TALON INTERNATIONAL, INC.
Form 10-K
March 28, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(mark one)

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

For the fiscal year ended December 31, 2016

[_] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 1-13669

TALON INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in Its Charter)

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

21900 Burbank Blvd., Suite 270	
Woodland Hills, California	**91367**
(Address of Principal Executive Offices)	(Zip Code)

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

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

None

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

Common Stock, $0.001 par value

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

Yes [_] No [X]

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

Yes [_] No [X]

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [_]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

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

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

At June 30, 2016, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was $3,490,620.

At March 24, 2017 the issuer had 92,274,255 shares of Common Stock, $0.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

TALON INTERNATIONAL, INC.

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Forward Looking Statements

This report and other documents we file with the SEC contain forward looking statements that are based on current expectations, estimates, forecasts and projections about us, our future performance, our business or others on our behalf, our beliefs and our management's assumptions. In addition, we, or others on our behalf, may make forward looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls. Words such as "expect," "anticipate," "outlook," "could," "target," "project," "intend," "plan," "believe," "seek," "estimate," "should," "continue," variations of such words and similar expressions are intended to identify such forward looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We describe our respective risks, uncertainties and assumptions that could affect the outcome or results of operations in "Item 1A. Risk Factors." We have based our forward looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward looking statements. Reference is made in particular to forward looking statements regarding projections or estimates concerning our business, including demand for our products and services, customer acceptance of new products, 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, competitive position, adequate liquidity to fund our operations and meet our other cash requirements, and the global economic environment in general and consumer demand for apparel. Except as required under the federal securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update publicly any forward looking statements after the distribution of this report, whether as a result of new information, future events, changes in assumptions, or otherwise.

PART I

ITEM 1. BUSINESS

General

Talon International, Inc. specializes in the manufacturing and distribution of a comprehensive range of apparel components and accessories including custom zippers, apparel trim components (such as tags, labels, patches, fasteners, packaging, and similar items), and specialty stretch technology for interlinings. These items are sold to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We manufacture and distribute zippers under our *Talon*® brand name to manufacturers for apparel brands and retailers such as Polo Ralph Lauren, Abercrombie & Fitch, Fat Face, Eddie Bauer, Guess, Ben Sherman and Express, as well as mass merchants such as

Kohl's, JC Penney and Wal-Mart. We also provide outsourced trim design, sourcing and management services and supply custom branded trim components for manufacturers of fashion apparel such as V. F. Corporation, American Eagle, Victoria's Secret, Fat Face, Abercrombie & Fitch, Polo Ralph Lauren, Express, and many others. Under our *Tekfit*® brand, we develop and sell fabric stretch technology that utilizes patented processes and proprietary know-how to create stretchable comfort waistbands, shirt collars, and inner pocketing panels to manufacturers for apparel brands and retailers such as Dockers, PVH, Uniqlo and Superior Uniforms.

We were incorporated in the State of Delaware in 1997. We serve as the parent holding company of our consolidated subsidiaries, which are all wholly-owned subsidiaries. Our initial public offering was effective in January 1998. Our website address, www.talonzippers.com, as provided in this Annual Report on Form 10-K is not intended to function as a hyperlink and the information on our website is not and should not be considered part of this report and is not incorporated by reference in this document.

Business Summary

We operate our business within the following product groups: Talon Zipper and Talon Trim (which includes our *Tekfit* stretch technology products). In our Talon Zipper group, we design, engineer, test and distribute custom zippers under our *Talon* trademark to apparel brands and manufacturers on a global basis. *Talon* enjoys extensive brand recognition and heritage within the apparel industry worldwide and is a 120+ year-old brand, renowned for its quality and product innovation and as the inventor of the formed wire metal zipper for the jeans industry. We are a specified custom zipper and preferred zipper brand for numerous manufacturers in the designer, sportswear, children's wear and outerwear markets worldwide. We provide multiple lines of high quality custom zippers, including metal, coil and plastic zippers, vintage zippers, and specialty zippers for kids clothing and other fit-for-purpose applications, such as footwear, workwear and specialty bags. All products are for distribution to apparel manufacturers worldwide, including markets in China, Taiwan, India, Indonesia, Bangladesh, Vietnam, the Middle East, Europe, Mexico and Central America. We have sales and marketing teams in most of these areas. We have joint manufacturing arrangements in strategic international local markets to manufacture, finish and distribute our products locally under the *Talon* brand name. Our manufacturing partners operate under our direct manufacturing and quality assurance oversight, in accordance with our manufacturing specifications and quality standards, using only Talon approved and authorized raw materials. The unique and comprehensive supply chain network results in high quality finished zippers for our customers in their local markets. Our operating structure allows us to significantly improve the speed at which we serve the market and the service we provide to our customers, and to effectively expand the geographic footprint of our *Talon* products.

Our Talon Trim products group act as a fully-integrated single-source designer, product developer and exclusive supplier for a full range of custom trim items for manufacturers of fashion apparel. Our business focuses on servicing all of the trim requirements of our customers at the manufacturing and retail brand level of the fashion apparel industry. Our Talon Trim products include essentially all components required to manufacture a garment with the exception of the fabric and the thread. Talon Trim items include labels, buttons, rivets, leather patches, woven labels, heat transfer seals, tapes, ribbons, printed marketing material, polybasic, packing cartons and hangers. Talon Trim items comprise a relatively small part of the cost of most apparel products but comprise the vast majority of components necessary to fabricate and finish a typical apparel product. We offer customers a one-stop outsource service for all zipper and trim related matters. Our teams work with industry merchants, product developers and designers, and function as an extension of their staff.

Our Talon Trim products also include our Talon Stretch Technology products. Under the *Tekfit* brand, we supply apparel manufacturers with interlining products and an advanced, patented fabric technology that creates stretchable fabric from non-stretchable material. This innovative technology allows the fabric to be altered through the addition of stretch characteristics resulting in greatly improved fit and comfort. Manufacturers use this technology to build-in stretch into standard waistbands that does not alter the appearance of the garment, but will allow the waist to stretch out and back by as much as two waist sizes. They also utilize this technology within inner pocketing shapewear panels to provide a firm comfort fit across the stomach and hips, while manufacturers of dress shirts use this stretch technology to produce comfortable, flexible shirt collars. Talon's Stretch Technology and its *Tekfit* brand products have multiple applications in virtually any garment where added flexibility and comfort is desired.

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Our Talon Zipper and Talon Trim product teams collaborate with customers on their design vision and present examples of their vision in graphic form for all apparel accessory components. We design the buttons, snaps, hang tags, labels, zippers, zipper pulls and other items to meet the customer's needs. Once our customer selects the designs they prefer, our sourcing and production teams coordinate with our manufacturing partners worldwide to ensure the best manufacturing solution for the items being produced. The proper manufacturing solution is an essential part of the expertise and service we provide to customers. Selecting the best facility to ensure timely production, the proper finishes, or other material needs or manufacturing techniques to be used is critical. We offer customers a depth and breadth of knowledge in the manufacturing of these products that our customers cannot otherwise easily achieve. We are consistently innovating new items, manufacturing techniques and finishes, introducing many new, fresh and unique ideas to our customers. Once our customers make a final decision on the accessories that will be used on their garments, we are in many instances identified as the sole or preferred source supplier for the project, and our customers' factories are then directed to purchase the products directly from us. Throughout the garment manufacturing process, we consistently monitor the timing and accuracy of the production items until delivery to our customers' apparel factories.

We serve as a nominated supplier in our Talon Zipper and Talon Trim products (including our *Tekfit* stretch technology products) for a variety of major retail brand and private-label oriented companies. A nominated supplier is a supplier that has been approved for its quality and service by a major retail brand or private-label company. Apparel contractors manufacturing for the retail brand or private-label company typically purchase their zipper and trim components from a supplier that has been nominated. We seek to expand our services as a supplier of select items for such customers, to being a preferred or single-source provider of the entire customer's authorized trim and zipper requirements. Our ability to offer a full range of trim and zipper products is attractive to brand name and private-label oriented customers because it enables the customer to address their quality and supply needs for all of their trim requirements from a single source, avoiding the time and expense necessary to monitor quality and supply from multiple vendors and manufacturer sources. Becoming a nominated supplier to brand customers gives us an advantage to become the preferred or sole vendor of trim and zipper items for all apparel manufacturers contracted for production for that brand name.

