TALON INTERNATIONAL, INC.
Form 10-K
March 27, 2013
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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

Commission file number 1-13669

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

Delaware (State or Other Jurisdiction of Incorporation or Organization)		95-4654481 (I.R.S. Employer Identification No.)
	21900 Burbank Blvd., Suite 270 Woodland Hills, California (Address of Principal Executive Offices)	 91367 (Zip Code)

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

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

None

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

Common Stock, $.001 par value

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

Yes [_] No [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 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 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, 2012, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was $762,110.

At March 26, 2013 the issuer had 24,900,808 shares of Common Stock, $.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

TALON INTERNATIONAL, INC.

INDEX TO FORM 10-K

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," "shou "continue," variations of such words and similar expressions are intended to identify such forward looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We describe our respective risks, uncertainties and assumptions that could affect the outcome or results of operations in "Item 1A. Risk Factors." We have based our forward looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward looking statements. Reference is made in particular to forward looking statements regarding projections or estimates concerning our business, including demand for our products and services, mix of revenue streams, ability to control 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 full range of apparel accessories including zippers and trim items to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We manufacture and distribute zippers under our Talon® brand name to manufacturers for apparel brands and retailers such as Abercrombie & Fitch, Fat Face, Wal-Mart, Kohl's, JC Penney, Polo Ralph Lauren, Guess and Express, among others. We also provide full service outsourced trim design, sourcing and management services and supply specified trim items for manufacturers of fashion apparel such as V. F. Corporation, Victoria's Secret, Tom Tailor, Fat Face, Abercrombie & Fitch, American Eagle, Polo Ralph Lauren, Express, and others. Under our Tekfit® brand, we develop and sell a stretch waistband that utilizes a patented technology to manufacturers for apparel brands and retailers such as Saks Fifth Avenue, HMX and Superior Uniforms.

We were incorporated in the State of Delaware in 1997. We were formed to serve as the parent holding company of Tag-It, Inc., a California corporation, Tag-It Pacific (HK) LTD, a BVI corporation, Tagit de Mexico, S.A. de C.V., A.G.S. Stationery, Inc., a California corporation, and Pacific Trim & Belt, Inc., a California corporation. All of these companies were consolidated under a parent limited liability company in October 1997 and became our wholly owned subsidiaries immediately prior to the effective date of our initial public offering in January 1998. In 2000, we formed two wholly owned subsidiaries of Tag-It Pacific, Inc.: Tag-It Pacific Limited, a Hong Kong corporation and Talon International, Inc., a Delaware corporation. During 2006 we formed two wholly owned subsidiaries of Talon International, Inc. (formerly Tag-It Pacific, Inc.): Talon Zipper (Shenzhen) Company Ltd. in China and Talon

International Pvt. Ltd., in India. On July 20, 2007 we changed our corporate name from Tag-It Pacific, Inc. to Talon International, Inc. Our website is www.talonzippers.com.

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.

Business Summary

We operate our business within three product groups, Talon, Trim and Tekfit®. In our Talon group, we design, engineer, test and distribute zippers under our Talon trademark to apparel brands and manufacturers. Talon enjoys brand recognition in the apparel industry worldwide. Talon is a 100-year-old brand, which is known for its quality and product innovation and was the original pioneer of the formed wire metal zipper for the jeans industry, and is a specified zipper brand for manufacturers in the designer, sportswear and outerwear markets worldwide. We provide multiple lines of high quality zippers, including metal, coil and plastic custom zippers, vintage zippers, and a specialty zipper for kids clothing, all for distribution to apparel manufacturers worldwide, including Hong Kong, China, Taiwan, India, Indonesia, Bangladesh, the European markets, Mexico and Central America. We have sales and marketing teams in most of these areas. We have developed Talon "Authorized", joint manufacturing arrangements in strategic international local markets to manufacture, finish and distribute zippers locally under the Talon brand name. Our manufacturing partners operate under our direct manufacturing and quality assurance oversight, to our manufacturing specifications and quality standards, using only Talon approved and authorized raw materials, resulting in the highest 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 to effectively expand the geographic footprint of our Talon products.

In our Trim products group, we act as a fully integrated single-source designer, product developer and exclusive supplier for a full range of trim items for manufacturers of fashion apparel. Our business focuses on servicing all of the trim requirements of our customers at the manufacturing and retail brand level of the fashion apparel industry. Trim items include labels, buttons, rivets, printed marketing material, polybasic, packing cartons and hangers. Trim items comprise a relatively small part of the cost of most apparel products but comprise the vast majority of components necessary to fabricate 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 and Trim products 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 pullers and other items to meet the customers' 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 a critical 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 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 typically identified as the sole or preferred source supplier for the project, and our customer's 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 finally delivered to our customer's apparel factories.

Under our Tekfit brand we supply apparel manufacturers advanced, patented fabric technologies to produce a unique stretchable waistband for their garments. This technology allows the fabric to be altered through the addition of stretch characteristics resulting in greatly improved fit and comfort. Pant manufacturers use this technology to build-in a stretch factor into standard waistbands that does not alter the appearance of the garment, but will allow the waist to stretch out and back by as much as two waist sizes.

We serve as a specified supplier in our zipper, trim and waistband products for a variety of major retail brand and private-label oriented companies. A specified supplier is a supplier that has been approved for its quality and service by a major retail brand or private-label company. Apparel contractors manufacturing for the retail brand or private-label company must purchase their zipper and trim components from a supplier that has been specified. We seek to expand our services as a supplier of select items for such customers, to being a preferred or single-source provider of the entire customer's authorized trim and zipper requirements. Our ability to offer a full range of trim and zipper products is attractive to brand name and private-label oriented customers because it enables the customer to address their quality and supply needs for all of their trim requirements from a single source, avoiding the time and expense necessary to monitor quality and supply from multiple vendors and manufacturer sources. Becoming a specified supplier to brand customers gives us 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, representatives, program managers, creative design personnel and global production and distribution coordinators 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 apparel accessory solutions. We plan to continue to expand operations in Asia, Europe, and Central America to take advantage of the large apparel manufacturing markets in these regions.

Products

Talon Zippers - 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, China, Taiwan, India, Indonesia and Bangladesh and through these designated offices to other international markets.

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 under the Talon brand, 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.

Trim - We consider our high level of customer service as a fully integrated single-source supplier essential to our success. We combine our high level of customer service within our Trim solutions with a history of design and manufacturing expertise to offer our customers a complete trim solution product. We believe this full-service product gives us a competitive edge over companies that only offer selected trim components because our full service solutions save our customers substantial time in ordering, designing, sampling and managing trim orders from several different suppliers. Our tracking and order management systems allow us to seamlessly supply trim solutions and products to apparel brands, retailers and manufacturers around the world. We produce customized woven, leather, synthetic, embroidered and novelty labels and tapes, which can be printed on or woven into a wide range of fabrics and other materials using various types of high-speed equipment.

Tekfit - We market and supply a proprietary stretch waistband using our patented technology. We provide apparel manufacturers with proprietary equipment, custom materials and an advanced, patented fabric technology that allow for the manufacture of stretch characteristics into their standard waistbands resulting in greatly improved fit and comfort. This technology is used to build-in a stretch factor into standard waistbands that does not alter the appearance of the garment, but will allow the fabric to stretch out and back by as much as two waist sizes. Our supply of this product to customers was limited since 2006 by a licensing dispute. In March 2012 we ended the licensing dispute, and acquired all U.S. existing licenses and patents for this product technology, and settled all matters of litigation with the original owner. Following the end of this dispute we again began to actively expand our marketing and selling efforts of this unique product and brand within the industry. The revenues we derived from the sales of products incorporating the stretch waistband technology were substantially limited for the years 2012, 2011 and 2010 as a consequence of this former litigation.

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

	Year Ended December 31,					
	2012		2011		2010	
Product Group Net Sales:						
Talon zipper.	49.4	%	54.3	%	59.1	%
Trim	50.5	%	45.7	%	40.8	%
Tekfit	0.1	%	0.0	%	0.1	%

Design and Development

Our in-house creative teams produce products with innovative technology and designs that we believe distinguish our products from those of our competitors. We support our skills and expertise in material procurement and product-manufacturing coordination with product technology and designs intended to meet fashion demands, as well as functional and cost parameters. 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.

Many specialty design companies with which we compete have limited engineering, 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 development costs are low, many of which are borne by our customers. Our design teams are based in our U.S. and Asian facilities.

Customers

We have more than 956 active customers. Our customers include the designated suppliers of well-known apparel retailers and brands, such as, VF Corporation, Victoria's Secret, Tom Tailor, Fat Face, Abercrombie and Fitch, American Eagle, Polo Ralph Lauren, Phillips-Van Heusen, Super Dry, Eddie Bauer, Babies-R-Us, and Guess among others. Our customers also include contractors for specialty retailers such as Express and mass merchant retailers such as Wal-Mart, Kohl's, J.C. Penney, and Costco.

For the years ended December 31, 2012, 2011 and 2010, our three largest customers combined represented approximately 6%, 8% and 9%, respectively, of consolidated net sales.

5

Sales and Marketing

We sell our products through our own sales force based in the United States, Hong Kong, China, India, Indonesia, Taiwan, and Bangladesh. We contract with outside sales representatives in the U.S. and Europe, and we develop Central America opportunities through our U.S. sales force and outside sales representatives. We also employ customer service representatives who are assigned to key customers and provide local customer support. We have developed relationships with our major customers at senior levels and our sales teams actively participate with these customers in their marketing and sales programs and sales strategies. When we become the outsourcing vendor for a customer's packaging or trim requirements, we position ourselves as if we are an in-house department of the customer's trim components 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 and scrutiny. 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 guarantee our customers that all materials used in the manufacture of our products are fully compliant with all 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 zippers, trim items and apparel accessories and oversee the manufacture and distribution of the full range of our products. Through our Asian facilities we supply customers numerous significant zipper and trim programs, and serve these 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".

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. The apparel retailers typically experience higher sales volumes during the second and third quarters associated with back-to-school sales efforts and in the fourth quarter in association with year-end holiday purchases. Sales of our products typically precede the retail sales patterns by 90 to 150 days. 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.

6

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 United States 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 stretch quality of our Tekfit waistbands will also allow us to compete effectively in the market for waistband components.

Segment Information

We operate in one industry segment, the distribution of a full range of apparel zipper and trim products to manufacturers of fashion apparel, specialty retailers and mass merchandisers. We separately report our revenues and gross margins by our 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, Taiwan, India, Indonesia, 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, Note 10 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, 2012, we had approximately 188 full-time employees including 26 in the United States and 162 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) shareholder 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.

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.

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

Our results of operations depend to a significant extent upon the commercial success of our larger customers. If these customers fail to purchase our products at anticipated levels, or our relationship with these customers or the 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.

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 uncertainty or recession 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.

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.

Most 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 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 customer's 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 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.

We must consolidate and centralize the management of our subsidiaries and significantly expand and improve our financial and operating controls. Additionally, we must effectively integrate the information systems of our worldwide operations with the information systems of our principal offices in California. Our failure to do so could result in lost revenues, delay financial reporting or 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 customer’s needs. Such defects or interruptions could result in lost revenues and lost customers.

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.

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.

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

If we need to sell or issue additional shares of common stock or 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 a number of anti-takeover measures that may depress the price of our common stock.

Our stockholders' rights plan, our ability to issue additional shares of preferred stock and some provisions of our certificate of incorporation and bylaws and of Delaware law could make it more difficult for a third party to make an unsolicited takeover attempt of us. These anti-takeover measures may depress the price of our common stock by making it more difficult for third parties to acquire us by offering to purchase shares of our stock at a premium to its market price.

CVC holds voting control of our outstanding voting securities, which could limit other stockholders' ability to influence the outcome of key transactions.

With our entry into the Recapitalization Agreement in July 2010, we issued to CVC California LLC ("CVC") Series B Preferred Stock which upon conversion, when combined with the 1,750,000 shares of common stock already owned by CVC, represents 64.7% of our company's current outstanding voting securities as of March 26, 2013. As a result, CVC has the voting power to determine the outcome of any matter submitted to a vote of the holders of our common stock, including the election of a majority of the members of our Board of Directors and any change in control transaction. This concentration of ownership of our voting securities could have the effect of causing, delaying or preventing a change of control of our company or discouraging or preventing a potential acquirer from attempting to obtain control of our company. This, in turn, could have a negative effect on the market price of our common stock.

We may face interruption of production and services due to increased security measures in response to terrorism.

Our business depends on the free flow of products and services through the channels of commerce. In response to terrorists' activities and threats aimed at the United States, transportation, mail, financial and other services may be slowed or stopped altogether. Extensive delays or stoppages in transportation, mail, financial or other services could have a material adverse effect on our business, results of operations and financial condition. Furthermore, we may experience an increase in operating costs, such as costs for transportation, insurance and security as a result of the activities and potential delays. We may also experience delays in receiving payments from payers that have been affected by the terrorist activities. The United States economy in general may be adversely affected by the terrorist activities and any economic downturn could adversely impact our results of operations, impair our ability to raise capital or otherwise adversely affect our ability to grow our business.

ITEM 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 13,785 square feet of office, warehouse and product development spaces in the US and 37,656 square feet of office, warehouse, product development and showroom spaces within Asia. The lease agreements related to these properties expire at various dates through May 2017. We believe our existing facilities are adequate to meet our needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

On May 7, 2012, we filed a lawsuit against Adidas America, Inc. in the U.S. District Court for the Central District of California asserting claims of trademark infringement, unfair competition, deceptive trade practices and related claims, under both U.S. and California law. The claims arose out of Adidas's use of the "Techfit" name for its apparel, which we asserted infringed our previously registered Tekfit trademark. On May 21, 2012, Adidas then filed a counterclaim against Talon seeking cancellation of our Tekfit U.S. trademark registrations and recovery of legal fees. On January 15, 2013, we accepted a cash settlement from Adidas and both parties dismissed all related actions with prejudice and ensured that future use of their trademarks would not create confusion to the consumer.

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.

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, 2012		
1st Quarter.	$0.11	$0.05
2nd Quarter	0.09	0.04
3rd Quarter	0.05	0.03
4th Quarter	0.14	0.03
Year ended December 31, 2011		
1st Quarter.	$0.20	$0.09
2nd Quarter	0.20	0.07
3rd Quarter	0.16	0.09
4th Quarter	0.13	0.04

On March 26, 2013 the closing sales price of our common stock as reported on the OTCQB was $0.05 per share. As of March 26, 2013, there were 22 recorded holders of our common stock and approximately 84.6% of our outstanding shares were held by brokers and dealers.

Dividends

We have never paid dividends on our common stock. Pursuant to our certificate of incorporation, we are restricted from paying dividends on our common stock without obtaining approval from the holder of our Series B Preferred stock. It is our intention to retain future earnings for use in our business.

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 per share data)				
	2012	2011	2010	2009	2008
Consolidated Statements of Operations Data:					
Talon zippers net sales	$ 22,062	$ 22,613	$ 24,517	$ 21,341	$ 28,429
Trim net sales	22,519	19,048	16,936	17,274	19,537
Tekfit net sales	20	8	7	61	205
Total net sales	$ 44,601	$ 41,669	$ 41,460	$ 38,676	$ 48,171
Income (loss) from operations (1)	$ 995	$ 1,339	$ 1,471	$ 289	$ (5,962)
Net income (loss) (2)	$ 679	$ 729	$ (1,467)	$ (2,693)	$ (8,359)
Net income (loss) per share	$ 0.03	$ 0.04	$ (0.07)	$ (0.13)	$ (0.41)
Basic and dilutive net income (loss) per share applicable to Common Shareholders	$ (0.12)	$ (0.10)	$ (0.17)	$ (0.13)	$ (0.41)
Weighted average shares outstanding – basic and diluted	22,458	20,568	20,291	20,291	20,291
Total comprehensive income (loss)(2)	$ 685	$ 761	$ (1,510)	$ (2,718)	$ (8,303)
Consolidated Balance Sheets Data:					
Cash and cash equivalents	$ 8,927	$ 5,749	$ 2,795	$ 2,265	$ 2,400
Total assets	$ 18,976	$ 16,358	$ 13,828	$ 13,834	$ 15,603
Notes payable and capital lease obligations (2)	$ 3	$ 324	$ 362	$ 15,270	$ 13,316
Series B Convertible Preferred Stock	$ 23,979	$ 20,672	$ 17,820	$ -	$ -
Stockholders' equity (Deficit)	$ (16,028)	$ (13,919)	$ (12,801)	$ (11,179)	$ (8,762)
Per Share Data:					
Net book value per common share	$ (0.68)	$ (0.66)	$ (0.63)	$ (0.55)	$ (0.43)
Common shares outstanding	23,401	21,001	20,291	20,291	20,291

(1) Income (loss) from operations for each fiscal year includes the following items:

	(In thousands)				
	2012	2011	2010	2009	2008
Trademark infringement litigation costs	$ (574)	$ -	$ -	$ -	$ -

Inventory impairment	-	-	-	-	(692)
Losses from a former customer and impairment of related marketable securities	-	-	-	-	(1,040)
Executive severance	-	-	-	-	(724)
Related party note receivable recovery (impairment)	-	-	275	(200)	(474)
Prior years consulting fees	-	-	-	(201)	-
Impairment charges Idle Equipment and Building	-	-	-	-	(2,430)
Combined	$ (574)	$ -	$ 275	$ (401)	$ (5,360)

(2) Loss on extinguishment of debt was included in the net loss for the year ended December 31, 2010 in amount of approximately $571,000, see Note 5 in the accompanying Notes to Consolidated Financial Statements.

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

Overview

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

The following management's discussion and analysis is intended to assist the reader in understanding our consolidated financial statements. This management's discussion and analysis is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and accompanying notes. Amounts presented in this report are rounded to the nearest thousand dollars, except per share amounts.

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

We 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 under the Talon brand, improve our time-to-market throughout the world by sourcing, finishing and distributing to apparel manufacturers in their local markets.

Our primary business focus is on serving as an outsourced apparel zipper and trims supplier, product design and development, sampling and sourcing department 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 trim components, 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 in the field, in addition to our brand and retail customer. 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 business provides manufacturers with the patented technology, manufacturing know-how, equipment and materials required to produce an expandable waistband. Our efforts to increase sales of this product have in the last few years been limited by a licensing dispute. However, all parties involved in the legal dispute concluded a Settlement Agreement and Release in March 2012 that included an unconditional release of Talon and its related entities from all lawsuits, claims, liabilities, agreements, and contracts (among other potential claims) involved in the matter, and resulted in Talon obtaining full ownership to all U.S. patents and technology rights. Accordingly, following settlement of the dispute we again began to actively expand our marketing and selling efforts of this unique product and brand within the industry.

Recapitalization

On July 30, 2010, we entered into a Recapitalization Agreement (the "Recapitalization Agreement") with CVC California, LLC, pursuant to which we issued to CVC an aggregate of 407,160 shares of a newly created senior series of preferred stock, designated Series B Convertible Preferred Stock, in payment of an aggregate of $16,707,000 owed by us to CVC under our Loan Agreement with CVC. Each share of Series B Preferred Stock is convertible into 100 shares of Common Stock. The Series B Preferred Stock has other rights, preferences, privileges and restrictions, including a liquidation preference, redemption rights and class voting rights, which are summarized in Note 5 in the accompanying Notes to Consolidated Financial Statements.

