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TALON INTERNATIONAL, INC.

Form 10-K

April 15, 2008

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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007

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  
(State or Other Jurisdiction of  
Incorporation or Organization)

95-4654481  
(I.R.S. Employer  
Identification No.)

21900 BURBANK BLVD., SUITE 270  
WOODLAND HILLS, CALIFORNIA 91367  
(Address of Principal Executive Offices) (Zip Code)

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

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

NONE

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

COMMON STOCK, \$.001 PAR VALUE

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

Yes  No

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

Yes  No

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

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405

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of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [ ]

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

Large accelerated filer [ ]    Accelerated filer [ ]    Non-accelerated filer [ ]  
 Smaller reporting company [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 June 30, 2007 the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was \$18,202,356. At April 11, 2008 the issuer had 20,291,433 shares of Common Stock, \$.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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TALON INTERNATIONAL, INC.  
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### FORWARD LOOKING STATEMENTS

This report and other documents we file with the SEC contain forward looking statements that are based on current expectations, estimates, forecasts and projections about us, our future performance, our business or others on our behalf, our beliefs and our management's assumptions. In addition, we, or others on our behalf, may make forward looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls, and conference calls. Words such as "expect," "anticipate," "outlook," "could," "target," "project," "intend," "plan," "believe," "seek," "estimate," "should," "may," "assume," "continue," variations of such words and similar expressions are intended to identify such forward looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. We describe our respective risks, uncertainties, and assumptions that could affect the outcome or results of operations in "Item 1A. Risk Factors." We have based our forward looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward looking statements. Reference is made in particular to forward looking statements regarding projections or estimates concerning our business, including demand for our products and services, 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. Except as required under the federal

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securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update publicly any forward looking statements after the distribution of this report, whether as a result of new information, future events, changes in assumptions, or otherwise.

### PART I

#### ITEM 1. BUSINESS

##### GENERAL

Talon International, Inc. specializes in the manufacturing and distribution of a full range of apparel accessories including zippers and trim items to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We manufacture and distribute zippers under our TALON(R) brand name to manufacturers for apparel brands and retailers such as Levi Strauss & Co., Abercrombie & Fitch, Wal-Mart, Kohl's, The Gap, Juicy Couture, and JC Penney, among others. We also provide full service outsourced trim design, sourcing and management services and supply specified trim items for manufacturers of fashion apparel such as Abercrombie & Fitch, Victoria's Secret, American Eagle, Motherhood, Express, Polo Ralph Lauren and others. Under our TEKFIT(R) brand, we develop and sell apparel components that utilize a patented technology, including a stretch waistband.

We were incorporated in the State of Delaware in 1997. We were formed to serve as the parent holding company of Tag-It, Inc., a California corporation, Tag-It Printing & Packaging Ltd., which changed its name in 1999 to Tag-It Pacific (HK) LTD, a BVI corporation, Tagit de Mexico, S.A. de C.V., A.G.S. Stationery, Inc., a California corporation, and Pacific Trim & Belt, Inc., a California corporation. All of these companies were consolidated under a parent limited liability company in October 1997. These companies became our wholly owned subsidiaries immediately prior to the effective date of our initial public offering in January 1998. In 2000, we formed two wholly owned subsidiaries of Tag-It Pacific, Inc: Tag-It Pacific Limited, a Hong Kong corporation, and Talon International, Inc., a Delaware corporation. During 2006 we formed two wholly owned subsidiaries of Talon International, Inc. (formerly Tag-It Pacific, Inc.): Talon Zipper (Shenzhen) Company Ltd. in China, and Talon International Pvt. Ltd., in India. Our web site is WWW.TAGITPACIFIC.COM. On July 20, 2007 we changed our corporate name from Tag-It Pacific, Inc. to Talon International, Inc. Our web site address provided in this Annual Report on Form 10-K is not intended to function as a hyperlink and the information on our website is not and should not be considered part of this report and is not incorporated by reference in this document.

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##### BUSINESS SUMMARY

We operate our business within three product groups, Talon, Trim, and Tekfit. In our Talon group, we design, engineer, test and distribute zippers under our TALON trademark and trade names to apparel brands and manufacturers. TALON enjoys brand recognition in the apparel industry worldwide. TALON is a 100-year-old brand, which is well known for quality and product innovation, and was the original pioneer of the formed wire metal zipper for the jeans industry and is a specified zipper brand for manufacturers in the sportswear and outerwear markets worldwide. We provide a line of high quality zippers, including a specialty zipper for kids clothing, for distribution to apparel manufacturers in Asia, Mexico and Central America and have sales and marketing

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teams in all of these areas. We have also developed, and are now implementing, joint manufacturing arrangements in various geographic international local markets to finish and sell zippers under the TALON brand name. Our contractors work with, purchase or install equipment locally for dying and producing finished zippers. We expect this program to significantly improve the speed at which we serve the market and to expand the geographic footprint of our TALON products. The TALON zipper is promoted both within our trim packages, as well as a stand-alone product line.

In our Trim products group, we act as a fully integrated single-source supplier, designer and sourcing agent of a full range of trim items for manufacturers of fashion apparel. Our business focuses on servicing all of the trim requirements of our customers at the manufacturing and retail brand level of the fashion apparel industry. Trim items include labels, buttons, rivets, printed marketing material, polybasic, packing cartons, and hangers. Trim items comprise a relatively small part of the cost of most apparel products but comprise the vast majority of components necessary to fabricate a typical apparel product. We offer customers a one-stop outsourced service for all trim related matters. Our teams work with the apparel designers, and function as an extension of their staff.

If our customer is creating a new pair of cargo pants for their fall collection, our Trim products group will collaborate with them on their design vision, then present examples of their vision in graphic form for all apparel accessory components. We will design the buttons, snaps, hang tags, labels, zippers, zipper pullers and other items. Once our customer selects the designs they like, our sourcing and production teams coordinate with our proprietary database of manufacturers worldwide to ensure the best manufacturing solution for the items being produced. The proper manufacturing and sourcing solution is a critical part of our service. Knowing the best facility or supplier to ensure timely production, the proper paper finishes, distressing or other types of material needs or manufacturing techniques to be used is critical. Because we perform this function for many different global projects and apparel brands, we have a depth and breadth of knowledge in the manufacturing and sourcing that our customers cannot achieve, and therefore offer a significant value to our customers. In addition, because we are consistently innovating new items, manufacturing techniques and finishes, we bring many new, fresh and unique ideas to our customers. Once we identify the appropriate supply source, we create production samples of all of our designs and products, and review the samples with our customers so they can make a final decision while looking at the actual items that will be used on the garments. When the customer selects the appropriate items, we are identified as the sole-source trim supplier for the project, and our customer's factories are then required to purchase the trim products from us. Throughout the garment manufacturing process, we consistently monitor the timing and accuracy of the production items to ensure the production items exactly match all samples when delivered to our customer's apparel factories.

We also serve as a specified supplier in our zipper and trim products for a variety of major retail brand and private-label oriented companies. A specified supplier is a supplier that has been approved for its quality and service by a major retail brand or private-label company. Apparel contractors manufacturing for the retail brand or private-label company must purchase their zipper and trim requirements from a supplier that has been specified. We seek to expand our services as a supplier of select items for such customers, to being a preferred or single-source provider of the entire brand customer's authorized trim and zipper requirements. Our ability to offer a full range of trim and zipper products is attractive to brand name and private-label oriented customers because it enables the customer to address their quality and supply needs for all of their trim requirements from a single source, avoiding the time and expense necessary to monitor quality and supply from multiple vendors and manufacturer sources. Becoming a specified supplier to brand customers gives us

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an advantage to become the preferred or sole vendor of trim and zipper items for all apparel manufacturers contracted for production for that brand name.

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Our teams of sales employees, representatives, program managers, creative design personnel and global production and distribution coordinators at our facilities located in the United States, China, India and the Caribbean enable us to take advantage of and address the increasingly complicated requirements of the large and expanding demand for complete apparel accessory solutions. We plan to continue to expand operations in Asia, Europe, Central and South America and the Caribbean to take advantage of the large apparel manufacturing markets in these regions.

### PRODUCTS

**TALON ZIPPERS** - We offer a full line of metal and synthetic zippers bearing the TALON brand name. TALON zippers are used primarily by manufacturers in the apparel industry and are distributed through our distribution facilities in the United States, India and China and through our agents, distributors and affiliates in other international markets.

We plan to expand our distribution of TALON zippers through the establishment of a network of TALON owned sales, distribution and manufacturing locations, distribution relationships and joint ventures. The network of these distributors and manufacturing joint ventures, in combination with TALON owned and affiliated facilities under the TALON brand, is expected to improve our time-to-market by eliminating the typical setup and build-out phase for new manufacturing capacity throughout the world, and by sourcing, finishing and distributing to apparel manufacturers in their local markets. The branded apparel zipper market is dominated by one company and we are positioning TALON to be a viable global alternative to this competitor and capture an increased market share position. We plan to leverage the brand awareness of the TALON name by branding other products in our line with the TALON name.

**TRIM** - We consider our high level of customer service as a fully integrated single-source supplier essential to our success. We combine our high level of customer service within our TRIM solutions with a history of design and manufacturing expertise to offer our customers a complete trim solution product. We believe this full-service product gives us a competitive edge over companies that only offer selected trim components because our full service solutions saves our customers substantial time in ordering, designing, sampling and managing trim orders from several different suppliers. Our proprietary tracking and order management systems allow us to seamlessly supply trim solutions and products to apparel brands, retailers and manufacturers around the world.

We produce customized woven, leather, synthetic, embroidered and novelty labels and tapes, which can be printed on or woven into a wide range of fabrics and other materials using various types of high-speed equipment. As an additional service, we may provide our customers the machinery used to attach the buttons, rivets and snaps we distribute.

In 2005 we marketed and supplied complete trim packages on a per-garment basis which we assembled on behalf of our customers. Each trim package included all items of trim that a customer needed in the manufacture of a particular item of apparel, including thread, zippers, labels, buttons, rivets, polybags, packing cartons and hangers. We also included printed marketing materials such as hang tags, bar-coded hang tags, pocket flashers, waistband tickets and size stickers that were attached to products to identify

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and promote the products, permit automated data collection, provide brand identification and communicate consumer information such as a product's retail price, size, fabric content and care instructions. We continue to sell the trim package components separately, but phased-out the offering as a complete kit in late 2005 as our cost of labor for the assembly was no longer competitive, and the market was not willing to pay the premium for pre-assembly of the trim material. In 2005 we also decided to discontinue offering thread as a portion of our trim products and we negotiated an agreement with our supplier for the return of substantially all of the company's thread products. We instead, are sharpening our focus on the market opportunity in which we add the most value, our full-service Trim solutions.

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TEKFIT - We distribute a proprietary stretch waistband under our Exclusive License and Intellectual Property Rights agreement with Pro-Fit Holdings, Limited. The agreement gives us the exclusive rights to sell or sublicense stretch waistbands manufactured under the patented technology developed by Pro-Fit for garments manufactured anywhere in the world for sale in the U.S. market and for all U.S. brands for the life of the patent. We offer apparel manufacturers advanced, patented fabric technologies to utilize in their garments under the TEKFIT name. This technology allows fabrics to be altered through the addition of stretch characteristics resulting in greatly improved fit and comfort. This technology allows pant manufacturers to build-in a stretch factor into standard waistbands that does not alter the appearance of the garment, but will allow the waist to stretch out and back by as much as two waist sizes. Previously, we supplied Levi Strauss & Co. with TEKFIT waistbands for their Dockers(R) programs, under an exclusive supply agreement. In October 2006 our exclusive contract with this brand 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.

Our efforts to expand this product offering to other customers have also been limited by a licensing dispute. As described more fully in Item 3 "Legal Proceedings" we are presently in litigation with Pro-Fit related to our exclusively licensed rights to sell or sublicense stretch waistbands manufactured under Pro-Fit's patented technology. The revenues we derive from the sale of products incorporating the stretch waistband technology represented approximately 2% of our consolidated revenue for the year ended December 31, 2007, and 19% for the years ended December 31, 2006 and 2005. Accordingly, the 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, or if we are unsuccessful in securing new customers to replace the revenues previously generated by our exclusive sales of this product to Levi.

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

	Year Ended December 31,		
	2007	2006	2005
Product Group Net Revenue:			
Talon zipper .....	52.2%	34.8%	28.7%
Trim .....	46.1%	46.1%	52.4%
Tekfit .....	1.7%	19.1%	18.9%

DESIGN AND DEVELOPMENT

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Our in-house creative team produces products with innovative technology and designs that we believe distinguish our products from those of our competitors. We support our skills and expertise in material procurement and product-manufacturing coordination with product technology and designs intended to meet fashion demands, as well as functional and cost parameters. In 2006, we introduced the Talon KidZip which is a specialty zipper for children's apparel engineered to surpass industry established strength and safety tests, while maintaining the fashion image and requirements of today's apparel demands.

Many specialty design companies with which we compete have limited engineering, sourcing or manufacturing experience. These companies create products or designs that often cannot be implemented due to difficulties in the manufacturing process, the expenses of required materials, or a lack of functionality in the resulting product. We design products to function within the limitations imposed by the applicable manufacturing framework. Using our manufacturing and sourcing experience, we ensure delivery of quality products and we minimize the time-consuming delays that often arise in coordinating the efforts of independent design houses and manufacturing facilities. By supporting our material procurement and product manufacturing services with design services, we believe that we reduce development and production costs and deliver products to our customers sooner than many of our competitors. Our development costs are low, most of which are borne by our customers. Our design teams are based out of our California and Hong Kong facilities.

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### CUSTOMERS

We have more than 500 active customers. Our customers include the designated suppliers of well-known apparel manufacturers, such as Levi Strauss & Co., Abercrombie & Fitch, Juicy Couture, Victoria's Secret, and Polo Ralph Lauren, among others. Our customers also include contractors for specialty retailers such as Express and the Gap and mass merchant retailers such as Wal-Mart, Kohl's and Target.

For the year ended December 31, 2007, our three largest customers represented approximately 9% of our consolidated net sales. For the year ended December 31, 2006, no single customer represented more than 9% of our consolidated net sales; however our three largest customers represented approximately 18% of our consolidated net sales. For the year ended December 31, 2005, no single customer represented more than 10% of our consolidated net sales; however, our three largest customers represented approximately 22% of our consolidated net sales.

The results of our operations will depend to an extent upon the commercial success of these customers. If these customers fail to purchase our products at anticipated levels, or the relationship terminates, it may have an adverse affect on our results of operations. If the financial condition of these customers were to deteriorate, resulting in an impairment of their ability to purchase inventories or repay receivables, it may also have an adverse affect on our results of operations. The financial position and operations of these customers are monitored on an ongoing basis. United States export sales are not a significant part of our business. Backlogs are not considered material in the industries in which we compete.

### SALES AND MARKETING

We sell our principal products through our own sales force based in Los



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Angeles, California, various other cities in the United States, Hong Kong, China, India, Taiwan and the Dominican Republic. We also employ customer service representatives who are assigned to key customers and provide in-house customer service support. Our executives have developed relationships with our major customers at senior levels. These executives actively participate in marketing and sales functions and the development of our overall marketing and sales strategies. When we become the outsourcing vendor for a customer's packaging or trim requirements, we position ourselves as if we are an in-house department of the customer's trim procurement operation.

### SOURCING AND ASSEMBLY

We have developed expertise in identifying high quality materials, competitive prices and approved vendors for particular products and materials. This expertise enables us to produce a broad range of packaging and trim products at various price points. The majority of products that we procure and distribute are purchased on a finished good basis. Raw materials, including paper products and metals used to manufacture zippers, used in the assembly of our Trim products are available from numerous sources and are in adequate supply. We purchase products from several qualified material suppliers.

We create most product artwork and any necessary dies and molds used to design and manufacture our products. All other products that we design and sell are produced by third party vendors or under our direct supervision or through joint manufacturing arrangements. We are confident in our ability to secure high quality manufacturing sources. We intend to continue to outsource production to qualified vendors, particularly with respect to manufacturing activities that require substantial investment in capital equipment.

Principally through our Hong Kong facility, we distribute TALON zippers, trim items and apparel packaging and coordinate the manufacture and distribution of the full range of our products. Our Hong Kong facility supplies several significant trim programs, services customers located in Asia and the Pacific Rim and sources products for our Los Angeles based operations.

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### INTELLECTUAL PROPERTY RIGHTS AND LICENSES

We have trademarks as well as copyrights, software copyrights and trade names for which we rely on common law protection, including the TALON trademark. Several of our other trademarks are the subject of applications for federal trademark protection through registration with the United States Patent and Trademark Office, including "Talon", "Tag-It", "Managed Trim Solution" and "TekFit". We also rely on our Exclusive License and Intellectual Property Rights agreement with Pro-Fit to sell our TEKFIT Stretch waistbands. The agreement gives us the exclusive rights to sell or sublicense stretch waistbands manufactured under the patented technology developed by Pro-Fit for garments manufactured anywhere in the world for the U.S. market and for all U.S. brands, for an indefinite term that extends for the duration of the patent and trade secrets licensed under the agreement. We are presently in litigation with Pro-Fit relating to our rights under the agreement, as described more fully elsewhere in this report.

### SEASONALITY

We typically experience seasonal fluctuations in sales volume. These seasonal fluctuations result in sales volume decreases in the first and fourth quarters of each year due to the seasonal fluctuations experienced by the

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majority of our customers. The apparel industry typically experiences higher sales volume in the second quarter in preparation for back-to-school purchases, and the third quarter in preparation for year-end holiday purchases.

### INVENTORIES

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

### COMPETITION

We compete in highly competitive and fragmented industries that include numerous local and regional companies that provide some or all of the products we offer. We also compete with United States and international design companies, distributors and manufacturers of tags, trim, packaging products and zippers. Some of our competitors, including Paxar Corporation, YKK, Universal Button, Inc., Avery Dennison Corporation and Scovill Fasteners, Inc. have greater name recognition, longer operating histories and greater financial and other resources.

Because of our integrated materials procurement and assembly capabilities and our full-service trim solutions, we believe that we are able to effectively compete for our customers' business, particularly where our customers require coordination of separately sourced production functions. We believe that to successfully compete in our industry we must offer superior product pricing, quality, customer service, design capabilities, delivery lead times and complete supply-chain management. We also believe the TALON brand name and the quality of our TALON brand zippers will allow us to gain market share in the zipper industry. The unique stretch quality of our TEKFIT waistbands will also allow us to compete effectively in the market for waistband components.

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### SEGMENT INFORMATION

We operate primarily in one industry segment, the distribution of a full range of apparel zipper and trim products to manufacturers of fashion apparel, specialty retailers and mass merchandisers.

### FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

We sell the majority of our products for use by U.S. based brands, retailers and manufacturers. The majority of these customers produce their products or outsource the production of their products in manufacturing facilities located outside of the U.S., primarily in Asia, Mexico, the Dominican Republic and Central and South America.

A summary of our domestic and international net sales and long-lived

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assets is set forth in Item 8 of this Annual Report on Form 10-K, Note 14 of Notes to the Consolidated Financial Statements.

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

### EMPLOYEES

As of December 31, 2007, we had approximately 219 full-time employees including 36 in the United States, 85 employees in Hong Kong, 77 employees in China, 7 in Indonesia, 6 in India, 4 in The Dominican Republic, 2 in Taiwan, 1 in Thailand and 1 in Vietnam. Our labor forces are non-union. We believe that we have satisfactory employee and labor relations.

### CORPORATE GOVERNANCE AND INFORMATION RELATED TO SEC FILINGS

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

### ITEM 1A. RISK FACTORS

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

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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 Item 3, "Legal Proceedings" for discussion of this litigation. In the past, we had derived a significant amount of revenues from the sale of products

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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 affect on our results because:

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

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.

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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:

- o The volume and timing of customer orders received during the quarter;
- o The timing and magnitude of customers' marketing campaigns;
- o The loss or addition of a major customer;
- o The availability and pricing of materials for our products;
- o The increased expenses incurred in connection with the introduction of new products;
- o Currency fluctuations;
- o Delays caused by third parties; and
- o 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 Item 3, "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 AFFECT 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 affect 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

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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.

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IF WE ARE UNABLE TO SATISFY THE FINANCIAL COVENANTS IN OUR DEBT AGREEMENTS IN FUTURE PERIODS, THE LENDER COULD DECLARE THE DEBT OBLIGATIONS IN DEFAULT, WHICH WOULD HAVE A MATERIAL ADVERSE EFFECT ON OUR LIQUIDITY, BUSINESS AND OPERATIONS.

Our revolving credit and term loan agreement requires certain covenants, including a minimum level of EBITDA beginning with period ending June 30, 2008, as discussed in Note 7 of the Notes to Consolidated Financial Statements. In the event that we fail to satisfy the minimum EBITDA requirement for three consecutive quarters, the credit agreement will be in default and the full amount of our outstanding obligations will become due. In anticipation of us not being able to meet the required covenants due to various reasons, we either negotiate for changes in the relative covenants or an advance waiver or would have to reclassify the relevant debt as current. However, our expectations of future operating results and continued compliance with other debt covenants cannot be assured and our lender's actions are not controllable by us. If we are in default under the loan agreement, all amounts due under the loan agreement can be declared immediately due and payable and, unless we are able to secure alternative financing to repay the lender in full, the lender would have the right to exercise its remedies including enforcement of its lien on substantially all of our assets. Further, if the debt is placed in default, we would be required to reduce our expenses, including by curtailing operations, and to raise capital through the sale of assets, issuance of equity or otherwise, any of which could have a material adverse effect on our financial condition and results of operations.

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

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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:

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

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.

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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.

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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:

- o The failure of our quarterly operating results to meet expectations of investors or securities analysts;
- o Adverse developments in the financial markets, the apparel industry and the worldwide or regional economies;
- o Interest rates;
- o Changes in accounting principles;



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- o Intellectual property and legal matters;
- o Sales of common stock by existing shareholders or holders of options;
- o Announcements of key developments by our competitors; and
- o 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.

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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 April 11, 2008, our officers and directors and their affiliates

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beneficially owned approximately 14.5% of the outstanding shares of our common stock. The Dyne family, which includes Mark Dyne, Colin Dyne, who are also our directors; Larry Dyne, the estate of Harold Dyne and Jonathan Burstein; beneficially owned approximately 13.3% of the outstanding shares of our common stock at April 11, 2008. Additionally, at April 11, 2008 our lender Bluefin Capital LLC beneficially owned approximately 8.6% of the outstanding shares of our common stock. As a result, our lender, 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.

IF WE ARE UNABLE TO REDEPLOY OUR MANUFACTURING ASSETS TO SOUTHEAST ASIA OUR MANUFACTURING ASSETS VALUE WOULD BE ADVERSELY AFFECTED.

