

TALON INTERNATIONAL, INC.

Form 10-K

March 28, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(mark one)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2016

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 Registrant as Specified in Its Charter)

Delaware

95-4654481

(State or Other Jurisdiction of
Incorporation or Organization) (I.R.S. Employer
Identification No.)

21900 Burbank Blvd., Suite 270

Woodland Hills, California 91367

(Address of Principal Executive Offices) (Zip Code)

(818) 444-4100

(Registrant's Telephone Number, Including Area Code)

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

None

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

Common Stock, \$0.001 par value

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

Yes No

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

Yes No

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer, or a smaller reporting company. See the 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 June 30, 2016, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was \$3,490,620.

At March 24, 2017 the issuer had 92,274,255 shares of Common Stock, \$0.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

TALON INTERNATIONAL, INC.

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Forward Looking Statements

This report and other documents we file with the SEC 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. In addition, we, or others on our behalf, may make forward looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls. Words such as "expect," "anticipate," "outlook," "could," "target," "project," "intend," "plan," "believe," "seek," "estimate," "should," "continue," variations of such words and similar expressions are intended to identify such forward looking statements. 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 in "Item 1A. Risk Factors." 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 demand for our products and services, customer acceptance of new products, 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, competitive position, adequate liquidity to fund our operations and meet our other cash requirements, and the global economic environment in general and consumer demand for apparel. Except as required under the federal securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update publicly any forward looking statements after the distribution of this report, whether as a result of new information, future events, changes in assumptions, or otherwise.

PART I

ITEM 1. BUSINESS

General

Talon International, Inc. specializes in the manufacturing and distribution of a comprehensive range of apparel components and accessories including custom zippers, apparel trim components (such as tags, labels, patches, fasteners, packaging, and similar items), and specialty stretch technology for interlinings. These items are sold to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We manufacture and distribute zippers under our *Talon*® brand name to manufacturers for apparel brands and retailers such as Polo Ralph Lauren, Abercrombie & Fitch, Fat Face, Eddie Bauer, Guess, Ben Sherman and Express, as well as mass merchants such as

Kohl's, JC Penney and Wal-Mart. We also provide outsourced trim design, sourcing and management services and supply custom branded trim components for manufacturers of fashion apparel such as V. F. Corporation, American Eagle, Victoria's Secret, Fat Face, Abercrombie & Fitch, Polo Ralph Lauren, Express, and many others. Under our *Tekfit*® brand, we develop and sell fabric stretch technology that utilizes patented processes and proprietary know-how to create stretchable comfort waistbands, shirt collars, and inner pocketing panels to manufacturers for apparel brands and retailers such as Dockers, PVH, Uniqlo and Superior Uniforms.

We were incorporated in the State of Delaware in 1997. We serve as the parent holding company of our consolidated subsidiaries, which are all wholly-owned subsidiaries. Our initial public offering was effective in January 1998. Our website address, www.talonzippers.com, as provided in this Annual Report on Form 10-K is not intended to function as a hyperlink and the information on our website is not and should not be considered part of this report and is not incorporated by reference in this document.

Business Summary

We operate our business within the following product groups: Talon Zipper and Talon Trim (which includes our *Tekfit* stretch technology products). In our Talon Zipper group, we design, engineer, test and distribute custom zippers under our *Talon* trademark to apparel brands and manufacturers on a global basis. *Talon* enjoys extensive brand recognition and heritage within the apparel industry worldwide and is a 120+ year-old brand, renowned for its quality and product innovation and as the inventor of the formed wire metal zipper for the jeans industry. We are a specified custom zipper and preferred zipper brand for numerous manufacturers in the designer, sportswear, children's wear and outerwear markets worldwide. We provide multiple lines of high quality custom zippers, including metal, coil and plastic zippers, vintage zippers, and specialty zippers for kids clothing and other fit-for-purpose applications, such as footwear, workwear and specialty bags. All products are for distribution to apparel manufacturers worldwide, including markets in China, Taiwan, India, Indonesia, Bangladesh, Vietnam, the Middle East, Europe, Mexico and Central America. We have sales and marketing teams in most of these areas. We have joint manufacturing arrangements in strategic international local markets to manufacture, finish and distribute our products locally under the *Talon* brand name. Our manufacturing partners operate under our direct manufacturing and quality assurance oversight, in accordance with our manufacturing specifications and quality standards, using only Talon approved and authorized raw materials. The unique and comprehensive supply chain network results in high quality finished zippers for our customers in their local markets. Our operating structure allows us to significantly improve the speed at which we serve the market and the service we provide to our customers, and to effectively expand the geographic footprint of our *Talon* products.

Our Talon Trim products group act as a fully-integrated single-source designer, product developer and exclusive supplier for a full range of custom trim items for manufacturers of fashion apparel. Our business focuses on servicing all of the trim requirements of our customers at the manufacturing and retail brand level of the fashion apparel industry. Our Talon Trim products include essentially all components required to manufacture a garment with the exception of the fabric and the thread. Talon Trim items include labels, buttons, rivets, leather patches, woven labels, heat transfer seals, tapes, ribbons, printed marketing material, polybasic, packing cartons and hangers. Talon Trim items comprise a relatively small part of the cost of most apparel products but comprise the vast majority of components necessary to fabricate and finish a typical apparel product. We offer customers a one-stop outsource service for all zipper and trim related matters. Our teams work with industry merchants, product developers and designers, and function as an extension of their staff.

Our Talon Trim products also include our Talon Stretch Technology products. Under the *Tekfit* brand, we supply apparel manufacturers with interlining products and an advanced, patented fabric technology that creates stretchable fabric from non-stretchable material. This innovative technology allows the fabric to be altered through the addition of stretch characteristics resulting in greatly improved fit and comfort. Manufacturers use this technology to build-in stretch into standard waistbands that does not alter the appearance of the garment, but will allow the waist to stretch out and back by as much as two waist sizes. They also utilize this technology within inner pocketing shapewear panels to provide a firm comfort fit across the stomach and hips, while manufacturers of dress shirts use this stretch technology to produce comfortable, flexible shirt collars. Talon's Stretch Technology and its *Tekfit* brand products have multiple applications in virtually any garment where added flexibility and comfort is desired.

Our Talon Zipper and Talon Trim product teams collaborate with customers on their design vision and present examples of their vision in graphic form for all apparel accessory components. We design the buttons, snaps, hang tags, labels, zippers, zipper pulls and other items to meet the customer's needs. Once our customer selects the designs they prefer, our sourcing and production teams coordinate with our manufacturing partners worldwide to ensure the best manufacturing solution for the items being produced. The proper manufacturing solution is an essential part of the expertise and service we provide to customers. Selecting the best facility to ensure timely production, the proper finishes, or other material needs or manufacturing techniques to be used is critical. We offer customers a depth and breadth of knowledge in the manufacturing of these products that our customers cannot otherwise easily achieve. We are consistently innovating new items, manufacturing techniques and finishes, introducing many new, fresh and unique ideas to our customers. Once our customers make a final decision on the accessories that will be used on their garments, we are in many instances identified as the sole or preferred source supplier for the project, and our customers' factories are then directed to purchase the products directly from us. Throughout the garment manufacturing process, we consistently monitor the timing and accuracy of the production items until delivery to our customers' apparel factories.

We serve as a nominated supplier in our Talon Zipper and Talon Trim products (including our *Tekfit* stretch technology products) for a variety of major retail brand and private-label oriented companies. A nominated supplier is a supplier that has been approved for its quality and service by a major retail brand or private-label company. Apparel contractors manufacturing for the retail brand or private-label company typically purchase their zipper and trim components from a supplier that has been nominated. We seek to expand our services as a supplier of select items for such customers, to being a preferred or single-source provider of the entire customer's authorized trim and zipper requirements. Our ability to offer a full range of trim and zipper products is attractive to brand name and private-label oriented customers because it enables the customer to address their quality and supply needs for all of their trim requirements from a single source, avoiding the time and expense necessary to monitor quality and supply from multiple vendors and manufacturer sources. Becoming a nominated supplier to brand customers gives us an advantage to become the preferred or sole vendor of trim and zipper items for all apparel manufacturers contracted for production for that brand name.

Our teams of sales employees, customer service representatives, merchandisers, creative design personnel and global production and distribution coordinators based at our facilities located in the United States, Europe, and throughout Southeast Asia, enable us to take advantage of and address the increasingly complicated requirements of the large and expanding demand for complete end-to-end apparel accessory solutions. We plan to continue to expand operations in Asia, Europe, and Latin America to take advantage of the large apparel manufacturing markets in these regions.

Products

Talon Zipper - We offer a full line of custom metal, coil and plastic zippers bearing the *Talon* brand name or logo. Talon zippers are used primarily by manufacturers in the apparel industry and are distributed through our distribution facilities in the United States, Europe, Hong Kong and China and through these designated offices to other international markets, including Taiwan, India, Bangladesh, Indonesia, Vietnam, Dominican Republic and others.

We expand our distribution of Talon zippers through the establishment of a combination of Talon owned sales and distribution locations, and strategic manufacturing and distribution relationships. These distribution and manufacturing relationships, in combination with Talon owned and affiliated facilities, improve our time-to-market by allowing us to source, finish and distribute to apparel manufacturers within their local markets. The branded apparel zipper market is dominated by one company and we have positioned *Talon* to be a viable global alternative to this competitor and capture an increased market share position. We leverage the brand awareness of the *Talon* name by branding other products in our line with the *Talon* name.

Talon Trim Group - We consider our high level of customer service as a fully integrated single-source supplier essential to our success. We combine our quality customer service within our Talon Trim solutions with a history of design and manufacturing expertise to offer our customers a complete trim solution product. We believe this full-service product gives us a competitive edge over companies that only offer selected trim components because our full service solutions save our customers substantial time in ordering, designing, sampling and managing trim sourcing from several different suppliers. Our tracking and order management systems allow us to seamlessly supply Talon Trim solutions and products to apparel brands, retailers and manufacturers around the world. We produce custom hang tags, metal fasteners, woven, leather, synthetic, embroidered and novelty labels and tapes, which can be printed on or woven into a wide range of fabrics, as well as interlining and stretch technology components and other materials using specialized equipment. Our *Tekfit* products, which are a part of the Talon Trim Group, provide manufacturers with fabric interlinings and patented technology, manufacturing know-how, proprietary equipment and materials necessary to produce expandable waistbands, shirt collars and various other stretch technology apparel interlining components. All of Talon Trim Group products are sold to a similar class of customers, sourced from specialty trim suppliers, are distributed using similar distribution methods and are sold by a shared salesforce; these similarities support the aggregation of the operating results into a combined Talon Trim Group.

The percentages of total revenue contributed by each of our two primary product groups for the last three fiscal years are as follows:

| | Years Ended December 31, | | |
|---------------------------------|-------------------------------------|-------------|-------------|
| Product Group Net Sales: | 2016 | 2015 | 2014 |
| Talon Zipper | 36.4% | 44.0% | 50.1% |
| Talon Trim | 63.6% | 56.0% | 49.9% |

Design and Development

Our in-house creative teams develop products with innovative technology and designs that we believe distinguish our products from those of our competitors. We are constantly innovating our products to expand our product offerings and address new market needs. We support our skills and expertise in material procurement and product manufacturing coordination with product technology and designs intended to meet fashion demands, as well as cost and functional parameters. An example of this is the *Talon KidZip®*, which is a specialty zipper for children's apparel, engineered to surpass industry established strength and safety standards, while maintaining the fashion image and requirements of today's apparel demands. We have introduced two new fit for purpose specialty zippers to our range of zipper products, including a specialty zipper line designed specifically for the demanding requirements of workwear applications; and a specialty zipper line designed specifically for the demanding requirements of footwear applications. Our workwear application zipper improves durability, strength and safety features required by construction, utility, and safety workers, while our footwear application zipper features improves durability over a standard zipper and is designed to endure under high stress applications experienced in a variety of footwear, such as boots and shoes.

Many specialty design companies with which we compete have limited capabilities with regard to the range of their product offerings, sourcing or manufacturing experience, and consequently they create products or designs that often cannot be implemented due to limitations in the manufacturing process, the high expense of required materials, or a lack of functionality in the resulting product. We design products to function within the limitations imposed by the applicable materials and manufacturing framework, while meeting our customers' specialty needs. Using our manufacturing experience, we ensure delivery of quality products and minimize the time-consuming delays that often arise in coordinating the efforts of independent design houses and manufacturing facilities. By supporting our material procurement and product manufacturing services with design services, we reduce development and production costs and deliver products to our customers sooner than many of our competitors. Our design teams are based in our U.S. and Asian facilities.

Customers

We have over 800 active customers representing more than 250 of the world's best known brands. Our customers include the designated suppliers of well-known apparel retailers and brands, such as VF Corporation, Fat Face, Express, Polo Ralph Lauren, American Eagle, Next, Eddie Bauer, Uniqlo, PVH, Ben Sherman, NY & Co., Guess, and Berne USA among others. Our customers also include contractors, agents and importers for mass merchant retailers such as Kohl's, Wal-Mart, JC Penney, Costco and others.

For the years ended December 31, 2016, 2015 and 2014, our three largest customers combined represented approximately 8%, 6% and 5%, respectively, of consolidated net sales.

Sales and Marketing

We sell our products through our own sales force based in the United States, Hong Kong, China, India, Indonesia, Vietnam and Bangladesh. We also sell through outside sales representatives in Europe, and we develop Central America opportunities through our U.S. sales force and outside sales representatives. We employ customer service representatives who are assigned to key customers and provide local customer support. We have developed relationships with our major customers and brands at senior levels, and our sales teams actively participate with these customers/brands in their marketing and sales programs and sales strategies. When we become the nominated supplier for a brand's packaging or trim requirements, we market ourselves as an in-house function of the brand's trim procurement operation.

Sourcing and Assembly

We have developed expertise in identifying high quality materials, competitive prices and approved manufacturers for particular products and materials and ensuring strict adherence to quality manufacturing processes and materials. Our expertise enables us to produce a broad range of apparel accessories and Trim products at competitive prices. The majority of products that we procure and distribute are secured on a finished-good basis, manufactured by our partners and under our direct oversight. Raw materials used to manufacture or assemble all of our products are obtained only from sources we authorize and specify and are in adequate supply. We purchase products only from qualified material suppliers, and typically guarantee our customers that all materials used in the manufacture of our products are compliant with government regulations and controls over restricted substances.

We develop product artwork and any necessary dies and molds used to design and manufacture our products. Products that we design and sell are produced by manufacturing partners under our direct supervision or through joint manufacturing arrangements. We are confident in our ability to identify, secure and maintain high quality manufacturing sources. We will continue to build upon our production through qualified suppliers, particularly with respect to manufacturing activities that require substantial investments in time and capital equipment.

Principally through our Asian facilities, we distribute Talon Zipper and Talon Trim apparel accessories and stretch technology components, and oversee the manufacture and distribution of the full range of our products. Through our Asian facilities, we serve our customers worldwide.

Intellectual Property Rights and Licenses

We have trademarks as well as patent rights, copyrights, software copyrights and trade names for which we rely on common law protection, including the *Talon* trademark. Several of our other trademarks are the subject of applications for federal trademark protection through registration with the United States Patent and Trademark Office, including “*Talon*,” “*Tag-It*,” “*Kidzip*” and “*Tekfit*.” We hold patent rights for several key processes and products, including the Tekfit stretchable fabric products, specialty zippers and garment fasteners.

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 75 to 90 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.

Inventories

In order to meet the rapid delivery requirements of our customers, we may be required to purchase inventories of raw materials based upon projections made by our customers. In these cases we may carry a substantial amount of inventory on their behalf. We manage this risk by obtaining customer commitments to purchase any excess materials or inventories. These commitments provide that in the event that inventories remain with us in excess of the apparel program life or the termination of production of a customer's product line related to the inventories, the customer is required to purchase the inventories from us under normal invoice and selling terms. While these agreements provide us some advantage in the negotiated disposition of these inventories, we cannot be assured that our customers will complete these agreements or that we can enforce these agreements without adversely affecting our business operations.

Competition

We operate in highly competitive and fragmented segments of the apparel industry that include numerous local and regional companies that provide some or all of the products we offer. We also compete with U.S. and international design companies, distributors and manufacturers of tags, trim, packaging products and zippers. Some of our competitors are significantly larger in size and resources than us and have greater name recognition, longer operating histories and more financial and other resources.

Because of our integrated materials, manufacturing and assembly capabilities and our full-service zipper and trim solutions, we believe that we are able to effectively compete for our customers' business, particularly where our customers require a high level of confidence regarding compliance with restricted substance regulations, and with the effective coordination of separately sourced production functions. We believe that we successfully compete in our industry by offering superior product pricing, quality, customer service, design capabilities, delivery lead times and complete supply-chain management. We also believe the *Talon* brand name and the quality of our *Talon* brand zippers allows us to gain market share in the apparel accessory industry. The unique qualities of our *Tekfit* stretch fabric technology will also allow us to compete effectively in the growing market for waistband, shirt collar and shapewear garment components.

Segment Information

We operate in one industry segment, the distribution of a full range of apparel zipper, trim and interlining products to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We separately report our revenues and gross margins by our product selling groups in this segment to the extent these are distinguished and separate.

Financial Information about Geographic Areas

The majority of our products sold are for use by U.S. and European based brands, retailers and manufacturers. The majority of these customers produce their products or outsource the production of their products in manufacturing facilities located outside of the U.S. or Europe, primarily in China, India, Indonesia, Vietnam, Bangladesh and Central America.

A summary of our domestic and international net sales and long-lived assets is set forth in Item 8 of Part II of this Annual Report on Form 10-K, in Note 8 in the accompanying Notes to Consolidated Financial Statements.

We are subject to certain risks referred to in Item 1A, “Risk Factors” and Item 3, “Legal Proceedings,” including those normally attending international and domestic operations, such as changes in economic or political conditions, currency fluctuations, foreign taxes, exchange control regulations and the effect of international relations and domestic affairs of foreign countries on the conduct of business, legal proceedings and the availability and pricing of raw materials.

Employees

As of December 31, 2016, we had 201 full-time employees including 30 in the United States and 171 employees in Asia. Our labor forces are non-union. We believe that we have satisfactory employee and labor relations.

Corporate Governance and Information Related to SEC Filings

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed with, or furnished to, the Securities and Exchange Commission (“SEC”) pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our website, www.talonzippers.com (in the “Investor” section, as soon as reasonably practical after electronic filing with or furnishing of such material to the SEC). We make available on our website our (i) stockholder communications policies, (ii) Code of Ethical Conduct and (iii) Employee Complaint Procedures for Accounting and Auditing Matters. These materials are also available free of charge in print to stockholders who request them by writing to: Investor Relations, Talon International, Inc., 21900 Burbank Boulevard, Suite 270, Woodland Hills, CA 91367. Our website address provided in this Annual Report on Form 10-K is not intended to function as a hyperlink and the information on our website is not and should not be considered part of this report and is not incorporated by reference in this document.

ITEM 1A. RISK FACTORS

Several of the matters discussed in this document contain forward-looking statements that involve risks and uncertainties. Factors associated with the forward-looking statements that could cause actual results to differ from those projected or forecast are included in the statements below. In addition to other information contained in this report, readers should carefully consider the following cautionary statements and risk factors.

U.S. and global financial and economic uncertainties could negatively affect our business, results of operations and financial condition.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also retailers which are served by many of our largest customers. The worldwide apparel industry is heavily influenced by general economic cycles. Purchases of fashion apparel and accessories tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. Many factors affect the level of consumer spending in the apparel industries, including among others: prevailing economic conditions, levels of employment, salaries and wage rates, energy costs, interest rates, the availability of consumer credit, taxation and consumer confidence in future economic conditions. During periods of recession or economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, or maintain our earnings from operations as a percentage of net sales. As a result, our operating results may be adversely and materially affected by weak or downward trends in the United States or global economy.

If we lose our larger brand and retail nominations or customers, or the customers fail to purchase at anticipated levels, our sales and operating results will be adversely affected.

Our results of operations depend to a significant extent upon the commercial success of our larger brand nominations and customers. If we lose our significant brand nominations, or these customers fail to purchase our products at anticipated levels, or our relationship with these customers or the brands and retailers they serve diminishes, it may have an adverse effect on our results because we may lose a primary source of revenue if these customers choose not to purchase our products or services; we may lose the nomination of the retailer or brand; we may not be able to recoup development and inventory costs associated with this customer; and we may not be able to collect our receivables from them.

We may not be able to satisfy the financial covenants in our Credit Agreement and if we cannot, then our lender could declare the debt obligations in default.

Our Commercial Credit Agreement entered into on August 10, 2015 and as amended on December 21, 2015 (the “Credit Agreement”), with our secured lender, Princess Investment Holdings Limited (“Princess Investment”), requires certain financial covenants, including a requirement not to incur a loss after taxes (as calculated in accordance with GAAP) of more than \$1,000,000 in the aggregate for any two consecutive fiscal quarters, not to incur a loss after taxes for any three consecutive fiscal quarters and not to incur a loss after taxes for any trailing twelve month period ending at the end of any fiscal quarter.

In the event we do not meet the required covenants with our lender in future periods, we would need to negotiate for changes in the relative covenants or request a waiver with the lender of the non-compliance from the lender, however there is no assurance that any lender would comply with these requests. Our expectations of future operating results and compliance with all debt covenants cannot be assured and our lender’s actions are not controllable by us. If we default under the loan agreement, all amounts due under the loan agreement could be declared immediately due and payable and, unless we are able to secure alternative financing to repay the lender, the lender would have the right to exercise its remedies including enforcement of its lien on substantially all of our assets. Further, if the debt is placed in default, we could be required to reduce our expenses, curtail operations and/or raise capital through the sale of assets, issuance of equity or otherwise.

The loss of key management and sales personnel could adversely affect our business, including our ability to obtain and secure accounts and generate sales.

Our success has and will continue to depend upon key management and sales personnel, many of whom would be difficult to replace. The loss of the services of key employees could have a material adverse effect on our business, including our ability to establish and maintain client relationships. Our future success will depend in large part upon our ability to attract and retain personnel with a variety of sales, operating and managerial skills.

Global credit conditions may increase our credit risks.

Many of our customers are extended credit terms which are approved by us internally. While we attempt to cover as much of our credit risks as possible, not all of our risks can be fully covered due to the countries we operate in or the current credit conditions. Such exposure may translate into losses should there be any adverse changes to the financial condition of customers.

We operate in an industry that is subject to significant fluctuations in operating results that may result in unexpected reductions in revenue and stock price volatility.

We operate in an industry that is subject to seasonal and operational fluctuations that can significantly impact our results from quarter to quarter. Factors that may influence our quarterly operating results include:

- The volume and timing of customer orders received during the quarter;
- The timing and magnitude of our customers' marketing campaigns;
- The loss or addition of a major customer or of a major retailer nomination;
- The availability and pricing of materials for our products;
- The increased expenses incurred in connection with the introduction of new products;
- Currency fluctuations;
- Political factors that may affect the expected flow of commerce;
- Delays caused by third parties; and
- Changes in our product mix or in the relative contribution to sales of our subsidiaries.

Due to these factors, it is possible that in some quarters our operating results may be below our stockholders' expectations and those of public market analysts. If this occurs, the price of our common stock could be adversely affected.

Our products may not comply with various industry and governmental regulations and our customers may incur losses in their products or operations as a consequence of our non-compliance.