Our teams of sales employees, customer service representatives, merchandisers, creative design personnel and global production and distribution coordinators based at our facilities located in the United States, Europe, and throughout Southeast Asia, enable us to take advantage of and address the increasingly complicated requirements of the large and expanding demand for complete end-to-end apparel accessory solutions. We plan to continue to expand operations in Asia, Europe, and Latin America to take advantage of the large apparel manufacturing markets in these regions.

Products

Talon Zipper - We offer a full line of custom metal, coil and plastic zippers bearing the *Talon* brand name or logo. Talon zippers are used primarily by manufacturers in the apparel industry and are distributed through our distribution facilities in the United States, Europe, Hong Kong and China and through these designated offices to other international markets, including Taiwan, India, Bangladesh, Indonesia, Vietnam, Dominican Republic and others.

We expand our distribution of Talon zippers through the establishment of a combination of Talon owned sales and distribution locations, and strategic manufacturing and distribution relationships. These distribution and manufacturing relationships, in combination with Talon owned and affiliated facilities, improve our time-to-market by allowing us to source, finish and distribute to apparel manufacturers within their local markets. The branded apparel zipper market is dominated by one company and we have positioned *Talon* to be a viable global alternative to this competitor and capture an increased market share position. We leverage the brand awareness of the *Talon* name by branding other products in our line with the *Talon* name.

Talon Trim Group - We consider our high level of customer service as a fully integrated single-source supplier essential to our success. We combine our quality customer service within our Talon Trim solutions with a history of design and manufacturing expertise to offer our customers a complete trim solution product. We believe this full-service product gives us a competitive edge over companies that only offer selected trim components because our full service solutions save our customers substantial time in ordering, designing, sampling and managing trim sourcing from several different suppliers. Our tracking and order management systems allow us to seamlessly supply Talon Trim solutions and products to apparel brands, retailers and manufacturers around the world. We produce custom hang tags, metal fasteners, woven, leather, synthetic, embroidered and novelty labels and tapes, which can be printed on or woven into a wide range of fabrics, as well as interlining and stretch technology components and other materials using specialized equipment. Our *Tekfit* products, which are a part of the Talon Trim Group, provide manufacturers with fabric interlinings and patented technology, manufacturing know-how, proprietary equipment and materials necessary to produce expandable waistbands, shirt collars and various other stretch technology apparel interlining components. All of Talon Trim Group products are sold to a similar class of customers, sourced from specialty trim suppliers, are distributed using similar distribution methods and are sold by a shared salesforce; these similarities support the aggregation of the operating results into a combined Talon Trim Group.

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

	Years Ended December 31,		
	2016	**2015**	**2014**
Product Group Net Sales:			
Talon Zipper	36.4%	44.0%	50.1%
Talon Trim	63.6%	56.0%	49.9%

Design and Development

Our in-house creative teams develop products with innovative technology and designs that we believe distinguish our products from those of our competitors. We are constantly innovating our products to expand our product offerings and address new market needs. We support our skills and expertise in material procurement and product manufacturing coordination with product technology and designs intended to meet fashion demands, as well as cost and functional parameters. An example of this is the *Talon KidZip®,* which is a specialty zipper for children's apparel, engineered to surpass industry established strength and safety standards, while maintaining the fashion image and requirements of today's apparel demands. We have introduced two new fit for purpose specialty zippers to our range of zipper products, including a specialty zipper line designed specifically for the demanding requirements of workwear applications; and a specialty zipper line designed specifically for the demanding requirements of footwear applications. Our workwear application zipper improves durability, strength and safety features required by construction, utility, and safety workers, while our footwear application zipper features improves durability over a standard zipper and is designed to endure under high stress applications experienced in a variety of footwear, such as boots and shoes.

Many specialty design companies with which we compete have limited capabilities with regard to the range of their product offerings, sourcing or manufacturing experience, and consequently they create products or designs that often cannot be implemented due to limitations in the manufacturing process, the high expense of required materials, or a lack of functionality in the resulting product. We design products to function within the limitations imposed by the applicable materials and manufacturing framework, while meeting our customers' specialty needs. Using our manufacturing experience, we ensure delivery of quality products and minimize the time-consuming delays that often arise in coordinating the efforts of independent design houses and manufacturing facilities. By supporting our material procurement and product manufacturing services with design services, we reduce development and production costs and deliver products to our customers sooner than many of our competitors. Our design teams are based in our U.S. and Asian facilities.

Customers

We have over 800 active customers representing more than 250 of the world's best known brands. Our customers include the designated suppliers of well-known apparel retailers and brands, such as VF Corporation, Fat Face, Express, Polo Ralph Lauren, American Eagle, Next, Eddie Bauer, Uniqlo, PVH, Ben Sherman, NY & Co., Guess, and Berne USA among others. Our customers also include contractors, agents and importers for mass merchant retailers such as Kohl's, Wal-Mart, JC Penney, Costco and others.

For the years ended December 31, 2016, 2015 and 2014, our three largest customers combined represented approximately 8%, 6% and 5%, respectively, of consolidated net sales.

Sales and Marketing

We sell our products through our own sales force based in the United States, Hong Kong, China, India, Indonesia, Vietnam and Bangladesh. We also sell through outside sales representatives in Europe, and we develop Central America opportunities through our U.S. sales force and outside sales representatives. We employ customer service representatives who are assigned to key customers and provide local customer support. We have developed relationships with our major customers and brands at senior levels, and our sales teams actively participate with these customers/brands in their marketing and sales programs and sales strategies. When we become the nominated supplier for a brand's packaging or trim requirements, we market ourselves as an in-house function of the brand's trim procurement operation.

Sourcing and Assembly

We have developed expertise in identifying high quality materials, competitive prices and approved manufacturers for particular products and materials and ensuring strict adherence to quality manufacturing processes and materials. Our expertise enables us to produce a broad range of apparel accessories and Trim products at competitive prices. The majority of products that we procure and distribute are secured on a finished-good basis, manufactured by our partners and under our direct oversight. Raw materials used to manufacture or assemble all of our products are obtained only from sources we authorize and specify and are in adequate supply. We purchase products only from qualified material suppliers, and typically guarantee our customers that all materials used in the manufacture of our products are compliant with government regulations and controls over restricted substances.

We develop product artwork and any necessary dies and molds used to design and manufacture our products. Products that we design and sell are produced by manufacturing partners under our direct supervision or through joint manufacturing arrangements. We are confident in our ability to identify, secure and maintain high quality manufacturing sources. We will continue to build upon our production through qualified suppliers, particularly with respect to manufacturing activities that require substantial investments in time and capital equipment.

Principally through our Asian facilities, we distribute Talon Zipper and Talon Trim apparel accessories and stretch technology components, and oversee the manufacture and distribution of the full range of our products. Through our Asian facilities, we serve our customers worldwide.

Intellectual Property Rights and Licenses

We have trademarks as well as patent rights, copyrights, software copyrights and trade names for which we rely on common law protection, including the *Talon* trademark. Several of our other trademarks are the subject of applications for federal trademark protection through registration with the United States Patent and Trademark Office, including "*Talon,*" "*Tag-It,*" "*Kidzip*" and "*Tekfit.*" We hold patent rights for several key processes and products, including the Tekfit stretchable fabric products, specialty zippers and garment fasteners.

Seasonality

We typically experience seasonal fluctuations in sales volume consistent with the purchase demands of the apparel industry. In most years, these seasonal fluctuations result in lower sales volumes for our business in the first and fourth quarters of each year due to the seasonal buying patterns by the majority of our customers. Sales of our products typically precede the retail sales patterns by approximately 90 to 150 days, with this cycle pattern closer to 75 to 90 days for our more generic products sold to mass merchandisers. The apparel retailers typically experience their highest sales volumes during the fourth quarter in association with year-end holiday purchases. Backlogs of sales orders are not considered material in the industries in which we compete, which reduces the predictability of our sales and reinforces the volatility of these cyclical buying patterns on our sales volume. Operating expenses typically follow our seasonal sales patterns fluctuating with the quarterly sales. However our first quarter is typically burdened with higher costs associated with year-end audits, legal reviews, and costs associated with SEC filings, resulting in proportionally higher costs in the first quarter. Because of these fluctuations in our sales and operating costs, results for any quarter are not necessarily indicative of the results that may be achieved for the full year.

Inventories

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

Competition

We operate in highly competitive and fragmented segments of the apparel industry that include numerous local and regional companies that provide some or all of the products we offer. We also compete with U.S, and international design companies, distributors and manufacturers of tags, trim, packaging products and zippers. Some of our competitors are significantly larger in size and resources than us and have greater name recognition, longer operating histories and more financial and other resources.