In connection with the Recapitalization Agreement our Board of Directors was reconfigured to consist of five members, with three members designated by the Series B Preferred Stockholders to serve as Series B Directors.

Concurrently with execution of the Recapitalization Agreement, we entered into a Stockholders Agreement with CVC, and with Lonnie D. Schnell, Chief Executive Officer, Chief Financial Officer and a member of our Board of Directors, and Larry Dyne, our President, pursuant to which:

- CVC agreed that in connection with any director nominees to be submitted to holders of our common stock for election at a stockholders' meeting, a committee of our Board comprised solely of directors then serving on the Board who were not elected or appointed by holders of Series B Preferred Stock, acting by majority vote, shall have the right to designate all of the Board's nominees for director to be elected by holders of our Common Stock.

- CVC agreed that in connection with any election of directors submitted to our stockholders for election at a stockholders' meeting, CVC will attend the stockholders' meeting, in person or by proxy, and vote (or cause to be voted) all of CVC's shares of our voting stock in favor of the Board's nominees for director.

- Messrs. Schnell and Dyne provided CVC with a right of first refusal with respect to any shares of our voting securities that Messrs. Schnell and Dyne propose to sell in a private placement transaction, and agreed to provide CVC with advance notice of their intent to sell the Company's voting securities in any public sale transaction.

- CVC provided Messrs. Schnell and Dyne with a tag-along right, providing Messrs. Schnell and Dyne with the right to sell their shares of our voting securities in a transaction where CVC is selling its shares of our voting securities.

- Messrs. Schnell and Dyne agreed with CVC to vote their shares of Talon voting stock in favor of a merger or consolidation of the company into or with another corporation or any share exchange, business combination or other such transaction in which we are a constituent party, or any sale of all or substantially all of our assets (a "Triggering Transaction"), in each case to the extent such transaction is first approved by CVC.

- CVC agreed not to sell or otherwise transfer its shares of our voting securities, or to vote its shares of the Company's voting securities in favor of any Triggering Transaction, at any time on or before July 31, 2011, other than in connection with a transaction that is approved by a majority of our voting shares (where, in calculating such majority, the votes attributable to CVC's shares of our voting securities are excluded in the numerator but included in the denominator).

- We provided CVC with a preemptive right, pursuant to which CVC will have the right, subject to certain exceptions set forth in the Stockholders Agreement, to acquire in a subsequent issuance of securities by us a number of offered securities that will allow CVC to maintain its percentage ownership of our voting securities.

18

- CVC agreed with Messrs. Schnell and Dyne that in connection with a Triggering Transaction, CVC, and any other holder of Series B Preferred Stock and shares of common stock acquired upon conversion thereof, shall pay to Messrs. Schnell and Dyne a portion (beginning at 5% and increasing to 10%) of the sales proceeds payable in the Triggering Transaction to CVC or such other holder in respect of such Series B Preferred Stock or conversion shares. Each of Messrs. Schnell and Dyne's right to receive such portion of the sales proceeds is conditional upon the Triggering Transaction occurring (i) while employed by the Company or (ii) within 12 months following termination of employment with the Company for any reason other than termination of employment for "cause" or termination of employment by Messrs. Schnell or Dyne without "good reason" (as such terms are defined in their respective employment agreements).

For further details on the transaction, see Notes 4 and 5 in the accompanying Notes to Consolidated Financial Statements.

Results of Operations

Net Sales

For the years ended December 31, 2012, 2011 and 2010, total sales by geographic region based on customer delivery locations were as follows:

	Year Ended December 31,		
	2012	2011	2010
Sales:			
United States	$4,495,000	$3,519,000	$3,574,000
Hong Kong	14,595,000	14,696,000	14,509,000
China	10,760,000	9,558,000	10,412,000
Bangladesh	2,242,000	2,093,000	2,547,000
Other	12,509,000	11,803,000	10,418,000
Total	$44,601,000	$41,669,000	$41,460,000

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

	Year Ended December 31,		
	2012	2011	2010
Product Group Net Sales:			
Talon zipper	$22,062,000	$22,613,000	$24,517,000
Trim	22,519,000	19,048,000	16,936,000
Tekfit	20,000	8,000	7,000
Total	$44,601,000	$41,669,000	$41,460,000

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.

Net sales for the year ended December 31, 2012 were $44,601,000, an increase of $2,932,000 over the net sales for the same period in 2011. The increases reflected sales to new specialty apparel customers and new programs within key customer accounts, partially offset by a decline in the sales of generic zippers to price sensitive mass merchandise and licensing customers. Over the past year we have focused our sales efforts on increasing sales to specialty apparel customers rather than mass merchandise customers. Our sales strategy is to continue to focus on customers who precede quality, brand image and product value before low-cost selections.

Net sales for the year ended December 31, 2011 were $41,669,000, a slight increase over the same period in 2010. The net increase mainly reflected sales to new customers and new programs within key customer accounts approximating $7.1 million offset by a decline of approximately $5.8 million in the sales of generic zippers to price sensitive mass merchandise and licensing customers who shifted their purchase to low-cost factories in Asia. The general economic weakness and increased commodity costs in the U.S. apparel market also resulted in lower unit demand for our products during the first half of 2011 compared to the first half of 2010.

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, 2012, 2011 and 2010 (amounts in thousands) and the percentage change in such operating expenses as compared to the previous year:

	2012	Change	2011	Change	2010
Sales	$44,601	7 %	$41,669	1 %	$41,460
Cost of goods sold	30,140	6 %	28,465	(2)%	28,999
% of sales	68 %		68 %		70 %
Sales and marketing expenses	4,974	17 %	4,261	40 %	3,035
% of sales	11 %		10 %		7 %
General and administrative expense	$8,492	12 %	$7,604	(4)%	$7,954
% of sales	19 %		18 %		19 %

Cost of goods sold

Cost of goods sold for the year ended December 31, 2012 increased $1,676,000, and represented 68% of sales in each of the years ended December 31, 2012 and 2011. The increase in the cost of goods sold was the result of higher overall sales volumes of $1,764,000, higher manufacturing overheads, inventory obsolescence costs and freight expenses of $579,000, offset by lower direct purchase costs associated with a greater mix of higher-margin products in the Talon and the Trim Divisions of $667,000.

Cost of goods sold for the year ended December 31, 2011 decreased $535,000, resulting in a lowering of costs to 68% of sales versus 70% of sales for the year ended December 31, 2010. The reduction in the cost of goods sold evidenced approximately $523,000 in lower direct costs associated with a greater mix of high margin (relatively lower cost) products in the Talon and the Trim Divisions, lower manufacturing support and inventory obsolescence costs and freight expenses of $139,000, partially offset by added costs of $127,000 associated with the overall sales volumes increase.

Sales and marketing expenses

Sales and marketing expenses for the year ended December 31, 2012 totaled $4,974,000, an increase of $713,000 as compared to same period in 2011. Sales expenses increased mainly due to the continued investment in strengthening and expanding our internal sales force within the U.S., Europe and Asia during 2011 and the first half of 2012; and increased commissions to our sales representative network. Increased sales and marketing efforts are designed to expand our presence in select product markets within the U.S., Europe and Asia where we see significant growth potential.

Sales and marketing expenses for the year ended December 31, 2011 were $4,261,000, or 10.2% of sales, as compared to $3,035,000, or 7.3% of sales, for the same period in 2010. Sales expenses increased mainly due to a strategic expansion of our internal sales force and external sales representatives network in the U.S., Europe and Asia begun during 2011, in an effort to significantly expand our presence in select product markets within the U.S., Europe and Asia.

General and administrative expenses

General and administrative expenses for the year ended December 31, 2012 were $8,492,000 or 19.0% of sales, an increase of $888,000 as compared to the same period in 2011. The increase mainly reflects the absence of a non-recurring benefit recorded in 2011 for the expiration and settlement of claims by former suppliers to our discontinued Mexico operations totaling $381,000; increased legal fees of $344,000 to maintain and defend our patent and trademark filings worldwide; and higher professional expenses consisting of fees to third party advisors and board members of $201,000 related to an ad hoc committee of our Board of Directors; offset by cost reductions of $38,000.

General and administrative expenses for the year ended December 31, 2011 were $7,604,000, or 18.2% of sales, as compared with $7,954,000, or 19.2% of sales, for the same period in 2010. The reduction of $350,000 mainly reflects the expiration and settlement of 2007 and prior claims by previous suppliers to our discontinued Mexico operations totaling $381,000; lower professional fees and facilities expenses of $368,000; and lower depreciation expenses of $209,000; offset by increased charges for non-cash compensation expenses of $340,000 and the beneficial effect of the sale of a note of $275,000 recorded in 2010.

Interest expense and interest income

Interest expense for the year ended December 31, 2012 was $51,000, as compared to interest expense of $128,000 for the same periods in 2011. Interest income for the year ended December 31, 2012 and 2011 was $4,000.

Interest expense for the year ended December 31, 2011 decreased by $1,675,000 or 93% to $128,000, as compared to interest expense of $1,803,000 in 2010. The decrease was the result of the elimination of amounts owed under our former revolving credit line and term notes with CVC that were converted into preferred stock as of July 30, 2010. (See Note 4 in the accompanying Notes to Consolidated Financial Statements). Interest income for the year ended December 31, 2011 decreased by $27,000 as compared to $31,000 in 2010 primarily due to the recognition of and collection of interest income on the related party note receivable in 2010, which we sold to a third party (See Note 2 in the accompanying Notes to Consolidated Financial Statements).

Loss on extinguishment of debt

Loss on extinguishment of debt in the amount of $571,000 was recorded during the year ended December 31, 2010 as a result of the transactions pursuant to the Recapitalization Agreement between us and our lender. See Note 5 in the accompanying Notes to Consolidated Financial Statements. There was no loss on extinguishment of debt for the 2012 and 2011 fiscal years.

Income taxes

Provision for income taxes for the year ended December 31, 2012 was $268,000, as compared to a $486,000 for the year ended December 31, 2011. The provision for income taxes for the year ended December 31, 2012 includes the elimination of a tax liability of $196,000 that was originally established in 2007 in connection with foreign tax positions that could have been subject to reversal upon a regulatory review. At March 31, 2012 the time limit for a regulatory assessment of the tax position expired and the liability was removed. (See Note 8 in the accompanying Notes to Consolidated Financial Statements). During the year ended December 31, 2012 funds transfers from our foreign subsidiaries were lower than in the same period in 2011. Consequently, the provision for income taxes compared to the same period in 2011 reflected lower withholding tax from our Asian operations offset by higher income tax expense due to higher profitability in the foreign subsidiaries.

Provision for income taxes for the year ended December 31, 2011 was $486,000, which included a U.S. charge for foreign taxes arising from intellectual property charges to our foreign operations, a charge for foreign taxes in China arising from collected service fees, a tax provision for Hong Kong operations offset by lower deferred tax assets in Hong Kong, and a U.S. tax basis difference related to our indefinite lived intangible asset. There was not sufficient evidence to determine that it was more likely than not that we would be able to utilize our net operating loss carry forwards to offset future taxable income and as a result, these deferred tax assets have a full valuation reserve applied against them.

Provision for income taxes for the year ended December 31, 2010 was approximately $596,000. During the year ended December 31, 2010 we recorded a deferred income tax liability in the amount of approximately $609,000 due to a tax basis difference related to our indefinite lived intangible asset, following our determination during the third quarter of 2010 that we would no longer be able to support the use of the deferred tax asset related to net operating losses to offset the liability (See Note 8 in the accompanying Notes to Consolidated Financial Statements). The net tax benefit from income taxes other than this deferred income tax liability is mainly associated with our foreign operations. There was not sufficient evidence to ensure that it was more likely than not that we would be able to utilize our domestic operating loss carry forwards (as well as a portion of our foreign net operating loss carry forwards) to offset future taxable income and consequently the tax benefit of these losses are offset by a full valuation reserve provided against them.

Liquidity and Capital Resources

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

	December 31, 2012	December 31, 2011
Cash and cash equivalents	$8,927,000	$5,749,000
Total assets	$18,976,000	$16,358,000
Current liabilities	$9,893,000	$8,464,000
Long term liabilities	$1,132,000	$1,141,000
Preferred Stock	$23,979,000	$20,672,000
Stockholders' Equity (Deficit)	$(16,028,000)	$(13,919,000)
Total Equity and Preferred Stock	$7,951,000	$6,753,000

We believe that our existing cash and cash equivalents and our anticipated cash flows from our operating activities will be sufficient to fund our minimum working capital and capital expenditure needs for operating activities for at least the next twelve months.

Cash and cash equivalents

Most of our cash is held with financial institutions. Substantially all of the balances at December 31, 2012 and 2011 were in excess of federally insured limits, and there was no restricted cash.

Cash and cash equivalents of $8,927,000 increased by $3,178,000 at December 31, 2012 as compared to December 31, 2011, principally due to net cash provided by operating activities partially offset by the acquisition of property and equipment and intangibles and payments of notes payables.

Cash and cash equivalents of $5,749,000 at December 31, 2011 increased by $2,954,000 as compared to December 31, 2010, principally due to net cash provided by operating activities partially offset by the acquisition of property and equipment and payment of notes payable to related parties.

Cash flows

The following table summarizes our cash flow activity for the years ended December 31, 2012, 2011 and 2010:

	Year Ended December 31,		
	2012	2011	2010
Net cash provided by operating activities	$3,853,000	$3,042,000	$940,000
Net cash (used in) investing activities	(375,000)	(118,000)	(89,000)
Net cash used in financing activities	(312,000)	(39,000)	(305,000)
Net effect of foreign currency translation on cash	12,000	69,000	(15,000)
Net increase in cash and cash equivalents	$3,178,000	$2,954,000	$531,000

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, 2012, 2011 and 2010 resulted principally from:

	Year Ended December 31,		
	2012	2011	2010
Net income before non-cash charges	$1,894,000	$2,521,000	$1,690,000
Inventory reduction	298,000	231,000	301,000
Accounts receivable reduction (increase)	246,000	(392,000)	65,000
Accounts payable and accrued expenses increase (reduction)	1,729,000	1,002,000	(963,000)
Other reductions in operating capital	(314,000)	(320,000)	(153,000)
Cash provided by operating activities	$3,853,000	$3,042,000	$940,000

Investing Activities

Net cash used in investing activities for the year ended December 31, 2012 was $375,000 for the acquisition of intangibles of $179,000 and the acquisition of property and equipment of $196,000.

Net cash used in investing activities for the year ended December 31, 2011 was $118,000, primarily representing the acquisition of property and equipment of $173,000, offset by proceeds from the sale of equipment in the amount of $55,000.

Net cash used in investing activities for the year ended December 31, 2010 was $89,000, reflecting the acquisition of property and equipment of $91,000 partially offset by proceeds from the sale of equipment held for sale of $2,000.

Financing Activities

Net cash used in financing activities for the year ended December 31, 2012 was $312,000, reflecting the payment of notes payable to related parties in the amount of $241,000, payment of other notes payable in the amount of $67,000, and repayment of borrowings under capital leases of $4,000.

Net cash used in financing activities for the year ended December 31, 2011 was $39,000, reflecting payment of a note payable to related parties in the amount of $45,000 and repayment of borrowings under capital leases of $6,000, offset by proceeds from the exercise of stock options in the amount of $12,000.

Net cash used in financing activities for the year ended December 31, 2010 was $305,000 and reflects preferred stock issuance costs, payment of loan modification fees and repayment of borrowings under capital leases.

On June 27, 2007, we entered into a Revolving Credit and Term Loan Agreement (the "Loan Agreement") with Bluefin Capital, LLC that provided for a $5.0 million revolving credit facility and a $9.5 million term loan, each with a three year term originally maturing on June 30, 2010, which was subsequently extended to July 30, 2010. Bluefin Capital subsequently assigned its rights and obligations under the Loan Agreement to an affiliate, CVC. Borrowings under the Loan Agreement were secured by all of our assets.

On July 30, 2010, we entered into a Recapitalization Agreement in which we issued to CVC shares of Series B Preferred Stock in payment of all of our outstanding obligations under the Loan Agreement. At that date, we had outstanding borrowings and accrued interest of $11,548,000 under the term notes and $5,159,000 under the revolving credit note, all of which was exchanged for the Series B Preferred Stock. See Note 5 in the accompanying Notes to Consolidated Financial Statements.

In connection with the Recapitalization Agreement, we amended the Loan Agreement to extend the maturity date of the Loan Agreement from July 30, 2010 until July 31, 2012, reduce the maximum borrowings available under the Revolver to $3,000,000, and amend various additional terms and conditions of the Loan Agreement. We paid CVC a non-refundable fee of $60,000 in consideration of CVC entering into the amendment and paid a $50,000 commitment fee during the third quarter of 2011 to ensure the availability of the revolver through July 31, 2012. Upon execution of the amendment, CVC waived all prior events of default under the Loan Agreement. On July 31, 2012, the Loan Agreement, which had no borrowings outstanding, expired along with all performance covenants, obligations and liens in connection with the Loan Agreement.

We have financed equipment purchases through capital lease obligations. Our equipment financing obligation as of December 31, 2012 was approximately $4,000 and bore interest at rate of 15.4% per annum. Under these obligations, we are required to make monthly payments of principal and interest through November 2013.

The outstanding balance (including accrued interest) of our notes payable to related parties at December 31, 2012 and December 31, 2011 was $0 and $240,000, respectively. Included in the balance at December 31, 2011 was a demand note which bore interest at 10%, had no scheduled monthly payments and was due within fifteen days following demand. The demand note totaled $199,000 as of December 31, 2011, and was paid in full in March 2012 for $200,000. The balance of the notes payable to related parties of $41,000 as of December 31, 2011 represented a note payable to an officer. The note bore 6% interest annually and was paid in full in accordance with its terms in January 2012.

We have satisfied our working capital requirements primarily through cash flows generated from operations and borrowings under our credit facility. As we continue to expand globally with our apparel manufacturing in offshore locations, our customers are substantially all foreign-based and foreign-owned entities. We continue to evaluate both financing and equity options to provide capital if needed to fund our expansion and on-going operations. If we experience greater than anticipated 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 European markets. If our cash from operations is less than anticipated or our working capital requirements and capital expenditures are greater than we expect, we may need to raise debt or equity financing in order to provide for our operations.

Contractual Obligations

The following summarizes our contractual obligations at December 31, 2012 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	3-5 Years	More than 5 years
Capital lease obligations	$ 4,000	$ 4,000	$ -	$ -	$ -
Operating leases	1,207,000	572,000	633,000	2,000	-
Total Obligations	$ 1,211,000	$ 576,000	$ 633,000	$ 2,000	$ -

Off-Balance Sheet Arrangements

At December 31, 2012 and 2011, 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 shareholder of more than 5% of our common stock or any member of their immediate family had or will have a direct or indirect material interest, see Item 13, “Certain Relationships and Related Transactions and Director Independence,” 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 collectability of customer accounts. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, an additional allowance may be required. Allowance adjustments are charged to operations in the period in which the facts that give rise to the adjustments become known. The bad debt expenses, recoveries and allowances for the years ended December 31, 2012, 2011 and 2010 are as follows:

	Year ended December 31, 2012	2011	2010
Bad debt recovery, related party note receivable	$ -	$ -	$ (275,000)
Bad debt expense (recovery), other accounts receivable	$ (33,000)	$ 28,000	$ (109,000)
Allowance for doubtful accounts, Accounts receivable	$ 1,000	$ 53,000	$ 133,000

- 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 valuations provisions and allowances for inventory valuation reserves for the years ended December 31, 2012, 2011 and 2010 are as follows. The net recovery in 2011 resulted mainly due to sale of legacy zippers held in inventory:

	Year ended December 31, 2012	2011	2010
Inventory valuation provisions, net	$ 48,000	$ (36,000)	$ 106,000
Allowance for inventory valuation reserves	$ 261,000	$ 485,000	$ 884,000

- 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. A deferred income tax liability related to indefinite lived intangibles should not be offset against deferred income tax assets. 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. See Note 8 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 returns have been insignificant.