Our products are produced under strict supervision and controls to ensure that all materials and manufacturing processes comply with the industry and governmental regulations governing the markets in which these products are sold. However, if these controls fail to detect or prevent non-compliant materials from entering the manufacturing process, our products could cause damages to our customers' products or processes and could also result in fines being incurred. The possible damages, replacement costs and fines could significantly exceed the value of our products and these risks may not be covered by our insurance policies.

If customers default on inventory purchase commitments with us, we may be left holding non-salable inventory.

We hold inventories for specific customer programs, which the customers have committed to purchase. If any customer defaults on these commitments, or insists on markdowns, we may incur a charge in connection with our holding non-salable inventory and this would have a negative impact on our operations and cash flow.

Because we depend on a limited number of suppliers, we may not be able to always obtain materials when we need them and we may lose sales and customers.

Lead times for materials we order can vary significantly and depend on many factors, including the specific supplier, the contract terms and the demand for particular materials at a given time. From time to time, we may experience fluctuations in the prices and disruptions in the supply of materials. Shortages or disruptions in the supply of materials, or our inability to procure materials from alternate sources at acceptable prices in a timely manner, could lead us to miss deadlines for orders and lose sales and customers.

Our customers have cyclical buying patterns, which may cause us to have periods of low sales volume.

Most of our customers are in the apparel industry. The apparel industry historically has been subject to substantial cyclical variations. Our business has experienced significant cyclical fluctuations due, in part, to customer buying patterns, which may result in periods of low sales usually in the first and fourth quarters of our financial year. Backlogs of sales orders are not considered material in the industries in which we compete, which reduces the predictability of revenues and reinforces the volatility of these cyclical buying patterns on our sales volume.

If we experience disruptions at any of our foreign facilities, we will not be able to meet our obligations and may lose sales and customers.

Currently, we do not operate duplicate facilities in different geographic areas. Therefore, in the event of a regional disruption where we maintain one or more of our facilities, it is unlikely that we could shift our operations to a different geographic region and we may have to cease or curtail our operations in a selected area. This may cause us to lose sales and customers. The types of disruptions that may occur include:

- Foreign trade disruptions;
- Import restrictions;
- Labor disruptions;
- Embargoes;
- Government intervention;
- Natural disasters; or
- Regional pandemics.

Counterfeit products are not uncommon in the apparel industry and our customers may make claims against us for products we have not produced, adversely impacting us by these false claims.

Counterfeiting of valuable trade names is commonplace in the apparel industry and while there are industry organizations and federal laws designed to protect the brand owner, these counterfeit products are not always detected and it can be difficult to prove the manufacturing source of these products. Accordingly, we may be adversely affected if counterfeit products damage our relationships with customers, and we incur costs to prove these products are counterfeit, to defend ourselves against false claims and to pay for false claims.

On occasion, we have discovered that certain Asian factories have counterfeited Talon's zippers. We undertake efforts to eliminate and prosecute all offenders. Counterfeiting of known quality brand products is commonplace within Asia and in particular where retailers limit their sources to recognized brands such as Talon. The full extent of counterfeiting of Talon products, its effect on our business operations and the costs to investigate and eliminate this activity are ongoing and are generally undeterminable. However, based upon evidence available, we believe the impact is not significant to our current overall operations. We continue to work closely with major retailers to identify these activities within the marketplace and will aggressively combat these efforts worldwide to protect the *Talon* brand.

Our business model is dependent on integration of information systems on a global basis and, to the extent that we fail to maintain and support our information systems, it can result in lost revenues.

As part of our operations we must consolidate and centralize the management of our subsidiaries. Additionally, we must effectively integrate the information systems of our worldwide operations with the information systems of our principal offices in California. Our failure to do so could result in lost revenues, delay financial reporting or have adverse effects on the information reported.

Internet-based systems that we rely upon for our order tracking and management systems may experience disruptions and as a result we may lose revenues and customers.

To the extent that we fail to adequately update and maintain the hardware and software implementing our integrated systems, our customers may be delayed or interrupted due to defects in our hardware or our source code. In addition, since our software is Internet-based, interruptions in Internet service generally can negatively impact our ability to use our systems to monitor and manage various aspects of our customers' needs. Such defects or interruptions could result in lost revenues and lost customers.

Security breaches and improper access to or disclosure of our proprietary information, or other hacking attacks on our systems, could adversely affect our business.

Our industry is prone to cyber attacks, with third parties seeking unauthorized access to our proprietary information and technology. Computer malware, viruses, and hacking and phishing attacks by third parties have become more prevalent in our industry and may occur on our systems in the future. We believe such attempts are increasing in number and in technical sophistication, and in some instances we may be unable to anticipate these techniques or to implement adequate preventative measures. Additionally, we may be unaware of an incident or its magnitude and effects. Although we have developed systems and processes that are designed to protect our proprietary information and to prevent other cybersecurity breaches, we cannot guarantee that such measures will provide absolute security.

Any failure to prevent or mitigate security breaches and improper access to or disclosure of our proprietary information could result in the loss or misuse of such proprietary information, which could harm our business and diminish our competitive position. Such attacks may also create system disruptions or cause shutdowns. Publicity about vulnerabilities and attempted or successful incursions could damage our reputation with customers and reduce demand for our products and services.

Affected private parties or government authorities could initiate legal or regulatory actions against us in connection with any security breaches, which could cause us to incur significant expense and liability or result in orders or consent decrees forcing us to modify our business practices. Any of these events could have a material and adverse effect on our business, reputation, and operating results.

Unauthorized use of our proprietary technology may increase our litigation costs and adversely affect our sales.

We rely on trademark, patent, trade secret and copyright laws to protect our designs and other proprietary property worldwide. We cannot be certain that these laws will be sufficient to protect our property. In particular, the laws of some countries in which our products are distributed or may be distributed in the future may not protect our products and intellectual rights to the same extent as the laws of the United States. If litigation is necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others, such litigation could result in substantial costs and diversion of resources. This could have a material adverse effect on our operating results and financial condition. Ultimately, we may be unable, for financial or other reasons, to enforce our rights under intellectual property laws, which could result in lost sales.

If our products infringe any other person's proprietary rights, we may be sued and have to pay legal expenses and judgments and redesign or discontinue selling our products.

From time to time in our industry, third parties allege infringement of their proprietary rights. Any infringement claims, whether or not meritorious, could result in costly litigation or require us to enter into royalty or licensing agreements as a means of settlement. If we are found to have infringed the proprietary rights of others, we could be required to pay damages, cease sales of the infringing products and redesign the products or discontinue their sale. Any of these outcomes, individually or collectively, could have a material adverse effect on our operating results and financial condition.

The outcome of any dispute or litigation in which we have been named as a defendant is unpredictable and an adverse decision in any such matter could have a material adverse effect on our financial position and results of operations.

From time to time we are party to various disputes or litigation matters. These claims may divert financial and management resources that would otherwise be used to benefit our operations. Although we believe that we have meritorious defenses and arguments to the claims made in each and all of the matters to which we have been named a party and we intend to contest each vigorously, no assurances can be given that the results of these matters will be favorable to us. We maintain product liability, errors and omissions, product recall and director and officer insurance that we regard as reasonably adequate to protect us from potential claims; however, we cannot assure adequacy to cover any loss, or that we will be able to maintain our current levels of insurance at a reasonable cost or at all.

We may not be able to realize the anticipated benefits of acquisitions.

We may consider strategic acquisitions as opportunities arise. Acquisitions involve numerous risks, including diversion of our management's attention away from our operating activities. We cannot assure you that we will not encounter unanticipated problems or liabilities relating to the integration of an acquired company's operations, nor can we assure you that we will realize the anticipated benefits of any future acquisitions.

Our actual tax liabilities may differ from estimated tax resulting in unfavorable adjustments to our future results.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities. Our estimate of the potential outcome of uncertain tax issues is subject to our assessment of relevant risks, facts and circumstances existing at that time. Our future results may include favorable or unfavorable adjustments to our

estimated tax liabilities in the period the assessments are made or resolved, which may impact our effective tax rate and our financial results.

We may face interruption of production and services due to increased security measures in response to terrorism.

Our business depends on the free flow of products and services through the channels of commerce. In response to terrorists' activities and threats aimed at the United States, transportation, mail, financial and other services may be slowed or stopped altogether. Extensive delays or stoppages in transportation, mail, financial or other services could have a material adverse effect on our business, results of operations and financial condition. Furthermore, we may experience an increase in operating costs, such as costs for transportation, insurance and security as a result of the activities and potential delays. We may also experience delays in receiving payments from payers that have been affected by the terrorist activities. The United States economy in general may be adversely affected by terrorist activities and any economic downturn could adversely impact our results of operations, impair our ability to raise capital or otherwise adversely affect our ability to grow our business.

We have experienced and may continue to experience major fluctuations in the market price for our common stock.

The following factors could cause the market price of our common stock to decrease, perhaps substantially:

The failure of our quarterly operating results to meet expectations of investors or securities analysts;
Adverse developments in the financial markets, the apparel industry and the worldwide or regional economies;
Changes in interest rates;
Changes in accounting principles;
Disputes relating to intellectual property and legal matters;
Sales of common stock by existing stockholders or holders of options;
Announcements of key developments by our competitors; and
The reaction of markets and securities analysts to announcements and developments involving our company.

If we need to sell or issue additional shares of common stock or assume additional debt to finance future growth, our stockholders' ownership could be diluted or our earnings could be adversely impacted.

Our business strategy may include expansion through internal growth, by acquiring complementary businesses or by establishing strategic relationships with targeted customers and suppliers. In order to do so, or to fund our other activities, we may issue additional equity securities that could dilute our stockholders' value. We may also assume additional debt and incur impairment losses to our intangible assets if we acquire another company.

We have adopted anti-takeover measures that may depress the price of our common stock.

Our ability to issue shares of preferred stock without stockholder approval and some provisions of our certificate of incorporation and bylaws and of Delaware law could make it more difficult for a third party to make an unsolicited takeover attempt of our Company. These anti-takeover measures may depress the price of our common stock by making it more difficult for third parties to acquire us by offering to purchase shares of our stock at a premium to its market price.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in the greater Los Angeles area, in Woodland Hills, California. We lease approximately 14,644 square feet of office, warehouse and product development spaces in the U.S. and 43,421 square feet of office, warehouse, product development, lab and testing space within Asia. The lease agreements related to these properties expire at various dates through October 2020. We believe our existing facilities are adequate to meet our needs for the foreseeable future.

ITEM 3. 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 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Common Stock**

Our common stock is currently listed on the OTCQB under the trading symbol "TALN". The following table sets forth the high and low sales prices for the Common Stock as reported by the OTCQB during the periods indicated.

Over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

| | High | Low |
|-------------------------------------|-------------|------------|
| Year ended December 31, 2016 | | |
| 1st Quarter | \$0.18 | \$0.12 |
| 2nd Quarter | 0.17 | 0.08 |
| 3rd Quarter | 0.15 | 0.06 |
| 4th Quarter | 0.18 | 0.09 |
| Year ended December 31, 2015 | | |
| 1st Quarter | \$0.20 | \$0.03 |
| 2nd Quarter | 0.19 | 0.13 |
| 3rd Quarter | 0.18 | 0.05 |
| 4th Quarter | 0.20 | 0.13 |

On March 24, 2017 the closing sales price of our common stock as reported on the OTCQB was \$0.09 per share. As of March 24, 2017, there were 26 record holders of our common stock and approximately 73.7% of our outstanding shares were held by brokers and dealers.

Dividends

We have never paid dividends on our common stock. In addition, our Credit Agreement with Princess Investment prohibits us from paying dividends without prior approval by Princess Investment. It is our intention to retain future earnings for use in our business.

Issuer Purchases of Equity Securities

We did not repurchase any of our common stock in the fourth quarter of 2016.

Recent Sales of Unregistered Securities

On February 10, 2016, the Company issued warrants to purchase 250,000 shares of the Company's common stock to an outside services company. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.14 per share and include a "cashless" exercise provision. The issuance of these securities was exempt from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is not necessarily indicative of our future financial position or results of future operations and should be read in conjunction with Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements and Notes thereto included in Item 8, “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

| | (In thousands except share data) | | | | |
|---|---|-------------|-------------|-------------|-------------|
| | 2016 | 2015 | 2014 | 2013 | 2012 |
| <i>Consolidated Statements of Operations Data:</i> | | | | | |
| Talon Zipper net sales | \$17,582 | \$21,284 | \$24,710 | \$28,756 | \$22,062 |
| Talon Trim net sales (5) | \$30,678 | \$27,069 | \$24,613 | \$23,691 | \$22,539 |
| Total net sales | \$48,260 | \$48,353 | \$49,323 | \$52,447 | \$44,601 |
| Income from operations (3) | \$2,712 | \$1,420 | \$1,740 | \$2,757 | \$995 |
| Net income (1)(2)(3)(4) | \$995 | \$511 | \$572 | \$9,731 | \$679 |
| Net income per share | \$0.01 | \$0.01 | \$0.01 | \$0.17 | \$0.03 |
| Basic net income (loss) per share | \$0.01 | \$0.01 | \$0.01 | \$0.26 | \$(0.12) |
| Diluted net income (loss) per share | \$0.01 | \$0.01 | \$0.01 | \$0.24 | \$(0.12) |
| Weighted average share outstanding - basic | 92,272 | 92,268 | 92,154 | 56,213 | 22,458 |
| Weighted average share outstanding - diluted | 93,325 | 93,522 | 94,301 | 60,555 | 22,458 |
| Total comprehensive income (1)(2)(3)(4) | \$966 | \$498 | \$573 | \$9,778 | \$685 |
| <i>Consolidated Balance Sheet Data:</i> | | | | | |
| Cash and cash equivalents | \$4,914 | \$2,852 | \$2,603 | \$3,780 | \$8,927 |
| Total assets | \$21,155 | \$19,265 | \$18,102 | \$20,523 | \$18,976 |
| Debt facilities and capital lease obligations | \$4,102 | \$3,575 | \$4,164 | \$6,000 | \$3 |
| Series B Convertible Preferred Stock | \$- | \$- | \$- | \$- | \$23,979 |
| Stockholders' equity (deficit) | \$7,462 | \$6,210 | \$5,134 | \$4,431 | \$(16,028) |
| <i>Per Share Data:</i> | | | | | |
| Net book value per common share | \$0.08 | \$0.07 | \$0.06 | \$0.05 | \$(0.68) |
| Common shares outstanding | 92,274 | 92,268 | 92,268 | 91,342 | 23,401 |

(1) Net income for the year ended December 31, 2016 included \$250,000 of recovered funds previously recorded as a business email compromise fraud loss in 2015.

Net income for the year ended December 31, 2015 included a \$715,000 one-time accrual for severance payments (2) to our former CEO and board member, which were recognized upon separation, a \$250,000 business email compromise fraud loss, and a \$134,000 loss on extinguishment of debt.

- (3) Income from operations for the year ended December 31, 2013 includes \$330,000, related to trademark infringement litigation recovery.
- (4) Benefit from income taxes, net, in the amount of \$7,492,000 was recorded on December 31, 2013, arising from the recognition of our net deferred tax assets principally associated with our U.S. operating loss carryforwards.

During the 2015 fiscal year, we realigned the reporting of our operating segments into two reporting segments (5)(Zippers and Trim) and have reclassified prior period results to reflect these product categories. Our Tekfit operating segment results are now aggregated and reported as part of our Trim operating segment.

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

The following management's discussion and analysis is intended to assist the reader in understanding our consolidated financial statements. 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. Amounts presented in this report, with the exception of the Consolidated Financial Statements and accompanying Notes to the Financial Statements, are rounded to the nearest thousand dollars, except per share amounts.

Overview

Talon International, Inc. designs, manufactures, sells and distributes apparel zippers, various apparel trim products and specialty waistbands, shirt collars and other stretch technology and 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 two product groups – Talon Zipper and Talon Trim.

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, improve our time-to-market throughout the world by sourcing, finishing and distributing to apparel manufacturers in their local markets.

Our primary business is serving as an outsourced apparel zipper, trim and stretch technology material supplier. We provide product design and development, sampling and sourcing services 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 Tekfit stretch technology business provides manufacturers with Talon's patented material 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. We are actively expanding our

marketing and selling efforts of this unique product within the industry, including by introducing this technology to major retailers.

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 6 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 adoption within the retailers' products of Tekfit technology requires significant time to accomplish. However, once adopted the production volumes continue to build as the technology is accepted across multiple styles with the retailer.

Results of Operations

Net Sales

For the years ended December 31, 2016, 2015 and 2014, total sales by geographic region based on customer delivery locations were as follows:

| | Years Ended December 31, | | |
|----------------------|---------------------------------|--------------|--------------|
| | 2016 | 2015 | 2014 |
| <i>Sales:</i> | | | |
| United States | \$4,172,000 | \$3,416,000 | \$4,396,000 |
| China | 12,441,000 | 12,650,000 | 15,564,000 |
| Hong Kong | 11,617,000 | 10,638,000 | 11,497,000 |
| Bangladesh | 3,534,000 | 3,103,000 | 2,523,000 |
| Vietnam | 3,634,000 | 3,920,000 | 2,378,000 |
| India | 2,880,000 | 3,291,000 | 2,086,000 |
| Other | 9,982,000 | 11,335,000 | 10,879,000 |
| Total | \$48,260,000 | \$48,353,000 | \$49,323,000 |

The net sales for our two primary product groups are as follows:

| | Years Ended December 31, | | |
|--|---------------------------------|--------------|--------------|
| | 2016 | 2015 | 2014 |
| <i>Product Group Net Sales:</i> | | | |
| Talon Zipper | \$17,582,000 | \$21,284,000 | \$24,710,000 |
| Talon Trim | 30,678,000 | 27,069,000 | 24,613,000 |
| Total | \$48,260,000 | \$48,353,000 | \$49,323,000 |

Net sales are influenced by a number of factors, including demand, pricing strategies, new product launches, competitive products, product supply and foreign exchange rates. See Item 1 “Business” for a discussion of our principal products.

Sales for the year ended December 31, 2016 were \$48,260,000, reflecting a slight decrease of \$93,000 or -0.2% as compared to the same period in 2015. Our Talon Zipper products sales for the year ended December 31, 2016 were \$3,702,000 lower than the same period in 2015 due to decreased sales of \$928,000 within our mass merchandising brand customers as compared to 2015, and by \$2,773,000 in sales to our specialty retail brands customers as compared to 2015. For the year ended December 31, 2016, sales of Talon Trim products, which consist primarily of sales to specialty retail branded customers, increased by \$3,609,000 compared to the same period in 2015, mainly due to new stretch technology programs and customers.

In 2016, we continued to experience reduced sales to our mass merchandising Talon Zipper customers and selected specialty retail brand customers, including specialty teen retailers we serve with our Talon Zipper which decreased sales were offset by increased sales of our Talon Trim products. This marks a continuation of the general apparel retail trends, including weakness, which began in the second quarter of 2014 and which have continued throughout 2016. While retail trends are highly cyclical, industry data indicates that with lower consumer demand and excess carryover retail inventories which have been observed in the general apparel retail markets, the potential remains for continued weakening sales to our sensitive mass merchandising and, to a lesser degree to our specialty retail brand customers. This outlook is expected to be offset, however, by expansion of existing customer programs and new customers adopting our stretch technology products into their product offerings.

Sales for the year ended December 31, 2015 were \$48,353,000, reflecting a decrease of \$970,000 or 2.0% as compared to the same period in 2014. Our Talon Zipper products sales for the year ended December 31, 2015 were \$3,426,000 lower than the same period in 2014 due to decreased sales of \$3,177,000 within our mass merchandising brand customers as compared to 2014, and by \$249,000 in sales to our specialty retail brands customers as compared to 2014. For the year ended December 31, 2015, sales of Talon Trim products, which consist primarily of sales to specialty retail branded customers, increased by \$2,456,000 compared to the same period in 2014, mainly due to new stretch technology programs and customers.

Cost of goods sold and selected operating expenses

The following table summarizes cost of goods sold and selected operating expenses for the years ended December 31, 2016, 2015 and 2014 (amounts in thousands) and the percentage change in such operating expenses as compared to the previous year:

| | Years Ended December 31, | | | | | |
|------------------------------------|---------------------------------|---------------|-------------|---------------|-------------|----------|
| | 2016 | Change | 2015 | Change | 2014 | |
| Sales | \$48,260 | 0 | % \$48,353 | -2 | % | \$49,323 |
| Cost of goods sold | \$30,631 | -4 | % \$32,070 | -4 | % | \$33,315 |
| % of sales | 63 | % | 66 | % | 68 | % |
| Sales and marketing expense | \$6,786 | 6 | % \$6,415 | 1 | % | \$6,330 |
| % of sales | 14 | % | 13 | % | 13 | % |
| General and administrative expense | \$8,132 | -4 | % \$8,448 | 6 | % | \$7,938 |
| % of sales | 17 | % | 17 | % | 16 | % |

Cost of goods sold

Cost of goods sold for the year ended December 31, 2016 decreased \$1,439,000 as compared to the same period in 2015, representing a 0.5% improvement as a percentage of sales. \$52,000 of the decrease in the cost of goods sold was the result of lower overall sales volume, \$1,214,000 was due to lower direct purchase costs associated with a greater mix of higher-margin products in the Talon Zipper and the Talon Trim products, \$323,000 was due to lower freight and duty costs, offset by \$150,000 of higher manufacturing overhead and inventory obsolescence costs.

Cost of goods sold for the year ended December 31, 2015 decreased \$1,245,000 as compared to the same period in 2014, representing a 2% improvement as a percentage of sales. \$556,000 of the decrease in the cost of goods sold was the result of lower overall sales volume, \$867,000 was due to lower direct purchase costs associated with a greater mix of higher-margin products in the Talon Zipper and the Talon Trim products, offset by \$178,000 of higher manufacturing overhead costs, inventory obsolescence costs and freight expenses.

Sales and marketing expenses

Sales and marketing expenses for the year ended December 31, 2016 totaled \$6,786,000, an increase of \$371,000 when compared to the same period in 2015. This was mainly due to \$200,000 of additional compensation costs, \$73,000 of increased facilities and related expenses, \$137,000 of additional new product development and marketing costs, offset by a \$21,000 decrease in travel and related costs.

Sales and marketing expenses for the year ended December 31, 2015 totaled \$6,415,000, which was a slight increase when compared to the same period in 2014. This was mainly due to \$124,000 of additional compensation costs and \$156,000 of increased facilities and related expenses offset by a \$254,000 reduction in new product development and marketing costs.

General and administrative expenses

General and administrative expenses for the year ended December 31, 2016 totaled \$8,132,000, or 16.8% of sales, as compared to general and administrative expenses in the prior year of \$8,448,000 or 17.5% of sales. General and administrative expenses were lower by \$316,000 during the year ended December 31, 2016, as compared to the same period in 2015, mainly due to a \$358,000 decrease in compensation costs, a \$297,000 reduction in administrative costs as a result of the recovery of a business email compromise fraud loss (see below) offset by a \$195,000 increase in additional professional services and \$115,000 increase in additional travel and related costs.

General and administrative expenses for the year ended December 31, 2015 totaled \$8,448,000 or 17.5% as a percentage of sales, as compared to general and administrative expenses in the prior year of \$7,938,000 or 16.1% as a percentage of sales. General and administrative expenses were higher by \$510,000 during the year ended December 31, 2015, as compared to the same period in 2014, mainly due to a \$715,000 one-time accrual for severance payments to our former CEO and board member, recognized upon separation in 2015, \$250,000 as a result of a business email compromise fraud loss (see below) offset by a \$426,000 reduction in other compensation costs and a \$236,000 reduction in facilities and related expenses.

