TALON INTERNATIONAL, INC.
Form 10-Q
November 19, 2007

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

FORM 10-Q

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

For the quarterly period ended September 30, 2007.

OR

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

Commission file number 1-13669

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

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

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

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

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

Yes [X] No [ ]

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

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

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

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

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

INDEX TO FORM 10-Q

PART I
FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

CONDENSED CONSOLIDATED BALANCE SHEETS

	(unaudited) September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 2,318,712	$ 2,934,673
Accounts receivable, net	3,866,355	4,664,766
Note receivable, net	--	1,378,491
Inventories, net	2,710,051	3,051,220
Prepaid expenses and other current assets	449,743	541,034
Total current assets	9,344,861	12,570,184
Property and equipment, net	5,418,095	5,623,040
Fixed assets held for sale	826,904	826,904
Note receivable, less current portion	--	1,420,969
Due from related party	736,557	675,137
Intangible assets, net	4,110,751	4,139,625
Other assets, net	592,971	437,569
Total assets	$ 21,030,139	$ 25,693,428
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 5,363,432	$ 4,533,145
Accrued legal costs	226,507	427,917
Other accrued expenses	2,246,344	2,832,363
Demand notes payable to related parties	85,176	664,970
Current portion of capital lease obligations	383,090	432,728
Current portion of notes payable	294,259	1,107,207
Secured convertible promissory notes	--	12,472,622
Total current liabilities	8,598,808	22,470,952
Capital lease obligations, less current portion	247,763	474,733
Notes payable, less current portion	925,104	1,061,514
Revolver note payable	3,807,806	--
Term note payable, net of discount	7,289,480	--
Other long term liabilities	83,651	--
Total liabilities	20,952,612	24,007,199
Commitments and contingencies	--	--
Stockholders' Equity:		
Preferred stock Series A, $0.001 par value; 250,000 shares authorized; no shares issued or outstanding	--	--
Common stock, $0.001 par value, 100,000,000 shares authorized; 20,041,433 shares issued and outstanding at September 30, 2007; 18,466,433 at December 31, 2006	20,041	18,466
Additional paid-in capital	54,394,342	51,792,502
Accumulated deficit	(54,357,221)	(50,124,739)
Accumulated other comprehensive income-foreign currency	20,365	--

Total stockholders' equity	77,527	1,686,229
Total liabilities and stockholders' equity	$ 21,030,139	$ 25,693,428

See accompanying notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	20
Net sales	$ 9,013,135	$ 13,366,945	$ 31,670,234	$ 38,2
Cost of goods sold	6,486,659	9,218,539	22,422,412	27,1
Gross profit	2,526,476	4,148,406	9,247,822	11,1
Selling expenses	722,447	910,996	2,161,666	2,1
General and administrative expenses	2,731,665	2,606,936	7,749,445	7,9
Reserve for impairment of note receivable	2,127,653	--	2,127,653	
Total operating expenses	5,581,765	3,517,932	12,038,764	10,0
Income (loss) from operations	(3,055,289)	630,474	(2,790,942)	1,0
Interest expense, net	647,514	236,500	1,138,088	7
Income (loss) before income taxes	(3,702,803)	393,974	(3,929,030)	3
Provision for income taxes	(20,972)	54,857	57,652	
Net income (loss)	$ (3,681,831)	$ 339,117	$ (3,986,682)	$ 2
Basic income (loss) per share	$ (0.18)	$ 0.02	$ (0.21)	$
Diluted income (loss) per share	$ (0.18)	$ 0.02	$ (0.21)	$
Weighted average number of common shares outstanding:				
Basic	20,041,433	18,440,927	19,060,664	18,3
Diluted	20,041,433	19,279,648	19,060,664	18,7

See accompanying notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	Common Stock		Preferred Stock Series A	
	Shares	Amount	Shares	Amoun
BALANCE, JANUARY 1, 2007	18,466,433	$ 18,466	--	$
Common stock and warrants issued in private placement transaction	1,500,000	1,500	--	
Common stock issued upon exercise of options and warrants	75,000	75	--	
Stock based compensation	--	--	--	
Cumulative Effect of Prior Period Adjustments (FIN 48)	--	--	--	
Accumulated other comprehensive income: foreign currency translation	--	--	--	
Net loss	--	--		
BALANCE, SEPTEMBER 30, 2007	20,041,433	$ 20,041	--	$

	Additional Paid-In Capital	Retained Earnings/ Accumulated (Deficit)	Accumulated Other Comprehensive Income	To Stockh Equ
BALANCE, JANUARY 1, 2007	$ 51,792,502	$(50,124,739)	$ --	$ 1,6
Common stock and warrants issued in private placement transaction	2,374,169	--	--	2,3
Common stock issued upon exercise of options and warrants	42,671	--	--	
Stock based compensation	185,000	--	--	1

Cumulative Effect of Prior Period Adjustments (FIN 48)	--	(245,800)	--	(2
Accumulated other comprehensive income: foreign currency translation	--	--	20,365	
Net loss	--	--	(3,986,682)	(3,9
BALANCE, SEPTEMBER 30, 2007	$ 54,394,342	$(54,357,221)	$ 20,365	$

See accompanying notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ende September 30,	
	2007	200
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (3,986,682)	$ 26
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	878,834	91
Amortization of deferred financing cost and debt discounts	496,264	23
Increase (decrease) in allowance for doubtful accounts	2,331,018	(1,04
Decrease in inventory valuation reserves	(52,000)	(5,84
Disposal of assets	--	10
Stock based compensation	185,000	28
Changes in operating assets and liabilities:		
Accounts receivable	670,046	1,64
Note receivable	671,807	31
Inventories	393,169	8,26
Prepaid expenses and other current assets	91,291	(6
Due from related party	(61,420)	8
Other assets	(22,649)	(17
Accounts payable	830,287	(1,79
Accrued legal costs	(306,250)	(14
Other accrued expenses	(795,881)	(22
Net cash provided by operating activities	1,322,834	2,82
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	(585,470)	(32
Proceeds from sale of equipment	--	
Net cash used by investing activities	(585,470)	(32

CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options and warrants	42,746	
Proceeds from issuance of stock and warrants, net of issuance costs	2,306,918	
Revolver note borrowings	4,307,806	
Term note borrowings, net of issuance costs	6,849,582	
Payments for capital lease obligations	(334,401)	(43
Repayment of demand notes payable to related parties	(579,794)	
Repayment of notes payable	(949,358)	(61
Payment of revolver note	(500,000)	
Payment of secured convertible promissory notes	(12,500,000)	
Net cash from (used by) financing activities	(1,356,501)	(1,04
Net increase (decrease) in cash and cash equivalents	(619,137)	1,44
Net effect of foreign currency exchange translation on cash	3,176	
Cash at beginning of period	2,934,673	2,27
Cash and cash equivalents at end of period	$ 2,318,712	$ 3,72
Supplemental disclosures of cash flow information:		
Income taxes paid during the period	$ 172,542	$
Non-cash financing activities:		
Capital lease obligation	$ 57,793	$ 34
Deferred financing cost	$ 238,491	$
Accounts payable & accrued legal converted to notes payable	$ --	$ 1,77
Effect of foreign currency translation on net assets	$ 17,189	$

See accompanying notes to condensed consolidated financial statements.

