TALON INTERNATIONAL, INC.
Form 10-Q
August 10, 2017

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

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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, 2017

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 registrant as specified in its charter)

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

21900 Burbank Boulevard, Suite 270

Woodland Hills, California 91367

(Address of Principal Executive Offices)(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]
(do not check if smaller reporting company)	Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with the new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

At August 9, 2017, the issuer had **92,338,283** shares of Common Stock, $.001 par value, issued and outstanding.

TALON INTERNATIONAL, INC.

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TALON INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2017 (Unaudited)	**December 31, 2016**
Assets		
Current assets:		
Cash and cash equivalents	$4,671,318	$4,913,577
Accounts receivable, net	5,887,103	4,315,608
Inventories, net	473,958	500,482
Prepaid expenses and other current assets	783,698	702,906
Total current assets	11,816,077	10,432,573
Property and equipment, net	789,781	884,208
Intangible assets, net	4,260,055	4,266,596
Deferred income tax assets, net	5,040,223	5,224,018
Other assets	407,285	347,638
Total assets	$22,313,421	$21,155,033
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of revolving line of credit from related party, net	$39,322	$-
Current portion of capital lease obligations	24,709	23,749
Accounts payable	7,152,544	6,378,896
Accrued expenses	2,609,865	2,972,689
Total current liabilities	9,826,440	9,375,334
Revolving line of credit from related party, net of current portion, discounts and deferred financing costs	4,055,892	4,041,345
Capital lease obligations, net of current portion	24,436	37,035
Deferred income tax liabilities	1,589	3,037
Other liabilities	220,693	236,088
Total liabilities	14,129,050	13,692,839
Commitments and contingencies (Note 12)		
Stockholders' Equity:		
Common Stock, $0.001 par value, 300,000,000 shares authorized; 92,338,283 and 92,274,255 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	92,338	92,274
Additional paid-in capital	65,147,086	65,040,432

Accumulated deficit	(57,134,163)	(57,743,904)
Accumulated other comprehensive income	79,110	73,392
Total stockholders' equity	8,184,371	7,462,194
Total liabilities and stockholders' equity	$22,313,421	$21,155,033

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2017	**2016**	**2017**	**2016**
Net sales	$12,885,747	$14,454,889	$24,003,281	$25,719,521
Cost of goods sold	8,115,985	9,003,343	15,145,143	16,103,716
Gross profit	4,769,762	5,451,546	8,858,138	9,615,805
Sales and marketing expenses	1,481,858	1,760,120	3,089,424	3,263,006
General and administrative expenses	2,169,316	1,888,408	4,468,267	4,314,366
Total operating expenses	3,651,174	3,648,528	7,557,691	7,577,372
Income from operations	1,118,588	1,803,018	1,300,447	2,038,433
Interest expense, net	156,742	155,761	310,668	306,408
Income before provision for income taxes	961,846	1,647,257	989,779	1,732,025
Provision for income taxes	357,643	689,559	380,038	725,210
Net income	$604,203	$957,698	$609,741	$1,006,815
Basic and diluted net income per share	$0.01	$0.01	$0.01	$0.01
Weighted average number of common shares outstanding - Basic	92,304,510	92,271,078	92,289,466	92,269,455
Weighted average number of common shares outstanding - Diluted	93,015,012	93,474,581	92,949,619	93,486,633
Net income	$604,203	$957,698	$609,741	$1,006,815
Other comprehensive income (loss) from foreign currency translation	3,776	(11,753)	5,718	(11,456)
Total comprehensive income	$607,979	$945,945	$615,459	$995,359

See accompanying notes to consolidated financial statements.

