TALON INTERNATIONAL, INC.
Form 10-Q
August 14, 2007

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

FORM 10-Q

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

For the quarterly period ended June 30, 2007.

OR

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

Commission file number 1-13669

TALON INTERNATIONAL, INC.
(Exact Name of Issuer as Specified in its Charter)

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

21900 BURBANK BOULEVARD, SUITE 270
WOODLAND HILLS, CALIFORNIA 91367
(Address of Principal Executive Offices)

(818) 444-4100
(Registrant's Telephone Number, Including Area Code)

TAG-IT PACIFIC, INC.
(Former name, former address and former fiscal year, if changed since last report)

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 [X] No [_]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer . See definition of "accelerated filer and large accelerated filer"in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [_] Accelerated filer [_] Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company (as

defined in Rule 12b-2 of the Act). Yes [_] No [X]

AT AUGUST 14, 2007 THE ISSUER HAD 20,041,433 SHARES OF COMMON STOCK, $.001 PAR VALUE, ISSUED AND OUTSTANDING.

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TALON INTERNATIONAL, INC.
(FORMERLY TAG-IT PACIFIC, INC.)

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TALON INTERNATIONAL, INC.
(FORMERLY TAG-IT PACIFIC, INC.)

CONSOLIDATED BALANCE SHEETS

	June 30, 2007	December 31, 2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 3,822,264	$ 2,934,673
Restricted cash	9,500,000	--
Accounts receivable, net	6,040,757	4,664,766
Note receivable	1,450,051	1,378,491
Inventories, net	2,555,072	3,051,220
Recoverable legal costs	1,180,748	107,108
Prepaid expenses and other current assets	675,063	433,926
Total current assets	25,223,955	12,570,184
Property and equipment, net	5,575,712	5,623,040
Fixed assets held for sale	826,904	826,904
Note receivable, less current portion	677,601	1,420,969
Due from related party	722,918	675,137
Other intangible assets, net	4,110,751	4,139,625
Other assets	720,546	437,569
Total assets	$ 37,858,387	$ 25,693,428
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 6,391,504	$ 4,006,241
Accrued legal costs	1,267,167	427,917
Other accrued expenses	3,289,601	3,359,267
Demand notes payable to related parties	85,176	664,970
Current portion of capital lease obligations	395,294	432,728
Current portion of notes payable	405,878	1,107,207
Secured convertible promissory notes	12,488,490	12,472,622
Total current liabilities	24,323,110	22,470,952
Capital lease obligations, less current portion	351,292	474,733
Notes payable, less current portion	1,000,482	1,061,514
Revolver note payable	1,307,806	--
Term note payable	7,106,260	--
Other long term liabilities	83,651	--
Total liabilities	34,172,601	24,007,199
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock Series A, $0.001 par value; 250,000 shares authorized; no shares issued or outstanding	--	--
Common stock, $0.001 par value, 100,000,000 shares authorized; 20,041,433 shares issued and outstanding at June 30, 2007; 18,466,433 at December 31, 2006	20,041	18,466
Additional paid-in capital	54,341,135	51,792,502

Accumulated deficit	(50,675,390)	(50,124,739)
Total stockholders' equity	3,685,786	1,686,229
Total liabilities and stockholders' equity	$ 37,858,387	$ 25,693,428

See accompanying notes to consolidated financial statements

TALON INTERNATIONAL, INC.
(FORMERLY TAG-IT PACIFIC, INC.)

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	$ 13,566,981	$ 14,246,087	$ 22,657,099	$ 24,884,303
Cost of goods sold	9,484,488	10,118,850	15,827,411	17,914,341
Gross profit	4,082,493	4,127,237	6,829,688	6,969,962
Selling expenses	841,326	674,894	1,547,561	1,220,519
General and administrative expenses	2,406,192	2,557,062	5,017,780	5,296,499
Total operating expenses	3,247,518	3,231,956	6,565,341	6,517,018
Income from operations	834,975	895,281	264,347	452,944
Interest expense, net	265,858	229,139	490,574	516,205
Income (loss) before income taxes	569,117	666,142	(226,227)	(63,261)
Provision for income taxes	78,624	11,500	78,624	11,500
Net Income (loss)	$ 490,493	$ 654,642	$ (304,851)	$ (74,761)
Basic income (loss) per share	$ 0.03	$ 0.04	$ (0.02)	$ (0.00)
Diluted income (loss) per share	$ 0.02	$ 0.04	$ (0.02)	$ (0.00)
Weighted average number of common shares outstanding:				
Basic	18,590,884	18,358,360	18,562,151	18,300,027
Diluted	20,058,682	18,598,442	18,562,151	18,300,027

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.
(FORMERLY TAG-IT PACIFIC, INC.)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months En
	2007
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	$ (304,851)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	592,011
Amortization of deferred financing cost and debt discounts	163,593
Increase (decrease) in allowance for doubtful accounts	61,500
Decrease in inventory valuation reserves	(165,280)
Disposal of asset	--
Stock based compensation	125,000
Changes in operating assets and liabilities:	
Receivables, including related party	(1,485,273)
Inventories	661,428
Recoverable legal costs	(1,073,640)
Prepaid expenses and other current assets	(241,137)
Other Assets	35,207
Accounts payable and accrued expenses	2,560,129
Accrued legal	769,467
Income taxes payable	77,931
Net cash provided by operating activities	1,776,085
CASH FLOWS FROM INVESTING ACTIVITIES:	
Acquisition of property and equipment	(514,812)
Proceeds from sale of equipment	--
Net cash used by investing activities	(514,812)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Collection of notes receivable	671,808
Proceeds from exercise of stock options and warrants	42,746
Proceeds from issuance of stock and warrants, net of issuance costs	2,313,711
Revolver note borrowings	1,307,806
Term note borrowings, net of issuance costs	6,842,789
Repayment of capital leases	(160,875)
Repayment of notes payable	(1,891,667)
Net cash from (used by) financing activities	9,126,318
Net increase in cash and restricted cash	10,387,591
Cash at beginning of period	2,934,673
Cash and restricted cash at end of period	$ 13,222,264

Supplemental disclosures of cash flow information: Cash received (paid) during the period for:		
Interest paid	$	(477,176)
Interest received	$	154,263
Income tax paid	$	95,056
Non-cash financing activities:		
Capital lease obligation	$	35,809
Deferred financing cost	$	203,434
Accounts payable & accrued legal converted to notes payable	$	--

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.
(FORMERLY TAG-IT PACIFIC, INC.)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1. PRESENTATION OF INTERIM INFORMATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying unaudited consolidated financial statements reflect all adjustments that, in the opinion of the management of Talon International, Inc. and its consolidated subsidiaries (collectively, the "Company"), are considered necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of the Company included in the Company's Form 10-K for the year ended December 31, 2006. The balance sheet as of December 31, 2006 has been derived from the audited financial statements as of that date but omits certain information and footnotes required for complete financial statements.

On July 20, 2007 the Company changed its name from Tag-It Pacific, Inc. to Talon International, Inc.

Certain reclassifications have been made to the prior year financial statements to conform to the 2007 presentation.