Because of our integrated materials, manufacturing and assembly capabilities and our full-service zipper and trim solutions, we believe that we are able to effectively compete for our customers' business, particularly where our customers require a high level of confidence regarding compliance with restricted substance regulations, and with the effective coordination of separately sourced production functions. We believe that we successfully compete in our industry by offering superior product pricing, quality, customer service, design capabilities, delivery lead times and complete supply-chain management. We also believe the *Talon* brand name and the quality of our *Talon* brand zippers allows us to gain market share in the apparel accessory industry. The unique qualities of our *Tekfit* stretch fabric technology will also allow us to compete effectively in the growing market for waistband, shirt collar and shapewear garment components.

Segment Information

We operate in one industry segment, the distribution of a full range of apparel zipper, trim and interlining products to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We separately report our revenues and gross margins by our product selling groups in this segment to the extent these are distinguished and separate.

Financial Information about Geographic Areas

The majority of our products sold are for use by U.S. and European based brands, retailers and manufacturers. The majority of these customers produce their products or outsource the production of their products in manufacturing facilities located outside of the U.S. or Europe, primarily in China, India, Indonesia, Vietnam, Bangladesh and Central America.

A summary of our domestic and international net sales and long-lived assets is set forth in Item 8 of Part II of this Annual Report on Form 10-K, in Note 8 in the accompanying Notes to Consolidated Financial Statements.

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

Employees

As of December 31, 2016, we had 201 full-time employees including 30 in the United States and 171 employees in Asia. Our labor forces are non-union. We believe that we have satisfactory employee and labor relations.

Corporate Governance and Information Related to SEC Filings

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

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ITEM 1A. RISK FACTORS

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

U.S. and global financial and economic uncertainties could negatively affect our business, results of operations and financial condition.

Our 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 are served by many of our largest customers. 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, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, or maintain our earnings from operations as a percentage of net sales. As a result, our operating results may be adversely and materially affected by weak or downward trends in the United States or global economy.

If we lose our larger brand and retail nominations or customers, or the customers fail to purchase at anticipated levels, our sales and operating results will be adversely affected.

Our results of operations depend to a significant extent upon the commercial success of our larger brand nominations and customers. If we lose our significant brand nominations, or these customers fail to purchase our products at anticipated levels, or our relationship with these customers or the brands and retailers they serve diminishes, it may have an adverse effect on our results because we may lose a primary source of revenue if these customers choose not to purchase our products or services; we may lose the nomination of the retailer or brand; we may not be able to recoup development and inventory costs associated with this customer; and we may not be able to collect our receivables from them.

We may not be able to satisfy the financial covenants in our Credit Agreement and if we cannot, then our lender could declare the debt obligations in default.

Our Commercial Credit Agreement entered into on August 10, 2015 and as amended on December 21, 2015 (the “Credit Agreement”), with our secured lender, Princess Investment Holdings Limited (“Princess Investment”), requires certain financial covenants, including a requirement not to incur a loss after taxes (as calculated in accordance with GAAP) of more than $1,000,000 in the aggregate for any two consecutive fiscal quarters, not to incur a loss after taxes for any three consecutive fiscal quarters and not to incur a loss after taxes for any trailing twelve month period ending at the end of any fiscal quarter.

In the event we do not meet the required covenants with our lender in future periods, we would need to negotiate for changes in the relative covenants or request a waiver with the lender of the non-compliance from the lender, however there is no assurance that any lender would comply with these requests. Our expectations of future operating results and compliance with all debt covenants cannot be assured and our lender’s actions are not controllable by us. If we default under the loan agreement, all amounts due under the loan agreement could be declared immediately due and payable and, unless we are able to secure alternative financing to repay the lender, the lender would have the right to exercise its remedies including enforcement of its lien on substantially all of our assets. Further, if the debt is placed in default, we could be required to reduce our expenses, curtail operations and/or raise capital through the sale of assets, issuance of equity or otherwise.

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 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.

Global credit conditions may increase our credit risks.

Many of our customers are extended credit terms which are approved by us internally. While we attempt to cover as much of our credit risks as possible, not all of our risks can be fully covered due to the countries we operate in or the current credit conditions. Such exposure may translate into losses should there be any adverse changes to the financial condition of 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 seasonal and operational fluctuations that can significantly impact our results from quarter to quarter. 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 our customers' marketing campaigns;
- The loss or addition of a major customer or of a major retailer nomination;
- The availability and pricing of materials for our products;
- The increased expenses incurred in connection with the introduction of new products;
- Currency fluctuations;
- Political factors that may affect the expected flow of commerce;
- 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.

Our products may not comply with various industry and governmental regulations and our customers may incur losses in their products or operations as a consequence of our non-compliance.

Our products are produced under strict supervision and controls to ensure that all materials and manufacturing processes comply with the industry and governmental regulations governing the markets in which these products are sold. However, if these controls fail to detect or prevent non-compliant materials from entering the manufacturing process, our products could cause damages to our customers' products or processes and could also result in fines being incurred. The possible damages, replacement costs and fines could significantly exceed the value of our products and these risks may not be covered by our insurance policies.

If customers default on inventory purchase commitments with us, we may be left holding non-salable inventory.

We hold 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 non-salable inventory and this would have a negative impact on our operations and cash flow.

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.

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 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. Backlogs of sales orders are not considered material in the industries in which we compete, which reduces the predictability of revenues and reinforces the volatility of these cyclical buying patterns on our sales volume.

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 in a selected area. 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.

Counterfeit products are not uncommon in the apparel industry and our customers may make claims against us for products we have not produced, adversely impacting us 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 and to pay for false claims.

On occasion, we have discovered that certain Asian factories have counterfeited Talon's zippers. We undertake efforts to eliminate and prosecute all offenders. Counterfeiting of known quality brand products is commonplace within Asia and in particular where retailers limit their sources to recognized brands such as Talon. The full extent of counterfeiting of Talon products, its effect on our business operations and the costs to investigate and eliminate this activity are ongoing and are generally undeterminable. However, based upon evidence available, we believe the impact is not significant to our current overall operations. We continue to work closely with major retailers to identify these activities within the marketplace and will aggressively combat these efforts worldwide to protect the *Talon* brand.

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.

As part of our operations we must consolidate and centralize the management of our subsidiaries. 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 have adverse effects on the information reported.

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

Security breaches and improper access to or disclosure of our proprietary information, or other hacking attacks on our systems, could adversely affect our business.

Our industry is prone to cyber attacks, with third parties seeking unauthorized access to our proprietary information and technology. Computer malware, viruses, and hacking and phishing attacks by third parties have become more prevalent in our industry and may occur on our systems in the future. We believe such attempts are increasing in number and in technical sophistication, and in some instances we may be unable to anticipate these techniques or to implement adequate preventative measures. Additionally, we may be unaware of an incident or its magnitude and effects. Although we have developed systems and processes that are designed to protect our proprietary information and to prevent other cybersecurity breaches, we cannot guarantee that such measures will provide absolute security.

Any failure to prevent or mitigate security breaches and improper access to or disclosure of our proprietary information could result in the loss or misuse of such proprietary information, which could harm our business and diminish our competitive position. Such attacks may also create system disruptions or cause shutdowns. Publicity about vulnerabilities and attempted or successful incursions could damage our reputation with customers and reduce demand for our products and services.

Affected private parties or government authorities could initiate legal or regulatory actions against us in connection with any security breaches, which could cause us to incur significant expense and liability or result in orders or consent decrees forcing us to modify our business practices. Any of these events could have a material and adverse effect on our business, reputation, and operating results.

Unauthorized use of our proprietary technology may increase our litigation costs and adversely affect our sales.

We rely on trademark, patent, 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.

The outcome of any dispute or 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.

From time to time we are party to various disputes or 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 and arguments to the claims made in each and all of the matters to which we have been named a party and we intend to contest each vigorously, no assurances can be given that the results of these matters will be favorable to us. We maintain product liability, errors and omissions, product recall and director and officer insurance that we regard as reasonably adequate to protect us from potential claims; however, we cannot assure adequacy to cover any loss, or that we will be able to maintain our current levels of insurance at a reasonable cost or at all.

We may not be able to realize the anticipated benefits of acquisitions.

We may consider strategic acquisitions as opportunities arise. 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 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 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.