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TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2017	**2016**
Cash flows from operating activities:		
Net income	$609,741	$1,006,815
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	157,292	148,292
Amortization of deferred financing cost and debt discounts	53,870	52,138
Stock based compensation	106,718	175,512
Deferred income taxes, net	182,347	517,206
Change in provision for bad debt	29,678	(37,823)
Inventory valuation provisions (recoveries), net	(9,883)	(12,826)
Changes in operating assets and liabilities:		
Accounts receivable	(1,576,323)	(962,477)
Inventories	37,424	29,977
Prepaid expenses and other current assets	(77,561)	(146,400)
Other assets	(57,955)	(55,658)
Accounts payable and accrued expenses	356,774	1,359,236
Other liabilities	(18,252)	(46,764)
Net cash (used in) provided by operating activities	(206,130)	2,027,228
Cash flows from investing activities:		
Acquisitions of property and equipment	(52,360)	(242,925)
Net cash used in investing activities	(52,360)	(242,925)
Cash flows from financing activities:		
Payment of capital leases	(11,639)	(10,754)
Payments related to taxes on the exercise of stock options	-	(700)
Net cash used in financing activities	(11,639)	(11,454)
Net effect of foreign currency exchange translation on cash	27,870	(41,720)
Net increase (decrease) in cash and cash equivalents	(242,259)	1,731,129
Cash and cash equivalents at beginning of period	4,913,577	2,852,315
Cash and cash equivalents at end of period	$4,671,318	$4,583,444

See accompanying notes to consolidated financial statements.

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TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Supplemental disclosures of cash flow information:

	Six Months Ended June 30,	
	2017	**2016**
Cash received (paid) during the period for:		
Interest paid	$(257,764)	$(19,599)
Interest received	$965	$914
Income tax paid, net (principally foreign)	$(46,322)	$(35,171)
Non-cash financing activities:		
Interest accrued on revolving line of credit from related party	$-	$235,586
Non-cash exercise of stock options	$64	$6

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Presentation of Interim Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in comprehensive financial statements have been condensed or omitted pursuant to such rules and regulations, although the management of Talon International, Inc. and its consolidated subsidiaries (collectively, the "Company") believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments, necessary to state fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for 2017.

Note 2. Summary of Significant Accounting Policies

A complete description of the Company's Significant Accounting Policies is included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, and should be read in conjunction with these unaudited consolidated financial statements. The Significant Accounting Policies noted below are only those policies that have changed materially or have supplemental information included for the periods presented here.

Allowance for Accounts Receivable Doubtful Accounts

The Company is required to make judgments as to the collectability of accounts receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful accounts represent allowances for customer trade accounts that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables to their net realizable value. The Company records these allowances based on estimates related to the following factors: (i) customer specific allowances; (ii) amounts based upon an aging schedule; and (iii) an estimated amount, based on the Company's historical experience, for issues not yet identified. Bad debt expense, net for the three and six months ended June 30, 2017 were $46,981 and $29,610, respectively. Bad debt recoveries, net for the three and six months ended June 30, 2016 were $(19,794) and $(20,046), respectively.

Fair Value Measurements

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

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

Level 2—Include other inputs that are directly or indirectly observable in the marketplace.

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company's financial instruments include cash and cash equivalents, and revolving line of credit from related party. In accordance with ASC 820, the Company measures its cash equivalents at fair value. The Company has determined that the book value of the financial instruments is representative of their fair values. The Company's cash equivalents are classified within Level 1 and valued primarily using quoted market prices utilizing market observable inputs. At June 30, 2017 and December 31, 2016, cash equivalents consisted of money market funds measured at fair value on a recurring basis; fair value of the Company's money market funds was approximately $450,334 and $1,125,000, respectively.

Intangible Assets

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

The Company applies Accounting Standards Update ("ASU") 2012-02, "*Intangibles – Goodwill and Other - Testing Indefinite-lived Intangible Assets for Impairment*" to determine whether an impairment is required. The guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then the company is required to estimate the fair value of the indefinite-lived intangible assets and perform a quantitative impairment test in accordance with ASC 350-30. The Company completed the required assessment as of December 31, 2016, and noted no impairment. On an ongoing basis, the Company monitors for interim triggering events and noted no triggering events that would result in impairment as of June 30, 2017.

From time to time the Company makes investments in product and technical opportunities that are complimentary to or enhancements to its apparel accessories business. During the three and six months ended June 30, 2017 and 2016, the Company made no investments in property rights. As of June 30, 2017 and December 31, 2016 the Company had accumulated investments of $38,738 for intellectual property rights complimentary to the Company's Talon Zipper products, which were not yet in service.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Intangible assets as of June 30, 2017 and December 31, 2016 are as follows:

	June 30, 2017	**December 31, 2016**
Tradename - Talon trademark	$4,110,751	$4,110,751
Intellectual property rights	217,459	217,459
Less: Accumulated amortization (10 to 17 years)	(68,155)	(61,614)
Intellectual property rights, net	149,304	155,845
Intangible assets, net	$4,260,055	$4,266,596

Amortization expense for intangible assets was $3,271 for each of the three and six months ended June 30, 2017 and 2016, respectively.