Central to our operating strategy was to restructure the business model from a fully integrated manufacturing operation targeted at the South American marketplace to a supply-chain model employing strategically located contract manufacturers throughout Southeast Asia. The re-deployment of our manufacturing assets could require multiple facilities in various geographical locations strategically located in close proximity to our more significant and important customers throughout Southeast Asia. If we cannot achieve its plan to redeploy the assets, the carrying value of our assets would be adversely affected and could result in significant reductions in the carrying value of the assets and have an adverse effect on our results of operations.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our headquarters are located in the greater Los Angeles area, in Woodland Hills, California, where we lease approximately 8,800 square feet of administrative and product development space. In addition to the Woodland Hills facility, we lease 120 square feet of office space in New York, New York; 1,400

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square feet of office space in Columbus, Ohio; 3,400 square feet of warehouse space in Simi Valley, California; 17,700 square feet of office and warehouse space in Kwun Tong, Hong Kong; 6,600 square feet of office and showroom space in Shenzhen, China; office space square footage totaling 5,400 in various other cities in China; 6,000 square feet of office space in Bangalore, India; and 4,100 square feet of warehouse space in Santiago, Dominican Republic. The lease agreements related to these properties expire at various dates through September 2010. We also own a building with 41,650 square feet of manufacturing and warehouse space in Kings Mountain, North Carolina, which is being held for sale. We believe our existing facilities are adequate to meet our needs for the foreseeable future.

### ITEM 3. 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. On April 2, 2007 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 was filed on October 15, 2007. Our brief was filed on November 28, 2007. We believe that this matter will be resolved favorably on appeal, or in a later 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 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 action is still pending in the United States District Court. The action is presently stayed pending resolution or trial of an earlier filed action between Pro-Fit Holdings and their attorneys who have sued Pro-Fit Holdings and have obtained a judgment. In the past, we had 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

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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 our business. We believe 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 our consolidated financial condition if adversely determined against us.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of 2007.

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## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### COMMON STOCK

Our common stock has been quoted on the OTC Bulletin Board under the symbol "TALN" since December 28, 2007. Our common stock was previously traded on the American Stock Exchange under the symbol "TAG." The following table sets forth the high and low sales prices for the Common Stock as reported by the American Stock Exchange and the OTC Bulletin Board during the periods indicated.

	HIGH	LOW
	----	---
YEAR ENDED DECEMBER 31, 2007		
1st Quarter.....	\$ 2.07	\$ 1.06
2nd Quarter.....	1.58	0.66
3rd Quarter.....	1.14	0.70
4th Quarter.....	0.82	0.30
YEAR ENDED DECEMBER 31, 2006		
1st Quarter.....	\$ 0.84	\$ 0.33
2nd Quarter.....	0.81	0.38
3rd Quarter.....	1.38	0.63
4th Quarter.....	1.35	0.72

On April 10, 2008, the closing sales price of our common stock as reported on OTC Bulletin Board was \$0.36 per share. As of April 11, 2008, there were 22 record holders of our common stock.

#### DIVIDENDS

We have never paid dividends on our common stock. We are restricted from paying dividends under our senior secured credit facility. It is our intention to retain future earnings for use in our business.

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PERFORMANCE GRAPH

The following graph sets forth the percentage change in cumulative total stockholder return of our common stock during the period from December 31, 2002 to December 31, 2007, compared with the cumulative returns of the American Stock Exchange Market Value (U.S. & Foreign) Index and The Dow Jones U.S. Clothing & Accessories Index. The comparison assumes \$100 was invested on December 31, 2002 in our common stock and in each of the foregoing indices. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

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[PERFORMANCE GRAPH OMITTED]

	Cumulative Total Return				
	12/02	12/03	12/04	12/05	12/06
TALON INTERNATIONAL, INC.	100.00	123.69	123.97	9.92	28.37
AMEX COMPOSITE	100.00	143.18	175.20	215.26	257.04
DOW JONES US CLOTHING & ACCESSORIES	100.00	125.07	147.77	154.32	191.2

The information under this "Performance Graph" subheading shall not be deemed to be "filed" for the purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liabilities of such section, nor shall such information or exhibit be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

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ITEM 6. SELECTED FINANCIAL DATA

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

	YEARS ENDED DECEMBER 31,			
	(In thousands except per share da			
	2003(1)	2004(1,2)	2005(1)	2006
	-----	-----	-----	-----

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### CONSOLIDATED STATEMENT OF OPERATIONS DATA:

Total revenue .....	\$ 64,443	\$ 55,109	\$ 47,331	\$ 48,82
Income (loss) from operations .....	\$ (5,881)	\$ (14,482)	\$ (27,098)	\$ 1,33
Net income (loss) .....	\$ (4,745)	\$ (17,609)	\$ (29,538)	\$ 30
Net income (loss) per share - basic .....	\$ (0.46)	\$ (1.02)	\$ (1.62)	\$ 0.0
Net income (loss) per share - diluted .....	\$ (0.46)	\$ (1.02)	\$ (1.62)	\$ 0.0
Weighted average shares outstanding - basic .....	10,651	17,316	18,226	18,37
Weighted average shares outstanding - diluted .....	10,651	17,316	18,226	18,95

### CONSOLIDATED BALANCE SHEET DATA:

Cash and cash equivalents .....	\$ 14,443	\$ 5,461	\$ 2,277	\$ 2,93
Total assets .....	\$ 67,770	\$ 56,448	\$ 30,321	\$ 25,69
Capital lease obligations, line of credit and notes payable .....	\$ 11,759	\$ 18,792	\$ 16,001	\$ 16,21
Convertible redeemable preferred stock .....	\$ 2,895	\$ --	\$ --	\$ --
Stockholders' equity .....	\$ 43,564	\$ 30,195	\$ 912	\$ 1,68
Total liabilities and stockholders' equity .....	\$ 67,770	\$ 56,448	\$ 30,321	\$ 25,69

### PER SHARE DATA:

Net book value per common share .....	\$ 3.79	\$ 1.66	\$ 0.05	\$ 0.0
Common shares outstanding .....	11,508	18,171	18,241	18,46

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- (1) We incurred restructuring costs of \$6.4 million, \$0.4 million, and \$7.7 million during the years ended December 31, 2005, 2004 and 2003, respectively.
- (2) We incurred net charges of \$4.3 million from the write-off of obligations due from a former major customer and other fourth quarter adjustments totaling \$9.5 million during the year ended December 31, 2004.

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

The following management's discussion and analysis is intended to assist the reader in understanding our consolidated financial statements. This discussion 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 brand zippers.

Talon International, Inc. designs, sells, manufactures 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 owned sales, distribution and manufacturing locations, distribution relationships and joint ventures. The network of these distributors and manufacturing joint ventures, in combination with TALON owned and affiliated facilities under the TALON brand, is expected to improve our time-to-market by eliminating the typical setup and build-out phase for new manufacturing capacity throughout the world, and by sourcing, finishing and distributing to apparel manufacturers in their local markets.

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We have structured our trim business to focus 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 design, development, sampling 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. We plan to aggressively expand our trim business globally, so we may better serve our apparel factory customers in the field, in addition to our brand and retail customer. We believe we can lead the industry in trim sourcing by having both an intimate relationship with our brand and retail customers, and having a distributed service organization to serve our factory customers (those that manufacture for the apparel brand and retailers) globally.

Our TEKFIT services provide manufacturers with the patented technology, manufacturing know-how and materials required to produce pants incorporating an expandable waistband. These products were previously produced by several manufacturers for one single brand. In October 2006 our exclusive supply contract with this brand expired.

Our efforts to expand this product offering to other customers have also been limited by a licensing dispute. As described more fully in this report under Item 3. "Legal Proceedings", we are presently in litigation with Pro-Fit Holdings Limited related to our exclusively licensed rights to sell or sublicense stretch waistbands manufactured under Pro-Fit's patented technology. This impacted 2007 Tekfit sales and resulted in a \$8.6 million or 93% decrease from 2006 sales.

The revenues we derive from the sale of products incorporating the stretch waistband technology, represented approximately 2% of our consolidated revenues for the year ended December 31, 2007 and 19% of consolidated revenues for the years ended December 31, 2006 and 2005; accordingly our growth prospects could be materially adversely affected if our dispute with Pro-Fit is not resolved in a manner favorable to us, or if we are unsuccessful in securing new customers to replace the revenues previously generated by the single brand.

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In an effort to better align our organizational and cost structures with its future growth opportunities, in August 2005 our Board of Directors adopted a restructuring plan that was substantially completed by December 31, 2005. The plan included restructuring our global operations by eliminating redundancies in our Hong Kong operation, closing our facilities in Mexico, and closing our North Carolina manufacturing facility. We have also refocused our sales efforts on higher margin products, which may result in lower net sales initially as we focus on acquiring high quality customers, and decrease our customer concentration. As a result of this restructuring, we now operate with fewer employees and will have lower associated operating and distribution expenses.

### RESULTS OF OPERATIONS

#### NET SALES

For the years ended December 31, 2007, 2006, and 2005, total sales by geographic region based on customer delivery locations were as follows:

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	Year Ended December 31,		
	2007	2006	2005
Sales:			
United States .....	\$ 3,692,468	\$ 4,223,052	\$ 7,052,196
Hong Kong .....	14,178,421	13,650,419	7,901,079
Dominican Republic .....	700,868	8,966,828	150,793
China .....	11,159,726	6,063,416	7,091,034
India .....	2,187,684	1,205,486	809,972
Bangladesh .....	1,924,943	2,070,349	798,699
Mexico .....	783,762	2,476,313	12,945,861
Other .....	5,901,683	10,169,139	10,581,542
Total .....	\$40,529,555	\$48,825,002	\$47,331,176

The net revenues for the three primary product groups are as follows:

	Year Ended December 31,		
	2007	2006	2005
Product Group Net Revenue:			
Talon zipper .....	\$21,159,595	\$17,005,203	\$13,593,479
Trim .....	18,688,698	22,502,947	24,788,397
Tekfit .....	681,262	9,316,852	8,949,300
	\$40,529,555	\$48,825,002	\$47,331,176

Sales are influenced by a number of factors, including demand, pricing strategies, foreign exchange effects, new product launches and indications, competitive products, product supply, and acquisitions. See Item 1 "Business" for a discussion of our principal products.

The net decrease of sales in 2007 was primarily due to lower sales of waistband products as a result of the expiration in October of 2006 of our exclusive contract for these products (\$8.6 million); reduced operations in Mexico as production shifted from this area to Asia and we closed our operations in 2005 and 2006; and lower trim sales due to fewer and smaller programs with our customers (\$3.8 million). Talon zipper sales continued to increase as we

expanded our operations throughout China and southeast Asia (\$4.1 million); partially offsetting the declines from the Mexico and the Latin American regions for the Trim products and resulting in a net gain in Talon product sales overall.

Sales in 2006 increased modestly from 2005 as a net result of a substantial decline within selected markets offset by large increases in other geographical markets. Sales, principally of Trim products, to customers in Mexico declined sharply in 2006 from 2005 (\$6.0 million) as the industry shift of apparel production from Latin America to Asia continued from 2005, from the discontinuance of approximately \$4.0 million in sales of products from 2005, and



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as we completed the closure of our assembly and distribution operations within Mexico. Total Trim product sales declined by approximately \$2.3 million in 2006 as compared to 2005 as a consequence of the reductions from Mexico and the U.S. described above offset by increased sales in Asia and the Dominican Republic resulting mainly from the shift in industry trends. Sales of TALON products to customers within the U.S. also declined significantly (approximately \$3.6 million) as a result of the industry shift of apparel production and as a result of our closure of our manufacturing facility in North Carolina during the third quarter of 2005. The decline of Talon product sales from the North and Central American regions was substantially offset by the shifting of this production to manufacturers within Asia, and our expansion of operations with customers in this region, resulting in a net increase in Talon product sales for 2006 over 2005 of approximately \$3.4 million. Additionally, expanded demand by our former exclusive customer for the TEKFIT waistband also resulted in an increase of approximately \$0.4 million in 2006 over 2005 in our sales to the Dominican Republic, where the principal manufacturers of this product are located, and sales of Trim products into this region increased as key customer sales shifted out of the Mexico marketplace to this region. Sales within "other geographical regions" also reflect the worldwide shifting of apparel production to Asia.

The net decrease of sales in 2005 was primarily due to a decrease in sales to our customers in Mexico of Trim products and, to a lesser extent, TALON zippers, resulting from the industry shift of apparel production from Latin America to Asia, and due to our restructuring in the third quarter of 2005 which disrupted sales in the Mexico regions as we prepared for a shift of operations to Asia. Sales in Asia of our Trim products and Talon zippers increased significantly during 2005 partially offsetting the declines from the Mexico and the Latin American regions for the Trim products and resulting in a net gain in Talon product sales overall. We responded to these market changes in 2005 with the implementation of a restructuring plan that included reducing our operations in Mexico and focusing our efforts on the market in Asia. Sales of our TEKFIT waistband decreased in 2005 because of lower demand from our exclusive customer for this product. During 2005, we continued our plan to decrease reliance on two significant customers in Mexico. These two customers contributed approximately \$7.7 million or 16.3% of revenues for the year ended December 31, 2005.

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### COST OF GOODS SOLD AND SELECTED OPERATING EXPENSES

The following table summarizes cost of goods sold and selected operating expenses for the years ended December 31, 2007, 2006, and 2005 (amounts in thousands):

	2007	CHANGE	2006	CHANGE	
	-----	-----	-----	-----	-----
Sales .....	\$ 40,530	(17)%	\$ 48,825	3%	\$
Cost of goods sold .....	28,423	(17)%	34,356	(27)%	
% of sales .....	70%		70%		
Selling expenses .....	3,126	12%	2,778	(5)%	
% of sales .....	8%		6%		
General and administrative expense .....	10,877	1%	10,873	(32)%	

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% of sales .....	27%		22%	
Bad debt expense (recoveries) .....	187	(136)%	(513)	(109)%
% of sales .....	0%		(1)%	
Reserve for impairment of note receivable	1,088	100%	--	--
% of sales .....	3%			
Restructuring Charges .....	--	--	--	(100)%
% of sales .....				

### COST OF GOODS SOLD

Cost of goods sold for the year ended December 31, 2007, declined \$5.9 million or 17% from 2006 primarily a result of the 17% decrease in sales. The reduction in cost of goods sold from 2006 was principally attributable to lower overall sales volumes and lower direct margin resulting from a change in the mix in sales by product group, partially offset by 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.

Cost of goods sold for the year ended December 31, 2006 declined \$12.7 million or 27% from 2005 as the result of a number of the actions we implemented in connection with our 2005 restructuring plan, and as a result of our focus on higher margin product sales and continued efforts to reduce costs worldwide. Cost of goods sold in 2006 declined by approximately \$4.8 million (10.3%) from 2005 as a result of higher direct margins on products sold; by approximately \$1.9 million (4.0%) from lower freight & duty charges as a result of relocating our operations closer to our customers in Asia; by a reduction in inventory adjustments and obsolescence of \$1.6 million (3.5%) due primarily to inventories located at our Mexico production operations; by the elimination of \$3.4 million (7.3%) in restructuring charges incurred in 2005; and by approximately \$1.8 million (3.8%) from reductions in manufacturing and overhead charges as a result of reduced employee related costs and operating expenses of our North Carolina and Mexico operations; offset by increases of approximately \$0.8 million (1.8%) on higher sales volumes.

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Cost of goods sold increased for the year ended December 31, 2005 included a \$3.4 million (7.7%) write-down of inventory in connection with our 2005 restructuring plan, and an increase in our inventory obsolescence reserve of \$2.1 million (4.7%), including \$0.5 million in the fourth quarter of 2005.

### SELLING EXPENSES

Selling expenses for the year ended December 31, 2007 increased \$0.4 million or 12.0% from 2006 as a result of the increased number of sales offices and employees within Asia and their associated compensation (\$0.4 million), and facilities, travel and administrative costs (\$0.4 million), offset by lower marketing costs (\$0.1 million) and lower royalty fees on waistband products (\$0.3 million).

Selling expense for the year ended December 31, 2006 decreased \$0.2 million or 5.0% from 2005 as a result of lower travel and entertainment costs of

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\$0.3 million; lower legal costs of \$0.3 million; and other employee benefit and administrative cost reductions of approximately \$0.1 million; offset by increases in sales commissions of approximately \$0.3 million and increased spending for sales and marketing programs of \$0.2 million.

Selling expenses increased \$0.3 million or 1.0% for the year ended December 31, 2005 because we were unable to reduce expenses in direct proportion to the decrease in sales.

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the year ended December 31, 2007 of \$10.9 million remained relatively unchanged from 2006. General and administrative expenses were effected by a \$0.2 million increase from 2006 attributable to increased employee costs due to the continued expansion within Asia and increased professional and audit fees of \$0.9 million; offset by reduced legal costs of \$0.6 million, \$0.1 million decrease in insurance costs, and \$0.4 million reduction in management incentive bonuses, commissions and stock-based compensation. Included in professional and audit fees were non-recurring charges of \$0.6 million related to existing consulting contracts with two former directors of the Company.

General and administrative expenses for the year ended December 31, 2006 decreased \$5.2 million or 32% from 2005. The decrease was primarily the result of the \$0.5 million write-off of goodwill primarily associated with closed operations, reductions in legal costs by \$1.9 million principally as a reduction of our costs associated with the ProFit litigation, lower employee and benefit costs by \$1.9 million from reduced employment levels, reduced facility costs of \$0.6 million, and reductions in other administrative and travel costs of \$1.4 million, offset by approximately \$0.7 million in increased professional and audit fees as we changed auditors and utilized more professional consultants in lieu of full time regular employee, and stock based compensation expense of \$0.4 million associated with the implementation of SFAS 123(R).

Included in general and administrative expenses for the year ended December 31, 2005 were legal expenses of approximately \$3.5 million related primarily to the Pro-Fit litigation, and an impairment charge to goodwill of \$0.5 million incurred in connection with the 2005 restructuring plan; offset by reductions of approximately \$1.0 million associated with lower employment levels and related costs in connection with the restructuring plan.

### BAD DEBT EXPENSE (RECOVERIES)

Bad debt expense for the year ended December 31, 2007 increased by \$0.6 million as a result of \$0.1 million in bad debt provisions in 2007 compared to bad debt recoveries of \$0.5 million in 2006.

Bad debt expense for the year ended December 31, 2006 reflected a net recovery of \$0.5 million as compared to bad debt expenses of \$5.9 million for the year ended December 31, 2005. The bad debt recoveries in 2006 represent collections of accounts written-off in prior years as uncollectible, and the 2005 expense is primarily related to outstanding unsettled receivables from a former customer.

### IMPAIRMENT OF NOTE RECEIVABLE

Operating expense in 2007 included \$1.1 million in bad debt reserve

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provisions associated with the note receivable due the Company from Azteca Production International, Inc. See Notes 2 and 3 of the Consolidated Financial Statements.

### RESTRUCTURING CHARGES

Restructuring costs in 2005 were the result of the adoption of our 2005 restructuring plan. Restructuring costs recorded in the third quarter of 2005 were \$6.2 million. Additional costs of \$0.2 million were incurred in the fourth quarter of 2005. Total restructuring costs of \$6.4 million were recorded in the Consolidated Statement of Operations for the year ended December 31, 2005 as follows (in millions):

Cost of goods sold	\$3.4
Operating expenses:	
General & administrative expenses	0.5
Restructuring charges	2.5
	-----
Total restructuring costs	\$6.4
	=====

### INTEREST EXPENSE AND INTEREST INCOME

Interest expense for the year ended December 31, 2007 increased approximately \$0.6 million or 41.6% to \$1.9 million from \$1.4 million during 2006 as a result of higher average debt levels in 2007 compared to 2006. For the year ended December 31, 2007 interest expense included \$725,000 in amortized deferred financing charges and higher costs on our revolving credit and term notes as compared to our previous secured convertible notes payable. During the third quarter 2007, we charged off approximately \$111,000 in unamortized deferred financing costs and discounts related to and in conjunction with the early payment of the secured convertible promissory notes in July 2007. Interest income for the year ended December 31, 2007 of \$242,000 decreased approximately \$126,000 or 34.2% from \$368,000 during 2006 related primarily to the elimination of the note receivable discussed in Note 3 to the consolidated financial statements.

Net expense for the year ended December 31, 2006 decreased from 2005 by approximately \$0.4 million principally as a result of interest earnings in 2006 from the note receivable.

Included in interest expense for the year ended December 31, 2005 was the \$0.8 million 6.5% mortgage note payable to First National Bank dated June 2004, and the \$0.9 million 6.5% equipment note payable to First National Bank dated November 2004 which were outstanding for the entire year in 2005 compared to a partial year in 2004; partially offset by the repayment of a remaining \$1.4 million due pursuant to a note payable and a reduction in amounts due to factor in 2005.

### INCOME TAXES

The provision for income taxes was \$0.1 million for the year ended December 31, 2007. Income tax provisions for the year ended December 31, 2007 principally include income tax provisions from operations in China and India; offset by an income tax benefit from net operating loss carryforward in Hong Kong.

Income tax provisions for the year ended December 31, 2006 principally include a royalty tax from the Inland Revenue Department in Hong Kong applicable to 2005, net of an estimated tax benefit for 2006 foreign losses and minimum federal and state filing fees.

The provision for income taxes for the year ended December 31, 2005 principally reflects the elimination of the net deferred tax asset in 2005 of \$1.0 million, and estimated foreign taxes. Based on the Company's net operating losses, there is not sufficient evidence to determine that it is more likely than not that the Company will be able to utilize its net operating loss carry forwards to offset future taxable income.

#### LIQUIDITY AND CAPITAL RESOURCES

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

	DECEMBER 31, 2007	DECEMBER 31, 2006
	-----	-----
Cash and cash equivalents .....	\$ 2,919	\$ 2,935
Total assets .....	22,094	25,694
Current debt .....	10,457	22,471
Non-current debt .....	12,354	1,536
Stockholders' equity .....	(717)	1,686

#### CASH AND CASH EQUIVALENTS

Our cash is held with financial institutions. Substantially all of the balances at December 31, 2007 and 2006 are in excess of federally insured limits. As of December 31, 2007 there was no restricted cash. At December 31, 2006 we had restricted cash balances of \$50,000 related to cash collateral for a letter of credit with Wells Fargo Bank.

#### FINANCING ARRANGEMENTS

On June 27, 2007, we 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% of our eligible receivables and 55% of eligible inventory, and provides for monthly interest payments at the prime rate plus 2.0%. The term loan bears interest at 8.5% annually with quarterly interest payments and repayment in full at maturity. Borrowings under both credit facilities are secured by all our assets. There was \$879,000 in available borrowings at December 31, 2007. See Note 18 of the Consolidated Financial Statements for an amendment to the borrowing base formula.

On April 3, 2008, we executed a further amendment to the existing revolving credit and term loan agreement with Bluefin Capital. The amendment provided for an amendment of the EBITDA and other financial covenants, and the redemption of the stock warrants previously issued to Bluefin Capital in exchange for the issuance of an additional note payable to Bluefin Capital for \$1.0 million at an interest rate of 8.5%. We will record a reduction to equity and an increase to notes payable for the fair value of the warrants redeemed. The difference between the fair value of the warrants of \$221,723 and the face value of the note will be accreted over the life of the note. The note will incur interest at 8.5% on the principal amount of \$1.0 million and the quarterly accretion will also be reflected as interest expense. The additional note and all accrued interest under the note are due and payable on June 30, 2010.

