TALON INTERNATIONAL, INC.
Form 10-Q
May 13, 2010

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 March 31, 2010.

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

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

Large accelerated filer [ ]	Accelerated filer [ ]	Non-accelerated filer [ ]	Smaller reporting company [X]

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

At May 13, 2010 the issuer had 20,291,433 shares of Common Stock, $.001 par value, issued and outstanding.

TALON INTERNATIONAL, INC.

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TALON INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

	March 31, 2010 (Unaudited)	December 31, 2009
Assets		
Current Assets:		
Cash and cash equivalents	$1,757,772	$2,264,606
Accounts receivable, net	3,501,645	3,021,642
Inventories, net	1,549,533	1,679,302
Prepaid expenses and other current assets	115,061	240,554
Total current assets	6,924,011	7,206,104
Property and equipment, net	2,066,825	2,280,586
Intangible assets, net	4,110,751	4,110,751
Other assets	282,824	236,386
Total assets	$13,384,411	$13,833,827
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$6,392,357	$6,337,368
Accrued expenses	2,632,518	2,678,659
Revolver note payable	4,988,988	4,988,988
Term notes payable, net of discounts	10,288,595	9,876,114
Notes payable to related parties	268,195	265,871
Current portion of long term obligations	93,968	115,336
Total current liabilities	24,664,621	24,262,336
Capital lease obligations, net of current portion	22,036	23,477
Other liabilities	689,565	726,875
Total liabilities	25,376,222	25,012,688
Commitments and contingencies (Note 11)		
Stockholders' Deficit:		
Preferred stock Series A, $0.001 par value; 250,000 shares authorized; no shares issued or outstanding	-	-
Common stock, $0.001 par value, 100,000,000 shares authorized; 20,291,433 shares issued and outstanding at March 31, 2010 and December 31, 2009	20,291	20,291
Additional paid-in capital	55,115,597	55,070,568
Accumulated deficit	(67,191,652)	(66,344,009)
Accumulated other comprehensive income	63,953	74,289
Total stockholders' deficit	(11,991,811)	(11,178,861)

Total liabilities and stockholders' deficit	$13,384,411	$13,833,827

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2010	2009
Net sales	$8,235,260	$6,515,754
Cost of goods sold	5,798,567	4,531,587
Gross profit	2,436,693	1,984,167
Sales and marketing expenses	656,822	701,814
General and administrative expenses	1,955,573	1,817,523
Total operating expenses	2,612,395	2,519,337
Loss from operations	(175,702)	(535,170)
Interest expense, net	707,197	636,951
Net loss before provision for (benefit from) income taxes	(882,899)	(1,172,121)
Provision for (benefit from) income taxes	(35,256)	6,407
Net loss	$(847,643)	$(1,178,528)
Basic and diluted net loss per share	$(0.04)	$(0.06)
Weighted average number of common shares outstanding - Basic and diluted	20,291,433	20,291,433

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2010	2009
Cash flows from operating activities:		
Net loss	$(847,643)	$(1,178,528)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	213,903	169,107
Amortization of deferred financing cost and debt discounts	412,481	342,101
Stock based compensation	45,029	40,826
Bad debt expense (recoveries)	(17,443)	4,670
Additions to inventory valuation reserves	35,155	-
Changes in operating assets and liabilities:		
Accounts receivables, including related parties	(461,914)	26,374
Inventories	94,614	(350,431)
Prepaid expenses and other current assets	125,494	(170,120)
Other assets.	(46,230)	25,679
Accounts payable and accrued expenses	11,205	269,353
Other liabilities	(37,310)	-
Net cash used in operating activities	(472,659)	(820,969)
Cash flows from investing activities:		
Proceeds from sale of equipment	-	646
Acquisition of property and equipment	-	(314,416)
Net cash used in investing activities	-	(313,770)
Cash flows from financing activities:		
Payment of notes payable	-	(73,027)
Payment of capital leases	(23,439)	(70,555)
Net cash used in financing activities	(23,439)	(143,582)
Net effect of foreign currency exchange translation on cash	(10,736)	1,631
Net reduction in cash and cash equivalents	(506,834)	(1,276,690)
Cash and cash equivalents at beginning of period	2,264,606	2,399,717
Cash and cash equivalents at end of period	$1,757,772	$1,123,027

See accompanying notes to consolidated financial statements.

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TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Supplemental disclosures of cash flow information:

	Three Months Ended March 31, 2010	2009
Cash received (paid) during the period for:		
Interest paid	$(196,016)	$(273,367)
Interest received	$9,384	$268
Income tax paid	$(2,460)	$(17,491)
Non-cash financing activities:		
Interest accrued on notes payable	$2,954	$-
Effect of foreign currency translation on net assets	$(10,336)	$(3,085)
Capital lease obligation	$-	$10,494

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Presentation of Interim Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying unaudited consolidated financial statements reflect all adjustments that, in the opinion of the management of Talon International, Inc. and its consolidated subsidiaries (collectively, the "Company"), are considered necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of the Company included in the Company's Form 10-K for the year ended December 31, 2009. The balance sheet as of December 31, 2009 has been derived from the audited financial statements as of that date but omits certain information and footnotes required for complete financial statements.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has experienced substantial recurring losses from operations and has an accumulated deficit of $67.2 million as of March 31, 2010 and a working capital deficit of $17.7 million as of March 31, 2010. These matters, among others, raise substantial doubt about the Company's ability to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to generate sufficient cash flow to meet its obligations on a timely basis; to obtain additional financing as will be required by June 30, 2010, and ultimately to attain profitable operations. See Note 3 "Significant Risks and Uncertainties".

Note 2. Summary of Significant Accounting Policies

A complete description of the Company's Significant Accounting Policies is included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and should be read in conjunction with these unaudited consolidated financial statements. The Significant Accounting Policies noted below are only those policies that have changed materially or have supplemental information included for the periods presented here.

