to 0.70:1.00 and for June 30, 2015 to 1.00:1.00; the minimum EBITDA requirement for the 12-month period ended as of the last day of each of these quarters during 2015 was reduced from \$2,750,000 to \$1,750,000; the requirement of no incurrence of a net loss after taxes for more than two consecutive fiscal quarters was changed to be effective January 1, 2015; net principal repayments totaling \$600,000 in 2015 were added to the Term Loan Payable scheduled payments (\$400,000 were paid during the second quarter of 2015 and the remaining \$200,000 were paid subsequent to June 30, 2015, on July 1, 2015), and excluded from the Fixed Charge Coverage Ratio calculation; the interest rate on the Term Loan Payable and Revolving Credit Loan was increased by 1% effective March 1, 2015; and the Company paid a loan modification fee of \$50,000, half of which was paid on March 31, 2015 and the other half was paid on June 30, 2015. Additional legal fees were charged by Union Bank during the first quarter of 2015 in the amount of \$6,915. The remaining principal of the Term Loan Payable was also re-amortized to be paid in the remaining 18 monthly installments of \$84,722 each. As a result of this amendment, the Company anticipated that it would meet the required financial covenants in the following year.

The Company did not satisfy the minimum EBITDA requirement for the 12-month period ended June 30, 2015, due primarily to a \$705,000 one-time accrual for severance payments to Lonnie D. Schnell, the Company's former CEO and board member, that was recognized upon separation during the three months ended June 30, 2015. Subsequent to June 30, 2015, on August 4, 2015, the Company obtained a waiver from Union Bank of this non-compliance. The Company paid Union Bank a waiver fee of \$25,000 as a condition to the waiver.

The payment and performance of all indebtedness and other obligations under the Credit Facilities are secured by liens on substantially all of the Company assets pursuant to the terms and conditions of security agreements and guaranties executed by the Company and its principle operating subsidiaries including Talon Technologies, Inc. (U.S. operation) and Tag-It Pacific Limited (Hong Kong operation).

The Company had outstanding borrowings as of June 30, 2015 and December 31, 2014 of \$3,925,000 and \$4,333,334, respectively, under the Credit Facilities, of which \$2,200,000 and \$1,500,000, respectively, relates to obligations

under the Revolving Credit Loan and the remainder relates to the Term Loan Payable. During the three and six months ended June 30, 2015, the Company obtained advances under the Revolving Credit Loan of \$500,000 and \$700,000, respectively resulting in a net increase in the outstanding borrowings to \$2,200,000 at June 30, 2015. Approximately \$671,000 remained in available borrowings under the Revolving Credit Loan as of June 30, 2015.

Subsequent to June 30, 2015, on August 10, 2015, the Company signed an amendment to the Credit Agreement with Union Bank, which provided for the elimination of financial covenants for the remaining term of the Credit Agreement, permitted the Company to incur \$3,000,000 of subordinated indebtedness, and required the repayment of the outstanding Term Loan Payable in the principal amount of \$1,440,278 plus accrued and unpaid interest by August 31, 2015. On August 11, 2015, the Company received an advance from Princess Investment under the Loan Agreement in the amount of \$1,500,000, of which \$1,440,278 was used to pay off the Term Loan Payable to Union Bank on August 12, 2015. As a result, approximately \$932,000 were reclassified from current portion of term loan payable to term loan payable, net of current portion, as reflected on the Company's Balance Sheets as of June 30, 2015. See Subsequent events Note 13.

Interest expense, net, included on the Company's Consolidated Statements of Operations and Comprehensive Income is comprised as follows:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2015</b>               | <b>2014</b> | <b>2015</b>             | <b>2014</b> |
| Revolving credit loan                            | \$35,663                  | \$14,534    | \$60,702                | \$30,746    |
| Term loan payable                                | 38,038                    | 68,400      | 81,023                  | 141,088     |
| Amortization of deferred financing cost          | 31,544                    | 22,570      | 57,914                  | 45,139      |
| Total Credit Facilities related interest expense | 105,245                   | 105,504     | 199,639                 | 216,973     |
| Other interest expense, net                      | 897                       | 4,110       | 922                     | 3,912       |
| Interest expense , net                           | \$106,142                 | \$109,614   | \$200,561               | \$220,885   |

#### **Note 8. Stockholders' Equity**

##### ***Private Placement of Common Stock***

In July 2013 the Company raised \$5,500,000 of new equity through the sale, in a private placement transaction, of 61,111,109 shares of the Company's common stock at a price of \$0.09 per share. Zipper Holdings, LLC, a related party company controlled by Mark Dyne, the Chairman of the Company's Board of Directors, acquired 8,333,333 shares of common stock in the private placement.

In connection with the private placement, the Company entered into a series of Subscription Agreements (the “Subscription Agreements”) and a Registration Rights Agreement (the “Registration Rights Agreement”) with the investors in the transaction. The Subscription Agreement entered into with Kutula Holdings Ltd. (“Kutula”) grants Kutula the right to nominate one member of the Company’s Board of Directors, so long as Kutula continues to hold at least 15,500,000 of the shares (as adjusted for stock splits and the like) purchased pursuant to its Subscription Agreement, subject to certain disclosure requirements and other limitations. The Registration Rights Agreement provides for demand registration rights, such that upon the demand of holders of at least 25% of the shares issued in the private placement and subject to certain conditions, the Company will then file a registration statement covering the shares issued in the private placement that requested to be included in such registration. The Registration Rights Agreement also provides certain piggyback rights, in which the holders of shares acquired in the private placement have the right to include those shares in a Company-initiated registration.

Pursuant to its obligations under the Registration Rights Agreement, the Company filed a registration statement on Form S-1 with the SEC on November 20, 2014 to register for resale all of the 61,111,109 shares issued in the private placement. The registration statement was declared effective on December 4, 2014.

### *Authorized Common Stock and Preferred Stock*

On November 8, 2013, the Company's stockholders approved an amendment to the Company's Certificate of Incorporation to increase the number of shares of common stock authorized to be issued from 100,000,000 to 300,000,000. At the Company's 2015 Annual Meeting of Stockholders, the stockholders approved an amendment to the Company's Certificate of Incorporation to allow for a reverse split of the Company's outstanding shares of common stock any time prior to the 2016 Annual Meeting authorizing the Board of Directors, when and if the Board of Directors determined that such action is appropriate.

The Company's Certificate of Incorporation presently authorizes the issuance of 3,000,000 shares of Preferred Stock, having a par value of \$0.001 per share. No shares of Preferred Stock were outstanding at June 30, 2015 or December 31, 2014.

### **Note 9. Stock-Based Compensation**

The Company accounts for stock-based awards to employees and directors in accordance with FASB ASC 718, "*Compensation - Stock Compensation*", which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values.