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We financed building, land and equipment purchases through notes payable and capital lease obligations expiring through June 2011. These obligations bear interest at rates of 6.5% and 6.6% per annum, and under these obligations, we are required to make monthly payments of principal and interest.

The outstanding balance of our demand notes payable to related parties at December 31, 2007 and 2006 was \$85,000 and \$665,000, respectively. The demand notes totaling \$85,000 bear interest at various rates between 0%-10%, have no scheduled monthly payments, and are due within fifteen days from demand.

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### CASH FLOWS

The following table summarizes our cash flow activity for the years ended December 31, 2007, 2006, and 2005 (amounts in thousands):

	2007	2006	2005
Net cash provided by operating activities .....	\$ 2,137	\$ 1,794	\$ 1,112
Net cash used in investing activities .....	(725)	(345)	(1,454)
Net cash used in financing activities .....	(1,433)	(791)	(2,841)
Net increase (decrease) in cash and cash equivalents	(16)	657	(3,183)

### OPERATING ACTIVITIES

Cash and cash equivalents for the year ended December 31, 2007 decreased by \$0.1 million from December 31, 2006 principally arising from cash generated by operating activities, net of payments on notes payable and capital leases.

Cash provided by operating activities was \$2.1 million for the year ended December 31, 2007. The cash generated by operating activities during 2007 resulted primarily from reductions in accounts receivable net of applied reserves of \$3.3 million; \$0.6 million in reductions in inventory net of reserves applied; \$0.6 million in collections on the note receivable; and increases in accounts payable of \$2.1 million; net of reductions in prepaid assets and other assets of approximately \$0.5 million. Included in the net reserves was the write-off of the Azteca note and subsequent payment in shares as discussed in Note 2 to the Consolidated Financial Statements.

Cash and cash equivalents for the year ended December 31, 2006 increased by \$0.7 million from December 31, 2005 principally arising from cash generated by operating activities, net of payments on notes payable and capital leases.

Cash provided by operating activities was \$1.8 million for the year ended December 31, 2006. The cash generated by operating activities during 2006 resulted primarily from net earnings (before non-cash expenses) of approximately \$2.3 million; reductions in inventory net of applied reserves of \$2.5 million; \$1.0 million in reductions in accounts receivable net of reserves applied; and approximately \$0.6 million in collections on the note receivable; net of reductions in accounts payable of \$2.6 million; repayments on notes payable of \$0.9 million and reductions in other liabilities, net of approximately \$1.2

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million. The note receivable collections are associated with unsettled accounts receivable from a former customer converted into a note receivable in early 2006. The repayments on the notes payable are principally associated with previously accrued legal expenses converted into a note payable in May of 2006. Payments on the note payable are made from collections received from the note receivable which is pledged to the note payable. These notes are non-recurring settlements associated primarily with sales and expenses from 2005 and prior transactions.

The net decrease in inventory of \$2.5 million for the year ended December 31, 2006 reflects our efforts to dispose of and lower slower-moving and obsolete inventory components. The cost of net inventories eliminated during 2006 was \$8.6 million, and reserves applicable to this inventory of \$6.1 million were applied to these dispositions. Accounts receivable for the year ended December 31, 2006 declined by \$2.1 million primarily as a result of improved collections and faster turns of accounts receivable, and by approximately \$0.7 million in accounts written-off. Accounts receivable reserves declined by \$1.1 million from the write-off of uncollectible accounts and by approximately \$0.4 million from the collection of accounts reserved for in prior years. In addition, during 2006 collections of accounts written-off in prior years was \$0.5 million.

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The increase in cash provided by operating activities during the year ended December 31, 2005 resulted from, among other changes, a \$10.6 million decrease in accounts receivable, including the collection of a \$4.5 million receivable from one customer; a \$3 million increase in accounts payable; a \$2.8 million decrease in inventories; a \$2.1 million increase in accrued legal costs; substantially offset by a net loss of \$29.5 million.

At December 31, 2005, accounts receivable from Azteca Productions International ("Azteca"), a significant customer, was approximately \$10,968,000 less a reserve of \$7,528,000, totaling \$3,440,000, net. In February 2006, we accepted a note agreement from Azteca which provided for total payments including principal and interest of \$4.0 million in exchange for the net outstanding accounts receivable balance. The balance of the note receivable at December 31, 2005 of \$3,440,000 reflects a \$560,000 charge to discount the note, using a 10.5% discount rate, to its net present value. The Azteca accounts receivable, net at December 31, 2005 was reclassified on the accompanying consolidated balance sheets to note receivable to reflect this subsequent settlement.

### INVESTING ACTIVITIES

Net cash used in investing activities for the year ended December 31, 2007 and 2006 consisted of capital expenditures of \$0.7 million and \$0.3 million, respectively, for leasehold improvements, office equipment for new employees, improvements in our technology systems and a marketing website acquisition.

### FINANCING ACTIVITIES

Net cash used in financing activities for the year ended December 31, 2007 was \$1.4 million. During 2007, \$13.8 million (net of issuance costs) was provided by the issuance of common stock and warrants, and by borrowings under a new debt facility (see Note 7) designated to pay off our previously existing convertible promissory notes and to provide funds for future growth. The proceeds from this debt facility were used to pay the \$12.5 million of secured

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convertible promissory notes, and \$1.0 million was used to pay a related party note of \$0.6 million and associated accrued interest. Approximately \$1.2 million was used primarily for the repayment of borrowings under capital leases and notes payable and \$0.5 million in initial borrowings under the revolving note were repaid.

Net cash used in financing activities for the years ended December 31, 2006 and 2005 reflects the repayment of notes payable and capital lease obligations. In 2005 cash used in financing activities also included, the repayment of borrowings under a bank line of credit partially offset by proceeds from the exercise of stock options and warrants.

On June 27, 2007 we 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% of our eligible receivables and 55% of eligible inventory, and provides for monthly interest payments at the prime rate plus 2.0%. The term loan bears interest at 8.5% annually with quarterly interest payments and repayment in full at maturity. Borrowings under both credit facilities are secured by all of our assets. Under the terms of the credit agreement we are required to meet certain cash flow and coverage ratios, among other restrictions including a restriction from declaring or paying a dividend prior to repayment of all the obligations. The financial covenants require that we to maintain at the end of each fiscal quarter beginning June 30, 2008 "EBITDA" (as defined in the Agreement) for the preceding four quarters in excess of our principal and interest payments for the same four-quarter period. In the event that we fail to satisfy the minimum EBITDA requirement for two consecutive quarters, the credit agreement will be in default and the full amount of the notes outstanding will become due. On November 19, 2007 the Company entered into an agreement with Bluefin Capital, LLC to modify this financial covenant and to extend until June 30, 2008 (with a further extension to March 31, 2009 provided certain conditions are met by June 30 2008) the application of the EBITDA covenant in exchange for additional common stock of the Company and a price adjustment to the lenders outstanding warrants issued in connection with the loan agreement. As of December 31, 2008, we had outstanding borrowings of \$9.5 million under the term note, and \$3.8 million under the revolving credit note.

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In connection with the revolving credit and term loan agreement, we 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 were exercisable over a five-year period and 700,000 warrants were exercisable at \$0.95 per share; 700,000 warrants were exercisable at \$1.05 per share; and 700,000 warrants were exercisable at \$1.14 per share. The relative fair value (\$2,374,169, 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 was to be amortized 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 \$486,000. 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.

On November 19, 2007, we completed an amendment to the revolving credit and term loan agreement and issued an additional 250,000 shares of common stock to the lender for \$0.001 per share. The exercisable price for 2,100,000 warrants issued for the purchase of common stock was amended to an exercise price of



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\$0.75 per share. The new relative fair value (\$2,402,936, 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 was to be amortized over the term of the note and recognized as additional interest cost as amortized.

On April 3, 2008, we executed a further amendment to the existing revolving credit and term loan agreement with Bluefin Capital. The amendment provided for an amendment of the EBITDA and other financial covenants, and the redemption of the stock warrants previously issued to Bluefin Capital in exchange for the issuance of an additional note payable to Bluefin Capital for \$1.0 million at an interest rate of 8.5%. We will record a reduction to equity and an increase to notes payable for the fair value of the warrants redeemed. The difference between the fair value of the warrants of \$221,723 and the face value of the note will be accreted over the life of the note. The note will incur interest at 8.5% on the principal amount of \$1.0 million and the quarterly accretion will also be reflected as interest expense. The additional note and all accrued interest under the note are due and payable on June 30, 2010.

We believe that our existing cash and cash equivalents, and our anticipated cash flows from our operating activities will be sufficient to fund our minimum working capital and capital expenditure needs as well as provide for our scheduled debt service requirements for at least the next twelve months. This conclusion is based on the belief that our operating assets, strategic plan, operating expectations and operating expense structure will provide for sufficient profitability from operations before non-cash charges to fund our operating capital requirements and to achieve our debt service requirements, and that our existing cash and cash equivalents will be sufficient to fund our expansion and capital requirements.

We have historically satisfied 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 credit facility provides limited financing secured by our accounts receivable, and our current borrowing capability may not provide the level of financing we need to continue in or to expand into additional foreign markets. 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.

If we 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 credit agreement.

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

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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 December 31, 2007 and the effects such obligations are expected to have on liquidity and cash flow in future periods:

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Demand notes payable to to related parties (1)	\$ 213,100	\$ 213,100	\$ --	\$ --	\$ --
Capital lease obligations	\$ 561,800	\$ 363,200	\$ 198,600	\$ --	\$ --
Operating leases .....	\$ 1,244,700	\$ 576,600	\$ 668,100	\$ --	\$ --
Revolver & Term Note .....	\$16,207,100	\$ 1,159,700	\$15,047,400	\$ --	\$ --
Other notes payable .....	\$ 1,379,000	\$ 421,700	\$ 957,300	\$ --	\$ --
Total Obligations ...	\$19,605,700	\$ 2,734,300	\$16,871,400	\$ --	\$ --
	=====	=====	=====	=====	=====

- (1) The majority of notes payable to related parties are due on demand with the remainder due and payable on the fifteenth day following the date of delivery of written demand for payment, and include accrued interest payable through December 31, 2007.

At December 31, 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

For a description of transactions to which we were or will be a party, and in which any director, executive officer, or shareholder of more than 5% of our common stock or any member of their immediate family had or will have a direct or indirect material interest, see Item 13, "Certain Relationships and Related Transactions and Director Independence," of this Report.

### APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions for the reporting period and as of

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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

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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:

- o 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. During the year ended December 31, 2007, bad debt expense was \$0.2 million (with provisions of \$0.2 million), net recoveries were \$0.5 million (with provisions of \$0.2 million) for the year ended December 31, 2006, and bad debt expense for the year ended December 31, 2005 was \$12.5 million. The bad debt expense in 2005 was primarily associated with specific receivables from a former customer. The 2005 accounts with the customer were settled in early 2006 with the acceptance of a note receivable at a substantial discount and with the full write-off of the second customer accounts where most all collection efforts had failed. During 2006 accounts receivable delinquencies were substantially eliminated lowering the risk for additional material write-offs. The note receivable accepted from the former customer in early 2006 represents a continuing risk of collection and its performance is evaluated each quarter.
- o Inventories are stated at the lower of cost, determined using the first-in, first-out basis, or market value and are all substantially finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory 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. Provisions for reserves for inventory valuation for the years ended December 31, 2007, 2006 and 2005 and 2004, were \$0.1 million, \$0.6 million and \$2.5 million, respectively. The increase in the provision during 2005 was primarily related to the remaining inventory we owned at our operations in Mexico. The closure of our manufacturing operations and from the exit of operations in Mexico as part of the 2005 restructuring plan substantially eliminates our acquisition or production of inventory that is not directly associated with a customer's order. Accordingly, the risk of future inventory obsolescence adjustments is substantially reduced in 2006. The provisions recorded in prior years are considered adequate to dispose of the remaining inventories without further adjustment.

- o 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

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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. See Notes to consolidated financial statements, Note 12, "Income Taxes".

- 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

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our long-lived assets. Long-lived assets are evaluated on a continual basis and impairment adjustments are made based upon management's valuations. As part of our 2005 restructuring plan, certain long-lived assets, primarily machinery and equipment, were impaired and their values adjusted accordingly. The long-lived assets are planned to be re-deployed through manufacturing arrangements with our principal suppliers in Asia. The fair value of these assets will be affected by our ability to secure appropriate manufacturing arrangements and to utilize the equipment to meet future production requirements. If we are unable to secure favorable arrangements or to secure sufficient production through these operations the fair value of this equipment may be impaired.

- o 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.
  
- o 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, records changes based on updated estimates. See Note 11, "2005 Restructuring Costs".

- o 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

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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 Financial Accounting Standards Board ("FASB") issued SFAS No. 157, FAIR VALUE MEASUREMENTS ("SFAS 157"), which defines fair value, provides a framework for measuring fair value and expands the disclosures required for fair value measurements. SFAS 157 applies to all accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. For fiscal years beginning after November 15, 2007, companies will be required to implement SFAS 157 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. The FASB did, however, provide a one-year deferral for the implementation of Statement 157 for other nonfinancial assets and liabilities. An exposure draft will be issued for comment in the near future on this partial deferral. Accordingly, we will adopt SFAS 157 for financial assets and liabilities commencing in the first quarter of 2008. We are currently assessing the potential impact of SFAS 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND LIABILITIES - INCLUDING AN AMENDMENT OF FASB STATEMENT NO. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and, accordingly, we have adopted SFAS 159 in the first quarter of 2008. We are currently assessing the impact of SFAS 159 on our consolidated financial statements.

In December 2007, the SEC issued SAB No. 110, CERTAIN ASSUMPTIONS USED IN VALUATION METHODS - EXPECTED TERM ("SAB 110"). According to SAB 110, under certain circumstances the SEC staff will continue to accept beyond December 31, 2007 the use of the simplified method in developing an estimate of expected term of share options that possess certain characteristics in accordance with SFAS 123(R) beyond December 31, 2007. We have adopted SAB 110 effective January 1, 2008 and continue to use the simplified method in developing the expected term used for our valuation of stock-based compensation.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS 141(R)"). SFAS 141(R) establishes principles and requirements for how the acquiror of a business (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (b) recognizes and measures in its financial statements the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning on or after December 15, 2008 and, accordingly, we will apply SFAS 141(R) for acquisitions effected subsequent to the date of adoption.

In December 2007, the FASB issued SFAS No. 160, NONCONTROLLING INTERESTS IN CONSOLIDATED FINANCIAL STATEMENTS--AN AMENDMENT OF ACCOUNTING RESEARCH BULLETIN NO. 51 ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to

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the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective beginning January 1, 2009. We are currently assessing the potential impact of SFAS 160 on our consolidated financial statements.

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### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All of our sales are denominated in United States dollars or the currency of the country in which our products originate. We are exposed to market risk for fluctuations in the foreign currency exchange rates for certain product purchases that are denominated in Hong Kong dollars and Chinese Yuan. We do not intend to purchase additional contracts to hedge the exchange exposure for future product purchases. There were no hedging contracts outstanding as of December 31, 2007. 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 December 31, 2007, the Revolving Credit Note of \$3.8 million was subject to interest rate fluctuations. A one percentage point increase in interest rates would result in an annualized increase to interest expense of approximately \$38,000 on our variable rate borrowings.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Talon International, Inc.  
Woodland Hills, California

We have audited the consolidated balance sheets of Talon International, Inc. and

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subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity and convertible redeemable preferred stock, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedules of Talon International, Inc., listed in Item 15(a). These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Talon International, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements, taken as a whole, present fairly in all material respects the information set forth therein.

We were not engaged to examine management's assertion about the effectiveness of Talon International, Inc.'s internal control over financial reporting as of December 31, 2007 included in the accompanying Management's Report on Internal Control Over Financial Reporting and accordingly, we do not express an opinion thereon.

As discussed in Note 1 to the consolidated financial statements, the Company has adopted the provisions of Statement of Financial Accounting Standards Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109" on January 1, 2007.

/s/ Singer Lewak Greenbaum & Goldstein LLP

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SINGER LEWAK GREENBAUM & GOLDSTEIN LLP  
Los Angeles, California  
April 11, 2008

TALON INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
	-----	-----
Assets		
Current Assets:		



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Cash and cash equivalents .....	\$ 2,918,858	\$ 2,934,673
Marketable Securities available for sale ....	1,040,000	--
Accounts receivable .....	3,504,351	4,664,766
Note receivable .....	--	1,378,491
Inventories, net .....	2,487,427	3,051,220
Prepaid expenses and other current assets ...	945,566	541,034
	-----	-----
Total current assets .....	10,896,202	12,570,184
Property and equipment, net .....	5,210,446	5,623,040
Fixed Assets held for sale .....	700,000	826,904
Note receivable, less current portion .....	--	1,420,969
Due from related parties .....	625,454	675,137
Other intangible assets, net .....	4,110,751	4,139,625
Other assets .....	551,054	437,569
	-----	-----
Total assets .....	\$ 22,093,907	\$ 25,693,428
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable .....	\$ 6,603,929	\$ 4,006,241
Accrued legal costs .....	498,846	427,917
Other accrued expenses .....	2,646,662	3,359,267
Demand notes payable to related parties .....	85,176	664,970
Current portion of capital lease obligations .	323,317	432,728
Current portion of notes payable .....	299,108	1,107,207
Current portion of secured convertible promissory notes .....	--	12,472,622
	-----	-----
Total current liabilities .....	10,457,038	22,470,952
Capital lease obligations, less current portion	189,705	474,733
Notes payable, less current portion .....	848,484	1,061,514
Revolver note payable .....	3,807,806	--
Term note payable, net of discount of \$2,075,500 .....	7,424,573	--
Other long term liabilities .....	83,651	--
Total liabilities .....	22,811,257	24,007,199
	-----	-----
Commitments and contingencies (Note 13)		
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; 20,291,433 shares issued and outstanding at December 31, 2007; 18,466,433 at December 31, 2006 ....	20,291	18,466
Additional paid-in capital .....	54,510,161	51,792,502
Accumulated deficit .....	(55,292,246)	(50,124,739)
Accumulated other comprehensive income- foreign currency .....	44,444	--
	-----	-----
Total stockholders' equity (deficit) .....	(717,350)	1,686,229
	-----	-----
Total liabilities and stockholders' equity .....	\$ 22,093,907	\$ 25,693,428
	=====	=====

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See accompanying notes.

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TALON INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
	-----	-----	-----
Net sales .....	\$ 40,529,555	\$ 48,825,002	\$ 47,331,176
Cost of goods sold .....	28,422,820	34,356,034	47,070,381
	-----	-----	-----
Gross profit .....	12,106,735	14,468,968	260,795
Selling expenses .....	3,125,634	2,777,772	2,928,659
General and administrative expenses .....	10,877,374	10,872,887	16,098,363
Bad debt expense (recoveries) .....	186,753	(513,347)	5,857,946
Reserve for impairment of note receivable .....	1,087,653	--	--
Restructuring charges .....	--	--	2,474,281
	-----	-----	-----
Total operating expenses .....	15,277,414	13,137,312	27,359,249
Income(loss) from operations .....	(3,170,679)	1,331,656	(27,098,454)
Interest expense, net .....	1,680,079	988,453	1,379,786
	-----	-----	-----
Income(loss) before income taxes .....	(4,850,758)	343,203	(28,478,240)
Provision for income taxes .....	70,949	33,900	1,059,479
	-----	-----	-----
Net income (loss) .....	\$ (4,921,707)	\$ 309,303	\$ (29,537,719)
	=====	=====	=====
Basic income(loss) per share .....	\$ (0.24)	\$ 0.02	\$ (1.62)
	=====	=====	=====
Diluted income( loss) per share .....	\$ (0.24)	\$ 0.02	\$ (1.62)
	=====	=====	=====
Basic weighted average shares outstanding .	20,155,563	18,377,484	18,225,851
	=====	=====	=====
Diluted weighted average shares outstanding	20,155,563	18,955,796	18,225,851
	=====	=====	=====

See accompanying notes.

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TALON INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND  
CONVERTIBLE REDEEMABLE PREFERRED STOCK  
YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005

	Common Stock		Preferred Stock Series A	
	Shares	Amount	Shares	Amount
BALANCE, JANUARY 1, 2005 ...	18,171,301	\$ 18,173	--	\$ --
Common stock issued upon exercise of options and warrants .....	69,744	68	--	--
Net loss .....	--	--	--	--
BALANCE, DECEMBER 31, 2005 .	18,241,045	18,241	--	--
Common stock issued for services .....	225,388	225	--	--
Stock based compensation ...	362,120	--	--	--
Net loss .....	--	--	--	--
BALANCE, DECEMBER 31, 2006 .	18,466,433	18,466	--	--
Common stock issued upon exercise of options ...	75,000	75	--	--
Common stock warrants issued in private placement transaction .	1,750,000	1,750	--	--
Stock based compensation	--	--	--	--
Other comprehensive income-foreign currency translation .....	--	--	--	--
Adoption of Fin 48 .....	--	--	--	--
Net loss .....	--	--	--	--
BALANCE, DECEMBER 31, 2007 .	20,291,433	\$ 20,291	--	\$ --
	Additional Paid-In Capital	Other Comprehensive Income	Retained Earnings (Deficit)	Total
BALANCE, JANUARY 1, 2005 ...	\$ 51,073,402	\$ --	(20,896,333)	\$ 30,195,242
Common stock issued upon exercise of options and warrants .....	254,476	--	--	254,544
Net loss .....	--	--	(29,537,709)	(29,537,70)
BALANCE, DECEMBER 31, 2005 .	51,327,878	--	(50,434,042)	912,077
Common stock issued for services .....	102,504	--	--	102,729

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Stock based compensation ...			--	362,120
Net loss .....	--	--	309,303	309,303
	-----	-----	-----	-----
BALANCE, DECEMBER 31, 2006 .	51,792,502	--	(50,124,739)	1,686,229
Common stock issued upon				
exercise of options ...	42,671	--	--	42,746
Common stock warrants				
issued in private				
placement transaction .	2,429,988	--	--	2,431,738
Stock based compensation	245,000	--	--	245,000
Other comprehensive				
income-foreign currency				
translation .....	--	44,444	--	44,444
Adoption of Fin 48 .....	--	--	(245,800)	(245,800)
Net loss .....	--	--	(4,921,707)	(4,921,707)
BALANCE, DECEMBER 31, 2007 .	\$ 54,510,161	\$ 44,444	\$(55,292,246)	\$ (717,350)
	=====	=====	=====	=====

See accompanying note

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TALON INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2007	Year Ended December 31, 2006
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss) .....	\$ (4,921,707)	\$ 309,303
Adjustments to reconcile net income (loss) to net cash		
provided by (used in) operating activities:		
Depreciation and amortization .....	1,168,434	1,523,225
Amortization of deferred financing cost and debt discounts	736,042	--
Decrease in deferred income taxes .....	--	--
Common stock and warrants issued for services .....	--	32,729
Stock based compensation .....	245,000	362,120
Increase(decrease) in allowance for doubtful accounts ....	(935,501)	(1,117,500)
Increase(decrease) in inventory valuation reserve .....	(68,988)	(6,064,000)
Asset impairment .....	126,904	--
Asset impairment due to restructuring .....	--	--
Impairment of goodwill .....	--	--
Disposal of assets .....	58,076	129,179
Changes in operating assets and liabilities:		
Accounts receivable .....	3,258,569	2,086,076
Note receivable collections .....	596,491	640,539
Inventories .....	632,781	8,585,879
Prepaid expenses and other current assets .....	(404,532)	77,543
Other assets .....	(118,499)	(140,217)
Accounts payable .....	2,070,784	(2,587,985)
Accrued legal costs .....	70,929	(442,194)
Other accrued expenses .....	(377,565)	(733,767)

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Repayment of notes payable converted from accounts payable	--	(867,297)
Income taxes payable .....	--	(480)
	-----	-----
Net cash provided by (used in) operating activities .....	2,137,218	1,793,153
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of equipment .....	--	2,500
Acquisition of property and equipment .....	(725,498)	(347,188)
	-----	-----
Net cash used in investing activities .....	(725,498)	(344,688)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from secured convertible promissory notes .....	--	254,544
Proceeds from exercise of stock options and warrants .....	--	--
Payment of capital lease obligations .....	(452,232)	(604,351)
Payments on notes payable .....	--	(186,838)
Repayment of notes payable .....	(1,187,882)	--
Repayment of related party note payable .....	(579,794)	--
Proceeds from revolver credit facility .....	4,307,806	--
Proceeds from stock options and warrants .....	42,746	--
Proceeds from term note .....	7,041,852	--
Proceeds from note .....	166,753	--
Proceeds from related party note .....	125,000	--
Payment of financing term note .....	(449,840)	--
Proceeds for equity financing, net of offering costs .....	2,463,017	--
Proceeds from cost-equity financing .....	89,868	--
Repayment of revolver .....	(500,000)	--
Repayment of convertible note .....	(12,500,000)	--
	-----	-----
Net cash (used in) provided by financing activities .....	(1,432,706)	(791,189)
	-----	-----
Net increase (decrease) in cash and cash equivalents .....	(20,986)	657,276
Net effect of foreign currency exchange translation on cash ...	5,171	--
	-----	-----
Cash and cash equivalents, beginning of year .....	2,934,673	2,277,397
	-----	-----
Cash and cash equivalents, end of year .....	\$ 2,918,858	\$ 2,934,673
	=====	=====

See accompanying notes.