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. PRESENTATION OF INTERIM INFORMATION

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

Annual Report on Form 10-K (and amendments thereto) for the year ended December 31, 2006. The balance sheet as of December 31, 2006 has been derived from the audited financial statements as of that date but omits certain information and footnotes required for complete financial statements.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A complete description of the Company's Significant Accounting Policies is included in the Company's Annual Report on Form 10-K (and amendments thereto) for the year ended December 31, 2006, and should be read in conjunction with these unaudited condensed consolidated financial statements. The Significant Accounting Policies noted below are only those policies that have changed materially or have supplemental information included for the periods presented here.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

We are required to make judgments as to the collectability of accounts receivable based on established aging policy, historical experience and future expectations. The allowance for doubtful accounts represents amounts 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. Bad debt expense, including the impairment of note receivable for the three and nine months ended September 30, 2007 are $2,307,446 and $2,349,568, respectively, compared to recoveries of bad debts of $133,780 and $531,121, for the three and nine months ended September 30, 2006. Total provisions for doubtful accounts during the third quarter of 2007 includes a provision reserved against the Azteca note receivable as explained in Note 4.

INTANGIBLE ASSETS

Intangible assets consist of our trade name 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 are 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 respective estimated useful lives, which average 5 years, and reviewed for

impairment in accordance with the provisions of FASB Statement No. 144, ACCOUNTING FOR IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. Amortization expense for these assets for the nine months ended September 30, 2006 was $86,625. During the first quarter of 2007, the exclusive license and intellectual property rights became fully amortized with amortization expense of $28,875.

OTHER ACCRUED EXPENSES

Other accrued expenses consist of incurred obligations that are not yet payable, such as deferred compensation and accrued benefits, interest, and advance customer payments and deposits. As of September 30, 2007, other accrued expenses included $582,670 in advance customer payments and deposits (as compared to $512,339 at December 31, 2006).

CLASSIFICATION OF EXPENSES

COSTS 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 expense.

SELLING EXPENSES - Selling expenses primarily include royalty expense, sales salaries and commissions, travel and entertainment, marketing and other sales related costs. Marketing and advertising efforts are expensed as incurred and for the three and nine months ended September 30, 2007 were $17,465 and $146,551, respectively, compared to $198,319 and $198,393 for the three and nine months ended September 30, 2006, respectively.

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

INTEREST EXPENSE, NET - Interest expense reflects the cost of borrowing and amortization of deferred financing costs and discounts. Interest expense for the three and nine months ended September 30, 2007 totaled $677,717 and $1,354,723, respectively, (compared to $340,965 and $1,017,044 for the three and nine months ended September 30, 2006, respectively). Interest income consists of earnings from outstanding amounts due to the Company under notes and other interest bearing receivables. For the three and nine months ended September 30, 2007 the Company recorded interest income of $30,203 and $216,635 respectively, compared to $104,465 and $264,339 for the same periods in 2006.

Cash paid for interest charges for the nine months ended September 30, 2007 and 2006 amounted to $1,019,831 and $731,327, respectively. Interest payments received during the nine months ended September 30, 2007 and 2006 totaled $170,215 and $228,800, respectively.

SHIPPING AND HANDLING COSTS

In accordance with Emerging Issues Task Force (EITF) 00-01, 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 cost 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 nine months ended September 30, 2007 and 2006 were $178,435 and $67,426, respectively ($59,383 and $49,006 for the three months ended September 30, 2007 and 2006, respectively). Total shipping and handling costs incurred as a component of cost of sales for the nine months ended September 30, 2007 and 2006 were $622,384 and $500,305, respectively ($194,145 and $161,420 for the three months ended September 30, 2007 and 2006, respectively).

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. The Chinese yuan was translated at an end-of-period exchange rate of approximately 7.5176 Chinese yuan per US dollar at September 30, 2007 (7.8175 at December 31, 2006). The Indian rupee was translated at an end-of-period exchange rate of approximately 44.12 Indian rupees per US dollar at September 30, 2007 (39.81 at December 31, 2006). 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. Included in other accumulated comprehensive income was a cumulative foreign currency translation adjustment gain of $20,365 at September 30, 2007 (none at December 31, 2006).

COMPREHENSIVE INCOME

The Company adopted Statement of Financial Standard No. 130, "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130 establishes standards for the reporting and display of comprehensive income and its components in financial statements.

Comprehensive income and its components for the three and nine months ended September 30, 2006 and 2007 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income (loss)	$(3,681,831)	$ 339,117	$(3,986,682)	$ 264,356
Other comprehensive income:				
Foreign currency translation	20,365	--	20,365	--
Total comprehensive income (loss)	$(3,661,466)	$ 339,117	$(3,966,317)	$ 264,356

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

RECLASSIFICATIONS

Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. The amortization of deferred financing costs and discounts are reported as "Interest Expense, net" on the accompanying unaudited condensed consolidated statement of operations. These items were previously reported as "General and Administrative Expenses". Current trade liabilities related to inventory receipts without invoices are reported as "Accounts payable" on the accompanying unaudited condensed consolidated balance sheets. These items were previously reported as "Other accrued expenses".

NOTE 3. INCOME (LOSS) PER SHARE

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

THREE MONTHS ENDED SEPTEMBER 30, 2007:	INCOME (LOSS)	SHARES	PER SHARE
Basic Loss per share:			
Available to common stockholders	$(3,681,831)	20,041,433	$ (0.18)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders .	$(3,681,831)	20,041,433	$ (0.18)
THREE MONTHS ENDED SEPTEMBER 30, 2006:			
Basic Income per share:			
Available to common stockholders	$ 339,117	18,440,927	$ 0.02
Effect of Dilutive Securities:			
Options	--	838,721	--
Warrants	--	--	--
Income available to common stockholders	$ 339,117	19,279,648	$ 0.02
NINE MONTHS ENDED SEPTEMBER 30, 2007:			
Basic Loss per share:			
Available to common stockholders	$(3,986,682)	19,060,664	$ (0.21)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders .	$(3,986,682)	19,060,664	$ (0.21)
NINE MONTHS ENDED SEPTEMBER 30, 2006:			
Basic Income per share:			
Available to common stockholders	$ 264,356	18,347,509	$ 0.01
Effect of Dilutive Securities:			
Options	--	372,022	--
Warrants	--	--	--
Income available to common stockholders	$ 264,356	18,719,531	$ 0.01

Warrants to purchase 3,163,813 shares of common stock exercisable at between $0.95 and $5.06 per share, and options to purchase 4,738,235 shares of common stock exercisable at between $0.37 and $5.23 per share, were outstanding for the three and nine months ended September 30, 2007. For the three and nine months ended September 30, 2007 convertible debt of $12,500,000 convertible at $3.65 per share was outstanding until July 2007 when the debt was fully repaid. Other convertible debt of $500,000 convertible at $4.50 per share was outstanding during the periods until June 27, 2007 when the debt was fully paid. Warrants issued in July 2004 to purchase 30,000 shares of common stock exercisable at $4.29 per share, were outstanding during the periods until they expired in July 2007. These shares were not included in the computation of diluted loss per share for the three or nine months ended September 30, 2007 because exercise or conversion would have an antidilutive effect on the loss per share.

For the three and nine months ended September 30, 2006 warrants to purchase 1,243,813 shares of common stock exercisable at between $3.50 and $5.06 per share, options to purchase 4,897,635 shares of common stock exercisable at between $0.37 and $5.23 per share, convertible debt of $12,500,000 convertible at $3.65 per share, and other convertible debt of $500,000 convertible at $4.50 per share were outstanding. In connection with the Share-Based Payment ("SFAS 123(R)") calculation (see note 8) 3,435,135 and 2,775,135 shares were included in the computation of diluted income per share for the three and nine months ended September 30, 2006, respectively.