#### *Stock Options*

The Company's 2008 Stock Incentive Plan initially authorized the issuance of up to 2,500,000 shares of common stock in awards to individuals under the plan. On November 19, 2010, an amendment to the 2008 Stock Incentive Plan increased the authorized shares from 2,500,000 to 4,810,000. On November 8, 2013, the Company's stockholders approved a further amendment to the 2008 Stock Incentive Plan to increase from 4,810,000 to 15,000,000 the number of shares of common stock that may be issued pursuant to awards under the plan.

The Company's 2007 Stock Plan was approved by the Company's stockholders in 2007, and replaced the 1997 Stock Plan that had previously authorized the granting of a variety of stock-based incentive awards. The 2007 Stock Plan authorizes up to 2,600,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan.

The Board of Directors, who determines the recipients and terms of the awards granted, administers the Company's stock plans. Awards under the Company's stock plans are generally granted with an exercise price equal to the average market price of the Company's stock for the five trading days following the date of approval of the grant. Those option awards generally vest over periods determined by the Board of Directors from immediate to 4 years of continuous service and have 10 year contractual terms.

During the three and six months ended June 30, 2015, 300,000 and 400,000 options, respectively were granted. During the three and six months ended June 30, 2014, 400,000 options were granted.

During the six months ended June 30, 2014, options were exercised to acquire 186,458 shares of common stock under the 2007 and 2008 Stock Incentive Plans, and 148,820 shares were retained by the Company in payment of the exercise price of \$0.18 weighted average per share and the tax associated with the exercise of the options. At the time of exercise, the intrinsic value of the options exercised was \$0.27 per share, and the retained shares had a value of \$40,181. During the six months ended June 30, 2014, options were also exercised to acquire 277,084 shares of common stock under the 2008 Stock Incentive Plan. Cash received upon exercise was \$29,709 at a weighted average of \$0.11 per share. At the time of exercise, the intrinsic value of the options exercised was \$0.23 per share. No options were exercised during the three months ended June 30, 2014, and the three and six months ended June 30, 2015.

As of June 30, 2015, the Company had \$436,156 of unamortized stock-based compensation expense related to options issued to employees and directors, which will be recognized over the remaining weighted average period of 3.19 years. As of June 30, 2014, unamortized stock-based compensation expense related to options issued to employees and directors was \$136,172, which was to be recognized over the weighted average period of approximately 3.07 years.

The following table summarizes the activity in the Company's share based compensation plans during the six months ended June 30, 2015.

|                                       | <b>Number of</b> | <b>Weighted</b> |
|---------------------------------------|------------------|-----------------|
|                                       | <b>Shares</b>    | <b>Average</b>  |
|                                       |                  | <b>Exercise</b> |
|                                       |                  | <b>Price</b>    |
| <b><i>Employees and Directors</i></b> |                  |                 |
| Options outstanding - January 1, 2015 | 9,747,767        | \$ 0.20         |
| Granted                               | 100,000          | \$ 0.19         |
| Exercised                             | -                | \$ -            |
| Cancelled                             | (175,000 )       | \$ 0.93         |
| Options outstanding - March 31, 2015  | 9,672,767        | \$ 0.19         |
| Granted                               | 300,000          | \$ 0.16         |
| Exercised                             | -                | \$ -            |
| Cancelled                             | (1,657,500)      | \$ 0.21         |
| Options outstanding - June 30, 2015   | 8,315,267        | \$ 0.19         |

***Restricted Stock Units (RSUs)***



On July 30, 2010, the Company awarded each of Lonnie D. Schnell (the Company's Chief Executive Officer through April 10, 2015) and Larry Dyne (the Company's Chief Executive Officer effective April 13, 2015 and President at the time) a restricted stock unit award (an "RSU Award") for 5,778,500 shares of the Company's common stock. Each RSU Award vested 50% on August 30, 2011, and 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to partial acceleration of vesting as part of the executives' severance benefits and full acceleration of vesting upon a change in control of the Company. As of July 30, 2010, the RSUs were valued at \$2,263,884, which was reduced by the fair value of the options surrendered by the employees in connection with these grants.

On August 30, 2010, Mr. Schnell and Mr. Dyne elected to defer the settlement in common shares of 5,434,200 RSUs beyond the vesting dates.

On January 30, 2014, 610,894 shares of common stock were issued upon final settlement of vested restricted stock units, and the equivalent of 544,806 shares were retained by the Company in payment of the tax associated with the vesting of restricted stock units previously granted to the reporting persons. No shares were issued upon settlement of vested restricted stock units during 2015.

There were no outstanding RSUs and no unamortized stock-based compensation expense related to RSUs as of June 30, 2015 and December 31, 2014.

**Note 10. Income taxes**

Provision for income taxes, net, for the three and six months ended June 30, 2015 was \$218,192 and \$137,177, respectively. Provision for income taxes, net, for the three and six months ended June 30, 2014 was \$557,475 and \$571,134, respectively.

Current income taxes receivable were associated with foreign and domestic prepayments net of income tax payable, and totaled \$65,627 and \$66,270 as of June 30, 2015 and December 31, 2014, respectively.

Current income taxes payable were principally associated with foreign withholdings, funds transfers, and income tax payable from the Company's Asia operations. Current income taxes payable as of June 30, 2015 and December 31, 2014 totaled \$200,212 and \$78,455, respectively, and were included in accrued expenses.

Deferred income tax assets, net, totaled \$6,130,725 and \$6,120,838 as of June 30, 2015 and December 31, 2014, respectively, are included in long term deferred income tax assets, net, and in current deferred income tax assets, net.

Deferred income tax liabilities totaled \$9,054 and \$13,961 as of June 30, 2015 and December 31, 2014, respectively.

**Note 11. Commitments and Contingencies**

The Company currently has pending claims and complaints that arise in the ordinary course of the Company's business. The Company believes that it has meritorious defenses to these claims and that the claims are either covered by insurance or would not have a material effect on the Company's consolidated financial position or results of operations if adversely determined against the Company.

In November 2002, the FASB issued Topics of the FASB ASC 460-10, “*Guarantees*” (“ASC 460-10”) and FASB ASC 850-10, “*Related Party Disclosures*” (“ASC 850-10”). The following is a summary of the Company’s agreements that it has determined are within the scope of ASC 460-10 and ASC 850-10:

In accordance with the bylaws of the Company, and indemnification agreements entered into with the members of the Board of Directors and executive officers, the Company’s officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director serving in such capacity. The term of the indemnification period is for the lifetime of the officer or director. The maximum potential amount of future payments the Company could be required to make under the indemnification provisions of its bylaws and indemnification agreements is unlimited. However, the Company has a director and officer liability insurance policy that reduces its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of the indemnification provisions of its bylaws and indemnification agreements is minimal and therefore, the Company has not recorded any related liabilities.

The Company enters into indemnification provisions under its agreements with investors and its agreements with other parties in the normal course of business, typically with suppliers, customers and landlords. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights, and generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal and accordingly, the Company has not recorded any related liabilities.