- We are currently involved in various lawsuits, claims and inquiries, most of which are routine to the nature of the business and in accordance with 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 July 2012, the FASB issued Accounting Standards Update ("ASU") 2012-02, "Intangibles – Goodwill and Other - Testing Indefinite-lived Intangible Assets for Impairment." The updated guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then we are required to estimate the fair value of the indefinite-lived intangible assets and perform the quantitative impairment test in accordance with ASU 350-30. This ASU is effective for fiscal years, and interim periods within those years, beginning after September 15, 2012. Early adoption is permitted as of a date before July 27, 2012, and we have elected to adopt ASU 2012-02 as of December 31, 2012. The adoption of ASU 2012-02 did not have a material impact on our 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, 2012. 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

TABLE OF CONTENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Talon International, Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule of Talon International, Inc. and subsidiaries, 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 based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit 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 Talon International, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and comprehensive income (loss) and their cash flows for each of the three years in the period ended December 31, 2012, 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, 2013

TALON INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$8,927,333	$5,749,341
Accounts receivable, net	3,635,136	3,777,771
Inventories, net	730,503	1,076,522
Prepaid expenses and other current assets	456,460	314,761
Total current assets	13,749,432	10,918,395
Property and equipment, net	763,770	1,092,609
Intangible assets, net	4,279,943	4,110,751
Other assets	182,671	236,411
Total assets	$18,975,816	$16,358,166
Liabilities, Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities:		
Accounts payable	$7,866,662	$6,607,041
Accrued expenses	2,023,535	1,543,465
Notes payable to related parties	-	239,942
Other notes and current portion of capital lease obligations	3,247	73,148
Total current liabilities	9,893,444	8,463,596
Capital lease obligations, net of current portion	-	10,461
Deferred income taxes	945,543	751,148
Other liabilities	186,051	379,803
Total liabilities	11,025,038	9,605,008
Commitments and contingencies (Note 9)		
Series B Convertible Preferred Stock, $0.001 par value; 407,160 shares authorized, issued and outstanding	23,979,216	20,671,738
Stockholders' Equity (Deficit):		
Series A Preferred Stock, $0.001 par value; 250,000 shares authorized; no shares issued or outstanding	-	-
Common Stock, $0.01 par value, 100,000,000 shares authorized; 23,400,808 and 21,000,808 shares issued and outstanding at December 31, 2012 and December 31, 2011, respectively	23,401	21,001
Additional paid-in capital	58,458,731	57,948,111
Accumulated deficit	(74,578,052)	(71,949,921)
Accumulated other comprehensive income	67,482	62,229
Total stockholders' equity (deficit)	(16,028,438)	(13,918,580)
Total liabilities, preferred stock and stockholders' equity (deficit)	$18,975,816	$16,358,166

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Year Ended December 31, 2012	2011	2010
Net sales	$ 44,600,872	$ 41,668,507	$ 41,459,747
Cost of goods sold	30,140,471	28,464,741	28,999,355
Gross profit	14,460,401	13,203,766	12,460,392
Sales and marketing expenses	4,974,037	4,260,609	3,035,228
General and administrative expenses	8,491,596	7,603,909	7,953,756
Total operating expenses	13,465,633	11,864,518	10,988,984
Income from operations	994,768	1,339,248	1,471,408
Interest expense, net	47,308	123,998	1,771,662
Loss on extinguishment of debt	-	-	570,915
Income (loss) before provision for income taxes	947,460	1,215,250	(871,169)
Provision for income taxes	268,113	486,117	595,651
Net income (loss)	$ 679,347	$ 729,133	$ (1,466,820)
Available to Preferred Shareholders:			
Series B Preferred Stock Original Issue Discount	-	-	(903,172)
Series B Preferred Stock Liquidation Preference Increase	(3,307,478)	(2,851,274)	(1,113,779)
Loss applicable to Common Shareholders	$ (2,628,131)	$ (2,122,141)	$ (3,483,771)
Per share amounts:			
Net income (loss) per share	$ 0.03	$ 0.04	$ (0.07)
Available to Preferred Shareholders	(0.15)	(0.14)	(0.10)
Basic and diluted net income (loss) per share applicable to Common Shareholders	$ (0.12)	$ (0.10)	$ (0.17)
Weighted average number of common shares outstanding – Basic and diluted	22,458,185	20,567,640	20,291,433
Net income (loss)	$ 679,347	$ 729,133	$ (1,466,820)
Other comprehensive income (loss) -			
Foreign currency translation	5,253	31,474	(43,534)
Total comprehensive income (loss)	$ 684,600	$ 760,607	$ (1,510,354)

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	Common Stock		Preferred Stock Series A		Additional Paid-In	Other Comprehensive Income	Accumulated	
	Shares	Amount	Shares	Amount	Capital	(losses)	Deficit	Total
Balance, January 1, 2010	20,291,433	$ 20,291	-	$ -	$ 55,070,568	$ 74,289	$ (66,344,009)	$ (11,178,861)
Stock based compensation					621,403			621,403
Foreign currency translation						(43,534)		(43,534)
Series B Preferred Stock Beneficial Conversion Feature					1,283,343			1,283,343
Series B Preferred Stock original issue discount							(903,172)	(903,172)
Series B Preferred Stock Liquidation Preference Increase							(1,113,779)	(1,113,779)
Net loss							(1,466,820)	(1,466,820)
Balance, December 31, 2010	20,291,433	20,291	-	-	56,975,314	30,755	(69,827,780)	(12,801,420)
Stock based compensation					961,477			961,477
Foreign currency translation						31,474		31,474
Exercise of stock options	109,375	110			11,920			12,030
RSU's settlement in Common Stock	600,000	600			(600)			-
Series B Preferred Stock Liquidation Preference Increase							(2,851,274)	(2,851,274)
Net income							729,133	729,133
Balance, December 31, 2011	21,000,808	21,001	-	-	57,948,111	62,229	(71,949,921)	(13,918,580)
Stock based compensation					513,020			513,020
Foreign currency translation						5,253		5,253
RSU's settlement in Common Stock	2,400,000	2,400			(2,400)			-
							(3,307,478)	(3,307,478)

Series B Preferred Stock Liquidation Preference Increase								
Net income							679,347	679,347
Balance, December 31, 2012	23,400,808	$ 23,401	-	$ -	$ 58,458,731	$ 67,482	$ (74,578,052)	$ (16,028,438)

See accompanying notes to consolidated financial statements.

33

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2012	2011	2010
Cash flows from operating activities:			
Net income (loss)	$679,347	$729,133	$(1,466,820)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	525,439	605,987	793,603
(Gain) on disposal of equipment	(67,576)	(38,976)	-
Loss on extinguishment of debt	-	-	570,915
Amortization of deferred financing cost and debt discounts	17,500	30,000	861,596
Stock based compensation	513,020	961,477	621,403
Deferred income tax, net	210,721	240,686	586,664
Bad debt expense (recovery), related party note receivable	-	-	(275,000)
Bad debt expense (recovery), other accounts receivable	(32,718)	28,350	(108,797)
Inventory valuation provisions, net	48,094	(35,824)	106,169
Changes in operating assets and liabilities:			
Accounts receivable	246,483	(391,920)	65,131
Inventories	297,928	231,293	301,142
Prepaid expenses and other current assets	(140,968)	19,079	(89,558)
Other assets.	20,196	21,415	(77,070)
Accounts payable and accrued expenses	1,728,957	1,001,978	(963,416)
Other liabilities	(193,752)	(361,074)	14,002
Net cash provided by operating activities	3,852,671	3,041,604	939,964
Cash flows from investing activities:			
Proceeds from sale of equipment	168	55,000	2,609
Capital expenditures	(196,074)	(173,401)	(91,285)
Acquisitions of intangibles	(178,722)	-	-
Net cash used in investing activities	(374,628)	(118,401)	(88,676)
Cash flows from financing activities:			
Proceeds from exercise of stock options	-	12,030	-
Payment of capital leases	(4,410)	(6,011)	(54,233)
Preferred stock issuance costs	-	-	(190,744)
Payment of revolver fees - financing costs	-	-	(60,000)
Payment of notes payable to related parties	(240,957)	(44,340)	-
Payment of other notes payable	(66,675)	-	-
Net cash used in financing activities	(312,042)	(38,321)	(304,977)
Net effect of foreign currency exchange translation on cash	11,991	69,175	(15,633)
Net increase in cash and cash equivalents	3,177,992	2,954,057	530,678
Cash and cash equivalents at beginning of period	5,749,341	2,795,284	2,264,606
Cash and cash equivalents at end of period	$8,927,333	$5,749,341	$2,795,284

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2012	2011	2010
Supplemental disclosures of cash flow information:			
Cash received (paid) during the period for:			
Interest paid	$(2,910)	$(119,951)	$(404,306)
Interest received	$3,809	$4,190	$30,841
Income tax paid, net (principally foreign)	$(331,139)	$(140,148)	$(97,132)
Non-cash financing activities:			
Conversion of revolver and term notes to preferred stock	$-	$-	$16,706,685
Beneficial conversion feature for issuance of preferred stock	$-	$-	$(1,283,343)
Series B preferred stock original issue discount	$-	$-	$903,172
Series B preferred stock liquidation preference increase	$3,307,478	$2,851,274	$1,113,779
Restricted Stock Units settled in common stock	$2,400	$600	$-
Interest accrued on notes payable	$1,540	$11,587	$11,864
Capital lease terminations	$9,802	$-	$-
Effect of foreign currency translation on net assets	$5,253	$31,474	$(43,534)
Non-cash investing activity:			
Equipment exchanged for manufacturing services	$67,632	$46,368	$-

See accompanying notes to consolidated financial statements.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

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

Organization and Basis of Presentation

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

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

All significant intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of foreign subsidiaries are translated at rates of exchange in effect at the close of the period. Revenues and expenses are translated at the weighted average of exchange rates in effect during the year. The resulting translation gains and losses are deferred and are shown as a separate component of stockholders' deficit, if material, and transaction gains and losses, if any, are recorded in the consolidated statement of operations in the period incurred. During 2012, 2011 and 2010, foreign currency translation and transaction gains and losses were not material. The Company does not engage in hedging activities with respect to exchange rate risk.

Use of Estimates

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

36

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. The Company had approximately $3.1 million and $5.4 million at financial institutions in excess of governmentally insured limits at December 31, 2012 and 2011.

Allowance for Accounts Receivable Doubtful Accounts

The Company is required to make judgments as to the collectability of accounts receivable based on established aging policy, historical experience and future expectations. The allowances for doubtful accounts represent allowances for customer trade accounts that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables or note receivable to their net realizable value. The Company records these allowances based on estimates related to the following factors: (i) customer specific allowances; (ii) amounts based upon an aging schedule; and (iii) an estimated amount, based on the Company's historical experience, for issues not yet identified. The Company writes off an account when it is considered to be uncollectible. The total allowance for accounts receivable doubtful accounts at December 31, 2012 and 2011 was $1,093 and $52,844, respectively.

Inventories

Inventories are stated at the lower of cost, determined using the first-in, first-out basis, or market value and are all substantially finished goods. The costs of inventory include the purchase price, inbound freight and duties, conversion costs and certain allocated production overhead costs. Inventory reserves are recorded for damaged, obsolete, excess and slow-moving inventory. The Company uses estimates to record these reserves. Slow-moving inventory is reviewed by category and may be partially or fully reserved for depending on the type of product and the length of time the product has been included in inventory. Reserve adjustments are made for the difference between the cost of the inventory and the estimated market value, if lower, and charged to operations in the period in which the facts that give rise to these adjustments become known. Market value of inventory is estimated based on the impact of market trends, an evaluation of economic conditions and the value of current orders relating to the future sales of this type of inventory.

Inventories consist of the following:

	December 31,	
	2012	2011
Finished goods	$991,635	$1,561,974
Less inventory valuation reserves	(261,132)	(485,452)
Total inventories	$730,503	$1,076,522

Impairment of Long-Lived Assets

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Property and Equipment

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

Property and equipment consist of the following:

	December 31,	
	2012	2011
Furniture and fixtures	$295,298	$298,156
Machinery and equipment	791,354	927,580
Computer equipment	3,909,233	3,801,393
Leasehold improvements	436,311	437,660
Automobile	15,711	-
Cost, total	5,447,907	5,464,789
Accumulated depreciation and amortization	4,684,137	4,372,180
Property and equipment, net	$763,770	$1,092,609

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

Furniture and fixtures	5 years
Machinery and equipment	5 to 10 years
Computer equipment	5 years
Leasehold improvements	Term of the lease or the estimated life of the related improvements, whichever is shorter.
Automobile	4 years

Depreciation expense for the years ended December 31, 2012, 2011 and 2010 was $515,909, $605,987 and $793,603 respectively.

Intangible Assets, net

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In July 2012, the FASB issued Accounting Standards Update ("ASU") 2012-02, "Intangibles – Goodwill and Other - Testing Indefinite-lived Intangible Assets for Impairment." The updated guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then the company is required to estimate the fair value of the indefinite-lived intangible assets and perform a quantitative impairment test in accordance with ASU 350-30. The updated guidance was effective for annual and interim indefinite lived intangibles asset impairment tests performed for fiscal years, and interim periods within those years, beginning after September 15, 2012. Early adoption was permitted as of a date before July 27, 2012. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements. We completed the required assessment as at the end of 2012, 2011, and 2010, and noted no impairment. Consequently, no impairment charges were recorded

On April 2, 2002, the Company entered into an Exclusive License and Intellectual Property Rights Agreement (the "License Agreement") with Pro-Fit Holdings Limited ("Pro-Fit"). The License Agreement granted the Company the exclusive rights to sell or sublicense waistbands manufactured under patented technology developed by Pro-Fit for garments manufactured anywhere in the world for sale in the United States market and to all United States brands. The License Agreement had an indefinite term that extended for the duration of the trade secrets and patented technology licensed under the License Agreement. The Company recorded an intangible asset amounting to $612,500 which has been fully amortized.

During the quarter ended March 31, 2012 the Company completed the acquisition from Pro-Fit and related parties of all U.S. patents, applications, trademarks, rights and technology associated with the stretch waistband technology that was formerly exclusively licensed under the License Agreement, and the License Agreement was terminated. During the quarter ended March 31, 2012 the Company also acquired other intellectual property related to accessory components used with a variety of apparel products. The total purchase price and related fees for all intangibles acquired in 2012 totaled $178,722, and is amortized based on the estimated useful lives between 10 and 17 years. Amortization expense for intangible assets for the year ended December 31, 2012 was $9,530.

Intangible assets as of December 31, 2012 and 2011 are as follows:

	December 31, 2012	2011
Tradename – Talon trademark	$4,110,751	$4,110,751
Intellectual property rights and exclusive license	178,722	612,500
Accumulated amortization	(9,530)	(612,500)
Intellectual property rights, net	169,192	-
Intangible assets, net	$4,279,943	$4,110,751

Convertible Preferred Stock

The Company classifies its conditionally redeemable convertible preferred shares, which are subject to redemption upon the occurrence of uncertain events not solely within our control, as temporary equity in the mezzanine section of the consolidated balance sheets, in accordance with the guidance enumerated in FASB ASC No. 480-10 "Distinguishing Liabilities from Equity", FASB ASC No. 210 "Classification and Measurement of Redeemable Securities" and Rule 5-02.28 of Regulation S-X, when determining the classification and measurement of preferred stock.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company evaluated the conversion option of its convertible preferred shares in accordance with FASB ASC No. 470-20, "Debt with Conversion and Other Options", Accounting for Convertible Securities with Beneficial Conversion Features ("BCF") or Contingently Adjustable Conversion Ratios. A convertible financial instrument includes a BCF when the fair market value of the preferred stock is lower than the value of common stock when the preferred stock converts to common stock at the issuance date. The BCF shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of the feature to additional paid-in capital.

The convertible preferred shares, which are redeemable preferred securities, are reported at their current liquidation preference amount. Redeemable securities initially are recorded at their fair value minus the BCF and minus preferred stock issuance costs, and then are subsequently adjusted for changes in the preferred stock value in accordance with the following guidelines:

- When an equity instrument is not currently redeemable but it is probable that the equity instrument will become redeemable (for example, when the redemption depends solely on the passage of time), then changes in the redemption value are recognized as they occur, and the carrying amount of the instrument is adjusted to equal the current redemption value. An increase in the carrying amount of the instrument reduces income available to common shareholders in the calculation of earnings per share.

- When the liquidation preference increases on preferred shares it is added to the preferred stock carrying amount, and reduces income available to common shareholders in the calculation of earnings per share.

Revenue Recognition

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

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

Shipping and Handling Costs

The Company records shipping and handling costs billed to customers as a component of revenue and shipping and handling costs incurred by the Company for outbound freight are recorded as a component of cost of goods sold.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Income Taxes

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

The provisions of FASB ASC 740, "Income Taxes," (“ASC 740”) require the establishment of a valuation allowance when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will not be realized. ASC 740 provides that an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset.

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

On January 1, 2007 the Company adopted the provisions of accounting guidance regarding uncertain income tax positions under ASC 740. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on the recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition associated with income tax liabilities. As a result of the implementation of ASC 740, the Company recognized an increase in liabilities for unrecognized tax benefits of approximately $245,800, which was accounted for as an increase in the January 1, 2007 accumulated deficit. The amount subsequently increased due to interest and penalties accrual. During the year ended December 31, 2012 the Company recorded an income tax benefit due to the elimination of a tax liability of $196,423 recorded in 2007 which was associated with tax positions that could have been subject to reversal upon a regulatory review. At March 31, 2012 the time limit for regulatory assessment of the tax liability expired and the liability was removed; see Note 8.

Stock-Based Compensation

The Company has employee equity incentive plans, which are described more fully in Note 6. Effective January 1, 2006, the Company adopted FASB ASC 718, “Compensation - Stock Compensation” (“ASC 718”), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. Accordingly, the Company measures share-based compensation at the grant date based on the fair value of the award.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ASC 718 requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statements of Operations. Stock-based compensation expense recognized in the Statements of Operations for the years ended December 31, 2012, 2011 and 2010 included compensation expense for share-based payment awards granted prior to, but not yet vested as of January 1 of the applicable year based on the grant date fair value estimated in accordance with the pro-forma provisions of ASC 718 and compensation expense for the share-based payment awards granted subsequent to January 1 based on the grant date fair value estimated in accordance with the provisions of ASC 718. For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method. As stock-based compensation expense recognized in the Statements of Operations for 2012, 2011 and 2010 is based on awards expected to vest, ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For the years ended December 31, 2012, 2011 and 2010, expected forfeitures are immaterial and as such the Company is recognizing forfeitures as they occur.