Allowance for Accounts and Notes Receivable Doubtful Accounts

The Company is required to make judgments as to the collectability of accounts and notes receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful accounts represent allowances for customer trade accounts and notes receivable that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables or note receivable to their net realizable value. The Company records these allowances based on estimates related to the following factors: (i) customer specific allowances; (ii) amounts based upon an aging schedule; and (iii) an estimated amount, based on our historical experience, for issues not yet identified. Bad debt expense (recoveries) for the three months ended March 31, 2010 and 2009 was $(17,443) and $4,670, respectively.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Fair Value Measurements

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") No 820, "Fair Value Measurements and Disclosures" ("ASC 820"). Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

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

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

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

In accordance with this guidance, the Company measures its cash equivalents at fair value. The Company's cash equivalents are classified within Level 1. Cash equivalents are valued primarily using quoted market prices utilizing market observable inputs. At March 31, 2010 and December 31, 2009, cash equivalents consisted of money market funds measured at fair value on a recurring basis. Fair value of the Company's money market funds was approximately $790,000 and $495,000, respectively.

Effective January 1, 2009, the Company adopted the FASB staff position that delayed the guidance on fair value measurements for non financial assets and non financial liabilities. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

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 ASC 350, "Intangibles - Goodwill and Other". 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 ASC 360, "Property, Plant and Equipment". The exclusive license and intellectual property rights are fully amortized.

Classification of Expenses

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

Sales and Marketing Expenses – Sales and marketing 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 months ended March 31, 2010 and 2009 were $3,510 and $27,144 respectively.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 months ended March 31, 2010 and 2009 totaled $716,581 and $637,219, respectively. Interest income consists of earnings from outstanding amounts due to the Company under notes and other interest bearing receivables. The Company recorded interest income of $9,384 and $268, respectively, for the three months ended March 31, 2010 and 2009.

Foreign Currency Translation

The Company has operations and holds assets in various foreign countries. The local currency is the functional currency for the Company subsidiaries in China and India. Assets and liabilities are translated at end-of-period exchange rates while revenues and expenses are translated at the average exchange rates in effect during the period. Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income until the translation adjustments are realized. Included in other accumulated comprehensive income were a cumulative foreign currency translation adjustment gain of $63,953 and $74,289 at March 31, 2010 and December 31, 2009, respectively.

Comprehensive Loss

Comprehensive loss consists of net loss and unrealized gains on foreign currency translation adjustments. Comprehensive loss and its components for the three months ended March 31, 2010 and 2009 is as follows:

	Three Months Ended March 31,	
	2010	2009
Net loss	$ (847,643)	$ (1,178,528)
Other comprehensive income -		
Foreign currency translation	10,336	(3,085)
Total comprehensive loss	$ (837,307)	$ (1,181,613)

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 loss for the periods presented.

Reclassifications

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

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TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 3. Significant Risks and Uncertainties

The Company's consolidated financial statements have been prepared on a going concern basis of accounting which contemplates the continuity of operations and the realization of assets, liabilities and commitments in the normal course of business. During the years 2009 and 2008, the Company experienced net losses, and has a working capital deficit and an accumulated deficit as of March 31, 2010 of $17,740,610 and $67,191,652, respectively.

The Company's cash flows from operating activities in 2010 will not be sufficient to make the debt payments and deferred interest of $15,932,237 due at June 30, 2010 as required by the Revolving Credit and Term Loan Agreement with CVC California, LLC ("CVC"). Accordingly an extension or modification of the CVC debt will be required prior to the due date or it will be necessary for the Company to raise additional debt or equity financing in order to satisfy the CVC debt. If the Company cannot obtain an extension or modification of the CVC debt, or raise additional equity or debt to satisfy this requirement it will default on the CVC credit agreement. There can be no assurance that additional debt or equity financing will be available to the Company on acceptable terms or at all. If the Company is unable to secure additional financing and satisfy its debt obligation to CVC, the Company's financial condition and results of operations could be materially adversely affected and the Company may not be able to continue to operate as a going concern. See Note 8.

The Company was not in compliance with the minimum EBITDA requirement of the CVC credit agreement for the quarter ended March 31, 2010. The Company did not pay the waiver fee available in the credit agreement to waive the non-compliance at March 31, 2010 within the timeline established in the Agreement. Accordingly, the unresolved non-compliance constitutes an Event of Default under the Agreement. The Company is currently negotiating with CVC regarding this default.

The Company's consolidated financial statements do not reflect any adjustments relating to the recoverability and classification of recorded asset amounts or classification of liabilities that would be required if a default under the Company's credit agreement occurred and the Company was unable to obtain a waiver, modify the covenants, or satisfy the payment obligations under the agreement.

The Company's performance is subject to worldwide economic conditions and their impact on levels of consumer spending that affect not only the ultimate consumer, but also retailers, which constitute many of its largest customers. Consumer spending has deteriorated significantly over the last eighteen months and may remain depressed, or be subject to further deterioration for the foreseeable future. The worldwide apparel industry is heavily influenced by general economic cycles. Purchases of fashion apparel and accessories tend to decline in periods of recession or uncertainty regarding future economic prospects, as disposable income declines. Many factors affect the level of consumer spending in the apparel industries, including, among others: prevailing economic conditions, levels of employment, salaries and wage rates, energy costs, interest rates, the availability of consumer credit, taxation and consumer confidence in future economic conditions.

During periods of recession or economic uncertainty, the Company may not be able to maintain or increase the sales to existing customers, make sales to new customers or maintain the Company's earnings from operations as a percentage of net sales. As a result, the operating results may be adversely and materially affected by sustained or further downward trends in the United States or global economy. The Company's ability to continue as a going concern is dependent on its ability to generate sufficient cash flow to meet its obligations on a timely basis, to obtain additional financing as may be required and ultimately to attain profitable operations.

TALON INTERNATIONAL, INC.

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In response to these economic conditions, the Company has taken steps to significantly reduce its operating costs, eliminate employees in response to lower volumes, and curtail capital and discretionary spending to better align the Company's organizational and cost structures with future Company and industry expectations and uncertainties and insure the Company will have sufficient cash flow to cover its operating needs. The Company has also implemented programs to increase sales incentives, to secure preferred supplier status with customers and to accelerate cash collections from customers.

There can be no assurance that the Company will be successful in any of these matters or that the Company's efforts will be sufficient to ensure the Company can continue as a going concern.

Note 4. New Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update 2010-06, "Fair Value Measurements and Disclosures" (Topic 820): Improving Disclosures about Fair Value Measurements. This guidance amends the disclosure requirements related to recurring and nonrecurring fair value measurements and requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for the reporting period beginning January 1, 2011. The adoption of this updated guidance was not significant to the consolidated financial statements.