NOTE 4. NOTE RECEIVABLE

At September 30, 2007 Azteca Production International, Inc. owes the Company a balance of $2,127,653 plus accrued and unpaid interest from July 1, 2007, under a Note Payable and Settlement Agreement entered into during February 2006. The note is payable in monthly installments over thirty-one months beginning March 1, 2006 with payments ranging from $133,000 - $267,000 per month until paid in full, but not 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. Azteca further expressed its belief that it would not be able to make any note payments in the foreseeable future.

Under the terms of the note, a default results in full acceleration of the balance due, and the maker is also liable for interest accruing and all costs associated with the collection of the note balance. The Company has initiated legal actions to secure all legal remedies available to it under the terms of the note, and is taking legal steps to secure all assets or collateral available to the Company under the law. The Company will pursue recovery of this note and all associated costs to the full extent of the law.

Despite the Company's legal remedies, the Company believes the likelihood of recovery is remote, given the circumstances and current financial conditions of Azteca Production International, Inc. and Diversified Apparel, LLC. Accordingly, in the quarter ended September 30, 2007, the Company recorded a reserve for impairment of note receivable to operations for an amount equal to the outstanding balance of the note as of September 30, 2007.

NOTE 5. INVENTORIES

Inventories are stated at the lower of cost, determined using the first-in, first-out ("FIFO") basis, or market value and are all categorized as finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory valuation reserves are recorded for damaged, obsolete, excess and slow-moving inventory. 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 inventory valuation allowances were $120,654 for the three and nine months ended September 30, 2007.

Inventories consist of the following:

	September 30, 2007	December 31, 2006
Finished goods ..	$ 3,900,051	$ 4,293,220
Less reserves ...	(1,190,000)	(1,242,000)
Total inventories	$ 2,710,051	$ 3,051,220

NOTE 6. FIXED ASSETS HELD FOR SALE

Fixed assets held for sale consist of the North Carolina land and manufacturing facility that was closed in connection with the Company's 2005 Restructuring Plan. The carrying value of these assets at both September 30, 2007 and December 31, 2006 is $826,904. The assets are financed with a mortgage note payable with $695,618 outstanding at September 30, 2007 and $712,950 at December 31, 2006.

Management has the authority to approve the disposal of these assets and is committed to a plan to sell the facility. The facility is available for immediate sale in its present condition and the Company has initiated and is pursuing actions to locate a buyer and list the property with commercial real estate brokers to complete the sale of the facility. The Company believes the sale of the facility is probable but has not concluded due to market and regional conditions. The Company's plan to dispose of the facility is not likely to be changed or withdrawn and the Company has no future plans to use the facility.

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 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. See Note 13, Subsequent Events.

At closing on June 27, 2007, the proceeds of the term loan ($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 are exercisable over a five-year period and 700,000 warrants are exercisable at $0.95 per share; 700,000 warrants are exercisable at $1.05 per share; and 700,000 warrants are exercisable at $1.14 per share. The relative fair value of the equity ($2,374,169, 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 will 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.

Interest expense related to the Revolving Credit and Term Loan Agreement for the three and nine months ended September 30, 2007 were $467,360 and $484,006, respectively, which includes $220,503 and $230,382 in amortization of discounts and deferred financing costs, respectively.

NOTE 8. STOCK BASED COMPENSATION

The Company accounts for stock-based awards to employees and directors in accordance with Statement of Financial Accounting Standards No. 123 revised, Share-Based Payment, ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. Options issued to consultants are accounted for in accordance with the provisions of Emerging Issues Task Force (EITF) No. 96-18, "Accounting for Equity Instruments that are Issued to Others than Employees for Acquiring, or in Conjunction with Selling, Goods or Services". There were 46,600 options granted to employees during the nine months ended September 30, 2007 (none during the three months ended September 30, 2007) at a weighted average exercise price of $1.02 per share. The estimated fair value of options granted in the nine months ended September 30, 2007 was $31,700. Common shares of 1,500,000 and warrants to acquire 2,100,000 shares of common stock were issued on June 27, 2007 to a non-employee in connection with a debt financing facility at a weighted average exercise price of $1.05 per share for the warrants and $0.001 per share for the common shares issued. The estimated total fair value of the warrants and shares of common stock granted during the three and nine months ended September 30, 2007 was $2,879,020. The relative fair value of warrants and shares of common stock issued, less financing costs, is accounted for as debt discount related to the $9.5 million term note entered into in June 2007. Assumptions used to value options granted to employees were expected volatility of 69%, expected term of 6.1 years, risk-free interest rate of approximately 5.0%, and an expected dividend yield of zero. Assumptions used to value warrants granted to non-employees were expected volatility of 78%, expected term of 5 years (contractual life), risk-free interest rate of 5.0%, and expected dividend yield of zero. In January, 2007, a consultant exercised options to acquire 75,000 shares of common stock. Cash received upon exercise was $42,750 or $0.57 per share. At the time of exercise, the total intrinsic value of the options exercised was approximately $72,000 (or $0.96 per share). Because the option exercised was a non-qualified stock option, the Company will receive a tax deduction based upon the intrinsic value amount.

As of September 30, 2007, the Company had approximately $467,000 of unamortized stock-based compensation expense related to options issued to employees and directors, which will be recognized over the weighted average period of 2.2 years. This expected expense will change if any stock options are granted or cancelled prior to the respective reporting periods or if there are any changes required to be made for estimated forfeitures.

During the three months ended September 30, 2006, the Company granted options to acquire 660,000 common shares at an exercise price of $0.69 per share. During the nine months ended September 30, 2006, the Company granted awards of stock for 225,388 shares at an average market price of $0.45 per share and granted options to acquire 3,345,135 shares at an average exercise price of $0.47 per share. Awards to acquire 1,625,000 shares were granted to employees

outside of the 1997 Plan, and awards of stock and options to acquire 165,253 shares were granted to a consultant. The estimated fair value of awards granted during the three months ended September 30, 2006 was $43,756 and the estimated fair value of all awards granted during the nine months ended September 30, 2006 was $353,024 of which $70,000 was accrued for as of December 31, 2005. Assumptions used to value options granted to employees during the nine months ended September 30, 2006 were expected volatility of 57% to 64%, expected term of 5.0 years to 6.1 years, risk-free interest rate of approximately 4.8%, and an expected dividend yield of zero. Assumptions used to value options granted to consultants were expected volatility of 65%, expected term of 10 years (contractual life), risk-free interest rate of 4.5%, and expected divided yield of zero.

The following table summarizes the activity in the Company's share based plans during the three and nine months ended September 30, 2007. At September 30, 2007 the 1997 Stock Plan expired and no further awards may be issued under this Plan.

	Number of Shares	Weighted Average Exercise Price
EMPLOYEES AND DIRECTORS		
Options and warrants outstanding - January 1, 2007	5,002,635	$ 1.41
Granted	--	--
Exercised	--	--
Cancelled	(299,500)	$ 1.03
Options and warrants outstanding - March 31, 2007	4,703,135	$ 1.44
Granted	46,600	$ 1.02
Exercised	--	--
Cancelled	(3,000)	$ 1.27
Options and warrants outstanding - June 30, 2007	4,746,735	$ 1.44
Granted	--	--
Exercised	--	--
Cancelled	(8,500)	$ 1.27
Options and warrants outstanding - September 30, 2007	4,738,235	$ 1.44
NON-EMPLOYEES		
Options and warrants outstanding - January 1, 2007	1,318,813	$ 4.13
Granted	--	--
Exercised	(75,000)	$ .57
Cancelled	(150,000)	$ 3.50
Options and warrants outstanding - March 31, 2007	1,093,813	$ 4.46
Granted	2,100,000	$ 1.05
Exercised	--	--
Cancelled	--	--
Options and warrants outstanding - June 30, 2007	3,193,813	$ 2.22
Granted	--	--
Exercised	--	--
Cancelled	(30,000)	$ 4.29
Options and warrants outstanding - September 30, 2007	3,163,813	$ 2.20

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 September 30, 2007 no awards under the 2007 Stock Plan had been granted.