## Note 12. Segment Reporting and Geographic Information

The Company manufactures and distributes a full range of zipper (Talon Zipper), trim (Talon Trim) and waistband, shirt collars and other apparel components utilizing proprietary stretch technology (Talon Tekfit) to manufacturers of fashion apparel, specialty retailers and mass merchandisers. The Company's organization is based on divisions representing the major product lines, and the Company's operating decisions use these divisions to assess performance, allocate resources and make other operating decisions. Within these product lines there is not enough difference between the types of products to justify segmented reporting by product type or to account for these products separately. The net revenues and operating margins for the three primary product groups are as follows:

|                        | <b>Three Months ended June 30, 2015</b> |                       |                         |                               |
|------------------------|---|-----------------------|-------------------------|-------------------------------|
|                        | <b>Talon<br/>Zipper</b>                 | <b>Talon<br/>Trim</b> | <b>Talon<br/>Tekfit</b> | <b>Talon<br/>Consolidated</b> |
| Net sales              | \$8,537,310                             | \$6,631,077           | \$618,891               | \$15,787,278                  |
| Cost of goods sold     | 6,299,158                               | 4,005,649             | 449,512                 | 10,754,319                    |
| Gross profit           | \$2,238,152                             | \$2,625,428           | \$169,379               | 5,032,959                     |
| Operating expenses     |   |                       |                         | 4,260,118                     |
| Income from operations |   |                       |                         | \$772,841                     |

**Three Months ended June 30, 2014**

|                        | <b>Talon<br/>Zipper</b> | <b>Talon<br/>Trim</b> | <b>Talon<br/>Tekfit</b> | <b>Talon<br/>Consolidated</b> |
|------------------------|-------------------------|-----------------------|-------------------------|-------------------------------|
| Net sales              | \$8,617,171             | \$7,324,480           | \$17,518                | \$ 15,959,169                 |
| Cost of goods sold     | 6,073,050               | 4,494,881             | (14,222 )               | 10,553,709                    |
| Gross profit           | \$2,544,121             | \$2,829,599           | \$31,740                | 5,405,460                     |
| Operating expenses     |                         |                       |                         | 3,923,896                     |
| Income from operations |                         |                       |                         | \$ 1,481,564                  |

**Six Months ended June 30, 2015**

|                        | <b>Talon<br/>Zipper</b> | <b>Talon<br/>Trim</b> | <b>Talon<br/>Tekfit</b> | <b>Talon<br/>Consolidated</b> |
|------------------------|-------------------------|-----------------------|-------------------------|-------------------------------|
| Net sales              | \$13,942,925            | \$11,616,816          | \$1,035,959             | \$ 26,595,700                 |
| Cost of goods sold     | 10,211,521              | 7,159,706             | 627,607                 | 17,998,834                    |
| Gross profit           | \$3,731,404             | \$4,457,110           | \$408,352               | 8,596,866                     |
| Operating expenses     |                         |                       |                         | 7,969,844                     |
| Income from operations |                         |                       |                         | \$ 627,022                    |

**Six Months ended June 30, 2014**

|                        | <b>Talon<br/>Zipper</b> | <b>Talon<br/>Trim</b> | <b>Talon<br/>Tekfit</b> | <b>Talon<br/>Consolidated</b> |
|------------------------|-------------------------|-----------------------|-------------------------|-------------------------------|
| Net sales              | \$14,409,206            | \$12,869,618          | \$23,463                | \$ 27,302,287                 |
| Cost of goods sold     | 10,166,473              | 7,970,042             | 25,356                  | 18,161,871                    |
| Gross profit (loss)    | \$4,242,733             | \$4,899,576           | \$(1,893 )              | 9,140,416                     |
| Operating expenses     |                         |                       |                         | 7,516,657                     |
| Income from operations |                         |                       |                         | \$ 1,623,759                  |

The Company distributes its products internationally and has reporting requirements based on geographic regions. Revenues are attributed to countries based upon customer delivery locations and the net book value of long-lived assets (consisting of property and equipment and intangibles) is attributed to countries based on the location of the assets, as follows:

| <i>Sales:</i>           | Three Months Ended |              | Six Months Ended |              |
|-------------------------|--------------------|--------------|------------------|--------------|
|                         | June 30,<br>2015   | 2014         | June 30,<br>2015 | 2014         |
| <i>Country / Region</i> |                    |              |                  |              |
| United States           | \$939,366          | \$1,218,508  | \$1,673,511      | \$2,397,635  |
| China                   | 4,702,275          | 6,045,572    | 7,494,658        | 9,019,491    |
| Hong Kong               | 3,131,271          | 3,100,321    | 5,433,105        | 6,221,158    |
| Bangladesh              | 1,408,343          | 551,508      | 2,477,397        | 1,107,523    |
| Vietnam                 | 1,206,436          | 561,535      | 1,647,848        | 1,110,195    |
| India                   | 823,474            | 749,824      | 1,432,592        | 1,264,969    |
| Other                   | 3,576,113          | 3,731,901    | 6,436,589        | 6,181,316    |
| Total                   | \$15,787,278       | \$15,959,169 | \$26,595,700     | \$27,302,287 |

|                           | June 30,<br>2015 | December<br>31,<br>2014 |
|---------------------------|------------------|-------------------------|
| <i>Long-lived Assets:</i> |                  |                         |
| United States             | \$4,814,780      | \$4,554,831             |
| China                     | 182,224          | 178,873                 |
| Hong Kong                 | 115,597          | 150,966                 |
| Total                     | \$5,112,601      | \$4,884,670             |

### Note 13. Subsequent Events

The Company evaluated subsequent events after the balance sheet date of June 30, 2015 through the date of the filing of this report.

On August 10, 2015, the Company entered into an amendment to the Credit Agreement with Union Bank, which provided for the elimination of financial covenants for the remaining term of the Credit Agreement, permitted the Company to incur \$3,000,000 of subordinated indebtedness, and required the repayment by August 31, 2015 of the outstanding Term Loan Payable in the principal amount of \$1,440,278 plus accrued and unpaid interest.

On August 10, 2015, the Company entered into a loan and reimbursement agreement (“Loan Agreement”) with Princess Investment Holdings, Inc. (“Princess Investment”), pursuant to which Princess Investment agreed to make available to the Company a loan of up to \$3,000,000 (the “Subordinated Loan”). Advances under the Loan Agreement will accrue interest on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Subordinated Loan is payable monthly beginning September 1, 2015, and the principal amount is payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. The Loan Agreement requires payment of a \$60,000 loan fee, which is required to be paid at maturity.

The payment and performance of all indebtedness and other obligations of the Company to Princess Investment, including all borrowings under the Loan Agreement, are guaranteed by the Company's subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement. The payment and performance of all indebtedness and other obligations of the Company to Princess Investment under the Loan Agreement and related agreements are secured by liens on substantially all of the assets of the Company and its subsidiary guarantors pursuant to the terms and conditions of a Pledge and Security Agreement executed by the Company and guarantors in favor of Princess Investment.