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TALON INTERNATIONAL, INC.  
Consolidated Statements of Cash Flows

	Year Ended December 31, 2007	Year Ended December 31, 2006
	-----	-----

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash received (paid) during the year for:

Interest paid .....	\$ (1,166,333)	\$ (975,609)
Interest received .....	\$ 182,263	\$ 320,232
Income taxes paid .....	\$ (90,530)	\$ (33,900)
Income taxes received .....	\$ --	\$ --

Non-cash financing activity:

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Capital lease obligation .....	\$ 57,793	\$ 64,432	
Deferred financing cost .....	\$ 217,302	\$ --	
Effect of foreign currency translation on net assets .....	\$ 10,728	\$ --	
Accounts receivable, net converted to notes receivable ....	\$ --	\$ --	
Trade payable & accrued legal, converted to notes payable..	\$ --	\$ 1,775,000	

See accompanying notes.

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

#### NOTE 1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### NATURE OF BUSINESS

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

##### ORGANIZATION AND BASIS OF PRESENTATION

Talon International, Inc. is the parent holding company of Tag-It, Inc., a California corporation, Tag-It Pacific (HK) Ltd., a BVI corporation, Tag-It de Mexico, S.A. de C.V., A.G.S. Stationery, Inc., a California corporation (collectively, the "Subsidiaries"), all of which were consolidated under a parent limited liability company on October 17, 1997 and became wholly-owned subsidiaries of the Company immediately prior to the effective date of the Company's initial public offering in January 1998. Immediately prior to the initial public offering, the outstanding membership units of Tag-It Pacific LLC were converted to 2,470,001 shares of common stock of the Company. In January 2000, the Company formed Tag-It Pacific Limited, a Hong Kong corporation, and in April 2000, the Company formed Talon International, Inc., a Delaware corporation. During 2006 we formed two wholly owned subsidiaries of Tag-It Pacific, Inc.; Talon Zipper (Shenzhen) Company Ltd. in China, and Talon International Pvt. Ltd., in India. All newly formed corporations are 100% wholly-owned Subsidiaries of Talon International, Inc. Logistica en Avios, S.A. de C.V. was an affiliated entity over which the Company exercised control, and as such, is accounted for in the same manner as a wholly-owned subsidiary.

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

All significant intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of foreign subsidiaries are translated at rates of exchange in effect at the close of the period. Revenues and expenses are translated at the weighted average of exchange rates in effect during the year. The resulting translation gains and losses are deferred and are shown as a separate component of stockholders' equity, if material, and transaction gains and losses, if any, are recorded in the consolidated statement of income in the period incurred. During 2007, 2006 and 2005, foreign currency

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translation and transaction gains and losses were not material. The Company does not engage in hedging activities with respect to exchange rate risk.

### USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with 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. Actual results could differ from those estimates.

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

### CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. The Company had approximately \$2.7 million and \$2.9 million at financial institutions in excess of federally insured limits at December 31, 2007 and 2006.

### MARKETABLE SECURITIES

The portfolio of marketable securities is stated at the lower of cost or market at the balance sheet date and consists of common stocks. The Company accounts for its investments, which are all available for sales securities, under the provisions of Statement of Financial Accounting Standards ( "SFAS" ) 115, "Accounting for Certain Investments in Debt and Securities". Realized gains or losses are determined on the specific identification method and are reflected in income. Unrealized losses are recorded directly in other comprehensive income except those unrealized losses that are deemed to be other than temporary, which losses are reflected in income. See Note 2 of the Consolidated Financial Statements.

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

We are required to make judgments as to the collectibility of accounts receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful accounts represent allowances for customer trade accounts receivable that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables to their net realizable value. We record 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 our historical experience, for issues not yet identified. See Note 3 of the Consolidated Financial Statements.

### INVENTORIES

Inventories are stated at the lower of cost, determined using the first-in, first-out basis, or market value and are all substantially finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory reserves are recorded for damaged, obsolete, excess and slow-moving inventory. 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

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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:

	Year Ended December 31,	
	2007	2006
Finished goods .....	\$3,506,439	\$4,293,220
Less reserves .....	1,019,012	1,242,000
	-----	-----
Total inventories .....	\$2,487,427	\$3,051,220
	=====	=====

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

#### PROPERTY AND EQUIPMENT AND FIXED ASSETS HELD FOR SALE

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

Depreciation of property and equipment is computed using the straight-line method based on estimated useful lives as follows:

Furniture and fixtures	5 years	
Machinery and equipment	5 to 10 years	
Computer equipment	5 years	
Leasehold improvements	Term of the lease or the estimated life of the related improvements, whichever is shorter.	
Dies, and molds	3 months to 1 years	
Idle equipment	5 to 10 years	

Property and equipment consist of the following:

	Year Ended December 31,	
	2007	2006
Furniture and fixtures .....	\$ 600,491	\$ 582,832



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Machinery and equipment .....	1,694,921	1,682,296
Computer equipment .....	4,137,834	3,422,058
Leasehold improvements .....	248,129	214,807
Dies, and molds .....	106,273	106,273
Idle equipment .....	4,198,880	4,434,980
	-----	-----
	10,986,528	10,443,246
Accumulated depreciation and amortization .....	5,776,082	4,820,206
	-----	-----
Net property and equipment .....	\$ 5,210,446	\$ 5,623,040
	=====	=====

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was \$1,136,000, \$1,090,000, and \$1,499,000, respectively.

During the year ended December 31, 2007, the Company wrote-off fixed assets with a net book of value of \$54,000 related to scrap dies and molds. During the year ended December 31, 2005, the Company wrote-off fixed assets with a net book value of \$2,036,000 in connection with the 2005 restructuring plan.

Idle equipment is principally machinery and equipment used for the production of zipper chain and the assembly of finished zippers. This equipment was originally associated with the production and assembly facilities in North Carolina and in Mexico, and was temporarily rendered idle with the closing of these operations in connection with the 2005 Restructuring Plan. The Company intends to redeploy this equipment during the next year within production operations being established in Asia and India. The equipment continues to be depreciated based upon its estimated useful lives.

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TALON INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company has evaluated the idle equipment for impairment and has determined that an impairment does not exist at December 31, 2007. If future events occur that adversely affect the idle equipment the Company will record an impairment.

Fixed assets held for sale consists of the North Carolina land and manufacturing facility. Management has the authority and has committed to sell the asset; the asset is listed for sale with a commercial real estate agent who is actively marketing the property; the sale of the asset is probable and the sale is expected to be completed within one year. See Note 11, "2005 Restructuring Plan". This asset held for sale is financed by a mortgage note with a balance of \$690,000 at December 31, 2007 and \$713,000 at December 31, 2006.

OTHER INTANGIBLE ASSETS

Intangible assets consist of tradename and exclusive license and intellectual property rights. Intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of FASB Statement No. 142, Goodwill and Other Intangible Assets. Intangible assets with estimable useful lives are amortized over their

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respective estimated useful lives, which average 5 years, to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

At December 31, 2007, the Company evaluated its Other Intangible Assets and determined that there was no impairment of these assets and made no changes to the net carrying amount of Tradename for the years ended December 31, 2007 and 2006. Amortization expense related to exclusive license and intellectual property rights of \$115,500 were recorded for each of the years ended December 31, 2006 and 2005. During the first quarter of 2007, the exclusive license and intellectual property became fully amortized. For the year ended December 31, 2007, amortization expense of \$29,000 was recorded.

Other intangible assets as of December 31, 2007 and 2006 are as follows:

	Year Ended December 31,	
	2007	2006
Other Intangible Assets:		
Tradename .....	\$ 4,110,750	\$ 4,110,750
Accumulated amortization .....	--	--
	4,110,750	4,110,750
Exclusive license and intellectual property rights .....	577,500	577,500
Accumulated amortization .....	(577,500)	(548,625)
	0	28,875
Exclusive license and intellectual property rights, net .....	0	28,875
Other intangible assets, net .....	\$ 4,110,750	\$ 4,139,625
	\$ 4,110,750	\$ 4,139,625

### IMPAIRMENT OF LONG-LIVED ASSETS

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.

During the year ended December 31, 2007, the Company recorded an impairment on the building held for sale of \$127,000 reducing the carrying value of the building to \$700,000. No impairment was recorded in 2006. During the year ended December 31, 2005, the Company recorded asset impairment charges in

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connection with its 2005 Restructuring Plan (See Note 11).

### INCOME TAXES

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

The provisions of SFAS No. 109, "Accounting for Income Taxes," require the establishment of a valuation allowance when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will not be realized. SFAS No. 109 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset.

The Company believes that its estimate of deferred tax assets and determination to record a valuation allowance against such assets are critical accounting estimates because they are subject to, among other things, an estimate of future taxable income, which is susceptible to change and dependent upon events that may or may not occur, and because the impact of recording a valuation allowance may be material to the assets reported on the balance sheet and results of operations.

On January 1, 2007 the Company adopted the provisions of Financial Accounting Standard 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 \$246,000, which was accounted for as an increase in the January 1, 2007 accumulated deficit.

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

#### STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "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

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estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. The Company's financial statements as of and for the years ended December 31, 2006 and 2007 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). There was no stock-based compensation expense related to employee or director stock options recognized during the year ended December 31, 2005. 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."

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's income before income taxes and net income for the year ended December 31, 2007 and 2006 are \$245,000 and \$395,000, respectively, lower than if it had continued to account for share-based compensation under APB Opinion 25.

The following table illustrates the effect on net income and loss per share if the Company had applied the fair value recognition provisions of SFAS 123(R) to stock-based awards granted under the Company's stock option plans in all periods presented. For purposes of this pro-forma disclosure, the fair value of the options is estimated using the Black-Scholes-Merton option-pricing formula ("Black-Scholes model") and amortized to expense generally over the options' vesting periods.

	2005
	-----
Net loss as reported .....	\$ (29,537,709)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects .....	--
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects .....	(221,167)
	-----
Pro forma net loss .....	\$ (29,758,876)
	=====
Loss per share:	
Basic - as reported .....	\$ (1.62)
Basic - pro forma .....	\$ (1.63)

TALON INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using

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an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statements of Operations. Stock-based compensation expense recognized in the Statements of Operations for the years ended December 31, 2006 and 2007 included compensation expense for share-based payment awards granted prior to, but not yet vested as of January 1 of the applicable year based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123(R) and compensation expense for the share-based payment awards granted subsequent to January 1 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method, which is consistent with how the prior-period pro formas were provided. As stock-based compensation expense recognized in the Statements of Operations for 2006 and 2007 is based on awards expected to vest, SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For the years ended December 31, 2006 and 2007, expected forfeitures are immaterial and as such the Company is recognizing forfeitures as they occur. In the pro-forma information provided under SFAS 123(R) for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB Opinion 25. Under the intrinsic value method, the Company recognized share-based compensation equal to the award's intrinsic value at the time of grant over the requisite service periods using the straight-line method. Forfeitures were recognized as incurred. During the year ended December, 31, 2005, there was no stock-based compensation expense recognized in the Statements of Operations for awards issued to employees and directors as the awards had no intrinsic value at the time of grant because their exercise prices equaled the fair values of the common stock at the time of grant.

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant uses the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards, and actual and projected employee stock option exercise behaviors. The Company estimates expected volatility using historical data. The expected option term is estimated using the "safe harbor" provisions under SAB 107.

The Company has elected to adopt the detailed method provided in SFAS 123(R) for calculating the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

### FOREIGN CURRENCY TRANSLATION

The Company has operations and holds assets in various foreign countries. The local currency is the functional currency for our 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 (loss) until the translation adjustments are realized.

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

### COMPREHENSIVE INCOME

The Company has adopted Statement of Financial Standard No. 130, "Reporting Comprehensive Income" ("SFAS 130"), issued by the FASB and effective for financial statements with fiscal years beginning after December 15, 1997. SFAS 130 establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements.

Included in comprehensive income for the year ended December 31, 2007 are unrealized gains in foreign currency translation gain of \$44,000. The foreign currency translation adjustment represents the net currency translation adjustment gains and losses related to our China and India subsidiaries. There were no material other comprehensive income items for the years ended December 31, 2007 and 2006.

### REVENUE RECOGNITION

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

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

### RECLASSIFICATION

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

### CLASSIFICATION OF EXPENSES

**COST OF SALES** - Cost of goods sold primarily includes expenses related to inventory purchases, customs, duty, freight, overhead expenses and reserves for obsolete inventory. Overhead expenses primarily consist of warehouse and operations salaries, and other warehouse expenses.

**SELLING EXPENSE** - Selling expenses primarily include royalty expense, sales salaries and commissions, travel and entertainment, marketing and other sales-related costs.

**GENERAL AND ADMINISTRATIVE EXPENSES** - General and administrative expenses primarily include administrative salaries, employee benefits, professional service fees, facility expenses, information technology costs, investor relations, travel and entertainment, depreciation and amortization, bad

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debts, restructuring costs and other general corporate expenses.

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

**INTEREST EXPENSE AND INTEREST INCOME** - Interest expense reflects the cost of borrowing and amortization of deferred financing costs and discounts. Interest expense for the years ended December 31, 2007, 2006 and 2005 was \$1,922,000, \$1,357,000 and \$1,446,000, respectively. Interest income of \$242,000, \$368,000 and \$66,000 for the years ended December 31, 2007, 2006 and 2005, respectively, consists of earnings from outstanding amounts due to the Company under notes and other interest bearing receivables.

#### SHIPPING AND HANDLING COSTS

In accordance with Emerging Issues Task Force 00-10, Accounting for Shipping and Handling Fees and Costs, the Company records shipping and handling costs billed to customers as a component of revenue, and shipping and handling costs incurred by the Company for outbound freight are recorded as a component of cost of sales. Total shipping and handling costs included as a component of revenue for the years ended December 31, 2007, 2006 and 2005 amounted to \$235,000, \$146,000, and \$98,000, respectively. Total shipping and handling costs included as a component of cost of sales for each of these years amounted to \$1,105,000, \$691,000, and \$925,000.

#### RESTRUCTURING CHARGES

The Company records 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 as they are incurred and on the accrual basis for one-time benefit arrangements. The Company records 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 the Company 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. The Company reviews the status of restructuring activities on a quarterly basis and, if appropriate, records changes based on updated estimates. See Note 11, "2005 Restructuring Plan".

#### LITIGATION

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.

#### FAIR VALUE OF FINANCIAL INFORMATION

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The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value. ACCOUNTS RECEIVABLE: Due to the short-term nature of the receivables, the fair value approximates the carrying value. DUE FROM RELATED PARTIES AND NOTES PAYABLE TO RELATED PARTIES: Due to the short-term nature and current market borrowing rates of the loans and notes, the fair value approximates the carrying value. NOTES PAYABLE: Fair value approximates carrying value based upon current market borrowing rates for loans with similar terms and maturities.

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

#### NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, FAIR VALUE MEASUREMENTS ("SFAS 157"), which defines fair value, provides a framework for measuring fair value and expands the disclosures required for fair value measurements. SFAS 157 applies to all accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. For fiscal years beginning after November 15, 2007, companies will be required to implement SFAS 157 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. The FASB did, however, provide a one-year deferral for the implementation of Statement 157 for other nonfinancial assets and liabilities. An exposure draft will be issued for comment in the near future on this partial deferral. Accordingly, we will adopt SFAS 157 for financial assets and liabilities commencing in the first quarter of 2008. We are currently assessing the potential impact of SFAS 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND LIABILITIES - INCLUDING AN AMENDMENT OF FASB STATEMENT NO. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and, accordingly, we will adopt SFAS 159 in the first quarter of 2008. We are currently assessing the impact of SFAS 159 on our consolidated financial statements.

In December 2007, the SEC issued SAB No. 110, CERTAIN ASSUMPTIONS USED IN VALUATION METHODS - EXPECTED TERM ("SAB 110"). According to SAB 110, under certain circumstances the SEC staff will continue to accept beyond December 31, 2007 the use of the simplified method in developing an estimate of expected term of share options that possess certain characteristics in accordance with SFAS 123(R) beyond December 31, 2007. We will adopt SAB 110 effective January 1, 2008 and continue to use the simplified method in developing the expected term used for our valuation of stock-based compensation.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS 141(R)"). SFAS 141(R) establishes principles and requirements for how the acquiror of a business (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (b) recognizes and measures in its financial statements the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate



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the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning on or after December 15, 2008 and, accordingly, we will apply SFAS 141(R) for acquisitions effected subsequent to the date of adoption.

In December 2007, the FASB issued SFAS No. 160, NONCONTROLLING INTERESTS IN CONSOLIDATED FINANCIAL STATEMENTS--AN AMENDMENT OF ACCOUNTING RESEARCH BULLETIN NO. 51 ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective beginning January 1, 2009. We are currently assessing the potential impact of SFAS 160 on our consolidated financial statements.

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

#### NOTE 2--MARKETABLE SECURITIES

On December 31, 2007, the Company obtained 2,000,000 shares of unrestricted common stock with a value of \$1,040,000 in exchange for the Azteca Note Receivable discussed in Note 3. Pursuant to restrictions on the sale of these shares on the open market, the Company is limited to selling no more than 10,000 shares per day unless the Company sells the shares through a private sale. The portfolio of marketable securities is stated at the lower of cost or market at the balance sheet date and consists of common stocks. No realized or unrealized gains or losses were recognized during the year ended December 31, 2007. The value of the common stock on April 10, 2008 had decreased \$340,000 to \$700,000.

#### NOTE 3--ACCOUNTS AND NOTE RECEIVABLE

At December 31, 2006 a note receivable from Azteca Productions International, Inc. ("Azteca") was outstanding in the amount of \$2,799,460. The note was a receivable to be paid in monthly installments over thirty-one months beginning March 1, 2006. The payments were \$50,000 per month for the first 5 months, and then ranged from \$133,000-\$267,000 per month until paid in full, but no later than July 1, 2008.

Azteca failed to make the scheduled note payments due on July 1, 2007, and all subsequent periods thereafter, triggering a default and exhausting all cure periods under the note, resulting in the entire note balance being due and payable. On September 10, 2007 after meeting with and conducting extensive discussions with Azteca, Azteca failed to provide to the Company certain security interests as required under the note to make the scheduled note payments and Azteca further expressed its belief that it would be unable to make any note payments in the foreseeable future. As a result, in September 2007, the Company reflected a charge of \$2,127,653 to fully reserve the outstanding balance from Azteca. In December 2007, an agreement was reached whereby Azteca delivered shares of common stock in lieu of the note receivable. In December 2007, the Company reversed part of the impairment recorded in September 2007 and reflected income of \$1,040,000.

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Accounts receivable are included on the accompanying consolidated balance sheet net of an allowance for doubtful accounts. The total allowance for doubtful accounts at December 31, 2007 and 2006 was \$140,420 and \$71,500, respectively.

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TALON INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4--DEMAND NOTES PAYABLE TO RELATED PARTIES

Demand notes payable to related parties consist of the following:

	Year Ended December 31,	
	2007	2006
	-----	-----
Two notes payable issued from 1995-1998 to parties related to or affiliated with directors of the Company with interest rates ranging from 0% to 10% per annum, due and payable on the fifteenth day following delivery of written demand for payment .....	\$ 85,176	\$ 85,176
Convertible secured note payable issued in October 2000 to a director of the Company bears interest at 11%, payable quarterly, is due on demand and convertible into common stock at the election of the holder at a rate of \$4.50 per share, the market value of the Company's common stock on the date of approval by the Company's Board of Directors. The note is secured by substantially all of the Company's assets .....	--	500,000
Unsecured notes payable to a director of the Company accrue interest at 7% and 8.5% per annum, principal and interest due on demand and fifteen days from demand .....	--	79,795
	-----	-----
	\$ 85,176	\$664,971
	=====	=====

Interest expense related to the demand notes payable to related parties for the years ended December 31, 2007, 2006 and 2005 amounted to \$30,568, \$67,753 and \$67,753, respectively. Included in accrued expenses at December 31, 2007 and 2006 was \$127,915 and \$515,738 of related accrued interest. Interest paid on the demand notes during the year ended December 31, 2007 was \$518,546. There was no interest paid on the demand notes during the year ended December 31, 2006.