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant uses the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards and actual and projected employee stock option exercise behaviors. The Company estimates expected volatility using historical data. The expected option term is estimated using the "safe harbor" provisions under ASC 718.

Foreign Currency Translation

The Company has operations and holds assets in various foreign countries. The local currency is the functional currency for the Company's subsidiaries in China and India. Assets and liabilities are translated at end-of-period exchange rates while revenues and expenses are translated at the average exchange rates in effect during the period.

Equity is translated at historical rates and the resulting cumulative translation adjustments are included as a component of accumulated other comprehensive income (loss) until the translation adjustments are realized. Gains and losses resulting from foreign currency transactions and remeasurement adjustments of monetary assets and liabilities not held in an entity's functional currency (affects primarily the Company's subsidiary in Hong Kong where the local currency Hong Kong Dollar is not the functional currency) are included in earnings.

Classification of Expenses

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

Sales and Marketing Expense – Sales and marketing expenses primarily include royalty expense, sales salaries and commissions, travel and entertainment, marketing and other sales-related costs.

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Interest Expense and Interest Income – Interest expense reflects the cost of borrowing and amortization of deferred financing costs and discounts. Interest expense for the years ended December 31, 2012, 2011 and 2010 was $51,117, $128,188 and $1,802,503, respectively. Interest income of $3,809, $4,190 and $30,841 for the years ended December 31, 2012, 2011 and 2010, respectively, consists of earnings from outstanding amounts due to the Company under notes and other interest bearing receivables.

As of March 31, 2012, the Company elected to change its policy on the classification of interest and penalties associated with tax positions originally recorded in 2007 that could be subject to reversal upon a regulatory review. In accordance with accounting guidance under FASB ASC 740 “Income Taxes” regarding uncertain income tax positions, the Company chose to report interest and penalties associated with uncertain tax positions in the provision for (benefit from) income taxes, net instead of interest expense. This presentation is preferable in order to reflect the full impact of the uncertain income tax position into one classification on our Consolidated Statement of Operations and Comprehensive Loss. Historical amounts are insignificant, and due to immateriality the prior periods presented have not been adjusted to apply the new accounting method retrospectively in accordance with FASB ASC 250 “Accounting Changes and Error Corrections” (See Note 8).

Comprehensive Income (loss)

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

In the first quarter of 2012 we adopted FASB ASU 2011-05, “Presentation of Comprehensive Income” (“ASU 2011-05”) and ASU 2011-12, “Comprehensive Income (Topic 220)”, which amended ASC Topic 220, “Comprehensive Income”, and was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company chose the option provided by ASU 2011-05 to present the total of comprehensive income (loss), the components of net income (loss) and the components of other comprehensive income (loss) in a single continuous statement. Adoption of the guidance did not have any impact on our results of operations or financial condition.

Litigation

On April 16, 2004, we originally filed suit against Pro-Fit Holdings, Limited in the U.S. District Court for the Central District of California – Tag-It Pacific, Inc. v. Pro-Fit Holdings, Limited, CV 04-2694 LGB (RCx) -- asserting various contractual and tort claims relating to our exclusive license and intellectual property agreement with Pro-Fit, seeking declaratory relief, injunctive relief and damages. Other related actions were subsequently filed by the parties. In 2008 Pro-Fit and certain related companies were placed into administration in the United Kingdom and filed petitions under Chapter 15 of the United States Bankruptcy Code. Consequently, all litigation against Pro-Fit was stayed.

In March 2012 we concluded a Settlement Agreement and Release with Pro-Fit and the other parties involved in the litigation and administration proceedings. The Settlement Agreement provided for no damages to be paid by any party, for the unconditional release of Talon and related entities from all claims involved in the matter, dismissal of all actions with prejudice, and our purchase of all of the U.S. patents, licenses, rights and technology associated with the former exclusive license.

43

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On May 7, 2012, we filed a lawsuit against Adidas America, Inc. in the U.S. District Court for the Central District of California asserting claims of trademark infringement, unfair competition, deceptive trade practices and related claims, under both U.S. and California law. The claims arose out of Adidas's use of the “Techfit” name for its apparel, which we asserted infringed our previously registered Tekfit trademark. On May 21, 2012, Adidas then filed a counterclaim against Talon seeking cancellation of our Tekfit U.S. trademark registrations and recovery of legal fees. On January 15, 2013, we accepted a cash settlement from Adidas and both parties dismissed all related actions with prejudice and ensured that future use of their trademarks would not create confusion to the consumer.

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.

Fair Value of Financial Instruments

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

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

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

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

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

In accordance with this guidance, the Company measures its cash equivalents at fair value. The Company’s cash equivalents are classified within Level 1. Cash equivalents are valued primarily using quoted market prices utilizing market observable inputs. At December 31, 2012 and 2011, cash equivalents consisted of money market fund balances measured at fair value on a recurring basis; fair value of the Company’s money market funds was approximately $2,230,000 and $1,822,000, respectively.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

New Accounting Pronouncements

In July 2012, the FASB issued ASU 2012-02, "Intangibles – Goodwill and Other - Testing Indefinite-lived Intangible Assets for Impairment." The updated guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then the company is required to estimate the fair value of the indefinite-lived intangible assets and perform the quantitative impairment test in accordance with ASU 350-30. This ASU is effective for fiscal years, and interim periods within those years, beginning after September 15, 2012. Early adoption is permitted as of a date before July 27, 2012. The Company adopted ASU 2012-03 as of December 31, 2012. The adoption of ASU 2012-02 did not have a material impact on our financial position, results of operations or cash flows.

NOTE 2 — RELATED PARTY NOTES AND TRANSACTIONS

The outstanding amounts of notes payable to related parties in current liabilities as of December 31, 2012 and 2011 were $0 and $239,942, respectively.

Demand notes payable to related parties as of December 31, 2011 included a demand note issued in 1995 to Monto Holdings, Pty, Ltd., a company previously affiliated at the time of the note issuance with Mark Dyne, the Chairman of the Board of Directors of the Company and a stockholder, in the amount of $198,783 with interest rates of 10% per annum, due and payable on the fifteenth day following delivery of written demand for payment. The note was paid in full, including accrued interest, for $199,798 in March 2012.

At December 31, 2011, notes payable to related parties included a note and associated interest due to Lonnie D. Schnell, the Chief Executive Officer and Chief Financial Officer of the Company, in the amount of $41,159. The note was issued on August 6, 2009 in partial satisfaction of 2008 annual incentive amounts to which Mr. Schnell was entitled. The note bore 6% interest annually and the maturity date was the earlier of December 31, 2011 or ten days following Mr. Schnell's employment termination date. The note payable and accrued interest was paid in full in January 2012.

Interest expense, interest accrual and interest amount paid related to the notes payable to related parties for the years ended December 31, 2012, 2011 and 2010 were as follows:

	Year Ended December 31,		
	2012	2011	2010
Interest expense	$1,015	$9,066	$9,344
Accrued interest balance	$-	$144,023	$155,040
Interest paid	$145,038	$20,083	$-

Colin Dyne was a director, officer and significant stockholder of Sequential Brands Group, Inc. through late 2012. He is the brother of both Mark Dyne, the Chairman of the board of directors of the Company and Larry Dyne, the President of the Company. The Company had sales to Sequential Brands Group, Inc. during the years ended December 31, 2011 and 2010 of $142,530 and $120,270, respectively. The Company had no sales to Sequential Brands Group, Inc. in 2012.

45

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In November 2009, the Company entered into an agreement with Colin Dyne, to pay a commission on the collected revenues associated with the sales of products to a specific retail brand. The agreement expired during the fourth quarter of 2011. During the years ended December 31, 2011 and 2010 commissions of $72,640 and $172,506 were earned under this agreement, respectively.

NOTE 3—LONG TERM OBLIGATIONS

Capital Leases

The Company financed one equipment purchase through capital lease obligation expiring in November 2013. This obligation bears interest at the rate of 15.4% per annum. As of December 31, 2012 the entire amount of $3,247 was included in the Company's current liabilities. Future minimum annual payments under the capital lease obligation amounts to $3,751 including interest of $504 to be paid in 2013.

At December 31, 2012, total property and equipment under capital lease obligations and related accumulated depreciation was $10,494 and $8,538. respectively. At December 31, 2011, total property and equipment under capital lease obligations and related accumulated depreciation was $31,450 and $16,532 respectively.

Note Payable

The note payable as of December 31, 2011 consisted of a $25,200 demand note payable to E.C.D. International dated September 30, 1995; bearing interest at 10.0%; payable on the fifteenth day following delivery of written demand for payment. The note was paid in full during March 2012.

NOTE 4 - DEBT FACILITY

The Company originally entered into a Revolving Credit and Term Loan Agreement (the "Loan Agreement") on June 27, 2007 with Bluefin Capital, LLC ("Bluefin"). Bluefin subsequently assigned its rights and obligations under the Loan Agreement to an affiliate, CVC California, LLC ("CVC"). On July 30, 2010, the Company entered into a Recapitalization Agreement (the "Recapitalization Agreement") with CVC in which the Company issued to CVC shares of the Company's Series B Convertible Preferred Stock in payment of all of the outstanding obligations owed by the Company to CVC under the Loan Agreement, (see Note 8). All of the outstanding obligations owed to CVC under the Loan Agreement that became due and payable on July 30, 2010, in the amount of $16,706,685, were converted into Series B Convertible Preferred Stock pursuant to the Recapitalization Agreement. These obligations consisted of outstanding borrowings and accrued interest of $11,548,098 under term notes, and $5,158,587 under a revolving credit note.

In connection with the Recapitalization Agreement, the Loan Agreement (now fully paid and expired) was amended to extend the maturity date from July 30, 2010 until July 31, 2012, reduce the maximum borrowings available under the Revolver to $3,000,000, and amend various additional terms and conditions of the Loan Agreement. The Company paid CVC a non-refundable fee in the amount of $60,000 in consideration of CVC entering into the July 2010 amendment and making this facility available and paid a $50,000 commitment fee during the third quarter of 2011 to ensure the availability of the revolver through July 31, 2012. Upon execution of the amendment, CVC waived all prior events of default under the Loan Agreement. Borrowings under the Loan Agreement were secured by all of the Company's assets.

46

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On July 31, 2012, with no borrowings outstanding, the Loan Agreement expired along with all performance covenants, obligations and liens against any assets of the Company. At December 31, 2011, there were no borrowings under the Revolver portion of the Loan Agreement and no term loans under the Loan Agreement.

Interest expense related to the Loan Agreement was composed of interest on debt, amortization of debt discount, and amortization of deferred financing costs. In total, the interest expense for the years ended December 30, 2012, 2011 and 2010 was $46,667, 50,833 and 1,754,364, respectively. Total interest expense related to the Loan Agreement in the periods was comprised as follows:

- Amortization of deferred financing costs for the years ended December 31, 2012, 2011 and 2010 was $17,500, $30,000 and $135,614, respectively.

- Commitment fee expense for the years ended December 31, 2012 and 2011 was $29,167 and $20,833, respectively.

- Interest on debt related to the Loan Agreement for the year ended December 31, 2010 was $892,857.

- Amortization of the debt discount related to the Loan Agreement for the year ended December 31, 2010 was $725,982.

NOTE 5—PREFERRED STOCK AND STOCKHOLDERS’ EQUITY (DEFICIT)

Preferred Stock

Series B Convertible Preferred Stock

On July 30, 2010, the Company entered into the Recapitalization Agreement with CVC, pursuant to which the Company issued to CVC an aggregate of 407,160 shares of a newly created series of the Company’s preferred stock, designated Series B Convertible Preferred Stock, $0.001 par value per share (the “Series B Preferred Stock”), in payment of an aggregate of $16,706,685 owed by the Company to CVC under the Loan Agreement. Certain rights, preferences, privileges and restrictions of the Series B Preferred Stock are summarized below.

The Series B Preferred Stock has the following rights, preferences, privileges and restrictions:

- The Series B Preferred Stock ranks senior to the common stock and to any other preferred stock unless such preferred stock is created and issued on a senior or pari passu basis in accordance with the Company’s certificate of incorporation.

- Each share of Series B Preferred Stock is convertible into 100 shares of the Company’s common stock (subject to adjustment for stock splits, reverse stock split, etc.) at any time and from time to time at each holder’s option, unless the Series B Preferred Stock is exchanged for its Liquidation Preference as noted below.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- Upon the liquidation, dissolution or winding up of the Company, each share of Series B Preferred Stock is entitled to receive upon the surrender and cancellation of such shares (and prior to any distribution to holders of other equity securities), an amount equal to $41.033 per share plus all accrued dividends (the "Liquidation Preference"). A merger, consolidation, share exchange or other reorganization resulting in a change in control of the Company, or any sale of all or substantially all of the Company's assets, will be deemed a liquidation and winding up for purposes of the Company's obligation to pay the Liquidation Preference.

The Series B Preferred Stock Liquidation Preference will increase at the rate of 16% per annum, compounded annually, in the form of a dividend accrual on the Liquidation Preference. The dividend however is only payable in connection with the payment of the Liquidation Preference upon the liquidation, dissolution or winding up of the Company or upon redemption of Series B Preferred Stock, and in each case exchange for the surrender of the Series B Preferred Stock. No portion of the Liquidation Preference or the associated accrued dividends are convertible into common stock, nor will any portion of the Liquidation Preference or the accrued dividends be payable on shares of Series B Preferred Stock in the event of or following the conversion of such shares into common stock.

- The Company has the right, at any time upon not less than thirty (30) days' prior written notice to the holders of Series B Preferred Stock, to redeem the Series B Preferred Stock in whole (but not in part) for a price equal to the then-applicable Liquidation Preference. The holders of Series B Preferred Stock shall have the option, exercisable at any time and from time to time commencing on July 31, 2016, to require the Company to redeem any or all of the Series B Preferred Stock held by such holders, at the then-applicable Liquidation Preference amount.

- The Series B Preferred Stock vote with the common stock as a single class on all matters submitted or required to be submitted to a vote of the Company's stockholders, with each share of Series B Preferred Stock having a number of votes equal to the number of shares of common stock that may be acquired upon conversion thereof as of the applicable date of determination. Additionally, the Series B Preferred Stock have the right to vote as a separate class with respect to certain matters affecting the Series B Preferred Stock, including but not limited to (a) the creation or issuance of any other class or series of preferred stock, (b) any amendments with respect to the rights, powers, preferences and limitations of the Series B Preferred Stock, (c) paying dividends or distributions in respect of or redeem the Company's common stock or any other junior securities; and (d) certain affiliate transactions. Any such vote shall require the affirmative vote or consent of a majority of the outstanding shares of Series B Preferred Stock.

- As long as the outstanding Series B Preferred Stock represents 35% or more of the voting shares of the Company, on an as-converted to common stock basis, then (a) our Board of Directors shall consist of not more than seven members, (b) the holders of Series B Preferred Stock shall have the right to elect three directors if the Board has five or fewer total directors, and four directors if the Board has six or seven directors (the directors elected by the Series B Preferred Stock are referred to as the "Series B Directors"), and (c) those members serving on the Board who were not elected by holders of the Series B Preferred Stock shall have the right to designate all remaining directors. At least two of the Series B Directors must be, and remain at all times while serving as a director, an independent director that qualifies for service on the audit committee of a corporation with securities listed on the Nasdaq Stock Market as provided in Nasdaq Marketplace Rule 5605(c)(2) (or any successor thereto). Once the outstanding shares of Series B Preferred Stock represent less than 35% of the voting shares on an as-converted to common stock basis, then the entire Board will thereafter be elected by all stockholders having voting rights, voting as a single class.

48

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The conversion of the term notes, revolver and related interest and fees into the Series B Preferred Stock (fair value of $17,277,600 as of July 30, 2010) was considered to be debt extinguishment according to the FASB ASC No.405 “Liabilities” and FASB ASC No. 470-50 “Debt, Modifications and Extinguishments” (“ASC 470-50”). Per ASC 470-50 a loss on extinguishment of debt of $570,915 was recorded on July 30, 2010 and is included in the Consolidated Statement of Operations for the year ended December 31, 2010. The loss on extinguishment is equal to the difference between fair value of the preferred stock and the fair value of the debt extinguished at the transaction date. The fair value of the Series B Preferred Stock on the issuance date was determined by the Company and independent valuation specialists using the option pricing valuation model.

The Company applied the guidance enumerated in FASB ASC No. 480 “Distinguishing Liabilities from Equity”, FASB ASC No. 210 “Classification and Measurement of Redeemable Securities” and Rule 5-02.28 of Regulation S-X, when determining the classification and measurement of preferred stock. The Company classifies conditionally redeemable convertible preferred shares, which includes preferred shares subject to redemption upon the occurrence of uncertain events not solely within the control of the Company, as temporary equity in the mezzanine section of the consolidated balance sheet. The Series B Preferred Stock is redeemable at the option of the holders after the sixth anniversary of issuance, which is not within the control of the Company.

The Company determined that there are no embedded features that would require separate reporting as derivative instruments. Therefore, the Company evaluated the conversion option of the convertible preferred shares under FASB ASC No. 470-20, “Debt with Conversion and Other Options”, Accounting for Convertible Securities with Beneficial Conversion Features (“BCF”) or Contingently Adjustable Conversion Ratios. A convertible financial instrument includes a BCF if the fair value of the instrument is lower than the fair value of shares of the common stock it is convertible into on the issuance date. The BCF shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of the conversion feature to additional paid-in capital. The Company has recorded a BCF value of $1,283,343 in connection with the issuance of the Series B Preferred Stock on July 30, 2010.

The Series B Preferred Stock was initially recorded at the fair value of $17,277,600 as of July 30, 2010, reduced by the BCF ($1,283,343) as stated above and stock issuance costs ($190,744), for a net value of $15,803,513 as of July 30, 2010. The value of the Series B Preferred Stock was adjusted as follows as a consequence of its redemption features and the following approach is implemented by the Company:

- The Series B Preferred Stock is not currently redeemable but it is probable that the preferred stock will become redeemable due to the redemption option available to the preferred stock holders on July 30, 2016. Changes in the redemption value are recognized immediately as they occur, and the carrying amount of the instrument is adjusted to equal the redemption value at the end of each reporting period. This method views the end of the reporting period as if it were also the redemption date for the Series B Preferred Stock. Accordingly, the adjustment of $903,172 to record the preferred stock at its redemption value (“Original issue discount”) was charged against the preferred stock carrying value and retained earnings during the year ended December 31, 2010. In addition, the resulting increase in the carrying amount of the Series B Preferred Stock reduces the income applicable to common shareholders reported in the calculation of earnings per share.