On August 11, 2015, the Company received an advance from Princess Investment under the Loan Agreement in the amount of \$1,500,000, of which \$1,440,278 was used to pay off the Term Loan Payable to Union Bank on August 12, 2015. As a result, approximately \$932,000 were reclassified from current portion of term loan payable to term loan payable, net of current portion, as reflected on the Company's Balance Sheets as of June 30, 2015.

Pursuant to the Loan Agreement, the Company issued Princess Investment warrants to purchase 1,000,000 shares of the Company's common stock. The warrants are exercisable over a five-year period and exercise price of \$0.18 per share. The warrants did not require cash settlements.

As a result of the repayment of the Union Bank Term Loan Payable, the Company expects to record a loss on debt extinguishment in non-operating expenses in the Company's Consolidated Statements of Operations and Comprehensive Income for the period ending September 30, 2015. The complete impact of these transactions on the Company's results of operations for the period ending September 30, 2015 is still being evaluated.



## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Forward Looking Statements**

### **Overview**

This report and other documents we file with the Securities and Exchange Commission contain forward looking statements that are based on current expectations, estimates, forecasts and projections about us, our future performance, our business or others on our behalf, our beliefs and our management's assumptions. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. We describe our respective risks, uncertainties, and assumptions that could affect the outcome or results of operations below. We have based our forward looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward looking statements. Reference is made in particular to forward looking statements regarding projections or estimates concerning our business, including adequate liquidity to fund our operations and meet our other cash requirements, demand for our products and services, mix of revenue streams, ability to control or reduce operating expenses, anticipated gross margins and operating results, cost savings, product development efforts, general outlook of our business and industry, international businesses, and competitive position.

The following management's discussion and analysis is intended to assist the reader in understanding our consolidated financial statements and our business. This management's discussion and analysis is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and accompanying notes.

Talon International, Inc. designs, manufactures, sells and distributes apparel zippers, various apparel trim products and specialty waistbands, shirt collars and other apparel components to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We sell and market these products under various branded names including *Talon*® and *Tekfit*®. As a result, we operate the business globally under three product groups - Talon Zipper, Talon Trim and Talon Tekfit.

We pursue the global expansion of our business through the establishment of Talon owned sales and distribution locations, and strategic manufacturing relationships. The manufacturing arrangements, in combination with Talon owned and affiliated facilities under the Talon brand, improve our time-to-market throughout the world by sourcing, finishing and distributing to apparel manufacturers in their local markets.

Our primary business focus is on serving as an outsourced apparel zipper, trim and inner lining supplier, product design and development, sampling and sourcing department for the most demanding brands and retailers. We believe

that design differentiation among brands and retailers is a critical marketing tool for our customers. By assisting our customers in the design, development, sampling and sourcing of all apparel components other than fabric and thread, we generally achieve higher margins for our products, create long-term relationships with our customers, grow our sales to a particular customer by serving a larger proportion of their brands and better differentiate our sales and services from those of our competitors. We are expanding our business globally, to better serve our apparel customers at the factory level, in addition to global brands and retailers. We believe we can lead the industry in apparel accessories by having strong relationships with our brand and retail customers and having a distributed service organization to serve our factory customers globally.

Our Talon Tekfit business provides manufacturers with Talon's patented fabric stretch technology, manufacturing know-how, proprietary equipment and materials necessary to produce expandable waistbands, shirt collars and various other stretch technology apparel inner lining components. In recent years we have begun to actively expand our marketing and selling efforts of this unique product within the industry.

The adoption of new and innovative technology by major retailers, particularly where it modifies the style, design or performance of a garment, is a complicated and time-consuming process. New product innovations by major retailers can require 10 to 12 months to complete the design, marketing and manufacturing of the new item, and depending upon the seasonal aspect of the garment, introduction of the product to the market could require several additional months. Accordingly, the re-introduction of the Talon Tekfit technology requires significant time to accomplish adoption within the retailers' products. However, once adopted we anticipate the production volumes will continue to build as the technology is accepted across multiple styles with a retailer.

### **Seasonality**

We typically experience seasonal fluctuations in sales volume consistent with the purchase demands of the apparel industry. In most years, these seasonal fluctuations result in lower sales volumes for our business in the first and fourth quarters of each year due to the seasonal buying patterns by the majority of our customers. Sales of our products typically precede the retail sales patterns by approximately 90 to 150 days, with this cycle pattern closer to 45 to 75 days for our more generic products sold to mass merchandisers. The apparel retailers typically experience their highest sales volumes during the fourth quarter in association with year-end holiday purchases. Backlogs of sales orders are not considered material in the industries in which we compete, which reduces the predictability of our sales and reinforces the volatility of these cyclical buying patterns on our sales volume. Operating expenses typically follow our seasonal sales patterns fluctuating with the quarterly sales. However our first quarter is typically burdened with higher costs associated with year-end audits, legal reviews, and costs associated with SEC filings, resulting in proportionally higher costs in the first quarter. Because of these fluctuations in our sales and operating costs, results for any quarter are not necessarily indicative of the results that may be achieved for the full year.

### **Results of Operations**

The following table sets forth selected statements of operations data shown as a percentage of net sales for the periods indicated:

| <b>Three Months<br/>Ended</b> | <b>Six Months<br/>Ended</b> |
|-------------------------------|-----------------------------|
| <b>June 30,</b>               | <b>June 30,</b>             |

|                                     | <b>2015</b> | <b>2014</b> | <b>2015</b> | <b>2014</b> |
|-------------------------------------|-------------|-------------|-------------|-------------|
| Net sales                           | 100.0%      | 100.0%      | 100.0%      | 100.0%      |
| Cost of goods sold                  | 68.1        | 66.1        | 67.7        | 66.5        |
| Gross profit                        | 31.9        | 33.9        | 32.3        | 33.5        |
| Sales and marketing expenses        | 10.4        | 10.7        | 12.3        | 11.4        |
| General and administrative expenses | 16.6        | 13.9        | 17.6        | 16.2        |
| Interest expense, net               | 0.7         | 0.7         | 0.8         | 0.8         |
| Provision for income taxes, net     | 1.4         | 3.5         | 0.5         | 2.1         |
| Net income                          | 2.8 %       | 5.1 %       | 1.1 %       | 3.0 %       |

*Sales*

For the three and six months ended June 30, 2015 and 2014, sales by geographic region based on the customer delivery locations as a percentage of sales were as follows:

| <b>Region</b> | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---------------|---------------------------|-------------|-------------------------|-------------|
|               | <b>June 30, 2015</b>      | <b>2014</b> | <b>June 30, 2015</b>    | <b>2014</b> |
| United States | 6.0 %                     | 7.6 %       | 6.3 %                   | 8.8 %       |
| China         | 29.8                      | 37.9        | 28.2                    | 33.0        |
| Hong Kong     | 19.8                      | 19.4        | 20.4                    | 22.8        |
| Bangladesh    | 8.9                       | 3.5         | 9.3                     | 4.1         |
| Vietnam       | 7.6                       | 3.5         | 6.2                     | 4.1         |
| India         | 5.2                       | 4.7         | 5.4                     | 4.6         |
| Other         | 22.7                      | 23.4        | 24.2                    | 22.6        |
|               | 100.0%                    | 100.0%      | 100.0%                  | 100.0%      |

Sales for the three months ended June 30, 2015 were \$15,787,000, reflecting a decline of \$172,000 or 1.1% as compared to the same period in 2014. Our Talon Zipper products sales for the three months ended June 30, 2015 were \$80,000 lower than the same period in 2014. Talon Zipper products sales for the three months ended June 30, 2015 decreased by \$898,000 within our mass merchandising brand customers as compared to 2014, which was offset by an increase of \$818,000 in sales to our specialty retail brands customers as compared to 2014. For the three months ended June 30, 2015, Talon Trim products sales declined by \$693,000 compared to the same period in 2014. Substantially all of our Talon Trim products sales are to our specialty retail branded customers. For the three months ended June 30, 2015, the Talon Tekfit products sales increased by \$601,000 compared to the same period in 2014, mainly due to new Talon Tekfit programs and customers.