NOTE 2. EARNINGS (LOSS) PER SHARE

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

THREE MONTHS ENDED JUNE 30, 2007:	INCOME (LOSS)	SHARES	PER SHARE
Basic Income per share:			
Income available to common stockholders	$ 490,493	18,590,884	$ 0.03
Effect of Dilutive Securities:			
Options	--	1,463,278	(0.01)
Warrants	--	4,520	--
Income available to common stockholders	$ 490,493	20,058,682	$ 0.02
THREE MONTHS ENDED JUNE 30, 2006:			
Basic Income per share:			
Income available to common stockholders	$ 654,642	18,358,360	$ 0.04
Effect of Dilutive Securities:			
Options	--	240,082	--
Warrants	--	--	--
Income available to common stockholders .	$ 654,642	18,598,442	$ 0.04
SIX MONTHS ENDED JUNE 30, 2007:			
Basic loss per share:			
Loss available to common stockholders .	$ (304,851)	18,562,151	$ (0.02)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders ...	$ (304,851)	18,562,151	$ (0.02)
SIX MONTHS ENDED JUNE 30, 2006:			
Basic loss per share:			
Loss available to common stockholders .	$ (74,761)	18,300,027	$ (0.00)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders	$ (74,761)	18,300,027	$ (0.00)

Warrants to purchase 3,193,813 shares of common stock exercisable at between $0.95 and $5.06 per share, options to purchase 4,746,735 shares of common stock exercisable at between $0.37 and $5.23 per share, and convertible debt of $12,500,000 convertible at $3.65 per share, were outstanding for the three and six months ended June 30, 2007. In connection with the Share-Based Payment calculation (see note 3), 4,880,135 shares were included in the computation of diluted income per share for the three month period ended June

30, 2007. These shares were not included in the computation of diluted loss per share for the six months ended June 30, 2007 because exercise or conversion would have an antidilutive effect on the loss per share.

Warrants to purchase 1,243,813 shares of common stock exercisable at between $3.50 and $5.06 per share, options to purchase 4,434,888 shares of common stock exercisable at between $0.37 and $5.23 per share, convertible debt of $12,500,000 convertible at $3.65 per share, and other convertible debt of $500,000 convertible at $4.50 per share were outstanding for the three and six months ended June 30, 2006. In connection with the Share-Based Payment calculation (see note 3), 2,775,135 shares were included in the computation of diluted income per share for the three month period ended June 30, 2006. These shares were not included in the computation of diluted loss per share for the six months ended June 30, 2006 because exercise or conversion would have an antidilutive effect on the loss per share.

NOTE 3. STOCK BASED COMPENSATION

The Company accounts for stock-based awards to employees and directors in accordance with Statement of Financial Accounting Standards No. 123 revised, Share-Based Payment, ("SFAS 123(R)") 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 consultants are accounted for in accordance with the provisions of Emerging Issues Task Force (EITF) No. 96-18, "Accounting for Equity Instruments That Are Issued to Others Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services".

There were 46,600 options granted to employees during the three and six months ended June 30, 2007 at a weighted average exercise price of $1.02 per share. The estimated fair value of options granted during the three and six months ended June 30, 2007 was $31,700. Common shares of 1,500,000 and warrants to acquire 2,100,000 shares of common stock were issued during the three and six months ended June 30, 2007 to a non-employee in connection with a debt financing facility at a weighted average exercise price of $1.05 per share for the warrants and $0.001 per share for the common shares issued. The estimated total fair value of the warrants and shares of common stock granted during the three and six months was $2,879,020. The relative fair value of warrants and shares of common stock issued, less financing costs, is accounted for as debt discount related to the $9.5 million Term note entered into in June 2007. Assumptions used to value options granted to employees were expected volatility of 69%, expected term of 6.1 years, risk-free interest rate of approximately 5.0%, and an expected dividend yield of zero. Assumptions used to value warrants granted to non-employee were expected volatility of 78%, expected term of 5 years (contractual life), risk-free interest rate of 5.0%, and expected dividend yield of zero. In January, 2007, a consultant exercised options to acquire 75,000 shares of common stock. Cash received upon exercise was $42,750 or $0.57 per share. At the time of exercise, the total intrinsic value of the options exercised was approximately $72,000 (or $0.96 per share). Because the option exercised was a non-qualified stock option, the Company will receive a tax deduction for the intrinsic value amount.

As of June 30, 2007, the Company had approximately $537,000 of unamortized stock-based compensation expense related to options issued to employees and directors, which will be recognized over the weighted average period of 2.3 years. This expected expense will change if any stock options are granted or cancelled prior to the respective reporting periods or if there are any changes required to be made for estimated forfeitures.

During the three months ended June 30, 2006, the Company did not grant any stock-based awards to employees or non-employees. During the six months ended June 30, 2006, the Company granted awards of stock for 225,388 shares at an average market price of $0.45 per share and options to acquire 2,685,135 shares at an average exercise price of $0.42 per share. Awards to acquire 1,625,000 shares were granted to employees outside of the 1997 Plan, and awards of stock and options to acquire 165,253 shares were granted to a consultant. The estimated fair value of all awards granted during the six months was $666,000, of which

$70,000 was accrued for as of December 31, 2005. Assumptions used to value options granted to employees were expected volatility of 57%, expected term of 5.3 years to 6.1 years, risk-free interest rate of approximately 4.4%, and an expected dividend yield of zero. Assumptions used to value options granted to consultants were expected volatility of 65%, expected term of 10 years (contractual life), risk-free interest rate of 4.5%, and expected dividend yield of zero.

The following table summarizes the activity in the Company's share based plans during the three and six months ended June 30, 2007. At June 30, 2007 the Company may issue additional awards to acquire up to a total of 2,502,877 shares of common stock under the 1997 Plan.

	Number of Shares	Weighted Average Exercise Price
EMPLOYEES AND DIRECTORS		
Options and warrants outstanding - January 1, 2007	5,002,635	$ 1.41
Granted	--	--
Exercised	--	--
Cancelled	(299,500)	$ 1.03
Options and warrants outstanding - March 31, 2007	4,703,135	$ 1.44
Granted	46,600	$ 1.02
Exercised	--	--
Cancelled	(3,000)	$ 1.27
Options and warrants outstanding - June 30, 2007	4,746,735	$ 1.44
NON-EMPLOYEES		
Options and warrants outstanding - January 1, 2007	1,318,813	$ 4.13
Granted	--	--
Exercised	(75,000)	$ .57
Cancelled	(150,000)	$ 3.50
Options and warrants outstanding - March 31, 2007	1,093,813	$ 4.46
Granted	2,100,000	$ 1.05
Exercised	--	--
Cancelled	--	--
Options and warrants outstanding - June 30, 2007	3,193,813	$ 2.22

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NOTE 4. INVENTORIES

Inventories are stated at the lower of cost or market value and are all categorized as finished goods. Inventory reserves are recorded for damaged, obsolete, excess 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.

Inventories consist of the following:	June 30, 2007	December 31, 2006
Finished goods	$3,631,791	$4,293,220
Less reserves	1,076,720	1,242,000
Total inventories	$2,555,071	$3,051,220

NOTE 5. INCOME TAXES

On January 1, 2007 the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on the recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition associated with income tax liabilities.

As a result of the implementation of FIN 48, the Company recognized an increase in liabilities for unrecognized tax benefits of approximately $245,800, which was accounted for as an increase in the January 1, 2007 accumulated deficit.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in income tax expense. For the three and six months ended June 30, 2007 the Company recognized accrued interest for unrecognized tax benefits of approximately $4,000. There was no interest or penalties recognized during the three months or six months ended June 30, 2006 for unrecognized tax benefits. At June 30, 2007 the Company had approximately $37,875 accrued in interest and penalties associated with the unrecognized tax liabilities.

NOTE 6. CONTINGENCIES AND GUARANTEES

In May, 2006, the Company received notice from the American Stock Exchange ("AMEX") that it was not in compliance with certain of the continued

listing standards as set forth in the AMEX Company Guide due to the failure to comply with Section 1003(a)(i) and Section 1003(a)(ii) of the Company Guide, which effectively required that the Company maintain shareholders' equity of at least $4,000,000. Following the notice from AMEX the Company was afforded the opportunity to submit a "plan of compliance" to AMEX outlining in detail how the Company expected to achieve the minimum equity requirements and to regain compliance. On August 3, 2006 the Company received notification from AMEX that the Company's plan to regain compliance with the minimum shareholders' equity requirements of the AMEX Company Guide had been accepted and the Company has been granted an extension until November 16, 2007 to achieve the AMEX continued listing requirements. During this period the Company will be subject to periodic review by the AMEX Staff and failure to make progress consistent with the plan or to regain compliance with continued listing standards by the end of the extension period could result in being delisted from the American Stock Exchange.