In February 2010, the FASB issued updated guidance related to subsequent events. As a result of this updated guidance, public filers must still evaluate subsequent events through the issuance date of their financial statements; however, they are not required to disclose the date in which subsequent events were evaluated in their financial statements disclosures. This amended guidance became effective upon its issuance on February 24, 2010 at which time the Company adopted this updated guidance.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 5. Net Loss Per Share

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

Three months ended March 31, 2010:	Net loss	Shares	Per Share
Basic net loss per share:			
Applicable to common stockholders	$ (847,643)	20,291,433	$ (0.04)
Effect of Dilutive Securities:			
Options	-	-	-
Warrants	-	-	-
Net loss to common stockholders	$ (847,643)	20,291,433	$ (0.04)
Three months ended March 31, 2009:			
Basic net loss per share:			
Applicable to common stockholders	$ (1,178,528)	20,291,433	$ (0.12)
Effect of Dilutive Securities:			
Options	-	-	-
Warrants	-	-	-
Net loss to common stockholders	$ (1,178,528)	20,291,433	$ (0.06)

Options to purchase 6,571,371 shares of common stock exercisable between $0.06 and $5.23 per share were outstanding for the three months ended March 31, 2010, but were not included in the computation of diluted net loss per share because exercise or conversion would have an antidilutive effect on the net loss per share.

Warrants to purchase 318,495 shares of common stock exercisable at $3.65 and options to purchase 4,935,599 shares of common stock exercisable between $0.18 and $5.23, were outstanding for the three months ended March 31, 2009, but were not included in the computation of diluted net loss per share because the effect of exercise or conversion would have an antidilutive effect on net loss per share.

Note 6. Accounts Receivable

Accounts receivable are included on the accompanying consolidated balance sheets net of an allowance for doubtful accounts. The total allowance for doubtful accounts at March 31, 2010 and December 31, 2009 was $215,160 and $232,329, respectively.

Note 7. 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Inventory valuation reserves are recorded for damaged, obsolete, excess and slow-moving inventory. The Company uses estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this type of inventory.

Inventories consist of the following:

	March 31, 2010	December 31, 2009
Finished goods	$ 2,572,616	$ 2,863,923
Less reserves	(1,023,083)	(1,184,621)
Total inventories	$ 1,549,533	$ 1,679,302

Note 8. 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. Bluefin Capital subsequently assigned its rights and obligations under the credit facility agreements to an affiliate, CVC California, LLC. The revolving credit portion of the facility permitted borrowings based upon a formula including 85% of the Company's eligible receivables and 55% of eligible inventory, and provided for monthly interest payments at the prime rate (3.25% at March 31, 2010) 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 substantially all of the assets of the Company.

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 warrants to purchase 2,100,000 shares of common stock. The warrants were exercisable over a five-year period and initially 700,000 warrants were exercisable at $0.95 per share; 700,000 warrants were exercisable at $1.05 per share; and 700,000 warrants were exercisable at $1.14 per share. The warrants did not require cash settlements. The relative fair value of the equity ($2,374,169, which includes a reduction for financing costs) issued with this debt facility was allocated to paid-in-capital and reflected as a debt discount to the face value of the term note.

This discount is being 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 as a reduction to the face value of the note on the balance sheet.

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TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

On November 19, 2007, the Company entered into an amendment to the credit agreement to modify the original financial covenants and to extend until June 30, 2008 the application of the original EBITDA covenant in exchange for additional common stock of the Company and a price adjustment to the outstanding warrants issued to the lender in connection with the loan agreement. In connection with this amendment the Company issued an additional 250,000 shares of common stock to the lender for $0.001 per share, and the exercise price for all of the previously issued warrants for the purchase of 2,100,000 shares of common stock was amended to an exercise price of $0.75 per share. The new relative fair value of the equity issued with this debt of $2,430,000, including the modifications in this amendment and a reduction for financing costs, is being amortized over the term of the note.

On April 3, 2008, the Company executed a further amendment to the credit agreement. The amendment included a redefining of the EBITDA covenants, and the cancellation of the common stock warrants previously issued to the lender in exchange for the issuance by the Company of an additional note payable to CVC for $1.0 million. The note bears interest at 8.5% and both the note and accrued interest are payable at maturity on June 30, 2010. In addition, the Company's borrowing base was modified in this amendment by increasing the allowable portion of inventory held by third party vendors to $1.0 million with no more than $500,000 held at any one vendor and increasing the percentage of accounts receivable to be included in the borrowing base to 85%. The Company incurred a one-time modification fee of $145,000 to secure the amendment. The new relative fair value of the equity issued with this debt of $2,542,000, including the modifications in this amendment and a reduction for financing costs, is being amortized over the term of the note.

In connection with the April 2008 amendment the Company evaluated the debt amendment under ASC 470-50, "Debt - Modifications and Extinguishments". It was determined that the debt modification did not constitute a material change as defined by ASC 470-50 and did not qualify for treatment as a troubled debt restructuring. Accordingly, the Company recorded a reduction to equity and an increase to notes payable for the fair value of the warrants of $260,205 and the difference ($739,795) between the fair value of the warrants at the time of repurchase and the face value of the note has been recorded as an additional deferred cost and is reflected as a reduction to the face value of the note on the balance sheet. This cost is being amortized using the interest-method over the life of the modified notes and is to be reflected as interest expense.

Under the terms of the credit agreement, as amended, the Company is required to meet certain coverage ratios, among other restrictions, including a restriction from declaring or paying a dividend prior to repayment of all the obligations. The financial covenants, as amended, require that the Company maintain at the end of each fiscal quarter "EBITDA" (as defined in the agreement) in excess of the principal and interest payments for the same period of not less than $1.00 and in excess of ratios set out in the agreement for each quarter.

The Company failed to satisfy the minimum EBITDA requirement for quarter ended December 31, 2008 as well as the quarter ended March 31, 2009, and in connection with such failures, on March 31, 2009 the Company entered into a further amendment to the agreement with CVC.

This amendment provided for the issuance of an additional term note to CVC in the principal amount of $225,210 in lieu of paying a cash waiver fee in connection with the Company's failures to satisfy the EBITDA requirement for the quarters ended December 31, 2008 and March 31, 2009; deferral of the term note quarterly interest payment of $215,000 due April 1, 2009; a temporary increase to the borrowing base formulas and calculations under the revolving credit facility; the re-lending by CVC of $125,000 under the term loan portion of credit facility; a consent to allow the

Company to sell equipment that has been designated as held for sale; and the granting to CVC of the right to designate a non-voting observer to attend all meetings of the Company's Board of Directors.