In December 2015, we determined that we were the victim of criminal fraud known to law enforcement authorities as business e-mail compromise fraud which involved employee impersonation and fraudulent requests targeting our finance department. The fraud resulted in a transfer of funds in the amount of \$250,000 to an overseas account held by a third party and we recorded a charge of \$250,000 in the fourth quarter of 2015. In September 2016, we were able to fully recover the funds transferred to the third party, less our legal expenses, and as a result, we recorded a benefit of \$250,000 in the third quarter of 2016.

Loss on extinguishment of debt

Loss on extinguishment of debt in the amount of \$134,000 was recorded during the year ended December 31, 2015 as a result of paying off the Term Loan Payable to Union Bank. See Note 2 in the accompanying Notes to Consolidated Financial Statements. There was no loss on extinguishment of debt during the year ended December 31, 2016.

Interest expense and interest income

Interest expense for the year ended December 31, 2016, increased by \$106,000 to \$619,000, as compared to the same period in 2015. Interest expense for the year ended December 31, 2015, increased by \$102,000 to \$513,000, as compared to the same period in 2014. Interest expense for the year ended December 31, 2016 included borrowings under Princess Investment Holdings, Inc. Credit facility (“Princess Investment Credit Facility”) and the related amortization of deferred financing costs and amortization of debt discounts (See Note 2 to the accompanying Notes to Consolidated Financial Statements). Interest expense for the year ended December 31, 2015, included borrowings under the Princess Investment Credit Facility and the related amortization of deferred financing costs and amortization of debt discounts as well as borrowings under our Credit Facilities with MUFG Union Bank, N.A., which were terminated on December 23, 2015 (formerly Union Bank, N.A., “Union Bank”).

A brief summary of interest expense and interest income is presented below:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Amortization of deferred financing costs | \$ 18,000 | \$ 152,000 | \$ 91,000 |
| Amortization of debt discounts | 86,000 | 22,000 | - |
| Interest expense under Credit Facilities | 488,000 | 308,000 | 318,000 |
| Other interest expense | 29,000 | 34,000 | 6,000 |
| Interest expense | 621,000 | 516,000 | 415,000 |
| Interest income | (2,000) | (3,000) | (4,000) |
| Interest expense, net | \$ 619,000 | \$ 513,000 | \$ 411,000 |

Income taxes

Provision for income taxes, net, for the year ended December 31, 2016, was \$1,097,000 as compared to \$262,000 in 2015 mainly due to higher taxable income and a higher effective tax rate in 2016 versus 2015. The provision for income taxes at December 31, 2016 and 2015 includes consideration of all taxable income worldwide (See Note 6 in the accompanying Notes to Consolidated Financial Statements).

Provision for income taxes, net, for the year ended December 31, 2015, was \$262,000 as compared to \$756,000 in 2014 mainly due to lower taxable income and a lower effective tax rate in 2015 versus 2014. The provision for income taxes at December 31, 2015 and 2014 includes consideration of all taxable income worldwide.

Liquidity and Capital Resources

The following table summarizes selected financial data at the following year end dates:

| | December 31, | |
|---------------------------|---------------------|--------------|
| | 2016 | 2015 |
| Cash and cash equivalents | \$4,914,000 | \$2,852,000 |
| Total assets | \$21,155,000 | \$19,265,000 |
| Current liabilities | \$9,375,000 | \$9,238,000 |
| Long term liabilities | \$4,318,000 | \$3,817,000 |
| Stockholders' equity | \$7,462,000 | \$6,210,000 |

We believe that our existing cash and cash equivalents, our anticipated cash flows from our operating activities, and available borrowings from our Credit Facilities, will be sufficient to fund our minimum working capital and capital expenditure needs for operating activities for at least the next twelve months. Approximately \$1,500,000 remained in available borrowings under our Princess Investment Credit Facility as of December 31, 2016.

Cash and cash equivalents

Most of our cash is held within various financial institutions globally and as of December 31, 2016 and 2015 there were no restricted cash balances.

Cash and cash equivalents increased by \$2,061,000 at December 31, 2016, as compared to December 31, 2015, principally due to \$2,595,000 in cash provided by operating activities, offset by \$404,000 in payments for the acquisition of property and equipment, net of proceeds from selling of property and equipment and \$22,000 in repayment of borrowings under capital leases.

Cash and cash equivalents increased by \$249,000 at December 31, 2015, as compared to December 31, 2014, principally due to \$1,073,000 in cash provided by operating activities, \$4,000,000 revolving line of credit borrowings from Princess Investment (“Revolving Line of Credit”) and \$700,000 in Union Bank revolving credit loan borrowings (“Revolving Credit Loan”) offset by \$2,833,000 in Union Bank term loan (“Term Loan Payable”) payments paid off at August 11, 2015, \$2,200,000 repayments of Revolving Credit Loan paid off at December 23, 2015, \$148,000 in payments of financing costs associated with credit facilities and \$250,000 in payments for the acquisition of property and equipment and intellectual property rights, net of proceeds from selling of property and equipment.

Cash flows

The following table summarizes our cash flow activity for the years ended December 31, 2016, 2015 and 2014:

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|---------------|
| | 2016 | 2015 | 2014 |
| Net cash provided by operating activities | \$2,595,000 | \$1,073,000 | \$889,000 |
| Net cash used in investing activities | (404,000) | (250,000) | (271,000) |
| Net cash used in financing activities | (23,000) | (493,000) | (1,791,000) |
| Net effect of foreign currency translation on cash | (107,000) | (81,000) | (3,000) |
| Net increase (reduction) in cash and cash equivalents | \$2,061,000 | \$249,000 | \$(1,176,000) |

Operating Activities

The net cash provided by operating activities is our primary recurring source of funds, and reflects net income from operations, excluding non-cash charges and changes in operating capital. The net cash provided by operating activities during the years ended December 31, 2016, 2015 and 2014 resulted principally from:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Net income before non-cash expenses | \$2,506,000 | \$1,314,000 | \$1,477,000 |
| Inventory reductions (increases) | 157,000 | (171,000) | 311,000 |
| Accounts receivable (increases) reductions | (538,000) | (827,000) | 539,000 |
| Accounts payable and accrued expenses increases (reductions) | 728,000 | 748,000 | (1,432,000) |
| Other increases (decreases) in operating capital | (258,000) | 9,000 | (6,000) |
| Net cash provided by operating activities | \$2,595,000 | \$1,073,000 | \$889,000 |

Investing Activities

Net cash used in investing activities for the year ended December 31, 2016 was \$404,000 due to the net acquisition and disposal of property and equipment.

Net cash used in investing activities for the year ended December 31, 2015 was \$250,000, due to \$223,000 relating to the net acquisition and disposal of property and equipment and \$27,000 associated with an acquisition of intellectual property rights.

Net cash used in investing activities for the year ended December 31, 2014 was \$271,000, due to \$225,000 relating to the net acquisition and disposal of property and equipment and \$46,000 associated with an acquisition of intellectual property rights.

Financing Activities

Net cash used in financing activities for the year ended December 31, 2016 was \$23,000 reflecting \$22,000 in repayment of borrowings under capital leases and \$1,000 in payments related to taxes associated with the exercise of stock options.

Net cash used in financing activities for the year ended December 31, 2015 was \$493,000 reflecting \$2,833,000 in Term Loan Payable payments, \$2,200,000 in repayments of Revolving Credit Loan borrowings, \$148,000 in payments of financing costs associated with Credit Facilities and \$12,000 in repayment of borrowings under capital leases, offset by \$4,000,000 Revolving Line of Credit from related party borrowings, and \$700,000 in Revolving Credit Loan borrowings under our Union Bank Credit Facilities.

Net cash used in financing activities for the year ended December 31, 2014 was \$1,791,000, which reflects \$2,167,000 in Term Loan Payable payments, \$10,000 in payments of financing costs associated with Credit Facilities and \$144,000 in payments related to taxes associated with the exercise of stock options and RSU settlements, partially offset by \$1,000,000 in Revolving Credit Loan borrowings under our Credit Facilities, net of \$500,000 in repayments, and \$30,000 in proceeds from the exercise of stock options.

Facility with Princess Investment

On August 10, 2015, the Company entered into a loan and reimbursement agreement (“Loan Agreement”) with Princess Investment Holdings Inc. (“Princess Investment”). Princess Investment may be deemed an affiliate of Kutula Holdings, Ltd., a significant stockholder of the Company, which also has the contractual right to designate a director to the Company’s Board of Directors. Pursuant to the Loan Agreement, Princess Investment agreed to make available to the Company a loan of up to \$3,000,000 (“Revolving Line of Credit”). Advances under the Loan Agreement accrued interest initially on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Revolving Line of Credit was payable monthly beginning September 1, 2015, and the principal amount was payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. 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 immediately upon issuance for a five-year period at an exercise price of \$0.18 per share and include a “cashless” exercise option. 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 MUFG Union Bank N.A. on August 12, 2015 (See Retired Union Bank Credit Facilities). The Company borrowed an additional \$500,000 through December 21, 2015, and had an outstanding balance of \$2,000,000 under the Revolving Line of Credit from Princess Investment at December 21, 2015.

On December 21, 2015, the Company entered into an amended and restated credit agreement (the “Princess Investment Credit Agreement”) with Princess Investment, which amended the existing Loan Agreement, dated August 10, 2015, with Princess Investment to, among other things, increase the borrowing availability under the Loan Agreement from \$3,000,000 to \$6,000,000 and extend the maturity date of the loan to December 21, 2020 (the “Maturity Date”). The Princess Investment Credit Agreement requires the Company to comply with certain financial covenants, including a requirement not to incur a loss after taxes (as calculated in accordance with GAAP) of more than \$1,000,000 in the aggregate for any two consecutive fiscal quarters, not to incur a loss after taxes for any three consecutive fiscal quarters and not to incur a loss after taxes for any trailing twelve month period ending at the end of any fiscal quarter. At December 31, 2016, the Company was in compliance with all covenants.

Princess Investment will make advances under the Revolving Line of Credit from time to time as requested by the Company. The Company may prepay the Revolving Line of Credit at any time, and amounts prepaid may be re-borrowed through November 21, 2020. Under the amended terms, the Revolving Line of Credit will accrue interest on the unpaid principal balance at an annual rate of 11.5%. Interest on the Revolving Line of Credit for the period from December 21, 2015 through December 1, 2016 was accrued and added to principal on December 1, 2016, and thereafter interest will be payable monthly in arrears. No principal payments will be due during the period ending December 31, 2017. Thereafter, principal will be payable \$25,000 per month during the twelve months ended December 31, 2018, \$35,000 per month during the twelve months ended December 31, 2019 and \$50,000 per month during the twelve months ended December 31, 2020, with the remaining outstanding principal amount payable on the Maturity Date. The Princess Investment Credit Agreement continues to require payment of a \$60,000 loan fee at maturity.

The payment and performance of all the indebtedness and other obligations to Princess Investment, including all borrowings under the Princess Investment Credit Agreement, are guaranteed by the subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement entered into on August 10, 2015, as amended on December 21, 2015. The payment and performance of all of the indebtedness and other obligations to Princess Investment under the Princess Investment Credit Agreement and related agreements are secured by liens on substantially all of the Company's assets and the assets of the Company's subsidiary guarantors pursuant to a Pledge and Security Agreement entered into on August 10, 2015, as amended on December 21, 2015.

Pursuant to the Princess Investment Credit Agreement, the Company issued to Princess Investment warrants to purchase 2,000,000 shares of its common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.18 per share, and include a "cashless" exercise option.

On December 23, 2015, the Company received an advance from Princess Investment under the Princess Investment Credit Agreement in the amount of \$2,000,000, of which \$1,622,000 was used to pay in full all indebtedness outstanding under the Commercial Credit Agreement, dated December 31, 2013, with MUFG Union Bank N.A., which indebtedness was scheduled to mature on December 31, 2015.

Upon repayment of the indebtedness under the Company's Credit Agreement with Union Bank, Union Bank released its liens on the Company's assets and those of the Company's subsidiaries, Princess Investment became the only secured lender, and in addition to the Credit Agreement, the following agreements (the "Security Agreements") terminated in accordance with their terms: Continuing Guaranties, dated December 31, 2013, executed by the Company's current subsidiaries, Talon Technologies, Inc. and Tag-It Pacific Limited in favor of Union Bank; Security Agreements, dated December 31, 2013, executed by the Company and its current domestic subsidiary, Talon Technologies, Inc., and Union Bank; a Debenture executed by Tag-It Pacific Limited and Union Bank; an Intercreditor Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank; and a Subordination Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank.

After consideration of FASB ASC 480 "*Distinguishing Liability and Equity*" and ASC 815 "*Derivatives and Hedging*", the Company concluded that the warrants issued to Princess Investment should be recorded as an equity instrument. The fair value of the first one million warrants of \$130,000 issued with the debt facility at August 10, 2015 and the fair value of the additional two million warrants of \$320,000 issued with the debt facility at December 21, 2015 were valued using the Black-Scholes model. The fair value of the warrants was recorded as additional paid in capital and reflected as a debt discount to the face value of the Revolving Line of Credit, which discount is amortized over the term of the Loan and recognized as additional interest costs, as amortized.

At December 31, 2016 and December 31, 2015, the Company had an outstanding principal balance of approximately \$4,456,000 and \$4,000,000 respectively under the Revolving Line of Credit, and as of December 31, 2016 and December 31, 2015, approximately \$1,500,000 and \$2,000,000 respectively remained in available borrowings under the Revolving Line of Credit.

Retired Union 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 initially provided for a 24 month revolving loan commitment and a 36 month term loan. The term loan was extinguished during the quarter ended September 30, 2015 by the payment on August 12, 2015 of \$1,440,278 representing the outstanding principal and interest thereon, and the revolving loan commitment with Union Bank was paid off on December 23, 2015, in each case using proceeds from related party borrowings (See Revolving Line of Credit from Related Party).

The revolving loan commitment included 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 December 31, 2014.

The Credit Agreement initially provided for a term loan in the amount of \$5,000,000 (the “Term Loan Payable” and together with the Revolving Credit Loan, the “Union Bank 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 Credit Agreement contained representations and warranties, affirmative, negative and events of default, applicable to the Company and its subsidiaries which were customary for Union Bank Credit Facilities of this type. The Credit Agreement initially contained financial covenants applicable to the Company and its subsidiaries 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 Credit Agreement was further amended to change 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 during the third quarter of 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 Company did not satisfy the minimum EBITDA requirement for the 12-month period ended June 30, 2015, due primarily to a \$715,000 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. On August 4, 2015, the Company obtained a waiver from Union Bank of this minimum EBITDA requirement non-compliance and paid Union Bank a waiver fee of \$25,000 as a condition to the waiver.

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 of the outstanding Term Loan Payable in the principal amount of \$1,440,278 plus accrued and unpaid interest by August 31, 2015. In connection with the amendment, the Company incurred approximately \$18,000 in legal fees, representing additional financing costs to the Union Bank Credit Facilities. On August 11, 2015, the Company received an advance from Princess Investment, and on August 12, 2015, the Company paid off \$1,440,278 in outstanding Term Loan Payable from Union Bank as well as the unpaid interest.

Prior to repayment, the payment and performance of all indebtedness and other obligations under the Union Bank Credit Facilities were 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).

Capital Leases

We have financed purchases of furniture and fixtures through various capital lease obligations. Our capital lease obligations as of December 31, 2016 are \$61,000 and bear interest at a rate 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 Facilities. 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 debt financing and equity options to provide capital to fund our expansion and on-going operations. If we experience significant 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

The following summarizes our contractual obligations at December 31, 2016 and the effects such obligations are expected to have on liquidity and cash flow in future periods:

| Contractual Obligations | Payments Due by Period (\$) | | | |
|--|-----------------------------|---------------------|--------------|--------------|
| | Total | Less than 1 Year | 1-3 Years | 4-5 Years |
| Revolving line of credit from related party | \$6,309,000 | \$512,000 | \$5,797,000 | \$- |
| Operating leases | 2,094,000 | 885,000 | 1,209,000 | - |
| Capital leases | 67,000 | 28,000 | 39,000 | - |
| Software as a Service "SaaS" license agreement | 1,113,000 | 294,000 | 614,000 | 205,000 |
| Total Obligations | \$9,583,000 | \$1,719,000 | \$7,659,000 | \$205,000 |

Off-Balance Sheet Arrangements

At December 31, 2016 and 2015, 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 are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Related Party Transactions

For a description of certain 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, see Item 13, "Certain Relationships and Related Transactions and Director Independence," in Part III of this Report.

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 of operations, 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 the collectibility of customer accounts. 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 bad debt expenses, recoveries and allowances for the years ended December 31, 2016, 2015 and 2014 are as follows:

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Bad debt expense, net | \$11,000 | \$20,000 | \$15,000 |
| Allowance for accounts receivable doubtful accounts | \$40,000 | \$67,000 | \$51,000 |

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 by the disposition of inventory and write-off of reserved inventory, and increased by additions to the reserve for slow moving inventory. The inventory valuation provisions (recoveries) and allowances for inventory valuation reserves for the years ended December 31, 2016, 2015 and 2014 are as follows:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Inventory valuation provisions (recoveries), net | \$8,000 | \$20,000 | \$(17,000) |
| Allowance for inventory valuation reserves | \$64,000 | \$69,000 | \$199,000 |

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. 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. Benefit from income taxes, net in the amount of \$7,492,000 was recorded on December 31, 2013, arising from the recognition of our net deferred tax assets principally associated with our U.S. operating loss carryforwards. (See Note 6 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 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 Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") No. 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 January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-03, "*Accounting Changes and Error Corrections (Topic 250) and Investments – Equity Method and Joint Ventures (Topic 323)*." This ASU responds to SEC staff announcements made in 2016 as it relates to the disclosure of the future impact of the effects of the new FASB guidance on revenue, leases and credit losses on financial instruments in accordance with Staff Accounting Bulletin 74. This ASU was effective upon issuance in January 2017. Management has adopted ASU 2017-03 effective for January 2017.

In December 2016, the FASB issued ASU No. 2016-20, “*Technical Corrections and Improvements (Topic 606): Revenue from Contracts with Customers.*” This ASU provides amendments to Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, allow entities not to make quantitative disclosures about remaining performance obligations in certain cases and require entities that use any of the new or previously existing optional exemptions to expand their qualitative disclosures. It also makes 12 additional technical corrections and improvements to the new revenue standard. The effective date and transition requirements are the same as those in ASC 606. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In December 2016, the FASB issued ASU No. 2016-19, “*Technical Corrections and Improvements*”. This ASU clarifies guidance, corrects errors and makes minor improvements affecting a variety of topics in the Accounting Standards Codification. Most of the amendments are not expected to have a significant effect on practice, but some of them could change practice for some entities. Transition guidance and a delayed effective date are provided for amendments that the FASB deemed more substantive. The other amendments are effective immediately. Management has implemented as necessary and is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, “*Income Taxes*” (Topic 740): *Intra-Entity Transfers of Assets Other Than Inventory*.” This ASU improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual reporting period for which interim or annual financial statements have not been issued. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows* (Topic 230): *Classification of Certain Cash Receipts and Cash Payments*.” This ASU provides amendments to specific statement of cash flows classification issues. The guidance is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments – Credit Losses*” (Topic 326), which replaces the incurred loss impairment methodology in current generally accepted accounting principles (“GAAP”) with a methodology that reflects expected credit losses. The update is intended to provide financial statement users with more useful information about expected credit losses. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019, with early adoption permitted for the fiscal years, and interim periods within those fiscal years, beginning December 15, 2018. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements. Management does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, “*Compensation-Stock Compensation* (Topic 718): *Improvements to Employee Share-Based Payment Accounting*.” The updated accounting guidance simplifies the accounting for share-based payment award transactions including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 “*Leases*” (Topic 842). The new standard requires lessee recognition on the balance sheet of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. It further requires recognition in the income statement of a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis. Finally, it requires classification of all cash payments within operating activities in the statement of cash flows. It is effective for fiscal years commencing after December 15, 2018 and early adoption is permitted. In accordance with this standard, the Company will be establishing a right-of-use asset and an offsetting lease liability. Once adopted, we expect to report higher assets and liabilities as a result of including additional lease information on the consolidated balance sheet. The adoption of ASU 2016-02 is not expected to have a material impact on the Company’s consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, “*Balance Sheet Classification of Deferred Taxes*”. This ASU is part of the FASB’s simplification initiative directed at reducing complexity in accounting standards. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction. For public business entities, the amendments are effective in fiscal years beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The guidance may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively (i.e., reclassifying the comparative balance sheet). Management has adopted ASU 2015-17 effective for the fourth quarter of 2016. We presented the net deferred tax assets as noncurrent and reclassified any current deferred tax assets in the consolidated balance sheet on a retroactive basis. As a result, \$997,000 and \$746,000 of current deferred income taxes were reclassified to non-current deferred tax assets for the periods ending December 31, 2016 and 2015, respectively.

In August 2015, the FASB issued ASU 2015-15, “*Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements*”. We previously reported that in April 2015, the FASB issued ASU 2015-03, “*Simplifying the Presentation of Debt Issuance Costs*”, which simplifies the presentation of debt issuance costs by requiring that debt issuance costs related to a recognized liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in ASU 2015-15 address the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements such that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 and ASU 2015-03 are effective for financial statements of public business entities issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company chose to early adopt the amendment at December 31, 2015. Other than reclassification of debt issuance costs net of amortization from assets to liabilities, no other effect is included on our financial statements.

In July 2015, the FASB issued ASU 2015-11, “*Simplifying the Measurement of Inventory*”, to reduce the complexity in accounting for inventory. This ASU requires entities to measure inventory at the lower of cost or net realizable value, replacing the market value approach that required floor and ceiling considerations. This guidance for public entities is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. We are in the process of evaluating the adoption of this ASU, but do not expect this to have a material effect on our financial position, results of operations or cash flows.

In August 2014, the FASB issued ASU 2014-15, “*Presentation of Financial Statements - Going Concern (Subtopic 205-40)*.” ASU 2014-15 addresses management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company’s ability to continue as a going concern within one year from the date the financial statements are issued. Management’s evaluation should be based on relevant conditions and events that are known and reasonably knowable

at the date that the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Management has adopted this guidance effective for the fourth quarter of 2016.