On October 12, 2005, a shareholder class action complaint -- HUBERMAN V.TAG-IT PACIFIC, INC., ET AL., Case No. CV05-7352 R(Ex) -- was filed against us and certain of our current and former officers and directors in the United States District Court for the Central District of California, alleging claims under Section 10(b) and Section 20 of the Securities Exchange Act of 1934. A lead plaintiff was appointed, and his amended complaint alleged that defendants made false and misleading statements about the Company's financial situation and its relationship with certain of its large customers. The action was brought on behalf of all purchasers of our publicly-traded securities during the period from November 13, 2003 to August 12, 2005.

On February 20, 2007, the Court denied class certification. Plaintiff moved the court to reconsider the ruling, and also to intervene a new plaintiff to pursue class certification. Both of those motions were denied on April 2, 2007. In addition, the same day the Court granted defendants' motion for summary judgment, and on or about April 5, 2007, the Court entered judgment in favor of all defendants. On or about April 30, 2007, plaintiff filed a notice of appeal, and his opening appellate brief is due on October 15, 2007. The Company believes that this matter will be resolved in trial or in settlement within the limits of its insurance coverage. However, the outcomes of this action or an estimate of the potential losses, if any, related to the lawsuit cannot be reasonably predicted, and an adverse resolution of the lawsuit could potentially have a material adverse effect on the Company's financial position and results of operations.

On April 16, 2004 the Company filed suit against Pro-Fit Holdings, Limited ("Pro-Fit") in the U.S. District Court for the Central District of California - TAG-IT PACIFIC, INC. V. PRO-FIT HOLDINGS, LIMITED, CV 04-2694 LGB (RCx) -- asserting various contractual and tort claims relating to our exclusive license and intellectual property agreement with Pro-Fit, seeking declaratory relief, injunctive relief and damages. It is the Company's position that the agreement with Pro-Fit gives us the exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. On June 5, 2006 the Court denied the Company's motion for partial summary judgment, but did not find that the Company breached its agreement with Pro-Fit and a trial is required to determine issues concerning our activities in Columbia and whether other actions by Pro-Fit constituted an unwillingness or inability to fill orders. The Court also held that Pro-Fit was not "unwilling or unable" to fulfill orders by refusing to fill orders with goods produced in the United States. The Court has not yet set a date for trial of this matter. The Company has historically derived a significant amount of revenue from the sale of products incorporating

the stretch waistband technology and the Company's business, results of operations and financial condition could be materially adversely affected if the dispute with Pro-Fit is not resolved in a manner favorable to the Company. Additionally, the Company has incurred significant legal fees in this litigation, and unless the case is settled, the Company will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

A subsidiary, Tag-It de Mexico, S.A. de C.V., operated under the Mexican government's Maquiladora Program, which entitled Tag-It de Mexico to certain favorable treatment as respects taxes and duties regarding certain imports. In July of 2005, the Mexican Federal Tax Authority asserted a claim against Tag-It de Mexico alleging that certain taxes had not been paid on imported products during the years 2000, 2001, 2002 and 2003. In October of 2005, the Company filed a procedural opposition to the claim and submitted documents to the Mexican Tax Authority in opposition to this claim, supporting the Company's position that the claim was without merit. The Mexican Federal Tax Authority failed to respond to the opposition filed, and the required response period by the Tax Authority has lapsed. In addition, a controlled entity incorporated in Mexico (Logistica en Avios, S.A. de C.V.) through which the Company conducted its operations in 2005, may be subjected to a claim or claims from the Mexican Tax Authority, as identified directly above, and additionally to other tax issues, including those arising from employment taxes. The Company believes that any such claim is defective on both procedural and documentary grounds and does not believe there will be a material adverse effect on us.

The Company currently has pending a number of other claims, suits and complaints that arise in the ordinary course of our business. The Company believes that we have meritorious defenses to these claims and that the claims are either covered by insurance or, after taking into account the insurance in place, would not have a material effect on the Company's consolidated financial condition if adversely determined against the Company.

In November 2002, the FASB issued FIN No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others - and interpretation of FASB Statements No. 5, 57 and 107 and rescission of FIN 34." The following is a summary of the Company's agreements that it has determined are within the scope of FIN 45:

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. These indemnification provisions 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 7. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements"("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, and does not require any new fair value measurements. The application of SFAS No. 157 however may change current practice within an organization. SFAS No. 157 is effective for all fiscal years beginning after November 15, 2007, with earlier application encouraged. We do not believe that SFAS No. 157 will have a material impact on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115," ("SFAS No. 159") which expands the use of fair value. Under SFAS No. 159 a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and other eligible financial instruments. SFAS No. 159 is effective for years beginning after November 15, 2007. We do not believe that SFAS No. 159 will have a material impact on our financial position, results of operations or cash flows.

NOTE 8. GEOGRAPHIC INFORMATION

The Company specializes in the distribution of a full range of apparel zipper and trim items to manufacturers of fashion apparel, specialty retailers and mass merchandisers. There is not enough difference between the types of products developed and distributed by the Company to account for these products separately or to justify segmented reporting by product type.

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:

	Three Months Ended June 30,		Six Months Ended June 30,	
Country / Region	2007	2006	2007	2006
United States	$ 1,048,400	$ 1,025,100	$ 1,890,900	$ 1,938,400
Asia	11,531,500	8,418,400	18,554,800	14,738,800
Mexico	319,400	1,444,200	599,400	2,579,700
Dominican Republic	269,600	2,631,300	654,700	4,272,100
Other	398,100	727,100	957,300	1,355,300

	$13,567,000	$14,246,100	$22,657,100	$24,884,300

	June 30, 2007	December 31, 2006
LONG-LIVED ASSETS:		
United States	$ 9,459,100	$ 9,531,659
Asia	439,500	386,516
Mexico	1,400	5,078
Dominican Republic	613,500	668,067
	$10,513,500	$10,591,320

NOTE 9. DEBT FACILITY

On June 27, 2007 the Company entered into a Revolving Credit and Term Loan Agreement with Bluefin Capital, LLC that provides for a $5.0 million revolving credit loan and a $9.5 million term loan for a three year period ending June 30, 2010. The revolving credit portion of the facility permits borrowings based upon a formula including 75% the Company's eligible receivables and 55% of eligible inventory, and provides for monthly interest payments at prime plus 2%. The term loan bears interest at 8 1/2% annually with quarterly interest payments. Both of the notes are secured by all of the assets of the Company and mature on June 30, 2010. At closing the proceeds of the term loan were deposited into a restricted cash escrow account and $3.0 million of the borrowings available under the revolving credit note were reserved and held for payment of the Company's $12.5 million convertible promissory notes maturing in November 2007. During July 2007 waivers were obtained from all holders of the convertible promissory notes allowing for early payment of their notes without penalty, and as of July 31, 2007 all of the note holders had been paid in full. At June 30, 2007 the convertible promissory notes payable are reflected in current liabilities.

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As of June 30, 2007 the Company had borrowed $9.5 million under the term note, and $1,307,806 under the revolving credit note. The proceeds of the term note were held in a restricted cash escrow for future payment of the convertible promissory notes, and the proceeds of the borrowings under the revolving credit note were used to pay the related party note payable and accrued interest due to Mark Dyne, Chairman of the Board of the Company, in the amount of $1,004,306, and to pay the initial loan and legal fees due at closing.