- The annual 16% liquidation preference increase on outstanding preferred shares is accrued each reporting period as an addition to the carrying value of the preferred stock and reduces the income applicable to common shareholders reported in the calculation of earnings per share.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the Series B Preferred Stock activity:

Series B Preferred Stock as of December 31, 2009	$-
Series B Preferred Stock, net of discount for BCF and issuance costs on July 30, 2010	15,803,513
Series B Preferred Stock original issue discount	903,172
Series B Preferred Stock liquidation preference increase	1,113,779
Series B Preferred Stock as of December 31, 2010	17,820,464
Series B Preferred Stock liquidation preference increase	2,851,274
Series B Preferred Stock as of December 31, 2011	$20,671,738
Series B Preferred Stock liquidation preference increase	3,307,478
Series B Preferred Stock as of December 31, 2012	$23,979,216

Series A Preferred Stock

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

Common Stock

Stockholders Agreement

Concurrently with execution of the Recapitalization Agreement, on July 30, 2010, the Company entered into a Stockholders Agreement with CVC, and with Lonnie D. Schnell, Chief Executive Officer, Chief Financial Officer and a member of the Board of Directors of the Company, and Larry Dyne, President of the Company ("Messrs. Schnell and Dyne"), pursuant to which:

- CVC agreed that in connection with any director nominees to be submitted to holders of the Company's common stock for election at a stockholders' meeting, a committee of our Board comprised solely of directors then serving on the Board who were not elected or appointed by holders of Series B Preferred Stock, acting by majority vote, shall have the right to designate all of the Board's nominees for director to be elected by holders of the Company's Common Stock.

- CVC agreed that in connection with any election of directors submitted to the Company's stockholders for election at a stockholders' meeting, CVC will attend the stockholders' meeting, in person or by proxy, and vote (or cause to be voted) all of CVC's shares of the Company's voting stock in favor of the Board's nominees for director.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- Messrs. Schnell and Dyne granted CVC a right of first refusal with respect to any shares of the Company's voting securities that Messrs. Schnell and Dyne propose to sell in a private placement transaction, and agreed to provide CVC with advance notice of their intent to sell the Company's voting securities in any public sale transaction.

- CVC granted Messrs. Schnell and Dyne a tag-along right, providing Messrs. Schnell and Dyne with the right to sell their shares of the Company's voting securities in a transaction where CVC is selling its shares of the Company's voting securities.

- Messrs. Schnell and Dyne agreed with CVC to vote their shares of Talon voting stock in favor of a merger or consolidation of the Company into or with another corporation or any share exchange, business combination or other such transaction in which the Company is a constituent party, or any sale of all or substantially all of the Company's assets (a "Triggering Transaction"), in each case to the extent such transaction is first approved by CVC.

- CVC agreed not to sell or otherwise transfer its shares of the Company's voting securities, or to vote its shares of the Company's voting securities in favor of any Triggering Transaction, at any time on or before July 31, 2011, other than in connection with a transaction that is approved by a majority of the Company's voting shares (where, in calculating such majority, the votes attributable to CVC's shares of the Company's voting securities are excluded in the numerator but included in the denominator).

- The Company provided CVC with a preemptive right, pursuant to which CVC will have the right, subject to certain exceptions set forth in the Stockholders Agreement, to acquire in a subsequent issuance of securities by the Company a number of offered securities that will allow CVC to maintain its percentage ownership of the Company's voting securities.

- CVC agreed with Messrs. Schnell and Dyne that in connection with a Triggering Transaction, CVC, and any other holder of Series B Preferred Stock and shares of common stock acquired upon conversion thereof, shall pay to Messrs. Schnell and Dyne a portion (beginning at 5% and increasing to 10%) of the sales proceeds payable in the Triggering Transaction to CVC or such other holder in respect of such Series B Preferred Stock or conversion shares. Each of Messrs. Schnell and Dyne's right to receive such portion of the sales proceeds is conditional upon the Triggering Transaction occurring (i) while employed by the Company or (ii) within 12 months following termination of employment with the Company for any reason other than termination of employment for "cause" or termination of employment by Messrs. Schnell or Dyne without "good reason" (as such terms are defined in their respective employment agreements).

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Exclusive License and Intellectual Property Rights Agreement

As mentioned in Note 1, on April 2, 2002, the Company entered into the License Agreement with Pro-Fit. The Agreement gave the Company the exclusive rights to sell or sublicense waistbands manufactured under patented technology developed by Pro-Fit for garments manufactured anywhere in the world for the United States market and all United States brands. In accordance with the License Agreement, the Company issued 150,000 shares of its common stock which were recorded at the market value of the stock on the date of the Agreement. The License Agreement had an indefinite term that extends for the duration of the trade secrets licensed under the License Agreement. The Company has recorded an intangible asset amounting to $612,500, which was fully amortized. During the quarter ended March 31, 2012 the Company completed the acquisition from Pro-Fit and related parties of all U.S. patents, applications, trademarks, rights and technology associated with the stretch waistband technology that was formerly exclusively licensed under the License Agreement, and the License Agreement was terminated.

NOTE 6—STOCK-BASED COMPENSATION

The Company accounts for stock-based awards to employees and directors in accordance with FASB ASC 718, “Compensation - Stock Compensation” (“ASC 718”), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values.

Stock Options

The Company’s 2008 Stock Plan, which was approved by the Company’s stockholders in 2008, authorized up to 2,500,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan. On November 19, 2010, the Company’s stockholders approved an amendment to the Company’s 2008 Stock Incentive Plan to increase from 2,500,000 to 4,810,000 the number of shares of common stock that may be issued pursuant to awards thereunder.

The Company’s 2007 Stock Plan was approved by the Company’s stockholders in 2007, which replaced the 1997 Stock Plan. The 2007 Stock Plan authorizes up to 2,600,000 shares of common stock for issuance pursuant to awards granted to individuals under the plan.

On October 1, 1997, the Company adopted the 1997 Stock Incentive Plan (the “1997 Plan"), which authorized the granting of a variety of stock-based incentive awards.

The Board of Directors, who determines the recipients and terms of the award granted, administers the Company’s stock plan. Since 2006, option awards under the Company’s stock plans are generally granted with an exercise price equal to the average market price of the Company’s stock for the five trading days following the date of approval of the grant. Those option awards generally vest over periods determined by the Board from immediate to 4 years of continuous service and have 10 year contractual terms.

Options granted for the year ended December 31, 2012, 2011 and 2010 totaled 630,000, 1,405,000 and 530,000, respectively.

Options granted to certain employees in 2008 included certain vesting acceleration features based on Company performance as determined by the Board of Directors each year. Consistent with ASC 718-10, the stock based compensation expense for the employee options are recognized on a time-phased vesting schedule through the vesting date of December 31, 2010.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the year ended December 31, 2011, a former employee exercised options to acquire 109,375 shares of common stock under the 2008 Stock Incentive Plan. Cash received upon exercise was $12,030 or $0.11 per share. At the time of exercise, the intrinsic value of the options exercised was $0.04 per share. No options were exercised during the years ended December 31, 2012 and 2010.

The Recapitalization Agreement constituted a change of control of the Company and as a result, on July 30, 2010, all options previously granted to Lonnie Schnell and Larry Dyne became fully vested in accordance with provisions in their employment agreements and their option grants. On July 30, 2010 the Company entered into new executive employment agreements with Messrs. Schnell and Dyne and they each agreed to cancel all option grants previously awarded to them on or before December 31, 2007. Accordingly, options to purchase a total of 1,005,500 shares of common stock were cancelled effective July 30, 2010 (See Note 5).

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

	Number of Shares	Weighted Average Exercise Price
Employees and Directors		
Options outstanding - December 31, 2009	6,637,850	$ 0.73
Granted	530,000	$ 0.16
Cancelled	(2,020,750)	$ 1.56
Options outstanding - December 31, 2010	5,147,100	$ 0.35
Granted	1,405,000	$ 0.10
Exercised	(109,375)	$ 0.11
Cancelled	(300,625)	$ 1.79
Options outstanding - December 31, 2011	6,142,100	$ 0.22
Granted	630,000	$ 0.05
Cancelled	(400,000)	$ 0.15
Options outstanding - December 31, 2012	6,372,100	$ 0.21

The Company's determination of fair value of share-based payment awards on the date of grant uses the Black-Scholes model and the assumptions noted in the following table for the years indicated. Expected volatilities are based on the historical volatility of the Company's stock price and other factors. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards and actual and projected employee stock option exercise behaviors. The expected option term is estimated using the "safe harbor" provisions under ASC 718. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield in effect at the time of the grant.

	Year ended December 31,		
	2012	2011	2010
Expected volatility	140%	134 - 138%	131%
Expected term in years	5.3 - 6.1	5.3 - 6.1	6.1
Expected dividends	-	-	-
Risk-free rate	2.7%	1.5 - 2.7 %	1.9%

53

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the Company's stock option information under all Stock Plans as of December 31, 2012 is as follows:

Employees and Directors	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Intrinsic Value
Outstanding at December 31, 2012	6,372,100	$0.21	6.7	$0.00
Vested and Expected to Vest	6,348,389	$0.21	6.7	$0.00
Exercisable	5,277,413	$0.24	6.3	$0.00

The aggregate intrinsic value of the stock options was calculated as the difference between the exercise price of a stock option and the quoted price of the Company's common stock at December 31, 2012. It excluded stock options that have exercise prices in excess of the quoted price of the Company's common stock at December 31, 2012.

There were approximately $82,000 of total unrecognized compensation costs related to non-vested stock options as of December 31, 2012. This cost is expected to be recognized over the weighted-average period of 2.0 years.

When options are exercised, the Company's policy is to issue previously registered, unissued shares of common stock. The Company's 2008 and 2007 Stock Incentive Plans, as amended, authorize up to 4,810,000 and 2,600,000 shares of common stock, respectively, for issuance pursuant to awards granted to individuals under the plans.

Restricted Stock Units (RSU's)

On July 30, 2010, the Company awarded each of Lonnie Schnell and Larry Dyne a restricted stock unit award (an "RSU Award") for 5,778,500 shares of the Company's common stock. Each RSU Award vested 50% on August 30, 2011, and vests 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to partial acceleration of vesting as part of the executives' severance benefits and full acceleration of vesting upon a change in control of the Company. As of July 30, 2010, the RSU's were valued at $2,263,384 which was reduced by the fair value of the options surrendered (see Stock Options above).

On August 30, 2010, Messrs. Schnell and Dyne elected to defer the settlement in common shares of 5,434,200 RSU's beyond the vesting dates. On August 30, 2011, based on the deferral schedules, 600,000 common shares were issued upon settlement of a portion of vested units under the RSU Awards. At the time of the issuance the intrinsic value of these shares was $0.10 per share. On January 30, 2012, based on the deferral schedules, 900,000 common shares were issued upon settlement of a portion of vested units under the RSU Awards. At the time of the issuance the intrinsic value of these shares was $0.05 per share. On July 30, 2012 1,500,000 common shares were issued upon settlement of a portion of vested units under the RSU Awards. At the time of the issuance the intrinsic value of these shares was $0.04 per share. Subsequent to December 31, 2012 1,500,000 common shares were issued upon settlement of a portion of vested units under the RSU Awards. At the time of the issuance the intrinsic value of these shares was $0.04 per share.

As of December 31, 2012, the Company had $490,000 of unamortized stock-based compensation expense related to RSU's, which will be recognized over the remaining weighted average period of 1.1 years.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes RSU's activity:

	Number of RSU's Unvested	Vested	Total	Weighted Average Grant date value per RSU
RSU's Issued – July 2010	11,557,000	-	11,557,000	$ 0.196
RSU's outstanding - December 31, 2010	11,557,000	-	11,557,000	$ 0.196
Vested	(5,778,500)	5,778,500	-	$ 0.196
Common stock issued	-	(600,000)	(600,000)	$ 0.196
RSU's outstanding - December 31, 2011	5,778,500	5,178,500	10,957,000	$ 0.196
Vested	(2,311,400)	2,311,400	-	$ 0.196
Common stock issued	-	(2,400,000)	(2,400,000)	$ 0.196
RSU's outstanding - December 31, 2012	3,467,100	5,089,900	8,557,000	$ 0.196

NOTE 7—NET INCOME (LOSS) PER SHARE

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

	Year Ended December 31, 2012			2011			2010		
Years ended:	Net income (loss) (Numerator)	Shares (Denominator)	Per Share Amount	Net income (loss)(Numerator)	Shares (Denominator)	Per Share Amount	Net loss (Numerator)	Shares (Denominator)	Per Share Amount
Net income (loss)	$679,347	22,458,185	$0.03	$729,133	20,567,640	$0.04	$(1,466,820)	20,291,433	$(0.07)
Series B preferred stock original discount	-	-	-	-	-	-	(903,172)	-	(0.04)
Series B preferred stock liquidation preference increase	(3,307,478)	-	(0.15)	(2,851,274)	-	(0.14)	(1,113,779)	-	(0.06)
Basic net income	(2,628,131)	22,458,185	(0.12)	(2,122,141)	20,291,433	(0.10)	(3,483,771)	20,291,433	(0.17)

(loss) applicable to common stockholders									
Stock options, RSUs and Series B preferred stock with dilutive effect	-	-	-	-	-	-	-	-	-
Diluted net income (loss) applicable to common stockholders	$(2,628,131)	22,458,185	$(0.12)	$(2,122,141)	20,291,433	$(0.10)	$(3,483,771)	20,291,433	$(0.17)

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Options to purchase 6,372,100 shares of common stock exercisable between $0.04 and $5.23 per share, RSU's to settle for 8,557,000 common shares and Series B Preferred Stock to be converted into 40,716,000 shares of common stock were outstanding for the year ended December 31, 2012, but were not included in the computation of diluted net income (loss) per share applicable to common shareholders because they would have an antidilutive effect on the net income (loss) per share.

Options to purchase 6,142,100 shares of common stock exercisable between $0.06 and $5.23 per share, RSU's to settle for 10,957,000 common shares and Series B Preferred Stock to be converted into 40,716,000 shares of common stock were outstanding for the year ended December 31, 2011, but were not included in the computation of diluted net income (loss) per share applicable to common shareholders because they would have an antidilutive effect on the net income (loss) per share.

Options to purchase 5,147,100 shares of common stock exercisable between $0.06 and $5.23 per share, RSU's to settle for 11,557,000 common shares and Series B Preferred Stock to be converted into 40,716,000 shares of common stock were outstanding for the year ended December 31, 2010, but were not included in the computation of diluted net income (loss) per share applicable to common shareholders because they would have an antidilutive effect on the net income (loss) per share.

NOTE 8—INCOME TAXES

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

	Year Ended December 31,		
	2012	2011	2010
Current:			
Federal	$ 76,250	$ 161,306	$ 12,588
State	3,322	2,528	978
Foreign	(22,180)	84,560	(4,579)
	57,392	248,394	8,987
Deferred:			
Federal	115,736	115,800	479,353
State	26,984	26,794	129,201
Foreign	68,001	95,129	(21,890)
	210,721	237,723	586,664
	$ 268,113	$ 486,117	$ 595,651

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Year Ended December 31,		
	2012	2011	2010
Current:			
Federal statutory rate	34.0 %	34.0 %	34.0 %
State taxes net of federal benefit	2.1	1.6	(9.9)
Change in effective foreign tax rate	(23.9)	(26.0)	(3.2)
Loss on extinguishment of debt	-	-	(22.3)
Other permanent differences	(54.9)	(13.6)	(6.5)
Foreign withholding taxes	13.3	24.7	(5.2)
Net operating loss valuation allowance	95.7	35.9	(1.3)
Change in uncertainty in income taxes	(19.8)	-	-
Other	(18.2)	(16.6)	(54.0)
	28.3 %	40.0 %	(68.4) %

Net income (loss) before income taxes is as follows:

	Year Ended December 31,		
	2012	2011	2010
Domestic	$(163,227)	$(457,736)	$(670,201)
Foreign	1,110,687	1,672,986	(200,968)
	$947,460	$1,215,250	$(871,169)

The primary components of temporary differences which give rise to the Company’s deferred tax being presented as part of Prepaid expenses and other current assets, Deferred income tax, or Deferred income tax liability (in long term liabilities) in the Company’s balance sheet are as follows:

	December 31,	
	2012	2011
Net deferred tax:		
Net operating loss carry-forward	$ 9,381,454	$ 8,205,788
Intangible assets, net	(811,472)	(650,938)
Property and equipment, net	(100,606)	(183,952)
Bad debt allowance	-	2,161
Related party interest	-	56,746
Inventory allowance	57,979	58,238
Credit carryforwards	13,920	13,920
Stock awards expense	739,492	730,778
Payroll	63,415	22,857
Other	149,694	203,797
	9,493,876	8,459,395
Less: Valuation allowance	(10,439,419)	(9,194,219)
	$ (945,543)	$ (734,824)
Presented as:		
Other assets	$ -	$ 16,324

Deferred income tax liability	$ (945,543)	$ (751,148)

57

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On January 1, 2007 as a result of the implementation of ASC 740, the Company recognized an increase in liabilities for unrecognized tax benefits of $245,800, which was accounted for as an increase in the January 1, 2007 accumulated deficit. Interest recorded per ASC 740 was recorded as part of interest expense in the Company's statements of operations. At March 31, 2012 the Company recorded an income tax benefit, associated with the elimination of a portion of the ASC 740 tax liability, of $196,423 as the time limit for regulatory assessment of the tax liability had expired.

A reconciliation of the ASC 740 adjustments is as follows:

	Year Ended December 31, 2012	2011
Beginning Balance	$321,325	$305,425
Interest and penalties	8,700	15,900
Elimination of a tax liability	(196,423)	-
Ending Balance	$133,602	$321,325

At December 31, 2012 and 2011, the Company had Federal net operating loss carry-forwards (or "NOLs") of approximately $22.9 million and $19.9 million, respectively, and State NOLs of $27.5 million and $22.5 million, respectively. The Federal NOL and State NOL are available to offset future taxable income through 2032. Section 382 of the Internal Revenue Code places a limitation on the realizability of net operating losses in future periods if the ownership of the Company has changed more than 50% within a three-year period. Due to the Recapitalization Agreement between the Company and CVC on July 30, 2010 (See note 4 and Note 5) the application of I.R.C. Section 382 was required. As a consequence of the application of Section 382, the Company's NOL limitation was determined to be approximately $2.2 million annually for each of the first five years and $0.7 million annually for up to 20 years following the date of the transaction. At the date of the Recapitalization transaction the Section 382 limitation reduced the Company's NOL carry-forwards by approximately $45.0 million for the Federal NOL and $9.0 million for the State NOL. Income taxes are accounted for under the asset and liability method.

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

The provisions of ASC 740 require the establishment of a valuation allowance unless, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred tax asset will be realized. ASC 740 provides an important factor in determining whether a deferred tax asset will be realized is whether there has been sufficient income realized in recent years and whether sufficient income is expected to be realized in future years to utilize the deferred tax asset. In 2012, 2011 and 2010 the Company determined, based upon its cumulative operating losses, that it was not more likely than not that it would fully realize most of its domestic and foreign deferred tax assets in the future years. Consequently, at December 31, 2012 and 2011 the Company recorded a valuation allowance of $10.4 million and $9.2 million, respectively, which fully reserved the carrying value of its net deferred tax assets.

58

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

In 2012 and 2011 there were no undistributed earnings from the Company's foreign subsidiaries. In 2010, the Company included in its consolidated U.S. federal tax return approximately $34,000 a deemed dividend due to earnings from the Company's foreign subsidiary.