Other pronouncements issued by the FASB or other authoritative accounting standards groups with future effective dates are either not applicable or are not expected to be significant to the Company's financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All of our sales are denominated in United States dollars or the currency of the country in which our products originate. We are exposed to market risk for fluctuations in the foreign currency exchange rates for certain product purchases that are denominated in Hong Kong dollars and Chinese Yuan. We do not intend to purchase contracts to hedge the exchange exposure for future product purchases. There were no hedging contracts outstanding as of December 31, 2016. Currency fluctuations can increase the price of our products to foreign customers, which can adversely impact the level of our export sales from time to time. The majority of our cash equivalents are held in United States dollars in various bank accounts and we do not believe we have significant market risk exposure with regard to our investments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Talon International, Inc. and Subsidiaries
Woodland Hills, California

We have audited the accompanying consolidated balance sheets of Talon International, Inc. and Subsidiaries (collectively, “the Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income and comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the financial statement schedule of the Company, listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ SingerLewak LLP
SingerLewak LLP

Los Angeles,
California

March 27, 2017

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TALON INTERNATIONAL, INC.**Consolidated balance sheets**

| | December 31, 2016 | December 31, 2015 |
|--|----------------------------------|----------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$4,913,577 | \$2,852,315 |
| Accounts receivable, net | 4,315,608 | 3,796,209 |
| Inventories, net | 500,482 | 655,360 |
| Prepaid expenses and other current assets | 702,906 | 554,389 |
| Total current assets | 10,432,573 | 7,858,273 |
| Property and equipment, net | 884,208 | 781,893 |
| Intangible assets, net | 4,266,596 | 4,313,948 |
| Deferred income tax assets, net | 5,224,018 | 6,043,412 |
| Other assets | 347,638 | 267,325 |
| Total assets | \$21,155,033 | \$19,264,851 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$6,378,896 | \$6,087,561 |
| Accrued expenses | 2,972,689 | 3,128,304 |
| Current portion of capital lease obligations | 23,749 | 21,940 |
| Total current liabilities | 9,375,334 | 9,237,805 |
| Revolving line of credit from related party, net of discounts and deferred financing costs | 4,041,345 | 3,492,772 |
| Capital lease obligations, net of current portion | 37,035 | 60,784 |
| Deferred income tax liabilities | 3,037 | 5,406 |
| Other liabilities | 236,088 | 257,903 |
| Total liabilities | 13,692,839 | 13,054,670 |
| Commitments and contingencies (Note 7) | | |
| Stockholders' Equity: | | |
| Common Stock, \$0.001 par value, 300,000,000 shares authorized; 92,274,255 and 92,267,831 shares issued and outstanding at December 31, 2016 and December 31, 2015, respectively | 92,274 | 92,268 |
| Additional paid-in capital | 65,040,432 | 64,754,306 |
| Accumulated deficit | (57,743,904) | (58,738,782) |

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| | | |
|--|--------------|--------------|
| Accumulated other comprehensive income | 73,392 | 102,389 |
| Total stockholders' equity | 7,462,194 | 6,210,181 |
| Total liabilities and stockholders' equity | \$21,155,033 | \$19,264,851 |

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.**Consolidated statements of INCOME AND COMPREHENSIVE INCOME**

| | Years Ended December 31, | | |
|---|---------------------------------|------------------|------------------|
| | 2016 | 2015 | 2014 |
| Net sales | \$48,259,855 | \$48,352,699 | \$49,322,684 |
| Cost of goods sold | 30,631,070 | 32,069,601 | 33,314,773 |
| Gross profit | 17,628,785 | 16,283,098 | 16,007,911 |
| Sales and marketing expenses | 6,785,592 | 6,414,932 | 6,330,386 |
| General and administrative expenses | 8,131,560 | 8,447,694 | 7,937,820 |
| Total operating expenses | 14,917,152 | 14,862,626 | 14,268,206 |
| Income from operations | 2,711,633 | 1,420,472 | 1,739,705 |
| Interest expense, net | 619,430 | 513,435 | 411,270 |
| Loss on extinguishment of debt | - | 134,049 | - |
| Income before provision for income taxes | 2,092,203 | 772,988 | 1,328,435 |
| Provision for income taxes | 1,097,325 | 261,661 | 756,366 |
| Net income | \$994,878 | \$511,327 | \$572,069 |
| Basic and diluted net income per share | \$0.01 | \$0.01 | \$0.01 |
| Weighted average number of common shares outstanding - Basic | 92,271,868 | 92,267,831 | 92,153,648 |
| Weighted average number of common shares outstanding - Diluted | 93,324,691 | 93,521,809 | 94,301,166 |
| Net income | \$994,878 | \$511,327 | \$572,069 |
| Other comprehensive income (loss) from foreign currency translation | (28,997) | (13,786) | 1,390 |
| Total comprehensive income | \$965,881 | \$497,541 | \$573,459 |

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

Consolidated Statements of Stockholders' equity

Years Ended December 31, 2016, 2015 and 2014

| | Common Stock | | Additional | Other | Comprehensive Accumulated | |
|---------------------------------------|-------------------|-----------------|---------------------|-------------------|---------------------------|--------------------|
| | Shares | Amount | Paid-in | Income | Deficit | Total |
| Balance at January 1, 2014 | 91,342,215 | \$91,342 | \$64,046,631 | \$ 114,785 | \$(59,822,178) | \$4,430,580 |
| Stock Based Compensation | - | - | 243,377 | - | - | 243,377 |
| Foreign currency translation | - | - | - | 1,390 | - | 1,390 |
| RSU's settlement in common stock | 610,894 | 611 | (136,812) | - | - | (136,201) |
| Exercise of stock options | 314,722 | 315 | 22,058 | - | - | 22,373 |
| Net Income | - | - | - | - | 572,069 | 572,069 |
| Balance at December 31, 2014 | 92,267,831 | 92,268 | 64,175,254 | 116,175 | (59,250,109) | 5,133,588 |
| Stock Based Compensation | - | - | 129,052 | - | - | 129,052 |
| Foreign currency translation | - | - | - | (13,786) | - | (13,786) |
| Issuance of warrants to related party | - | - | 450,000 | - | - | 450,000 |
| Net Income | - | - | - | - | 511,327 | 511,327 |
| Balance at December 31, 2015 | 92,267,831 | 92,268 | 64,754,306 | 102,389 | (58,738,782) | 6,210,181 |
| Stock Based Compensation | - | - | 286,833 | - | - | 286,833 |
| Foreign currency translation | - | - | - | (28,997) | - | (28,997) |
| Exercise of stock options | 6,424 | 6 | (707) | - | - | (701) |
| Net Income | - | - | - | - | 994,878 | 994,878 |
| Balance at December 31, 2016 | 92,274,255 | \$92,274 | \$65,040,432 | \$ 73,392 | \$(57,743,904) | \$7,462,194 |

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

Consolidated Statements of Cash Flows

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| <i>Cash flows from operating activities:</i> | | | |
| Net income | \$994,878 | \$511,327 | \$572,069 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 301,008 | 257,376 | 265,590 |
| Loss on disposal of property and equipment | 602 | 122 | 2,297 |
| Loss on extinguishment of debt | - | 134,049 | - |
| Amortization of deferred financing cost and debt discounts | 104,276 | 174,474 | 90,572 |
| Stock based compensation | 286,833 | 129,052 | 243,377 |
| Deferred income taxes, net | 817,025 | 68,186 | 305,074 |
| Change in provision for bad debt | (26,918) | 19,938 | 14,624 |
| Inventory valuation provisions (recoveries), net | (5,505) | 19,973 | (16,949) |
| Adjustment to intangible asset cost | 34,268 | - | - |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (537,688) | (826,936) | 539,056 |
| Inventories | 156,622 | (170,788) | 310,876 |
| Prepaid expenses and other current assets | (155,539) | (7,660) | 26,796 |
| Other assets. | (83,113) | (22,847) | (36,458) |
| Accounts payable and accrued expenses | 728,028 | 748,445 | (1,432,069) |
| Other liabilities | (19,914) | 38,493 | 3,904 |
| Net cash provided by operating activities | 2,594,863 | 1,073,204 | 888,759 |
| <i>Cash flows from investing activities:</i> | | | |
| Proceeds from sale of equipment | 475 | 509 | 2,783 |
| Acquisitions of property and equipment | (404,102) | (224,046) | (227,989) |
| Acquisitions of intangibles assets | - | (26,948) | (46,057) |
| Net cash used in investing activities | (403,627) | (250,485) | (271,263) |
| <i>Cash flows from financing activities:</i> | | | |
| Proceeds from exercise of stock options | - | - | 29,709 |
| Payments related to taxes on exercise of stock options and settlement of RSU's | (700) | - | (143,537) |
| Revolving line of credit from related party borrowings | - | 4,000,000 | - |
| Revolving credit loan borrowings | - | 700,000 | 1,000,000 |
| Financing costs associated with credit facilities | - | (147,669) | (10,000) |
| Repayments of revolving credit loan | - | (2,200,000) | (500,000) |
| Payments of term loan payable | - | (2,833,334) | (2,166,666) |
| Payment of capital leases | (21,940) | (12,017) | - |

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| | | | |
|---|-------------|-------------|-------------|
| Net cash used in financing activities | (22,640) | (493,020) | (1,790,494) |
| Net effect of foreign currency exchange translation on cash | (107,334) | (80,522) | (3,372) |
| Net increase (decrease) in cash and cash equivalents | 2,061,262 | 249,177 | (1,176,370) |
| Cash and cash equivalents at beginning of period | 2,852,315 | 2,603,138 | 3,779,508 |
| Cash and cash equivalents at end of period | \$4,913,577 | \$2,852,315 | \$2,603,138 |

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.**Consolidated Statements of Cash Flows**

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Cash received (paid) during the period for: | | | |
| Interest paid | \$(73,196) | \$(310,379) | \$(324,842) |
| Interest received | \$2,338 | \$2,764 | \$3,863 |
| Income tax paid, net (principally foreign) | \$(232,492) | \$(150,818) | \$(417,589) |
| Non-cash financing activities: | | | |
| Warrants issued to related party | \$- | \$450,000 | \$- |
| Lease incentives | \$- | \$133,333 | \$- |
| Capital lease obligation | \$- | \$94,741 | \$- |
| Interest accrued on revolving line of credit from related party | \$444,297 | \$11,346 | \$- |
| Non-cash exercise of stock options and settlements of RSU's in common stock | \$6 | \$- | \$649 |
| Effect of foreign currency translation on net assets | \$(28,997) | \$(13,786) | \$1,390 |

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Talon International, Inc. (together with its subsidiaries, the “Company”) is an apparel company that specializes in the distribution of trim items to manufacturers of fashion apparel, specialty retailers and mass merchandisers. The Company acts as a full service outsourced trim management department for manufacturers, a specified supplier of trim items to owners of specific brands, brand licensees and retailers, a manufacturer and distributor of zippers under the *Talon* brand name and a distributor of stretch waistbands that utilize licensed patented technology under the *Tekfit* brand name.

Organization and Basis of Presentation

Talon International, Inc. is the parent holding company of Talon Technologies, Inc., a California corporation (“Talon Tech”), formerly A.G.S. Stationery, Inc., Tag-It Pacific Limited, a Hong Kong corporation (“Tag-It HK”), Talon Zipper (Shenzhen) Co. Ltd., a China corporation, Talon International Private Limited, an India corporation and Talon Trims India Private Limited, an India corporation (collectively, the “Subsidiaries”), all of which are wholly-owned operating subsidiaries of the Company.

All significant intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of foreign subsidiaries are translated at rates of exchange in effect at the close of the period. Revenues and expenses are translated at the weighted average of exchange rates in effect during the year. The resulting translation gains and losses are deferred and are shown as a separate component of stockholders’ equity, if material, and transaction gains and losses, if any, are recorded in the consolidated statement of operations in the period incurred. During 2016, 2015 and 2014, foreign currency translation and transaction gains and losses were not material. The Company does not engage in hedging activities with respect to exchange rate risk.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 of allowances 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.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. The Company had approximately \$4.6 million and \$2.9 million at financial institutions in excess of governmentally insured limits at December 31, 2016 and 2015.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Allowance for Accounts Receivable Doubtful Accounts**

The Company is required to make judgments as to the collectability 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. The Company writes off an account when it is considered to be uncollectible. The total allowance for accounts receivable doubtful accounts at December 31, 2016 and 2015 was \$40,299 and \$67,217, respectively.

Inventories

Inventories are stated at the lower of cost, determined using the first-in, first-out 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 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 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.

Inventories consist of the following:

| | December 31, | |
|----------------|---------------------|-------------|
| | 2016 | 2015 |
| Finished goods | \$563,989 | \$724,372 |

| | | |
|------------------------------------|-----------|-----------|
| Less: Inventory valuation reserves | (63,507) | (69,012) |
| Inventories, net | \$500,482 | \$655,360 |

Impairment of Long-Lived Assets

The Company records impairment charges when the carrying amounts of long-lived assets are determined not to be recoverable. Impairment is measured by assessing the usefulness of an asset or by comparing the carrying value of an asset to its fair value. Fair value is typically determined using quoted market prices, if available, or an estimate of undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. The amount of impairment loss is calculated as the excess of the carrying value over the fair value. Changes in market conditions and management strategy have historically caused us to reassess the carrying amount of the Company's long-lived assets. The Company completed the required assessment at December 31 ,2016 and 2015, and noted no impairment.

Property and Equipment

Property and equipment are recorded at historical cost. Maintenance and repairs are expensed as incurred. Upon retirement or other disposition of property and equipment, the related cost and accumulated depreciation or amortization are removed from the accounts and any gains or losses are included in results of operations.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Property and equipment consist of the following:

| | December 31, | | Depreciable | |
|---|---------------------|-------------|---------------------|------|
| | 2016 | 2015 | Life | |
| | | | In Years (1) | |
| Office equipment and computer related | \$3,875,051 | \$4,126,720 | 3 | - 5 |
| Machinery and production related equipment | 1,262,490 | 971,502 | 5 | - 10 |
| Leasehold improvements (2) | 638,613 | 620,007 | | |
| Furniture and fixtures | 353,418 | 347,505 | 5 | |
| Total cost | 6,129,572 | 6,065,734 | | |
| Less: Accumulated depreciation and amortization | (5,245,364) | (5,283,841) | | |
| Property and equipment, net | \$884,208 | \$781,893 | | |

(1) Depreciation of property and equipment is computed using the straight-line method based on estimated useful lives as shown above.

(2) Depreciable life for leasehold improvements represents the term of the lease or the estimated life of the related improvements, whichever is shorter.

Depreciation expense for the years ended December 31, 2016, 2015 and 2014 was \$287,924, \$244,292 and \$252,507 respectively.

Intangible Assets, net

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 Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“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. Per ASC 350 the Company has 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 December 31, 2016 and 2015, 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 year ended December 31, 2016 the Company made no investment in intellectual property rights. During the year ended December 31, 2015, the Company invested \$26,948 in the acquisition of intellectual property rights complimentary to the Company’s Talon Zipper products. As of December 31, 2016 and December 31, 2015 the Company had accumulated investments of \$38,738 and \$73,005, respectively, for intellectual property rights complimentary to the Company’s Talon Zipper products, which were not yet in service.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Intangible assets as of December 31, 2016 and 2015 are as follows:

| | December 31, 2016 | | 2015 |
|--|------------------------------|---|--------------|
| Tradenname - Talon trademark | \$ 4,110,751 | | \$ 4,110,751 |
| Intellectual property rights and exclusive license | 217,459 | | 251,727 |
| Less: Accumulated amortization (10 to 17 years) | (61,614 |) | (48,530) |
| Intellectual property rights, net | 155,845 | | 203,197 |
| Intangible assets, net | \$ 4,266,596 | | \$ 4,313,948 |

Amortization expense for intangible assets was \$13,084 for the years ended December 31, 2016, 2015 and 2014.

Accrued Expenses

Accrued expenses consist of the following:

| | December 31, 2016 | 2015 |
|--------------------------------------|------------------------------|-------------|
| Accrued payroll and related expenses | \$1,532,734 | \$1,731,121 |
| Accrued commissions | 557,369 | 645,503 |
| Accrued rebates | 316,287 | 339,780 |
| Taxes payable | 184,232 | 108,854 |
| Accrued expenses | 268,330 | 243,954 |
| Other | 113,737 | 59,092 |
| Total accrued expenses | \$2,972,689 | \$3,128,304 |

Revenue Recognition

Sales are recognized when persuasive evidence of an arrangement exists, product delivery has occurred, 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 goods sold are recorded at the time title transfers to customers. Actual product returns are charged against estimated sales return allowances.

Sales rebates and discounts are common practice in the industries in which the Company operates. Volume, promotional, price, cash and other discounts and customer incentives are accounted for as a reduction to gross sales. Rebates and discounts are recorded based upon estimates at the time products are sold. These estimates are based upon historical experience for similar programs and products. The Company reviews such rebates and discounts on an ongoing basis and accruals for rebates and discounts are adjusted, if necessary, as additional information becomes available.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Shipping and Handling Costs

The Company records shipping and handling costs billed to customers as a component of revenue and shipping and handling costs incurred by the Company for outbound freight are recorded as a component of cost of goods sold.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carry-forwards. Deferred tax liabilities and assets at the end of each period are determined using enacted tax rates. The Company records deferred tax assets arising from temporary timing differences between recorded net income and taxable net income when and if the Company believes 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.

The provisions of FASB ASC 740, "*Income Taxes*," ("ASC 740") require the establishment of a valuation allowance when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will not be realized. ASC 740 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset.

The Company believes that its estimate of deferred tax assets 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.

In the fourth quarter of 2016, the Company implemented ASU 2015-17, “*Balance Sheet Classification of Deferred Taxes*”. This ASU is part of the FASB's simplification initiative directed at reducing complexity in accounting standards. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction. The Company presented the net deferred tax assets as noncurrent and reclassified any current deferred tax assets in the consolidated balance sheet on a retroactive basis. As a result, \$997,000 and \$746,000 of current deferred income taxes were reclassified to non-current deferred tax assets for the periods ending December 31, 2016 and 2015, respectively.

Stock-Based Compensation

The Company has employee equity incentive plans, which are described more fully in Note 4. The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors based on estimated fair values in accordance with FASB ASC 718 “*Compensation - Stock Compensation*” (“ASC 718”). Accordingly, the Company measures share-based compensation at the grant date based on the fair value of the award.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ASC 718 requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statements of Operations. Stock-based compensation expense recognized in the Consolidated Statements of Operations and Comprehensive Income for the years ended December 31, 2016, 2015 and 2014 included compensation expense for share-based payment awards granted prior to, but not yet vested as of January 1 of the applicable year based on the grant date fair value estimated in accordance with the pro-forma provisions of ASC 718, and compensation expense for the share-based payment awards granted subsequent to January 1 based on the grant date fair value estimated in accordance with the provisions of ASC 718. For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method. As stock-based compensation expense recognized in the Consolidated Statements of Operations and Comprehensive Income for 2016, 2015 and 2014 is based on awards expected to vest, in accordance with ASC 718, forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant uses the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards and actual and projected employee stock option exercise behaviors. The Company estimates expected volatility using historical data. The expected option term is estimated using the "safe harbor" provisions under ASC 718.

Foreign Currency Translation

The Company's reporting currency is US dollars. 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. Gains and losses resulting from foreign currency transactions and remeasurement adjustments of monetary assets and liabilities not held in an entity's functional currency, which primarily affects the Company's subsidiary in Hong Kong where the local currency of the Hong Kong Dollar is not the functional currency, are included in earnings.

Classification of Expenses

Cost 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 warehouse and operations salaries and other warehouse expenses.

Sales and Marketing Expense – Sales and marketing expenses primarily include sales salaries and commissions, travel and entertainment, marketing and other sales-related costs.

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 and Interest Income – Interest expense reflects the cost of borrowing, amortization of deferred financing costs and amortization of debt discounts. Interest expense for the years ended December 31, 2016, 2015 and 2014 was \$621,768, \$516,199, and \$415,133, respectively. Interest income of \$2,338, \$2,764, and \$3,863 for the years ended December 31, 2016, 2015 and 2014, respectively, consists of earnings from interest bearing receivables.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 utilizing 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.

Litigation

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

Fair Value of Financial Instruments

FASB ASC 820, “*Fair Value Measurements and Disclosures*” defines fair value 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 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—Include 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, revolving line of credit from related party, revolving credit loan and term loan payable. In accordance with ASC 820, the Company measures its cash equivalents at fair value. The Company has determined that the book value of the financial instruments is representative of their fair values. The Company's cash equivalents are classified within Level 1 and valued primarily using quoted market prices utilizing market observable inputs. At December 31, 2016 and 2015, cash equivalents consisted of money market fund balances measured at fair value on a recurring basis; fair value of the Company's money market funds was approximately \$1,125,000 and \$860,000, respectively.

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.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

New Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-03, "*Accounting Changes and Error Corrections (Topic 250) and Investments – Equity Method and Joint Ventures (Topic 323)*." This ASU responds to SEC staff announcements made in 2016 as it relates to the disclosure of the future impact of the effects of the new FASB guidance on revenue, leases and credit losses on financial instruments in accordance with Staff Accounting Bulletin 74. This ASU was effective upon issuance in January 2017. Management has adopted ASU 2017-03 effective for January 2017.

In December 2016, the FASB issued ASU No. 2016-20, "*Technical Corrections and Improvements (Topic 606): Revenue from Contracts with Customers*." This ASU provides amendments to Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, allow entities not to make quantitative disclosures about remaining performance obligations in certain cases and require entities that use any of the new or previously existing optional exemptions to expand their qualitative disclosures. It also makes 12 additional technical corrections and improvements to the new revenue standard. The effective date and transition requirements are the same as those in ASC 606. Management is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

In December 2016, the FASB issued ASU No. 2016-19, "*Technical Corrections and Improvements*". This ASU clarifies guidance, corrects errors and makes minor improvements affecting a variety of topics in the Accounting Standards Codification. Most of the amendments are not expected to have a significant effect on practice, but some of them could change practice for some entities. Transition guidance and a delayed effective date are provided for amendments that the FASB deemed more substantive. The other amendments are effective immediately. Management has implemented as necessary and is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, "*Income Taxes*" (Topic 740): *Intra-Entity Transfers of Assets Other Than Inventory*." This ASU improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual reporting period for which interim or annual financial statements have not been issued. Management is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*.” This ASU provides amendments to specific statement of cash flows classification issues. The guidance is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments – Credit Losses*” (Topic 326), which replaces the incurred loss impairment methodology in current generally accepted accounting principles (“GAAP”) with a methodology that reflects expected credit losses. The update is intended to provide financial statement users with more useful information about expected credit losses. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019, with early adoption permitted for the fiscal years, and interim periods within those fiscal years, beginning December 15, 2018. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements. Management does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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In March 2016, the FASB issued ASU No. 2016-09, “*Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.*” The updated accounting guidance simplifies the accounting for share-based payment award transactions including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. Management is currently evaluating the impact of this accounting standard on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 “*Leases*” (Topic 842). The new standard requires lessee recognition on the balance sheet of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. It further requires recognition in the income statement of a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis. Finally, it requires classification of all cash payments within operating activities in the statement of cash flows. It is effective for fiscal years commencing after December 15, 2018 and early adoption is permitted. In accordance with this standard, the Company will be establishing a right-of-use asset and an offsetting lease liability. Once adopted, the Company expects to report higher assets and liabilities as a result of including additional lease information on the consolidated balance sheet. The adoption of ASU 2016-02 is not expected to have a material impact on the Company’s consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, “*Balance Sheet Classification of Deferred Taxes*”. This ASU is part of the FASB's simplification initiative directed at reducing complexity in accounting standards. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction. For public business entities, the amendments are effective in fiscal years beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The guidance may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively (i.e., reclassifying the comparative balance sheet). Management has adopted ASU 2015-17 effective for the fourth quarter of 2016. The Company presented the net deferred tax assets as noncurrent and reclassified any current deferred tax assets in the consolidated balance sheet on a retroactive basis. As a result, \$997,067 and \$746,370 of current deferred income taxes were reclassified to non-current deferred tax assets for the periods ending December 31, 2016 and 2015, respectively.