In connection with the Revolving Credit and Term Loan Agreement, the Company issued 1,500,000 shares of common stock to the lender for $0.001 per share, and issued 2,100,000 warrants for the purchase of common stock. The warrants are exercisable over a five-year period and 700,000 warrants are exercisable at $0.95 per share; 700,000 warrants are exercisable at $1.05 per share; and 700,000 warrants are exercisable at $1.14 per share. The relative fair value of the equity ($2,380,962, which includes a reduction for financing costs) of the equity issued with this debt facility was allocated to paid-in-capital and reflected as a debt discount to the face value of the term note. This discount will be accreted over the term of the note and recognized as additional interest cost as amortized. Costs associated with the debt facility included debt fees, commitment fees, registration fees, and legal and

professional fees of $548,000. The costs allocable to the debt instruments are reflected in other assets as deferred financing costs and are being amortized over the term of the notes.

NOTE 10. SUBSEQUENT EVENTS

During July 2007 the Company obtained waivers from all of the convertible promissory note holders to accept payment of their notes without penalty. All of the restricted cash escrow funds, together with an additional $3.0 million borrowed under the revolving credit note at July 31, 2007 were used during the month to pay the convertible promissory notes in full.

On July 31, 2007, at the Company's annual meeting of stockholders, the 2007 Stock Plan was approved which replaces the 1997 Stock Plan upon its expiration on October 1, 2007. 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. At June 30, 2007 2,502,877 shares were available for issuance under the 1997 Stock Plan which expires on October 1, 2007 if not issued.

At June 30, 2007 we have an outstanding note receivable from Azteca Production International, Inc. of $2,127,652. The note is receivable in monthly installments over thirty-one months beginning March 1, 2006 and the payments currently range from $133,000 - $267,000 per month until paid in full. Accounts receivable at June 30, 2007 includes $219,900 due from Azteca, against which $119,800 in checks from Azteca were being held. At August 1, 2007 $47,900 of these checks had been collected. On April 11, 2007 a favorable verdict was awarded to the plaintiff in a trademark infringement lawsuit in which Azteca is a defendant and is now appealing. This adverse ruling against Azteca may impact their ability to repay our note receivable. On July 1, 2007 we did not receive the July 1st note payment on our note receivable from Azteca and we submitted a notice of default. On July 23, 2007 we received an election from Azteca to defer the July 1st payment for an additional 30 days from our default notice in accordance with terms allowing this deferral in the note agreement. Accordingly, the July 1st note payment is now due September 14, 2007. On August 1, 2007 we did not receive the August 1st note payment and accordingly submitted a notice of default to Azteca Production International, Inc. In accordance with the terms of the note agreement, Azteca has a 30 day cure period to correct the existing default. The outcome of these events or an estimate of the potential impact if any, on the collectibility of our note receivable cannot be reasonably predicted at this time. The failure to collect payments under this note could have a material adverse effect on our financial position and results of operations.

On July 20, 2007 the Company changed its name from Tag-It Pacific, Inc. to Talon International, Inc. and changed its AMEX trading symbol from TAG to TLN.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. We describe our respective risks,

uncertainties, and assumptions that could affect the outcome or results of operations below. We have based our forward looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward looking statements. Reference is made in particular to forward looking statements regarding projections or estimates concerning our business, including demand for our products and services, mix of revenue streams, ability to control and/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.

OVERVIEW

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.

On July 20, 2007, we changed our corporate name from Tag-It Pacific, Inc. to Talon International, Inc. in order to reflect our core marketing strategy of focusing on growth opportunities in the global zipper market with our Talon(R) brand zippers.

Talon International, Inc. designs, sells and distributes apparel zippers, specialty waistbands and various apparel trim products to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We sell and market these products under various branded names including Talon and Tekfit. We operate the business globally under three product groups.

We plan to increase our global expansion of Talon zippers through the establishment of a network of Talon locations, distribution relationships, and joint ventures. The network of global manufacturing and distribution locations are expected to improve our global footprint and allow us to more effectively serve apparel brands and manufacturers globally.

Our trim business focus is as an outsourced product development, sourcing and sampling department for the most demanding brands and retailers. We believe that trim design differentiation among brands and retailers has become a critical marketing tool for our customers. By assisting our customers in the development, design and sourcing of trim, we expect to achieve higher margins for our trim products, create long-term relationships with our customers, grow our sales to a particular customer by supplying trim for a larger proportion of their brands, and better differentiate our trim sales and services from those of our competitors.

Our Tekfit services provide manufacturers with the patented technology, manufacturing know-how and materials required to produce garments incorporating an expandable waistband. These products historically have been produced by several manufacturers for one single brand under an exclusive supply contract. This contract expired in October 2006 and we now intend to expand this product to other brands. Our expansion has been limited to date due to the exclusive contract as well as licensing dispute. As

described more fully in this report under Contingencies and Guarantees (see Note 6 to our unaudited consolidated financial statements), we are presently in litigation with Pro-Fit Holdings Limited regarding our exclusively licensed rights to sell or sublicense stretch waistbands manufactured under Pro-Fit's patented technology. As we have derived a significant amount of revenue from the sale of products incorporating the stretch waistband technology, our business, results of operations and financial condition could be materially adversely affected if our dispute with Pro-Fit is not resolved in a manner favorable to us.

RESULTS OF OPERATIONS

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

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2007	2006	2007	2006
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	69.9	71.0	69.9	72.0
Gross profit	30.1	29.0	30.1	28.0
Selling expenses	6.2	4.7	6.8	4.9
General and administrative expenses	17.7	18.5	22.1	21.9
Interest & taxes	2.5	1.1	2.5	1.5
Net income (loss)	3.7%	4.7%	(1.3)%	(0.3)%

SALES

For the three months and six months ended June 30, 2007 and 2006, sales by geographic region based on the location of the customer as a percentage of sales were:

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2007	2006	2007	2006
United States	7.7%	7.2%	8.3%	7.8%
Asia	85.0%	59.1%	81.9%	59.2%
Mexico	2.4%	10.1%	2.6%	10.4%
Dominican Republic	2.0%	18.5%	2.9%	17.2%
Other	2.9%	5.1%	4.3%	5.4%
	100.0%	100.0%	100.0%	100.0%

Sales for the three months ended June 30, 2007 were $13.6 million or $0.7 million (4.8%) less than sales for the three months ended June 30, 2006. Sales for the six months ended June 30, 2007 were $22.7 million or $2.2 million (8.9%) less than sales for the same period in 2006. The reduction in sales for the three and six months ended June 30, 2007 as compared to the same period in 2006 is primarily attributable to lower sales of waistband products as a result of the termination in October of 2006 of our exclusive sales contract for these products. For the three and six months ended June 30, 2007 sales included $0.2 million and $0.6 million, respectively of waistband product sales, as compared to sales of $2.5 million and $4.4 million, respectively of these products for comparable periods in 2006.

Sales within Asia increased $3.1 million, or 37% for the three months ended June 30, 2007 and $3.8 million, or 26% for the six months ended June 30, 2007 as compared to the same periods in 2006. The

increase in sales within Asia is principally the result of increased sales of Talon zippers and our continued expansion in China.

Sales of trim products for the three months and six months ended June 30, 2007 declined $1.4 million and $2.3 million, respectively as compared to the same periods in 2006 principally as a result of lower sales of trim products to our customers in Mexico and the U.S. as production shifted from these areas to Asia and other worldwide markets, and as a result of sales of $0.8 million recognized in the second quarter of 2006 associated with a revenue restatement from a 2005 agreement.