We have experienced and may continue to experience major fluctuations in the market price for our common stock.

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;
- Changes in interest rates;
- Changes in accounting principles;
- Disputes relating to intellectual property and legal matters;
- Sales of common stock by existing stockholders or holders of options;
- Announcements of key developments by our competitors; and
- The reaction of markets and securities analysts to announcements and developments involving our company.

If we need to sell or issue additional shares of common stock or assume additional debt to finance future growth, our stockholders' ownership could be diluted or our earnings could be adversely impacted.

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

We have adopted anti-takeover measures that may depress the price of our common stock.

Our ability to issue shares of preferred stock without stockholder approval 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 our Company. 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in the greater Los Angeles area, in Woodland Hills, California. We lease approximately 14,644 square feet of office, warehouse and product development spaces in the U.S. and 43,421 square feet of office, warehouse, product development, lab and testing space within Asia. The lease agreements related to these properties expire at various dates through October 2020. We believe our existing facilities are adequate to meet our needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

We currently have pending various 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 would not have a material effect on our consolidated financial condition if adversely determined against us.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

Common Stock

Our common stock is currently listed on the OTCQB under the trading symbol "TALN". The following table sets forth the high and low sales prices for the Common Stock as reported by the OTCQB during the periods indicated. Over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	High	Low
Year ended December 31, 2016		
1st Quarter	$0.18	$0.12
2nd Quarter	0.17	0.08
3rd Quarter	0.15	0.06
4th Quarter	0.18	0.09
Year ended December 31, 2015		
1st Quarter	$0.20	$0.03
2nd Quarter	0.19	0.13
3rd Quarter	0.18	0.05
4th Quarter	0.20	0.13

On March 24, 2017 the closing sales price of our common stock as reported on the OTCQB was $0.09 per share. As of March 24, 2017, there were 26 record holders of our common stock and approximately 73.7% of our outstanding shares were held by brokers and dealers.

Dividends

We have never paid dividends on our common stock. In addition, our Credit Agreement with Princess Investment prohibits us from paying dividends without prior approval by Princess Investment. It is our intention to retain future earnings for use in our business.

Issuer Purchases of Equity Securities

We did not repurchase any of our common stock in the fourth quarter of 2016.

Recent Sales of Unregistered Securities

On February 10, 2016, the Company issued warrants to purchase 250,000 shares of the Company's common stock to an outside services company. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of $0.14 per share and include a “cashless” exercise provision. The issuance of these securities was exempt from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

ITEM 6. SELECTED FINANCIAL DATA

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

	(In thousands except share data)				
	2016	**2015**	**2014**	**2013**	**2012**
Consolidated Statements of Operations Data:					
Talon Zipper net sales	$17,582	$21,284	$24,710	$28,756	$22,062
Talon Trim net sales (5)	$30,678	$27,069	$24,613	$23,691	$22,539
Total net sales	$48,260	$48,353	$49,323	$52,447	$44,601
Income from operations (3)	$2,712	$1,420	$1,740	$2,757	$995
Net income (1)(2)(3)(4)	$995	$511	$572	$9,731	$679
Net income per share	$0.01	$0.01	$0.01	$0.17	$0.03
Basic net income (loss) per share	$0.01	$0.01	$0.01	$0.26	$(0.12)
Diluted net income (loss) per share	$0.01	$0.01	$0.01	$0.24	$(0.12)
Weighted average share outstanding - basic	92,272	92,268	92,154	56,213	22,458
Weighted average share outstanding - diluted	93,325	93,522	94,301	60,555	22,458
Total comprehensive income (1)(2)(3)(4)	$966	$498	$573	$9,778	$685
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$4,914	$2,852	$2,603	$3,780	$8,927
Total assets	$21,155	$19,265	$18,102	$20,523	$18,976
Debt facilities and capital lease obligations	$4,102	$3,575	$4,164	$6,000	$3
Series B Convertible Preferred Stock	$-	$-	$-	$-	$23,979
Stockholders' equity (deficit)	$7,462	$6,210	$5,134	$4,431	$(16,028)
Per Share Data:					
Net book value per common share	$0.08	$0.07	$0.06	$0.05	$(0.68)
Common shares outstanding	92,274	92,268	92,268	91,342	23,401

(1) Net income for the year ended December 31, 2016 included $250,000 of recovered funds previously recorded as a business email compromise fraud loss in 2015.

(2) Net income for the year ended December 31, 2015 included a $715,000 one-time accrual for severance payments to our former CEO and board member, which were recognized upon separation, a $250,000 business email compromise fraud loss, and a $134,000 loss on extinguishment of debt.

(3) Income from operations for the year ended December 31, 2013 includes $330,000, related to trademark infringement litigation recovery.

(4) Benefit from income taxes, net, in the amount of $7,492,000 was recorded on December 31, 2013, arising from the recognition of our net deferred tax assets principally associated with our U.S. operating loss carryforwards.

(5) During the 2015 fiscal year, we realigned the reporting of our operating segments into two reporting segments (Zippers and Trim) and have reclassified prior period results to reflect these product categories. Our Tekfit operating segment results are now aggregated and reported as part of our Trim operating segment.

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

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. Amounts presented in this report, with the exception of the Consolidated Financial Statements and accompanying Notes to the Financial Statements, are rounded to the nearest thousand dollars, except per share amounts.

Overview

Talon International, Inc. designs, manufactures, sells and distributes apparel zippers, various apparel trim products and specialty waistbands, shirt collars and other stretch technology and apparel components to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We sell and market these products under various branded names including *Talon*® and *Tekfit*®. As a result, we operate the business globally under two product groups – Talon Zipper and Talon Trim.

We pursue the global expansion of our business through the establishment of Talon owned sales and distribution locations, and strategic manufacturing relationships. The manufacturing arrangements, in combination with Talon owned and affiliated facilities, improve our time-to-market throughout the world by sourcing, finishing and distributing to apparel manufacturers in their local markets.

Our primary business is serving as an outsourced apparel zipper, trim and stretch technology material supplier. We provide product design and development, sampling and sourcing services for the most demanding brands and retailers. We believe that design differentiation among brands and retailers is a critical marketing tool for our customers. By assisting our customers in the design, development, sampling and sourcing of all apparel components other than fabric and thread, we generally achieve higher margins for our products, create long-term relationships with our customers, grow our sales to a particular customer by serving a larger proportion of their brands and better differentiate our sales and services from those of our competitors. We are expanding our business globally, to better serve our apparel customers at the factory level, in addition to global brands and retailers. We believe we can lead the industry in apparel accessories by having strong relationships with our brand and retail customers and having a distributed service organization to serve our factory customers globally.

Our Tekfit stretch technology business provides manufacturers with Talon's patented material stretch technology, manufacturing know-how, proprietary equipment and materials necessary to produce expandable waistbands, shirt collars and various other stretch technology apparel inner lining components. We are actively expanding our marketing and selling efforts of this unique product within the industry, including by introducing this technology to major retailers.

The adoption of new and innovative technology by major retailers, particularly where it modifies the style, design or performance of a garment, is a complicated and time-consuming process. New product innovations by major retailers can require 6 to 12 months to complete the design, marketing and manufacturing of the new item, and depending upon the seasonal aspect of the garment, introduction of the product to the market could require several additional months. Accordingly, the adoption within the retailers' products of Tekfit technology requires significant time to accomplish. However, once adopted the production volumes continue to build as the technology is accepted across multiple styles with the retailer.

Results of Operations

Net Sales

For the years ended December 31, 2016, 2015 and 2014, total sales by geographic region based on customer delivery locations were as follows:

	Years Ended December 31,		
	2016	**2015**	**2014**
Sales:			
United States	$4,172,000	$3,416,000	$4,396,000
China	12,441,000	12,650,000	15,564,000
Hong Kong	11,617,000	10,638,000	11,497,000
Bangladesh	3,534,000	3,103,000	2,523,000
Vietnam	3,634,000	3,920,000	2,378,000
India	2,880,000	3,291,000	2,086,000
Other	9,982,000	11,335,000	10,879,000
Total	$48,260,000	$48,353,000	$49,323,000

The net sales for our two primary product groups are as follows:

	Years Ended December 31,		
	2016	**2015**	**2014**
Product Group Net Sales:			
Talon Zipper	$17,582,000	$21,284,000	$24,710,000
Talon Trim	30,678,000	27,069,000	24,613,000
Total	$48,260,000	$48,353,000	$49,323,000

Net sales are influenced by a number of factors, including demand, pricing strategies, new product launches, competitive products, product supply and foreign exchange rates. See Item 1 “Business” for a discussion of our principal products.