TALON INTERNATIONAL, INC.

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The Company was not in compliance with the minimum EBITDA requirement of the CVC credit agreement for the quarter ended March 31, 2010. The Company did not pay the waiver fee available in the credit agreement to waive the non-compliance at March 31, 2010 within the timeline established in the Agreement. Accordingly, the unresolved non-compliance constitutes an Event of Default under the Agreement. The Company is currently negotiating with CVC regarding this default.

As of March 31, 2010, the Company had outstanding borrowings of $10,725,210 under the term notes (discounted carrying value of $10,288,595), and $4,988,988 under the revolving credit note.

Interest expense related to the Revolving Credit and Term Loan Agreement for the three months ended March 31, 2010 and 2009 was $705,873 and $623,456, respectively, which includes $412,482 and $342,101, respectively in amortization of discounts and deferred financing costs.

Note 9. Stock-Based Compensation

The Company accounts for stock-based awards to employees and directors in accordance with FASB ASC 718, “Compensation - Stock Compensation” (“ASC 718”), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. Options issued to consultants are accounted for in accordance with the provisions of FASB ASC 505-50, “Equity-Based Payments to Non-Employees”.

On July 14, 2008, at the Company’s annual meeting of stockholders, a new 2008 Stock Plan was approved by the stockholders. The 2008 Stock Plan authorizes up to 2,500,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan. On July 31, 2007, at the Company’s annual meeting of stockholders, the 2007 Stock Plan was approved which replaced the 1997 Stock Plan. The 2007 Stock Plan authorizes up to 2,600,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan. Options granted to certain employees in 2008 include certain vesting acceleration features based on Company performance as determined by the Board of Directors each year. Consistent with ASC 718-10, the stock based compensation expense for the employee options are recognized on a time-phased vesting schedule through the vesting date of December 31, 2010. In calculating the outcome of meeting performance conditions for 2009, the Company exceeded the performance criteria and accordingly, accelerated vesting was applied to the eligible stock options. No options were granted for the three months ended March 31, 2010 and 2009.

As of March 31, 2010, the Company had approximately $165,000 of unamortized stock-based compensation expense related to options issued to employees and directors, which will be recognized over the weighted average period of 1.4 years. As of March 31, 2009, unamortized stock-based compensation expense related to options issued to employees and directors was approximately $325,400, which is being recognized over the weighted average period of approximately 2 years.

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The following table summarizes the activity in the Company's share based plans during the three months ended March 31, 2010.

	Number of Shares	Weighted Average Exercise Price
Employees and Directors		
Options outstanding - January 1, 2010	6,637,850	$ 0.73
Granted	-	-
Exercised	-	-
Cancelled	(66,479)	$ 4.55
Options outstanding - March 31, 2010	6,571,371	$ 0.69

Note 10. Income taxes

The Company accrues interest and penalties related to unrecognized tax benefits in interest and penalties expense. For the three months ended March 31, 2010 and 2009, the Company accrued interest and penalties for unrecognized tax benefits of $3,975. At March 31, 2010 and December 31, 2009, the Company had approximately $81,600 and $77,625, respectively, accrued in interest and penalties associated with the unrecognized tax liabilities.

Deferred tax assets were $135,727 and $89,564 at March 31, 2010 and December 31, 2009, respectively, related to the Company's foreign operations and were included in other assets. Due to prior operating losses incurred, no benefit for domestic and part of foreign income taxes has been recorded since there is not sufficient evidence to determine that the Company will be able to utilize its net operating loss carryforwards to offset future taxable income. Other tax liabilities were $13,071 and $10,151 as of March 31, 2010 and December 31, 2009, respectively, and were included in other accrued expenses. As of December 31, 2009 prepaid income tax totaled $5,527.

Note 11. Commitments and Contingencies

On April 16, 2004, the Company 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 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 exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. The Company also filed a second civil action against Pro-Fit and related companies in the California Superior Court which was removed to the United States District Court, Central District of California. In the second quarter of 2008, Pro-Fit and certain related companies were placed into administration in the United Kingdom and filed petitions under Chapter 15 of Title 11 of the United States Code. As a consequence of the chapter 15 filings, all litigation by the Company against Pro-Fit has been stayed. The Company has incurred significant legal fees in this litigation, and unless the case is settled or resolved, may continue to incur additional legal fees in order to assert its rights and claims against Pro-Fit and any successor to those assets of Pro-Fit that are subject to its exclusive license and intellectual property agreement with Pro-Fit and to defend against any counterclaims.

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

In November 2002, the FASB issued Topics of the FASB ASC 460-10, "Guarantees" ("ASC 460-10") and FASB ASC 850-10, "Related Party Disclosures" ("ASC 850-10"). The following is a summary of the Company's agreements that it has determined are within the scope of ASC 460-10 and ASC 850-10:

In accordance with the bylaws of the Company, officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The term of the indemnification period is for the lifetime of the officer or director. The maximum potential amount of future payments the Company could be required to make under the indemnification provisions of its bylaws is unlimited. However, the Company has a director and officer liability insurance policy that reduces its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of the indemnification provisions of its bylaws is minimal and therefore, the Company has not recorded any related liabilities.

The Company enters into indemnification provisions under its agreements with investors and its agreements with other parties in the normal course of business, typically with suppliers, customers and landlords. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights. 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 12. Segment Reporting and Geographic Information

The Company manufactures and distributes a full range of zipper, trim and waistband items to manufacturers of fashion apparel, specialty retailers and mass merchandisers. Our organization is based on divisions representing the major product lines, and our operating decisions use these divisions to assess performance, allocate resources and make other operating decisions. Within these product lines there is not enough difference between the types of products to justify segmented reporting by product type or to account for these products separately. The net revenues and operating margins for the three primary product groups are as follows:

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	Three Months Ended March 31, 2010			
	Talon	Trim	Tekfit	Consolidated
Net sales	$ 4,934,302	$ 3,300,958	$ -	$ 8,235,260
Cost of goods sold	3,621,872	2,154,195	22,500	5,798,567
Gross profit	$ 1,312,430	$ 1,146,763	$ (22,500)	2,436,693
Operating expenses				2,612,395
Loss from operations				$ (175,702)