GROSS MARGIN

Gross margin for the three months ended June 30, 2007 was $4.1 million, essentially comparable to the gross margin of $4.1 million for the same period in 2006. Gross margin for the six months ended June 30, 2007 was $6.8 million or $0.1 million (2%) less than gross margin for the same period in 2006. The change in gross margin for the three and six months ended June 30, 2007 as compared to the same periods in 2006 was principally attributable to reduced costs associated with lower overall sales volumes, lower direct margin resulting from a change in the mix in product sales, reduced distribution charges since more products are now sourced and delivered within the same marketplace, reduced manufacturing and assembly overhead costs and lower inventory obsolescence and management charges as inventory levels have been reduced and turns accelerated. A brief recap of the change in gross margin for the three and six months ended June 30, 2007 as compared with the same periods in 2006 is as follows:

	(Amounts in thousands)		
	THREE MONTHS		SIX MO
	AMOUNT	%(1)	AMOUNT
Gross margin (decrease) increase as a result of:			
Lower volumes	$ (234)	(5.6)	$ (791)
Product margin mix	(20)	(0.5)	(319)
Vendor cost reductions negotiated in 2006	(261)	(6.3)	(261)
Reduced freight and duty costs	151	3.7	316
Lower manufacturing & assembly costs	163	3.9	130
Reduced obsolescence & inventory costs	109	2.7	639
Other cost of sales charges	47	1.1	146
Gross margin (decrease)	$ (45)	(1.0)%	$ (140)

(1) Represents the percentage change in the 2007 period, as compared to the same period in 2006.

SELLING EXPENSES

Selling expenses for the three months ended June 30, 2007 were $0.8 million, or 6.2% of sales compared to $0.7 million or 4.7% of sales for the same period in 2006. The increase in selling expense is principally due to the increased number of sales offices and salespersons within China and their associated compensation and travel costs, offset in part by lower royalty fees on waistband products.

Selling expenses for the six months ended June 30, 2007 were $1.5 million or 6.8% of sales compared to $1.2 million or 4.9% of sales for the same period in 2006. The increase in selling expense is principally due to the increased number of sales offices and salesmen within China and their associated compensation and travel costs and increased marketing cost associated with the Talon brand offset in part by lower royalty fees on waistband products.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the three months ended June 30, 2007 were $2.4 million or $0.2 million less than for the same period in 2006. General and administrative expenses for the six months ended June 30, 2007 were $5.0 million or $0.3 million less than for the same period in 2006.

General and administrative expense for the three month period ended June 30, 2007 increased by approximately $217,000 as a result of $53,000 in bad debt provisions in 2007 compared to bad debt recoveries of $164,000 in 2006; by $133,000 due to additional consulting fees on contracts with former employees; and general and administrative expense decreased by approximately $156,000 as a result of lower facility costs; by $275,000 in lower legal, audit and investor costs; and by approximately $64,000 in other lower overall general and administrative expenses.

For the six month period ended June 30, 2007 general and administrative expenses as compared to the same period of 2006 declined by approximately $0.3 million. The net reduction reflected an increase of $439,000 as a result of $42,000 in bad debt provisions in 2007 compared to bad debt recoveries of $397,000 in 2006; offset by decreases in general and administrative expenses by $164,000 resulting from lower facility costs; by $459,000 in lower legal, audit and investor costs, and by approximately $95,000 in other lower general and administrative costs.

INTEREST EXPENSE

Interest expense increased by approximately $37,000 to $266,000 for the three months ended June 30, 2007, as compared to the same period in 2006. The increase principally reflects lower interest earnings on cash and the note receivable, in addition to higher debt amortization costs. Interest expense for the six months ended June 30, 2007 decreased by approximately $25,000 to $491,000, as compared to the same period in 2006. The change for the period from 2006 is due mainly to lower borrowings under a bank line of credit and certain notes. Interest expense for the remaining term of the new debt facility entered into in June 2007 will include approximately $0.2 million per quarter in non-cash charges for debt accretion and deferred financing costs amortization.

INCOME TAXES

Income tax expense for the three and six months ended June 30 2007 was $78,624 and for the three and six months ended June 30, 2006 the income tax

expense was $11,500. The tax expense in both 2007 and 2006 is associated with foreign income taxes from earnings within our Asian facilities. Due to prior operating losses incurred within the year no benefit for domestic income taxes has been recorded since there is not sufficient evidence to determine that we will be able to utilize our net operating loss carryforwards to offset future taxable income.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes selected financial data (amounts in thousands) at:

	JUNE 30, 2007	DECEMBER 31, 2006
Cash and cash equivalents	$ 3,822	$ 2,935
Total assets	$ 28,358	$ 25,693
Current debt	$ 11,835	$ 22,471
Non-current debt	$ 12,838	$ 1,536
Stockholders' equity	$ 3,686	$ 1,686

CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the six months ended June 30, 2007 increased $887,000 from December 31, 2006 principally arising from cash generated by operating activities, and Restricted cash increased by $9.5 million from borrowings under a term loan agreement.

Cash provided by operating activities is our primary recurring source of funds, and was approximately $1.8 million for the six months ended June 30, 2007. The cash provided by operating activities during the six months resulted principally from net earnings before non-cash charges of $576,000; an increase in trade accounts payable of $2,560,000; a net reduction of $496,000 in inventory (a $661,000 reduction in inventory levels, net of established reserves of $165,000); offset by an increase in current receivables of $1,424,000; an increase in net recoverable legal fees of $304,000; and an increase in prepaid expenses and other of $128,000.

During the six months ended June 30, 2006 established reserves for uncollectible accounts receivable were applied to approximately $0.6 million of accounts written-off, and approximately $0.3 million in reserves were eliminated following the collection of previously reserved accounts. Cash used by operating activities for the six months ended June 30, 2005 was $148,000.

Net cash used in investing activities for the six months ended June 30, 2007 was $515,000 as compared to $26,000 for the six months ended June 30, 2006. These expenditures were principally associated with leasehold improvements in new facilities, office equipment for new employees, improvements in our technology systems and a marketing website acquisition. In 2006 the cash used for investing activities consisted primarily of capital expenditures for replacing computer equipment.

Net cash of $9,126,000 was generated from financing activities for the six months ended June 30, 2007. $10,507,000 (net of issuance costs) was provided by the issuance of common stock and warrants, and by borrowings under a new debt facility (see Note 9) designated to payoff our existing convertible promissory notes and to provide funds for future growth. The proceeds from this debt facility initially included $9,500,000 that was funded to a restricted escrow

account to partially pay the $12,500,000 of outstanding convertible promissory notes, and $1,004,000 was used to pay a related party note and associated accrued interest. Approximately $374,000 was used primarily for the repayment of borrowings under capital leases and notes payable partially offset by collections on the note receivable and the proceeds of the exercise of stock options. Additionally, net cash used by financing activities for the six months ended June 30, 2006 was $467,000 and represented the repayment of notes payable and capital leases, partially offset by funds collected from the note receivable.

We currently satisfy our working capital requirements primarily through cash flows generated from operations. As we continue to expand globally in response to the industry trend to outsource apparel manufacturing to offshore locations, our foreign customers, some of which are backed by U.S. brands and retailers, are increasing. Our revolving debt facility provides limited financing secured by our accounts receivable, and our current borrowing capability may not provide the level of financing we need to expand into additional foreign markets. As a result, we are continuing to evaluate non-traditional financing of our foreign assets and equity transactions to provide capital needed to fund our expansion and operations.

We have incurred significant legal fees in our litigation with Pro-Fit Holdings Limited. Unless the case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

We believe that our existing cash and cash equivalents and anticipated cash flows from our operating activities and available financing will be sufficient to fund our minimum working capital and capital expenditure needs for at least the next twelve months. This conclusion is based on the belief that our

strategic plan and the company's current structure will allow for continued profitability; and that we will collect our note and accounts receivable in accordance with existing terms.

If we are unable to collect our note and accounts receivable, or experience greater than anticipated reductions in sales, we may need to raise additional capital, or further reduce the scope of our business in order to fully satisfy our future short-term liquidity requirements. If we cannot raise additional capital or reduce the scope of our business in response to a substantial decline in sales, we may default on our debt agreement. The event of a default on the debt agreements will materially affect the business operations in the long-term, however the on-going operations for 2007 are nevertheless anticipated to substantially continue throughout the 2007 year-end.