Sales for the six months ended June 30, 2015 were \$26,596,000, reflecting a decline of \$707,000 or 2.6% as compared to the same period in 2014. Our Talon Zipper products sales for the six months ended June 30, 2015 were \$466,000 lower than the same period in 2014. Talon Zipper products sales for the six months ended June 30, 2015 decreased by \$1,553,000 within our mass merchandising brand customers as compared to 2014, which was offset by a \$1,087,000 increase in sales to our specialty retail brands customers as compared to 2014. For the six months ended June 30, 2015, Talon Trim products sales declined by \$1,253,000 compared to the same period in 2014. Substantially all of our Talon Trim products sales are to our specialty retail branded customers. For the six months ended June 30, 2015, the Talon Tekfit products sales increased by \$1,012,000 compared to the same period in 2014, mainly due to new Talon Tekfit programs and customers.

*Gross Profit*

Gross profit for the three months ended June 30, 2015 was \$5,033,000 (or 31.9% of sales), reflecting a reduction of \$373,000 as compared to the same period in 2014. The reduction in gross profit for the three months ended June 30, 2015, as compared to the prior year, was principally attributable to lower overall sales volumes and higher freight, duty and manufacturing support costs, offset by improved product mix.

Gross profit for the six months ended June 30, 2015 was \$8,597,000 (or 32.3% of sales), reflecting a reduction of \$544,000 as compared to the same period in 2014. The reduction in gross profit for the six months ended June 30, 2015, as compared to prior year, was principally attributable to lower overall sales volumes and higher freight, duty and manufacturing support costs, offset by improved product mix.

A recap of the change in gross profit for the three and six months ended June 30, 2015, as compared to the same period in 2014, is as follows:

|   | <b>Three Months<br/>Ended</b>                         |                        | <b>Six Months<br/>Ended</b>                           |                        |
|---|---|------------------------|---|------------------------|
|   | <b>June 30, 2015</b>                                  |                        | <b>June 30, 2015</b>                                  |                        |
|   | <b>as compared to<br/>the same period<br/>in 2014</b> |                        | <b>as compared to<br/>the same period<br/>in 2014</b> |                        |
|   | <b>\$(1)</b>  | <b>%<sup>(1)</sup></b> | <b>\$(1)</b>  | <b>%<sup>(1)</sup></b> |
| <b>Gross profit changes as a result of:</b> |   |                        |   |                        |
| Lower sales volumes                         | (129,000 )  | (2.4 )                 | (265,000)   | (2.9 )                 |
| Change in mix of products                   | 159,000   | 2.9                    | 148,000   | 1.6                    |
| Higher freight and duty costs               | (187,000 )  | (3.5 )                 | (139,000)   | (1.5 )                 |
| Higher manufacturing overhead costs         | (216,000 )  | (3.9 )                 | (288,000)   | (3.1 )                 |
| Gross profit change                         | (373,0000)  | (6.9 )                 | (544,000)   | (5.9 )                 |

<sup>(1)</sup> Represents the amount or percentage, as applicable, of change in each item in the three and six months ended June 30, 2015 period as compared to the same period in 2014.

#### *Sales and marketing expenses*

Sales and marketing expenses for the three months ended June 30, 2015 totaled \$1,642,000, a decrease of \$60,000 as compared to the same period in 2014, mainly due to \$106,000 reduced marketing expense and new product development costs, offset by \$32,000 increased facilities and related expenses, and \$32,000 increased travel and entertainment expenses.

Sales and marketing expenses for the six months ended June 30, 2015 totaled \$3,284,000, an increase of \$166,000 as compared to the same period in 2014, mainly due to \$80,000 increased compensation costs, \$80,000 increased facilities and related expenses costs, \$86,000 increased travel, communications and related expenses, offset by \$73,000 reduced marketing expense and new product development costs.

#### *General and administrative expenses*

General and administrative expenses for the three months ended June 30, 2015 totaled \$2,618,000 or 16.6% as a percentage of sales, as compared to general and administrative expenses in the prior year of \$2,222,000 or 13.9% percentage of sales. General and administrative expenses were higher by \$397,000 during the three months ended June 30, 2015, as compared to the same period in 2014, mainly due to a \$705,000 one-time accrual for severance payments to our former CEO and board member, recognized upon separation during the three months ended June 30, 2015, offset by \$368,000 lower compensation costs.

General and administrative expenses for the six months ended June 30, 2015 totaled \$4,686,000 or 17.6% as a percentage of sales, as compared to general and administrative expenses in the prior year of \$4,399,000 or 16.1% as a percentage of sales. General and administrative expenses were higher by \$287,000 during the six months ended June 30, 2015, as compared to the same period in 2014, mainly due to a \$705,000 one-time accrual for severance payments to our former CEO and board member, recognized upon separation during the three months ended June 30, 2015, offset by \$385,000 lower other compensation costs.

*Interest expense and interest income*

Interest expense for the three and six months ended June 30, 2015 and 2014 included borrowings under our Credit Facilities and the related amortization of deferred financing costs (See Note 7 to the accompanying Notes to Consolidated Financial Statements). A brief summary of interest expense and interest income is presented below:



|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2015</b>               | <b>2014</b> | <b>2015</b>             | <b>2014</b> |
| Amortization of deferred financing costs | \$32,000                  | \$23,000    | \$58,000                | \$45,000    |
| Interest expense under Credit Facilities | 74,000                    | 83,000      | 142,000                 | 172,000     |
| Other interest expense                   | 1,000                     | 5,000       | 2,000                   | 5,000       |
| Interest expense                         | 107,000                   | 111,000     | 202,000                 | 222,000     |
| Interest income                          | (1,000 )                  | (1,000 )    | (1,000 )                | (1,000 )    |
| Interest expense, net                    | \$106,000                 | \$110,000   | \$201,000               | \$221,000   |

*Income taxes*

Provision for income taxes, net, for the three and six months ended June 30, 2015, was \$218,000 and \$137,000, respectively.