In August 2015, the FASB issued ASU 2015-15, “*Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements*”. The Company previously reported that in April 2015, the FASB issued ASU 2015-03, “*Simplifying the Presentation of Debt Issuance Costs*”, which simplifies the presentation of debt issuance costs by requiring that debt issuance costs related to a recognized liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in ASU 2015-15 address the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements such that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 and ASU 2015-03 are effective for financial statements of public business entities issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company chose to early adopt the amendment at December 31, 2015. Other than reclassification of debt issuance costs net of amortization from assets to liabilities, no other effect is included on the Company’s financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In July 2015, the FASB issued ASU 2015-11, “*Simplifying the Measurement of Inventory*”, to reduce the complexity in accounting for inventory. This ASU requires entities to measure inventory at the lower of cost or net realizable value, replacing the market value approach that required floor and ceiling considerations. This guidance for public entities is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company is in the process of evaluating the adoption of this ASU, but does not expect this to have a material effect on our financial position, results of operations or cash flows.

Other pronouncements issued by the FASB or other authoritative accounting standards groups with future effective dates are either not applicable or are not expected to be significant to the Company’s financial position, results of operations or cash flows.

In August 2014, the FASB issued ASU 2014-15, “*Presentation of Financial Statements - Going Concern (Subtopic 205-40)*.” ASU 2014-15 addresses management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company’s ability to continue as a going concern within one year from the date the financial statements are issued. Management’s evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Management has adopted this guidance effective for the fourth quarter of 2016.

NOTE 2 - CREDIT FACILITIES, LONG TERM OBLIGATIONS AND RELATED PARTY TRANSACTIONS

Revolving Line of Credit from Related Party

On August 10, 2015, the Company entered into a loan and reimbursement agreement (“Loan Agreement”) with Princess Investment Holdings Inc. (“Princess Investment”). Princess Investment may be deemed an affiliate of Kutula Holdings,

Ltd., a significant stockholder of the Company, which also has the contractual right to designate a director to the Company's Board of Directors. Pursuant to the Loan Agreement, Princess Investment agreed to make available to the Company a loan of up to \$3,000,000 ("Revolving Line of Credit"). Advances under the Loan Agreement accrued interest initially on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Revolving Line of Credit was payable monthly beginning September 1, 2015, and the principal amount was payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. 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 immediately upon issuance for a five-year period at an exercise price of \$0.18 per share and include a "cashless" exercise option. 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 MUFG Union Bank N.A. on August 12, 2015 (See Retired Union Bank Credit Facilities). The Company borrowed an additional \$500,000 through December 21, 2015, and had an outstanding balance of \$2,000,000 under the Revolving Line of Credit from Princess Investment at December 21, 2015.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On December 21, 2015, the Company entered into an amended and restated credit agreement (the “Princess Investment Credit Agreement”) with Princess Investment, which amended the existing Loan Agreement, dated August 10, 2015, with Princess Investment to, among other things, increase the borrowing availability under the Loan Agreement from \$3,000,000 to \$6,000,000 and extend the maturity date of the loan to December 21, 2020 (the “Maturity Date”). The Princess Investment Credit Agreement requires the Company to comply with certain financial covenants, including a requirement not to incur a loss after taxes (as calculated in accordance with GAAP) of more than \$1,000,000 in the aggregate for any two consecutive fiscal quarters, not to incur a loss after taxes for any three consecutive fiscal quarters and not to incur a loss after taxes for any trailing twelve month period ending at the end of any fiscal quarter. For the year ended December 31, 2016, the Company was in compliance with all covenants.

Princess Investment will make advances under the Revolving Line of Credit from time to time as requested by the Company. The Company may prepay the Revolving Line of Credit at any time, and amounts prepaid may be re-borrowed through November 21, 2020. Under the amended terms, the Revolving Line of Credit will accrue interest on the unpaid principal balance at an annual rate of 11.5%. Interest on the Revolving Line of Credit for the period from December 21, 2015 through December 1, 2016 was accrued and added to principal on December 1, 2016, and thereafter interest will be payable monthly in arrears. No principal payments will be due during the period ending December 31, 2017. Thereafter, principal will be payable \$25,000 per month during the twelve months ended December 31, 2018, \$35,000 per month during the twelve months ended December 31, 2019 and \$50,000 per month during the twelve months ended December 31, 2020, with the remaining outstanding principal amount payable on the Maturity Date. The Princess Investment Credit Agreement continues to require payment of a \$60,000 loan fee at maturity.

The payment and performance of all the indebtedness and other obligations to Princess Investment, including all borrowings under the Princess Investment Credit Agreement, are guaranteed by the subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement entered into on August 10, 2015, as amended on December 21, 2015. The payment and performance of all of the indebtedness and other obligations to Princess Investment under the Princess Investment Credit Agreement and related agreements are secured by liens on substantially all of the Company’s assets and the assets of the Company’s subsidiary guarantors pursuant to a Pledge and Security Agreement entered into on August 10, 2015, as amended on December 21, 2015.

Pursuant to the Princess Investment Credit Agreement, the Company issued to Princess Investment warrants to purchase 2,000,000 shares of its common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.18 per share, and include a “cashless” exercise option.

On December 23, 2015, the Company received an advance from Princess Investment under the Princess Investment Credit Agreement in the amount of \$2,000,000, of which \$1,622,000 was used to pay in full all indebtedness outstanding under the Commercial Credit Agreement, dated December 31, 2013, with MUFG Union Bank N.A., which indebtedness was scheduled to mature on December 31, 2015.

Upon repayment of the indebtedness under the Company's Credit Agreement with Union Bank, Union Bank released its liens on the Company's assets and those of the Company's subsidiaries, Princess Investment became the only secured lender, and in addition to the Credit Agreement, the following agreements (the "Security Agreements") terminated in accordance with their terms: Continuing Guaranties, dated December 31, 2013, executed by the Company's current subsidiaries, Talon Technologies, Inc. and Tag-It Pacific Limited in favor of Union Bank; Security Agreements, dated December 31, 2013, executed by the Company and its current domestic subsidiary, Talon Technologies, Inc., and Union Bank; a Debenture executed by Tag-It Pacific Limited and Union Bank; an Intercreditor Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank; and a Subordination Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

After consideration of FASB ASC 480 “*Distinguishing Liability and Equity*” and ASC 815 “*Derivatives and Hedging*”, the Company concluded that the warrants issued to Princess Investment should be recorded as an equity instrument. The fair value of the first one million warrants of \$130,000 issued with the debt facility at August 10, 2015 and the fair value of the additional two million warrants of \$320,000 issued with the debt facility at December 21, 2015 were valued using the Black-Scholes model. The fair value of the warrants was recorded as additional paid in capital and reflected as a debt discount to the face value of the Revolving Line of Credit, which discount will be amortized over the term of the Loan and recognized as additional interest costs as amortized.

At December 31, 2016, the Company had an outstanding principal balance of \$4,455,643 under the Revolving Line of Credit, and approximately \$1,544,357 remained in available borrowings under the Revolving Line of Credit as of December 31, 2016.

| | December 31, | |
|---|---------------------|-------------|
| | 2016 | 2015 |
| \$6,000,000 revolving line of credit from related party and accrued interest payable per terms under Princess Investment Credit Agreement through maturity date of December 21, 2020; interest at a rate per annum of 11.5% as of December 31, 2016 | \$4,455,643 | \$4,011,346 |
| Less: Debt discounts net of related amortization | (342,028) | (428,114) |
| Less: Deferred financing costs net of related amortization | (72,270) | (90,460) |
| Revolving line of credit, net of debt discounts and deferred financing costs | 4,041,345 | 3,492,772 |
| Less: Current portion | - | - |
| Revolving line of credit, net of debt discounts, deferred financing costs and current portion | \$4,041,345 | \$3,492,772 |

Future minimum annual payments under the Revolving Line of Credit obligation are as follows:

| Years ending December 31, | Amount | Principal (1) | Interest |
|----------------------------------|---------------|--------------------------|-----------------|
|----------------------------------|---------------|--------------------------|-----------------|

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| | | | |
|-------|-------------|-------------|-------------|
| 2017 | \$512,399 | \$- | \$512,399 |
| 2018 | 796,512 | 300,000 | 496,512 |
| 2019 | 875,646 | 420,000 | 455,646 |
| 2020 | 4,124,592 | 3,735,643 | 388,949 |
| Total | \$6,309,149 | \$4,455,643 | \$1,853,506 |

(1) Includes \$455,643 compounded interest from December 21, 2015 through November 30, 2016.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

| | Years Ended December 31, | | |
|---|---------------------------------|------------------|------------------|
| | 2016 | 2015 (1) | 2014 (1) |
| Revolving line of credit from related party | \$487,816 | \$120,883 | \$61,733 |
| Revolving credit loan | - | 93,280 | 257,071 |
| Term loan payable | - | 94,907 | - |
| Amortization of deferred financing costs | 18,190 | 152,589 | 90,572 |
| Amortization of debt discounts | 86,086 | 21,885 | - |
| Total Credit Facilities related interest expense | 592,092 | 483,544 | 409,376 |
| Other interest expense, net | 27,338 | 29,891 | 1,894 |
| Interest expense, net | \$619,430 | \$513,435 | \$411,270 |

(1) Interest expense related to a retired Debt Facility.

Retired Union 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 initially provided for a 24 month revolving loan commitment and a 36 month term loan. The term loan was extinguished during the quarter ended September 30, 2015, and the revolving loan commitment with Union Bank paid off on December 23, 2015, using proceeds from related party borrowings (See Revolving Line of Credit from Related Party).

The revolving loan commitment included 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 December 31, 2014.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Credit Agreement initially provided for a term loan in the amount of \$5,000,000 (the “Term Loan Payable” and together with the Revolving Credit Loan, the “Union Bank 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 events of default, applicable to the Company and its subsidiaries which are customary for Union Bank Credit Facilities of this type. The Credit Agreement initially contained financial covenants applicable to the Company and its subsidiaries 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 Credit Agreement was further amended to change 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 during the third quarter of 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 Company did not satisfy the minimum EBITDA requirement for the 12-month period ended June 30, 2015, due primarily to a \$715,000 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. On August 4, 2015, the Company obtained a waiver from Union Bank of this minimum EBITDA requirement non-compliance and 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 Union Bank Credit Facilities were 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).

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 of the outstanding Term Loan Payable in the principal amount of \$1,440,278 plus accrued and unpaid interest by August 31, 2015. In connection with the amendment, the Company incurred approximately \$18,000 in legal fees, representing additional financing costs to the Union Bank Credit Facilities. On August 11, 2015, the Company received an advance from Princess Investment, and on August 12, 2015, the Company paid off \$1,440,278 in outstanding Term Loan Payable from Union Bank as well as the unpaid interest.

During the year ended December 31, 2015, the Company obtained advances under the Revolving Credit Loan of \$700,000 and made repayments of \$2,200,000 during the year, resulting in no outstanding Revolving Credit Loan borrowing at December 31, 2015.

Capital Leases

The Company has financed purchases of furniture and fixtures through various capital lease obligations which bear interest at a rate of 8% per annum. Under these obligations, the Company is required to make monthly payments of principal and interest through May 2019.

At December 31, 2016, total property and equipment under capital lease obligations and related accumulated depreciation was \$94,739 and \$31,580, respectively. At December 31, 2015, total property and equipment under capital lease obligations and related accumulated depreciation was \$94,739 and \$12,632, respectively.

Future minimum annual payments under these capital lease obligations are as follows:

| Years ending December 31, | Amount |
|----------------------------------|---------------|
|----------------------------------|---------------|

| | |
|-----------------------------------|----------|
| 2017 | \$27,728 |
| 2018 | 27,728 |
| 2019 | 11,554 |
| Total payments | 67,010 |
| Less amount representing interest | (6,226) |
| Balance at December 31, 2016 | 60,784 |
| Less current portion | (23,749) |
| Long-term portion | \$37,035 |

NOTE 3 - STOCKHOLDERS' EQUITY

Authorized Common Stock and Preferred Stock

The Company's Certificate of Incorporation currently authorizes 300,000,000 shares of common stock and 3,000,000 shares of preferred stock, each having a par value of \$0.001 per share. No shares of preferred stock were outstanding at December 31, 2016 and 2015.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - STOCK-BASED COMPENSATION

The Company accounts for stock-based awards to employees and directors in accordance with FASB ASC 718, “*Compensation - Stock Compensation*” (“ASC 718”), 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. Options issued to all other non-employee parties are accounted for in accordance with the provisions of FASB ASC 505-50, “*Equity-Based Payments to Non-Employees*”.

Stock Options and Warrants

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 (which was adopted on October 1, 1997) 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. No further awards will be granted under the 2007 Stock 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.

Options granted for the years ended December 31, 2016, 2015 and 2014 totaled 4,525,000, 800,000 and 4,045,000, respectively.

During the year ended December 31, 2016, options were exercised to acquire 20,000 shares of common stock under the 2008 Stock Incentive Plan, and 13,576 shares were retained by the Company in payment of the weighted average exercise per share of \$0.06 and the tax associated with the exercise of the options. At the time of exercise, the intrinsic value of the options exercised was \$0.14 per share, and the retained shares had a value of \$1,900.

During the year ended December 31, 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 weighted average exercise per share of \$0.18 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 year ended December 31, 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 year ended December 31, 2015.

On February 10, 2016, the Company issued warrants to purchase 250,000 shares of the Company's common stock to an outside services company. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.14 per share and include a "cashless" exercise provision. The issuance of these securities was exempt from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Pursuant to the Princess Investment Loan Agreement and Credit Agreement, during the year ended December 31, 2015, the Company issued Princess Investment warrants to purchase 3,000,000 shares of the Company's common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.18 per share on a cashless basis (See Note 2).

The following table summarizes the activity in the Company's share-based compensation plans and other share-based grants:

| | Number | Weighted |
|---|---------------|-----------------|
| | of | Average |
| | Shares | Exercise |
| | | Price |
| <i>Employees and Directors</i> | | |
| Options outstanding - January 1, 2014 | 6,221,725 | \$ 0.19 |
| Granted | 4,045,000 | \$ 0.21 |
| Exercised | (463,542) | \$ 0.13 |
| Cancelled | (55,416) | \$ 0.19 |
| Options outstanding – December 31, 2014 | 9,747,767 | \$ 0.20 |
| Granted | 800,000 | \$ 0.15 |
| Exercised | - | \$ - |
| Cancelled | (2,112,500) | \$ 0.25 |
| Options outstanding – December 31, 2015 | 8,435,267 | \$ 0.18 |
| Granted | 4,525,000 | \$ 0.14 |
| Exercised | (20,000) | \$ 0.06 |
| Cancelled | (3,007,000) | \$ 0.19 |
| Options outstanding – December 31, 2016 | 9,933,267 | \$ 0.16 |
| <i>Non Employees</i> | | |
| Warrants outstanding –January 1, 2014 and December 31, 2014 | - | \$ - |
| Granted | 3,000,000 | \$ 0.18 |
| Exercised | - | \$ - |
| Cancelled | - | \$ - |
| Warrants outstanding –December 31, 2015 | 3,000,000 | \$ 0.18 |

| | | |
|--|-----------|---------|
| Granted | 250,000 | \$ 0.14 |
| Exercised | - | \$ - |
| Cancelled | - | \$ - |
| Warrants outstanding – December 31, 2016 | 3,250,000 | \$ 0.18 |

The Company's determination of fair value of share-based payment awards on the date of grant uses the Black-Scholes model and the assumptions noted in the following table for the years indicated. Expected volatilities are based on the historical volatility of the Company's stock price and other factors. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards and actual and projected employee stock option exercise behaviors. The expected option term is estimated using the "safe harbor" provisions under ASC 718. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield in effect at the time of the grant.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | Years Ended December 31, | | |
|-----------------------------------|--------------------------|-----------|-----------|
| | 2016 | 2015 | 2014 |
| <i>Stock Options and Warrants</i> | | | |
| Expected volatility | 246-262% | 242-266% | 255-260% |
| Expected term (yrs) | 5.0 -6.1 | 5.0 -6.1 | 5.3 -6.1 |
| Expected dividends | - | - | - |
| Risk-free rate | 1.1 -1.6% | 1.6 -2.0% | 1.6 -1.8% |

A summary of the Company's stock option and warrants information as of December 31, 2016, 2015 and 2014 is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Intrinsic Value |
|--|------------------------|--|---|--------------------|
| <i>Employees and Directors Stock Options</i> | | | | |
| At December 31, 2016 | | | | |
| Outstanding | 9,933,267 | \$ 0.16 | 6.7 | \$ 0.01 |
| Vested and expected to vest | 9,836,988 | \$ 0.16 | 6.7 | \$ 0.01 |
| Exercisable | 5,316,181 | \$ 0.17 | 4.8 | \$ 0.02 |
| At December 31, 2015 | | | | |
| Outstanding | 8,435,627 | \$ 0.18 | 5.7 | \$ 0.03 |
| Vested and expected to vest | 8,381,079 | \$ 0.18 | 5.6 | \$ 0.04 |
| Exercisable | 6,322,764 | \$ 0.18 | 4.6 | \$ 0.04 |
| <i>Non-Employee Warrants</i> | | | | |
| At December 31, 2016 | | | | |
| Outstanding | 3,250,000 | \$ 0.18 | 3.9 | \$ - |
| Vested and expected to vest | 3,250,000 | \$ 0.18 | 3.9 | \$ - |
| Exercisable | 3,250,000 | \$ 0.18 | 3.9 | \$ - |
| At December 31, 2015 | | | | |
| Outstanding | 3,000,000 | \$ 0.18 | 4.9 | \$ - |
| Vested and expected to vest | 3,000,000 | \$ 0.18 | 4.9 | \$ - |

| | | | | |
|-------------|-----------|---------|-----|------|
| Exercisable | 3,000,000 | \$ 0.18 | 4.9 | \$ - |
|-------------|-----------|---------|-----|------|

The aggregate intrinsic value of the stock options and warrants was calculated as the difference between the exercise price of a stock option or a warrant, as applicable, and the quoted price of the Company's common stock at December 31, 2016 and 2015. The aggregate intrinsic value excludes stock options or warrants that have exercise prices in excess of the quoted price of the Company's common stock at December 31, 2016 and 2015.

The total grant date fair value of stock options and warrants that vested during the years ended December 31, 2016, 2015 and 2014 was \$209,850, \$651,024 and \$129,896, respectively. Stock-based compensation expense for the years ended December 31, 2016, 2015 and 2014 was \$286,833, \$129,052 and \$243,377 respectively.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

There were approximately \$551,946 of total unrecognized compensation costs related to non-vested stock options as of December 31, 2016. This cost is expected to be recognized over a weighted-average period of 6.7 years. There were approximately \$363,197 of total unrecognized compensation costs related to non-vested stock options as of December 31, 2015. This cost was expected to be recognized over the weighted-average period of 5.7 years.

Restricted Stock Units (RSU's)

There were no outstanding RSUs and no unamortized stock-based compensation expense related to RSUs as of December 31, 2016, 2015 and 2014.

NOTE 5 - NET INCOME PER SHARE

The following table presents the basic and diluted net income per share for each period presented:

| | Net income (loss) | Shares | Per Share Amount |
|--|---------------------------------------|---------------|--------------------------------------|
| Year ended December 31, 2014 | | | |
| Basic net income: | | | |
| Net income | \$572,069 | 92,153,648 | \$ 0.01 |
| Effect of Dilutive Securities - Options | - | 2,147,518 | 0.00 |
| Diluted net income per share | \$572,069 | 94,301,166 | \$ 0.01 |
| Year ended December 31, 2015 | | | |
| Basic net income: | | | |
| Net income | \$511,327 | 92,267,831 | \$ 0.01 |

| | | | |
|---------------------------------|-----------|------------|---------|
| Effect of Dilutive Securities - | | | |
| Options | - | 1,253,978 | 0.00 |
| Diluted net income per share | \$511,327 | 93,521,809 | \$ 0.01 |

Year ended December 31, 2016

| | | | |
|---------------------------------|-----------|------------|---------|
| Basic net income: | | | |
| Net income | \$994,878 | 92,271,868 | \$ 0.01 |
| Effect of Dilutive Securities - | | | |
| Options | - | 1,052,823 | 0.00 |
| Diluted net income per share | \$994,878 | 93,324,691 | \$ 0.01 |

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended December 31, 2016, options to purchase 2,021,667 shares of common stock exercisable between \$0.04 and \$0.11 per share were included in the computation of diluted net income per share. Options to purchase 7,911,600 shares of common stock exercisable between \$0.10 and \$1.33 per share and warrants to purchase 3,250,000 shares of common stock exercisable between \$0.14 and \$0.18 per share, were outstanding, but were not included in the computation of diluted net income per share applicable to common stockholders because they would have an antidilutive effect on the net income per share.

For the year ended December 31, 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. Options to purchase 5,743,600 shares of common stock exercisable between \$0.15 and \$1.33 per share and warrants to purchase 3,000,000 shares of common stock exercisable at \$0.18 per share, were outstanding, but were not included in the computation of diluted net income per share applicable to common stockholders because they would have an antidilutive effect on the net income per share.

For the year ended December 31, 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. Options to purchase 4,681,100 shares of common stock exercisable between \$0.21 and \$5.23 per share were outstanding, but were not included in the computation of diluted net income per share applicable to common stockholders because they would have an antidilutive effect on the net income per share.

NOTE 6 - INCOME TAXES

The components of the provision for income taxes included in the consolidated statements of operations are as follows:

Years Ended December 31,
2016 2015 2014

Current:

| | | | |
|---------------|---------|---------|---------|
| Federal | \$- | \$- | \$- |
| State | (129) | 3,294 | 5,596 |
| Foreign | 280,429 | 190,181 | 445,696 |
| Total current | 280,300 | 193,475 | 451,292 |

Deferred:

| | | | |
|----------------|-------------|-----------|-----------|
| Federal | 491,014 | 56,835 | 259,028 |
| State | 328,380 | 4,051 | 68,214 |
| Foreign | (2,369) | 7,300 | (22,168) |
| Total deferred | 817,025 | 68,186 | 305,074 |
| Total | \$1,097,325 | \$261,661 | \$756,366 |

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

A reconciliation of the statutory Federal income tax rate with the Company's effective income tax rate is as follows:

| | Years Ended December 31, | | |
|---|-------------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| <i>Current:</i> | | | |
| Federal statutory rate | 34.0% | 34.0 % | 34.0 % |
| State taxes, net of federal benefit | 10.4 | 0.6 | 3.7 |
| Change in effective foreign tax rate | 3.1 | (4.1) | (12.5) |
| Foreign dividend, net of foreign tax credit | - | 3.8 | 21.1 |
| Other permanent differences | 3.6 | 6.2 | 8.8 |
| Change in valuation allowance | 1.4 | (14.6) | (1.9) |
| Change in uncertainty in income taxes | - | - | - |
| Other | (0.1) | 8.0 | 3.7 |
| Total | 52.4% | 33.9 % | 56.9 % |

Net income before income taxes is as follows:

| | Years Ended December 31, | | |
|----------|---------------------------------|-------------|--------------|
| | 2016 | 2015 | 2014 |
| Domestic | \$1,466,325 | \$574,028 | \$(151,579) |
| Foreign | 625,878 | 198,960 | 1,480,014 |
| Total | \$2,092,203 | \$772,988 | \$1,328,435 |

The primary components of temporary differences which give rise to the Company's deferred tax being presented as part of Deferred income tax assets, net (in long term assets), or Deferred income tax liabilities (in long term liabilities) in the Company's Consolidated Balance Sheet are as follows:

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | December 31, | |
|--|---------------------|-------------|
| | 2016 | 2015 |
| <i>Net deferred income taxes:</i> | | |
| Net operating loss carry-forward | \$4,989,624 | \$5,840,011 |
| Intangible assets, net | (1,426,909) | (1,304,246) |
| Property and equipment, net | (16,058) | (62,447) |
| Related party interest | 127,779 | 4,486 |
| Credit carryforwards | 1,212,818 | 1,019,565 |
| Stock awards expense | 317,041 | 351,375 |
| Payroll | 52,664 | 240,915 |
| Other | 62,303 | 17,393 |
| Total | 5,319,262 | 6,107,052 |
| Less: Valuation allowance | (98,281) | (69,046) |
| Net deferred income taxes | \$5,220,981 | \$6,038,006 |
| Presented as part of: | | |
| Current deferred income tax assets, net | \$- | \$- |
| Deferred income tax assets, net | \$5,224,018 | \$6,043,412 |
| Deferred income tax liabilities | \$(3,037) | \$(5,406) |

For the years ended December 31, 2016, 2015 and 2014 there were no unrecognized tax benefits as a result of tax positions taken during a prior period or during the current period, and there were no decreases in the unrecognized tax benefits relating to settlements with taxing authorities.