NOTE 5--CAPITAL LEASE OBLIGATIONS

The Company financed equipment purchases through various capital lease obligations expiring through March 2010. These obligations bear interest at various rates ranging from 4.6% to 12% per annum. Future minimum annual payments under these capital lease obligations are as follows:

YEARS ENDING DECEMBER 31,	Amount
---------------------------	--------

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2008 .....	\$ 363,200
2009 .....	196,222
2010 .....	2,378
2011 .....	--
2012 and thereafter .....	--
<hr/>	
Total payments .....	561,800
Less amount representing interest .....	(48,778)
<hr/>	
Balance at December 31, 2007 .....	513,022
Less current portion .....	323,317
<hr/>	
Long-term portion .....	\$ 189,705
	<u>=====</u>

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TALON INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2007, total property and equipment under capital lease obligations and related accumulated depreciation was \$3,533,154 and \$1,635,697, respectively. At December 31, 2006, total property and equipment under capital lease obligations and related accumulated depreciation was \$3,533,154 and \$1,178,469, respectively.

NOTE 6--NOTES PAYABLE

Notes payable consist of the following:

	Year Ended December 31,	
	2007	2006
	<hr/>	<hr/>
\$765,000 note payable to First National Bank dated June 3, 2004; interest at 6.5%; payable in eighty-four monthly payments of principal and interest of \$5,746 beginning July 2004; twenty-year amortization, all unpaid principal and interest due June 3, 2011 (seven years); secured by building in North Carolina .....	\$ 689,651	\$ 712,950
\$880,000 note payable to First National Bank dated November 22, 2004; interest at 6.5%; payable in sixty monthly payments of principal and interest of \$17,254 beginning December 2004; all unpaid principal and interest due November 22, 2009; secured by manufacturing equipment .....	371,863	548,068
\$1,650,000 note payable to Hennigan, Bennett & Dorman, LLP dated May 31, 2006; interest at 3.0%; payable in fourteen monthly payments of principal		

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and interest beginning June 2006, of \$50,000 for the first two payments, and \$133,333 for the next twelve months thereafter until July 1, 2007; secured by the note receivable ..... -- 907,703

\$180,000 note payable to Next Trim, LLC dated January 22, 2007; interest at 6.5%; payable in twenty-four monthly payments of principal and interest beginning January 2007, of \$7,500 until December 2008 .....	86,078	--
	-----	-----
Notes Payable .....	1,147,592	2,168,721
Less Current portion .....	299,108	1,107,207
	-----	-----
Notes payable, net of current portion .....	\$ 848,484	\$1,061,514
	=====	=====

Future minimum annual payments under these notes payable obligations are as follows:

YEARS ENDING DECEMBER 31,	Amount
	-----
2008 .....	\$ 299,108
2009 .....	210,218
2010 .....	28,301
2011 .....	609,965
2012 and thereafter .....	--
	-----
Total .....	\$1,147,592
	=====

TALON INTERNATIONAL, INC.  
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NOTE 7--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 the prime rate plus 2.0%. The term loan bears interest at 8.5% annually with quarterly interest payments and repayment in full at maturity. Borrowings under both credit facilities are secured by all of the assets of the Company.

Under the terms of the credit agreement the Company is required to meet certain cash flow and coverage ratios, among other restrictions including a restriction from declaring or paying a dividend prior to repayment of all the obligations. The financial covenants require the Company to maintain at the end of each fiscal quarter "EBITDA" (as defined in the Agreement) for the preceding four quarters in excess of the Company's principal and interest payments for the same four-quarter period. In the event that the Company fails to satisfy the

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minimum EBITDA requirement for two consecutive quarters, the credit agreement will be in default and the full amount of the notes outstanding will become due. For the period ended September 30, 2007 the Company believes that this EBITDA covenant was satisfied, but also informed the lender that the Company may fail to satisfy the EBITDA covenant for the quarters ending December 31, 2007 or March 31, 2008. The Company requested the lender to amend the loan agreement to allow for additional time to satisfy the covenant. On November 19, 2007 the Company entered into an agreement with Bluefin Capital, LLC to modify this financial covenant and to extend until June 30, 2008 (with a further extension to March 31, 2009 provided certain conditions are met by June 30 2008) the application of the EBITDA covenant in exchange for additional common stock of the Company and a price adjustment to the lenders outstanding warrants issued in connection with the loan agreement.

At closing on June 27, 2007, the proceeds of the term loan in the amount of \$9.5 million 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 closing the Company also borrowed \$1,004,306 under the revolving credit note and used the proceeds to pay the related party note payable and accrued interest due to Mark Dyne, Chairman of the Board of the Company. Additionally initial borrowings under the revolving credit note were used to pay the loan and legal fees due at closing. As of September 30, 2007 the Company had borrowed \$9.5 million under the term note, and \$3,807,806 under the revolving credit note.

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 were exercisable over a five-year period and 700,000 warrants were exercisable at \$0.95 per share; 700,000 warrants were exercisable at \$1.05 per share; and 700,000 warrants were exercisable at \$1.14 per share. The relative fair value (\$2,374,169, which includes a reduction for financing costs) 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 was to be amortized 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 \$486,000. 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.

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

On November 19, 2007, the Company completed an amendment on its debt facility and issued an additional 250,000 shares of common stock to the lender for \$0.001 per share. The exercisable price for 2,100,000 warrants issued for the purchase of common stock was amended to an issuable price of \$0.75 per share. The new relative fair value (\$2,402,936, 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 was to be amortized over the term of the note and recognized as additional interest cost as amortized. If the Company does not meet a requirement to register the common shares and warrants by May 15, 2008, the

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Company will incur a penalty of \$1,000 per day up to a maximum of \$700,000.

On April 3, 2008 the Company executed an amendment to the existing revolving credit and term loan agreement with Bluefin Capital. The amendment provided for an amendment of the EBITDA and other financial covenants, and the redemption of the stock warrants previously issued to Bluefin Capital in exchange for the issuance of an additional note payable to Bluefin Capital for \$1.0 million at an interest rate of 8.5%. The Company will record a reduction to equity and an increase to notes payable for the fair value of the warrants redeemed. The difference between the fair value of the warrants of \$221,723 and the face value of the note will be accreted over the life of the note. The note will incur interest at 8.5% on the principal amount of \$1.0 million and the quarterly accretion will also be reflected as interest expense. The additional note and all accrued interest under the note are due and payable on June 30, 2010.

Interest expense related to the Revolving Credit and Term Loan Agreement for the year ended December 31, 2007 was \$1,008,520, which includes \$461,102 in amortization of discounts and deferred financing costs.

### NOTE 8--STOCKHOLDERS' EQUITY AND CONVERTIBLE REDEEMABLE PREFERRED STOCK

#### PREFERRED STOCK

#### STOCKHOLDER'S RIGHTS PLAN

In October 1998, the Company adopted a stockholder's rights plan. Under the rights plan the Company distributed one preferred share purchase right for each outstanding share of Common Stock outstanding on November 6, 1998. Upon the occurrence of certain triggering events related to an unsolicited takeover attempt of the Company, each purchase right not owned by the party or parties making the unsolicited takeover attempt will entitle its holder to purchase shares of the Company's Series A Preferred Stock at a value below the then market value of the Series A Preferred Stock. The rights of holders of the Common Stock will be subject to, and may be adversely affected by, the rights of holders of the share purchase rights, the Series A Preferred Stock and any other preferred stock that may be issued in the future. The issuance of preferred stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could make it more difficult for a third party to acquire a majority of the Company's outstanding voting stock.

#### COMMON STOCK

#### 2003 PRIVATE PLACEMENT

On May 30, 2003, the Company raised approximately \$6,037,500 in a private placement transaction with five institutional investors. Pursuant to a securities purchase agreement with these institutional investors, the Company sold 1,725,000 shares of its common stock at a price per share of \$3.50. After commissions and expenses, the Company received net proceeds of approximately

\$5.5 million. The Company has registered the shares issued in the private placement with the Securities and Exchange Commission for resale by the investors. In conjunction with the private placement transaction, the Company

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issued warrants to purchase 172,500 shares of common stock to the placement agent. The warrants are exercisable beginning August 30, 2003 through May 30, 2008 and have a per share exercise price of \$5.06.

### EXCLUSIVE LICENSE AND INTELLECTUAL PROPERTY RIGHTS AGREEMENT

On April 2, 2002, the Company entered into an Exclusive License and Intellectual Property Rights Agreement (the "Agreement") with Pro-Fit Holdings Limited ("Pro-Fit"). The Agreement gives the Company the exclusive rights to sell or sublicense waistbands manufactured under patented technology developed by Pro-Fit for garments manufactured anywhere in the world for the United States market and all United States brands. In accordance with the Agreement, the Company issued 150,000 shares of its common stock which were recorded at the market value of the stock on the date of the Agreement. The shares contain restrictions related to the transfer of the shares and registration rights. The Agreement has an indefinite term that extends for the duration of the trade secrets licensed under the Agreement. The Company has recorded an intangible asset amounting to \$577,500, which was fully amortized by the year ended December 31, 2007. The Company is currently in litigation with this supplier (See Notes 1 and 13).

### NOTE 9--STOCK OPTION INCENTIVE PLAN AND WARRANTS

#### STOCK OPTION INCENTIVE PLAN

On July 31, 2007, at the Company's annual meeting of stockholders, the 2007 Stock Plan was approved which replaced the 1997 Stock Plan. 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 December 31, 2007 no awards under the 2007 Stock Plan had been granted.

On October 1, 1997, the Company adopted the 1997 Stock Incentive Plan (the "1997 Plan"), which authorized the granting of a variety of stock-based incentive awards. The Board of Directors, who determines the recipients and terms of the awards granted, administers the 1997 Plan. On July 31, 2006 at the Company's annual meeting of stockholder's two amendments to the 1997 Stock Plan were approved which (1) increased the maximum number of shares of common stock that may be issued pursuant to awards granted under the 1997 Plan from 3,077,500 shares to 6,000,000 shares, and (2) increased the number of shares of common stock that may be issued pursuant to awards granted to any individual under the plan in a single year to 50% of the total number of shares available under the plan.

The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price equal to the market price of the Company's stock on the date of the grant for years prior to 2006, and for the years ending after 2006, the average market price of the Company's stock for the five trading days prior to the date of the grant; those option awards generally vest over periods determined by the Board from immediate to 4 years of continuous service, and have 10 year contractual terms.

The following table summarizes all options issued to employees and directors including those issued outside the plan.

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The following table summarizes the activity for the periods:

EMPLOYEE AND DIRECTOR	Number of Shares	Weighted Average Exercise Price
	-----	-----
Options outstanding - January 1, 2005 .....	1,742,000	\$ 3.53
Granted .....	425,000	\$ 3.22
Exercised .....	(1,250)	\$ 3.63
Canceled .....	(332,750)	\$ 3.50
	-----	-----
Options outstanding - December 31, 2005 .....	1,833,000	\$ 3.46
Granted .....	3,471,135	\$ 0.31
Canceled .....	(301,500)	\$ 3.56
	-----	-----
Options outstanding - December 31, 2006 .....	5,002,635	\$ 1.41
Granted .....	46,600	\$ 1.02
Exercised .....	(75,000)	\$ 0.57
Canceled .....	(376,000)	\$ 0.76
	-----	-----
Options outstanding - December 31, 2007 .....	4,598,235	\$ 1.46
	=====	=====

The Company has also issued certain warrants and options to non-employees. As of December 31, 2007, there were warrants issued to acquire a total of 3,163,813 shares of common stock, outstanding to non-employees. During 2007 the Company issued 1,750,000 shares of stock to its lender with a fair market value of \$1,637,500.

The following table summarizes the activity for the periods:

NON-EMPLOYEES	Number of Shares	Weighted Average Exercise Price
	-----	-----
Options & warrants outstanding - January 1, 2005 ..	1,578,973	\$ 4.35
Granted .....	--	\$ --
Exercised .....	(68,494)	\$ 3.65
Canceled .....	(133,332)	\$ 4.54
	-----	-----
Options & warrants outstanding - December 31, 2005	1,377,147	\$ 4.36
Granted .....	75,000	\$ 0.57
Exercised .....	--	\$ --
Canceled .....	(133,334)	\$ 4.54
	-----	-----
Options & warrants outstanding - December 31, 2006	1,318,813	\$ 4.13
Granted .....	2,100,000	\$ 0.75
Canceled .....	(180,000)	\$ 3.63
	-----	-----
Options & warrants outstanding - December 31, 2007	3,238,813	\$ 2.00
	=====	=====

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant uses the Black-Scholes model and the assumptions noted in the following table for the years ended December 31, as indicated. Expected volatilities are based on the historical volatility of the



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Company's stock price and other factors. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards, and actual and projected employee stock option exercise behaviors. The expected option term is estimated using the "safe harbor" provisions under SAB

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

107. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield in effect at the time of the grant.

	2007	2006	2005
Expected volatility .....	64%	65%	64%
Expected term in years .....	6.1 yrs	6.1 yrs	1.2 yrs
Expected dividends .....	--	--	--
Risk-free rate .....	4.8%	4.5%	2.0%

A summary of the option activity under the 1997 Plan as of December 31, 2007, and changes during the year then ended is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Intrinsic Value
EMPLOYEE AND DIRECTOR				
Outstanding at December 31, 2007 ...	7,837,048	\$ 1.74	5.44	\$ 75,405
Vested and Expected to Vest .....	7,783,316	\$ 1.75	5.42	\$ 74,176
Exercisable .....	6,608,782	\$ 1.95	4.91	\$ 53,128

The weighted average grant-date fair value of options granted to employees and directors during the years ended December 31, 2007 and 2006 were \$0.33 and \$0.31, respectively. The total intrinsic value of options exercised during the year ended December 31, 2005 was \$1,700. There were no options exercised in 2007 and 2006.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Intrinsic Value
NON-EMPLOYEE OPTIONS & WARRANTS				
Outstanding at December 31, 2007 ...	3,163,813	\$ 1.99	4.5	\$ 31,638
Vested and Expected to Vest .....	3,163,813	\$ 1.99	4.5	\$ 31,638
Exercisable .....	3,163,813	\$ 1.99	4.5	\$ 31,638

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The weighted average grant-date fair value of options and warrants granted to non-employees during the years ended December 31, 2007 and 2006 was \$0.75 and \$0.57, respectively. There were no grants in 2005. The total intrinsic value of options and warrants exercised during the years ended December 31, 2007 and 2005 was \$21,000 and \$91,000, respectively. There were no options exercised in 2006. The fair value of the awards approximates the values expensed for pro-forma purposes for these periods.

As of December 31, 2007, there was \$398,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted, including warrants. This cost is expected to be recognized over the weighted-average period of 2.0 years. The total fair value of shares vested during the years ended December 31, 2007, 2006 and 2005 was \$245,000, \$236,000, and \$217,000, respectively.

When options are exercised, the Company's policy is to issue previously registered, unissued shares of common stock. As of December 31, 2006, the Company had 2,321,977 unissued shares of common stock available in its 1997 Plan. On July 31, 2007, at the Company's annual meeting of stockholders, the 2007 Stock Plan was approved, which authorizes up to 2,600,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan. The 2007 Plan shares have not yet been registered.

NOTE 10--INCOME (LOSS) PER SHARE

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

Years ended:	December 31, 2007			December 31, 2006	
	Loss (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)
Basic income (loss):					
Income (loss) available to common stockholders ...	\$ (4,921,707)	20,155,563	\$ (0.24)	\$ 309,303	18,377,484
Effect of dilutive securities:					
Options .....	--	--	--	--	578,312
Warrants .....	--	--	--	--	--
Income (loss) available to common stockholders .....	\$ (4,921,707)	20,155,563	\$ (0.24)	\$ 309,303	18,955,796

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December 31, 2005

Years ended:	Loss (Numerator)	Shares (Denominator)	Per Share Amount
Basic income (loss):			
Income (loss) available to common stockholders ...	\$ (29,537,709)	18,225,851	\$ (1.62)
Effect of dilutive securities:			
Options .....	--	--	--
Warrants .....	--	--	--
Income (loss) available to common stockholders .....	\$ (29,537,709)	18,225,851	\$ (1.62)

Warrants to purchase 3,163,813 shares of common stock at between \$0.75 and \$5.06 and options to purchase 4,653,235 shares of common stock at between \$0.37 and \$5.23, per share were outstanding for the year ended December 31, 2007, but were not included in the computation of diluted loss per share because the effect of exercise or conversion would have an antidilutive effect on loss per share.

Warrants to purchase 1,243,813 shares of common stock at between \$3.50 and \$5.06; options to purchase 1,642,500 shares of common stock at between \$1.27 and \$5.23; 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 year ended December 31, 2006, but were not included in the computation of diluted loss per share because the effect of exercise or conversion would have an antidilutive effect on the income per share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Warrants to purchase 1,377,147 shares of common stock at between \$3.50 and \$5.06, options to purchase 1,833,000 shares of common stock at between \$0.41 and \$5.23, 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 year ended December 31, 2005, but were not included in the computation of diluted loss per share because the effect of exercise or conversion would have an antidilutive effect on loss per share.

NOTE 11--2005 RESTRUCTURING PLAN

In an effort to better align the Company's organizational and cost structures with its future growth opportunities, in August 2005 the Company's Board of Directors adopted a restructuring plan for the Company that was substantially completed by December 2005. The plan included restructuring the Company's global operations by eliminating redundancies in its Hong Kong

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operation, closing its Mexican facilities, converting its Guatemala facility from a manufacturing site to a distributor, and closing its North Carolina manufacturing facility. The Company also refocused its sales efforts on higher margin products, which may have resulted in lower net sales with certain customers. As a result, the Company now operates with fewer employees and reduced associated operating and manufacturing expenses. The Company recorded charges in connection with its restructuring plan in accordance with SFAS No. 146 (As Amended), "Accounting for Costs Associated with Exit or Disposal Activities." In addition, the Company's restructuring plan resulted in the carrying value of certain long-lived assets, primarily equipment, being impaired. Accordingly, in 2005 the Company recorded a charge to recognize the impairment of these assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

The North Carolina manufacturing facility is a long-lived asset that is classified as "held for sale" because it meets the criteria listed in Paragraph 30 of SFAS 144. Management has committed to sell the asset, and is listing the property for sale with a commercial real estate agent. The Company believes the sale of the asset is probable and the sale is expected to be completed within one year. The major components of manufacturing equipment used in this plant to manufacture zippers are not classified as held for sale since the Company intends to re-deploy this equipment in the manufacture of TALON zippers through investment or sale of this equipment to its distributors of TALON zippers. This equipment is separately identified as idle equipment as a component of "Property and equipment" which are included in the accompanying consolidated balance sheets (See Note 1).

Restructuring costs recorded in 2005 were \$6,371,000. Restructuring costs include \$3,447,000 of inventory write-downs, restructuring charges of \$2,474,000 consisting of \$2,036,000 for the impairment of long-lived assets, primarily machinery and equipment, \$170,000 of one-time employee termination benefits and other costs of \$268,000, which were fully paid by the end of 2005. In addition, an impairment charge to goodwill in the amount of \$450,000 was recorded. This goodwill was associated with an acquisition made to benefit the Central and South American operations. Since these operations are being exited, management concluded that this goodwill was impaired and should be written off. These restructuring costs were recorded in the Consolidated Statement of Operations for the year ended December 31, 2005 in the following line items and amounts:

Cost of goods sold .....	\$3,447,000
Operating expenses:	
General & administrative expenses ...	450,000
Restructuring charges .....	2,474,000
	-----
Total restructuring costs .....	\$6,371,000
	=====

TALON INTERNATIONAL, INC.  
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NOTE 12--INCOME TAXES

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

Year Ended December 31,

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	2007	2006	2005
Current:			
Federal .....	\$ --	\$ 29,900	\$ 55,479
State .....	4,360	4,000	4,000
Foreign .....	66,589	--	--
	70,949	33,900	59,479
Deferred:			
Federal .....	--	--	850,000
State .....	--	--	150,000
	--	--	1,000,000
	\$ 70,949	\$ 33,900	\$1,059,479

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

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal statutory rate .....	(34.0)%	34.0%	(34.0)%
State taxes net of federal benefit .....	1.6	2.3	(5.8)
Income earned from foreign subsidiaries ...	54.9	18.7	0.2
Net operating loss valuation allowance adjustments .....	18.4	(71.7)	43.5
Change in effective state tax rate .....	(0.1)	22.4	--
Other .....	(39.3)	4.2	(0.2)
	1.5%	9.9%	3.7%

Income (loss) before income taxes is as follows:

	Year Ended December 31,		
	2007	2006	2005
Domestic .....	\$ (11,827,832)	\$ (1,341,475)	\$ (28,724,518)
Foreign .....	6,977,074	1,684,678	246,288
	\$ (4,850,758)	\$ 343,203	\$ (28,478,230)

TALON INTERNATIONAL, INC.  
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The primary components of temporary differences which give rise to the Company's deferred tax assets and deferred tax liabilities are as follows:

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	Year Ended December 31,	
	----- 2007 -----	----- 2006 -----
Net deferred tax asset:		
Net operating loss carry-forwards .....	\$ 20,222,679	\$ 19,053,346
Depreciation and amortization (liability) .....	(899,776)	(551,643)
Bad debt reserve .....	42,065	17,961
Related party interest .....	200,093	189,605
Inventory reserve .....	265,200	289,813
AMT credit carryforward .....	41,089	--
Other .....	332,420	225,656
	-----	-----
	20,203,770	19,224,738
Less: Valuation Allowance .....	(20,162,681)	(19,224,738)
	-----	-----
	\$ 41,089	\$ --
	=====	=====

On January 1, 2007 the Company adopted the provisions of Financial Accounting Standard 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 \$246,000, which was accounted for as an increase in the January 1, 2007 accumulated deficit.

A reconciliation of the FIN 48 adjustments is as follows:

Balance at Jan 1, 2007 .....	\$ --
Increase related to positions on items from prior years .....	212,000
Decrease related to positions on items from prior years .....	--
Interest and penalty on items from prior years .....	34,000
Increase related to 2007 .....	12,000
	-----
Total .....	\$258,000
	=====

At December 31, 2007 and 2006, Talon International, Inc. had Federal and state net operating loss carry-forwards (or "NOLs") of approximately \$55.9 million and \$53.6 million, respectively. The Federal NOL is available to offset future taxable income through 2025, and the state NOL expires in 2015. Section 382 of the Internal Revenue Code places a limitation on the realizability of net operating losses in future periods if the ownership of the Company has changed more than 50% within a three-year period. As of December 31, 2007, some of our net operating losses may be limited by the Section 382 rules. The amount of such limitations, if any, has not yet been determined.

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

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carry-forwards. Deferred tax liabilities and assets at the end of each period are determined using enacted tax rates. The Company records deferred tax assets arising from temporary timing differences between recorded net income and taxable net income when and if it believes that future earnings will be sufficient to realize the tax benefit. For those jurisdictions where the expiration date of tax benefit carry-forwards or the projected taxable earnings indicate that realization is not likely, a valuation allowance is provided.

The provisions of SFAS No. 109, "Accounting for Income Taxes," require the establishment of a valuation allowance when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will not be realized. SFAS No. 109 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset.