Provision for income taxes, net, for the three and six months ended June 30, 2014, was \$557,000 and \$571,000, respectively.

**Liquidity and Capital Resources**

The following table summarizes selected financial data at June 30, 2015 and December 31, 2014:

|                           | <b>June 30,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---------------------------|--------------------------|----------------------------------|
| Cash and cash equivalents | \$3,292,000              | \$2,603,000                      |
| Total assets              | \$21,709,000             | \$18,102,000                     |
| Current liabilities       | \$14,492,000             | \$11,912,000                     |

|                       |             |             |
|-----------------------|-------------|-------------|
| Long term liabilities | \$1,737,000 | \$1,057,000 |
| Stockholders' equity  | \$5,480,000 | \$5,134,000 |

We believe that our remaining cash and cash equivalents and our anticipated cash flows from our operating activities will be sufficient to fund our minimum working capital and capital expenditure needs for operating activities for at least the next twelve months. In addition, as of June 30, 2015, we had additional borrowing availability of \$671,000 under our revolving credit line.

#### *Cash and cash equivalents*

Cash and cash equivalents increased by \$689,000 at June 30, 2015, as compared to December 31, 2014, principally due to \$1,277,000 in cash provided by operating activities and \$700,000 in revolving credit facility borrowings ("Revolving Credit Loan"), offset by \$1,108,000 in term loan payments, \$57,000 in payments of financing costs associated with credit facilities and \$124,000 in payments for the acquisition of property and equipment and intellectual property rights.

Cash provided by operating activities is our primary recurring source of funds, and reflects net income from operations excluding non-cash charges, changes in operating capital and the impact of seasonality. During the six months ended June 30, 2015 and 2014, net cash provided by operating activities was \$1,277,000 and \$1,787,000, respectively.

The net cash provided by operating activities during the six months ended June 30, 2015 and 2014 resulted principally from:

|   | <b>Six Months Ended June</b> |             |
|---|------------------------------|-------------|
|   | <b>30,</b>                   |             |
|   | <b>2015</b>                  | <b>2014</b> |
| Net income before non-cash expenses               | \$510,000                    | \$1,391,000 |
| Inventory reductions (increases)                  | (25,000 )                    | 131,000     |
| Accounts receivable increases                     | (2,425,000)                  | (193,000 )  |
| Accounts payable and accrued expenses increases   | 3,384,000                    | 440,000     |
| Other increases (reductions) in operating capital | (167,000 )                   | 18,000      |
| Net cash provided by operating activities         | \$1,277,000                  | \$1,787,000 |

Net cash used in investing activities for the six months ended June 30, 2015 and 2014 was \$124,000 and \$144,000, respectively, associated mainly with the acquisition of property and equipment, and for the six months ended June 30, 2015 included \$20,000 in the acquisition of intellectual property rights.

Net cash used in financing activities for the six months ended June 30, 2015 and 2014 was \$467,000 and \$947,000, respectively. In 2015 this reflects \$1,108,000 in term loan payments, \$57,000 in payments of financing costs associated with credit facilities and \$2,000 in repayment of borrowings under capital leases, offset by \$700,000 in Revolving Credit Loan borrowings under our Credit Facilities, and in 2014, this reflects \$833,000, in term loan payments, offset by \$500,000 Revolving Credit Loan borrowings under our Credit Facilities, net of \$500,000 in repayments, \$144,000 in payments related to taxes associated with the exercise of stock options and RSU settlements, partially offset by \$30,000 in proceeds from the exercise of stock options.

On December 31, 2013, we entered into a Commercial Credit Agreement with MUFG Union Bank, N.A. (formerly Union Bank, N.A., "Union Bank")(See Note 7 in the accompanying Notes to Consolidated Financial Statements), and we used all of the proceeds of \$5,000,000 from the term loan ("Term Loan Payable") and \$827,000 of the proceeds of a Revolving Credit Loan under the Union Bank Credit Agreement to repay a \$5,800,000 Promissory Note and related interest to CVC California LLC, our controlling stockholder at the time.

The Credit Agreement we entered into with Union Bank provides for a Revolving Credit Loan in the amount of up to \$3,500,000 and a Term Loan Payable in the amount of \$5,000,000. The Revolving Credit Loan consists of revolving loans up to the \$3,500,000 and a sublimit of letters of credit not to exceed a maximum aggregate principal amount of \$1,000,000. Borrowings under the Revolving Credit Loan bear interest at two and one-half percent (2.50%) in excess of Union Bank's Reference Rate, which is an index rate determined by Union Bank from time to time as a means of pricing certain extensions of credit. We paid \$250,000 in financing costs associated with the credit agreement. The

payment and performance of all indebtedness and other obligations under the Credit Facilities are secured by liens on substantially all of our assets pursuant to the terms and conditions of one or more Security Agreements and guaranties duly executed by us and our principal operating subsidiaries including Talon Technologies, Inc. (U.S. operation), and Tag-It Pacific Limited (Hong Kong operation).

As of June 30, 2015 and December 31, 2014, we had outstanding borrowings of \$3,925,000 and \$4,333,000, respectively under our Credit Facilities, of which \$2,200,000 and \$1,500,000, respectively relates to obligations under Revolving Credit Loan and the remainder relates to the Term Loan Payable. As of June 30, 2015, we had \$671,000 in available borrowings.

The Credit Agreement, as amended through June 30, 2015, contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the parent company and its subsidiaries, which are customary for credit facilities of this type, including maintaining a specified Fixed Charge Coverage Ratio between Adjusted EBITDA and future principal and interest payments as of the close of each fiscal quarter; a minimum EBITDA as of the close of each quarter for the 12-month period ended as of the last day of the quarter; and no incurrence of a net loss after taxes for more than two consecutive fiscal quarters commencing January 1, 2015. We did not satisfy the minimum Fixed Charge Coverage Ratio requirement and the minimum EBITDA requirement for the 12-month periods ended September 30, 2014 and December 31, 2014, and in connection therewith obtained waivers of non-compliance from Union Bank for these periods. In exchange for the waivers, we paid fees in the amount of \$10,000 and a prepayment in the amount of \$500,000 was applied to the principal of the Term Loan Payable as of December 31, 2014, and other certain provisions of the Credit Agreement were amended. During the three and six months ended June 30, 2015, we made draws against our Revolving Credit Loan borrowings of \$500,000 and \$700,000, respectively, resulting in an increase in the outstanding borrowings during the year to \$2,200,000 at June 30, 2015. On March 3, 2015, we further amended the Credit Agreement with Union Bank and agreed to modify the financial covenants to make certain prepayments to the Term Loan Payable excluded from the Fixed Charge Coverage Ratio calculation, and to re-amortize the Term Loan Payable payments. The additional principal repayments agreed to in the Amendment total \$600,000, of which \$400,000 were paid during the second quarter of 2015 and the remaining \$200,000 subsequent to June 30, 2015, on July 1, 2015. In connection with the Amendment we paid to Union Bank a loan modification fee of \$50,000, half of which was paid on March 31, 2015 and the other half was paid on June 30, 2015. Additional legal fees were charged by Union Bank during the first quarter of 2015 in the amount of \$7,000. As a result of this amendment, we anticipated that we would meet all the required covenants during the following year.