At December 31, 2016 and 2015, the Company had Federal net operating loss carry-forwards (or “NOLs”) of approximately \$12.6 million and \$14.3 million, respectively, and State NOLs of \$15.0 million and \$18.4 million, respectively. The Federal NOL and State NOL are available to offset future taxable income through 2032. Section 382 of the Internal Revenue Code places a limitation on the ability to realize net operating losses in future periods if the ownership of the Company has changed more than 50% within a three-year period.

The provisions of ASC 740 require the establishment of a valuation allowance unless, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will be realized. An important factor in determining whether a deferred tax asset will be realized in accordance with ASC 740 is whether there has been sufficient income realized in recent years and whether sufficient income is expected to be realized in

future years to utilize the deferred tax asset.

The Company maintains a valuation allowance for its deferred tax assets until evidence exists to support the modification of the allowance. At the end of each period, the Company reviews supporting evidence, including the performance against sales and income projections, to determine if a modification of the valuation allowance is warranted. If it is determined that it is more likely than not that the Company will be not be able to recognize all or a greater portion of its deferred tax assets, the Company will at that time increase the valuation allowance.

In 2016 the Company did not include in its consolidated U.S. federal tax provision a deemed dividend and related gross-up due to earnings from the Company's Hong Kong foreign subsidiary.

In 2015 the Company included in its consolidated U.S. federal tax provision approximately \$150,000 deemed dividend and related gross-up due to earnings from the Company's Hong Kong foreign subsidiary.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In 2014 the Company included in its consolidated U.S. federal tax return \$1.4 million deemed dividend and related gross-up due to earnings from the Company's Hong Kong foreign subsidiary.

Tax years subject to examination by the tax authorities for Talon International, Inc. for Federal returns (US) are 2013 through 2016, for Talon International, Inc. State returns (US) are 2013 through 2016, and for the foreign subsidiaries, 2007 through 2016.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company is a party to a number of non-cancelable operating lease agreements involving buildings and equipment, which expire at various dates through 2020. The Company accounts for its leases in accordance with FASB ASC 840 "Leases," whereby step provisions, escalation clauses, tenant improvement allowances, increases based on an existing index or rate, and other lease concessions are accounted for in the minimum lease payments and are charged to the statement of operations on a straight-line basis over the related lease term.

The future minimum lease commitments at December 31, 2016, are approximately as follows:

| Years Ended December 31, | Amount |
|---------------------------------|---------------|
| 2017 | \$884,540 |
| 2018 | 584,221 |
| 2019 | 443,359 |

| | |
|------------------------|-------------|
| 2020 | 181,889 |
| Total minimum payments | \$2,094,009 |

Total rental expense for the years ended December 31, 2016, 2015 and 2014 aggregated \$949,897, \$878,518 and \$793,385, respectively.

Profit Sharing Plan

In October 1999, the Company established a 401(k) profit-sharing plan for the benefit of eligible employees. The Company may make annual contributions to the plan as determined by the Board of Directors. The Company matched contributions for all employees under the Company's 401(k) plan up to a maximum of 50% of an employee's contribution to a maximum of \$2,000 beginning in January 2014, subject to any limitations imposed by ERISA.

Total contributions for the years ended December 31, 2016, 2015 and 2014 amounted to \$50,430, \$60,055, and \$43,846, respectively.

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 condition if adversely determined against the Company.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director’s 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 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 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. Accordingly, the Company has not recorded any related liabilities.

NOTE 8 - SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

The Company manufactures and distributes a full range of zipper (Talon Zipper) and trim (Talon Trim) components, which includes stretch technology component products, to specialty retailers and mass merchandisers. The Company’s organization is based on operating divisions representing these major product lines, and the Company’s Chief

Operating Decision Makers (“CODM”, identified as the Company’s executive officers with the oversight of Talon’s Board of Directors) use these divisions to assess performance, allocate resources and make other operating decisions.

During the fourth quarter of 2015, the Company realigned how it reports its operating segments to better conform to the way management views the business. In making this determination, the Company examined how the CODM evaluates the performance of the Company and as such reconsidered the aggregation of reporting segments in accordance with the aggregation criteria under ASC 280, *Segment Reporting*.

As a result of this assessment, the Company has identified and realigned the reporting of its operating segments into two reporting segments (Talon Zipper and Talon Trim) and has reclassified prior period results to reflect these product categories. The Tekfit operating segment results are now aggregated and reported as part of the Trim operating segment.

Information about the assets for each of the reportable segments is not maintained by the Company and therefore is not reviewed by the CODM; the CODM reviews and assesses assets on a consolidated basis. As a result, information about the assets for each of the reportable segments is not included on the Company’s segment reporting footnote.

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

As the Company evolves, adjustments may be made as to how the Company allocates resources and analyzes performance, which can result in a change to these segments.

The net revenues and operating margins for the two reporting segments are as follows:

| | Years Ended December 31, 2016 | | |
|------------------------|--------------------------------------|--------------|---------------------|
| | Talon | Talon | |
| | Zipper | Trim | Consolidated |
| Net sales | \$17,582,328 | \$30,677,527 | \$48,259,855 |
| Cost of goods sold | 12,728,010 | 17,903,060 | 30,631,070 |
| Gross profit | \$4,854,318 | \$12,774,467 | 17,628,785 |
| Operating expenses | | | 14,917,152 |
| Income from operations | | | \$2,711,633 |

| | Years Ended December 31, 2015 | | |
|------------------------|--------------------------------------|--------------|---------------------|
| | Talon | Talon | |
| | Zipper | Trim | Consolidated |
| Net sales | \$21,283,641 | \$27,069,058 | \$48,352,699 |
| Cost of goods sold | 15,708,581 | 16,361,020 | 32,069,601 |
| Gross profit | \$5,575,060 | \$10,708,038 | 16,283,098 |
| Operating expenses | | | 14,862,626 |
| Income from operations | | | \$1,420,472 |

Years Ended December 31, 2014

| | Talon | Talon | Consolidated |
|------------------------|---------------|--------------|---------------------|
| | Zipper | Trim | |
| Net sales | \$24,709,639 | \$24,613,045 | \$49,322,684 |
| Cost of goods sold | 17,951,591 | 15,363,182 | 33,314,773 |
| Gross profit | \$6,758,048 | \$9,249,863 | 16,007,911 |
| Operating expenses | | | 14,268,206 |
| Income from operations | | | \$1,739,705 |

The Company distributes its products internationally and has reporting requirements based on geographic regions. Long-lived assets are attributed to countries based on the location of the assets and revenues are attributed to countries based on customer delivery locations, as follows:

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

| | Years Ended December 31, | | |
|---------------|---------------------------------|--------------|--------------|
| | 2016 | 2015 | 2014 |
| Sales: | | | |
| United States | \$4,172,104 | \$3,416,139 | \$4,396,352 |
| China | 12,440,661 | 12,649,786 | 15,564,055 |
| Hong Kong | 11,616,502 | 10,637,605 | 11,496,969 |
| Bangladesh | 3,534,179 | 3,103,010 | 2,522,576 |
| Vietnam | 3,633,967 | 3,920,185 | 2,377,472 |
| India | 2,880,394 | 3,290,555 | 2,086,261 |
| Other | 9,982,048 | 11,335,419 | 10,878,999 |
| Total | \$48,259,855 | \$48,352,699 | \$49,322,684 |

| | Years Ended | |
|---------------------------|---------------------|-------------|
| | December 31, | |
| | 2016 | 2015 |
| Long-lived Assets: | | |
| United States | \$4,915,383 | \$4,793,042 |
| China | 164,081 | 213,887 |
| Hong Kong | 66,347 | 88,912 |
| India | 4,993 | - |
| Total | \$5,150,804 | \$5,095,841 |

NOTE 9 - MAJOR CUSTOMERS AND VENDORS

Our sales depend to a significant extent upon the Company's customers. If we lose our significant brand nominations, or these customers fail to purchase our products at anticipated levels, or our relationship with these customers or the brands and retailers they serve diminishes, it may have an adverse effect on our results from operations.

For the years ended December 31, 2016, 2015 and 2014, the Company's three largest customers represented approximately 8%, 6% and 5%, respectively, of consolidated net sales.

Three vendors, each representing more than 10% of the Company's purchases, accounted for approximately 67% of the Company's purchases for the year ended December 31, 2016, approximately 74% of the Company's purchases for the year ended December 31, 2015, and approximately 68% of the Company's purchases for the year ended December 31, 2014.

Included in accounts payable and accrued expenses at December 31, 2016 and 2015 is \$4,006,087 and \$3,733,646 due to these vendors.

NOTE 10 - QUARTERLY RESULTS (UNAUDITED)

Quarterly results for the years ended December 31, 2016 and 2015 are reflected:

TALON INTERNATIONAL, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

| | Year Ended December 31, 2016 | | | |
|---|-------------------------------------|--------------|--------------|--------------|
| | 1st | 2nd | 3rd | 4th |
| Net sales | \$11,264,632 | \$14,454,889 | \$10,856,283 | \$11,684,051 |
| Gross profit | \$4,164,259 | \$5,451,546 | \$3,801,107 | \$4,211,873 |
| Income from operations | \$235,415 | \$1,803,018 | \$228,642 | \$444,558 |
| Net income (loss) | \$49,117 | \$957,698 | \$20,695 | \$(32,632) |
| Net income (loss) per share | \$- | \$0.01 | \$- | \$- |
| Basic and diluted net income (loss) per share applicable to Common Stockholders | \$- | \$0.01 | \$- | \$(0.00) |
| Total comprehensive income (loss) | \$48,619 | \$945,945 | \$18,419 | \$(47,102) |

| | Year Ended December 31, 2015 | | | |
|---|-------------------------------------|--------------|--------------|--------------|
| | 1st | 2nd | 3rd | 4th |
| Net sales | \$10,808,422 | \$15,787,278 | \$9,992,091 | \$11,764,908 |
| Gross profit | \$3,563,907 | \$5,032,959 | \$3,373,541 | \$4,312,691 |
| Income (loss) from operations | \$(145,819) | \$772,841 | \$163,231 | \$630,219 |
| Net income (loss) | \$(159,223) | \$448,507 | \$(90,353) | \$312,396 |
| Net income (loss) per share | \$- | \$- | \$- | \$- |
| Basic and diluted net income (loss) per share applicable to Common Stockholders | \$- | \$- | \$- | \$- |
| Total comprehensive income (loss) | \$(158,944) | \$448,818 | \$(100,573) | \$308,240 |

The Company typically experiences seasonal fluctuations in sales volume consistent with the purchase demands within the apparel industry. In most years, these seasonal fluctuations result in lower sales volumes for the Company's business in the first and fourth quarters of each year, with the second quarter being the Company's peak sales period, followed by the Company's third quarter due to the seasonal buying patterns by the majority of the Company's customers. Sales of the Company's products typically precede the retail sales patterns by 90 to 150 days. The apparel retailers typically experience their highest sales volumes during the fourth quarter in association with year-end holiday purchases, accordingly this order demand typically results in higher second and third calendar quarter revenues. Backlogs of sales orders are not considered material in the industries in which the Company competes, which reduces the predictability of the Company's sales and reinforces the volatility of these cyclical buying patterns on the Company's sales volume.

Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not aggregate to the per share amounts for the year.

NOTE 11 - SUBSEQUENT EVENTS

The Company evaluated subsequent events after the balance sheet date of December 31, 2016 through the date of the filing of this report, and determined that there were no reportable subsequent events.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. 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 principal financial officer, and Jamey Johns, our principal accounting 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 Mr. Johns concluded that these disclosure controls and procedures were effective as of the end of the period covered by this Annual Report on Form 10-K.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, the Company's management has conducted an assessment, including testing, using the criteria in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for

external purposes in accordance with accounting principles generally accepted in the United States. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Based on its assessment, our management has concluded that control over financial reporting was effective as of December 31, 2016.

Pursuant to applicable law, this annual report is not required to include an attestation report of our registered public accounting firm regarding internal control over financial reporting.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of our fiscal year ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth the name, age and position of each of our executive officers and directors as of March 27, 2017.

| Name | Age | Position |
|----------------------------------|------------|---|
| Directors: | | |
| Mark Dyne ⁽¹⁾ | 56 | Chairman of the Board of Directors |
| Larry Dyne ^{(1) (2)} | 44 | Chief Executive Officer, Interim Chief Financial Officer and Director |
| David Ellis | 53 | Director |
| Robert L. Golden | 54 | Director |
| Other Executive Officers: | | |
| Gary Dyne ⁽²⁾ | 60 | Executive Vice President of Global Sales |
| Peter Vaz | 48 | Executive Vice President of Asia Operations |

(1) Mark Dyne and Larry Dyne are brothers.

(2) Gary Dyne and Larry Dyne are first cousins.

Directors:

Mark Dyne Mr. Dyne has served as Chairman of the Board of Directors since 1997. Mr. Dyne currently serves as the Chief Executive Officer and the Managing Partner of Europlay Capital Advisors, LLC, a merchant banking and advisory firm. Mr. Dyne previously served on the Board of Directors of Skype Global S.a.r.l. the world's leader in V.O.I.P. communications. Mr. Dyne was also previously Chairman and Chief Executive Officer of Sega Gaming Technology Inc. (USA), and Chairman and Chief Executive Officer of Virgin Interactive Entertainment Ltd. Mr. Dyne was a founder and former director of Sega Ozisoft Pty Ltd. Mr. Dyne was nominated to our Board of Directors for his extensive domestic and international management experience.

Larry Dyne Larry Dyne is our Chief Executive Officer and has served as our Interim Chief Financial Officer since July 22, 2016. Prior to this, Mr. Dyne served as our President from 2009 until his appointment as Chief Executive Officer in April 2015. Mr. Dyne has been our employee since 1997, and an employee of a predecessor company since 1992. Over his tenure, Mr. Dyne has filled a number of roles with us including Executive Vice President of Sales as well as Vice President of Product Development and Global Sourcing, and Vice President of Trim Sales with responsibility for all domestic print production. Through these positions, Mr. Dyne has established extensive and long-term relationships with the world's top brands and clothing retailers.

**David
Ellis**

David Ellis has served on our Board of Directors since October 2010. Mr. Ellis is a co-founder of GemCap, a provider of asset-based loans, ranging from \$1 million to \$10 million, as a senior-secured lender. Through 2006, Mr. Ellis served as the President of Buxbaum Group. Mr. Ellis has twenty years of experience in the acquisition, insolvency and turnaround management businesses during which he built several international businesses, with an emphasis in the apparel industry. Mr. Ellis was nominated to our Board of Directors for his extensive domestic and international management experience, and knowledge of associated industry practices and trends, and for his financial and investment management expertise.

**Robert
L.
Golden**

Robert Golden joined our Board of Directors in September 2013. Mr. Golden has served as a partner at the accounting firm of Cohen, Bender & Golden, LLP in Los Angeles, California since 2015. Mr. Golden has also served as a partner at the accounting firm of Fenton & Ross in Los Angeles, California during 2013-2015. Mr. Golden has also served as Chief Financial Officer, since 2008, for Promo Shop, Inc., a promotional merchandising and marketing services company that provides creative branded merchandise and custom premiums. From 2004 to 2012, Mr. Golden was a Principal with the accounting firm of Saffer & Flint A.C. in Los Angeles. Prior to 2004, Mr. Golden spent nearly 20 years with national and regional accounting firms beginning with Ernst & Young in 1984. Mr. Golden is licensed as a Certified Public Accountant. Mr. Golden earned his Bachelor of Science in Business Administration with an emphasis in Accounting from the University of Southern California. Mr. Golden was nominated to our Board of Directors for his extensive management experience, knowledge of associated industry practices and trends, and for his financial management expertise.

**Other
Executive
Officers:**

**Gary
Dyne**

Gary Dyne was appointed Executive Vice President Global Accounts in April 2015. He has been our employee since 2002 and previously served as Vice President of Sales and Marketing. Mr. Dyne is responsible for driving and accelerating sales strategies from implementation thru to execution. Mr. Dyne has extensive knowledge of the industry and leadership expertise managing a global sales team. In addition to managing a global sales team, Mr. Dyne is also responsible for managing many of the company's key accounts. He has developed long term key relationships with customers both domestically and internationally.

**Peter
Vaz**

Peter Vaz was appointed as our Executive Vice President Asia in May 2015 and has served as Vice President Asia Sales since January 2011. Mr. Vaz has been with Talon since September 2006 and was formerly Director of Trims Operations until December 2010 overseeing Product Development, Supply Chain Management, Quality Assurance and Logistics. With over 20 years of industry experience, Mr. Vaz has fostered relationships across Asia with supply chain partners, clothing manufacturers and global brands. Mr. Vaz earned his Master in Business Administration from the University of Western Sydney, Australia after completing his Bachelor in Commerce with an accounting focus from Bombay University.

Director Nominations

Common Stock Director Nominations

Pursuant to a Subscription Agreement entered into with Kutula Holdings Ltd., we granted to 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 shares of our Common Stock. At this time, Kutula has not elected to nominate a director.

We do not currently have a standing nominating committee of the Board of Directors. The entire Board of Directors performs the duties of the nominating committee and is responsible for considering and approving nominations of candidates for directors, including determining the appropriate qualifications and experience required of such candidates, and related matters.

In carrying out their function to nominate candidates for election to the Board of Directors (the "Board" or "Board of Directors"), the Board considers the mix of skills, experience, character, commitment, and diversity of background of the Board of Directors at the time of such nominations. The Board of Directors believes that each candidate should be an individual who has demonstrated integrity and ethics in such candidate's personal and professional life, has an understanding of elements relevant to the success of a publicly-traded company and has established a record of professional accomplishment in such candidate's chosen field. Each candidate should be prepared to participate fully in Board's activities, including attendance at, and active participation in, meetings of the Board of Directors, and not have other personal or professional commitments that would, in the Board's judgment, interfere with or limit such candidate's ability to do so. The Board of Directors has no stated specific, minimum qualifications that must be met by a candidate for a position on our Board.

The Board of Directors' methods for identifying candidates for election to the Board (other than those proposed by our stockholders, as discussed below) include the solicitation of ideas for possible candidates from a number of sources including members of the Board, our executives, and other sources. The Board of Directors may also from time to time retain one or more third-party search firms to identify suitable candidates.

Our common stockholders may nominate one or more persons for election as a director at an annual meeting of stockholders if the stockholder complies with the notice, information and consent provisions contained in our Bylaws. The notice must be made in writing and include (1) the qualifications of the proposed nominee to serve on the Board of Directors, (2) the principal occupations and employment of the proposed nominee during the past five years, (3) directorships currently held by the proposed nominee and (4) a statement that the proposed nominee has consented to

the nomination. The recommendation should be addressed to our Secretary. During our fiscal year ended December 31, 2016, there were no changes to the procedures by which security holders may recommend nominees to our Board of Directors.

Board Committees

We do not currently maintain a separately designated audit, compensation, nominating or governance committee of the Board of Directors. The functions customarily delegated to these committees are performed by our full Board of Directors. The Board forms ad hoc committees from time to time to assist our Board in fulfilling its responsibilities with respect to matters that are the subject of the ad hoc committee's mandate.

Audit Committee and Audit Committee Financial Expert

The Company is not a "listed company" under SEC rules and is therefore not required to have a separate audit committee comprised of independent directors. Our full Board of Directors performs the functions of the audit committee. The Company has, however, determined that as of December 31, 2016, each of Messrs. Ellis and Golden is "independent" as that term is defined in Section 5605 of the NASDAQ Marketplace Rules applicable to companies listed on The NASDAQ Stock Market, and has also determined that each of Messrs. Ellis and Golden is an "audit committee financial expert" as defined in Item 407(d)(5) of Regulation S-K. The director biographies included above under this Item 10 describe the relevant experience of each director.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors and persons who own more than ten percent of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater-than-ten percent stockholders are required by Securities and Exchange Commission regulations to furnish us with all Section 16(a) forms they file. Based solely on our review of the copies of the forms received by us and written representations from certain reporting persons that they have complied with the relevant filing requirements, we believe that during the year ended December 31, 2016, all of our executive officers, directors and greater-than-ten percent stockholders complied with all Section 16(a) filing requirements.

Code of Ethics

We have adopted a Code of Ethical Conduct that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, as well as to our other employees and directors generally. A copy of our Code of Ethical Conduct is filed as an exhibit to our Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

The full Board of Directors is responsible for determining the compensation to be paid to our officers and directors, with recommendations from management as to the amount and/or form of officer compensation.

Our executive compensation program is administered by the Board of Directors. The Board is responsible for, among other functions: (1) reviewing and approving corporate goals and objectives relevant to the Chief Executive Officer's compensation and evaluating the performance of the Chief Executive Officer in light of these corporate goals and objectives; (2) administering our incentive-compensation and equity based plans; and (3) negotiating, reviewing and recommending the annual salary, bonus, stock awards and other benefits, direct and indirect, of the Chief Executive

Officer, and other current and former executive officers.

The Board of Directors also has the authority to select and/or retain outside counsel, compensation and benefits consultants, or any other consultants to provide independent advice and assistance in connection with the execution of its responsibilities. During the course of 2013, the Company utilized the services of a nationally recognized compensation consulting firm to recommend improvements to our executive and board compensation plans for alignment with our current business strategy. While the compensation consultant's analysis did not affect 2013 executive compensation, the Board of Directors considered the results from this study in formulating compensation plans for our executives beginning in 2014.

Our named executive officers for 2016 were as follows:

Larry Dyne, Chief Executive Officer effective April 13, 2015 (Interim Chief Financial Officer commencing on July 22, 2016).

Gary Dyne, Executive Vice President of Global Sales commencing on May 7, 2015.

Peter Vaz, Vice President of Asia Operations commencing on May 7, 2015.

Compensation Philosophy

Our executive compensation program is designed to drive company performance to maximize stockholder value while meeting our needs and the needs of our employees. The specific objectives of our executive compensation program include the following:

Alignment – to align the interests of executives and stockholders through equity-based compensation awards;

Retention – to attract, retain and motivate highly qualified, high performing executives to lead our continued growth and success; and

Performance – to provide rewards commensurate with performance by emphasizing variable compensation that is dependent upon the executive’s achievements and company performance.