	Three Months Ended March 31, 2009			
	Talon	Trim	Tekfit	Consolidated
Net sales	$ 3,331,693	$ 3,170,186	$ 13,875	$ 6,515,754
Cost of goods sold	2,522,728	2,001,386	7,473	4,531,587
Gross profit	$ 808,965	$ 1,168,800	$ 6,402	1,984,167
Operating expenses				2,519,337
Loss from operations				$ (535,170)

The Company distributes its products internationally and has reporting requirements based on geographic regions. Revenues are attributed to countries based upon customer delivery locations and 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, as follows:

Sales:	Three Months Ended March 31,	
Country / Region	2010	2009
United States	$ 805,620	$ 649,833
Hong Kong	3,221,942	2,417,932
China	1,534,791	1,163,564
Bangladesh	680,603	544,285
India	232,386	337,805
Other	1,759,918	1,402,335
Total	$ 8,235,260	$ 6,515,754

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	March 31, 2010	December 31, 2009
Long-lived Assets:		
United States	$ 4,805,221	$ 4,661,855
Hong Kong	1,086,261	1,193,617
China	217,321	236,768
Other	3,773	4,097
Total	$ 6,112,576	$ 6,096,337

Note 13. Related Party Notes and Transactions

Colin Dyne, a director and stockholder of the Company is also a director, officer and significant stockholder of People's Liberation, Inc., the parent company of Versatile Entertainment, Inc. and William Rast Sourcing. During the three months ended March 31, 2010, and 2009 the Company had sales of $0 and $224 to Versatile Entertainment, respectively. Accounts receivable of $40 and $200 were outstanding from Versatile Entertainment at March 31, 2010 and December 31, 2009, respectively.

During the three months ended March 31, 2010 and 2009 the Company had sales of $25,100 and $46,200, respectively, to William Rast Sourcing. Accounts receivable of $30,600 and $41,200 were outstanding from William Rast Sourcing at March 31, 2010 and December 31, 2009, respectively.

Note Receivable from Related Party, Net at March 31, 2010 and December 31, 2009 include the unsecured note and accrued interest receivable net of valuation reserves, of $0 due from Colin Dyne. The note bears interest at 7.5% and is due on demand. The amount of principal and accrued interest due from Colin Dyne under this note at March 31, 2010 and December 31, 2009 was $724,508 and $720,417, respectively.

In November 2009, the Company entered into an agreement to pay a commission to an affiliate of Colin Dyne of 7% of collected revenues associated with the sales of selected business opportunities, with 2% of the 7% earned applied to the note receivable balance. Commissions of $21,400 were paid in cash and $9,400 was applied to the note receivable balance for the three months ended March 31, 2010.

Notes payable to related parties includes demand notes and advances to parties related to or affiliated with Mark Dyne, the Chairman of the Board of Directors of the Company and a significant stockholder. The balance of demand notes payable and interest expense due to Mark Dyne and affiliated parties at March 31, 2010 and December 31, 2009 was $231,129 and $229,356, respectively.

Consulting fees and related interest paid or accrued to Diversified Consulting, LLC, a company owned by Mark Dyne, amounted to $49,169 and $37,500 for the three months ended March 31, 2010 and 2009. This consulting arrangement terminated on March 20, 2010. As of March 31, 2010 and December 31, 2009 accrued expenses includes consulting fees and associated interest in the amount of $263,237 and $251,568 due to Diversified Consulting, LLC, a company owned by Mark Dyne, in consideration for the final payment under the Diversified consulting agreement dated March 20, 2000.

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Notes payable to related parties also includes a note and associated interest due to Lonnie D. Schnell, the Chief Executive Officer and Chief Financial Officer of the Company. This note, issued on August 6, 2009 in partial satisfaction of 2008 annual incentive amounts to which Mr. Schnell was entitled, bears 6% interest annually and the maturity date is the earlier of December 31, 2011 or ten days following Mr. Schnell's employment termination date. The balance of the note payable and accrued interest expense due to Mr. Schnell at March 31, 2010 and December 31, 2009 was $37,066 and $36,516, respectively.

Note 14. Subsequent Events

The Company evaluated subsequent events after the balance sheet date of March 31, 2010 through the date these unaudited financial statements were issued.

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 Securities and Exchange Commission 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 adequate liquidity to fund our operations and meet our other cash requirements, demand for our products and services, mix of revenue streams, ability to control or reduce operating expenses, anticipated gross margins and operating results, cost savings, product development efforts, general outlook of our business and industry, international businesses, and competitive position.

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.

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

We pursue the global expansion of Talon zippers through the establishment of Talon owned sales, distribution and manufacturing locations, strategic distribution relationships and joint ventures. These distributors and manufacturing joint ventures, in combination with Talon owned and affiliated facilities under the Talon brand, improve our time-to-market by eliminating the typical setup and build-out phase for new manufacturing capacity throughout the world by sourcing, finishing and distributing to apparel manufacturers in their local markets.

We have structured our trim business to focus as an outsourced product development, sourcing and sampling department for the most demanding brands and retailers. We believe that trim design differentiation among brands and retailers has become a critical marketing tool for our customers. By assisting our customers in the design, development, sampling and sourcing of trim, we expect to achieve higher margins for our trim products, create long-term relationships with our customers, grow our sales to a particular customer by supplying trim for a larger proportion of their brands and better differentiate our trim sales and services from those of our competitors. We are expanding our trim business globally, so we may better serve our apparel factory customers in the field, in addition to our brand and retail customer. We believe we can lead the industry in trim sourcing by having both an intimate relationship with our brand and retail customers and having a distributed service organization to serve our factory customers (those that manufacture for the apparel brand and retailers) globally.

Our Tekfit business provides manufacturers with the patented technology, manufacturing know-how and materials required to produce pants incorporating an expandable waistband. Our efforts to expand this product offering to other customers have been limited by a licensing dispute. As described more fully in this report under Item 1. “Legal Proceedings”, we are presently in litigation with Pro-Fit Holdings Limited related to our exclusively licensed rights to sell or sublicense stretch waistbands manufactured under Pro-Fit’s patented technology. The revenues we derive from the sale of products incorporating the stretch waistband technology represented less than 1% of our consolidated revenues for the three month ended March 31, 2010 and 2009. Our business prospects for this group could be adversely affected if our dispute with Pro-Fit is not resolved in a manner favorable to us.