Tax years subject to examination by the tax authorities for Talon International, Inc. (US) are 2008 through 2012 and for the foreign subsidiaries, 2003 through 2012.

NOTE 9—COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company is a party to a number of non-cancelable operating lease agreements involving buildings and equipment, which expire at various dates through 2017. The Company accounts for its leases in accordance with FASB ASC 840 "Leases", whereby step provisions, escalation clauses, tenant improvement allowances, increases based on an existing index or rate, and other lease concessions are accounted for in the minimum lease payments and are charged to the statement of operations on a straight-line basis over the related lease term.

The future minimum lease commitments at December 31, 2012 are approximately as follows:

Years Ending December 31,		Amount
2013	$	572,000
2014		404,000
2015		201,000
2016 and after		30,000
Total minimum payments	$	1,207,000

Total rental expense for the years ended December 31, 2012, 2011 and 2010 aggregated $687,371, $629,699 and $651,285, respectively.

Profit Sharing Plan

In October 1999, the Company established a 401(k) profit-sharing plan for the benefit of eligible employees. The Company may make annual contributions to the plan as determined by the Board of Directors.

Total contributions for the years ended December 31, 2012, 2011 and 2010 amounted to $23,129, $21,184, and $16,750, respectively.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Contingencies

On May 7, 2012, the Company filed a lawsuit against Adidas America, Inc. in the U.S. District Court for the Central District of California asserting claims of trademark infringement, unfair competition, deceptive trade practices and related claims, under both U.S. and California law. The claims arose out of Adidas's use of the "Techfit" name for its apparel, which we asserted infringed our previously registered Tekfit trademark. On May 21, 2012, Adidas then filed a counterclaim against Talon seeking cancellation of our Tekfit U.S. trademark registrations and recovery of legal fees. On January 15, 2013, we accepted a cash settlement from Adidas and both parties dismissed all related actions with prejudice and ensured that future use of their trademarks would not create confusion to the consumer.

The Company currently has pending claims and complaints that arise in the ordinary course of the Company's business. The Company believes that it has meritorious defenses to these claims and that the claims are either covered by insurance or would not have a material effect on the Company's consolidated financial condition if adversely determined against the Company.

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

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

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10—SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

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

	Year Ended December 31, 2012			
	Talon	Trim	Tekfit	Consolidated
Net sales	$ 22,061,303	$ 22,519,125	$ 20,444	$ 44,600,872
Cost of goods sold	16,022,334	14,083,017	35,120	30,140,471
Gross profit (loss)	$ 6,038,969	$ 8,436,108	$ (14,676)	14,460,401
Operating expenses				13,465,633
Income from operations				$ 994,768

	Year Ended December 31, 2011			
	Talon	Trim	Tekfit	Consolidated
Net sales	$ 22,612,784	$ 19,047,959	$ 7,764	$ 41,668,507
Cost of goods sold	16,481,686	11,981,505	1,550	28,464,741
Gross profit	$ 6,131,098	$ 7,066,454	$ 6,214	13,203,766
Operating expenses				11,864,518
Income from operations				$ 1,339,248

	Year Ended December 31, 2010			
	Talon	Trim	Tekfit	Consolidated
Net sales	$ 24,517,016	$ 16,936,082	$ 6,649	$ 41,459,747
Cost of goods sold	18,141,430	10,771,096	86,829	28,999,355
Gross profit	$ 6,375,586	$ 6,164,986	$ (80,180)	12,460,392
Operating expenses				10,988,984
Income from operations			$	$ 1,471,408

The Company distributes its products internationally and has reporting requirements based on geographic regions. Long-lived assets are attributed to countries based on the location of the assets and revenues are attributed to countries based on customer delivery locations, as follows:

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Year Ended December 31, 2012	2011	2010
Sales:			
United States	$ 4,494,939	$ 3,519,137	$ 3,574,386
Hong Kong	14,594,685	14,695,433	14,509,155
China	10,759,863	9,557,952	10,412,168
Bangladesh	2,242,018	2,092,993	2,546,500
Other	12,509,367	11,802,992	10,417,538
Total	$ 44,600,872	$ 41,668,507	$ 41,459,747

	December 31, 2012	2011	2010
Long-lived Assets:			
United States	$ 4,551,101	$ 4,443,691	$ 4,623,448
Hong Kong	419,268	629,373	884,344
China	73,344	129,977	182,980
Other	-	319	2,306
Total	$ 5,043,713	$ 5,203,360	$ 5,693,078

NOTE 11—MAJOR CUSTOMERS AND VENDORS

For the years ended December 31, 2012, 2011 and 2010, the Company's three largest customers represented approximately 6%, 8% and 9%, respectively, of consolidated net sales.

Three vendors, each representing more than 10% of the Company's purchases, accounted for approximately 42% of the Company's purchases for the year ended December 31, 2012. Three vendors, each representing more than 10% of the Company's purchases, accounted for approximately 31% of the Company's purchases for the year ended December 31, 2011. Four vendors, each representing more than 10% of the Company's purchases, accounted for approximately 43% of the Company's purchases for the year ended December 31, 2010.

Included in accounts payable and accrued expenses at December 31, 2012 and 2011 is $2,907,345 and $3,663,146 due to these vendors.

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 – QUARTERLY RESULTS (UNAUDITED)

Quarterly results for the years ended December 31, 2012 and 2011 are reflected:

	Year Ended December 31, 2012			
	1st	2nd	3rd	4th
Net sales	$8,745,950	$13,179,849	$11,288,717	$11,386,356
Gross profit	$2,770,756	$4,358,729	$3,650,872	$3,680,044
Income (loss) from operations	$(473,826)	$974,358	$375,232	$119,004
Net income (loss)	$(205,630)	$671,134	$186,865	$26,978
Net income (loss) per share	$(0.01)	$0.03	$0.01	$0.00
Basic and diluted net income (loss) per share applicable to Common Shareholders	$(0.05)	$0.00	$(0.03)	$(0.04)
Total comprehensive income (loss)	$(221,264)	$700,454	$162,451	$42,959

	Year Ended December 31, 2011			
	1st	2nd	3rd	4th
Net sales	$9,228,193	$12,752,281	$9,404,648	$10,283,385
Gross profit	$2,890,553	$4,063,338	$2,827,787	$3,422,088
Income (loss) from operations	$(290,505)	$1,001,138	$(157,455)	$786,070
Net income (loss)	$(400,928)	$656,325	$(126,020)	$599,756
Net income (loss) per share	$(0.02)	$0.03	$(0.01)	$0.03
Basic and diluted net income (loss) per share applicable to Common Shareholders	$(0.05)	$(0.00)	$(0.04)	$(0.01)
Total comprehensive income (loss)	$(403,709)	$637,447	$(106,680)	$633,549

The Company typically experiences 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 the Company's business in the first and fourth quarters of each year due to the seasonal buying patterns by the majority of the customers. The apparel retailers typically experience higher sales volumes during the second and third quarters associated with back-to-school sales efforts and in the fourth quarter in connection with year-end holiday purchases. Sales of the Company's products typically precede the retail sales patterns by 90 to 150 days. Backlogs of sales orders are not considered material in the industries in which the Company competes with, which reduces the predictability of the Company's sales and reinforces the volatility of these cyclical buying patterns on the Company's sales volume.

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

TALON INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 – SUBSEQUENT EVENTS

The Company evaluated subsequent events after the balance sheet date of December 31, 2012 through the date of the filing of this report.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Controls and Procedures

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

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

Management’s Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, the Company’s management has conducted an assessment, including testing, using the criteria in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Based on its assessment, our management has concluded that control over financial reporting was effective as of December 31, 2012.

Pursuant to applicable law, this annual report is not required to include an attestation report of our registered public accounting firm regarding internal control over financial reporting.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of our fiscal year ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth the name, age and position of each of our executive officers and directors as of March 27, 2013.

Name	Age	Position
Directors:		
Mark Dyne (1)(3)(4)	52	Chairman of the Board of Directors
Lonnie D. Schnell (1)	64	Chief Executive Officer, Chief Financial Officer and Director
David Ellis (2)(4)	49	Director
Mark J. Hughes (2)	41	Director
Morris Weiss (2)(4)	53	Director
Other Executive Officers:		
Larry Dyne (3)	40	President
James E. Reeder	55	Vice President, Corporate Controller

(1) Messrs. Dyne and Schnell were elected by holders of Common Stock, and the seats they occupy on the Board will be filled by a vote of the holders of Common Stock, voting as a separate class.
(2) Messrs. Ellis, Hughes and Weiss were appointed by the sole holder of Series B Preferred Stock, and the seats they occupy on the Board will be filled by a vote of the holders of Series B Preferred Stock, voting as a separate class. Mr. Weiss was appointed on May 9, 2012.
(3) Mark Dyne and Larry Dyne are brothers.
(4) Member of the Special Committee of the Board.

Directors:

Mark Dyne

Mr. Dyne has served as Chairman of the Board of Directors since 1997. Mr. Dyne currently serves as the Chief Executive Officer and the Managing Partner of Europlay Capital Advisors, LLC, a merchant banking and advisory firm. Mr. Dyne previously served on the Board of Directors of Skype Global S.a.r.l. the world's leader in V.O.I.P. communications. Mr. Dyne was also previously Chairman and Chief Executive Officer of Sega Gaming Technology Inc. (USA), and Chairman and Chief Executive Officer of Virgin Interactive Entertainment Ltd. Mr. Dyne was a founder and former director of Sega Ozisoft Pty Ltd. Mr. Dyne was nominated to our board of directors for his extensive domestic and international management experience.

Lonnie D. Schnell	Mr. Schnell joined us in January 2006 as our Chief Financial Officer, was appointed as Chief Executive Officer in February 2008 and has served on our Board of Directors since May 2008. Mr. Schnell served as Vice President of Finance for Capstone Turbine Corporation, a manufacturer of micro-turbine electric generators from 2004 until 2005. From 2002 to 2004 Mr. Schnell served as Chief Financial Officer of EMSource, LLC, an electronic manufacturing service company. Previously, Mr. Schnell served as Chief Financial Officer of Vintage Capital Group, a private equity investment firm, and Chief Financial Officer of Need2Buy, Inc. a business-to-business internet marketplace for electronic components. Mr. Schnell completed an executive MBA program with the Stanford University Executive Institute, and earned his Bachelor of Science in Accounting at Christian Brothers University. Mr. Schnell is a Certified Public Accountant with experience in the international accounting firm of Ernst & Young LLP. Mr. Schnell was nominated to our Board of Directors for his extensive international management experience, knowledge of associated industry practices and trends, and for his financial management expertise.
David Ellis	David Ellis has served on our Board of Directors since October 2010. Mr. Ellis is a co-founder of GemCap, a provider of asset-based loans, ranging from $1 million to $10 million, as a senior-secured lender. Through 2006, Mr. Ellis served as the President of Buxbaum Group. Mr. Ellis has twenty years of experience in the acquisition, insolvency and turnaround management businesses during which he built several international businesses, with an emphasis in the apparel industry. Mr. Ellis was nominated to our Board of Directors for his extensive domestic and international management experience, and knowledge of associated industry practices and trends, and for his financial and investment management expertise.
Mark J. Hughes	Mark J. Hughes has served on our Board of Directors since July 2010. Mr. Hughes currently serves as a Managing Director at The Comvest Group, a private investment firm focused on providing equity and debt capital to lower middle-market companies. From July 2005 until joining ComVest, Mr. Hughes was a Managing Director at Tejas Securities Group, an investment and merchant bank focused on distressed debt, high yield and special situations. From March 1998 to June 2005, Mr. Hughes served as a Managing Director in the Investment Banking Group and an Equity Research Analyst at C.E. Unterberg, Towbin, an investment bank that specialized on advising, financing and investing in middle-market healthcare and technology companies. From 1996 to 1998, Mr. Hughes worked in Global Markets as a Foreign Exchange Analyst at Deutsche Bank. Prior to Deutsche Bank, Mr. Hughes spent three years as a Senior Auditor in the Hedge Fund and Broker Dealer Practice of Goldstein, Golub, & Kessler, LLC. Mr. Hughes was a CPA and received his B.S. from Rutgers College, Rutgers School of Business. Mr. Hughes was nominated to our board of directors for his extensive experience in private equity, capital markets, mergers and acquisitions, and corporate finance

matters, and his leadership skills enable him to provide support to Talon in areas of operations, finance, and strategy.

Morris Weiss	Morris Weiss has served on our Board of Directors since May 2012. Mr. Weiss is a partner at the law firm Hohmann, Taube & Summers, LLP, where Mr. Weiss specializes in commercial bankruptcy and restructuring matters as well as complex commercial litigation. Prior to joining Hohmann, Taube & Summers, LLP in 2010, Mr. Weiss was the Managing Director of IP Navigation Group, LLC, an international patent monetization company, from April 2010 to August 2010. Mr. Weiss was the Managing Director of Investment Banking of MDB Capital Group, LLC, an independent broker dealer, from May 2009 to April 2010. From January 2009 to April 2010, Mr. Weiss served on the board of directors of Atlas Mining Company (n/k/a Applied Minerals, Inc. (OTCQB: AMNL.OB)), the leading global producer of Halloysite Clay solutions, and from November 2008 to April 2009, Mr. Weiss served as the company's Chief Restructuring Officer. From February 2002 to October 2008, Mr. Weiss was the Managing Director and Head of Investment Banking of Tejas Securities Group, Inc., a full service, independent broker dealer. Mr. Weiss was nominated to our Board of Directors for his extensive domestic and international management experience, knowledge of associated industry practices and trends, and for his strategic growth management expertise.

Other Executive Officers:

Larry Dyne	Larry Dyne was appointed as our President in May 2009. He has been our employee since 1992, and was formerly Executive Vice President of Sales as well as vice president of product development and global sourcing, and vice president of trim sales. Through these positions, Mr. Dyne has established extensive and long-term relationships with the world's top brands and clothing retailers. He was also formerly responsible for domestic production for all printing.
James E. Reeder	James E. Reeder joined us in May 2009 and was appointed Vice President, Corporate Controller. From January 2007 to September 2008, Mr. Reeder served as Chief Financial Officer at Sheffield Manufacturing, an aerospace parts manufacturer and at Data Exchange Corporation, an international provider of supply chain solutions. From January 2002 to October 2006, Mr. Reeder was Vice President Finance for Special Devices, Inc., a manufacturer of automotive safety devices and was previously Chief Financial Officer for Power Lift Corporation, a distributor of Caterpillar materials and equipment. Mr. Reeder also served in various senior financial roles at Avery Dennison Corporation for approximately fourteen years. Mr. Reeder has an MBA in Finance and Strategic Planning from the University of California at Berkeley and a B.S., Economics Summa Cum Laude from California State Polytechnic University, Pomona.

Board Composition and Nominations

On July 30, 2010, we entered into a Recapitalization Agreement with CVC California, LLC, pursuant to which we issued to CVC an aggregate of 407,160 shares of a newly created senior series of preferred stock, designated Series B Convertible Preferred Stock, in payment of the full amount of the debt owed by us to CVC under our Loan Agreement with CVC. Each share of Series B Preferred Stock is convertible into 100 shares of Common Stock. The Series B Preferred Stock has other rights, preferences, privileges and restrictions, including a liquidation preference, redemption rights and class voting rights, which are summarized in Note 5 in the accompanying Notes to Consolidated Financial Statements.

In connection with the Recapitalization Agreement our Board of Directors was reconfigured to consist of five members, with three members designated by the Series B Preferred Stockholders to serve as Series B Directors.

Concurrently with execution of the Recapitalization Agreement, we entered into a Stockholders Agreement with CVC, and with Lonnie D. Schnell, Chief Executive Officer, Chief Financial Officer and a member of our Board of Directors, and Larry Dyne, our President, providing for, among other agreements, the following with respect to election of directors:

- CVC agreed that in connection with any director nominees to be submitted to holders of our common stock for election at a stockholders' meeting, a committee of our Board comprised solely of directors then serving on the Board who were not elected or appointed by holders of Series B Preferred Stock, acting by majority vote, shall have the right to designate all of the Board's nominees for director to be elected by holders of our Common Stock; and

- CVC agreed that in connection with any election of directors submitted to our stockholders for election at a stockholders' meeting, CVC will attend the stockholders' meeting, in person or by proxy, and vote (or cause to be voted) all of CVC's shares of our voting stock in favor of the Board's nominees for director.

Board Committees

Effective upon the closing of the Recapitalization Agreement on July 30, 2010, we eliminated our Board committees, and presently do not have a separately designated audit, compensation, nominating or governance committee of the Board of Directors. The functions customarily delegated to these committees are now performed by our full Board of Directors.

The Board forms ad hoc committees from time to time to assist our Board in fulfilling its responsibilities with respect to matters that are the subject of the ad hoc committee's mandate. During fiscal year 2012, the Board maintained a Special Committee to assist our Board by making recommendations on alternative capital structures, transactions and initiatives that the committee believes are reasonably likely to maximize stockholder value. The Special Committee currently consists of David Ellis, Mark Dyne and Morris Weiss.

Audit Committee and Audit Committee Financial Expert

The Company is not a "listed company" under SEC rules and is therefore not required to have a separate audit committee comprised of independent directors. Our full Board of directors performs the functions of the audit committee. The Company has, however, determined that as of December 31, 2012, each of Mssrs. Ellis and Weiss is "independent" as that term is defined in Section 5605 of the NASDAQ Marketplace Rules applicable to companies listed on The NASDAQ Stock Market, and has also determined that each of Messrs. Dyne, Schnell and Ellis is an "audit committee financial expert" as defined in Item 407(d)(5) of Regulation S-K. The director biographies included above under this Item 10 describe the relevant experience of each director.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors and persons who own more than ten percent of a registered class of our equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater-than-ten percent stockholders are required by Securities and Exchange Commission regulations to furnish us with all Section 16(a) forms they file. Based solely on our review of the copies of the forms received by us and written representations from certain reporting persons that they have complied with the relevant filing requirements, we believe that, during the year ended December 31, 2012, all of our executive officers, directors and greater-than-ten percent shareholders complied with all Section 16(a) filing requirements.

Code of Ethics

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

ITEM 11. EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

The full Board of Directors is responsible for determining the compensation to be paid to our officers and directors, with recommendations from management as to the amount and/or form of officer compensation. While our Board may utilize the services of consultants in determining or recommending the amount or form of executive and director compensation, we do not at this time employ consultants for this purpose, and did not employ compensation consultants at any time during 2012.

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

Our named executive officers for 2012 were as follows:

- Lonnie D. Schnell, Chief Executive Officer & Chief Financial Officer;
- Larry Dyne, President; and
- James E. Reeder, Vice President, Corporate Controller.

Compensation Philosophy

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

- Alignment – to align the interests of executives and stockholders through equity-based compensation awards;
- Retention – to attract, retain and motivate highly qualified, high performing executives to lead our continued growth and success; and
- Performance – to provide rewards commensurate with performance by emphasizing variable compensation that is dependent upon the executive's achievements and company performance.