In 2007, the Company determined, based upon its cumulative operating losses, that it was more likely than not that it would not be in a position to fully realize all of its deferred tax assets in future years with the exception of the alternative minimum tax credit carryforward of \$41,089. In 2006 and in prior years, the Company determined, based upon its cumulative operating losses, that it was more likely than not that it would not be in a position to fully realize all of its deferred tax assets in future years. Accordingly, at December 31, 2007 and 2006 the Company has recorded a valuation allowance of \$20.2 million and \$19.2 million, respectively; which reduces the carrying value of its net deferred tax assets. For the year ended December 31, 2006 the Company recorded operating income and various rate and tax timing differences and the value of its net deferred tax assets declined by \$2.2 million. Accordingly, a corresponding reduction in the valuation allowance was made, which retained the carrying value of the Company's net deferred tax assets at \$0. During 2005 the Company incurred additional operating losses which resulted in an increase in the Company's net deferred tax assets by \$11.5 million. Accordingly, it was determined that the valuation allowance from 2004 be increased by \$12.5 million to \$21.4 million, which reduced the carrying value of its net deferred tax assets to \$0 at December 31, 2005.

The Company intends to maintain a valuation allowance for its deferred tax assets until sufficient evidence exists to support the reversal or reduction of the allowance. At the end of each period, the Company will review supporting evidence, including the performance against sales and income projections, to determine if a release of the valuation allowance is warranted. If in future periods it is determined that it is more likely than not that the Company will be able to recognize all or a greater portion of its deferred tax assets, the Company will at that time reverse or reduce the valuation allowance.

The Company believes that its estimate of deferred tax assets and determination to record a valuation allowance against such assets are critical accounting estimates because they are subject to, among other things, an estimate of future taxable income, which is susceptible to change and dependent upon events that may or may not occur, and because the impact of recording a valuation allowance may be material to the assets reported on its balance sheet and results of operations.

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The Company has not provided withholding of U.S. federal income taxes on undistributed earnings of its foreign subsidiaries because the Company intends to reinvest those earnings indefinitely or any taxes on these earnings will be offset by the approximate credits for foreign taxes paid. It is not practical to determine the U.S. federal tax liability, if any, which would be payable if such earnings were not invested indefinitely. At December 31, 2007 and 2006, undistributed earnings from our foreign subsidiaries were \$6,286,000 and \$4,581,000, respectively.

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

#### NOTE 13--COMMITMENTS AND CONTINGENCIES

##### OPERATING LEASES

The Company is a party to a number of non-cancelable operating lease agreements involving buildings and equipment, which expire at various dates through 2011. The Company accounts for its leases in accordance with SFAS No. 13, whereby step provisions, escalation clauses, tenant improvement allowances, increases based on an existing index or rate, and other lease concessions are accounted for in the minimum lease payments and are charged to the income statement on a straight-line basis over the related lease term.

The future minimum lease commitments at December 31, 2007 are as follows:

Years Ending December 31,	Amount
2008 .....	\$ 576,611
2009 .....	412,139
2010 .....	240,527
2011 .....	15,468
	-----
Total minimum payments .....	\$1,244,745
	=====

Total rental expense for the years ended December 31, 2007, 2006 and 2005 aggregated \$591,312, \$640,864, and \$750,536, respectively.

##### PROFIT SHARING PLAN

In October 1999, the Company established a 401(k) profit-sharing plan for the benefit of eligible employees. The Company may make annual contributions to the plan as determined by the Board of Directors. Total contributions for the years ended December 31, 2007, 2006 and 2005 amounted to \$25,494, \$22,276, and \$16,807, respectively.

##### CONTINGENCIES

On December 26, 2007, the Company elected to voluntarily withdraw the listing of its common stock from trading on the American Stock Exchange. The common stock began trading on the OTC Bulletin Board (OTCBB) under the new symbol TALN.OB.



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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 the Company and certain of its 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 the Company's publicly-traded securities during the period from November 13, 2003 to August 12, 2005. On February 20, 2007, the Court denied class certification. On April 2, 2007 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 was filed on October 15, 2007. The Company's brief was filed on November 28, 2007. The Company believes that this matter will be resolved favorably on appeal, or in a later trial or in settlement within the limits of its insurance coverage. However, the outcomes of this action or an estimate of the potential

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

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 we filed suit against Pro-Fit Holdings, Limited 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 action is still pending in the United States District Court. The action is presently stayed pending resolution or trial of an earlier filed action between Pro-Fit Holdings and their attorneys who have sued Pro-Fit Holdings and have obtained a judgment. In the past, we had 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.

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.

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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

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

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 14--SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

The Company specializes in the distribution of a full range of 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 justify segmented reporting by product type. The Company believes that revenue by each major product class is a valuable business measurement. The net revenues for the three primary product groups are as follows:

	Year Ended December 31,		
	2007	2006	2005
Product Group Net Revenue:			
Talon zipper .....	\$21,159,595	\$17,005,203	\$13,593,479
Trim .....	18,688,698	22,502,947	24,788,397
Tekfit .....	681,262	9,316,852	8,949,300

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\$40,529,555	\$48,825,002	\$47,331,176
=====	=====	=====

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:

	Year Ended December 31,		
	2007	2006	2005
	-----	-----	-----
Sales:			
United States .....	\$ 3,692,468	\$ 4,223,052	\$ 7,052,196
Hong Kong .....	14,178,421	13,650,419	7,901,079
Dominican Republic .....	700,868	8,966,828	150,793
China .....	11,159,726	6,063,416	7,091,034
India .....	2,187,684	1,205,486	809,972
Bangladesh .....	1,924,943	2,070,349	798,699
Mexico .....	783,762	2,476,313	12,945,861
Other .....	5,901,683	10,169,139	10,581,542
	-----	-----	-----
Total .....	\$40,529,555	\$48,825,002	\$47,331,176
	=====	=====	=====
Long-lived Assets:			
United States .....	\$ 8,778,381	\$ 9,529,932	\$ 9,797,111
Hong Kong .....	556,864	336,149	222,467
Dominican Republic .....	558,198	667,238	776,279
Mexico .....	1,072	5,198	23,754
China .....	109,770	49,488	2,633
Other .....	16,912	3,315	1,120
	-----	-----	-----
Total .....	\$10,021,197	\$10,591,320	\$10,823,364
	=====	=====	=====

TALON INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15--MAJOR CUSTOMERS AND VENDORS

For the year ended December 31, 2007, the Company's three largest customers represented approximately 9% of consolidated net sales. For the year ended December 31, 2006, no single customer represented more than 9% of the Company's consolidated net sales; however the Company's three largest customers represented approximately 18% of consolidated net sales. For the year ended December 31, 2005, no single customer represented more than 10% of consolidated net sales; however, the Company's three largest customers represented approximately 22% of consolidated net sales.

Three vendors, each representing more than 10% of the Company's purchases, accounted for approximately 50% of the Company's purchases for the year ended December 31, 2007. One vendor accounted for substantially all of the Company's purchases associated with its Tekfit product for the year ended December 31, 2007. One major vendor accounted for substantially all of the

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Company's purchases associated with its Tekfit product for the year ended December 31, 2006 and represented 24% of the Company's overall purchases; and three vendors, each representing more than 10% of the Company's purchases, accounted for approximately 45% of the Company's purchases for the year ended December 31, 2006. Three vendors accounted for approximately 39% of the Company's purchases for the year ended December 31, 2005

Included in accounts payable and accrued expenses at December 31, 2007 and 2006 is \$2,239,000 and \$2,682,000 due to these vendors. Terms are sight to 60 days.

### NOTE 16--RELATED PARTY TRANSACTIONS

Prior to 2004 the Company operated an apparel trim supply agreement with Tarrant Apparel Group. Two of Tarrant's directors and significant shareholders are also shareholders of the Company. In 2004, following negotiations with Tarrant Apparel Group, the Company determined that a significant portion of the obligations due from this customer were uncollectible. Accordingly, included in general and administrative expenses for 2004 are charges of \$4.3 million related primarily to the write-down of this receivable and leaving a remaining balance receivable from this customer of \$4.5 million at December 31, 2004. An affiliate of the customer repaid the \$4.5 million receivable balance over the period from May through December 2005. The Company terminated its supply relationship with Tarrant in 2004; however the Company continues to conduct business with Tarrant on a limited basis. Total sales to Tarrant for the years ended December 31, 2007, 2006 and 2005 were \$143,000, \$3,000, and \$574,000, respectively. As of December 31, 2005, accounts receivable, related party included \$0.05 million due from Tarrant. No amounts were due from Tarrant at December 31, 2007 and 2006.

Colin Dyne, a director and stockholder of the Company is also a director, officer and significant shareholder in People's Liberation, Inc., the parent company of Versatile Entertainment, Inc. During 2007 and 2006 the Company had sales of \$241,000 and \$147,000, respectively, to Versatile Entertainment. Accounts receivable of \$44,000 and \$83,400 were outstanding from Versatile Entertainment at December 31, 2007 and 2006, respectively.

Due from related parties at December 31, 2007 and 2006 includes \$625,454 and \$675,137, respectively, 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. During 2007 certain notes payable due to Mr. Dyne were offset against and used to satisfy notes receivable from Mr. Dyne.

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

Demand notes payable to related parties includes notes and advances to Mark Dyne, the Chairman of the Board of Directors of the Company or to parties related to or affiliated with Mark Dyne. The balance of Demand notes payable to related parties at December 31, 2007 and 2006 was \$85,176 and 664,971, respectively. See Note 4 for further discussion of these notes, and related accrued interest and interest expense.

Jonathan Burstein, a former director of the Company, purchases products from the Company through an entity operated by his spouse. For the years December 31, 2007 and 2006, sales to this entity were \$88,491 and \$7,342, respectively. At December 31, 2007 and 2006, accounts receivable included

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\$28,657 and \$2,223, respectively, due from this entity. On October 25, 2007, Mr. Burstein resigned as a director of the Company.

Consulting fees of \$291,000 were paid for services provided by Jonathan Burstein for the year ended December 31, 2007. During the fourth quarter of 2007 the Company decided to terminate the consulting agreements of Mr. Burstein and another consultant. In accordance with SFAS No. 146, ACCOUNTING FOR COSTS ASSOCIATED WITH EXIT OR DISPOSAL ACTIVITIES ("SFAS 146"), the Company calculated the fair value of monthly compensation of the two contracts and recorded an accrual of \$538,000 at December 31, 2007 to reflect the liability for consulting costs that would continue to be incurred under their remaining terms.

Consulting fees paid to Diversified Investments, a company owned by Mark Dyne, amounted to \$150,000 for each of the years ended December 31, 2007, 2006 and 2005.

Consulting fees of \$304,000 and \$335,000 were paid for services provided by Colin Dyne, for the years ended December 31, 2007 and 2006, respectively.

Brent Cohen and Raymond Musci, both members of the Board of Directors were paid for services provided during the year ended December 31, 2005 in the amount of \$24,000, and \$21,000, respectively.

### NOTE 17--QUARTERLY RESULTS (UNAUDITED)

Quarterly results for the years ended December 31, 2007 and 2006 are reflected below:

	4TH -----	3RD -----	2ND -----	1ST -----
2007				
----				
Revenue .....	\$ 8,859,322	\$ 9,013,135	\$ 13,566,981	\$ 9,090,117
Gross profit .....	\$ 2,858,913	\$ 2,526,476	\$ 4,017,731	\$ 2,703,615
Operating income (loss) .....	\$ (379,737)	\$ (3,055,289)	\$ 878,009	\$ (613,662)
Net Income(loss) .....	\$ (935,025)	\$ (3,681,831)	\$ 490,493	\$ (795,344)
Basic income (loss) per share .....	\$ (0.05)	\$ (0.18)	\$ 0.03	\$ (0.04)
Diluted income (loss) per share ...	\$ (0.05)	\$ (0.18)	\$ 0.02	\$ (0.04)
2006				
----				
Revenue .....	\$ 10,573,755	\$ 13,366,944	\$ 14,246,087	\$ 10,638,216
Gross profit .....	\$ 3,350,600	\$ 4,148,406	\$ 4,127,237	\$ 2,842,725
Operating income (loss) .....	\$ 248,177	\$ 630,273	\$ 895,281	\$ (442,275)
Net Income(loss) .....	\$ 44,950	\$ 339,115	\$ 654,643	\$ (729,404)
Basic and diluted income (loss) per per share .....	\$ 0.00	\$ 0.02	\$ 0.04	\$ (0.04)

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

During 2007 and 2006, the Company had no material unusual or

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infrequently occurring items or adjustments that were recognized during the years.

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

### NOTE 18 - SUBSEQUENT EVENTS

As noted in Note 2 - Marketable Securities, the Company finalized an arrangement between the Company and Azteca Production International, Inc. a former distributor of Talon products on December 31, 2007. The agreement called for Azteca to deliver 2 million shares of common stock in a related company in exchange for cancellation of an outstanding note from Azteca that was in default. On January 16, 2008, Azteca delivered restricted shares to the Company which the Company returned. On January 30, 2008, the Company was notified that unrestricted shares had been delivered by Azteca and that the Company could begin trading these shares selling no more than 2 thousand shares a day. The stock price on January 30, 2008 was used to value the shares. The value of the common stock on April 10, 2008 had decreased \$340,000 to \$700,000.

Effective January 15, 2008, Wouter van Biene resigned his position as the Company's Chief Operating Officer. In connection with Mr. van Biene's resignation and in exchange for a full release of claims against the Company, we have agreed to pay Mr. van Biene twelve months of his current base salary and provide him twelve months of continued coverage under our group health plan. Approximately \$0.3 million in severance costs were recognized in January 2008.

Effective February 4, 2008, Stephen Forte resigned his position as the Company's Chief Executive Officer and as a member of the Board of Directors and from all positions with the Company's subsidiaries. In connection with Mr. Forte's resignation, on February 4, 2008, the Company entered into a Separation Agreement with Mr. Forte. The Separation Agreement further provides for the payment to Mr. Forte of the same severance benefits he would have received under his employment agreement had the Company terminated Mr. Forte's employment without cause. In exchange for his severance, Mr. Forte has released all claims against the Company. Approximately \$0.4 million in severance costs were recognized in January 2008.

Also effective February 4, 2008, Lonnie D. Schnell, Chief Financial Officer, was appointed Chief Executive Officer to replace Mr. Forte.

On March 27, 2008 Larry Dyne was appointed Executive Vice President of Global Sales and David Hunter was appointed Vice President, Corporate Controller and Principal Accounting Officer.

On April 3, 2008 the Company executed an amendment to the existing revolving credit and term loan agreement with Bluefin Capital. The amendment provided for an amendment of the EBITDA and other financial covenants, and the redemption of the stock warrants previously issued to Bluefin Capital in exchange for the issuance of an additional note payable to Bluefin Capital for \$1.0 million at an interest rate of 8.5%. The Company will record a reduction to equity and an increase to notes payable for the fair value of the warrants redeemed. The difference between the fair value of the warrants of \$221,723 and the face value of the note will be accreted over the life of the note. The note will incur interest at 8.5% on the principal amount of \$1.0 million and the quarterly accretion will also be reflected as interest expense. The additional note and all accrued interest under the note are due and payable on June 30, 2010. The Company's borrowing base was also modified increasing the allowable portion of inventory held by third party vendors to \$1.0 million with no more than \$500,000 held at any one vendor and by increasing the percentage of accounts receivable to be included in the borrowing base 75% to 85%.

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

None.

ITEM 9A(T). CONTROLS AND PROCEDURES

EVALUATION OF CONTROLS AND PROCEDURES

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

As of the end of the period covered by this report, management, with the participation of Stephen P. Forte, our former principal executive officer, and Lonnie D. Schnell, our principal financial officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, Mr. Forte and Mr. Schnell concluded that these disclosure controls and procedures were effective as of the end of the period covered in this Annual Report on Form 10-K.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, the Company's management has conducted an assessment, including testing, using the criteria in INTERNAL CONTROL - INTEGRATED FRAMEWORK, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Based on its assessment, our management has concluded that control over financial reporting was effective as of December 31, 2007.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report

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in this annual report.

## CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of our fiscal year ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## ITEM 9B. OTHER INFORMATION

None.

## PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth the name, age and position of each of our executive officers and directors as of March 17, 2008.

NAME	AGE	POSITION
----	---	-----
Mark Dyne (1).....	47	Chairman of the Board of Directors
Colin Dyne (1).....	45	Vice Chairman of the Board of Directors
Brent Cohen.....	49	Director
Joseph Miller.....	44	Director
Raymond Musci .....	47	Director
William Sweedler.....	41	Director
Lonnie D. Schnell.....	58	Chief Executive Officer & Chief Financial Officer
Larry Dyne.....	35	Executive Vice President, Sales
David A. Hunter.....	42	Vice President, Corporate Controller

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(1) Colin Dyne and Mark Dyne are brothers.

## CLASS II DIRECTORS: TERMS EXPIRING IN 2008

There are currently three vacancies among the Class II Directors.

## CLASS III DIRECTORS: TERMS EXPIRING IN 2009

MARK DYNE

Mr. Dyne has served as Chairman of the Board of Directors since 1997. Mr. Dyne currently serves as the Chief Executive Officer and the Managing Partner of Europlay Capital Advisors, LLC, a merchant banking and advisory firm. Mr. Dyne previously served as Chairman and Chief Executive Officer of Sega Gaming Technology Inc. (USA), a gaming company, and Chairman and Chief Executive Officer of Virgin Interactive Entertainment Ltd., a distributor of computer software programs and video games based in London, England. Mr. Dyne was a founder and director of Packard Bell NEC Australia Pty. Ltd., a manufacturer



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and distributor of personal computers through the Australian mass merchant channel, and he was a founder and former director of Sega Ozisoft Pty Ltd., a leading distributor of entertainment software in both Australia and New Zealand.

MEMBER: NOMINATING AND GOVERNANCE COMMITTEES

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COLIN DYNE

Currently, Mr. Dyne serves as Vice Chairman of the Board of Directors. Mr. Dyne founded Tag-It, Inc., one of our subsidiaries, in 1991 with his father, Harold Dyne. Mr. Dyne served as our President from inception and as our Chief Executive Officer from 1997 to 2005. Before founding Tag-It, Inc. in 1991, Mr. Dyne worked in numerous positions within the stationery products industry, including owning and operating retail stationery businesses and servicing the larger commercial products industry through contract stationery and printing operations.

RAYMOND MUSCI

Ray Musci has served as a Director of the Company since June 2005. Mr. Musci serves as a Director and President of MPLC, Inc. (OTCBB:MPNC), a publicly traded company that develops, publishes and distributes mobile entertainment services and products. From October 1999 to June 2005, Mr. Musci served as the President and Chief Executive Officer and a director of BAM! Entertainment, Inc., a publicly traded company that develops, publishes and distributes entertainment software products and video games. Mr. Musci currently serves as a director of Brilliant Digital Entertainment, Inc., a publicly traded corporation (OTCBB: BDEI). From May 1990 to July 1999, Mr. Musci served as the President, Chief Executive Officer and as a director of Infogrames Entertainment, Inc. (formerly Ocean of America, Inc.), a company that develops, publishes and distributes software products. Mr. Musci also previously served as a director of Ocean International, Ltd., the holding company of Ocean of America, Inc. and Ocean Software, Ltd., and as Executive Vice President/General Manager of Data East USA, Inc., a subsidiary of Data East Corp., a Japanese company.

MEMBER: AUDIT AND COMPENSATION COMMITTEES

CLASS I DIRECTORS: TERMS EXPIRING IN 2007

JOSEPH MILLER

Mr. Miller has served on the Board of Directors since June 2005. Since 2003, he has been a Managing Director of Europlay Capital Advisors, LLC, a merchant banking and advisory firm. From 1998 to 2003, Mr. Miller was a Senior Vice President at Houlihan Lokey Howard & Zukin, a leading middle-market investment bank. From 1994 to 1998, Mr. Miller served as the Vice President, Corporate

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Development for Alliance Communications Corporation, Canada's leading independent producer and distributor of filmed entertainment. Mr. Miller has bachelor's degree in Economics and Business from the University of California, Los Angeles

MEMBER: AUDIT COMMITTEE

BRENT COHEN

Mr. Cohen has served on the Board of Directors since 1998. Mr. Cohen has served as Chief Executive Officer and a director of Dovebid Inc. since August 2005. Mr. Cohen served as President and was a member of the Board of Directors of First Advantage Corporation (formed by the merger of US Search and First American Financial screening companies) from June 2003 to 2005. Mr. Cohen served as Chairman of the Board, President and Chief Executive Officer of US Search from February 2000 until June 2003. Mr. Cohen previously held various management positions in both the management consulting and auditing practice of Arthur Young & Company (now Ernst & Young). Mr. Cohen holds a Bachelor of Commerce degree, a Graduate Diploma in Accounting and an MBA from the University

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of Cape Town in South Africa. He is also a chartered accountant.

MEMBER: COMPENSATION, NOMINATING AND GOVERNANCE COMMITTEES

WILLIAM SWEEDLER

Mr. Sweedler has served on the Board of Directors since 2006. He is presently Chairman & CEO of Windsong Allegiance Group, a diversified brand management and operating company that specializes in the acquisition, development, licensing, and comprehensive creative management of consumer branded intellectual property. The company owns and licenses the brands, Como Sport, Calvin Klein Golf, Joseph Abboud Golf, and PRX. Mr. Sweedler previously served as President & CEO of Joe Boxer, a wholly owned division of the Iconix Brand Group (NASDAQ: ICON) of which he was Executive Vice President and member of the Board of Directors during 2005 to June 2006. Prior to Mr. Sweedler joining Iconix Brand Group, he was CEO & President of Windsong Allegiance Apparel Group from 2001 to 2005. The company owned, managed, and licensed the brands Joe Boxer, Hathaway, New Frontier, Pivot Rules, Alexander Julian, Geoffrey Beene, Ron Chereskin, and Hawaiian Tropic. In 1995, Mr. Sweedler co-founded, Windsong, Inc., a full service apparel operating and marketing company. Prior to Windsong, he worked as a Regional Account Manager at Polo Ralph Lauren. He graduated from Babson College with a B.S. in Finance & Investments in 1988. He has served as a public director at Iconix Brand Group and Bank of Westport as well as numerous private organizations.

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### MEMBER: AUDIT AND COMPENSATION COMMITTEES

#### OTHER EXECUTIVE OFFICERS

LONNIE D. SCHNELL

Mr. Schnell joined the Company in January 2006 as our Chief Financial Officer, and was appointed as Chief Executive Officer in February 2008. Mr. Schnell served as Vice President of Finance for Capstone Turbine Corporation, a manufacturer of micro-turbine electric generators from 2004 until 2005. From 2002 to 2004 Mr. Schnell served as Chief Financial Officer of EMSource, LLC, an electronic manufacturing service company. Prior to EMSource, in 2002, Mr. Schnell served as Chief Financial Officer of Vintage Capital Group, a private equity investment firm. From 1999 through 2002, Mr. Schnell served as Chief Financial Officer of Need2Buy, Inc. a business-to-business internet marketplace for electronic components. Mr. Schnell has completed an executive MBA program with the Stanford University Executive Institute, and earned his Bachelor of Science in Accounting at Christian Brothers University. Mr. Schnell is a Certified Public Accountant with experience in the international accounting firm of Ernst & Young LLP.