In order to achieve these specific objectives, our executive compensation program is guided by the following core principles:

Rewards under incentive plans are based upon our short-term and longer-term financial results and increasing stockholder value;

Senior executive pay is set at sufficiently competitive levels to attract, retain and motivate highly talented individuals who are necessary for us to achieve our goals, objectives and overall financial success;

Compensation of an executive is based on such individual’s role, responsibilities, performance and experience, taking into account the desired pay relationships within the executive team; and

Our executive compensation program places a strong emphasis on performance-based variable pay to ensure a high pay-for-performance culture. Annual performance of our company, primarily in terms of performance measured by an adjusted earnings before interest, taxes, depreciation and amortization for the year, and the executive are taken into account in determining annual bonuses that ensure a high pay-for-performance culture.

Compensation Elements

We compensate senior executives through a variety of components, including base salary, annual incentives, equity incentives and benefits and perquisites, in order to provide our employees with a competitive overall compensation package. The mix and value of these components are impacted by a variety of factors, such as responsibility level, individual negotiations, performance and market practice. The purpose and key characteristics for each component are described below.

Base Salary

Base salary provides executives with a steady income stream and is based upon the executive's level of responsibility, experience, individual performance and contributions to our overall success. Competitive base salaries, in conjunction with other pay components, enable us to attract and retain highly talented executives. The Board typically sets base salaries for our senior executives at market levels. However, base salaries will vary in practice based upon an individual's performance, individual experience and negotiations, and for changes in job responsibilities.

Management Incentive Bonuses

Management incentive bonuses are a variable performance-based component of compensation. The primary objective of an annual incentive bonus is to reward executives for achieving corporate and individual goals and to align a meaningful portion of total pay opportunities for executives and other key employees to the attainment of our company's performance goals. These awards are also used as a means to recognize the contribution of our executive officers to overall financial, operational and strategic success.

Equity Incentives

Equity incentives are intended to align senior executive and stockholder interests by linking a meaningful portion of executive pay to long-term stockholder value creation and financial success over a multi-year period. Equity incentives are also provided to our executives to attract and enhance the retention of executives and to facilitate stock ownership by our senior executives. The Board of Directors also considers individual and company performance when determining long-term incentive opportunities.

Health & Welfare and 401-K Benefits

The named executive officers participate in a variety of retirement, health and welfare and paid time-off benefits designed to enable us to attract and retain our workforce in a competitive marketplace. Health and welfare and paid time-off benefits help ensure that we have a productive and focused workforce.

Severance and Change of Control Arrangements

We do not have a formal plan for severance or separation pay for our employees, but we typically include a severance provision in the employment agreements of our executive officers that is triggered in the event of involuntary termination without cause or in the event the employee terminates their employment for a good reason. As described above, our employment agreement with Larry Dyne provides a lump sum payment and benefits continuation as a result of an involuntary termination without cause or for good reason.

Other Benefits

In order to attract and retain highly qualified executives, we provide some of our named executive officers, with automobile allowances that we believe are consistent with current market practices. Our executives also may participate in a 401(k) plan under which we matched contributions for all employees up to 50% of an employee's contribution to a maximum of \$2,000 beginning in January 2014, subject to any limitations imposed by ERISA. Our foreign executive officer in our Hong Kong operations participates in a Mandatory Provident Fund (MPF) plan under which we matched 100% the mandatory contributions of all employees, which was calculated based on 5% of their income up to a maximum of HKD 1,500 or \$194 per month, and amounted to HKD18,000 or \$2,319 for the year ended December 31, 2016.

Other Factors Affecting Compensation

Accounting and Tax Considerations

We consider the accounting implications of all aspects of our executive compensation program. Our executive compensation program is designed to achieve the most favorable accounting (and tax) treatment possible as long as doing so does not conflict with the intended plan design or program objectives.

Process for Setting Executive Compensation

When making pay determinations for named executive officers, the Board considers a variety of factors including, among others: (1) actual company performance as compared to pre-established goals; (2) overall company performance and size relative to industry peers; (3) individual executive performance and expected contribution to our future success; (4) changes in economic conditions and the external marketplace and (5) in the case of named executive officers, other than Chief Executive Officer, the recommendation of our Chief Executive Officer. Ultimately, the Board uses its judgment when determining how much to pay our executive officers. The Board evaluates each named executive officer's performance during the year against established goals, leadership qualities, business responsibilities, current compensation arrangements and long-term potential to enhance stockholder value.

The opinions of outside consultants may also be taken into consideration in deciding what salary, bonus, long-term incentives and other benefits and severance to give each executive in order to meet our objectives stated above.

The Board considers compensation information data gathered from annual reports and proxy statements from companies that the Board generally considers comparable to us; compensation of other Company employees for internal pay and equity purposes; and levels of other executive compensation plans from compensation surveys.

The Board sets the pay for the named executive officers and other executives, by element and in the aggregate, at levels that it believes are competitive and necessary to attract and retain talented executives capable of achieving our long-term objectives.

Factors Considered

In administering the compensation program for senior executives, including named executive officers, the Board considers the following:

Cash versus non-cash compensation. The pay elements are cash-based except for the long-term incentive program, which may be cash-based, equity-based, or a combination;

Prior year's compensation. The Board of Directors considers the prior year's bonuses and long-term incentive awards when approving bonus payouts or equity grants;

Adjustments to Compensation. On an annual basis, and in connection with setting executive compensation packages, the Board of Directors reviews our operating income growth, earnings before interest and taxes growth, earnings per share growth, cash flow growth, operating margin, revenue growth and total stockholder return performance. In addition, the Board of Directors considers peer group pay practices, emerging market trends and other factors. No specific weighting is assigned to these factors nor are particular targets set for any particular factor. Total compensation from year to year can vary significantly based on our and the individual executive's performance; and

Application of discretion. It is our policy and practice to use discretion in determining the appropriate compensation levels considering performance.

COMPENSATION COMMITTEE REPORT

The full Board of Directors performs the functions of a compensation committee and is responsible for considering and making decisions regarding executive compensation and is responsible for administering our stock option and executive incentive compensation plans.

The Board of Directors has reviewed and discussed with management the Compensation Discussion and Analysis included in this report. Based on the review and discussion with management, the Board of Directors has determined that the Compensation Discussion and Analysis should be included in the Company's Annual Report on Form 10-K.

Board of Directors

Mark Dyne

Larry Dyne

David Ellis

Robert L. Golden

March 27, 2017

EXECUTIVE COMPENSATION**Summary Compensation Table**

The following table sets forth, as to each person who served as Chief Executive Officer during 2016 and the two mostly highly compensated executive officers other than the Chief Executive Officer at the end of the 2016 whose compensation exceeded \$100,000 (referred to as “named executive officers”), information concerning all compensation earned for services to us in all capacities for 2016 and 2015.

| | Year | Salary | Bonus (1) | Option Award (2) | Non-Equity Incentive Plan Compensation (3) | All Other Compensation (5) | Total |
|------------------------------|------|-----------|--------------|------------------------|---|----------------------------------|-------------|
| Larry Dyne | | | | | | | |
| CEO, Interim CFO | 2016 | \$425,000 | \$- | \$162,298 | \$ 368,470 | \$ 51,377 | \$1,007,145 |
| | 2015 | 400,000 | - | - | 220,200 | 39,711 | 659,911 |
| Gary Dyne | | | | | | | |
| Executive VP Global Sales | 2016 | \$220,000 | \$83,265 | \$51,933 | \$ 5,920 | \$ 42,572 | \$403,690 |
| | 2015 | 200,000 | 25,000 | 14,995 | 32,774 | 26,009 | 298,778 |
| Peter Vaz (4) | | | | | | | |
| Executive VP Asia Operations | 2016 | \$201,003 | \$89,534 | \$51,935 | \$ - | \$ 4,982 | \$347,454 |
| | 2015 | 201,235 | 60,000 | 14,995 | 8,877 | 5,104 | 290,211 |

Bonus compensation consists of discretionary bonuses awarded to the named executives based upon performance.

(1) Bonuses are reported for the year in which they were earned and are generally paid in the first quarter of the subsequent year.

(2) Option award represents the aggregate grant date fair value computed in accordance with ASC 718 with respect to option awards granted in the applicable year. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to these grants, refer to Note 4 of our accompanying Notes to Consolidated Financial Statements in this Annual Report on Form 10-K. These amounts do not reflect the actual value that may be realized by the named executive officers which depends on the value of our shares in the future.

Non-equity incentive plan compensation consists of awards from the earnings before interest, taxes, depreciation and amortization (“EBITDA”) Bonus Plan, a cash incentive plan, which was established pursuant to our (3)employment agreement with Mr. Larry Dyne, or commissions based on sales for Mr. Gary Dyne and Mr. Vaz. Bonuses and commissions are reported for the year in which they were earned and are generally paid in the first quarter of the subsequent year.

(4) Amount paid or accrued in HKD were translated to USD using the average exchange rate for the month they were paid or accrued in our financials.

(5) All other compensation consists of the following (amounts in dollars):

| | Year | Health and medical insurance premiums | Life and disability insurance | Company matching contributions under Defined Contribution Plans | Severance payments | Other personal benefits | Total |
|------------------------------|------|---|-------------------------------------|---|-----------------------|-------------------------------|-----------|
| Larry Dyne | | | | | | | |
| CEO, Interim CFO | 2016 | \$ 27,714 | \$ 5,788 | \$ 2,000 | \$ - | \$ 15,875 | \$ 51,377 |
| | 2015 | 18,944 | 5,963 | 2,000 | - | 12,804 | 39,711 |
| Gary Dyne | | | | | | | |
| Executive VP Global Sales | 2016 | \$ 33,229 | \$ 1,068 | \$ 2,000 | \$ - | \$ 6,275 | \$ 42,572 |
| | 2015 | 21,304 | 1,244 | 2,000 | - | 1,461 | 26,009 |
| Peter Vaz (4) | | | | | | | |
| Executive VP Asia Operations | 2016 | \$ 2,140 | \$ 523 | \$ 2,319 | \$ - | \$ - | \$ 4,982 |
| | 2015 | 2,219 | 563 | 2,322 | - | - | 5,104 |

Executive Compensation

CEO and Interim CFO. The 2015 and 2016 base salary and other compensation for Larry Dyne, our Interim CFO effective July 22, 2016, our CEO effective April 13, 2015 and our President through April 10, 2015, were determined in accordance with our employment agreement and related amendments with Mr. Dyne. The terms and conditions established in this agreement were the result of consideration of our operating performance levels both prior to and at the time of entering into the agreement, comparative industry compensation levels and negotiations with Mr. Dyne. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Long-term equity in the form of options were granted to Mr. Dyne as an inducement to maximize performance and increase stockholder value. In 2016 and 2014, respectively, 1,250,000 and 1,000,000 shares of common stock were granted. The option grants were established to vest monthly over a four-year term, after a minimum initial term of twelve months. The options have an exercise price of \$0.14 and \$0.21 per share, respectively, and have a term of ten years. On July 30, 2010, Mr. Dyne was granted an RSU Award for 5,778,500 shares of our common stock. The RSU Award vested 50% on a date which was 13 months following the grant date, and vested an additional 10% on each date which was 18, 24, 30, 36 and 42 months following the grant date, and was subject to full acceleration of vesting upon a change in control of our Company, as defined in the RSU Award agreement. In addition to the long term incentive, Mr. Dyne was entitled to receive an annual cash bonus in 2014, 2015 and 2016 in an amount equal to a percentage of his base salary upon the Company achieving actual adjusted EBITDA, revenue and gross profits within a range of targets, and achievement of specific objectives. The EBITDA bonus award under Mr. Dyne's employment agreement and related amendments for 2014, 2015 and 2016 is shown in the table above as non-equity incentive plan compensation.

Executive Vice President of Global Sales. The compensation for Gary Dyne, our Executive Vice President Global Sales, is determined in accordance with our at-will employment agreement with Mr. Dyne. The terms and conditions established in this agreement were the result of consideration of our operating performance levels, and consistent with comparative industry compensation levels. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Long-term equity in the form of options were granted to Mr. Gary Dyne as an inducement to maximize performance and increase stockholder value. In 2016, 2015, and 2014, respectively, 400,000, 100,000 and 150,000 shares of common stock were granted. The option grants were established to vest monthly over a four-year term, after a minimum initial term of twelve months. The options have an exercise price of \$0.14, \$0.16 and \$0.21 per share, respectively, and have a term of ten years. Commission was paid to Mr. Gary Dyne based on the Company achieving (Talon Zipper and Talon Trim) adjusted direct margins goals as described in Mr. Gary Dyne's 2015 commission plan. In addition, a discretionary incentive bonus was awarded for 2015 and 2016 based on Mr. Gary Dyne's individual performance and contributions.

Executive Vice President of Asia Operations. The compensation for Peter Vaz, our Executive Vice President of Asia Operations, is as defined in his initial offer letter and in accordance with the standard terms of employment for our Hong Kong based employees. Mr. Vaz's base compensation was established as a result of consideration of our operating performance levels, consistent with comparative industry compensation levels, and evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Long-term equity in the form of options were granted to Mr. Vaz as an inducement to maximize performance and increase stockholder value. In 2016, 2015, and 2014, respectively, 400,000, 100,000 and 150,000 shares of common stock were granted. The option grants were established to vest monthly over a four-year term, after a minimum initial term of twelve months. The options have an exercise price of \$0.14, \$0.16 and \$0.21 per share, respectively, and have a term of ten years. Commission was paid to Mr. Vaz in 2015 for the period he was employed as Vice President of Asia Sales through May 7, 2015, based on the Company achieving (Talon Zipper and Talon Trim) adjusted direct margins goals as described in Mr. Vaz's 2015 commission plan. In addition, a discretionary incentive bonus was awarded for 2015 and 2016 based on Mr. Vaz's individual performance and contributions.

Grants of Plan-Based Awards in Fiscal 2016

The following table provides information about equity-awards granted to each named executive officer in 2016.

| Name | Grant Date ⁽¹⁾ | Approval Date ⁽¹⁾ | All Other | Exercise or Base Price of Option Awards (\$/SH) ⁽³⁾ | Market Price on Grant Date ⁽³⁾ | Grant |
|------------|---------------------------|------------------------------|---|--|---|-------|
| | | | Option Awards: Number of Securities Underlying Options ⁽²⁾ | | | |
| Larry Dyne | 2/10/16 | 2/3/16 | 1,250,000 | 0.14 | 0.13 | 0.13 |
| Gary Dyne | 2/10/16 | 2/3/16 | 400,000 | 0.14 | 0.13 | 0.13 |
| Peter Vaz | 2/10/16 | 2/3/16 | 400,000 | 0.14 | 0.13 | 0.13 |

Entitled to receive the award. The approval date is the date that the Board of Directors approves the award. Our
(1) policy is to set the exercise price of options as the average market price of the Company's stock for the five trading days following the date of approval of the grant, and the actual grant date is the last day of such five day period.

(2) Option awards have a 10 year term and vest over a four-year period.

The exercise price of option awards may differ from the market price on the date of grant. The exercise price of
(3) options granted in 2016 is equal to the average closing sales prices of our common stock for the five trading days prior to and including the grant date, as reported on the OTCQB, while the market price on the date of grant is the closing price of our common stock on that date.

(4) The grant date fair value is generally the amount we would expense in our financial statements over the award's service period, but does not include a reduction for forfeitures.

Outstanding Equity Awards at Fiscal Year 2016

The following table provides information with respect to outstanding stock options held by each of the named executive officers as of December 31, 2016:

| Name | Option Awards Number of Securities | | Underlying Unexercised Options | | |
|-------------------|---------------------------------------|--------------------|-----------------------------------|-------------------------------|---------------------------|
| | Grant (#) | (#) | Option Unexercisable | Option Exercise Price (\$) | Option Expiration Date |
| | Date | Exercisable (1) | | | |
| Larry Dyne | 2/10/16 | - | 1,250,000 | 0.14 | 2/10/26 |
| | 8/14/14 | 583,333 | 416,667 | 0.21 | 8/14/24 |
| | 6/25/08 | 700,000 | - | 0.20 | 6/24/18 |
| | 8/6/09 | 510,000 | - | 0.09 | 8/6/19 |
| Gary Dyne | 2/10/16 | - | 400,000 | 0.14 | 2/10/26 |
| | 6/12/15 | 37,500 | 62,500 | 0.16 | 6/12/25 |
| | 8/14/14 | 87,500 | 62,500 | 0.21 | 8/14/24 |
| | 1/13/11 | 450,000 | - | 0.10 | 1/13/21 |
| | 8/12/08 | 40,000 | - | 0.18 | 8/12/18 |
| | 6/25/08 | 110,000 | - | 0.20 | 6/25/18 |
| Peter Vaz | 6/22/07 | 45,000 | - | 1.01 | 6/22/17 |
| | 2/10/16 | - | 400,000 | 0.14 | 2/10/26 |
| | 6/12/15 | 37,500 | 62,500 | 0.16 | 6/12/25 |
| | 8/14/14 | 87,500 | 62,500 | 0.21 | 8/14/24 |
| | 1/13/11 | 55,000 | - | 0.10 | 1/13/21 |
| | 8/12/08 | 245,000 | - | 0.18 | 8/12/18 |
| | 6/25/08 | 40,000 | - | 0.20 | 6/25/18 |
| 6/22/07 | 210,000 | - | 1.01 | 6/22/17 | |

(1) These options become exercisable with respect to 25% of the total options shares at the end of one year from the date of the grant and the remaining shares become exercisable in 36 monthly installments equal to 1/48th of the

Option shares on the last day of each calendar month thereafter until fully exercisable.

Option Exercises in Fiscal Year 2016

There were no options exercised by named executive officers during 2016.

Employment Agreements, Termination of Employment and Change of Control Arrangements

Employment Agreements

We have entered into the following employment agreement and related amendments with Larry Dyne. Gary Dyne and Peter Vaz do not have an employment agreement with the Company.

Larry Dyne, CEO and Interim CFO. On July 30, 2010, we entered into an Executive Employment Agreement with Mr. Dyne as amended on June 15, 2012, November 8, 2013, August 7, 2014 and March 11, 2016. Mr. Dyne's employment agreement, as amended, provided that he would continue to serve as our President. On April 13, 2015, Mr. Dyne was appointed as Chief Executive Officer of our Company, and was also appointed to our Board to fill the vacancy on the board resulting from the resignation of our former Chief Executive Officer. The employment agreement, as amended, has a term continuing through December 31, 2017, and may be extended to December 31, 2018. Pursuant to this agreement, Mr. Dyne received an annual base salary of \$350,000 for the years ended December 31, 2012 and 2013. Starting on January 1, 2014, and through December 31, 2015, Mr. Dyne's annual base salary increased to \$400,000 and beginning on January 1, 2016 and through the remaining term of the agreement, Mr. Dyne's annual base salary will be \$425,000. Mr. Dyne's base salary may be increased, but not decreased, at the discretion of the Board. Mr. Dyne is entitled to receive an annual cash bonus in an amount equal to a percentage of his base salary upon the Company achieving actual adjusted EBITDA, revenue and gross profits within a range and meeting certain performance objectives as determined by the Board of Directors.

Mr. Dyne is entitled to an auto allowance of \$950 per month, and reimbursement of up to \$10,000 for legal fees incurred in connection with the negotiation of his employment agreement. In the event that prior to the end of the term, Mr. Dyne's employment is terminated by us "without cause" (as defined in the agreement), by Mr. Dyne for "good reason" (as defined in the agreement) or due to Mr. Dyne's death or disability, then conditional upon his execution of a release of claims, Mr. Dyne or his estate will be entitled to receive, in addition to all accrued salary, (1) severance payments equal to 18 months of Mr. Dyne's base salary, (2) all options issued to Mr. Dyne shall remain outstanding for 18 months following termination, and (3) continued medical coverage for Mr. Dyne and his dependents for 18 months following termination.

Potential Severance Payments

Pursuant to Mr. Dyne's Executive Employment Agreements as described above, Mr. Dyne will be entitled to receive severance benefits in the event that his employment is terminated due to his death or disability, by us without "cause" or by him for "good reason." The following table sets forth severance payments and benefits that we would have been obligated to pay to Mr. Dyne assuming a triggering event had occurred under his employment agreement as of December 31, 2016:

| Name | Cash | Non-Equity | | Total Severance Benefits (\$) |
|-------------------|----------------------|--------------------------------|--|--|
| | Severance Payment | Incentive Plan Compensation | Continuation of Health Benefits (\$) | |
| | (\$)(1) | (\$) | | |
| Larry Dyne | 719,985 | 368,470 | 27,508 | 1,115,963 |

Includes (a) earned and unpaid base salary through the date of termination, (b) accrued but unpaid vacation and (c) severance payments equal to 18 months of base salary for Mr. Dyne, payable in a lump sum or periodic payments (1) as provided in the executive's employment agreement, and (d) car allowance payments for Mr. Dyne due at the first day of the month during the severance period (18 months) as provided in the executive's employment agreement.

Potential Change in Control Payments

Currently, there are no benefits payable to our named executive officers upon a change in control.

Director Compensation

The general policy of the Board of Directors is that compensation for independent directors should be a mix of cash and equity-based compensation. We do not pay management directors for Board service in addition to their regular employee compensation. The full Board of Directors has the primary responsibility for reviewing and considering any revisions to director compensation.

The following table details the total compensation earned by our non-employee directors in 2016.

| Name | Fees earned or paid in cash | Option awards | Total |
|-----------------------------|---|------------------|-----------|
| Mark Dyne (1) | \$29,000 | \$ - | \$29,000 |
| David Ellis (2) | 29,000 | - | 29,000 |
| Morris D. Weiss (3) | 14,500 | - | 14,500 |
| Robert L. Golden (4) | 29,000 | - | 29,000 |
| Total | \$101,500 | \$ - | \$101,500 |

(1) As of December 31, 2016, Mr. Mark Dyne held options to purchase a total of 490,000 shares.

(2) As of December 31, 2016, Mr. David Ellis held options to purchase a total of 400,000 shares.

(3) Mr. Morris D. Weiss resigned from his position as board member on June 9, 2016.

(4) As of December 31, 2016, Mr. Robert L. Golden held options to purchase a total of 200,000 shares.

Our current policy, adopted as of January 1, 2014, is to pay non-employee directors an annual retainer of \$25,000 for service on our Board of Directors as well as \$1,000 for their attendance at any meeting of the Board of Directors, regardless of whether such meeting is held in person or telephonically. In addition, our current policy is to annually grant to each non-employee director an option to purchase 50,000 shares of our common stock immediately following reelection as directors at each annual meeting of stockholders. The options vest in 12 equal monthly installments, and

become fully vested one year from the date of grant.

Our Board of Directors does not have standing audit, compensation or nominating committees. The Board of Directors handles all audit, compensation and nominating committee matters. We also reimburse directors for their reasonable travel expenses incurred in attending board meetings or committee meetings.

The Board of Directors approved the foregoing new Board compensation policies effective for 2014 based, in part, on the results of a compensation study provided by a nationally recognized compensation consulting firm engaged by the Board in 2013.