Classification of Expenses

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

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

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

Interest Expense, net – Interest expense reflects the cost of borrowings, amortization of deferred financing costs and amortization of debt discounts. Interest expense for the three and six months ended June 30, 2017 totaled $157,275 and $311,633, respectively. Interest expense for the three and six months ended June 30, 2016 totaled $156,239 and $307,322, respectively. Interest income consists of earnings from cash held in interest bearing accounts. Interest income for each of the three months ended June 30, 2017 and 2016 was less than $1,000. Interest income for the six months ended June 30, 2017 and 2016 was $965 and $914, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Foreign Currency Translation

The Company's reporting currency is US dollars. The Company has operations and holds assets in various foreign countries. The local currency is the functional currency for the Company's subsidiaries in China and India. Assets and liabilities are translated at end-of-period exchange rates while revenues and expenses are translated at the average exchange rates in effect during the period. Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income until the translation adjustments are realized. Included in accumulated other comprehensive income was a cumulative foreign currency translation gain of $79,110 and $73,392 as of June 30, 2017 and December 31, 2016, respectively.

Comprehensive Income

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

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

Use of Estimates

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

Presentation

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3. New Accounting Pronouncements

In May 2017, the FASB issued ASU 2017-09, "Compensation —Stock Compensation (Topic 718): Scope of Modification Accounting." ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance is intended to reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if the award's fair value, vesting conditions and classification as an equity or liability instrument are the same immediately before and after the change. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Management does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-03, *"Accounting Changes and Error Corrections (Topic 250) and Investments – Equity Method and Joint Ventures (Topic 323)."* This ASU responds to SEC staff announcements made in 2016 as it relates to the disclosure of the future impact of the effects of the new FASB guidance on revenue, leases and credit losses on financial instruments in accordance with Staff Accounting Bulletin 74. This ASU was effective upon issuance in January 2017. Management has adopted ASU 2017-03 effective for the first quarter of 2017. The adoption of ASU 2017-03 did not have a material impact to the Company's consolidated financial statements.

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

In December 2016, the FASB issued ASU No. 2016-19, "*Technical Corrections and Improvements"*. This ASU clarifies guidance, corrects errors and makes minor improvements affecting a variety of topics in the Accounting Standards Codification. Most of the amendments are not expected to have a significant effect on practice, but some of them could change practice for some entities. Several provisions in this accounting guidance are effective immediately which did not have an impact on the Company's consolidated financial statements. Additional provisions in this accounting guidance are effective for the Company in annual financial reporting periods beginning after December 15, 2016. Management is currently evaluating the impact that the adoption of the additional provisions in this accounting guidance may have on the Company's consolidated financial statements.

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

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

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

In March 2016, the FASB issued ASU No. 2016-09, "*Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."* The updated accounting guidance simplifies the accounting for share-based payment award transactions including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Management has adopted this guidance for the first quarter of 2017. As required by the update, on a prospective basis, the Company will recognize excess tax benefits related to share-based payments in the provision for income taxes in the consolidated statements of income. Also, on a prospective basis, cash flows related to excess tax benefits recognized on stock-based compensation expense will be classified as an operating activity in the Company's consolidated statements of cash flows. Cash paid on employees' behalf related to shares withheld for tax purposes continues to be classified as a financing activity. Management elected to continue estimating stock-based compensation award forfeitures in determining the amount of compensation cost to be recognized each period.

In February 2016, the FASB issued ASU No. 2016-02 "Leases" (Topic 842). The new standard requires lessee recognition on the balance sheet of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. It further requires recognition in the income statement of a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis. Finally, it requires classification of all cash payments within operating activities in the statement of cash flows. It is effective for fiscal years commencing after December 15, 2018 and early adoption is permitted. In accordance with this standard, the Company will be establishing a right-of-use asset and an offsetting lease liability. Once adopted, management expects to report higher assets and liabilities as a result of including additional lease information on the consolidated balance sheet.

In July 2015, the FASB issued ASU 2015-11, "*Simplifying the Measurement of Inventory*", to reduce th