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

- Rewards under incentive plans are based upon our short-term and longer-term financial results and increasing stockholder value;

- Senior executive pay is set at sufficiently competitive levels to attract, retain and motivate highly talented individuals who are necessary for us to achieve our goals, objectives and overall financial success;

- Compensation of an executive is based on such individual's role, responsibilities, performance and experience, taking into account the desired pay relationships within the executive team; and

- Our executive compensation program places a strong emphasis on performance-based variable pay to ensure a high pay-for-performance culture. Annual performance of our company, primarily in terms of performance measured by an adjusted earnings before interest, taxes, depreciation and amortization for the year, and the executive are taken into account in determining annual bonuses that ensures a high pay-for-performance culture.

Compensation Elements

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

Base Salary

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

Management Incentive Bonuses

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

Equity Incentives

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

Health & Welfare and 401-K Benefits

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

Severance and Change of Control Arrangements

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

In order to preserve the morale and productivity and encourage retention of our key executives in the face of the disruptive impact of an actual or rumored change in control, we provide a bridge to future employment in the event that an executive's job is eliminated as a consequence of a change in control. This provision is intended to align executive and stockholder interests by enabling executives to consider corporate transactions that are in the best interests of the stockholders and other constituents without undue concern over whether the transactions may jeopardize the executive's own employment. Our employment agreements with our current named executive officers provide a lump sum payment and benefits continuation as a result of an involuntary termination without cause or for good reason following a change in control, plus accelerated vesting of stock or option awards.

Other Benefits

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

Other Factors Affecting Compensation

Accounting and Tax Considerations

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

Process for Setting Executive Compensation

When making pay determinations for named executive officers, the Board considers a variety of factors including, among others: (1) actual company performance as compared to pre-established goals, (2) overall company performance and size relative to industry peers, (3) individual executive performance and expected contribution to our future success, (4) changes in economic conditions and the external marketplace and (5) in the case of named executive officers, other than Chief Executive Officer, the recommendation of our Chief Executive Officer. Ultimately, the Board uses its judgment when determining how much to pay our executive officers. The Board evaluates each named executive officer's performance during the year against established goals, leadership qualities, business responsibilities, current compensation arrangements and long-term potential to enhance stockholder value. The opinions of outside consultants may also be taken into consideration in deciding what salary, bonus, long-term incentives and other benefits and severance to give each executive in order to meet our objectives stated above.

The Board considers compensation information from data gathered from annual reports and proxy statements from companies that the Board generally considers comparable to us; compensation of other company employees for internal pay and equity purposes; and levels of other executive compensation plans from compensation surveys.

The Board sets the pay for the named executive officers and other executives, by element and in the aggregate, at levels that it believes are competitive and necessary to attract and retain talented executives capable of achieving our long-term objectives.

Factors Considered

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

- Cash versus non-cash compensation. The pay elements are cash-based except for the long-term incentive program, which may be cash-based, equity-based, or a combination. In 2010, long-term incentive compensation included grants of restricted stock units to our Chief Executive Officer and to our President, which grants were made in connection with the recapitalization transaction that closed in July 2010;

- Prior year's compensation. The Board of Directors considers the prior year's bonuses and long-term incentive awards when approving bonus payouts or equity grants;

- Adjustments to Compensation. On an annual basis, and in connection with setting executive compensation packages, the Board of Directors reviews our operating income growth, earnings before interest and taxes growth, earnings per share growth, cash flow growth, operating margin, revenue growth and total stockholder return performance. In addition, the Board of Directors considers peer group pay practices, emerging market trends and other factors. No specific weighing is assigned to these factors nor are particular targets set for any particular factor. Total compensation from year to year can vary significantly based on our and the individual executive's performance; and

- Application of discretion. It is our policy and practice to use discretion in determining the appropriate compensation levels considering performance.

REPORT OF COMPENSATION COMMITTEE

The full Board of Directors performs the functions of a compensation committee and is responsible for considering and making decisions regarding executive compensation and is responsible for administering our stock option and executive incentive compensation plans.

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

Board of Directors
Mark Dyne
Lonnie D. Schnell
David Ellis
Mark J. Hughes
Morris Weiss

March 27, 2013

EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth, as to each person serving as Chief Executive Officer and Chief Financial Officer during 2012 and the two mostly highly compensated executive officers other than the Chief Executive Officer and Chief Financial Officer at the end of the 2012 whose compensation exceeded $100,000 (referred to as "named executive officers"), information concerning all compensation earned for services to us in all capacities for 2010, 2011 and 2012.

	Year	Salary	Bonus (1)	Stock Awards (2)	Option Awards (2)	Non-Equity Incentive Plan Compensation (3)	All Other Compensation (4)	Total
Lonnie D. Schnell								
Chief Executive Officer	2012	$375,002	$15,546	$-	$-	$ 172,146	$ 39,733	$602,427
and Chief Financial	2011	349,519	80,436	-	-	-	39,288	469,243
Officer	2010	324,615	-	1,143,344	-	162,500	31,668	1,662,127
Larry Dyne								
President	2012	350,001	15,546	-	-	160,669	23,438	549,654
	2011	324,519	75,436	-	-	-	22,693	422,648
	2010	299,615	-	1,120,540	-	150,000	19,393	1,589,548
James E. Reeder								
Vice President,	2012	176,981	5,000	-	-	-	22,346	204,327
Corporate Controller	2011	175,000	15,000	-	9,091	-	20,470	219,561
	2010	171,539	45,000	-	-	-	15,868	232,407

(1) Bonus compensation consists of discretionary annual cash bonuses awarded to the named executives based upon performance, and discretionary cash bonuses associated with the tax consequences of RSU settlements. Bonuses are reported for the year in which they were earned. Cash bonus are generally paid in the first quarter of the subsequent year.

(2) The awards in these columns represent the aggregate grant date fair value computed in accordance with ASC 718 with respect to option awards or stock awards granted in the applicable year. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to these grants, refer to Note 6 of our accompanying Notes to Consolidated Financial Statements in this Annual Report on Form 10-K. These amounts do not reflect the actual value that may be realized by the named executive officers which depends on the value of our shares in the future.

(3) Non-equity incentive plan compensation for 2012 and 2010 consists of awards from the EBITDA Bonus Plan, a cash incentive plan, which was established pursuant to our employment agreements with Mr. Schnell and Mr. Dyne signed on July 30, 2010 and a related amendment on June 15, 2012.

74

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

	Year	Health and medical insurance (a)	Life and disability insurance (b)	401k contribution (c)	Automobile allowances	Total
Lonnie D. Schnell	2012	$ 27,408	$ 1,722	$ 1,000	$ 9,603	$ 39,733
	2011	27,727	301	1,000	10,260	39,288
	2010	21,397	301	1,000	8,970	31,668
Larry Dyne	2012	15,250	5,572	1,000	1,616	23,438
	2011	15,438	4,084	1,000	2,171	22,693
	2010	11,588	4,025	1,000	2,780	19,393
James E. Reeder	2012	20,275	1,071	1,000	-	22,346
	2011	19,169	301	1,000	-	20,470
	2010	14,567	301	1,000	-	15,868

(a) Includes payments of medical premiums.
(b) Includes executive and group term life and disability insurance.
(c) Represents our contribution to 401k programs.

Executive Compensation

Chief Executive Officer and Chief Financial Officer. The 2010, 2011 and 2012 base salary and other compensation for Lonnie Schnell, our Chief Executive Officer was determined in accordance with our employment agreement and related amendments. The terms and conditions established in this agreement were the result of our consideration of our operating performance levels, at the time of entering into the agreement and for prior periods, comparative industry compensation levels and negotiations with Mr. Schnell. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Accordingly, the base compensation was established near minimum industry levels for the same role in comparable companies, and on July 30, 2010 Mr. Schnell was granted a restricted stock unit award ("RSU Award") for 5,778,500 shares of our common stock. The RSU Award vested 50% on a date which was 13 months following the grant date, and vests an additional 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to full acceleration of vesting upon a change in control of the Company, as defined in the RSU Award agreement. The settlement of vested shares under the RSU Award is subject to non-revocable deferral elections delivered by Mr. Schnell.

In addition to the long-term equity incentive, Mr. Schnell was entitled to receive an annual cash bonus in 2010, 2011 and 2012 in an amount equal to a percentage of his base salary upon the Company achieving actual adjusted earnings before interest, taxes, depreciation and amortization ("EBITDA") within a range, starting at 80%, of target adjusted EBITDA.

The EBITDA bonus award under Mr. Schnell's employment agreement and related amendment for 2010, 2011 and 2012 is shown in the table above as non-equity incentive plan compensation. The target EBITDA was not achieved for 2011, and therefore no non-equity incentive plan compensation was earned. However, Mr. Schnell was awarded a discretionary incentive cash bonus for 2011, shown in the table above under Bonus, based on the performance of the Company and Mr. Schnell's individual performance and contributions.

President. The 2010, 2011 and 2012 base salary and other compensation for Larry Dyne, our President was determined in accordance with our employment agreement and related amendments. The terms and conditions established in this agreement were the result of our consideration of our operating performance levels at the time of entering into the agreements and for prior periods, comparative industry compensation levels and negotiations with Mr. Dyne. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Accordingly, the base compensation was established near minimum industry levels for the same role in comparable companies, and on July 30, 2010 Mr. Dyne was granted a RSU Award for 5,778,500 shares of our common stock.

The RSU Award vested 50% on a date which was 13 months following the grant date, and vests an additional 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to full acceleration of vesting upon a change in control of our Company, as defined in the RSU Award agreement. The settlement of vested shares under the RSU Award is subject to non-revocable deferral elections delivered by Mr. Dyne. In addition to the long term incentive, Mr. Dyne was entitled to receive an annual cash bonus in 2010 2011 and 2012 in an amount equal to a percentage of his base salary upon the Company achieving actual adjusted EBITDA within a range, starting at 80%, of target adjusted EBITDA.

The EBITDA bonus award under Mr. Dyne's employment agreement and related amendment for 2010, 2011 and 2012 is shown in the table above as non-equity incentive plan compensation. The target EBITDA was not achieved for 2011, and therefore no non-equity incentive plan compensation was earned. However, Mr. Dyne was awarded a discretionary incentive cash bonus for 2011, shown in the table above under Bonus, based on the performance of the Company and Mr. Dyne's individual performance and contributions.

Vice President, Corporate Controller. The 2010, 2011 and 2012 compensation for James E. Reeder, our Vice President, Corporate Controller was in accordance with our at-will employment agreement with him. The terms and conditions established in this agreement were the result of our consideration of our operating performance levels, compensation levels for our previous corporate controller, comparative industry compensation levels and negotiations with Mr. Reeder. The base compensation was evaluated in conjunction with the long-term equity awards and annual bonus incentives to establish a compensation arrangement providing a substantial incentive for the achievement of our long-term objectives and for adding stockholder value. Accordingly, the base compensation was established near minimum industry levels for the same role in comparable companies. Cash bonus is a discretionary bonus award based on performance.

In 2011 long-term equity in the form of options for 100,000 shares of common stock, respectively, were granted to Mr. Reeder as an inducement to maximize performance and increase stockholder value. The option grants were established to vest monthly over a four-year term, after a minimum initial term of twelve months, to coincide with the objectives of our strategic plan. Bonuses for 2010, 2011 and 2012 are discretionary incentive bonuses awarded based on the performance of the Company and Mr. Reeder's individual performance and contributions.

Grants of Plan-Based Awards in Fiscal 2012

No equity awards were granted to any named executive officer in 2012.

76

Outstanding Equity Awards at Fiscal Year 2012

The following table provides information with respect to outstanding stock options and stock awards held by each of the named executive officers as of December 31, 2012

		Option Awards				RSU Stock Awards	
		Number of Securities Underlying Unexercised Options					
Name	Grant Date	(#) Exercisable	(#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)(2)	Market Value of Shares or Units of Stock That Have Not Vested ($)(3)
Lonnie D. Schnell	6/25/08	900,000	-	$ 0.20	06/24/18		
	8/6/09	700,000	-	$ 0.09	8/6/19		
	7/30/10					1,733,550	86,678
Larry Dyne	6/25/08	700,000	-	$ 0.20	06/24/18		
	8/6/09	510,000	-	$ 0.09	8/6/19		
	7/30/10					1,733,550	86,678
James E. Reeder	6/1/09	175,000	25,000 (1)	$ 0.11	6/1/19		
	1/13/11	47,917	52,083 (1)	$ 0.10	1/13/21		

(1) These options vest and become exercisable with respect to 25% of the total options shares at the end of one year from the date of the grant and the remaining shares shall become exercisable in 36 monthly installments equal to 1/48th of the Option shares on the last day of each calendar month thereafter until fully exercisable.

(2) Each RSU original award of 5,778,500 vests 50% on a date which is 13 months following the grant date, and 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to partial acceleration of vesting as part of the executives' severance benefits and full acceleration of vesting upon a change in control of the Company, as defined in the RSU Award agreement. Issuance of the common shares upon settlement of the vested portion of the RSU Award is subject to irrevocable deferral elections delivered by the recipients.

(3) Based on the closing price of the Common Stock on December 31, 2012 of $0.05, as reported by the OTCQB.

Option Exercises and Stock Vested in Fiscal Year 2012

The following table provides information with respect to restricted stock award vesting for each of the named executive officers during 2012. There were no options exercised by named executive officers during 2012.

	Stock Awards	
Name	Number of Shares Acquired on Vesting (#)(1)	Value Realized on Vesting ($)(1)(2)

Lonnie D. Schnell	1,155,700	$57,785
Larry Dyne	1,155,700	$57,785

(1) The shares shown in the table above indicate shares that vested under the RSU Awards on January 30, 2012 and July 30, 2012 (577,850 shares each of those dates). Pursuant to deferral elections made by both Mr. Schnell and Mr. Dyne, each of them elected to defer receipt of the common shares to be issued upon settlement of 127,850 vested RSU Awards as of January 30, 2012 until July 30, 2014, subject to earlier settlement in the event of a change of control or the death of the reporting person.

(2) Based on the closing price of the Common Stock on August 30, 2012 of $0.05, as reported by the OTCQB.

Employment Agreements, Termination of Employment and Change of Control Arrangements

Employment Agreements

We have entered into the following employment agreements and related amendments with Lonnie D. Schnell and Larry Dyne. Mr. Reeder does not have an employment agreement.

Lonnie D. Schnell, Chief Executive Officer and Chief Financial Officer. In connection with the Recapitalization Agreement, on July 30, 2010, we entered into an Executive Employment Agreement with Mr. Schnell as amended on June 15, 2012. Mr. Schnell's employment agreement and related amendment provides that he will continue to serve as our Chief Executive Officer. The employment agreement has a term continuing through December 31, 2014, and may be extended to December 31, 2015. Pursuant to this agreement and related amendment, Mr. Schnell received an annual base salary of $325,000 for the period starting on July 30, 2010 through December 31, 2010. Starting on January 1, 2011 through December 31, 2011, Mr. Schnell's annual base salary will be $350,000. Starting on January 1, 2012 through December 31, 2012, Mr. Schnell's annual base salary will be $375,000 through the remainder of the term of this agreement Such base salary may be increased, but not decreased, at the discretion of the Board. Mr. Schnell will be entitled to receive an annual cash bonus in an amount equal to a percentage of his base salary upon Talon achieving actual adjusted EBITDA within a range, starting at 80%, of target adjusted EBITDA. Target Adjusted EBITDA for 2013 and 2014 will be determined by the Board of Directors based our operating plan for the fiscal year as prepared by management and approved by the Board of Directors.

Mr. Schnell is entitled to an auto allowance of $1,000 per month, and reimbursement of up to $10,000 for legal fees incurred in connection with the negotiation of his employment agreement. In the event that prior to the end of the term, Mr. Schnell's employment is terminated by us "without cause" (as defined in the agreement), by Mr. Schnell for "good reason" (as defined in the agreement) or due to Mr. Schnell's death or disability, then conditional upon his execution of a release of claims, Mr. Schnell or his estate will be entitled to receive, in addition to all accrued salary, (1) severance payments equal to 18 months of Mr. Schnell's base salary, (2) all options issued to Mr. Schnell shall remain outstanding for 18 months following termination, and (3) continued medical coverage for Mr. Schnell and his dependents for 18 months following termination.

Larry Dyne, President. In connection with the Recapitalization Agreement, on July 30, 2010, we entered into an Executive Employment Agreement with Mr. Dyne as amended on June 15, 2012. Mr. Dyne's employment agreement and related amendment provides that he will continue to serve as our President. The employment agreement and related amendment has a term continuing through December 31, 2014, and may be extended to December 31, 2015. Pursuant to this agreement and related amendment, Mr. Dyne received an annual base salary of $300,000 for the period starting on July 30, 2010 through December 31, 2010. Starting on January 1, 2011 through December 31, 2011, Mr. Dyne's annual base salary will be $325,000. Starting on January 1, 2012 through the remainder of the term of this agreement, Mr. Dyne's annual base salary will be $350,000. Such base salary may be increased, but not decreased, at the discretion of the Board. Mr. Dyne will be entitled to receive an annual cash bonus in an amount equal to a percentage of his base salary upon Talon achieving actual adjusted EBITDA within a range, starting at 80%, of target adjusted EBITDA. Target Adjusted EBITDA for 2013 and 2014 will be determined by the Board of Directors based our operating plan for the fiscal year as prepared by management and approved by the Board of Directors.

Mr. Dyne is entitled to an auto allowance of $950 per month, and reimbursement of up to $10,000 for legal fees incurred in connection with the negotiation of his employment agreement. In the event that prior to the end of the term, Mr. Dyne's employment is terminated by us "without cause" (as defined in the agreement), by Mr. Dyne for "good reason" (as defined in the agreement) or due to Mr. Dyne's death or disability, then conditional upon his execution of a release of claims, Mr. Dyne or his estate will be entitled to receive, in addition to all accrued salary, (1) severance payments equal to 18 months of Mr. Dyne's base salary, (2) all options issued to Mr. Dyne shall remain outstanding for 18 months following termination, and (3) continued medical coverage for Mr. Dyne and his dependents for 18 months following termination.

Potential Severance Payments

Under the Executive Employment Agreements as described above, Messrs. Schnell and Dyne will be entitled to receive severance benefits in the event that the executive's employment is terminated due to executive's death or disability, by us without "cause" or by the executive for "good reason." The following table sets forth severance payments and benefits that we would have been obligated to pay to Messrs. Schnell and Dyne assuming a triggering event had occurred under each of their respective employment agreements as of December 31, 2012 as follows:

Name	Cash Severance Payment ($)(1)	Non-Equity Incentive Plan Compensation ($)	Continuation of Health Benefits ($)	Total Severance Benefits ($)
Lonnie D. Schnell	627,522	172,146	38,477	838,145
Larry Dyne	584,426	160,669	19,342	764,437

(1) Includes (a) earned and unpaid base salary through the date of termination, (b) accrued but unpaid vacation and (c) severance payments equal to 18 months of base salary and payable in a lump sum or periodic payments as provided in the executive's employment agreement and (d) car allowance payments due at the first day of the month during the severance period (18 months) as provided in the executive's employment agreement.

Potential Change in Control Payments

Each RSU Award to Messrs. Schnell and Dyne will vest 100% upon a change in control of our Company, as defined in the RSU Award agreement. In addition, in accordance with their deferral elections, the entire vested portion of the RSU Award subject to a deferral will be immediately settled in common shares upon a change in control transaction. The following table sets forth the change in control benefits that we would have been obligated to pay to our named executive officers assuming a change of control had occurred as of December 31, 2012.