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 future acquisitions, our borrowing base availability limitations related to eligible accounts receivable and inventories and our expansion into foreign markets. Our need for additional long-term financing includes the integration and expansion of our operations to exploit our rights under our Talon trade name, the expansion of our operations in the Asian, Central and South American and Caribbean markets and the further development of our waistband technology. 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 additional debt or equity financing in order to provide for our operations. We are continually evaluating various financing strategies to be used to expand our business and fund future

growth or acquisitions. There can be no assurance that additional debt or equity financing will be available on acceptable terms or at all. If we are unable to secure additional financing, we may not be able to execute our plans for expansion, including expansion into foreign markets to promote our Talon brand trade name, and we may need to implement additional cost savings initiatives.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

The following summarizes our contractual obligations at June 30, 2007 and the effects such obligations are expected to have on liquidity and cash flow in future periods:

	PAYMENTS DUE BY PERIOD				
CONTRACTUAL OBLIGATIONS	TOTAL	LESS THAN 1 YEAR	1 TO 3 YEARS	4 TO 5 YEARS	AFTE 5 YEA
Demand notes payable to related parties (1)	$ 209,500	$ 209,500	$ 0	$ 0	$
Capital lease obligations	$ 831,600	$ 474,000	$ 357,600	$ 0	$
Operating leases	$ 1,282,500	$ 492,100	$ 782,700	$ 7,700	$
Notes payable	$15,421,500	$ 1,590,300	$13,236,100	$ 595,100	$
Convertible notes payable (2) .	$ 3,051,700	$ 3,051,700	$ 0	$ 0	$
Total Obligations	$20,796,800	$ 5,817,600	$14,376,400	$ 602,800	$

(1) The majority of notes payable to related parties is due on demand with the remainder due and payable on the fifteenth day following the date of delivery of written demand for payment, and includes accrued interest payable through June 30, 2007.

(2) Net of $9,500,000 held in escrow for payment of these notes.

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At June 30, 2007 and 2006, 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

A director and significant shareholder of Tarrant Apparel Group is also a significant shareholder of the Company. Sales to Tarrant for the three months and six months ended June 30, 2007 were $139,900, and $140,000, respectively. Sales to Tarrant for the three and six months ended June 30, 2006 were zero and $1,000 respectively. As of June 30, 2007 there were accounts receivable of $140,000 due from Tarrant, and at December 31, 2006 there were no amounts due from Tarrant.

Colin Dyne, a director and stockholder of the Company is also a

director, officer and significant stockholder in People's Liberation, Inc. During the three and six months ended June 30, 2007 we had sales of $65,600 and $349,200, respectively, to subsidiaries of People's Liberation, Inc. For the three and six months ended June 30, 2006 we had no sales to Peoples Liberation, Inc. At June 30, 2007, accounts receivable included $56,500 outstanding from People's Liberation subsidiaries. At December 31, 2006, accounts receivable of $83,400 was outstanding from subsidiaries of People's Liberation, Inc.

Jonathan Burstein, a director of the Company, purchases products from the Company through an entity operated by his spouse. For the three and six months ended June 30, 2007 sales to this entity were $30,000 and $33,600, respectively. Sales to this entity for the three and six months ended June 30, 2006 were $800 and $10,600, respectively. At June 30, 2007, $19,500 was included in accounts receivable from this entity and at December 31, 2006 accounts receivable included $18,400 due from this entity.

Due from related parties at June 30, 2007 includes $722,900 and at December 31, 2006 includes $675,100 of unsecured notes, advances and accrued interest receivable from Colin Dyne. The notes and advances bear interest at 7.5% and are due on demand.

Demand notes payable to related parties includes notes and advances to parties related to or affiliated with Mark Dyne, Chairman of the Board of the Company. The principal balance of Demand notes payable to related parties at June 30, 2007 was $85,200 and at December 31, 2006 was $665,000. On June 27, 2007 a note payable to Mark Dyne in the principal amount of $665,000, plus accrued interest of $339,000, was paid in full.

Consulting fees paid to Diversified Investments, a company owned by Mark Dyne, amounted to $37,500 for the three months ended June 30, 2007 and 2006. Consulting fees paid for the six months ended June 30, 2007 and 2006 were $75,000.

Consulting fees of $75,000 and $ 125,200 were paid for services provided by Colin Dyne for the three months and six months ended June 30, 2007, respectively. For the three and six months ended June 30, 2006 consulting fees of $72,000 were paid to Colin Dyne. Consulting fees of $73,800 and $147,200 were paid for services provided by Jonathan Burstein, for the three months and six months ended June 30, 2007. No consulting fees were paid to Jonathan Burstein in 2006.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

disclosure of contingent liabilities and the reported amounts of revenue and expense. Actual results could differ from those estimates.

Critical accounting policies are those that are important to the

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

- Accounts receivable balances are evaluated on a continual basis and allowances are provided for potentially uncollectible accounts based on management's estimate of 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.

- Inventories are stated at the lower of cost or market value. 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 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.

- We record deferred tax assets 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 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. o We record 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 our long-lived assets. Long-lived assets are evaluated on a continual basis and impairment adjustments are made based upon management's valuations.

- 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 products sold are recorded at the time title transfers to customers. Actual product returns are charged against estimated sales return allowances.

- Upon approval of a restructuring plan by management, we record restructuring reserves for certain costs associated with facility closures and business reorganization activities as they are incurred or when they become probable and estimable. Such costs are recorded as a current liability. We record restructuring reserves in compliance with SFAS 146 "Accounting for Costs Associated with Exit or Disposal Activities", resulting in the recognition of employee severance and related termination benefits for recurring arrangements when they became probable and estimable and on the accrual basis for one-time benefit arrangements. We record other costs associated with exit activities as they are incurred. Employee severance and termination benefits are estimates based on agreements with the relevant union representatives or plans adopted by us that are applicable to employees not affiliated with unions. These costs are not associated with nor do they benefit continuing activities. Inherent in the estimation of these costs are assessments related to the most likely expected outcome of the significant actions to accomplish the restructuring. Changing business conditions may affect the assumptions related to the timing and extent of facility closure activities. We review the status of restructuring activities on a quarterly basis and, if appropriate, record changes based on updated estimates.

- 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 SFAS No. 5, "Accounting for 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.

NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, and does not require any new fair value measurements. The application of SFAS No. 157 however may change current practice within an organization. SFAS No. 157 is effective for all fiscal years beginning after November 15, 2007, with earlier application encouraged. We do not believe that SFAS No. 157 will have a material impact on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115," ("SFAS No. 159") which expands the use of fair value. Under SFAS No. 159 a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments,

accounts payable, guarantees, issued debt and other eligible financial instruments. SFAS No. 159 is effective for years beginning after November 15, 2007. We do not believe that SFAS No. 159 will have a material impact on our financial position, results of operations or cash flows.

CAUTIONARY STATEMENTS AND 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.

OUR GROWTH AND OPERATING RESULTS COULD BE MATERIALLY, ADVERSELY AFFECTED IF WE ARE UNSUCCESSFUL IN RESOLVING A DISPUTE THAT NOW EXISTS REGARDING OUR RIGHTS UNDER OUR EXCLUSIVE LICENSE AND INTELLECTUAL PROPERTY AGREEMENT WITH PRO-FIT. Pursuant to our agreement with Pro-Fit Holdings, Limited, we have exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. We are in litigation with Pro-Fit regarding our rights. See Part II, Item 1, "Legal Proceedings" for discussion of this litigation. We have derived a significant amount of revenues from the sale of products incorporating the stretch waistband technology. Our business, results of operations and financial condition could be materially adversely affected if we are unable to reach a settlement in a manner acceptable to us and ensuing litigation is not resolved in a manner favorable to us. Additionally, we have incurred significant legal fees in this litigation, and unless the case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

IF WE LOSE OUR LARGER CUSTOMERS OR THEY FAIL TO PURCHASE AT ANTICIPATED LEVELS, OUR SALES AND OPERATING RESULTS WILL BE ADVERSELY AFFECTED. Our results

of operations will depend to a significant extent upon the commercial success of our larger customers. If these customers fail to purchase our products at anticipated levels, or our relationship with these customers terminates, it may have an adverse effect on our results because:

- We will lose a primary source of revenue if these customers choose not to purchase our products or services;
- We may not be able to reduce fixed costs incurred in developing the relationship with these customers in a timely manner;
- We may not be able to recoup setup and inventory costs;
- We may be left holding inventory that cannot be sold to other customers; and
- We may not be able to collect our receivables from them.