Effects of the Global Economic Recession

During 2009, we experienced a general decrease in sales which reflected the impact of the global recession on the apparel industry and the corresponding lower demand for all apparel products including our Talon zipper and trims products. The apparel industry and our customers were expected to continue to be adversely impacted by this recession in early 2010 and perhaps beyond, depending upon the global economic trends. During year 2009 and first quarter of 2010 year-to-year comparative sales performance by quarter with prior years reflected improvements throughout the periods after the sharp retail industry decline that began late in 2008. The sales during the first quarter of 2010 reflected a sales increase from the same quarter in 2009 by more than 26% while the first quarter of 2009 reflected a sales decline from the same quarter in 2008 by more than 34%.

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 March 31,			
	2010		2009	
Net sales	100.0	%	100.0	%
Cost of goods sold	70.4		69.5	
Gross profit	29.6		30.5	
Sales and marketing expenses	8.0		10.8	
General and administrative expenses	23.7		27.9	
Interest expense, net and income taxes	8.2		9.9	
Net loss	(10.3	)%	(18.1	)%

Sales

For the three months ended March 31, 2010 and 2009, sales by geographic region based on the location of the customer as a percentage of sales were as follows:

Region	Three Months Ended March 31, 2010		2009	
United States	9.8	%	10.0	%
Hong Kong	39.1	%	37.1	%
China	18.6	%	17.9	%
Bangladesh	8.3	%	8.4	%
India	2.8	%	5.2	%
Other	21.4	%	21.4	%
	100.0	%	100.0	%

Sales for the three months ended March 31, 2010 were $8.2 million, an increase of $1.7 million or 26.4%, from the same period in 2009. The net increase reflects improved worldwide economic conditions for Talon's customers in the apparel industry and the higher demand for our Talon zipper products, new products at existing customers, and the addition of new customers.

Gross Profit

Gross profit for the three months ended March 31, 2010 was $2.4 million as compared to $2.0 million for the same period in 2009. The increase in gross profit for the three months ended March 31, 2010 as compared to the same period in 2009 was principally attributable to higher overall sales volumes, partially offset by a higher proportion of lower margin products, and higher expenditures for quality control and product development. A recap of the change in gross margin for the three months ended March 31, 2010 as compared with the same period in 2009 is as follows (amounts in thousands):

	Three Months Ended March 31, 2010 compared to same period in 2009				
	Amount(1)			%(1)	
Gross profit increased as a result of:					
Higher volumes	$	700		35.3	
Mix of products		(133	)	(6.7	)
Decreased freight and duty costs		48		2.4	
Increased contract services, obsolescence and other		(162	)	(8.2	)
Gross profit increase	$	453		22.8	

(1) Represents the amount or percentage, as applicable, change in each item in the three months ended March 31, 2010 period, as compared to the same period in 2009.

Sales and marketing expenses

Sales and marketing expenses for the three months ended March 31, 2010 were $0.7 million, or 8.0% of sales, as compared to $0.7 million, or 10.8% of sales, for the same period in 2009. Sales expenses decreased as a percentage of sales primarily due to lower sales force expenses in Asia.

General and administrative expenses

General and administrative expenses for the three months ended March 31, 2010 were $2.0 million, or 23.7% of sales, as compared with $1.8 million, or 27.9% of sales, for the same period in 2009. The increase mainly reflects higher personnel expenses due to filling of previously open roles and upgrading of selected positions.

Interest expense and interest income

Interest expense for the three months ended March 31, 2010 increased by approximately $79,000 to $717,000 as compared to the same period in 2009 due to increased borrowings under our revolving credit and term loan facility and the related amortization of deferred financing costs and debt discounts.

Interest income for the three months ended March 31, 2010 increased by approximately $9,100 to $9,400 due primarily to the application of 2% of the 7% collected revenues on a commission agreement of an affiliate of Colin Dyne to interest income on the note receivable (See Note 13 of the Notes to Consolidated Financial Statements).

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

	Three Months Ended March 31,	
	2010	2009
Amortization of deferred financing costs and debt discounts	$412,482	$342,101
Other interest expense	304,099	295,118
Interest expense	716,581	637,219
Interest income	(9,384)	(268)
Interest expense, net	$707,197	$636,951

Income taxes

Income tax provisions (benefit) for the three months ended March 31, 2010 and 2009 reflected a tax provision (benefit) of approximately $(35,000) and $6,000, respectively. The net tax benefit for the three months ended March 31, 2010 and the net tax provision for the three months ended March 31, 2009 are associated with domestic state income taxes, foreign withholding taxes from our domestic royalty charges to our foreign operations offset by a tax benefit for carry-forward net losses in our foreign offices. There is not sufficient evidence to determine that it is more likely than not that we will be able to utilize our domestic and part of our foreign net operating loss carry forwards to offset future taxable income and as a result, these losses have a full valuation reserve against them.

Liquidity and Capital Resources

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

	March 31, 2010	December 31, 2009
Cash and cash equivalents	$ 1,758	$ 2,265
Total assets	$ 13,384	$ 13,834
Current liabilities	$ 24,665	$ 24,262
Long-term debt, net of current liabilities	$ 711	$ 751
Stockholders' deficit	$ (11,992)	$ (11,179)

Our existing cash and cash equivalents and our anticipated cash flows from operating activities will not be sufficient to satisfy the CVC debt facility due at June 30, 2010. Accordingly an extension or modification of the CVC debt will be required prior to the due date or it will be necessary for us to raise additional debt or equity financing in order to satisfy the CVC debt. If we cannot obtain an extension or modification of the CVC debt, or raise additional equity or debt to satisfy this requirement we will default on our credit agreement. 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 or restructure our existing debt, CVC will have the right to exercise its remedies including enforcement of its lien on substantially all of our assets.

The Company was not in compliance with the minimum EBITDA requirement of the CVC credit agreement for the quarter ended March 31, 2010. The Company did not pay the waiver fee available in the credit agreement to waive the non-compliance at March 31, 2010 within the timeline established in the Agreement. Accordingly, the unresolved non-compliance constitutes an Event of Default under the Agreement. The Company is currently negotiating with CVC regarding this default.

Cash and cash equivalents

Cash and cash equivalents decreased by approximately $507,000 at March 31, 2010 as compared to December 31, 2009, principally due to net cash used in operating activities and cash used in financing activities.