Name	Value of Acceleration of Vesting of Equity Awards ($)(1)
Lonnie D. Schnell	86,678
Larry Dyne	86,678

(1) Based on the closing price of the Common Stock on December 31, 2012 of $0.05, as reported by the OTCQB.

Director Compensation

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

The following table details the total compensation earned by our non-employee directors in 2012.

Name	Fees earned or paid in cash	Option awards (5)	Total
Mark Dyne (1)	$68,000	$3,590	$71,590
David Ellis (2)	64,000	3,590	67,590
Mark J. Hughes (2)	14,000	3,590	17,590
Morris Weiss (3)	36,167	3,590	39,757
Michael Francis Snyder (4)	19,000	-	19,000
Total	$201,167	$14,360	$215,527

(1) As of December 31, 2012, Mr. Mark Dyne held options to purchase a total of 340,000 shares.

(2) As of December 31, 2012, each of the Messrs. Ellis and Hughes held options to purchase a total of 200,000 shares.

(3) As of December 31, 2012, Mr. Morris Weiss held options to purchase a total of 100,000 shares.

(4) Mr. Snyder resigned from his position as board member on April 9, 2012.

(5) The grant date fair value is generally the amount we would expense in our financial statements over the award's service period, but does not include a reduction for forfeitures.

Our current policy, adopted as of January 1, 2011, is to pay non-employee directors $1,000 for their personal attendance at any meeting of the Board of Directors or of a committee of the Board of Directors, and $500 for attendance at any telephonic meeting of the Board of Directors or of a committee of the Board of Directors. We will also pay non-employee directors an annual retainer of $10,000 for Board service and an additional monthly retainer of $2,000 for service on the Special Committee. The Chairman of the Board will receive an annual retainer of $15,000 for Board service. Our Board of Directors does not have standing audit, compensation or nominating committees. The Board of Directors handles all audit, compensation and nominating committee matters. We also reimburse directors for their reasonable travel expenses incurred in attending board meetings or committee meetings.

In addition, our current policy is to annually grant to each non-employee director an option to purchase 100,000 shares of our common stock, which will vest in 12 equal monthly installments. On January 13, 2011, we issued 100,000 options to each of the Messrs. Mark Dyne, David Ellis, Mark J. Hughes and Michael Francis Snyder, which became exercisable in 12 equal monthly installments on the last day of each calendar month, and were fully vested one year from the date of grant. On June 29, 2012, we issued 100,000 options to each of the Messrs. Mark Dyne, David Ellis, Mark J. Hughes and Morris Weiss, which become exercisable in 12 equal monthly installments on the last day of each calendar month, and become fully vested one year from the date of grant.

Risk Assessment Regarding Compensation Policies and Practices

Our compensation program for employees does not create incentives for excessive risk taking by our employees or involve risks that are reasonably likely to have a material adverse effect on Talon. Our base salary component of compensation does not encourage risk-taking because it is a fixed amount. Our executive bonus plan for senior executives and our equity compensation awards have the following risk-limiting characteristics:

- Cash awards to each executive officer under management incentive bonus plans are set in a market range and are limited by the terms of the plan for senior executives to a fixed maximum specified in the plan;
- Equity and discretionary cash awards are made based on a review of a variety of indicators of performance, thus diversifying the risk associated with any single indicator of performance;
- Neither cash nor equity awards are not tied to formulas that could focus executives on specific short-term outcomes;
- Members of the Board of Directors approve the final cash incentive awards made under the executive bonus plan for senior executives in their discretion, after the review of executive and corporate performance;
- Members of the Board of Directors approve all equity awards for senior executives in their discretion; and
- An equity award's value is delivered in the form of stock and options that vest over multiple years, which aligns the interests of executive officers to long-term stockholder interests.

Compensation Committee Interlocks and Insider Participation

The Board of Directors currently performs the function of a compensation committee. None of our current executive officers has served as a member of the board of directors or compensation committee of any entity for which a member of our Board of Directors has served as an executive officer.

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

Equity Compensation Plan Information

The following table sets forth certain information as of December 31, 2012 regarding equity compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance:

Name	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	6,372,100	$ 0.21	1,170,625
Equity compensation plans not approved by security holders	8,557,000	-	-

Equity compensation plans not approved by security holders consist of restricted stock units awarded to certain executives in 2010. Upon entering into employment agreements on July 30, 2010, each of Lonnie Schnell and Larry Dyne were granted a restricted stock unit award for 5,778,500 shares of our common stock. Each RSU Award vested 50% on the date that was 13 months following the grant date, and vests an additional 10% on each date which is 18, 24, 30, 36 and 42 months following the grant date, subject to full acceleration of vesting upon a change in control of our Company, as defined in the RSU Award agreement. On August 30, 2010, Messrs. Schnell and Dyne elected to defer the settlement in common shares of 5,434,200, total units vested under the RSU Awards beyond the vesting dates. On August 30, 2011, based on the deferral schedules. 600,000 common shares were issued in settlement of a portion of the vested units under the RSU Awards. On January 30, 2012, based on the deferral schedules, an additional 900,000 common shares were issued in settlement of a portion of the vested units under the RSU Awards. Subsequent to December 31, 2012, based on the deferral schedules, an additional 1,500,000 common shares were issued in settlement of a portion of the vested units under the RSU Awards.

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

Security Ownership of Certain Beneficial Owners and Management

The following table presents information regarding the beneficial ownership of our common stock as of March 27, 2013:

- each person who is known to us to be the beneficial owner of more than 5% of our outstanding common Stock;
- each of our current directors;
- each of our named executive officers; and
- all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission that deem shares to be beneficially owned by any person who has or shares voting or investment power with respect to such shares. Each share of our Series B Preferred Stock is convertible into one hundred shares of our Common Stock at the discretion of the holder. Accordingly, a holder of one share of our Series B Preferred Stock is deemed to be the beneficial owner of one hundred shares of our Common Stock for purposes of the table below. Shares of Common Stock underlying warrants or options currently exercisable or exercisable within sixty (60) days of the date of this information are deemed outstanding for purposes of computing the percentage ownership of the person holding such warrants or options but are not deemed outstanding for computing the percentage ownership of any other person. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person’s actual ownership or voting power with respect to the number of shares of Common Stock actually outstanding at March 27, 2013. Unless otherwise indicated, the persons named in this table have sole voting and sole investment power with respect to all shares shown as beneficially owned, subject to community property laws where applicable.

As of March 27, 2013, we had 24,900,808 shares of Common Stock and 407,160 shares of Series B Preferred Stock issued and outstanding. The address of each person listed is in our care, at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367, unless otherwise set forth below such person’s name.

Name of Beneficial Owner	Common Stock Shares	Common Stock %	Series B Preferred Stock Shares	Series B Preferred Stock %	% of Total Voting Power
Executive Officers and Directors:					
Lonnie D. Schnell (1)	3,975,000	15.0	--	--	5.9
Larry Dyne (2)	3,589,600	13.7	--	--	5.4
Mark Dyne (3)	1,134,001	4.5	--	--	1.7
James E. Reeder (4)	329,167	1.3	--	--	*
Mark J. Hughes (5)	183,334	*	--	--	*
David Ellis (5)	183,334	*	--		*
Morris Weiss (5)	83,334	*	--	--	*
Executive Officers and Directors as a Group (7 persons) (6)	9,477,770	33.0	--	--	13.7
5% Stockholders:					
CVC California, LLC (7) 525 Okeechobee Blvd., Suite 1050 West Palm Beach, Florida 33401	1,750,000	7.0	407,160	100	64.7

*Less than 1%.

(1) Consists of (i) 2,375,000 shares of Common Stock and (ii) 1,600,000 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable.

(2) Consists of (i) 2,379,600 shares of Common Stock and (ii) 1,210,000 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable.

(3) Consists of (i) 835,667 shares of Common Stock and (ii) 298,334 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.

(4) Consists of (i) 75,000 shares of Common Stock and (ii) 254,167 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.

(5) Consists entirely of shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.

(6) Consists of (i) 5,665,267 shares of Common Stock and (ii) 3,812,503 shares of Common Stock reserved for issuance upon exercise of stock options that are currently exercisable or will become exercisable within 60 days.

(7) Consists of (i) 1,750,000 shares of Common Stock, and (ii) 407,160 shares of Series B Preferred Stock, convertible into 40,716,000 shares of Common Stock. Excludes shares of Common Stock beneficially owned by Lonnie D. Schnell and Larry Dyne, which shares are the subject of a limited voting agreement with this stockholder and with respect to which this stockholder has been granted a limited proxy to vote such shares, in each case with respect to certain fundamental transaction involving the Company.

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

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Review and Approval of Related Party Transactions

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

Reportable Related Party Transactions

Other than the employment arrangements described elsewhere in this report and the transactions described below, since January 1, 2012, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or will be a party:

- in which the amount involved exceeds $120,000; and

- in which any director, executive officer, stockholder who beneficially owns 5% or more of our common stock or any member of their immediate family had or will have a direct or indirect material interest.

At December 31, 2011, notes payable to related parties included a note and associated interest due to Lonnie D. Schnell, our Chief Executive Officer and Chief Financial Officer, in the amount of $41,159. The note was issued on August 6, 2009 in partial satisfaction of 2008 annual incentive amounts to which Mr. Schnell was entitled. The note payable and accrued interest was paid in full in January 2012.

At December 31, 2011, notes payable to related parties included a demand note issued in 1995 to Monto Holdings, Pty, Ltd., a company previously affiliated at the time of the note issuance with Mark Dyne, Chairman of the Company's Board of Directors and a stockholder, in the amount of $198,783 including accrued interest. In March 2012 the note was paid in full.

Director Independence

Because our common stock is quoted on the OTCQB, we are not subject to the listing requirements of any securities exchange or Nasdaq regarding the independence of our directors. However, we have determined that, as of December 31, 2012, each of Mssrs. Ellis and Weiss is "independent" as that term is defined in Section 5605 of the NASDAQ Marketplace Rules applicable to companies listed on The NASDAQ Stock Market. The other members of our Board of Directors are not "independent" under such rules.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Services Provided by the Independent Auditors

Our Board of Directors performed the functions of the audit committee and is responsible for the appointment, compensation, retention and oversight of the work of the independent auditors.

SingerLewak LLP served as our independent registered public accounting firm for each of the fiscal years ended December 31, 2012, 2011 and 2010.

Audit Fees - The aggregate fees billed by our independent registered public accounting firm for professional services rendered for the audit of our annual financial statements and review of our financial statements included in our Forms 10-Q or services that are normally provided in connection with statutory and regulatory filings were $315,000 for fiscal year 2012, $326,000 for fiscal year 2011 and $310,000 for fiscal year 2010.

Audit-Related Fees - No fees were billed by our independent registered public accounting firm for professional services rendered for assurance and related services reasonably related to the performance of the audit or review of our financial statements (other than those reported above) for fiscal years 2012, 2011 and 2010.

Tax Fees - The aggregate fees billed by our independent registered public accounting firm for professional services rendered for tax compliance, tax advice and tax planning were $0 for fiscal year 2012, $31,000 for fiscal year 2011 and $59,000 for fiscal year 2010.

All Other Fees – The aggregate fees billed by our independent public registered accounting firm for services rendered to us other than the services described above under “Audit Fees,” “Audit-Related Fees” and “Tax Fees” were $4,000 for fiscal year 2012, $0 for fiscal year 2011 and $24,000 for fiscal year 2010 which was primarily related governmental regulations not related to our annual or quarterly financial statements.

The Board of Directors approved all of the foregoing services provided by SingerLewak LLP.

Policy Regarding Pre-Approval of Services Provided by the Independent Auditors

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

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULE

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

(1) Financial Statements

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

(2) Financial Statement Schedule

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

(3) Exhibits

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

Schedule II – Valuation and Qualifying Accounts and Reserves

Description	Balance at Beginning of Year	Additions (Adjustments)	Deductions	Balance at End of Year
2012				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet	$53,000	$ (26,000)	$26,000	$1,000
Reserve for inventory valuation deducted from inventories on the balance sheet	485,000	48,000	272,000	261,000
Valuation reserve deducted from Deferred tax assets	9,194,000	1,245,000	-	10,439,000
	$9,732,000	$ 1,267,000	$298,000	$10,701,000
2011				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet	$133,000	$ 32,000	$112,000	$53,000
Reserve for inventory valuation deducted from inventories on the balance sheet	884,000	(36,000)	363,000	485,000
Valuation reserve deducted from Deferred tax assets	9,397,000	541,000	744,000	9,194,000
	$10,414,000	$ 537,000	$1,219,000	$9,732,000
2010				
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet	$232,000	$ (76,000)	$23,000	$133,000
Allowance for doubtful accounts deducted from related party in the balance sheet	674,000	(275,000)	399,000	-
Reserve for inventory valuation deducted from inventories on the balance sheet	1,185,000	106,000	407,000	884,000
Valuation reserve deducted from Deferred tax assets	24,145,000	1,088,000	15,836,000	9,397,000
	$26,236,000	$ 843,000	$16,665,000	$10,414,000

(1) Additions to the allowance for doubtful accounts include provisions for uncollectible accounts. Bad debt expense includes (and additions above exclude) net direct write-offs of approximately $2,000, $4,000 and $18,000 for the years ended December 31, 2012, 2011 and 2010, respectively. Additions to the inventory valuation reserve include current year provisions. Additionally, in 2012, 2011 and 2010 there were direct write-offs of $168,000, $243,000 and $364,000, respectively.

(2) Deductions from the allowance for doubtful accounts include amounts applied to write-offs and reversals of prior period provisions. Deductions from the inventory valuation reserve include application of the reserve against obsolete, excess, slow-moving or disposed inventory.

SIGNATURES

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

TALON INTERNATIONAL, INC.

Date: March 27, 2013

/s/ Lonnie D. Schnell
By: Lonnie D. Schnell

Its: Chief Executive Officer & Chief Financial Officer
(Principal Executive Officer & Principal Financial Officer)

/s/ James E. Reeder
By: James E. Reeder

Its: Vice President, Corporate Controller
(Principal Accounting Officer)

POWER OF ATTORNEY

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

SIGNATURES

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

Signature	Title	Date
/s/ Lonnie D. Schnell Lonnie D. Schnell	Chief Executive Officer and Chief Financial Officer, Director (Principal Executive and Financial Officer)	March 27, 2013
/s/ James E. Reeder James E. Reeder	Vice President, Corporate Controller (Principal Accounting Officer)	March 27, 2013
/s/ Mark Dyne Mark Dyne	Chairman of the Board of Directors	March 27, 2013
/s/ David Ellis David Ellis	Director	March 27, 2013
/s/ Mark J. Hughes Mark J. Hughes	Director	March 27, 2013
/s/ Morris Weiss Morris Weiss	Director	March 27, 2013

EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1	Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
3.1.2	Certificate of Designation of Rights, Preferences and Privileges of Series A Preferred Stock. Incorporated by reference to Exhibit A to the Rights Agreement filed as Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
3.1.3	Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.4 to Annual Report on Form 10-KSB, filed March 28, 2000.
3.1.4	Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1.3 to Form 8-K filed on August 4, 2006.
3.1.5	Certificate of Ownership and Merger. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on July 20, 2007.
3.1.6	Certificate of Designation of Series B Convertible Preferred Stock. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on August 5, 2010.
3.1.7	Certificate of Amendment of Certificate of Incorporation of Registrant. Incorporated by reference to Exhibit 3.1 to Form 8-K filed on November 24, 2010.
3.2.1	Bylaws of Registrant. Incorporated by reference to Exhibit 3.2 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
3.2.2	Certificate of Amendment to the Bylaws of Talon International, Inc., dated as of August 2, 2011. Incorporated by reference to Exhibit 3.2 to Form 8-K filed on August 4, 2011.
4.1	Specimen Stock Certificate of Common Stock of Registrant. Incorporated by reference to Exhibit 4.1to Form SB-2 filed on October 21, 1997, and the amendments thereto.
4.2	Rights Agreement, dated as of November 4, 1998, between Registrant and American Stock Transfer and Trust Company as Rights Agent. Incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
4.3	Form of Rights Certificate. Incorporated by reference to Exhibit B to the Rights Agreement filed as Exhibit 4.1 to Current Report on Form 8-K filed as of November 4, 1998.
10.1	Form of Indemnification Agreement. Incorporated by reference to Exhibit 10.1to Form SB-2 filed on October 21, 1997, and the amendments thereto.

Exhibit Number	Exhibit Description
10.2+	Amended and Restated 1997 Stock Incentive Plan. Incorporated by reference to Exhibit 10.7 to Form 10-Q filed on November 13, 2006.
10.3+	Form of Non-statutory Stock Option Agreement. Incorporated by reference to Exhibit 10.30 to Form SB-2 filed on October 21, 1997, and the amendments thereto.
10.4	Form of Investor Rights Agreements dated December 28, 2001. Incorporated by reference to Exhibit 99.4 to Form 8-K filed on January 23, 2002.
10.5+	2007 Stock Plan. Incorporated by reference to Exhibit 10.20 to the Form 10-K filed on April 25, 2008.
10.6	Registration Rights Agreement, dated June 27, 2007, by Talon International, Inc., for the benefit of holders. Incorporated by reference to Exhibit 4.10 to Registration Statement on Form S-3 filed on August 10, 2007.
10.7+	Amended and Restated Talon International, Inc. 2008 Stock Incentive Plan. Incorporated by reference to Exhibit 10.20 to Form 10-K filed on March 28, 2011.
10.8	Stockholders Agreement, dated July 30, 2010, among Registration, CVC California, LLC, Lonnie D. Schnell and Larry Dyne. Incorporated by reference to Exhibit 10.5 to Form 8-K filed on August 5, 2010.
10.9+	Executive Employment Agreement, dated July 30, 2010, between Registrant and Lonnie D. Schnell. Incorporated by reference to Exhibit 10.25 to Form 10-Q filed on August 8, 2011.
10.9.1+	Amendment No. 1 to Executive Employment Agreement, dated as of June 15, 2012, between Registrant and Lonnie D. Schnell. Incorporated by reference to Exhibit 10.16.1 to Form 10-Q filed on August 13 2012.
10.10+	Executive Employment Agreement, dated July 30, 2010, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.26 to Form 10-Q filed on August 8, 2011.
10.10.1+	Amendment No. 1 to Executive Employment Agreement, dated as of June 15, 2012, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.17.1 to Form 10-Q filed on August 13 2012.
10.11+	Restricted Stock Unit Agreement, dated July 30, 2010, between Registrant and Lonnie D. Schnell. Incorporated by reference to Exhibit 10.8 to Form 8-K filed on August 5, 2010.
10.12+	Restricted Stock Unit Agreement, dated July 30, 2010, between Registrant and Larry Dyne. Incorporated by reference to Exhibit 10.9 to Form 8-K filed on August 5, 2010.
14.1	Code of Ethics. Incorporated by reference to Exhibit 14.1 to Form 10-K filed on March 30, 2004.

Exhibit Number	Exhibit Description
21.1	Subsidiaries.
23.1	Consent of SingerLewak LLP.
24.1	Power of Attorney (included on signature page).
31.1	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.
32.1	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) under the Securities and Exchange Act of 1934, as amended.
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

+ Indicates a management contract or compensatory plan.

* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purpose of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.