LARRY DYNE

Larry Dyne was appointed Executive Vice President of Sales in February 2008. He has been an employee of our company since 1992, and was formerly vice president of product development and global sourcing, as well as vice president of trim sales. Through these positions, Mr. Dyne has established extensive and long-term relationships with the world's top brands and clothing retailers. He was also formerly responsible for domestic production for all printing.

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DAVID A. HUNTER

David Hunter was appointed Vice President, Corporate Controller (and as our principal accounting officer) in February 2008. Mr. Hunter has extensive experience in both public and private accounting and joined Talon in December 2007 as the Corporate Controller. Prior to Talon, he served as the director of accounting and financial reporting for Walt Disney Studios. Before Disney, he served as a manager of accounting and analysis at WellPoint's Blue Cross of California division in its individual and small group practice before joining its financial operations practice. He is a certified public accountant with experience in the international accounting firm of Deloitte & Touche LLP, where he served as a manager in the audit and assurance practice. Mr. Hunter earned his Bachelor of Science in Accounting at California Lutheran University.

#### AUDIT COMMITTEE; AUDIT COMMITTEE FINANCIAL EXPERT

We currently have a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The

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Audit Committee currently consists of Raymond Musci, Joseph Miller and William Sweedler. The Board of Directors has further determined that Mr. Musci is an "audit committee financial expert" as such term is defined in Item 401(h) of Regulation S-K promulgated by the SEC.

### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors, and persons who own more than ten percent of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater-than-ten percent stockholders are required by Securities and Exchange Commission regulations to furnish the Company with all Section 16(a) forms they file. Based solely on our review of the copies of the forms received by us and written representations from certain reporting persons that they have complied with the relevant filing requirements, we believe that, during the year ended December 31, 2007, all of our executive officers, directors and greater-than-ten percent shareholders complied with all Section 16(a) filing requirements, except for the following: (i) three Statements of Changes in Beneficial Ownership on Form 4, reporting nine transactions, were filed late by Colin Dyne; (ii) one Annual Statement of Changes in Beneficial Ownership on Form 5, reporting five transactions, was filed late by Jonathan Burstein; and (iii) one Statement of Change in Beneficial Ownership on Form 4, reporting two transactions, was filed late by Bluefin Capital LLC.

### CODE OF ETHICS

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

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### ITEM 11. EXECUTIVE COMPENSATION

#### COMPENSATION DISCUSSION AND ANALYSIS

Talon International Inc.'s executive compensation program is administered by the Compensation Committee of our Board of Directors, or referred to in this section as the "Committee." The Committee is responsible for, among other functions: (1) reviewing and approving corporate goals and objectives relevant to the Chief Executive Officer's compensation and evaluating the performance of the Chief Executive Officer in light of these corporate goals and objectives; (2) reviewing and making recommendations to the Board of Directors with respect to the compensation of other executive officers; (3) administering our incentive-compensation and equity based plans, which may be subject to the approval of the Board of Directors; and (4) negotiating, reviewing and recommending the annual salary, bonus, stock options and other benefits, direct and indirect, of the Chief Executive Officer, and other current and former executive officers. The Committee also has the authority to select and/or retain outside counsel, compensation and benefits consultants, or any other consultants to provide independent advice and assistance in connection with the execution of its responsibilities.

Our named executive officers for 2007 were as follows:

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- o Stephen P. Forte, former Chief Executive Officer (resigned as of February 4, 2008);
- o Wouter van Biene, former Chief Operating Officer (resigned as of January 15, 2008); and
- o Lonnie D. Schnell, Chief Financial Officer (named Chief Executive Officer as of February 4, 2008)

### COMPENSATION PHILOSOPHY

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

- o ALIGNMENT - to align the interests of executives and shareholders through equity-based compensation awards;
- o RETENTION - to attract, retain and motivate highly qualified, high performing executives to lead our continued growth and success; and
- o PERFORMANCE - to provide rewards commensurate with performance by emphasizing variable compensation that is dependant upon the executive's achievements and company performance.

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

- o Rewards under incentive plans are based upon our short-term and longer-term financial results and increasing shareholder value;
- o Senior executive pay is set at sufficiently competitive levels to attract, retain and motivate highly talented individuals who are necessary for us to achieve our goals, objectives and overall financial success;

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- o Compensation of an executive is based on such individual's role, responsibilities, performance and experience, taking into account the desired pay relationships within the executive team; and
- o Our executive compensation program places a strong emphasis on performance-based variable pay to ensure a high pay-for-performance culture. Annual performance of our company and the executive are taken into account in determining annual bonuses that ensures a high pay-for-performance culture.

### COMPENSATION ELEMENTS

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

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performance and market practice. The purpose and key characteristics for each component are described below.

### BASE SALARY

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

### ANNUAL INCENTIVE BONUSES

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

### EQUITY INCENTIVES

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

### HEALTH & WELFARE AND 401-K BENEFITS

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

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### SEVERANCE AND CHANGE OF CONTROL ARRANGEMENTS

We do not have a formal plan for severance or separation pay for our employees, but we typically include a severance provision in the employment agreements of our executive officers that is triggered in the event of involuntary termination without cause or in the event of a change in control.

In order to preserve the morale and productivity and encourage retention of our key executives in the face of the disruptive impact of an actual or rumored change in control, we provide a bridge to future employment in the event that an executive's job is eliminated as a consequence of a change in control. This provision is intended to align executive and shareholder interests by enabling executives to consider corporate transactions that are in the best interests of the shareholders and other constituents without undue concern over

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whether the transactions may jeopardize the executive's own employment. Our employment agreements with our current named executive officers provide a lump sum payment and benefits continuation as a result of an involuntary termination without cause or for good reason following a change in control, plus accelerated vesting of stock or option awards.

### OTHER BENEFITS

In order to attract and retain highly qualified executives, we provide some of our named executive officers, including our former CEO, with automobile allowances that we believe are consistent with current market practices. Our executives also may participate in a 401(k) plan under which we match contributions for all employees up to 100% of an employee's contributions to a maximum of \$1,000 and subject to any limitations imposed by ERISA.

### OTHER FACTORS AFFECTING COMPENSATION

#### ACCOUNTING AND TAX CONSIDERATIONS

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

### PROCESS FOR SETTING EXECUTIVE COMPENSATION

When making pay determinations for named executive officers, the Committee considers a variety of factors including, among others: (1) actual company performance as compared to pre-established goals, (2) overall company performance and size relative to industry peers, (3) individual executive performance and expected contribution to our future success, (4) changes in economic conditions and the external marketplace and (5) in the case of named executive officers, other than Chief Executive Officer, the recommendation of our Chief Executive Officer. Ultimately, the Committee uses its judgment when determining how much to pay our executive officers. The Committee evaluates each named executive officer's performance during the year against established goals, leadership qualities, business responsibilities, current compensation arrangements and long-term potential to enhance shareholder value. The opinions of outside consultants are also taken into consideration in deciding what salary, bonus, long-term incentives and other benefits and severance to give each executive in order to meet our objectives stated above. The Committee considers, compensation information from data gathered from annual reports and proxy statements from companies that the Committee generally considers comparable to our Company; compensation of other Company employees for internal pay equity purposes; and levels of other executive compensation plans from compensation surveys. The Committee sets the pay for the named executive officers and other executives, by element and in the aggregate, at levels that it believes are competitive and necessary to attract and retain talented executives capable of achieving the Company's long-term objectives.

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### FACTORS CONSIDERED

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

- o CASH VERSUS NON-CASH COMPENSATION. The pay elements are cash-based except for the long-term incentive program, which

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is equity-based. In 2007, the long-term incentive program for the named executive officers consisted entirely of previously granted stock grants and option awards that vest in installments over a one to four year period from the date of grant;

- o PRIOR YEAR'S COMPENSATION. The committee considers the prior year's bonuses and long-term incentive awards when approving bonus payouts or equity grants;
- o ADJUSTMENTS TO COMPENSATION. On an annual basis, and in connection with setting executive compensation packages, the Committee reviews our operating income growth, earnings before interest and taxes growth, earnings per share growth, cash flow growth, operating margin, revenue growth, and total shareholder return performance. In addition, the Committee considers peer group pay practices, emerging market trends and other factors. No specific weighing is assigned to these factors nor are particular targets set for any particular factor. Total compensation from year to year can vary significantly based on our and the individual executive's performance. The base compensation of our former Chief Executive Officer during 2007 was \$325,000 annually in accordance with the provisions in his employment contract.
- o APPLICATION OF DISCRETION. It is our policy and practice to use discretion in determining the appropriate compensation levels considering performance.

### REPORT OF COMPENSATION COMMITTEE

The Compensation Committee of our Board of Directors consists of Brent Cohen, Raymond Musci and William Sweedler. The Compensation Committee is responsible for considering and making recommendations to the Board of Directors regarding executive compensation and is responsible for administering the Company's stock option and executive incentive compensation plans.

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

#### COMPENSATION COMMITTEE

Brent Cohen  
Raymond Musci  
William Sweedler

April 11, 2008

### EXECUTIVE COMPENSATION

#### SUMMARY COMPENSATION TABLE

The following table sets forth, as to each person serving as Chief Executive Officer and Chief Financial Officer during 2007, and the one highly compensated executive officer other than the Chief Executive Officer and Chief



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Financial Officer who were serving as executive officers at the end of the 2007 whose compensation exceeded \$100,000 (referred to as "named executive officers"), information concerning all compensation earned for services to us in all capacities for 2007.

NAME AND PRINCIPAL POSITION	YEAR	SALARY (\$)	STOCK AWARDS (\$) (4)	OPTION AWARDS (\$) (4)	NON-EQUITY INCENTIVE PLAN COMPENSATION (\$)	ALL O COMPEN (\$)
Lonnie D. Schnell (1) .....	2007	225,000	--	1,917	45,000	
Chief Executive Officer and ..	2006	171,346	--	31,998	45,025	
Chief Financial Officer						
Stephen P. Forte (2) .....	2007	325,000	--	7,851	--	
Former Chief Executive .....	2006	275,000	77,468	73,995	90,050	
Officer						
Wouter van Biene (3) .....	2007	225,000	--	1,986	--	
Former Chief Operating Officer	2006	180,000	--	27,526	45,025	

(1) Mr. Schnell was appointed Chief Executive Officer effective February 4, 2008.

(2) Mr. Forte resigned as Chief Executive Officer effective February 4, 2008.

(3) Mr. van Biene resigned as Chief Operating Officer effective January 15, 2008.

(4) The amounts in this column represent the dollar amounts recognized for financial statement reporting purposes in fiscal 2007 and 2006 with respect to stock awards and options granted in the applicable year as well as prior fiscal years in accordance with SFAS No. 123(R). Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to these grants, refer to Note 9 to our Consolidated Financial Statements in this Annual Report on Form 10-K. These amounts do not reflect the actual value that may be realized by the named executive officers which depends on the value of our shares in the future.

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

	MR. SCHNELL		MR. FORTE		MR. VAN BIENE	
	2007	2006	2007	2006	2007	2006
Health & medical insurance (a) .....	11,019	12,673	8,202	12,916	11,178	6,925
Life & disability insurance (b) .....	324	81	4,282	81	324	81
Automobile allowances ....	--	--	18,000	22,500	--	--
Consulting services (c) ..	--	11,880	--	--	--	--

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Total .....	11,343	24,634	30,484	35,497	11,502	7,006
	=====	=====	=====	=====	=====	=====

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- (a) Includes payments of medical premiums.
  - (b) Includes executive and group term life insurance.
  - (c) Represents fees for services provided prior to employment.

EXECUTIVE COMPENSATION

The 2007 compensation for our former Chief Executive Officer was in accordance with our employment agreement completed with Mr. Forte in March 2006. The terms and conditions established in this agreement were the result of our consideration of our 2005 operating performance, our 2005 Restructuring and Strategic Plan and current operating performance levels, as well as the compensation levels for our previous CEO, comparative industry compensation levels, and negotiations with Mr. Forte. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding shareholder value. Accordingly, the base compensation was established near minimum industry levels for the same role in comparable companies, and a long-term equity option of 900,000 shares of common stock, representing approximately 4.9% of our outstanding shares, was established as an inducement to maximum performance achievements and increased shareholder values. The option grant was established to vest monthly over a three-year term, after a minimum initial term of twelve months, to coincide with the objectives of our Strategic Plan. In addition to the long-term equity incentive, a cash incentive, a Management Incentive Program

("MIP"), was established as provided in Mr. Forte's employment agreement setting aside 15% of the Company's earnings before interest and taxes ("EBIT") for annual bonus awards to Mr. Forte and the other senior executives. One-half of this MIP Fund was allocated to Mr. Forte in 2006 and is shown in the table above as non-equity incentive plan compensation, and one-third of the MIP fund is to be allocated to Mr. Forte in 2007 through 2009. MIP Funds were not distributed in 2007 due the operating performance of the Company, however, a discretionary bonus was granted to Mr. Schnell as approved by the Board of Directors. In addition, Mr. Forte was provided a stock grant of 135,135 shares, and an additional option grant, vesting in one year, for 135,135 shares of common stock, in consideration of his significant contributions in the initial development and implementation of the Company's 2005 Restructuring Plan, and the development of the Company's Strategic Plan.

Messrs. van Biene and Schnell were employed early in 2006 at the recommendation of Mr. Forte, our former Chief Executive Officer, to assist in the completion of the 2005 Restructuring and Strategic Plan. The terms and conditions established in their employment agreements were also the result of our consideration of our 2005 operating performance, our 2005 Restructuring and Strategic Plan and current operating performance levels, as well as our previous compensation levels for similar positions, comparative industry compensation levels, and individual negotiations. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding shareholder value.

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Accordingly, the base compensation for their positions was established near minimum industry levels for the same role in comparable companies, and long-term equity incentives in the form of grants of options to purchase 325,000 shares to Mr. van Biene and 400,000 shares to Mr. Schnell, were established as an inducement to maximum performance achievements and increased shareholder values. The options vest monthly over a three-year term for Mr. van Biene, and a four-year term for Mr. Schnell, after a minimum initial term of twelve months, to coincide with the objectives of the Company's Strategic Plan. In addition Mr. van Biene and Mr. Schnell are participants in the MIP fund established by us as described above, pursuant to which we set aside 15% of our EBIT for annual bonus awards to the CEO and the other senior executives as approved by the Board of Directors. The payments allocated to Mr. van Biene and Mr. Schnell under the MIP fund are shown in the summary compensation table as non-equity incentive plan compensation.

### GRANTS OF PLAN-BASED AWARDS IN FISCAL 2007

There were no stock option grants to named executive officers during 2007.

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### OUTSTANDING EQUITY AWARDS AT FISCAL YEAR 2007

The following table provides information with respect to outstanding stock options held by each of the named executive officers as of December 31, 2007.

NAME	GRANT DATE	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS		OPTION EXERCISE PRICE (\$)	EX
		(#) EXERCISABLE	(#) UNEXERCISABLE		
Lonnie D. Schnell .....	1/26/06	191,667	208,333 (1)	\$ 0.59	
Stephen P. Forte .....	1/16/06	135,135	--	\$ 0.37	
	1/16/06	650,000	250,000 (2)	\$ 0.37	
Wouter van Biene .....	3/1/06	198,611	126,389 (3)	\$ 0.53	

(1) Mr. Schnell's options become exercisable with regard to 100,000 shares on January 26, 2007 and then with respect to 8,333 shares per month until fully vested.

(2) Mr. Forte's options become exercisable at 25,000 shares per month until fully vested. Mr. Forte resigned as of February 4, 2008, and the vesting of the outstanding options was fully accelerated pursuant to the separation agreement described below under "Employment Agreement, Termination of Employment and Change of Control Agreements."

(3) Mr. van Biene's options became exercisable with regard to 108,333 shares on March 1, 2007 and then with respect to 9,028 shares per month until

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fully vested. Mr. van Biene resigned as of January 15, 2008, and he received 12 months accelerated vesting of outstanding options in accordance with his separation arrangement.

### EMPLOYMENT AGREEMENTS, TERMINATION OF EMPLOYMENT AND CHANGE OF CONTROL ARRANGEMENTS

#### EMPLOYMENT AGREEMENTS

We have entered into the following employment agreements with our named executive officers.

LONNIE D. SCHNELL, CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER. On March 16, 2006, we entered into an employment agreement with Lonnie Schnell, pursuant to which Mr. Schnell serves as our Chief Financial Officer on an "at-will" basis. Pursuant to this offer letter, as amended, Mr. Schnell is entitled to receive an annual base salary of \$185,000 and will be eligible to receive an annual incentive bonus based upon our earnings before interest and taxes. In October 2006, Mr. Schnell's annual base salary was increased to \$225,000 as recognition for superior performance and individual contributions to the achievement to Company objectives. In the event that Mr. Schnell's employment is terminated by us without "cause" (as defined in the agreement) or due to Mr. Schnell's death or disability, then Mr. Schnell or his estate will be entitled to receive as severance, in addition to all accrued salary, (i) salary continuation and continuation of coverage under our group health plan for a period of twelve months and (ii) twelve months acceleration of vesting of all outstanding options. In connection with the offer letter and as an inducement to employment, we previously granted Mr. Schnell an option to purchase 400,000 shares of our common stock, which vests over a period of four years. Upon a change of control of our company, 50% of Mr. Schnell's then-outstanding unvested stock options shall vest and the remaining unvested options shall vest in full if Mr. Schnell is terminated, his position or base pay is reduced or he is required to relocate within six months before or twelve months following the change of control. As of February 4, 2008, Mr. Schnell was also named Chief Executive Officer.

STEPHEN FORTE, FORMER CHIEF EXECUTIVE OFFICER. On March 16, 2006, we entered into an Executive Employment Agreement with Stephen Forte, pursuant to which Mr. Forte served as our Chief Executive Officer. This employment agreement had a term continuing through December 31, 2008, which could be extended to

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December 31, 2009. Pursuant to this agreement, Mr. Forte received an annual base salary of \$275,000 for 2006 and \$325,000 for each subsequent year of the term and was entitled to receive an annual incentive bonus based upon our earnings before interest and taxes. In the event that prior to the end of the term, Mr. Forte's employment was terminated by us "without cause" (as defined in the agreement), by Mr. Forte for "good reason" (as defined in the agreement) or due to Mr. Forte's death or disability, then Mr. Forte or his estate would be entitled to receive, in addition to all accrued salary, (i) severance payments equal to Mr. Forte's base salary for the remaining term of the agreement or, in the case of death or disability, through December 31, 2008, (ii) a pro rated portion of the annual incentive bonus for the year in which the termination occurred, (iii) full acceleration of vesting of the options issued to Mr. Forte pursuant to the agreement and (iv) continued healthcare coverage for Mr. Forte and his dependents for the remaining term of the agreement.

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Effective February 4, 2008, Stephen Forte resigned his position as our Chief Executive Officer and as a member of our Board of Directors, as well from all positions with our subsidiaries. In connection with Mr. Forte's resignation, on February 4, 2008, we entered into a Separation Agreement with Mr. Forte. The Separation Agreement further provides for the payment to Mr. Forte of the same severance benefits he would have received under his employment agreement had we terminated Mr. Forte's employment without cause. In exchange for his severance, Mr. Forte has released all claims against us.

WOUTER VAN BIENE, FORMER CHIEF OPERATING OFFICER. On March 16, 2006, we entered into an employment agreement with Wouter van Biene, pursuant to which Mr. van Biene serves as our Chief Operating Officer on an "at-will" basis. Pursuant to this offer letter, Mr. van Biene is entitled to an annual base salary of \$225,000 and will be eligible to receive an annual incentive bonus based upon our earnings before interest and taxes. In the event that Mr. van Biene's employment is terminated by us without "cause" (as defined in the agreement) or due to Mr. van Biene's death or disability, then Mr. van Biene or his estate will be entitled to receive as severance, in addition to all accrued salary, (i) salary continuation and continuation of coverage under our group health plan for a period of six months if the termination occurs during the first year of employment, a period of twelve months if the termination occurs during the second year of employment or a period of eighteen months if the termination occurs after the second year of employment, and (ii) twelve months acceleration of vesting of all outstanding options. Effective January 15, 2008, Mr. van Biene resigned. In connection with Mr. van Biene's resignation and in exchange for a full release of claims against us, we have agreed to pay Mr. van Biene twelve months of his current base salary and provide him twelve months of continued coverage under our group health plan.

### POTENTIAL SEVERANCE PAYMENTS

As described above, our employment agreements with Messrs. Forte, van Biene and Schnell provided for severance benefits in the event that the executive's employment is terminated due to executive's death or disability or by the Company without "cause" and, in the case of Mr. Forte, for "good reason." The following table sets forth severance payments and benefits that we would have been obligated to pay to Messrs. Forte, van Biene and Schnell assuming a triggering event had occurred under each of their respective agreements as of December 31, 2007:

NAME	CASH SEVERANCE PAYMENT (\$) (1)	BONUS VALUE (\$)	CONTINUATION OF HEALTH BENEFITS (\$)	VALUE OF ACCELERATION OF VESTING OF EQUITY AWARDS (\$) (2)
Lonnie D. Schnell .....	240,968	--	11,343	--
Stephen P. Forte .....	310,420	--	12,483	10,000
Wouter van Biene .....	244,471	--	11,502	--

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- (1) Includes (i) earned and unpaid base salary through the date of termination, (ii) accrued but unpaid vacation and (iii) cash severance payments based on the executive's salary payable in a lump sum or periodic payments as provided in the executive's employment agreement.
- (2) Based on the closing price of our common stock on December 31, 2007 of \$0.41, as reported by the OTC Bulletin Board.

### POTENTIAL CHANGE IN CONTROL PAYMENTS

As described above, our employment agreements with Messrs. Forte, van Biene and Schnell provided for accelerated vesting of all or a portion of the options held by such executives upon a change in control. The following table sets forth the change in control benefits that we would have been obligated to pay to our named executive officers assuming a change of control had occurred as of December 31, 2007:

NAME	CHANGE IN CONTROL ONLY (2)	CHANGE IN CONTROL WITH ADDITIONAL TRIGGER (3)
Stephen P. Forte	10,000	10,000
Wouter van Biene	-	-
Lonnie D. Schnell	-	-

- 
- (1) Based on the closing price of our common stock on December 31, 2007 of \$0.41, as reported by the OTC Bulletin Board.
  - (2) Upon a change in control, (i) Mr. Forte was entitled to full acceleration of currently outstanding options and (ii) Messrs. van Biene and Schnell are each entitled to accelerated vesting with respect to 50% of the unvested portion of outstanding options.
  - (3) Messrs. van Biene and Schnell are each entitled to full acceleration of vesting of the remaining unvested portion of all outstanding stock options if, within in 12 months following the change in control: (i) he is terminated by the acquirer, (ii) his position is reduced to less than a general manager position or a vice president level position, (iii) his base pay is reduced below his prevailing base pay amount at the time of the change in control or (iv) he is asked to relocate to an office more than 60 miles from his office prior to the change in control.