Sales for the year ended December 31, 2016 were $48,260,000, reflecting a slight decrease of $93,000 or -0.2% as compared to the same period in 2015. Our Talon Zipper products sales for the year ended December 31, 2016 were $3,702,000 lower than the same period in 2015 due to decreased sales of $928,000 within our mass merchandising brand customers as compared to 2015, and by $2,773,000 in sales to our specialty retail brands customers as compared to 2015. For the year ended December 31, 2016, sales of Talon Trim products, which consist primarily of sales to specialty retail branded customers, increased by $3,609,000 compared to the same period in 2015, mainly due to new stretch technology programs and customers.

In 2016, we continued to experience reduced sales to our mass merchandising Talon Zipper customers and selected specialty retail brand customers, including specialty teen retailers we serve with our Talon Zipper which decreased sales were offset by increased sales of our Talon Trim products. This marks a continuation of the general apparel retail trends, including weakness, which began in the second quarter of 2014 and which have continued throughout 2016. While retail trends are highly cyclical, industry data indicates that with lower consumer demand and excess carryover retail inventories which have been observed in the general apparel retail markets, the potential remains for continued weakening sales to our sensitive mass merchandising and, to a lesser degree to our specialty retail brand customers. This outlook is expected to be offset, however, by expansion of existing customer programs and new customers adopting our stretch technology products into their product offerings.

Sales for the year ended December 31, 2015 were $48,353,000, reflecting a decrease of $970,000 or 2.0% as compared to the same period in 2014. Our Talon Zipper products sales for the year ended December 31, 2015 were $3,426,000 lower than the same period in 2014 due to decreased sales of $3,177,000 within our mass merchandising brand customers as compared to 2014, and by $249,000 in sales to our specialty retail brands customers as compared to 2014. For the year ended December 31, 2015, sales of Talon Trim products, which consist primarily of sales to specialty retail branded customers, increased by $2,456,000 compared to the same period in 2014, mainly due to new stretch technology programs and customers.

Cost of goods sold and selected operating expenses

The following table summarizes cost of goods sold and selected operating expenses for the years ended December 31, 2016, 2015 and 2014 (amounts in thousands) and the percentage change in such operating expenses as compared to the previous year:

	Years Ended December 31,				
	2016	**Change**	**2015**	**Change**	**2014**
Sales	$48,260	0 %	$48,353	-2 %	$49,323
Cost of goods sold	$30,631	-4 %	$32,070	-4 %	$33,315
% of sales	63 %		66 %		68 %
Sales and marketing expense	$6,786	6 %	$6,415	1 %	$6,330
% of sales	14 %		13 %		13 %
General and administrative expense	$8,132	-4 %	$8,448	6 %	$7,938
% of sales	17 %		17 %		16 %

Cost of goods sold

Cost of goods sold for the year ended December 31, 2016 decreased $1,439,000 as compared to the same period in 2015, representing a 0.5% improvement as a percentage of sales. $52,000 of the decrease in the cost of goods sold was the result of lower overall sales volume, $1,214,000 was due to lower direct purchase costs associated with a greater mix of higher-margin products in the Talon Zipper and the Talon Trim products, $323,000 was due to lower freight and duty costs, offset by $150,000 of higher manufacturing overhead and inventory obsolescence costs.

Cost of goods sold for the year ended December 31, 2015 decreased $1,245,000 as compared to the same period in 2014, representing a 2% improvement as a percentage of sales. $556,000 of the decrease in the cost of goods sold was the result of lower overall sales volume, $867,000 was due to lower direct purchase costs associated with a greater mix of higher-margin products in the Talon Zipper and the Talon Trim products, offset by $178,000 of higher manufacturing overhead costs, inventory obsolescence costs and freight expenses.

Sales and marketing expenses

Sales and marketing expenses for the year ended December 31, 2016 totaled $6,786,000, an increase of $371,000 when compared to the same period in 2015. This was mainly due to $200,000 of additional compensation costs, $73,000 of increased facilities and related expenses, $137,000 of additional new product development and marketing costs, offset by a $21,000 decrease in travel and related costs.

Sales and marketing expenses for the year ended December 31, 2015 totaled $6,415,000, which was a slight increase when compared to the same period in 2014. This was mainly due to $124,000 of additional compensation costs and $156,000 of increased facilities and related expenses offset by a $254,000 reduction in new product development and marketing costs.

General and administrative expenses

General and administrative expenses for the year ended December 31, 2016 totaled $8,132,000, or 16.8% of sales, as compared to general and administrative expenses in the prior year of $8,448,000 or 17.5% of sales. General and administrative expenses were lower by $316,000 during the year ended December 31, 2016, as compared to the same period in 2015, mainly due to a $358,000 decrease in compensation costs, a $297,000 reduction in administrative costs as a result of the recovery of a business email compromise fraud loss (see below) offset by a $195,000 increase in additional professional services and $115,000 increase in additional travel and related costs.

General and administrative expenses for the year ended December 31, 2015 totaled $8,448,000 or 17.5% as a percentage of sales, as compared to general and administrative expenses in the prior year of $7,938,000 or 16.1% as a percentage of sales. General and administrative expenses were higher by $510,000 during the year ended December 31, 2015, as compared to the same period in 2014, mainly due to a $715,000 one-time accrual for severance payments to our former CEO and board member, recognized upon separation in 2015, $250,000 as a result of a business email compromise fraud loss (see below) offset by a $426,000 reduction in other compensation costs and a $236,000 reduction in facilities and related expenses.

In December 2015, we determined that we were the victim of criminal fraud known to law enforcement authorities as business e-mail compromise fraud which involved employee impersonation and fraudulent requests targeting our finance department. The fraud resulted in a transfer of funds in the amount of $250,000 to an overseas account held by a third party and we recorded a charge of $250,000 in the fourth quarter of 2015. In September 2016, we were able to fully recover the funds transferred to the third party, less our legal expenses, and as a result, we recorded a benefit of $250,000 in the third quarter of 2016.

Loss on extinguishment of debt

Loss on extinguishment of debt in the amount of $134,000 was recorded during the year ended December 31, 2015 as a result of paying off the Term Loan Payable to Union Bank. See Note 2 in the accompanying Notes to Consolidated Financial Statements. There was no loss on extinguishment of debt during the year ended December 31, 2016.

Interest expense and interest income

Interest expense for the year ended December 31, 2016, increased by $106,000 to $619,000, as compared to the same period in 2015. Interest expense for the year ended December 31, 2015, increased by $102,000 to $513,000, as compared to the same period in 2014. Interest expense for the year ended December 31, 2016 included borrowings under Princess Investment Holdings, Inc. Credit facility ("Princess Investment Credit Facility") and the related amortization of deferred financing costs and amortization of debt discounts (See Note 2 to the accompanying Notes to Consolidated Financial Statements). Interest expense for the year ended December 31, 2015, included borrowings under the Princess Investment Credit Facility and the related amortization of deferred financing costs and amortization of debt discounts as well as borrowings under our Credit Facilities with MUFG Union Bank, N.A., which were terminated on December 23, 2015 (formerly Union Bank, N.A., "Union Bank").

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

	Years Ended December 31,		
	2016	**2015**	**2014**
Amortization of deferred financing costs	$18,000	$152,000	$91,000
Amortization of debt discounts	86,000	22,000	-
Interest expense under Credit Facilities	488,000	308,000	318,000
Other interest expense	29,000	34,000	6,000
Interest expense	621,000	516,000	415,000
Interest income	(2,000)	(3,000)	(4,000)
Interest expense, net	$619,000	$513,000	$411,000

Income taxes

Provision for income taxes, net, for the year ended December 31, 2016, was $1,097,000 as compared to $262,000 in 2015 mainly due to higher taxable income and a higher effective tax rate in 2016 versus 2015. The provision for income taxes at December 31, 2016 and 2015 includes consideration of all taxable income worldwide (See Note 6 in the accompanying Notes to Consolidated Financial Statements).

Provision for income taxes, net, for the year ended December 31, 2015, was $262,000 as compared to $756,000 in 2014 mainly due to lower taxable income and a lower effective tax rate in 2015 versus 2014. The provision for income taxes at December 31, 2015 and 2014 includes consideration of all taxable income worldwide.