Cash provided by operating activities is our primary recurring source of funds, and reflects net income (loss) from operations excluding non cash charges, and changes in operating capital. The three months ended March 31, 2010 and 2009 reflected a net use of approximately $473,000 and $821,000, respectively.

The cash used in operating activities during the three months ended March 31, 2010 and 2009 resulted principally from:

	Three Months ended March 31, 2010	2009
Net loss before non-cash expenses	$ (159,000)	$ (622,000)
Inventory reduction	95,000	26,000
Increased accounts receivables	(462,000)	(350,000)
Increased (reduced) accounts payable and accrued expense	11,000	(144,000)
Other increases in operating capital	42,000	269,000
Cash used in operating activities	$ (473,000)	$ (821,000)

Net cash used in investing activities for the three months ended March 31, 2010 and 2009 was approximately $0 and $314,000, respectively. The expenditures in the first three months of 2009 were principally associated with the development of our new ERP system that was implemented in March 2009.

Net cash used in financing activities for the three months ended March 31, 2010 was approximately $23,000 and reflects repayment of borrowings under capital leases. For the three months ended March 31, 2009 net cash of $144,000 was used in financing activities and primarily reflects the repayment of borrowings under capital leases and notes payable.

On June 27, 2007, we entered into a Revolving Credit and Term Loan Agreement with Bluefin Capital, LLC that provides for a $5.0 million revolving credit loan and a $9.5 million term loan with a three year term maturing June 30, 2010. Bluefin Capital subsequently assigned its rights and obligations under the credit facility agreements to an affiliate, CVC California, LLC ("CVC"). The revolving credit portion of the facility, as amended, permits borrowings based upon a formula including 85% of eligible receivables and 55% of eligible inventory and provides for monthly interest payments at the U.S.A. prime rate (3.25% at March 31, 2010) plus 2.0%. The term loan bears interest at 8.5% annually with quarterly interest payments and repayment in full at maturity.

Borrowings under both credit facilities are secured by all of our assets. As of March 31, 2010 and December 31, 2009 our borrowing base ($4,898,903 and $4,546,996, respectively) was lower than our actual borrowing as of March 31, 2010 and December 31, 2009 ($4,988,988), therefore we did not have available borrowing at those dates.

As described above, our cash flows from operating activities will not be sufficient to satisfy the CVC debt facility when it becomes due on June 30, 2010. Accordingly, we are seeking an extension or modification of the CVC debt prior to the due date and also exploring raising additional debt or equity financing in order to satisfy the CVC debt.

In connection with the Revolving Credit and Term Loan Agreement, we issued 1,500,000 shares of common stock to the lender for $0.001 per share, and issued warrants to purchase 2,100,000 shares of common stock. The warrants were exercisable over a five-year period and initially 700,000 warrants were exercisable at $0.95 per share; 700,000 warrants were exercisable at $1.05 per share; and 700,000 warrants were exercisable at $1.14 per share. The warrants did not require cash settlements. The relative fair value of the equity ($2,374,169, which includes a reduction for financing costs) issued with this debt facility was allocated to paid-in-capital and reflected as a debt discount to the face value of the term note.

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This discount is being 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 as a reduction to the face value of the note on the balance sheet.

On November 19, 2007, we entered into an amendment of the credit agreement with the lender to modify the original financial covenants and to extend until June 30, 2008 the application of the original EBITDA covenants in exchange for additional common stock and a price adjustment to the lenders outstanding warrants issued to the lender in connection with the loan agreement. In connection with this amendment we issued an additional 250,000 shares of common stock to the lender for $0.001 per share, and the exercise price for all of the previously issued warrants for the purchase of 2,100,000 shares of common stock was amended to an exercise price of $0.75 per share. The new relative fair value of the equity issued with this debt of $2,430,000, including the modifications in this amendment and a reduction for financing costs, is being amortized over the term of the note.

On April 3, 2008, we executed a further amendment to the credit agreement. The amendment included a redefining of the EBITDA covenants, and the cancellation of the common stock warrants previously issued to the lender in exchange for our issuance of an additional note payable to the lender for $1.0 million. The note bears interest at 8.5% and both the note and accrued interest are payable at maturity on June 30, 2010. In addition, our borrowing base was modified in this amendment by increasing the allowable portion of inventory held by third party vendors to $1.0 million with no more than $500,000 held at any one vendor and increasing the percentage of accounts receivable to be included in the borrowing base to 85%. We incurred a one-time modification fee of $145,000 to secure the amendment of the agreement. The new relative fair value of the equity issued with this debt of $2,542,000, including the modifications in this amendment and a reduction for financing costs, is being amortized over the term of the note.

Under the terms of the credit agreement, as amended, we are required to meet certain coverage ratios, among other restrictions including a restriction from declaring or paying a dividend prior to repayment of all the obligations. The financial covenants, as amended, require that we maintain at the end of each fiscal quarter “EBITDA” (as defined in the agreement) in excess of the principal and interest payments for the same period of not less than $1.00 and in excess of ratios set out in the agreement for each quarter.

We failed to satisfy the minimum EBITDA requirement for quarter ended December 31, 2008 as well as the quarter ended March 31, 2009, and in connection with such failures, on March 31, 2009 we entered into a further amendment to the credit agreement with CVC. This amendment provided for the issuance of an additional term note to CVC in the principal amount of $225,210 in lieu of paying a cash waiver fee in connection with our failures to satisfy the EBITDA requirements for the quarters ended December 31, 2008 and March 31, 2009; deferral of the term note quarterly interest payment of $215,000 due April 1, 2009; a temporary increase to the borrowing base formulas and calculations under the revolving credit facility; the re-lending by CVC of $125,000 under the term loan portion of credit facility; a consent to allow us to sell equipment that has been designated as held for sale more fully described in Note 8 of the Notes to Consolidated Financial Statements; and the granting to CVC of the right to designate a non-voting observer to attend all meetings of our Board of Directors.

We financed building, land and equipment purchases through notes payable and capital lease obligations expiring through June 2014. The building and land mortgage were fully paid when the property was sold in October 2008. The remaining equipment obligations bear interest at rates of 8.0% and 15.4% per annum, and under these obligations, we are required to make monthly payments of principal and interest.