We did not satisfy the minimum EBITDA requirement for the 12-month period ended June 30, 2015, due primarily to a \$705,000 one-time accrual for severance payments to our former CEO and board member, that was recognized upon separation during the three months ended June 30, 2015. Subsequent to June 30, 2015, on August 4, 2015, we obtained a waiver from Union Bank of this non-compliance. We paid Union Bank a waiver fee of \$25,000 as a condition to the waiver.

On August 10, 2015 we entered into an amendment to the Credit Agreement with Union Bank, changing various contractual terms and which removed the financial covenants contained in the Credit Agreement and permitted the Borrower to incur subordinated indebtedness to Princess Investment Holdings Inc. (“Princess Investment”), a Delaware corporation (which is a related company of Kutula Holdings, a major stockholder and related party to our Company), not exceeding \$3,000,000 in aggregate principal amount at any time outstanding; provided, however, that such indebtedness must be subject to a subordination agreement in favor of the Bank and in form and substance satisfactory thereto. In addition, the Term Loan Payable of \$1,440,000 was required to be prepaid in full, as well as all accrued and unpaid interest thereon through the date of prepayment. On August 11, 2015, we received from Princess Investment an advance in the amount of \$1,500,000 to pay off the Term Loan Payable to Union Bank. See Note 7 and Note 13 in the accompanying Notes to Consolidated Financial Statements.

We have financed purchases of furniture and fixtures through various capital lease obligations. Our equipment obligations as of June 30, 2015 are \$95,000 and bear interest at rates of 8.0% per annum. Under these obligations, we

are required to make monthly payments of principal and interest through May 2019.

We have satisfied our working capital requirements primarily through cash flows generated from operations and borrowings under our Credit Agreement. As we continue to expand globally with apparel manufacturing in offshore locations, our customers are substantially all foreign-based and foreign-owned entities. We continue to evaluate both financing and equity options to provide capital to fund our expansion and on-going operations. If we experience greater than anticipated reductions in sales, we may need to borrow or raise additional capital, or further reduce the scope of our business in order to fund our on-going operations or to satisfy our future short-term operating requirements. The extent of our future long-term capital requirements will depend on many factors, including our results of operations, future demand for our products, the size and timing of possible acquisitions, and our expansion into foreign markets. Our need for additional long-term financing may include the integration and expansion of our operations to exploit our rights under our *Talon* and *Tekfit* trade names, and the expansion of our operations in the Asian and other markets. If our cash from operations is less than anticipated, or our working capital requirements and capital expenditures are greater than we expect, we may need to raise debt or equity financing in order to provide for our operations.

### Contractual Obligations and Off-Balance Sheet Arrangements

The following summarizes our contractual obligations at June 30, 2015:

| Contractual Obligations | Payments Due by Period (\$) |                     |              |              |
|-------------------------|-----------------------------|---------------------|--------------|--------------|
|                         | Total                       | Less than<br>1 Year | 1-3<br>Years | 4-5<br>Years |
| Revolving credit loan   | \$2,200,000                 | \$2,200,000         | \$-          | \$-          |
| Term loan payable       | 1,811,000                   | 294,000             | 1,517,000    | --           |
| Operating leases        | 1,890,000                   | 676,000             | 1,139,000    | 75,000       |
| Capital leases          | 109,000                     | 28,000              | 81,000       | -            |
| Total Obligations       | \$6,010,000                 | \$3,198,000         | \$2,737,000  | \$75,000     |

At June 30, 2015 and December 31, 2014, we did not have any relationships with unconsolidated entities or financial partnerships (such as entities often referred to as structured finance or special purpose entities), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we do not have any of the risks associated with financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

### Related Party Transactions

During the three and six months ended June 30, 2015, there were no transactions to which we were or will be a party, and in which any director, executive officer, or stockholder of more than 5% of our common stock or any member of their immediate family had or will have a direct or indirect material interest.

### **Application of Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions for the reporting period and as of the financial statement date. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenue and expense. Actual results could differ from those estimates.



Critical accounting policies are those that are important to the portrayal of our financial condition and results, and which require us to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Accounts receivable balances are evaluated on a continual basis and allowances are provided for potentially uncollectible accounts based on management's estimate of their collectibility. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, an additional allowance may be required. Allowance adjustments are charged to operations in the period in which the facts that give rise to the adjustments become known.

The allowances for doubtful accounts receivable and the bad debt recoveries, net as at and for the three and six months ended June 30, 2015 and 2014, are as follows:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30, 2015</b>      | <b>2014</b> | <b>June 30, 2015</b>    | <b>2014</b> |
| Allowance for doubtful accounts receivable | \$34,000                  | \$28,000    | \$34,000                | \$28,000    |
| Bad debt recoveries, net                   |                           | \$(10,000)  | \$(19,000)              | \$(15,000)  |
|  |                           |             | \$(9,000)               |             |

Inventories are stated at the lower of cost, determined using the first-in, first-out ("FIFO") basis, or market value and are all substantially finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory is evaluated on a continual basis and reserve adjustments are made based on management's estimate of future sales value, if any, of specific inventory items. Inventory reserves are recorded for damaged, obsolete, excess, impaired and slow-moving inventory. We use estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this type of inventory. Inventory reserve is reduced following write-off of reserved inventory and increased by additions to reserve for slow moving inventory not expected to be sold.



We record deferred tax assets and liabilities arising from temporary timing differences between recorded net income and taxable net income when and if we believe that future earnings will be sufficient to realize the tax benefit. For those jurisdictions where the expiration date of tax benefit carry-forwards or the projected taxable earnings indicate that realization is not likely, a valuation allowance is provided. If we determine that we may not realize all of our deferred tax assets in the future, we will make an adjustment to the carrying value of the deferred tax asset, which would be reflected as an income tax expense. Conversely, if we determine that we will realize a deferred tax asset, which currently has a valuation allowance, we would be required to reverse the valuation allowance, which would be reflected as an income tax benefit. A deferred income tax liability related to indefinite lived intangibles should not be offset against deferred income tax assets. We believe that our estimate of deferred tax assets and liabilities and determination to record a valuation allowance against such assets are critical accounting estimates because they are subject to, among other things, an estimate of future taxable income, which is susceptible to change and dependent upon events that may or may not occur, and because the impact of recording a valuation allowance may be material to the assets reported on the balance sheet and results of operations. See Note 10 in the accompanying Notes to Consolidated Financial Statements.

Sales are recognized when persuasive evidence of an arrangement exists, product title has passed, pricing is fixed or determinable and collection is reasonably assured. Sales resulting from customer buy-back agreements, or associated inventory storage arrangements are recognized upon delivery of the products to the customer, the customer's designated manufacturer, or upon notice from the customer to destroy or dispose of the goods. Sales, provisions for estimated sales returns, and the cost of products sold are recorded at the time title transfers to customers. Actual product returns are charged against estimated sales return allowances, which returns have been insignificant.