NOTE 9. INCOME TAXES

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

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

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in income tax expense. For the three and nine months ended September 30, 2007 the Company recognized accrued interest for unrecognized tax benefits of approximately $4,000 and $8,000, respectively. There were no interest or penalties recognized during the three months or nine months ended September 30, 2006 for unrecognized tax benefits due to the provisions of FIN 48 not becoming effective until January 2007. At September 30, 2007 the Company had approximately $41,875 accrued in interest and penalties associated with the unrecognized tax liabilities.

NOTE 10. CONTINGENCIES AND GUARANTEES

In May, 2006, the Company received notice from the American Stock Exchange ("AMEX") that it was not in compliance with certain of the continued listing standards as set forth in the AMEX Company Guide due to the failure to comply with Section 1003(a)(i) and Section 1003(a)(ii) of the Company Guide, which effectively required that the Company maintain shareholders' equity of at least $4,000,000. Following the notice from AMEX the Company was afforded the opportunity to submit a "plan of compliance" to AMEX outlining in detail how the Company expected to achieve the minimum equity requirements and to regain compliance. On August 3, 2006 the Company received notification from AMEX that the Company's plan to regain compliance with the minimum shareholders' equity requirements of the AMEX Company Guide had been accepted and the Company has been granted an extension until November 16, 2007 to achieve the AMEX continued listing requirements.

The Company has not achieved the AMEX minimum equity requirements as of this filing and the extension period granted by AMEX has expired. Accordingly, the Company expects the AMEX to begin delisting proceedings shortly thereafter and to remove the Company's shares from trading on AMEX.

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. Our brief is currently due 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 losses, if any, related to the lawsuit cannot be reasonably predicted, and an adverse resolution of the lawsuit could potentially have a material adverse effect on the Company's financial position and results of operations.

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

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

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

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

In accordance with the bylaws of the Company, officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The term of the indemnification period is for the lifetime of the officer or director. The maximum potential amount of future payments the Company could be required to make under the indemnification provisions of its bylaws is unlimited. However, the Company has a director and officer liability insurance policy that reduces its exposure and

enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of the indemnification provisions of its bylaws is minimal and therefore, the Company has not recorded any related liabilities.

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

NOTE 11. NEW ACCOUNTING PRONOUNCEMENTS

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

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

NOTE 12. GEOGRAPHIC INFORMATION

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Product Group net Revenue:	2007	2006	2007	2006
Talon zipper ...	$ 4,280,168	$ 4,136,425	$17,471,285	$13,321,301
Trim	4,690,037	5,674,366	13,517,895	16,969,322
Tekfit	42,930	3,556,154	681,054	7,960,625
	$ 9,013,135	$13,366,945	$31,670,234	$38,251,248

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Country / Region	2007	2006	2007	2006
United States	$ 944,190	$ 1,205,357	$ 2,835,124	$ 3,143,816
Asia	7,466,034	7,206,857	26,020,853	21,940,718
Mexico	51,643	722,502	651,069	3,302,242
Dominican Republic	44,119	3,423,416	698,789	7,695,516
Other	507,149	808,813	1,464,399	2,168,956
	$ 9,013,135	$13,366,945	$31,670,234	$38,251,248

	September 30, 2007	December 31, 2006
LONG-LIVED ASSETS, NET:		
United States	$ 9,180,524	$ 9,531,659
Asia	587,937	386,516
Mexico	1,250	5,078
Dominican Republic	586,184	668,067
Net book value of long-lived assets	$10,355,895	$10,591,320

NOTE 13. SUBSEQUENT EVENTS

On November 19, 2007, the Company entered into an amendment to its Revolving Credit and Term Loan agreement with Bluefin Capital, LLC (See Note 7). The amendment includes a modification to the loan agreement that extends 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 and provides additional time to meet other non-performance related covenants. In consideration for the covenant waiver the Company agreed to (a) issue Bluefin Capital, LLC 250,000 shares of the Company's common stock; and (b) to re-price warrants for 2,100,000 shares of the Company's common stock issued on June 27, 2007 in connection with the loan agreement from a weighted average exercise price of $1.05 to $0.75 per share. In the event the Company completes an equity offering prior to June 30, 2008, Bluefin Capital agreed to accept 25% of the net proceeds of the equity offering as a prepayment on the term note, in lieu of a prepayment of 50% as provided for under the loan agreement, and to further extend until March 31, 2009 the application of the EBITDA covenant. In consideration for these changes the Company agreed, if it completes an equity offering, to issue Bluefin Capital an additional 500,000 shares of the Company's common stock, and to re-price their warrants to the price of warrants issued in the offering, if lower.

Under the provisions of Statement of Financial Accounting Standard, No. 123(R), the fair value of the common stock issued in exchange for this modification, together with the difference in the fair value of the warrants measured at the date of the re-pricing and the fair value of the warrants before the re-pricing, is recognized as an expense in the period the shares are issued and the price of the warrants is changed. Accordingly, the Company estimates the loan modification will result in a charge to earnings during the fourth quarter of 2007 of approximately $212,000 for the fair value of the equity components, plus approximately $110,000 in legal and other associated costs, for a total estimated charge of $322,000.

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

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

OVERVIEW

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

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

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

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

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

Our Tekfit services provide manufacturers with the patented technology, manufacturing know-how and materials required to produce garments incorporating an expandable waistband. These products historically have been produced by several manufacturers for one single brand under an exclusive supply contract. This contract expired in October 2006 and we now intend to expand this product to other brands. Our expansion has been limited to date due to the exclusive contract as well as licensing dispute. As described more fully in this report under Contingencies and Guarantees (see Note 10 to our unaudited condensed consolidated financial statements), we are presently in litigation with Pro-Fit Holdings Limited regarding our exclusively licensed rights to sell or sublicense stretch waistbands manufactured under Pro-Fit's patented technology. As we have derived a significant amount of revenue from the sale of products incorporating the stretch waistband technology, our business, results of operations and financial condition could be materially adversely affected if our dispute with Pro-Fit is not resolved in a manner favorable to us.

Under the terms of our credit agreement we are required to meet certain cash flow and coverage ratios. The financial covenant requires us to maintain at the end of each fiscal quarter "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. For the period ended September 30, 2007 we believed that this EBITDA covenant was satisfied, but also informed the lender that we may fail to satisfy the EBITDA covenant for the quarters ending December 31, 2007 or March 31, 2008. We requested the lender to amend the loan agreement to allow for additional time to satisfy the covenant. On November 19, 2007 we 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 shares of our common stock and a price adjustment to the lender's outstanding warrants. See Note 13, Subsequent Events.