In October 2006, our exclusive supply agreement with Levi Strauss & Co., pursuant to which we supplied Levi with TEKFIT waistbands for their Dockers programs, expired. With the expiration of this contract we now have broader access to other customers and we intend to actively expand this product offering to other brands. Sales of this product to Levi are expected to end during the second quarter of 2007 and to be significantly lower than in the previous year, and orders from new brands are not expected to fully offset these declines for several quarters, if at all. The revenues we derived from the sale of products incorporating the stretch waistband technology represented approximately 19% of our consolidated revenues for the years ended December 31, 2005 and 2006. A failure to attract new customers for our TEKFIT waistbands could have a material adverse effect on our sales and results of operations.

IF WE ARE NOT ABLE TO REGAIN COMPLIANCE WITH LISTING REQUIREMENTS, OUR SHARES MAY BE REMOVED FROM LISTING ON AMEX. In May 2006 we were advised by AMEX that we were non-compliant with the minimum net equity listing requirements and we were afforded an opportunity to submit a plan to AMEX that provided for increases in our equity beyond the minimum $4.0 million equity requirement within an eighteen-month timeframe from

the date of the notice from AMEX. On August 3, 2006 AMEX accepted our plan to regain compliance and has given us an extension until November 16, 2007 to become compliant with the AMEX continued listing standards. During this period, we will be subject to periodic review by the AMEX staff and failure to make progress consistent with the plan or to regain compliance with continued listing standards by the end of the extension period could result in being delisted from the American Stock Exchange. In addition we have suffered substantial recurring losses and may fail to comply with other listing requirements of AMEX. We may not be able to regain compliance with these matters within the time allowed by the exchange, and our shares of common stock may be removed from the listing on AMEX.

WE MAY NOT BE ABLE TO COLLECT OUR NOTE RECEIVABLE. On April 11, 2007 a favorable verdict was awarded to the plaintiff in a trademark infringement lawsuit in which Azteca Production International, Inc. is a defendant. We have an outstanding note from Azteca at June 30, 2007 of $2.1 million and this adverse ruling against them may impact their ability to repay our note receivable. The outcome of this event or an estimate of the potential impact if

any, on the collectibility of our note receivable cannot be predicted at this time. The failure to collect payments under this note as scheduled could have a material adverse effect on our financial position, results of operations and cash flow. At August 1, 2007 Azteca had deferred its July 1, 2007 payment under the terms of the agreement and was in default under its August payment requirements (See note 10).

IF CUSTOMERS DEFAULT ON INVENTORY PURCHASE COMMITMENTS WITH US, WE WILL BE LEFT HOLDING NON-SALABLE INVENTORY. We hold significant 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 significant amounts of non-salable inventory and this would have a negative impact on our operations and cash flow.

OUR REVENUES MAY BE HARMED IF GENERAL ECONOMIC CONDITIONS WORSEN. Our revenues depend on the health of the economy and the growth of our customers and potential future customers. When economic conditions weaken, certain apparel manufacturers and retailers, including some of our customers may experience financial difficulties that increase the risk of extending credit to such customers. Customers adversely affected by economic conditions have also attempted to improve their own operating efficiencies by concentrating their purchasing power among a narrowing group of vendors. There can be no assurance that we will remain a preferred vendor to our existing customers. A decrease in business from or loss of a major customer could have a material adverse effect on our results of operations. Further, if the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, we may experience a material adverse impact on our business, operating results, and financial condition.

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.

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 significant fluctuations in operating results from quarter to quarter, which may lead to unexpected reductions in revenues and stock price volatility. 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 customers' marketing campaigns;

- The loss or addition of a major customer;

- The availability and pricing of materials for our products;

- The increased expenses incurred in connection with the introduction of new products;

- Currency fluctuations;
- 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. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such a company. In October 2005, a securities class action lawsuit was filed against us. See Part II, Item 1, "Legal Proceedings" for a detailed description of this lawsuit.

THE OUTCOME OF 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. We are defendants in a number of 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 to the claims made in each and all of the litigation matters to which we have been named a party, and intend to contest each lawsuit vigorously, no assurances can be given that the results of these matters will be favorable to us. An adverse resolution of any of these lawsuits could have a material adverse effect on our financial position and results of operations.

We maintain product liability and director and officer insurance that we regard as reasonably adequate to protect us from potential claims; however we cannot assure you that it will be adequate to cover any losses. Further, the costs of insurance have increased dramatically in recent years, and the availability of coverage has decreased. As a result, we cannot assure you that we will be able to maintain our current levels of insurance at a reasonable cost, or at all.

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, and we expect our business to continue to experience, 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.

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. We must consolidate and centralize the management of our subsidiaries and significantly expand and improve our financial and operating controls. 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 adverse effects on the information reported.

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 to a significant extent 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.

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. 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.

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 customer's trim needs. Such defects or interruptions could result in lost revenues and lost customers.

THE REQUIREMENTS OF THE SARBANES-OXLEY ACT, INCLUDING SECTION 404, ARE BURDENSOME, AND OUR FAILURE TO COMPLY WITH THEM COULD HAVE A MATERIAL ADVERSE AFFECT ON OUR BUSINESS AND STOCK PRICE. Effective internal control over financial reporting is necessary for us to provide reliable financial reports and effectively prevent fraud. Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate and report on our internal control over financial reporting beginning with our annual report on Form 10-K for the fiscal year ending December 31, 2007. Our independent registered public accounting firm will need to annually attest to our evaluation, and issue their own opinion on our internal control over financial reporting beginning with our annual report on Form 10-K for the fiscal year ending December 31, 2008. We are preparing for compliance with Section 404 by strengthening, assessing and testing our system of internal control over financial reporting to provide the basis for our report. The process of strengthening our internal control over financial reporting and complying with Section 404 is expensive and time consuming, and requires significant management attention. Failure to implement required controls, or difficulties encountered in their implementation, could cause us to fail to meet our reporting obligations. If we or our auditors discover a material weakness in our internal control over financial reporting, the disclosure of that fact, even if the weakness is quickly remedied, could diminish investors' confidence in our financial statements and harm our stock

price. In addition, non-compliance with Section 404 could subject us to a variety of administrative sanctions, including the suspension of trading, ineligibility for listing on one of the national securities exchanges, and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price.

THERE ARE MANY COMPANIES THAT OFFER SOME OR ALL OF THE PRODUCTS AND SERVICES WE SELL AND IF WE ARE UNABLE TO SUCCESSFULLY COMPETE OUR BUSINESS WILL BE ADVERSELY AFFECTED. We compete in highly competitive and fragmented industries with numerous local and regional companies that provide some or all of the products and services we offer. We compete with national and international design companies, distributors and manufacturers of tags, packaging products, zippers and other trim items. Some of our competitors have greater name recognition, longer operating histories and greater financial and other resources than we do.

UNAUTHORIZED USE OF OUR PROPRIETARY TECHNOLOGY MAY INCREASE OUR LITIGATION COSTS AND ADVERSELY AFFECT OUR SALES. We rely on trademark, 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.