### DIRECTOR COMPENSATION

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

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The following table details the total compensation earned by the company's non-employee directors in 2007.

NAME	FEES EARNED OR PAID IN CASH (\$)	OPTION AWARDS (\$) (9)	ALL OTHER COMPENSATION (\$)	TOTAL (\$)
Mark Dyne (1)	40,000	3,230	100,500	143,730
Colin Dyne (2)	-	5,650	304,000	309,650
Brent Cohen (3)	84,583	1,250	14,417	100,250
Joseph Miller (4)	68,975	600	-	69,575
Raymond Musci (5)	64,375	600	-	64,975
William Sweedler (6)	39,667	300	-	39,967
Susan White (7)	33,417	600	4,833	38,850
Jonathan Burstein (8)	-	4,250	290,507	294,757
Total	260,667	16,480	784,607	1,061,754

(1) As of December 31, 2007, Mr. Mark Dyne held options to purchase a total of 323,000 shares. The other compensation consists of consulting and per diem fees earned for services rendered.

(2) As of December 31, 2007, Mr. Colin Dyne held options to purchase a total of 565,000 shares. The other compensation consists of consulting fees for services rendered.

(3) As of December 31, 2007, Mr. Cohen held options to purchase a total of 125,000 shares. The other compensation consists of consulting fees for services rendered.

(4) As of December 31, 2007, Mr. Miller held options to purchase a total of 60,000 shares.

(5) As of December 31, 2007, Mr. Musci held options to purchase a total of 60,000 shares.

(6) As of December 31, 2007, Mr. Sweedler held options to purchase a total of 30,000 shares.

(7) As of December 31, 2007, Ms. White held options to purchase a total of 60,000 shares. The other compensation consists of consulting fees for services rendered. Ms. White resigned from the Board of Directors as of October 1, 2007.

(8) As of December 31, 2007, Mr. Burstein held options to purchase a total of 425,000 shares. The other compensation consists of consulting fees for services rendered. Mr. Burstein resigned from the Board of Directors as of October 25, 2007.

(9) The amounts in this column represent the dollar amounts recognized for financial statement purposes in fiscal 2007 with respect to stock options granted in 2007 as well as prior fiscal years, in accordance with SFAS 123(R). For additional information on the valuation assumptions with respect to option grants, including the options granted in 2007, see Note 9 to the Consolidated Financial Statements in this Annual Report on Form 10-K. These amounts do not reflect the actual value that may be realized by

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the named executive officers which depends on the value of our shares in the future.

Our policy is to pay non-employee directors \$1,500 for their personal attendance at any meeting of the Board of Directors, \$1,000 for their personal attendance at any committee meeting, and \$500 for attendance at any telephonic meeting of the Board of Directors or of a committee of the Board of Directors. We also pay non-employee directors an annual retainer of \$20,000 for Board service and an additional retainer of \$5,000 for service on each committee. The Chairman of the Board receives an annual retainer of \$25,000 for Board service. We also reimburse directors for their reasonable travel expenses incurred in attending board or committee meetings and pay non-employee directors a per diem for board services.

We do not have a formal policy with regard to option grants to our Board of Directors, but we generally follow a practice of granting an option for 30,000 shares of stock upon initial appointment or election to the Board of Directors, and thereafter issuing annual option grants to all non-employee members of 30,000 shares.

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During 2006 and through March 31, 2007 we had a verbal agreement with Mr. Colin Dyne to provide consulting services following his resignation in 2005 as our Chief Executive Officer. We entered into a written agreement with Mr. Dyne effective April 1, 2007 that provides for continued consulting services through November 30, 2008 in exchange for a consulting fee of \$25,000 per month.

Effective January 1, 2007, we entered into a consulting agreement with Jonathan Burstein, previously a member of the Board of Directors. Under the terms of the consulting agreement, Mr. Burstein provides specified consulting services to us for a term of up to 24 months. As consideration for the services, we pay Mr. Burstein an amount of \$225,000 per annum plus an additional \$3,333.33 per month for the first 18 months of the term of the agreement. We also agreed to provide Mr. Burstein with medical benefits and an automobile allowance for a period of 18 months.

### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of our Board of Directors currently consists of Brent Cohen, Raymond Musci and William Sweedler. No current executive officer of the Company has served as a member of the board of directors or compensation committee of any entity for which a member of our Board of Directors or Compensation Committee has served as an executive officer.

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

#### EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth certain information as of December 31, 2007 regarding equity compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance:



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	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS -----	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS -----	REMAINING AV FOR FUTURE I UNDER EQU COMPENSATION -----
Equity compensation plans approved by security holders.....	3,048,235	\$ 1.99	2,600,00
Equity compensation plans not approved by security holders.....	4,788,813 -----	\$ 1.48 -----	- -----
Total.....	7,837,048 =====	\$ 1.67 =====	2,600,00 =====

Options and warrants issued pursuant to equity compensation plans not approved by security holders are summarized as follows:

- o 172,500 warrants issued for services in 2003, are exercisable at \$5.06 per share and expire in May 2008.
- o 572,818 warrants issued for services in 2003, are exercisable at \$4.74 per share and expire in December 2008.
- o 102,741 warrants issued in conjunction with a private placement transaction in 2004, are exercisable at \$3.65 per share and expire in November 2009.
- o 215,754 warrants issued for services in 2004, are exercisable at \$3.65 per share and expire in November 2009.
- o 2,100,000 warrants issued in conjunction with private placement transaction in 2007, are exercisable at \$0.75 per share and expire in June 2012.

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- o 1,625,000 inducement options issued to employees in 2006 are exercisable at a weighted average exercise price of \$0.46 per share and expire in January and March of 2016.

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

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table presents information regarding the beneficial ownership of our common stock as of April 11, 2008:

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

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- o each of our named executive officers; and
- o all of our directors and executive officers as a group

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission that deem shares to be beneficially owned by any person who has or shares voting or investment power with respect to such shares. Shares of common stock under warrants or options currently exercisable or exercisable within 60 days of the date of this information are deemed outstanding for purposes of computing the percentage ownership of the person holding such warrants or options but are not deemed outstanding for computing the percentage ownership of any other person. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of common stock actually outstanding at April 11, 2008. Unless otherwise indicated, the persons named in this table have sole voting and sole investment power with respect to all shares shown as beneficially owned, subject to community property laws where applicable. As of April 11, 2008, we had 20,291,433 shares of common stock issued and outstanding.

The address of each person listed is in our care, at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367, unless otherwise set forth below such person's name.

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES	PERCENT OF CLASS
-----		
DIRECTORS:		
Mark Dyne (1).....	1,242,001	6.0%
Colin Dyne (2).....	747,780	3.6%
Larry Dyne (3).....	547,137	2.6%
Lonnie D. Schnell (4).....	291,667	1.4%
William Sweedler (5).....	132,000	*
Brent Cohen (6) .....	125,000	*
Raymond Musci (6).....	60,000	*
Joseph M. Miller (6).....	60,000	*
David A. Hunter.....	-	*
Directors and executive officers as a group (9 persons) (7) .....	3,205,585	14.5%
OTHER 5% HOLDERS:		
Bluefin Capital, LLC .....	1,750,000	8.6%
105 S. Narcissus Ave., Suite 712 West Palm Beach, FL 33401		

-----  
\* Less than one percent.

(1) Includes 323,000 shares of common stock reserved for issuance upon exercise of stock options which are currently exercisable and 83,334 shares of common stock reserved for issuance upon exercise of warrants which are currently exercisable. Includes 176,600 shares held by a limited liability company of which Mr. Dyne is the manager and a member.

(2) Includes 565,000 shares of common stock reserved for issuance upon exercise of stock options that are currently exercisable.

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- (3) Includes 417,537 shares of common stock reserved for issuance upon exercise of stock options that are currently exercisable. Also includes 129,600 shares of common stock held by a family trust which Mr. Larry Dyne may be deemed to beneficially own.
- (4) Includes 191,667 shares of common stock reserved for issuance upon exercise of stock options that are currently exercisable.
- (5) Includes 30,000 shares of common stock reserved for issuance upon exercise of stock options that are currently exercisable.
- (6) Consists of shares of common stock reserved for issuance upon the exercise of the stock options that are currently exercisable.
- (7) Includes 1,772,204 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable and 83,334 shares of common stock reserved for issuance upon exercise of warrants which currently are exercisable.

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

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

#### REVIEW AND APPROVAL OF RELATED PARTY TRANSACTIONS

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

#### REPORTABLE RELATED PARTY TRANSACTIONS

Other than the employment arrangements described elsewhere in this report and the transactions described below, since January 1, 2007, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or will be a party:

- o in which the amount involved exceeds \$120,000; and
- o in which any director, executive officer, shareholder who beneficially owns 5% or more of our common stock or any member of their immediate family had or will have a direct or indirect material interest.

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Colin Dyne, a member of our Board, is a significant shareholder in People's Liberation, Inc., the parent company of Versatile Entertainment, Inc. During 2007, we had sales of \$241,000 to Versatile Entertainment. At December 31, 2007, accounts receivable of \$44,000 were outstanding from Versatile Entertainment.

At December 31, 2007, we had an aggregate of \$625,454 of unsecured notes, advances and accrued interest receivable due from Colin Dyne. The notes and advances bear interest at 7.5% and are due on demand.

We paid consulting fees of \$304,000 to Colin Dyne during year ended December 31, 2007 for consulting services provided, and have an agreement with Mr. Dyne for services through November 30, 2008. See the "Director Compensation" section in item 11 of this report for a description of this agreement.

At December 31, 2007, we had an aggregate of \$85,176 in notes and advances due to Mark Dyne, the Chairman of our Board of Directors or to parties related to or affiliated with Mark Dyne. The notes are payable on demand and accrue interest at rates ranging from 0% to 10% per annum.

We paid consulting fees to Diversified Investments, a company owned by Mark Dyne, in the amount of \$150,000 during the year ended December 31, 2007.

On January 1, 2007 we entered into an agreement with Jonathan Burstein, previously our Executive Vice President of Operations and formerly a member of our Board of Directors, to provide consulting services to the Company through December 31, 2008. We paid Mr. Burstein consulting fees of \$290,507 during the year ended December 31, 2007. This agreement was terminated by the Company during the fourth quarter of 2007.

### DIRECTOR INDEPENDENCE

Because our common stock is quoted on the OTC Bulletin Board, we are not subject to the listing requirements of any securities exchange or Nasdaq regarding the independence of our directors. However, our Board of Directors has determined that as of December 31, 2007, a majority of our Board of Directors is comprised of "independent" directors within the meaning of the applicable rules for companies listed on The Nasdaq Stock Market. The Board determined that each of Brent Cohen, Joseph Miller, Raymond Musci, and William Sweedler were independent. The Board has also determined that each of Joseph Miller, Raymond Musci and William Sweedler meet the independence requirements for services on the Audit Committee pursuant to the rules for companies traded on The NASDAQ Stock Market.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

#### SERVICES PROVIDED BY THE INDEPENDENT AUDITORS

The audit committee of our Board of Directors is responsible for the appointment, compensation, retention and oversight of the work of the independent auditors.

Singer Lewak Greenbaum & Goldstein LLP ("SLGG") served as our independent registered public accounting firm for each of the fiscal years ended December 31, 2006 and 2007.

AUDIT FEES - The aggregate fees billed by our independent registered accounting firm for professional services rendered for the audit of our annual

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financial statements and review of our financial statements included in our Forms 10-Q or services that are normally provided in connection with statutory and regulatory filings, were \$302,000 for fiscal year 2006 and \$350,000 for fiscal year 2007.

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AUDIT-RELATED FEES - The aggregate fees billed by our independent registered accounting firm for professional services rendered for assurance and related services reasonably related to the performance of the audit or review of our financial statements (other than those reported above) was \$66,000 for fiscal year 2006 and \$57,300 for fiscal year 2007.

TAX FEES - The aggregate fees billed by our independent registered accounting firm for professional services rendered for tax compliance, tax advice and tax planning were \$37,000 for fiscal year 2006 and \$33,400 for fiscal year 2007.

ALL OTHER FEES - The aggregate fees billed by our independent registered accounting firm for services rendered to us other than the services described above under "Audit Fees," "Audit-Related Fees" and "Tax Fees" were \$13,000 for fiscal year 2006 and \$25,400 for fiscal year 2007.

The audit committee approved all of the foregoing services provided by SLGG.

### POLICY REGARDING PRE-APPROVAL OF SERVICES PROVIDED BY THE INDEPENDENT AUDITORS

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

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### PART IV

#### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

(1) FINANCIAL STATEMENTS

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

### (2) FINANCIAL STATEMENT SCHEDULES

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

### (3) EXHIBITS

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

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### SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

COLUMN A Description	COLUMN B Balance at Beginning of Year	COLUMN C Additions	COLUMN D Deductions	COLUMN E Balance at End of Year
2007				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet .....	\$ 71,500	\$ 135,000	\$ 66,000	\$ 140,500
Reserve for obsolescence deducted from inventories on the balance sheet ....	1,242,000	148,000	368,000	1,022,000
Valuation reserve deducted from Deferred tax Assets .....	19,225,000	938,000	--	20,163,000
	<u>\$20,538,500</u>	<u>\$ 1,221,000</u>	<u>\$ 434,000</u>	<u>\$21,325,500</u>
2006				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet .....	\$ 1,189,000	\$ 198,000	\$ 1,315,500	\$ 71,500
Reserve for obsolescence deducted from inventories on the balance sheet ....	7,306,000	557,000	6,621,000	1,242,000
Valuation reserve deducted from Deferred tax Assets .....	21,447,000	--	2,222,000	19,225,000
	<u>\$29,942,000</u>	<u>\$ 755,000</u>	<u>\$10,158,500</u>	<u>\$20,538,500</u>
2005				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet .....	\$ 6,086,000	\$ 4,160,000	\$ 9,057,000	\$ 1,189,000
Reserve for obsolescence deducted from inventories on the balance sheet ....	6,365,000	2,538,000	1,597,000	7,306,000

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Valuation reserve deducted from Deferred tax Assets .....	8,900,000	12,547,000	--	21,447,000
	-----	-----	-----	-----
	\$21,351,000	\$19,245,000	\$10,654,000	\$29,942,000
	=====	=====	=====	=====

- (1) Additions to the allowance for doubtful accounts include provisions for uncollectible accounts. Bad debt expense includes (and additions above exclude) net recoveries of \$712,000 for the year ended December 31, 2006, and net direct write-offs of \$114,000 and \$1,698,000 for the years ended December 31, 2007 and 2005, respectively. Additions to the inventory obsolescence reserve include current year provisions. Additionally, in 2005 there were direct write-offs of inventory of \$3.4 million in connection with the restructuring, and in 2007 and 2006 there were direct write-offs of \$0.4 million and \$0.2 million, respectively.
- (2) Deductions from the allowance for doubtful accounts includes amounts applied to write-offs, reversals of prior period provisions, and, for the year ended December 31, 2005, deductions include \$7,528,000 related to the conversion of a trade account receivable to a note receivable. Deductions from the inventory obsolescence reserve include application of the reserve against obsolete, excess, slow-moving or disposed inventory.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TALON INTERNATIONAL, INC.

/S/LONNIE D. SCHNELL

-----  
 By: Lonnie D. Schnell  
 Its: Chief Executive Officer & Chief  
 Financial Officer

POWER OF ATTORNEY

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

SIGNATURES

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

SIGNATURE -----	TITLE -----	DATE -----
/s/ Lonnie D. Schnell ----- Lonnie D. Schnell	Chief Executive Officer and Chief Financial Officer (Principal Executive and Financial Officer)	April 15, 2008
/s/ David A. Hunter ----- David A. Hunter	Vice President Corporate Controller (Principal Accounting Officer)	April 15, 2008
/s/ Mark Dyne ----- Mark Dyne	Chairman of the Board of Directors	April 15, 2008
/s/ Colin Dyne ----- Colin Dyne	Vice Chairman of the Board of Directors	April 15, 2008
/s/ Brent Cohen ----- Brent Cohen	Director	April 15, 2008
/s/ Raymond Musci ----- Raymond Musci	Director	April 15, 2008
/s/ Joseph Miller ----- Joseph Miller	Director	April 15, 2008
/s/ William Sweedler ----- William Sweedler	Director	April 15, 2008

EXHIBIT INDEX

EXHIBIT NUMBER -----	EXHIBIT DESCRIPTION -----
3.1	Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto.



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- 3.1.2 Certificate of Designation of Rights, Preferences and Privileges of Series A Preferred Stock. Incorporated by reference to Exhibit A to the Rights Agreement filed as Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
- 3.1.3 Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.4 to Annual Report on Form 10-KSB, filed March 28, 2000.
- 3.1.4 Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1.3 to Form 8-K filed on August 4, 2006.
- 3.1.5 Certificate of Ownership and Merger. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on July 20, 2007.
- 3.2 Bylaws of Registrant. Incorporated by reference to Exhibit 3.2 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 4.1 Specimen Stock Certificate of Common Stock of Registrant. Incorporated by reference to Exhibit 4.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 4.2 Rights Agreement, dated as of November 4, 1998, between Registrant and American Stock Transfer and Trust Company as Rights Agent. Incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
- 4.3 Form of Rights Certificate. Incorporated by reference to Exhibit B to the Rights Agreement filed as Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
- 10.1 Form of Indemnification Agreement. Incorporated by reference to Exhibit 10.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.2 Promissory Note, dated September 30, 1996, provided by Tag-It, Inc. to Harold Dyne. Incorporated by reference to Exhibit 10.21 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.3 Promissory Note, dated June 30, 1991, provided by Tag-It, Inc. to Harold Dyne. Incorporated by reference to Exhibit 10.23 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.5 Promissory Note, dated February 29, 1996, provided by A.G.S. Stationary, Inc. to Monto Holdings Pty. Ltd. Incorporated by reference to Exhibit 10.25 of Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.6 Promissory Note, dated January 19, 1995, provided by Pacific Trim & Belt, Inc. to Monto Holdings Pty. Ltd. Incorporated by reference to Exhibit 10.26 to Form SB-2 filed on October 21, 1997, and the amendments thereto.

EXHIBIT NUMBER -----	EXHIBIT DESCRIPTION -----
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- 10.7(2) Amended and Restated 1997 Stock Incentive Plan. Incorporated by reference to Exhibit 10.7 to Form 10-Q filed on November 13, 2006.
- 10.8(2) Form of Non-statutory Stock Option Agreement. Incorporated by reference to Exhibit 10.30 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.9 Promissory Note, dated August 31, 1997, provided by Harold Dyne to Pacific Trim & Belt, Inc. Incorporated by reference to Exhibit 10.32 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.10 Promissory Note, dated October 15, 1997, provided by Harold Dyne to Pacific Trim & Belt, Inc. Incorporated by reference to Exhibit 10.34 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.11 Promissory Note, dated October 15, 1997, provided by A.G.S. Stationary Inc. to Monto Holdings Pty. Ltd. Incorporated by reference to Exhibit 10.48 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.12 Promissory Note, dated November 4, 1997, provided by Pacific Trim & Belt, Inc. to Monto Holdings Pty. Ltd. Incorporated by reference to Exhibit 10.49 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
- 10.13 Form of Investor Rights Agreements dated December 28, 2001. Incorporated by reference to Exhibit 99.4 to Form 8-K filed on January 23, 2002.
- 10.14(1) Intellectual Property Rights Agreement, dated April 2, 2002, between the Company and Pro-Fit Holdings, Ltd. Incorporated by reference to Exhibit 10.69 to Form 10-K/A filed on October 1, 2003.
- 10.15 Common Stock Purchase Warrant dated December 18, 2003 between the Company and Sanders Morris Harris Inc. Incorporated by reference to Exhibit 99.4 to Form 8-K filed on December 22, 2003.
- 10.16 Form of Common Stock Purchase Warrant, dated as of November 9, 2004. Incorporated by reference to Exhibit 10.3 to Form S-3 filed on December 9, 2004.
- 10.17 Common Stock Purchase Warrant dated as of November 9, 2004, issued by the Registrant in favor of Sanders Morris Harris Inc. Incorporated by reference to Exhibit 10.7 to Form S-3 filed on December 9, 2004.
- 10.18(2) Employment offer letter dated March 16, 2006 between the Registrant and Lonnie D. Schnell. Incorporated by reference to Exhibit 10.3 to Form 10-Q filed on May 22, 2006.
- 10.18.1(2) Amendment, dated May 25, 2007, to employment offer letter dated March 16, 2006 between the Registrant and Lonnie D. Schnell. Incorporated by reference to Exhibit 10.31.2 to Form 10-Q filed on August 14, 2007.
- 10.19(2) Consulting Agreement dated January 1, 2007 between the Registrant and Jonathan Burstein. Incorporated by reference to Exhibit 10.1 to Form 8-K filed on January 3, 2007.

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10.19(2) Consulting Agreement effective April 1, 2007 between the Registrant and Colin Dyne. Incorporated by reference to Exhibit 10.34 to Form 10-Q filed on May 15, 2007.

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EXHIBIT NUMBER -----	EXHIBIT DESCRIPTION -----
10.20(2)	2007 Stock Plan.
10.21	Revolving Credit and Tern Loan Agreement dated June 27, 2007, by and between Tag-It Pacific, Inc. and Bluefin Capital, LLC. Incorporated by reference to Exhibit 10.35 to Form 10-Q filed on August 14, 2007.
10.21.1	Amendment No. 1 to Loan Agreement dated July 30, 2007, by and between the Registrant and Bluefin Capital, LLC.
10.21.2	Amendment No. 2 to Loan Agreement dated November 19, 2007, by and between the Registrant and Bluefin Capital, LLC. Incorporated by reference to Exhibit 10.35.2 to Form 8-K filed on November 26, 2007.
10.22	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. Incorporated by reference to Exhibit 10.36 to Form 10-Q filed on August 14, 2007.
10.23	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. Incorporated by reference to Exhibit 10.37 to Form 10-Q filed on August 14, 2007.
10.24	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.
10.25	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.
10.26	Promissory Note, dated June 27, 2007, executed by Colin Dyne in favor of Tag-It Pacific, Inc. Incorporated by reference to Exhibit 10.40 to Form 10-Q filed on August 14, 2007.
14.1	Code of Ethics. Incorporated by reference to Exhibit 14.1 to Form 10-K filed on March 30, 2004.
21.1	Subsidiaries.

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- 23.1 Consent of Singer Lewak Greenbaum & Goldstein LLP.
- 24.1 Power of Attorney (included on signature page).
- 31.1 Certificate of Chief Executive Officer and 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.

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- (1) Certain portions of this agreement have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for an order granting confidential treatment pursuant to Rule 406 of the General Rules and Regulations under the Securities Act of 1933, as amended.
- (2) Indicates a management contract or compensatory plan.