RESULTS OF OPERATIONS

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2007	2006	2007	2006
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	72.0	69.0	70.8	70.9
Gross profit	28.0	31.0	29.2	29.1
Selling expenses	8.0	6.8	6.8	5.6
General and administrative expenses	30.3	19.5	24.5	20.7
Impairment of note receivable	23.6	--	6.7	--
Interest & taxes	7.0	2.2	3.8	2.1
Net income (loss)	(40.9)%	2.5%	(12.6)%	0.7%

SALES

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
REGION	2007	2006	2007	2006
United States	10.5%	9.0%	9.0%	8.2%

Asia	82.8%	53.9%	82.1%	57.4%
Mexico	0.6%	5.4%	2.1%	8.6%
Dominican Republic	0.5%	25.6%	2.2%	20.1%
Other	5.6%	6.1%	4.6%	5.7%
	100.0%	100.0%	100.0%	100.0%

Sales for the nine months ended September 30, 2007 were $31.7 million or $6.6 million (17.2%) less than sales for the same period in 2006. The reduction in sales for the nine months ended September 30, 2007 as compared to the same period in 2006 is the net result of an increase of $4.1 million (31.2%) in our Talon zipper sales as we expand our operations throughout China and southeast Asia, offset by lower sales of waistband products as a result of the expiration in October of 2006 of our exclusive contract for these products ($7.2

million); reduced operations in Mexico as production shifted from this area to Asia and we closed our operations in 2005 and 2006 ($2.0 million); as a result of sales ($0.7 million) recognized in the second quarter of 2006 associated with a revenue restatement from a 2005 agreement; and lower trim sales due to fewer and smaller programs with our customers ($0.8 million).

Sales for the three months ended September 30, 2007 were $9.0 million or $4.4 million (32.6%) less than sales for the three months ended September 30, 2006. The reduction in sales for the three months ended September 30, 2007 as compared to the same period in 2006 is principally the result of lower sales of waistband products from the expiration of our exclusive contract for these products ($3.5 million); a result of sales ($0.7 million) from Mexico in 2006 and our closure of the Mexican operations; and lower trim sales due to fewer and smaller programs with our customers ($0.3 million); offset by an increase in Talon zipper sales ($0.1 million). Talon zipper sales for the three months ended September 30, 2007 were partially impacted by the acceleration of zipper deliveries into the second quarter of 2007 as manufacturers worked to avoid additional VAT taxes in China effective July 31, 2007, and by expiring Chinese export quotas limiting the exportation of products manufactured in China for our customers. Talon zipper sales for the balance of 2007 will continue to be impacted by limited export quotas until 2008, and our continued expansion throughout Southeast Asia into Thailand, Vietnam and Indonesia is intended to partially offset these restrictions.

GROSS MARGIN

Gross margin for the three months ended September 30, 2007 was $2.5 million, as compared to $4.1 million for the same period in 2006. Gross margin for the nine months ended September 30, 2007 was $9.2 million as compared to $11.1 million for the same period in 2006. The reduction in gross margin for the three and nine months ended September 30, 2007 as compared to the same periods in 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.

A brief recap of the change in gross margin for the three and nine months ended September 30, 2007 as compared with the same periods in 2006 is as follows:

	(Amounts in thousands)			
	Three Months Ended September 30,		Nine Months En September 30	
	Amount	%(1)	Amount	%
Gross margin (decrease) increase as a result of:				
Lower volumes	$ (1,614)	(38.9)	$ (2,343)	
Product margin mix	(265)	(6.4)	(756)	
Reduced freight and duty costs	163	3.9	480	
Lower manufacturing & assembly costs	118	2.8	248	
Reduced obsolescence & inventory costs	6	.2	646	
Other cost of sales charges	(30)	(.7)	(145)	
Gross margin (decrease)	$ (1,622)	(39.1)	$ (1,870)	

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

SELLING EXPENSES

Selling expenses for the three months ended September 30, 2007 were $0.7 million, or 8.0% of sales compared to $0.9 million or 6.8% of sales for the same period in 2006. The change in selling expense is principally due to reduced spending for marketing programs, lower sales commissions on the lower volumes and lower royalty fees on Tekfit sales ($0.3 million), partially offset by increased salaries, facilities and other costs associated with new employees and offices within Asia ($0.1 million).

Selling expenses for the nine months ended September 30, 2007 were $2.2 million or 6.8% of sales compared to $2.1 million or 5.6% of sales for the same period in 2006. The increase in selling expense is principally due to the increased number of sales offices and employees within China and their associated compensation, facilities travel and administrative costs ($0.4 million) offset by lower marketing costs, lower royalty fees on waistband products, and reduced commissions on lower volumes ($0.3 million).

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the three months ended September 30, 2007 were $2.7 million or $0.1 million more than $2.6 million for the comparable period in 2006. General and administrative expenses for the nine months ended September 30, 2007 were $7.7 million or $0.2 million less than $7.9 million for the comparable period in 2006.

General and administrative expense for the three month period ended September 30, 2007 increased by approximately $0.2 million from increased employee costs and by $0.3 million as a result of $0.2 million in bad debt provisions in 2007 compared to bad debt recoveries of $0.1 million in 2006. General and administrative expenses decreased by approximately $0.3 million as a result of reduced legal and professional fees, lower facility costs and other lower overall general and administrative expenses.

For the nine months ended September 30, 2007 general and administrative expenses increased by approximately $0.1 million from increased employee costs and 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. Reduced legal and professional fees ($0.6 million) and lower facility and other overall general and administrative expenses ($0.6 million) offset the cost increases and resulted in the net reduction of costs.

IMPAIRMENT OF NOTE RECEIVABLE

Operating expenses for the three and nine months ended September 30, 2007 include $2.1 million in bad debt reserve provisions associated with the note receivable due the Company from Azteca Production International, Inc. See Note 4 of the unaudited condensed consolidated financial statements.

INTEREST EXPENSE AND INTEREST INCOME

Interest expense for the three months ended September 30, 2007 increased $337,000 from the same period in 2006. Interest expense for the nine months ended September 30, 2007 increased $338,000 from the same period in 2006. The increase for the quarter and nine months ended September 30, 2007 over the same periods in 2006 was principally as a result of increased amortization of deferred financing costs and discounts, and higher interest costs on the revolving credit and term notes as compared to the 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 three months and nine months ended September 30, 2007 decreased from the same period in 2006, primarily related to the note receivable discussed in Note 4 to the unaudited condensed consolidated financial statements.

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2007	2006	2007	2006
Interest expense	$ 345,045	$ 263,206	$ 858,458	$ 784,0
Amortization of deferred financing costs & debt discounts	332,672	77,759	496,265	233,0
Interest expense	677,717	340,965	1,354,723	1,017,0
Interest income	(30,203)	(104,465)	(216,635)	(264,3
Interest expense, net	$ 647,514	$ 236,500	$ 1,138,088	$ 752,7

INCOME TAXES

Income tax provisions for the three and nine months ended September 30 2007 reflected a tax benefit of $20,972 and a tax expense of $57,652, respectively. For the three and nine months ended September 30, 2006, income tax expense was $54,857 and $66,357, respectively. The tax expense in both 2007 and 2006 is associated with foreign income taxes from earnings of our Asian facilities. Due to prior operating losses incurred within the year no benefit for domestic income taxes has been recorded since there is not sufficient evidence to determine that we will be able to utilize our net operating loss carry-forwards to offset future taxable income.