Liquidity and Capital Resources

The following table summarizes selected financial data at the following year end dates:

	December 31, 2016	2015
Cash and cash equivalents	$4,914,000	$2,852,000
Total assets	$21,155,000	$19,265,000
Current liabilities	$9,375,000	$9,238,000
Long term liabilities	$4,318,000	$3,817,000
Stockholders' equity	$7,462,000	$6,210,000

We believe that our existing cash and cash equivalents, our anticipated cash flows from our operating activities, and available borrowings from our Credit Facilities, will be sufficient to fund our minimum working capital and capital expenditure needs for operating activities for at least the next twelve months. Approximately $1,500,000 remained in available borrowings under our Princess Investment Credit Facility as of December 31, 2016.

Cash and cash equivalents

Most of our cash is held within various financial institutions globally and as of December 31, 2016 and 2015 there were no restricted cash balances.

Cash and cash equivalents increased by $2,061,000 at December 31, 2016, as compared to December 31, 2015, principally due to $2,595,000 in cash provided by operating activities, offset by $404,000 in payments for the acquisition of property and equipment, net of proceeds from selling of property and equipment and $22,000 in repayment of borrowings under capital leases.

Cash and cash equivalents increased by $249,000 at December 31, 2015, as compared to December 31, 2014, principally due to $1,073,000 in cash provided by operating activities, $4,000,000 revolving line of credit borrowings from Princess Investment ("Revolving Line of Credit") and $700,000 in Union Bank revolving credit loan borrowings ("Revolving Credit Loan") offset by $2,833,000 in Union Bank term loan ("Term Loan Payable") payments paid off at August 11, 2015, $2,200,000 repayments of Revolving Credit Loan paid off at December 23, 2015, $148,000 in payments of financing costs associated with credit facilities and $250,000 in payments for the acquisition of property and equipment and intellectual property rights, net of proceeds from selling of property and equipment.

Cash flows

The following table summarizes our cash flow activity for the years ended December 31, 2016, 2015 and 2014:

	Years Ended December 31,		
	2016	**2015**	**2014**
Net cash provided by operating activities	$2,595,000	$1,073,000	$889,000
Net cash used in investing activities	(404,000)	(250,000)	(271,000)
Net cash used in financing activities	(23,000)	(493,000)	(1,791,000)
Net effect of foreign currency translation on cash	(107,000)	(81,000)	(3,000)
Net increase (reduction) in cash and cash equivalents	$2,061,000	$249,000	$(1,176,000)

Operating Activities

The net cash provided by operating activities is our primary recurring source of funds, and reflects net income from operations, excluding non-cash charges and changes in operating capital. The net cash provided by operating activities during the years ended December 31, 2016, 2015 and 2014 resulted principally from:

	Years Ended December 31,		
	2016	2015	2014
Net income before non-cash expenses	$2,506,000	$1,314,000	$1,477,000
Inventory reductions (increases)	157,000	(171,000)	311,000
Accounts receivable (increases) reductions	(538,000)	(827,000)	539,000
Accounts payable and accrued expenses increases (reductions	728,000	748,000	(1,432,000)
Other increases (decreases) in operating capital	(258,000)	9,000	(6,000)
Net cash provided by operating activities	$2,595,000	$1,073,000	$889,000

Investing Activities

Net cash used in investing activities for the year ended December 31, 2016 was $404,000 due to the net acquisition and disposal of property and equipment.

Net cash used in investing activities for the year ended December 31, 2015 was $250,000, due to $223,000 relating to the net acquisition and disposal of property and equipment and $27,000 associated with an acquisition of intellectual property rights.

Net cash used in investing activities for the year ended December 31, 2014 was $271,000, due to $225,000 relating to the net acquisition and disposal of property and equipment and $46,000 associated with an acquisition of intellectual property rights.

Financing Activities

Net cash used in financing activities for the year ended December 31, 2016 was $23,000 reflecting $22,000 in repayment of borrowings under capital leases and $1,000 in payments related to taxes associated with the exercise of stock options.

Net cash used in financing activities for the year ended December 31, 2015 was $493,000 reflecting $2,833,000 in Term Loan Payable payments, $2,200,000 in repayments of Revolving Credit Loan borrowings, $148,000 in payments of financing costs associated with Credit Facilities and $12,000 in repayment of borrowings under capital leases, offset by $4,000,000 Revolving Line of Credit from related party borrowings, and $700,000 in Revolving Credit Loan borrowings under our Union Bank Credit Facilities.

Net cash used in financing activities for the year ended December 31, 2014 was $1,791,000, which reflects $2,167,000 in Term Loan Payable payments, $10,000 in payments of financing costs associated with Credit Facilities and $144,000 in payments related to taxes associated with the exercise of stock options and RSU settlements, partially offset by $1,000,000 in Revolving Credit Loan borrowings under our Credit Facilities, net of $500,000 in repayments, and $30,000 in proceeds from the exercise of stock options.

Facility with Princess Investment

On August 10, 2015, the Company entered into a loan and reimbursement agreement ("Loan Agreement") with Princess Investment Holdings Inc. ("Princess Investment"). Princess Investment may be deemed an affiliate of Kutula Holdings, Ltd., a significant stockholder of the Company, which also has the contractual right to designate a director to the Company's Board of Directors. Pursuant to the Loan Agreement, Princess Investment agreed to make available to the Company a loan of up to $3,000,000 ("Revolving Line of Credit"). Advances under the Loan Agreement accrued interest initially on the unpaid principal balance at an annual rate of 12.5%. Accrued interest on the Revolving Line of Credit was payable monthly beginning September 1, 2015, and the principal amount was payable in monthly installments beginning September 1, 2016 and continuing through the maturity date of August 10, 2018. Pursuant to the Loan Agreement, the Company issued Princess Investment warrants to purchase 1,000,000 shares of the Company's common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of $0.18 per share and include a "cashless" exercise option. On August 11, 2015, the Company received an advance from Princess Investment under the Loan Agreement in the amount of $1,500,000, of which $1,440,278 was used to pay off the Term Loan Payable to MUFG Union Bank N.A. on August 12, 2015 (See Retired Union Bank Credit Facilities). The Company borrowed an additional $500,000 through December 21, 2015, and had an outstanding balance of $2,000,000 under the Revolving Line of Credit from Princess Investment at December 21, 2015.

On December 21, 2015, the Company entered into an amended and restated credit agreement (the "Princess Investment Credit Agreement") with Princess Investment, which amended the existing Loan Agreement, dated August 10, 2015, with Princess Investment to, among other things, increase the borrowing availability under the Loan Agreement from $3,000,000 to $6,000,000 and extend the maturity date of the loan to December 21, 2020 (the "Maturity Date"). The Princess Investment Credit Agreement requires the Company to comply with certain financial covenants, including a requirement not to incur a loss after taxes (as calculated in accordance with GAAP) of more than $1,000,000 in the aggregate for any two consecutive fiscal quarters, not to incur a loss after taxes for any three consecutive fiscal quarters and not to incur a loss after taxes for any trailing twelve month period ending at the end of any fiscal quarter. At December 31, 2016, the Company was in compliance with all covenants.

Princess Investment will make advances under the Revolving Line of Credit from time to time as requested by the Company. The Company may prepay the Revolving Line of Credit at any time, and amounts prepaid may be re-borrowed through November 21, 2020. Under the amended terms, the Revolving Line of Credit will accrue interest on the unpaid principal balance at an annual rate of 11.5%. Interest on the Revolving Line of Credit for the period from December 21, 2015 through December 1, 2016 was accrued and added to principal on December 1, 2016, and thereafter interest will be payable monthly in arrears. No principal payments will be due during the period ending December 31, 2017. Thereafter, principal will be payable $25,000 per month during the twelve months ended December 31, 2018, $35,000 per month during the twelve months ended December 31, 2019 and $50,000 per month during the twelve months ended December 31, 2020, with the remaining outstanding principal amount payable on the Maturity Date. The Princess Investment Credit Agreement continues to require payment of a $60,000 loan fee at maturity.

The payment and performance of all the indebtedness and other obligations to Princess Investment, including all borrowings under the Princess Investment Credit Agreement, are guaranteed by the subsidiaries Talon Technologies, Inc. and Tag-It Pacific Limited pursuant to a Guaranty Agreement entered into on August 10, 2015, as amended on December 21, 2015. The payment and performance of all of the indebtedness and other obligations to Princess Investment under the Princess Investment Credit Agreement and related agreements are secured by liens on substantially all of the Company's assets and the assets of the Company's subsidiary guarantors pursuant to a Pledge and Security Agreement entered into on August 10, 2015, as amended on December 21, 2015.