Risk Assessment Regarding Compensation Policies and Practices

Our compensation program for employees does not create incentives for excessive risk taking by our employees or involve risks that are reasonably likely to have a material adverse effect on our Company. Our base salary component of compensation does not encourage risk-taking because it is a fixed amount. Our executive bonus plan for senior executives and our equity compensation awards have the following risk-limiting characteristics:

Cash awards to each executive officer under management incentive bonus plans are set in a market range and are limited by the terms of the plan for senior executives to a fixed maximum specified in the plan;

Equity and discretionary cash awards are made based on a review of a variety of indicators of performance, thus diversifying the risk associated with any single indicator of performance;

Neither cash nor equity awards are tied to formulas that could focus executives on specific short-term outcomes;

Members of the Board of Directors approve the final cash incentive awards made under the executive bonus plan for senior executives in their discretion, after the review of executive and corporate performance;

Members of the Board of Directors approve all equity awards for senior executives in their discretion;
and

An equity award's value is delivered in the form of stock and options that vest over multiple years, which aligns the interests of executive officers to long-term stockholder interests.

Compensation Committee Interlocks and Insider Participation

The Board of Directors currently performs the function of a compensation committee. None of our current executive officers has served as a member of the board of directors or compensation committee of any entity for which a member of our Board of Directors has served as an executive officer.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity Compensation Plan Information

The following table sets forth certain information as of December 31, 2016, regarding equity compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance:

| Name | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants, and rights | Number of securities remaining available for future issuance under equity compensation plans |
|--|---|--|--|
| Equity compensation plans approved by security holders | 9,933,267 | \$ 0.17 | 7,250,555 |
| Equity compensation plans not approved by security holders | - | - | - |

Each of the above plans provides that the number of shares with respect to which options may be granted, and the number of shares of common stock subject to an outstanding option, shall be proportionately adjusted in the event of a subdivision or consolidation of shares or the payment of a stock dividend on common stock.

Security Ownership of Certain Beneficial Owners and Management

The following table presents information regarding the beneficial ownership of our common stock as of March 27, 2017:

each person who is known to us to be the beneficial owner of more than 5% of our outstanding common Stock;

each of our current directors;

each of our named executive officers; and

all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission that deem shares to be beneficially owned by any person who shares voting or investment power with respect to such shares. Shares of Common Stock underlying warrants or options currently exercisable or exercisable within sixty (60) days of the date of this information are deemed outstanding for purposes of computing the percentage ownership of the person holding such warrants or options but are not deemed outstanding for computing the percentage ownership of any other person. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of Common Stock actually outstanding at March 27, 2017. Unless otherwise indicated, the persons named in this table have sole voting and sole investment power with respect to all shares shown as beneficially owned, subject to community property laws where applicable.

As of March 27, 2017, we had 92,274,255 shares of Common Stock issued and outstanding. The address of each person listed is in our care, at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367, unless otherwise set forth below such person's name.

| Name of Beneficial Owner | Common Stock | |
|---|--------------|------|
| | Shares | % |
| Executive Officers and Directors: | | |
| Larry Dyne (1) | 7,598,947 | 8.0 |
| Gary Dyne (2) | 947,500 | 1.0 |
| Peter Vaz (3) | 846,500 | * |
| Mark Dyne (6) | 9,659,000 | 10.4 |
| David Ellis (4) | 400,000 | * |
| Robert L. Golden (4) | 200,000 | * |
| Executive Officers and Directors as a Group (6 persons) (7) | 19,651,947 | 20.3 |
| 5% Stockholders: | | |
| Kutula Holdings Ltd. Fascinatio Boulevard 764 2909 VA Capelle aan den Ijssel, Netherlands (8) | 38,888,889 | 42.1 |
| Perrtech Pty Limited Level 3, 11 New South Head Road Edgecliff NSW 2017, Sydney, Australia | 8,333,333 | 9.0 |
| Lonnie D. Schnell (5) | 5,218,097 | 5.7 |
| North Star Investment Management Corporation 20 N. Wacker Drive, Suite 1416, Chicago, Illinois 60606 | 5,333,233 | 5.8 |

*Less than 1%.

- (1) Consists of (i) 5,357,697 shares of Common Stock and (ii) 2,241,250 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or become exercisable within 60 days.
- (2) Consists of (i) 40,000 shares of Common Stock and (ii) 907,500 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.
- (3) Consists of (i) 34,000 shares of Common Stock and (ii) 812,500 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.
- (4) Consists entirely of shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.
- (5) Consists entirely of shares of Common Stock.
- (6) Consists of (i) 9,169,000 shares of Common Stock and (ii) 490,000 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.
- (7)

- Consists of (i) 9,253,000 shares of Common Stock and (ii) 10,398,947 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.
- (8) Jean-Paul Defesche exercises voting and dispositive power over the securities held by Kutula Holdings Ltd., but disclaims beneficial ownership of such securities except to the extent of his pecuniary interest in such securities.

The information as to shares beneficially owned has been individually furnished by our respective directors, named executive officers, and our other stockholders, or taken from documents filed with the Securities and Exchange Commission.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Review and Approval of Related Party Transactions

We have adopted a policy that requires Board of Directors' approval of transactions with related persons as defined by SEC regulations, including any sales or purchase transaction, asset exchange transaction, operating agreement, or advance or receivable transaction that could put our assets or operating performance at risk. All of our directors and executive officers are required at all times, but not less than annually, to disclose all relationships they have with companies or individuals that have conducted business with, or had an interest in, us. Our executive officers monitor our operations giving consideration to the disclosed relationships and refer potential transactions to the Board of Directors for approval. The Board of Directors considers a related party transaction for its potential economic benefit to us, to ensure the transaction is "arms length" and in accordance with our policies and that it is properly disclosed in our reports to stockholders.

Reportable Related Party Transactions

Other than the employment arrangements described elsewhere in this report and the transactions described below, since January 1, 2015, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or will be a party:

in which the amount involved exceeds \$120,000; and

in which any director, executive officer, stockholder who beneficially owns 5% or more of our common stock or any member of their immediate family had or will have a direct or indirect material interest.

On August 10, 2015, we entered into a loan and reimbursement agreement ("Loan Agreement") with Princess Investment pursuant to which Princess Investment agreed to make available to the Company a loan of up to \$3,000,000 ("Revolving Line of Credit"). 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 initially accrued interest on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Revolving Line of Credit was payable monthly beginning September 1, 2015, and the principal amount was payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. 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 immediately upon issuance for a five-year period at an exercise price of \$0.18 per share on a cashless basis. On August 11, 2015, we received an

advance from Princess Investment under the Loan Agreement in the amount of \$1,500,000, of which \$1,440,278 was used to pay off the Term Loan Payable to Union Bank on August 12, 2015. The Company borrowed an additional \$500,000 through December 21, 2015, and had an outstanding balance of \$2,000,000 under the Revolving Line of Credit from Princess Investment at December 21, 2015.

On December 21, 2015, we entered into an amended and restated credit agreement (the “Princess Investment Credit Agreement”) with Princess Investment, which amended our existing Loan Agreement, dated August 10, 2015, with Princess Investment to, among other things, increase the borrowing availability under the Loan Agreement from \$3,000,000 to \$6,000,000 and extend the maturity date of the loan to December 21, 2020 (“the Maturity Date”).

Princess Investment will make advances under the Revolving Line of Credit from time to time as requested by the Company. We may prepay the Revolving Line of Credit at any time, and amounts prepaid may be re-borrowed through November 21, 2020. Pursuant to the terms of the amendment, the Revolving Line of Credit will accrue interest on the unpaid principal balance at an annual rate of 11.5%. Interest on the Revolving Line of Credit for the period from December 21, 2015 through December 1, 2016 was accrued and added to principal on December 1, 2016, and thereafter interest will be payable monthly in arrears. No principal payments will be due during the period ending December 31, 2017. Thereafter, principal will be payable \$25,000 per month during the twelve months ended December 31, 2018, \$35,000 per month during the twelve months ended December 31, 2019 and \$50,000 per month during the twelve months ended December 31, 2020, with the remaining outstanding principal amount payable on the Maturity Date. The Princess Investment Credit Agreement continues to require payment of a \$60,000 loan fee at maturity.

The payment and performance of all our indebtedness and other obligations to Princess Investment, including all borrowings under the Princess Investment Credit Agreement, are guaranteed by our subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement entered into on August 10, 2015, as amended on December 21, 2015. The payment and performance of all of our indebtedness and other obligations to Princess Investment under the Princess Investment Credit Agreement and related agreements are secured by liens on substantially all of our assets and the assets of our subsidiary guarantors pursuant to a Pledge and Security Agreement entered into on August 10, 2015, as amended on December 21, 2015.

Pursuant to the Princess Investment Credit Agreement, the Company issued to Princess Investment warrants to purchase 2,000,000 shares of our common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of \$0.18 per share, and include a “cashless” exercise option.

On December 23, 2015, we received an advance from Princess Investment under the Princess Investment Credit Agreement in the amount of \$2,000,000, of which \$1,622,000 was used to pay in full all indebtedness outstanding under our Commercial Credit Agreement, dated December 31, 2013, with Union Bank, which indebtedness was scheduled to mature on December 31, 2015.

Total interest related to the Revolving Line of Credit for the year ended December 31, 2016 amounted to \$487,816. Total financing costs related to the Revolving Line of Credit during the year ended December 31, 2016 amounted to \$72,270, of which \$60,000 will be paid upon maturity. The financing costs are being amortized over the three year term of the Revolving Line of Credit.

At December 31, 2016, the Company had an outstanding principal balance of \$4,455,643 under the Revolving Line of Credit, and approximately \$1,500,000 remained in available borrowings under the Revolving Line of Credit as of December 31, 2016.

Director Independence

Because our common stock is quoted on the OTCQB, we are not subject to the listing requirements of any securities exchange or Nasdaq regarding the independence of our directors. However, we have determined that, as of December 31, 2016, each of Messrs. Ellis and Golden is “independent” as that term is defined in Section 5605 of the NASDAQ Marketplace Rules applicable to companies listed on The NASDAQ Stock Market. The other members of our Board of Directors are not “independent” under such rules.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Services Provided by the Independent Auditors

Our Board of Directors performs the functions of the audit committee and is responsible for the appointment, compensation, retention and oversight of the work of the independent auditors.

SingerLewak LLP served as our independent registered public accounting firm for each of the fiscal years ended December 31, 2016 and 2015.

Audit Fees - The aggregate fees billed by our independent registered public accounting firm for professional services rendered for the audit of our annual financial statements and review of our financial statements included in our Forms 10-Q or services that are normally provided in connection with statutory and regulatory filings were \$344,000 and \$354,000 for fiscal years 2016 and 2015, respectively.

Audit-Related Fees – The aggregate fees billed by our independent registered public accounting firm for professional services rendered for assurance and related services reasonably related to the performance of the audit or review of our financial statements (other than those reported above) were \$14,000 for fiscal year 2016 and none for fiscal year 2015.

Tax Fees - No fees were billed by our independent registered public accounting firm for professional services rendered for tax compliance, tax advice and tax planning for fiscal years 2016 and 2015.

All Other Fees – The aggregate fees billed by our independent public registered accounting firm for services rendered to us other than the services described above under “Audit Fees,” “Audit-Related Fees” and “Tax Fees” were none for fiscal year 2016 and 2015.

The Board of Directors approved all of the foregoing services provided by SingerLewak LLP.

Policy Regarding Pre-Approval of Services Provided by the Independent Auditors

The Board of Directors has established a general policy requiring its pre-approval of all audit services and permissible non-audit services provided by the independent auditors, along with the associated fees for those services. For both types of pre-approval, the Board of Directors considers whether the provision of a non-audit service is consistent with the SEC's rules on auditor independence, including whether provision of the service (1) would create a mutual or conflicting interest between the independent auditors and us, (2) would place the independent auditors in the position of auditing its own work, (3) would result in the independent auditors acting in the role of management or as our employee, or (4) would place the independent auditors in a position of acting as an advocate for us. Additionally, the Board of Directors considers whether the independent auditors are best positioned and qualified to provide the most effective and efficient service, based on factors such as the independent auditors' familiarity with our business, personnel, systems or risk profile and whether provision of the service by the independent auditors would enhance our ability to manage or control risk or improve audit quality or would otherwise be beneficial to us.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) List the following documents filed as a part of this report:

(1) *Financial Statements*

See Index to Financial Statements in Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference.

(2) *Financial Statement Schedule*

Schedule II – Valuation and Qualifying Accounts Reserves is included beginning on the following page.

(3) *Exhibits*

See Exhibit Index attached to this Annual Report on Form 10-K, which is incorporated herein by reference.

Schedule II – Valuation and Qualifying Accounts and Reserves

| Description | Balance at Beginning of Year | Additions (Adjustments) | Deductions | Balance at End of Year |
|--|---------------------------------------|----------------------------|------------|---------------------------------|
| 2016 | | | | |
| Allowance for doubtful accounts deducted from accounts receivable in the balance sheet | \$ 67,000 | \$ 13,000 | \$ 40,000 | \$ 40,000 |
| Reserve for inventory valuation deducted from inventories on the balance sheet | 69,000 | 8,000 | 13,000 | 64,000 |
| Valuation reserve deducted from deferred income tax assets | 69,000 | 39,000 | 10,000 | 98,000 |
| | \$ 205,000 | \$ 60,000 | \$ 63,000 | \$ 202,000 |
| 2015 | | | | |
| Allowance for doubtful accounts deducted from accounts receivable in the balance sheet | \$ 51,000 | \$ 19,000 | \$ 3,000 | \$ 67,000 |
| Reserve for inventory valuation deducted from inventories on the balance sheet | 199,000 | 20,000 | 150,000 | 69,000 |
| Valuation reserve deducted from deferred income tax assets | 240,000 | (171,000) | - | 69,000 |
| | \$ 490,000 | \$ (132,000) | \$ 153,000 | \$ 205,000 |
| 2014 | | | | |
| Allowance for doubtful accounts deducted from accounts receivable in the balance sheet | \$ 42,000 | \$ 23,000 | \$ 14,000 | \$ 51,000 |
| Reserve for inventory valuation deducted from inventories on the balance sheet | 230,000 | (17,000) | 14,000 | 199,000 |
| Valuation reserve deducted from deferred income tax assets | 278,000 | (38,000) | - | 240,000 |
| | \$ 550,000 | \$ (32,000) | \$ 28,000 | \$ 490,000 |

Additions to the allowance for doubtful accounts include provisions for uncollectible accounts. Bad debt expense includes (and additions above exclude) net direct write-offs of amounts representing less than \$1,000 for the years (1) ended December 31, 2016, 2015 and 2014. Additions to the inventory valuation reserve include current year provisions. Additionally, in 2016, 2015 and 2014 there were gross direct write-offs of \$86,000, \$189,000 and \$46,000, respectively.

Deductions from the allowance for doubtful accounts include amounts applied to write-offs and reversals of prior (2) period provisions. Deductions from the inventory valuation reserve include application of the reserve against obsolete, excess, slow-moving or disposed inventory.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

TALON INTERNATIONAL, INC.

Date: March 27, 2017

/s/ Larry Dyne

By: Larry Dyne

Its: Chief Executive Officer and Interim
Chief Financial Officer
(Principal Executive Officer and
Principal Financial Officer)

/s/ Jamey Johns

By: Jamey Johns

Its: Chief Accounting Officer
(Principal Accounting Officer)

POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Larry Dyne and Jamey Johns, and each of them, as his true and lawful attorneys-in-fact and agents with full power of substitution and resubstitution, for him and his name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the foregoing, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, or their substitutes, may lawfully do or cause to be done by virtue hereof.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|-------------------------|---|--------------------|
| /s/ Larry Dyne | Director, Chief Executive Officer and Interim | |
| Larry Dyne | Chief Financial Officer (Principal Executive Officer and Principal Financial Officer) | March 27, 2017 |
| /s/ Jamey Johns | Chief Accounting Officer (Principal Accounting Officer) | |
| Jamey Johns | | March 27, 2017 |
| /s/ Mark Dyne | Chairman of the Board of Directors | |
| Mark Dyne | | March 27, 2017 |
| /s/ David Ellis | Director | |
| David Ellis | | March 27, 2017 |

/s/ Robert L. Golden
Robert L. Golden Director

March 27, 2017

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EXHIBIT INDEX

Exhibit

| <u>Number</u> | <u>Exhibit Description</u> |
|---------------|--|
| 3.1 | Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto. |
| 3.1.1 | Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.4 to Annual Report on Form 10-KSB, filed March 28, 2000. |
| 3.1.2 | Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1.3 to Form 8-K filed on August 4, 2006. |
| 3.1.3 | Certificate of Ownership and Merger. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on July 20, 2007. |
| 3.1.4 | Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on November 24, 2010. |
| 3.1.5 | Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on November 12, 2013. |
| 3.2.1 | Bylaws of Registrant. Incorporated by reference to Exhibit 3.2 to Form SB-2 filed on October 21, 1997, and the amendments thereto. |
| 3.2.2 | Certificate of Amendment to the Bylaws of Talon International, Inc., dated as of August 2, 2011. Incorporated by reference to Exhibit 3.2 to Form 8-K filed on August 4, 2011. |
| 4.1 | Specimen Stock Certificate of Common Stock of Registrant. Incorporated by reference to Exhibit 4.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto. |
| 10.1 | Form of Indemnification Agreement. Incorporated by reference to Exhibit 10.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto. |
| 10.2+ | Amended and Restated 1997 Stock Incentive Plan. Incorporated by reference to Exhibit 10.7 to Form 10-Q filed on November 13, 2006. |
| 10.3+ | Form of Non-statutory Stock Option Agreement. Incorporated by reference to Exhibit 10.30 to Form SB-2 filed on October 21, 1997, and the amendments thereto. |
| 10.5+ | 2007 Stock Plan. Incorporated by reference to Exhibit 10.20 to the Form 10-K filed on April 25, 2008. |
| 10.7+ | Amended and Restated Talon International, Inc. 2008 Stock Incentive Plan. Incorporated by reference to Exhibit 10.20 to Form 10-K filed on March 28, 2011. |

- 10.10+ Executive Employment Agreement, dated July 30, 2010, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.26 to Form 10-Q filed on August 8, 2011.
- 10.10.1+ Amendment No. 1 to Executive Employment Agreement, dated as of June 15, 2012, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.17.1 to Form 10-Q filed on August 13, 2012.

Exhibit

Number Exhibit Description

10.10.2+ Amendment No. 2 to Executive Employment Agreement, dated as of November 6, 2013, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.3 to Form 8-K filed on November 12, 2013.

10.10.3+ Amendment No. 3, dated August 7, 2014, to Employment Agreement, dated July 30, 2010, between Registrant and Larry Dyne Incorporated by reference to Exhibit 10.10.3 to Form 10-Q, filed November 14, 2014.

10.10.4+ Exhibit to Employment Agreement dated July 30, 2010, between the Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.28 to Form 10-Q filed on November 12, 2015.

10.10.5+ Amendment No. 4 to Executive Employment Agreement, dated as of March 11, 2016, between the Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.1 to Form 8-K filed on March 15, 2016.

10.11+ Executive Employment Agreement, dated September 3, 2015, between Registrant and Nancy Agger-Nielsen. Incorporated by reference to Exhibit 10.27 to Form 10-Q filed on November 12, 2015.

10.15 Subscription Agreement dated July 12, 2013 between the Registrant and Kutula Holdings Ltd. Incorporated by reference to Exhibit 10.3 to Form 8-K filed on July 16, 2013.

10.17 Registration Rights Agreement dated July 12, 2013 among the Registrant, Kutula Holdings Ltd., Perrtech Pty Limited, Zipper Holdings, LLC, Fairways Investments, LLC and Manifest Capital, LLC. Incorporated by reference to Exhibit 10.5 to Form 8-K filed on July 16, 2013.

10.18 Commercial Credit Agreement dated December 31, 2013 between the Registrant and Union Bank, N.A. Incorporated by reference to Exhibit 10.1 to Form 8-K filed on January 7, 2014.

10.23 Lease, dated March 29, 2001, between the Registrant and Chase Manhattan Bank as Directed Trustee for Unova Master Trust. Incorporated by reference to Exhibit 10.23 to Form 10-K, filed March 16, 2015.

10.23.1 Amendment to Lease, dated October 1, 2005, between the Registrant and Woodland Burbank Corporation. Incorporated by reference to Exhibit 10.23.1 to Form 10-K, filed March 16, 2015.

10.23.2 Second Amendment to Lease, dated August 30, 2010, between the Registrant and Woodland Burbank Corporation. Incorporated by reference to Exhibit 10.23.2 to Form 10-K, filed March 16, 2015.

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- 10.23.3 Third Amendment to Lease, dated June 24, 2014, between the Registrant and Woodland Burbank Corporation. Incorporated by reference to Exhibit 10.23.3 to Form 10-K, filed March 16, 2015.
- 10.24 Loan and Reimbursement Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.24 to Form 10-Q, filed August 14, 2015.
- 10.24.2 Pledge and Security Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.24.2 to Form 10-Q, filed August 14, 2015.
- 10.24.3 Guaranty Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.24.3 to Form 10-Q, filed August 14, 2015.
- 10.24.6 Warrant Agreement dated August 10, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.24.6 to Form 10-K, filed March 16, 2015.
- 10.24.7 Amended and Restated Credit Agreement, dated December 21, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.1 to Form 8-K, filed December 28, 2015.
- 10.24.8 Amendment to Pledge and Security Agreement, dated December 21, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.3 to Form 8-K, filed December 28, 2015.
- 10.24.9 Amendment to Guaranty Agreement, dated December 21, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.5 to Form 8-K, filed December 28, 2015.
- 10.24.10 Form of Warrant Agreement, dated December 21, 2015, between the Registrant and Princess Investment Holdings Inc. Incorporated by reference to Exhibit 10.6 to Form 8-K, filed December 28, 2015.
- 10.25.1 Lease, Unit 101 & 108, dated May 21, 2015, between the Tag-It Pacific Limited (HK Operations) and the Sunbeam Manufacturing Company Limited. Incorporated by reference to Exhibit 10.25.1 to Form 10-Q, filed August 14, 2015.
- 10.25.2 Lease, Unit 1316, dated May 21, 2015, between the Tag-It Pacific Limited (HK Operations) and the Sunbeam Manufacturing Company Limited. Incorporated by reference to Exhibit 10.25.1 to Form 10-Q, filed August 14, 2015.
- 10.26 Lease, Unit 1601-8, dated August 10, 2015, between the Talon Zipper (Shenzhen) Co. Ltd. (Chinese Operations) and Chen Zhen Guang. Incorporated by reference to Exhibit 10.26 to Form 10-Q, filed August 14, 2015.

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| 10.27+ | Letter Agreement with Jamey Johns, effective as of March 21, 2016. Incorporated by reference to Exhibit 10.27 to Form 10-Q, filed May 12, 2016. |
| 10.28 | Consulting Agreement, dated as of July 19, 2016, between the Registrant and Nancy Agger-Nielsen. Incorporated by reference to Exhibit 10.1 to Form 8-K filed on July 25, 2016. |
| 10.29+ | Letter Agreement with Daniel Ryu, effective as of July 19, 2016. Incorporated by reference to Exhibit 10.2 to Form 8-K filed on July 25, 2016. |
| 14.1 | Code of Ethics. Incorporated by reference to Exhibit 14.1 to Form 10-K, filed March 16, 2015. |
| 21.1** | Subsidiaries. |
| 23.1** | Consent of SingerLewak LLP. |
| 23.2** | Consent of SingerLewak LLP. |
| 24.1** | Power of Attorney (included on signature page). |
| 31.1** | Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended. |
| 31.2** | Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended. |
| 32.1*** | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) under the Securities and Exchange Act of 1934, as amended. |
| 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.

** Filed herewith.

*** Furnished herewith.