LIQUIDITY AND CAPITAL RESOURCES

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

	SEPTEMBER 30, 2007	DECEMBER 31, 2006
Cash and cash equivalents	$ 2,319	$ 2,935
Total assets	$ 21,030	$ 25,693
Current debt	$ 8,599	$ 22,471
Non-current debt	$ 12,354	$ 1,536
Stockholders' equity	$ 78	$ 1,686

CASH AND CASH EQUIVALENTS

Cash provided by operating activities is our primary recurring source of funds, and was approximately $1.3 million for the nine months ended September 30, 2007. The cash provided by operating activities during the nine months resulted principally from a net loss before non-cash charges of $148,000; collections on the note receivable of $672,000; an decrease in operating capital (accounts receivable, inventories, accounts payable and other accrued expenses) of $1,098,000; and other increases in operating assets and liabilities of $299,000.

Net cash used in investing activities for the nine months ended September 30, 2007 was $585,000 as compared to $323,000 for the nine months ended September 30, 2006. These expenditures were principally associated with leasehold improvements in new facilities, office equipment for new employees, improvements in our technology systems and a marketing website acquisition. In 2006 the cash used for investing activities consisted primarily of capital expenditures for replacing computer equipment.

Net cash of $1,356,000 was used in financing activities for the nine months ended September 30, 2007. $13,507,000 (net of issuance costs) was provided by the issuance of common stock and warrants, and by borrowings under a new debt facility (see Note 7) designated to pay off our existing convertible

promissory notes and to provide funds for future growth. The proceeds from this debt facility were used to pay the $12,500,000 of secured convertible promissory notes, and $1,004,000 was used to pay a related party note ($580,000) and associated accrued interest. Approximately $1,284,000 was used primarily for the repayment of borrowings under capital leases and notes payable and during the quarter ended September 30, 2007 $500,000 in initial borrowings under the revolving note were repaid.

Our Revolving Credit and Term Loan Agreement with Bluefin Capital, LLC requires us to maintain at the end of each fiscal quarter, "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. For the period ended September 30, 2007 we believe that this EBITDA covenant was satisfied.

We have also informed our lender that we may not satisfy the EBITDA covenant for the quarters ending December 31, 2007 or March 31, 2008, and accordingly we requested our lender to amend the loan agreement to allow for additional time to satisfy the covenant. On November 19, 2007 we 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 shares of our common stock and a price adjustment to the lender's outstanding warrants. See Note 13, Subsequent Events.

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, and 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.

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

The extent of our future long-term capital requirements will depend on many factors, including our results of operations, future demand for our products, the size and timing of future acquisitions, our borrowing base availability limitations related to eligible accounts receivable and inventories and our expansion into foreign markets. Our need for additional long-term financing includes the integration and expansion of our operations to exploit our rights under our Talon trade name, the expansion of our operations in the Asian, Central and South American and Caribbean markets and the further development of our waistband technology. If our cash from operations is less than anticipated or our working capital requirements and capital expenditures are greater than we expect, we may need to raise additional debt or equity financing in order to provide for our operations. We are continually evaluating various financing strategies to be used to expand our business and fund future growth or acquisitions. There can be no assurance that additional debt or equity

financing will be available on acceptable terms or at all. If we are unable to secure additional financing, we may not be able to execute our plans for expansion, including expansion into foreign markets to promote our Talon brand trade name, and we may need to implement additional cost savings initiatives.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

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

	PAYMENTS DUE BY PERIOD				
CONTRACTUAL OBLIGATIONS	TOTAL	LESS THAN 1 YEAR	1 TO 3 YEARS	4 TO 5 YEARS	AFTE 5 YEA
Demand notes payable to related parties (1)	$ 211,300	$ 211,300	--	--	
Capital lease obligations	$ 694,900	$ 419,000	$ 275,900	--	
Operating leases	$ 1,331,800	$ 574,600	$ 753,300	$ 3,900	
Revolving Credit & Term notes .	$16,601,800	$ 1,197,800	$15,404,000	--	
Other Notes payable	$ 1,511,200	$ 461,000	$ 1,050,200	--	
Total Obligations	$20,351,000	$ 2,863,700	$17,483,400	$ 3,900	

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

At September 30, 2007 and 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

RELATED PARTY TRANSACTIONS

Todd Kay, a director and significant shareholder of Tarrant Apparel

Group is also a stockholder of the Company. Sales to Tarrant for the three months and nine months ended September 30, 2007 were $1,800, and $141,800, respectively. Sales to Tarrant for the three and nine months ended September 30, 2006 were $300 and $1,300 respectively. As of September 30, 2007 and at December 31, 2006 there were no amounts due from Tarrant.

Colin Dyne, a director and stockholder of the Company is also a director, officer and significant stockholder in People's Liberation, Inc. During the three and nine months ended September 30, 2007 we had sales of $115,500 and $323,000, respectively, to subsidiaries of People's Liberation, Inc. For the three and nine months ended September 30, 2006 we had sales of $22,100 and $55,100, respectively, to subsidiaries of Peoples Liberation, Inc. At September 30, 2007, accounts receivable included $94,800 outstanding from People's Liberation subsidiaries. At December 31, 2006, accounts receivable of $83,400 was outstanding from subsidiaries of People's Liberation, Inc.

Jonathan Burstein, a former director of the Company, purchases products from the Company through an entity operated by his spouse. For the three and nine months ended September 30, 2007 sales to this entity were $24,800 and $58,500, respectively. Sales to this entity for the three and nine months ended

September 30, 2006 were $10,500 and $21,100, respectively. At September 30, 2007, $7,700 was included in accounts receivable from this entity and at December 31, 2006 accounts receivable included $18,400 due from this entity. On October 25, 2007, Mr. Burstein resigned as a director of the Company.

Due from related parties at September 30, 2007 includes $736,600 and at December 31, 2006 includes $675,100 of unsecured notes, advances and accrued interest receivable from Colin Dyne. The notes and advances bear interest at 7.5% and are due on demand.

Demand notes payable to related parties includes notes and advances to parties related to or affiliated with Mark Dyne, Chairman of the Board of the Company. The principal balance of Demand notes payable to related parties at September 30, 2007 was $85,200 and at December 31, 2006 was $665,000. On June 27, 2007 a note payable to Mark Dyne in the principal amount of $579,795, plus accrued interest of $424,511, was paid in full.

Consulting fees paid to Diversified Investments, a company owned by Mark Dyne, amounted to $37,500 for the three months ended September 30, 2007 and 2006. Consulting fees paid for the nine months ended September 30, 2007 and 2006 were $112,500.

Consulting fees of $75,000 and $ 200,100 were paid for services provided by Colin Dyne for the three months and nine months ended September 30, 2007, respectively. For the three and nine months ended September 30, 2006 consulting fees of $36,000 and $108,000, respectively were paid to Colin Dyne. Consulting fees of $73,800 and $221,000 were paid for services provided by Jonathan Burstein, for the three months and nine months ended September 30, 2007, respectively. No consulting fees were paid to Jonathan Burstein in 2006.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

- Inventories are stated at the lower of cost, 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. Inventory is evaluated on a continual basis and reserve adjustments are made based on management's estimate of future sales value, if any, of specific inventory items. Inventory reserves are recorded for damaged, obsolete, excess and slow-moving inventory. We use estimates to record these reserves. Slow-moving inventory is reviewed by category and may be

partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this type of inventory.

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

o We record impairment charges when the carrying amounts of long-lived assets are determined not to be recoverable. Impairment is measured by assessing the usefulness of an asset or by comparing the carrying value of an asset to its fair value. Fair value is typically determined using quoted market prices, if available, or an estimate of undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. The amount of impairment loss is calculated as the excess of the carrying value over the fair value. Changes in market conditions and management strategy have historically caused us to reassess the carrying amount of our long-lived assets. Long-lived assets are evaluated on a continual basis and impairment adjustments are made based upon management's valuations.