Pursuant to the Princess Investment Credit Agreement, the Company issued to Princess Investment warrants to purchase 2,000,000 shares of its common stock. The warrants are exercisable immediately upon issuance for a five-year period at an exercise price of $0.18 per share, and include a "cashless" exercise option.

On December 23, 2015, the Company received an advance from Princess Investment under the Princess Investment Credit Agreement in the amount of $2,000,000, of which $1,622,000 was used to pay in full all indebtedness outstanding under the Commercial Credit Agreement, dated December 31, 2013, with MUFG Union Bank N.A., which indebtedness was scheduled to mature on December 31, 2015.

Upon repayment of the indebtedness under the Company's Credit Agreement with Union Bank, Union Bank released its liens on the Company's assets and those of the Company's subsidiaries, Princess Investment became the only secured lender, and in addition to the Credit Agreement, the following agreements (the "Security Agreements") terminated in accordance with their terms: Continuing Guaranties, dated December 31, 2013, executed by the Company's current subsidiaries, Talon Technologies, Inc. and Tag-It Pacific Limited in favor of Union Bank; Security Agreements, dated December 31, 2013, executed by the Company and its current domestic subsidiary, Talon Technologies, Inc., and Union Bank; a Debenture executed by Tag-It Pacific Limited and Union Bank; an Intercreditor Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank; and a Subordination Agreement, dated August 10, 2015, among the Company, Princess Investment and Union Bank.

After consideration of FASB ASC 480 "*Distinguishing Liability and Equity*" and ASC 815 "*Derivatives and Hedging*", the Company concluded that the warrants issued to Princess Investment should be recorded as an equity instrument. The fair value of the first one million warrants of $130,000 issued with the debt facility at August 10, 2015 and the fair value of the additional two million warrants of $320,000 issued with the debt facility at December 21, 2015 were valued using the Black-Scholes model. The fair value of the warrants was recorded as additional paid in capital and reflected as a debt discount to the face value of the Revolving Line of Credit, which discount is amortized over the term of the Loan and recognized as additional interest costs, as amortized.

At December 31, 2016 and December 31, 2015, the Company had an outstanding principal balance of approximately $4,456,000 and $4,000,000 respectively under the Revolving Line of Credit, and as of December 31, 2016 and December 31, 2015, approximately $1,500,000 and $2,000,000 respectively remained in available borrowings under the Revolving Line of Credit.

Retired Union Bank Credit Facilities

On December 31, 2013, the Company entered into a Commercial Credit Agreement (the "Credit Agreement") with MUFG Union Bank, N.A. (formerly Union Bank, N.A., "Union Bank"). The Credit Agreement initially provided for a 24 month revolving loan commitment and a 36 month term loan. The term loan was extinguished during the quarter ended September 30, 2015 by the payment on August 12, 2015 of $1,440,278 representing the outstanding principal and interest thereon, and the revolving loan commitment with Union Bank was paid off on December 23, 2015, in each case using proceeds from related party borrowings (See Revolving Line of Credit from Related Party).

The revolving loan commitment included available borrowings of up to $3,500,000 (the "Revolving Credit Loan"), consisting of revolving loans and a sublimit of letters of credit not to exceed a maximum aggregate principal amount of $1,000,000. Borrowings under the Revolving Credit Loan initially carried interest at a per annum rate of two and one-half percent (2.50%) in excess of a reference rate ("Reference Rate"), which is an index rate determined by Union Bank from time to time as a means of pricing certain extensions of credit. The Reference Rate was 3.25% as of December 31, 2014.

The Credit Agreement initially provided for a term loan in the amount of $5,000,000 (the "Term Loan Payable" and together with the Revolving Credit Loan, the "Union Bank Credit Facilities"). The Term Loan Payable was originally payable in 36 monthly payments of $138,889 beginning January 31, 2014 with interest payable at a per annum rate of two and three-quarters percent (2.75%) in excess of the Reference Rate. The Credit Agreement contained representations and warranties, affirmative, negative and events of default, applicable to the Company and its subsidiaries which were customary for Union Bank Credit Facilities of this type. The Credit Agreement initially contained financial covenants applicable to the Company and its subsidiaries including maintaining a Fixed Charge Coverage Ratio between Adjusted EBITDA and principal and interest payments (as defined in the Credit Agreement) of not less than 1.25:1.00 as of the close of each fiscal quarter and an EBITDA (as defined in the Credit Agreement) of at least $2,750,000 as of the close of each fiscal quarter, for the 12-month period ended as of the last day of the quarter. The Company did not satisfy the previous minimum Fixed Charge Coverage Ratio requirement (1.25:1.00) and the previous minimum EBITDA requirement of $2,750,000 for the 12-month periods ended September 30, 2014 and December 31, 2014, and in connection therewith obtained waivers of such non-compliance from Union Bank for those periods. In exchange for the waivers, the Company paid Union Bank a waiver fee of $10,000, and at December 31, 2014 a prepayment in the amount of $500,000 was made and applied to the principal of the Term Loan Payable and certain provisions of the Credit Agreement were amended.

On March 3, 2015, the Credit Agreement was further amended to change various contractual terms as follows: the Fixed Charge Coverage Ratio requirement was reduced for the periods ended March 31, 2015 to 0.70:1.00 and for June 30, 2015 to 1.00:1.00; the minimum EBITDA requirement for the 12-month period ended as of the last day of each of these quarters during 2015 was reduced from $2,750,000 to $1,750,000; the requirement of no incurrence of a net loss after taxes for more than two consecutive fiscal quarters was changed to be effective January 1, 2015; net principal repayments totaling $600,000 in 2015 were added to the Term Loan Payable scheduled payments ($400,000 were paid during the second quarter of 2015 and the remaining $200,000 were paid during the third quarter of 2015), and excluded from the Fixed Charge Coverage Ratio calculation; the interest rate on the Term Loan Payable and Revolving Credit Loan was increased by 1% effective March 1, 2015; and the Company paid a loan modification fee of $50,000, half of which was paid on March 31, 2015 and the other half was paid on June 30, 2015. Additional legal fees were charged by Union Bank during the first quarter of 2015 in the amount of $6,915. The Company did not satisfy the minimum EBITDA requirement for the 12-month period ended June 30, 2015, due primarily to a $715,000 one-time accrual for severance payments to Lonnie D. Schnell, the Company's former CEO and board member, that was recognized upon separation during the three months ended June 30, 2015. On August 4, 2015, the Company obtained a waiver from Union Bank of this minimum EBITDA requirement non-compliance and paid Union Bank a waiver fee of $25,000 as a condition to the waiver.

On August 10, 2015, the Company entered into an amendment to the Credit Agreement with Union Bank, which provided for the elimination of financial covenants for the remaining term of the Credit Agreement, permitted the Company to incur $3,000,000 of subordinated indebtedness, and required the repayment of the outstanding Term Loan Payable in the principal amount of $1,440,278 plus accrued and unpaid interest by August 31, 2015. In connection with the amendment, the Company incurred approximately $18,000 in legal fees, representing additional financing costs to the Union Bank Credit Facilities. On August 11, 2015, the Company received an advance from Princess Investment, and on August 12, 2015, the Company paid off $1,440,278 in outstanding Term Loan Payable from Union Bank as well as the unpaid interest.

Prior to repayment, the payment and performance of all indebtedness and other obligations under the Union Bank Credit Facilities were secured by liens on substantially all of the Company assets pursuant to the terms and conditions of security agreements and guaranties executed by the Company and its principle operating subsidiaries including Talon Technologies, Inc. (U.S. operation) and Tag-It Pacific Limited (Hong Kong operation).

Capital Leases

We have financed purchases of furniture and fixtures through various capital lease obligations. Our capital lease obligations as of December 31, 2016 are $61,000 and bear interest at a rate of 8.0% per annum. Under these obligations, we are required to make monthly payments of principal and interest through May 2019.

We have satisfied our working capital requirements primarily through cash flows generated from operations and borrowings under our Credit Facilities. As we continue to expand globally with apparel manufacturing in offshore locations, our customers are substantially all foreign-based and foreign-owned entities. We continue to evaluate both debt financing and equity options to provide capital to fund our expansion and on-going operations. If we experience significant reductions in sales, we may need to borrow or raise additional capital, or further reduce the scope of our business in order to fund our on-going operations or to 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 possible acquisitions, and our expansion into foreign markets. Our need for additional long-term financing may include the integration and expansion of our operations to exploit our rights under our *Talon* and *Tekfit* trade names, and the expansion of our operations in the Asian and other 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 debt or equity financing in order to provide for our operations.