COUNTERFEIT PRODUCTS ARE NOT UNCOMMON IN THE APPAREL INDUSTRY AND OUR CUSTOMERS MAY MAKE CLAIMS AGAINST US FOR PRODUCTS WE HAVE NOT PRODUCED AND WE MAY BE ADVERSELY IMPACTED 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, or we may have to pay for false claims.

OUR STOCK PRICE MAY DECREASE, WHICH COULD ADVERSELY AFFECT OUR BUSINESS

AND CAUSE OUR STOCKHOLDERS TO SUFFER SIGNIFICANT LOSSES. 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;
- Interest rates;
- Changes in accounting principles;
- Intellectual property and legal matters;
- Sales of common stock by existing shareholders 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 MAY NOT BE ABLE TO REALIZE THE ANTICIPATED BENEFITS OF ACQUISITIONS. We may consider strategic acquisitions as opportunities arise, subject to the obtaining of any necessary financing. 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 HAVE ADOPTED A NUMBER OF ANTI-TAKEOVER MEASURES THAT MAY DEPRESS THE PRICE OF OUR COMMON STOCK. Our stockholders' rights plan, our ability to issue additional shares of preferred stock 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 us. 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.

INSIDERS OWN A SIGNIFICANT PORTION OF OUR COMMON STOCK, WHICH COULD LIMIT OUR STOCKHOLDERS' ABILITY TO INFLUENCE THE OUTCOME OF KEY TRANSACTIONS. As of August 1, 2007, our officers and directors and their affiliates beneficially owned approximately 19% of the outstanding shares of our common stock. The Dyne family, which includes Mark Dyne, Colin Dyne, and Jonathan Burstein, who are also our directors; Larry Dyne and the estate of Harold Dyne; beneficially owned approximately 13% of the outstanding shares of our common stock at August 1, 2007. As a result, our officers and directors and the Dyne family are able to exert considerable influence over the outcome of any matters submitted to a vote of the holders of our common stock, including the election of our Board of Directors. The voting power of these stockholders could also discourage others from seeking to acquire control of us through the purchase of our common stock, which might depress the price of our common stock.

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 the 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.

ITEM 3. 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, Chinese yuans and British pounds. There were no hedging contracts outstanding as of June 30, 2007 or December 31, 2006. 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. At June 30, 2007 the Revolving Credit Note of $1.3 million was subject to interest rate fluctuations.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act is recorded,

processed, summarized and reported, within the time periods specified in the Securities Exchange Commission's rules and forms, including to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurance of achieving the desired control objectives.

As of June 30, 2007, we conducted an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2007, our disclosure controls and procedures were effective at a reasonable assurance level.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There were no significant changes in our internal controls over financial reporting that occurred during the second quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 12, 2005, a shareholder class action complaint -- HUBERMAN V.TAG-IT PACIFIC, INC., ET AL., Case No. CV05-7352 R(Ex) -- was filed against us and certain of our current and former officers and directors in the United States District Court for the Central District of California, alleging claims under Section 10(b) and Section 20 of the Securities Exchange Act of 1934. A lead plaintiff was appointed, and his amended complaint alleged that defendants made false and misleading statements about our financial situation and our relationship with certain of our large customers. The action was brought on behalf of all purchasers of our publicly-traded securities during the period from November 13, 2003 to August 12, 2005. On February 20, 2007, the Court denied class certification. Plaintiff moved the court to reconsider the ruling, and also to intervene a new plaintiff to pursue class certification. Both of those motions were denied on April 2, 2007. In addition, the same day the Court granted defendants' motion for summary judgment, and on or about April 5, 2007, the Court entered judgment in favor of all defendants. On or about April 30, 2007, plaintiff filed a notice of appeal, and his opening appellate brief is due on October 15, 2007. We believe that this matter will be resolved in trial or in settlement within the limits of its insurance coverage. However, the outcomes of this action or an estimate of the potential losses, if any, related to the lawsuit cannot be reasonably predicted, and an adverse resolution of the lawsuit could potentially have a material adverse effect on our financial position and results of operations.

On April 16, 2004 we filed suit against Pro-Fit Holdings, Limited ("Pro-Fit") in the U.S. District Court for the Central District of California - TAG-IT PACIFIC, INC. V. PRO-FIT HOLDINGS, LIMITED, CV 04-2694 LGB (RCx) -- asserting various contractual and tort claims relating to our exclusive license

and intellectual property agreement with Pro-Fit, seeking declaratory relief, injunctive relief and damages. It is our position that the agreement with Pro-Fit gives us the exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. On June 5, 2006 the Court denied our motion for partial summary judgment, but did not find that we breached our agreement with Pro-Fit and a trial is required to determine issues concerning our activities in Columbia and whether other actions by Pro-Fit constituted an unwillingness or inability to fill orders. The Court also held that Pro-Fit was not "unwilling or unable" to fulfill orders by refusing to fill orders with goods produced in the United States. The Court has not yet set a date for trial of this matter. We have historically derived a significant amount of revenue from the sale of products incorporating the stretch waistband technology and our business, results of operations and financial condition could be materially adversely affected if the dispute with Pro-Fit is not resolved in a manner favorable to us. Additionally, we have incurred significant legal fees in this litigation, and unless the case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

We currently have pending a number of other claims, suits and complaints that arise in the ordinary course of its business. We believe that we has meritorious defenses to these claims and that the claims are either covered by insurance or, after taking into account the insurance in place, would not have a material effect on our consolidated financial condition if adversely determined against us.

ITEM 1A. RISK FACTORS

A restated description of the risk factors associated with the Company is included under "Cautionary Statements and Risk Factors" in Management's Discussion and Analysis of Financial Condition and Results of Operations," contained in Item 2 of Part I of this report. This description includes any material changes to and supersedes the description of the risk factors associated with an investment in the Company previously disclosed in our Annual Report on Form 10-K for 2006 and is incorporated herein by reference.

ITEM 6. EXHIBITS

10.31.2(1)	Amendment, dated May 25, 2007, to employment offer letter between Tag-It Pacific, Inc. and Lonnie Schnell.
10.35	Revolving Credit and Tern Loan Agreement dated June 27, 2007, by and between Tag-It Pacific, Inc. and Bluefin Capital, LLC.
10.36	Guaranty Agreement, dated June 27, 2007, by Talon International, Inc., Tag-It, Inc., A.G.S. Stationary, Inc., Tag-It Pacific Limited, Tag-It Pacific (HK) Ltd., Tagit de Mexico, S.A. de C. V., Talon Zipper (Shenzhen) Company, Ltd., and Talon International, Pvt. Ltd. in favor of Bluefin Capital, LLC.
10.37	Collateral Agreement, dated June 27, 2007, by and among Tag-It Pacific, Inc., Talon International, Inc., Tag-It, Inc., A.G.S. Stationary, Inc., Tag-It Pacific Limited, Tag-It Pacific (HK) Ltd., Tagit de Mexico, S.A. de C. V., Talon Zipper (Shenzhen) Company, Ltd., and Talon International, Pvt. Ltd. in favor of Bluefin Capital, LLC.

10.38	Registration Rights Agreement, dated June 27, 2007, by Talon International, Inc., for the benefit of holders. Incorporated by reference to Exhibit 4.10 to Registration Statement on Form S-3 filed on August 10, 2007.
10.39	Form of Warrant issued to Bluefin Capital, LLC. Incorporated by reference to Exhibit 4.10 to Registration Statement on Form S-3 filed on August 10, 2007.
10.40	Promissory Note, dated June 27, 2007, executed by Colin Dyne in favor of Tag-It Pacific, Inc.
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.

(1) Indicates a management contract or compensatory plan.

SIGNATURES

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

Dated: August 14, 2007

TALON INTERNATIONAL, INC.

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/S/ LONNIE D. SCHNELL

By: Lonnie D. Schnell
Its: Chief Financial Officer