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, record changes based on updated estimates.

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 Contingencies." We accrue estimates of the probable and estimable losses for the resolution of these claims. The ultimate resolution of these claims could affect our future results of operations for any particular quarterly or annual period should our exposure be materially different from our earlier estimates or should liabilities be incurred that were not previously accrued.

NEW ACCOUNTING PRONOUNCEMENTS

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

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

CAUTIONARY STATEMENTS AND RISK FACTORS

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

WE DO NOT EXPECT TO REGAIN COMPLIANCE WITH AMEX LISTING REQUIREMENTS, AND WE EXPECT TO BE DELISTED BY THE AMEX AND THAT OUR SHARES WILL NO LONGER BE TRADED ON THIS EXCHANGE. In May 2006 we were advised by AMEX that we were non-compliant with the minimum net equity listing requirements and we were afforded an opportunity to submit a plan to AMEX that provided for increases in our equity beyond the minimum $4.0 million equity requirement within an eighteen-month timeframe from the date of the notice from AMEX. On August 3, 2006 AMEX accepted our plan to regain compliance and has given us an extension until November 16, 2007 to become compliant with the AMEX continued listing standards. We have suffered substantial operating losses and as of this filing we have not met the minimum listing requirements of AMEX. As a result, our shares of common stock may be removed from listing on AMEX.

WE DO NOT EXPECT TO BE ABLE TO COLLECT OUR NOTE RECEIVABLE. On April 11, 2007 a favorable verdict was awarded to the plaintiff in a trademark infringement lawsuit in which Azteca Production International, Inc. is a defendant. We have an outstanding note from Azteca of $2.1 million and this adverse ruling against them has impacted their ability to repay our note receivable. On September 10, 2007 we obtained further information from the maker that further evidenced their inability to pay the note, and accordingly we recorded an impairment reserve for the full value outstanding of $2.1 million. We will continue to pursue collection through all legal resources available to us. The failure to collect payments under this note as scheduled will have a material adverse effect on our financial position, results of operations and cash flow.

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

IF WE LOSE OUR LARGER CUSTOMERS OR THEY FAIL TO PURCHASE AT ANTICIPATED LEVELS, OUR SALES AND OPERATING RESULTS WILL BE ADVERSELY AFFECTED. Our results of operations will depend to a significant extent upon the commercial success of our larger customers. If these customers fail to purchase our products at anticipated levels, or our relationship with these customers terminates, it may have an adverse effect on our results because:

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

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

IF CUSTOMERS DEFAULT ON INVENTORY PURCHASE COMMITMENTS WITH US, WE WILL BE LEFT HOLDING NON-SALABLE INVENTORY. We hold significant inventories for specific customer programs, which the customers have committed to purchase. If any customer defaults on these commitments, or insists on markdowns, we may incur a charge in connection with our holding significant amounts of non-salable inventory and this would have a negative impact on our operations and cash flow.

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

BECAUSE WE DEPEND ON A LIMITED NUMBER OF SUPPLIERS, WE MAY NOT BE ABLE TO ALWAYS OBTAIN MATERIALS WHEN WE NEED THEM AND WE MAY LOSE SALES AND CUSTOMERS. Lead times for materials we order can vary significantly and depend on many factors, including the specific supplier, the contract terms and the

demand for particular materials at a given time. From time to time, we may experience fluctuations in the prices, and disruptions in the supply, of materials. Shortages or disruptions in the supply of materials, or our inability to procure materials from alternate sources at acceptable prices in a timely manner, could lead us to miss deadlines for orders and lose sales and customers.

WE OPERATE IN AN INDUSTRY THAT IS SUBJECT TO SIGNIFICANT FLUCTUATIONS IN OPERATING RESULTS THAT MAY RESULT IN UNEXPECTED REDUCTIONS IN REVENUE AND STOCK PRICE VOLATILITY. We operate in an industry that is subject to significant fluctuations in operating results from quarter to quarter, which may lead to unexpected reductions in revenues and stock price volatility. Factors that may influence our quarterly operating results include:

- The volume and timing of customer orders received during the quarter;
- The timing and magnitude of customers' marketing campaigns;

- The loss or addition of a major customer;
- The availability and pricing of materials for our products;
- The increased expenses incurred in connection with the introduction of new products;
- Currency fluctuations;
- Delays caused by third parties; and
- Changes in our product mix or in the relative contribution to sales of our subsidiaries.

Due to these factors, it is possible that in some quarters our operating results may be below our stockholders' expectations and those of public market analysts. If this occurs, the price of our common stock could be adversely affected. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such a company. In October 2005, a securities class action lawsuit was filed against us. See Part II, Item 1, "Legal Proceedings" for a detailed description of this lawsuit.

THE OUTCOME OF LITIGATION IN WHICH WE HAVE BEEN NAMED AS A DEFENDANT IS UNPREDICTABLE AND AN ADVERSE DECISION IN ANY SUCH MATTER COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR FINANCIAL POSITION AND RESULTS OF OPERATIONS. We are defendants in a number of litigation matters. These claims may divert financial and management resources that would otherwise be used to benefit our operations. Although we believe that we have meritorious defenses to the claims made in each and all of the litigation matters to which we have been named a party, and intend to contest each lawsuit vigorously, no assurances can be given that the results of these matters will be favorable to us. An adverse resolution of any of these lawsuits could have a material adverse effect on our financial position and results of operations.

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

OUR CUSTOMERS HAVE CYCLICAL BUYING PATTERNS WHICH MAY CAUSE US TO HAVE PERIODS OF LOW SALES VOLUME. Most of our customers are in the apparel industry. The apparel industry historically has been subject to substantial cyclical variations. Our business has experienced, and we expect our business to continue to experience, significant cyclical fluctuations due, in part, to customer buying patterns, which may result in periods of low sales usually in the first and fourth quarters of our financial year.

OUR BUSINESS MODEL IS DEPENDENT ON INTEGRATION OF INFORMATION SYSTEMS ON A GLOBAL BASIS AND, TO THE EXTENT THAT WE FAIL TO MAINTAIN AND SUPPORT OUR INFORMATION SYSTEMS, IT CAN RESULT IN LOST REVENUES. We must consolidate and centralize the management of our subsidiaries and significantly expand and improve our financial and operating controls. Additionally, we must effectively integrate the information systems of our worldwide operations with the information systems of our principal offices in California. Our failure to do so could result in lost revenues, delay financial reporting or adverse effects on the information reported.

THE LOSS OF KEY MANAGEMENT AND SALES PERSONNEL COULD ADVERSELY AFFECT OUR BUSINESS, INCLUDING OUR ABILITY TO OBTAIN AND SECURE ACCOUNTS AND GENERATE SALES. Our success has and will continue to depend to a significant extent upon key management and sales personnel, many of whom would be difficult to replace. The loss of the services of key employees could have a material adverse effect on our business, including our ability to establish and maintain client relationships. Our future success will depend in large part upon our ability to attract and retain personnel with a variety of sales, operating and managerial skills.