Contractual Obligations

The following summarizes our contractual obligations at December 31, 2016 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**
Revolving line of credit from related party	$6,309,000	$512,000	$5,797,000	$-
Operating leases	2,094,000	885,000	1,209,000	-
Capital leases	67,000	28,000	39,000	-
Software as a Service "SaaS" license agreement	1,113,000	294,000	614,000	205,000
Total Obligations	$9,583,000	$1,719,000	$7,659,000	$205,000

Off-Balance Sheet Arrangements

At December 31, 2016 and 2015, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Related Party Transactions

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

Application of Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions for the reporting period and as of 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 of operations, and which require us to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements:

Accounts receivable balances are evaluated on a continual basis and allowances are provided for potentially uncollectible accounts based on management's estimate of the collectibility of customer accounts. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, an additional allowance may be required. Allowance adjustments are charged to operations in the period in which the facts that give rise to the adjustments become known. The bad debt expenses, recoveries and allowances for the years ended December 31, 2016, 2015 and 2014 are as follows:

	Years Ended December 31,		
	2016	**2015**	**2014**
Bad debt expense, net	$11,000	$20,000	$15,000
Allowance for accounts receivable doubtful accounts	$40,000	$67,000	$51,000

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 by the disposition of inventory and write-off of reserved inventory, and increased by additions to the reserve for slow moving inventory. The inventory valuation provisions (recoveries) and allowances for inventory valuation reserves for the years ended December 31, 2016, 2015 and 2014 are as follows:

	Years Ended December 31,		
	2016	**2015**	**2014**
Inventory valuation provisions (recoveries), net	$8,000	$20,000	$(17,000)
Allowance for inventory valuation reserves	$64,000	$69,000	$199,000

We record deferred tax assets and liabilities 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 liabilities 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. Benefit from income taxes, net in the amount of $7,492,000 was recorded on December 31, 2013, arising from the recognition of our net deferred tax assets principally associated with our U.S. operating loss carryforwards. (See Note 6 in the accompanying Notes to Consolidated Financial Statements.)

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 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 Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") No. 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. We believe that we have meritorious defenses to these claims and that the claims are either covered by insurance or would not have a material effect on our consolidated financial position or results of operations if adversely determined against us.

New Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-03, *"Accounting Changes and Error Corrections (Topic 250) and Investments – Equity Method and Joint Ventures (Topic 323)."* This ASU responds to SEC staff announcements made in 2016 as it relates to the disclosure of the future impact of the effects of the new FASB guidance on revenue, leases and credit losses on financial instruments in accordance with Staff Accounting Bulletin 74. This ASU was effective upon issuance in January 2017. Management has adopted ASU 2017-03 effective for January 2017.

In December 2016, the FASB issued ASU No. 2016-20, "*Technical Corrections and Improvements* (Topic 606): *Revenue from Contracts with Customers*." This ASU provides amendments to Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, allow entities not to make quantitative disclosures about remaining performance obligations in certain cases and require entities that use any of the new or previously existing optional exemptions to expand their qualitative disclosures. It also makes 12 additional technical corrections and improvements to the new revenue standard. The effective date and transition requirements are the same as those in ASC 606. Management is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

In December 2016, the FASB issued ASU No. 2016-19, "*Technical Corrections and Improvements"*. This ASU clarifies guidance, corrects errors and makes minor improvements affecting a variety of topics in the Accounting Standards Codification. Most of the amendments are not expected to have a significant effect on practice, but some of them could change practice for some entities. Transition guidance and a delayed effective date are provided for amendments that the FASB deemed more substantive. The other amendments are effective immediately. Management has implemented as necessary and is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

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

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

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

In March 2016, the FASB issued ASU No. 2016-09, "*Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."* The updated accounting guidance simplifies the accounting for share-based payment award transactions including income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. Management is currently evaluating the impact of this accounting standard on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 "*Leases*" (Topic 842). The new standard requires lessee recognition on the balance sheet of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. It further requires recognition in the income statement of a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis. Finally, it requires classification of all cash payments within operating activities in the statement of cash flows. It is effective for fiscal years commencing after December 15, 2018 and early adoption is permitted. In accordance with this standard, the Company will be establishing a right-of-use asset and an offsetting lease liability. Once adopted, we expect to report higher assets and liabilities as a result of including additional lease information on the consolidated balance sheet. The adoption of ASU 2016-02 is not expected to have a material impact on the Company's consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "*Balance Sheet Classification of Deferred Taxes*". This ASU is part of the FASB's simplification initiative directed at reducing complexity in accounting standards. To simplify presentation, the new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction. For public business entities, the amendments are effective in fiscal years beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The guidance may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively (i.e., reclassifying the comparative balance sheet). Management has adopted ASU 2015-17 effective for the fourth quarter of 2016. We presented the net deferred tax assets as noncurrent and reclassified any current deferred tax assets in the consolidated balance sheet on a retroactive basis. As a result, $997,000 and $746,000 of current deferred income taxes were reclassified to non-current deferred tax assets for the periods ending December 31, 2016 and 2015, respectively.

In August 2015, the FASB issued ASU 2015-15, "*Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements*". We previously reported that in April 2015, the FASB issued ASU 2015-03, "*Simplifying the Presentation of Debt Issuance Costs*", which simplifies the presentation of debt issuance costs by requiring that debt issuance costs related to a recognized liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in ASU 2015-15 address the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements such that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 and ASU 2015-03 are effective for financial statements of public business entities issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company chose to early adopt the amendment at December 31, 2015. Other than reclassification of debt issuance costs net of amortization from assets to liabilities, no other effect is included on our financial statements.

In July 2015, the FASB issued ASU 2015-11, "*Simplifying the Measurement of Inventory*", to reduce the complexity in accounting for inventory. This ASU requires entities to measure inventory at the lower of cost or net realizable value, replacing the market value approach that required floor and ceiling considerations. This guidance for public entities is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. We are in the process of evaluating the adoption of this ASU, but do not expect this to have a material effect on our financial position, results of operations or cash flows.

In August 2014, the FASB issued ASU 2014-15, *"Presentation of Financial Statements - Going Concern (Subtopic 205-40).*" ASU 2014-15 addresses management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Management has adopted this guidance effective for the fourth quarter of 2016.

Other pronouncements issued by the FASB or other authoritative accounting standards groups with future effective dates are either not applicable or are not expected to be significant to the Company’s financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All of our sales are denominated in United States dollars or the currency of the country in which our products originate. We are exposed to market risk for fluctuations in the foreign currency exchange rates for certain product purchases that are denominated in Hong Kong dollars and Chinese Yuan. We do not intend to purchase contracts to hedge the exchange exposure for future product purchases. There were no hedging contracts outstanding as of December 31, 2016. 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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Talon International, Inc. and Subsidiaries
Woodland Hills, California

We have audited the accompanying consolidated balance sheets of Talon International, Inc. and Subsidiaries (collectively, "the Company") as of December 31, 2016 and 2015, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the financial statement schedule of the Company, listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ SingerLewak LLP
SingerLewak LLP

Los Angeles,
California

March 27, 2017

TALON INTERNATIONAL, INC.

Consolidated balance sheets

	December 31, 2016	**December 31, 2015**
Assets		
Current assets:		
Cash and cash equivalents	$4,913,577	$2,852,315
Accounts receivable, net	4,315,608	3,796,209
Inventories, net	500,482	655,360
Prepaid expenses and other current assets	702,906	554,389
Total current assets	10,432,573	7,858,273
Property and equipment, net	884,208	781,893
Intangible assets, net	4,266,596	4,313,948
Deferred income tax assets, net	5,224,018	6,043,412
Other assets	347,638	267,325
Total assets	$21,155,033	$19,264,851
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$6,378,896	$6,087,561
Accrued expenses	2,972,689	3,128,304
Current portion of capital lease obligations	23,749	21,940
Total current liabilities	9,375,334	9,237,805
Revolving line of credit from related party, net of discounts and deferred financing costs	4,041,345	3,492,772
Capital lease obligations, net of current portion	37,035	60,784
Deferred income tax liabilities	3,037	5,406
Other liabilities	236,088	257,903
Total liabilities	13,692,839	13,054,670
Commitments and contingencies (Note 7)		