We are currently involved in various lawsuits, claims and inquiries, most of which are routine to the nature of the business and in accordance with FASB ASC 450, "*Contingencies*". We accrue estimates of the probable and estimable losses for the resolution of these claims. The ultimate resolution of these claims could affect our future results of operations for any particular quarterly or annual period should our exposure be materially different from our earlier estimates or should liabilities be incurred that were not previously accrued. We believe that we have meritorious defenses to these claims and that the claims are either covered by insurance or would not have a material effect on our consolidated financial position or results of operations if adversely determined against us.

## New Accounting Pronouncements

In April 2015, the FASB issued ASU No. 2015-03, “*Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*” (“ASU 2015-03”). The amendment simplifies debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction of the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendment. ASU 2015-03 is effective for fiscal years, and interim reporting periods within those fiscal years, beginning December 15, 2015. Other than reclassification of debt issuance costs net of amortization from assets to liabilities, no other effect is expected to be included on our financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. ASU 2014-15 explicitly requires management to evaluate, at each annual or interim reporting period, whether there are conditions or events that exist which raise substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and annual and interim periods thereafter, with early adoption permitted. We do not expect that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard is effective as of the first interim period within annual reporting periods beginning on or after December 15, 2016, and will replace most existing revenue recognition guidance in U.S. GAAP. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We do not expect that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Not Applicable.

**Item 4. Controls and Procedures**

**Evaluation of Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities Exchange Commission's rules and forms, including to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act.

As of the end of the period covered by this report, management, with the participation of Larry Dyne, our principal executive officer, and Nancy Agger-Nielsen, our principal accounting officer and principal financial officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, Mr. Dyne and Ms. Agger-Nielsen concluded that these disclosure controls and procedures were effective as of the end of the period covered in this Quarterly Report on Form 10-Q.

**Changes in Internal Control over Financial Reporting**

During the quarter ended June 30, 2015, there were no changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



**Item 5. Other Information.**

On August 10, 2015, we entered into an amendment to the Credit Agreement with Union Bank, which provided for the elimination of financial covenants for the remaining term of the Credit Agreement, permitted us to incur \$3,000,000 of subordinated indebtedness, and required the repayment by August 31, 2015 of the outstanding Term Loan Payable in the principal amount of \$1,440,278 plus accrued and unpaid interest.

On August 10, 2015, we entered into a Loan and Reimbursement Agreement (“Loan Agreement”) with Princess Investment Holdings, Inc. (“Princess Investment”), pursuant to which Princess Investment agreed to make available to us a loan of up to \$3,000,000 (the “Subordinated Loan”). Princess Investment may be deemed an affiliate of Kutula Holdings, Ltd., a significant stockholder of our company which also has the contractual right to designate a director to our Board of Directors. Advances under the Loan Agreement will accrue interest on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Subordinated Loan is payable monthly commencing on September 1, 2015, and the principal amount is payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. The Loan Agreement requires payment of a \$60,000 loan fee, which is required to be paid at maturity.

The payment and performance of all our indebtedness and other obligations to Princess Investment, including all borrowings under the Loan Agreement, are guaranteed by the Company’s subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement. The payment and performance of all of our indebtedness and other obligations to Princess Investment under the Loan Agreement and related agreements are secured by liens on substantially all of the assets of the Company and its subsidiary guarantors pursuant to the terms and conditions of a Pledge and Security Agreement executed by the Company and guarantors in favor of Princess Investment.

On August 11, 2015, we received an advance from Princess Investment under the Loan Agreement in the amount of \$1,500,000, of which \$1,440,000 was used to pay off the Term Loan Payable to Union Bank on August 12, 2015.

Pursuant to the Loan Agreement, we issued Princess Investment warrants to purchase 1,000,000 shares of the Company’s common stock. The warrants are exercisable over a five-year period and exercisable at \$0.18 per share. The warrants did not require cash settlements.

The foregoing summaries of the Loan Agreement, the Pledge and Security Agreement, the Guaranty Agreement, the Intercreditor Agreement, the Subordination Agreement and the Warrant Agreement do not purport to be complete and are qualified in their entirety by references to the full text of such agreements, which are attached hereto as Exhibits 10.24, 10.24.2, 10.24.3, 10.24.4, 10.24.5 and 10.24.6, respectively.





**PART II**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings**

We currently have pending various claims and complaints that arise in the ordinary course of our business. We believe that we have meritorious defenses to these claims and that the claims are either covered by insurance or would not have a material effect on our consolidated financial condition if adversely determined against us.

**Item 1A. Risk Factors**

Risk factors are contained in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. No material change to such risk factors has occurred during the six months ended June 30, 2015.

**Item 6. Exhibits**

| <b><u>Exhibit No.</u></b> | <b><u>Description</u></b>   |
|---------------------------|---|
| 10.18.7                   | Seventh Amendment, dated August 10, 2015, to the Commercial Credit Agreement dated December 31, 2013 between the Registrant and MUFG Union Bank, N.A. (formerly Union Bank, N.A.).. |
| 10.24                     | Loan and Reimbursement Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc.  |
| 10.24.2                   | Pledge and Security Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc.   |
| 10.24.3                   | Guaranty Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc.  |

- 10.24.4 Intercreditor Agreement dated August 10, 2015, between the Registrant, Princess Investment Holdings Inc. and MUFG Union Bank, N.A.
- 10.24.5 Subordination Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc. and MUFG Union Bank, N.A.
- 10.24.6 Warrant Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc.
- 10.25.1 Lease, Unit 101 & 108, dated May 21, 2015, between Tag-It Pacific Limited (HK Operations) and The Sunbeam Manufacturing Company Limited.
- 10.25.2 Lease, Unit 1316, dated May 21, 2015, between Tag-It Pacific Limited (HK Operations) and The Sunbeam Manufacturing Company Limited.
- 10.26 Lease, Unit 1601-08, dated August 10, 2015, between Talon Zipper (Shenzhen) Co. Ltd. (Chinese Operations) and Chen Zhen Guang.
- 31.1 Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

**Exhibit No. Description**

31.2 Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS\* XBRL Instance

101.SCH\* XBRL Taxonomy Extension Schema

101.CAL\* XBRL Taxonomy Extension Calculation

101.DEF\* XBRL Taxonomy Extension Definition

101.LAB\* XBRL Taxonomy Extension Labels

101.PRE\* XBRL Taxonomy Extension Presentation

+Indicates a management contract or compensatory plan.

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

**SIGNATURES**

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

Dated: August 14, 2015 /s/ Larry Dyne

Larry Dyne  
Chief Executive Officer  
(Principal Executive Officer)

/s/ Nancy Agger-Nielsen

Nancy Agger-Nielsen  
Chief Financial Officer  
(Principal Accounting Officer and  
Principal Financial  
Officer)