IF WE EXPERIENCE DISRUPTIONS AT ANY OF OUR FOREIGN FACILITIES, WE WILL NOT BE ABLE TO MEET OUR OBLIGATIONS AND MAY LOSE SALES AND CUSTOMERS. Currently, we do not operate duplicate facilities in different geographic areas. Therefore, in the event of a regional disruption where we maintain one or more of our facilities, it is unlikely that we could shift our operations to a different geographic region and we may have to cease or curtail our operations. This may cause us to lose sales and customers. The types of disruptions that may occur include:

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

INTERNET-BASED SYSTEMS THAT WE RELY UPON FOR OUR ORDER TRACKING AND MANAGEMENT SYSTEMS MAY EXPERIENCE DISRUPTIONS AND AS A RESULT WE MAY LOSE REVENUES AND CUSTOMERS. To the extent that we fail to adequately update and maintain the hardware and software implementing our integrated systems, our customers may be delayed or interrupted due to defects in our hardware or our source code. In addition, since our software is Internet-based, interruptions in Internet service generally can negatively impact our ability to use our systems to monitor and manage various aspects of our customer's trim needs. Such defects or interruptions could result in lost revenues and lost customers.

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

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

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

IF OUR PRODUCTS INFRINGE ANY OTHER PERSON'S PROPRIETARY RIGHTS, WE MAY BE SUED AND HAVE TO PAY LEGAL EXPENSES AND JUDGMENTS AND REDESIGN OR DISCONTINUE SELLING OUR PRODUCTS. From time to time in our industry, third parties allege infringement of their proprietary rights. Any infringement claims, whether or not meritorious, could result in costly litigation or require us to enter into royalty or licensing agreements as a means of settlement. If we are found to have infringed the proprietary rights of others, we could be required to pay damages, cease sales of the infringing products and redesign the products or discontinue their sale. Any of these outcomes, individually or collectively, could have a material adverse effect on our operating results and financial condition.

COUNTERFEIT PRODUCTS ARE NOT UNCOMMON IN THE APPAREL INDUSTRY AND OUR CUSTOMERS MAY MAKE CLAIMS AGAINST US FOR PRODUCTS WE HAVE NOT PRODUCED AND WE MAY BE ADVERSELY IMPACTED BY THESE FALSE CLAIMS. Counterfeiting of valuable trade names is commonplace in the apparel industry and while there are industry organizations and federal laws designed to protect the brand owner, these counterfeit products are not always detected and it can be difficult to prove the manufacturing source of these products. Accordingly, we may be adversely affected if counterfeit products damage our relationships with customers, and we incur costs to prove these products are counterfeit, to defend ourselves against false claims, or we may have to pay for false claims.

OUR STOCK PRICE MAY DECREASE, WHICH COULD ADVERSELY AFFECT OUR BUSINESS AND CAUSE OUR STOCKHOLDERS TO SUFFER SIGNIFICANT LOSSES. The following factors could cause the market price of our common stock to decrease, perhaps substantially:

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

IF WE NEED TO SELL OR ISSUE ADDITIONAL SHARES OF COMMON STOCK OR INCUR ADDITIONAL DEBT TO FINANCE FUTURE GROWTH, OUR STOCKHOLDERS' OWNERSHIP COULD BE DILUTED OR OUR EARNINGS COULD BE ADVERSELY IMPACTED. Our business strategy may include expansion through internal growth, by acquiring complementary businesses

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

WE MAY NOT BE ABLE TO REALIZE THE ANTICIPATED BENEFITS OF ACQUISITIONS. We may consider strategic acquisitions as opportunities arise, subject to the obtaining of any necessary financing. Acquisitions involve numerous risks, including diversion of our management's attention away from our operating activities. We cannot assure you that we will not encounter unanticipated problems or liabilities relating to the integration of an acquired company's operations, nor can we assure you that we will realize the anticipated benefits of any future acquisitions.

OUR ACTUAL TAX LIABILITIES MAY DIFFER FROM ESTIMATED TAX RESULTING IN UNFAVORABLE ADJUSTMENTS TO OUR FUTURE RESULTS. The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities. Our estimate of the potential outcome of uncertain tax issues is subject to our assessment of relevant risks, facts, and circumstances existing at that time. Our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, which may impact our effective tax rate and our financial results.

WE HAVE ADOPTED A NUMBER OF ANTI-TAKEOVER MEASURES THAT MAY DEPRESS THE PRICE OF OUR COMMON STOCK. Our stockholders' rights plan, our ability to issue additional shares of preferred stock and some provisions of our certificate of incorporation and bylaws and of Delaware law could make it more difficult for a third party to make an unsolicited takeover attempt of us. These anti-takeover measures may depress the price of our common stock by making it more difficult for third parties to acquire us by offering to purchase shares of our stock at a premium to its market price.

INSIDERS OWN A SIGNIFICANT PORTION OF OUR COMMON STOCK, WHICH COULD LIMIT OUR STOCKHOLDERS' ABILITY TO INFLUENCE THE OUTCOME OF KEY TRANSACTIONS. As of September 30, 2007, our officers and directors and their affiliates beneficially owned approximately 20% of the outstanding shares of our common stock. The Dyne family, which includes Mark Dyne and Colin Dyne who are also our directors; Jonathan Burstein, Larry Dyne and the estate of Harold Dyne; beneficially owned approximately 13% of the outstanding shares of our common stock at September 30, 2007. Additionally, at September 30, 2007 our lender Bluefin Capital, LLC beneficially owned approximately 16.3% 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

All of our sales are denominated in United States dollars or the currency of the country in which our products originate. We are exposed to market risk for fluctuations in the foreign currency exchange rates for certain product purchases that are denominated in Hong Kong dollars, Chinese yuans and British pounds. There were no hedging contracts outstanding as of September 30, 2007 or December 31, 2006. Currency fluctuations can increase the price of our products to foreign customers which can adversely impact the level of our export sales from time to time. The majority of our cash equivalents are held in United States dollars in various bank accounts and we do not believe we have significant market risk exposure with regard to our investments. At September 30, 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.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF CONTROLS AND PROCEDURES

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

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

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the fiscal quarter ended September 30, 2007 there were no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 12, 2005, a shareholder class action complaint -- HUBERMAN V.TAG-IT PACIFIC, INC., ET AL., Case No. CV05-7352 R(Ex) -- was filed against us and certain of our current and former officers and directors in the United States District Court for the Central District of California, alleging claims under Section 10(b) and Section 20 of the Securities Exchange Act of 1934. A lead plaintiff was appointed, and his amended complaint alleged that defendants made false and misleading statements about our financial situation and our relationship with certain of our large customers. The action was brought on behalf of all purchasers of our publicly-traded securities during the period from November 13, 2003 to August 12, 2005. On February 20, 2007, the Court denied class certification. 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 is currently due 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 Court has not yet set a date for trial of this matter. We have historically derived a significant amount of revenue from the sale of products incorporating the stretch waistband technology and our business, results of operations and financial condition could be materially adversely affected if the dispute with Pro-Fit is not resolved in a manner favorable to us. Additionally, we have incurred significant legal fees in this litigation, and unless the case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

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

ITEM 1A. RISK FACTORS

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

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

On July 31, 2007, we held our 2007 annual meeting of stockholders. For the results of voting at the 2007 annual meeting of stockholders, see Item 8.01 of our Current Report on Form 8-K filed with the Securities and Exchange Commission on August 3, 2007.

ITEM 6. EXHIBITS

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

3.1.2 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 on 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.

31.1 Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.

31.2 Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.

32.1 Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) under the Securities and Exchange Act of 1934, as amended.

SIGNATURES

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

Dated: November 19, 2007

TALON INTERNATIONAL, INC.

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/S/ LONNIE D. SCHNELL

By: Lonnie D. Schnell
Its: Chief Financial Officer