The outstanding balance including accrued interest of our notes payable to related parties at March 31, 2010 and December 31, 2009 was $268,000 and $266,000, respectively. Included in this balance are demand notes of $85,000 which bear interest at 10% (total balance as of March 31, 2010 and December 31, 2009 of $231,000 and 230,000 respectively) have no scheduled monthly payments and are due within fifteen days following demand. The remainder of the notes payable to related parties includes our note payable to an officer for $37,000 and $36,000, respectively. The note bears 6% interest annually and the maturity date is the earlier of December 31, 2011 or ten days following employment termination date. The note is fully presented as part of current liabilities as of March 31, 2010 and December 31, 2009.

We have historically satisfied our working capital requirements primarily through cash flows generated from operations and borrowings under our credit facility. As we continue to expand globally with our apparel manufacturing in offshore locations, our customers (some of which are backed by U.S. brands and retailers) are substantially all foreign based entities. 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 on-going 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 operating requirements. The extent of our future long-term capital requirements will depend on many factors, including our results of operations, future demand for our products, the size and timing of 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 and European markets. If our cash from operations is less than anticipated or our working capital requirements and capital expenditures are greater than we expect, we may need to raise additional debt or equity financing in order to provide for our operations.

Contractual Obligations and Off-Balance Sheet Arrangements

The following summarizes our contractual obligations at March 31, 2010 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	1-3 Years	4-5 Years	After 5 Years
Demand notes payable to related parties (1)	$ 231,100	$ 231,100	$ -	$ -	$ -
Note payable to related party	37,100	37,100	-	-	-
Capital lease obligations	63,800	36,100	26,400	1,300	-
Operating leases	679,100	461,500	217,600	-	-
Revolver and term note	16,007,600	16,007,600	-	-	-
Other notes payable	61,700	61,700	-	-	-
Total Obligations	$ 17,080,400	$ 16,835,100	$ 244,000	$ 1,300	$ -

(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 March 31, 2010.

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At March 31, 2010 and December 31, 2009, 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

See Note 13 of the Notes to Consolidated Financial Statements for a discussion of related party transactions.

Application of Critical Accounting Policies and Estimates

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

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

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

  The net bad debt expenses, recoveries and allowances for the three months ended March 31, 2010 and 2009 are as follows:

	Three Months ended March 31,	
	2010	2009
Bad debt expenses for accounts receivables	$ (6,111)	$ 4,670
Bad debt recoveries for accounts receivable	$ (11,332)	$ -
Allowance for doubtful accounts, accounts receivables	$ 215,160	$ 222,633
Allowance for doubtful accounts, related party	$ 724,508	$ 486,727

- Inventories are stated at the lower of cost, determined using the first-in, first-out (“FIFO”) basis, or market value and are all substantially finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory is evaluated on a continual basis and reserve adjustments are made based on management’s estimate of future sales value, if any, of specific inventory items. Inventory reserves are recorded for damaged, obsolete, excess, impaired and slow-moving inventory. We use estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory.

  Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this type of inventory. Inventory reserve is reduced following legacy inventory sale and write-off of reserved inventory and increased by additions to reserve for slow moving 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. See Note 10 of the Notes to Consolidated Financial Statements.

- 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 may cause us to reassess the carrying amount of our long-lived assets.

- Sales are recognized when persuasive evidence of an arrangement exists, product title has passed, pricing is fixed or determinable and collection is reasonably assured. Sales resulting from customer buy-back agreements, or associated inventory storage arrangements are recognized upon delivery of the products to the customer, the customer’s designated manufacturer, or upon notice from the customer to destroy or dispose of the goods.

  Sales, provisions for estimated sales returns and the cost of products sold are recorded at the time title transfers to customers. Actual product returns are charged against estimated sales return allowances, which returns have been insignificant.

- We are currently involved in various lawsuits, claims and inquiries, most of which are routine to the nature of the business and in accordance with FASB ASC 450, "Contingencies". We accrue estimates of the probable and estimable losses for the resolution of these claims. The ultimate resolution of these claims could affect our future results of operations for any particular quarterly or annual period should our exposure be materially different from our earlier estimates or should liabilities be incurred that were not previously accrued.

New Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update 2010-06, "Fair Value Measurements and Disclosures" (Topic 820): Improving Disclosures about Fair Value Measurements. This guidance amends the disclosure requirements related to recurring and nonrecurring fair value measurements and requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for the reporting period beginning January 1, 2011. The adoption of this updated guidance was not significant to the consolidated financial statements.

In February 2010, the FASB issued updated guidance related to subsequent events. As a result of this updated guidance, public filers must still evaluate subsequent events through the issuance date of their financial statements; however, they are not required to disclose the date in which subsequent events were evaluated in their financial statements disclosures. This amended guidance became effective upon its issuance on February 24, 2010 at which time we adopted this updated guidance.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not Applicable

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

Changes in Internal Control over Financial Reporting

During the quarter ended March 31, 2010, there were no changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

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 exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. We also filed a second civil action against Pro-Fit and related companies in the California Superior Court which was removed to the United States District Court, Central District of California. In the second quarter of 2008, Pro-Fit and certain related companies were placed into administration in the United Kingdom and filed petitions under Chapter 15 of Title 11 of the United States Code.

As a consequence of the chapter 15 filings, all litigation by us against Pro-Fit has been stayed. We have incurred significant legal fees in this litigation, and unless the case is settled or resolved, may continue to incur additional legal fees in order to assert its rights and claims against Pro-Fit and any successor to those assets of Pro-Fit that are subject to our exclusive license and intellectual property agreement with Pro-Fit and to defend against any counterclaims.

We currently have pending various other claims and complaints that arise in the ordinary course of our business. We believe that we have meritorious defenses to these claims and that the claims are either covered by insurance or, 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

Risk factors are contained in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009. No material change to such risk factors has occurred during the three months ended March 31, 2010.

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Item 5. Other Information

The Company has determined to delay its 2010 Annual Meeting of Stockholders and has not yet established a record date or meeting date for the Annual Meeting. The Company will disclose the record date and meeting date after they are determined by the Board of Directors.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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: May 13, 2010	/s/ Lonnie D. Schnell Lonnie D. Schnell Chief Executive Officer and Chief Financial Officer (Principal Executive Officer and Principal Financial Officer)
	/s/ James E. Reeder James E. Reeder Vice President, Corporate Controller (Principal Accounting Officer)