TAG IT PACIFIC INC
Form 10-Q/A
April 17, 2006

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

FORM 10-Q/A
(AMENDMENT NO. 1)

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

For the quarterly period ended September 30, 2005.

OR

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

For the transition period from ____________ to _______________.

Commission file number 1-13669

TAG-IT PACIFIC, INC.
(Exact Name of Issuer as Specified in its Charter)

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

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

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

Indicate by check whether the issuer: (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 the past 90 days. Yes [X] No [_]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [_] No [X]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, par value $0.001 per share, 18,241,045 shares issued and outstanding as of November 21, 2005.

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EXPLANATORY NOTE

This Report on Form 10-Q/A amends the Quarterly Report on Form 10-Q for Tag-It Pacific, Inc. and our subsidiaries for the quarterly period ended September 30, 2005 and is being filed in order to restate our previously issued consolidated financial statements as of and for the three and nine months ended September 30, 2005. The restatement has been made to properly account for revenues in accordance with generally accepted accounting principles in connection with a sale and inventory storage agreement effective in the second quarter of 2005. See Note 2 - Restatement of Financial Statements, to our consolidated financial statements for additional discussion. Except for Items 1, 2 and 4 in Part I and Item 6 of Part II, no other information included in the original Form 10-Q is amended by this Form 10-Q/A.

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TAG-IT PACIFIC, INC.
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CAUTIONARY LEGEND REGARDING FORWARD-LOOKING STATEMENTS

Some of the information in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the

Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, both as amended. These forward-looking statements are subject to various risks and uncertainties. The forward-looking statements include, without limitation, statements regarding our future business plans and strategies and our future financial position or results of operations, as well as other statements that are not historical. You can find many of these statements by looking for words like "will", "may", "believes", "expects", "anticipates", "plans" and "estimates" and for similar expressions. Because forward-looking statements involve risks and uncertainties, there are many factors that could cause the actual results to differ materially from those expressed or implied. These include, but are not limited to, economic conditions. This Quarterly Report on Form 10-Q contains important cautionary statements and a discussion of many of the factors that could materially affect the accuracy of Tag-It Pacific's forward-looking statements and such statements and discussions are incorporated herein by reference. Any subsequent written or oral forward-looking statements made by us or any person acting on our behalf are qualified in their entirety by the cautionary statements and factors contained or referred to in this section. We do not intend or undertake any obligation to update any forward-looking statements to reflect events or circumstances after the date of this document or the date on which any subsequent forward-looking statement is made or to reflect the occurrence of unanticipated events.

PART I
FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.

TAG-IT PACIFIC, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2005 (as restated, see Note 2)	December 31, 2004
Assets		
Current Assets:		
Cash and cash equivalents	$ 1,892,377	$ 5,460,662
Trade accounts receivable, net	8,204,539	17,890,044
Trade accounts receivable, related party	1,400,000	4,500,000
Inventories, net	9,838,401	9,305,819
Prepaid expenses and other current assets	1,312,442	2,326,245
Deferred income taxes	--	1,000,000
Total current assets	22,647,759	40,482,770
Property and equipment, net of accumulated depreciation and amortization	7,205,136	9,380,026
Fixed assets held for sale	826,904	--
Tradename	4,110,750	4,110,750
Goodwill	--	450,000
License rights	168,000	259,875
Due from related parties	589,752	556,550
Other assets	761,583	1,207,885
Total assets	$ 36,309,884	$ 56,447,856

Liabilities and Stockholders' Equity		
Current Liabilities:		
Line of credit	$ 59,493	$ 614,506
Accounts payable and accrued expenses	13,954,596	7,460,916
Demand notes payable to related parties	664,971	664,971
Current portion of capital lease obligations	711,197	859,799
Current portion of note payable	183,798	174,975
Note payable	--	1,400,000
Total current liabilities	15,574,055	11,175,167
Capital lease obligations, less current portion	956,296	1,220,969
Note payable, less current portion	1,307,145	1,447,855
Secured convertible promissory notes	12,432,557	12,408,623
Total liabilities	30,270,053	26,252,614
Guarantees and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, Series A $0.001 par value; 250,000 shares authorized, no shares issued or outstanding	--	--
Common stock, $0.001 par value, 30,000,000 shares authorized; 18,241,045 shares issued and outstanding at September 30, 2005; 18,171,301 at December 31, 2004	18,243	18,173
Additional paid-in capital	51,327,873	51,073,402
Accumulated deficit	(45,306,285)	(20,896,333)
Total stockholders' equity	6,039,831	30,195,242
Total liabilities and stockholders' equity	$ 36,309,884	$ 56,447,856

See accompanying notes to consolidated financial statements.

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TAG-IT PACIFIC, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	200
	(as restated, see Note 2)		(as restated, see Note 2)	
Net sales	$ 9,472,898	$ 17,004,775	$ 38,167,821	$ 42,08
Cost of goods sold	11,567,128	12,658,879	36,254,108	30,85

Gross (loss) profit	(2,094,230)	4,345,896	1,913,713	11,23
Selling expenses	549,434	646,000	1,940,283	2,12
General and administrative expenses	4,908,555	3,226,995	19,649,868	8,87
Impairment of goodwill	450,000	--	450,000	
Restructuring costs	2,278,835	--	2,278,835	
Total operating expenses	8,186,824	3,872,995	24,318,986	10,99
(Loss) income from operations	(10,281,054)	472,901	(22,405,273)	23
Interest expense, net	264,551	161,828	802,400	49
(Loss) income before income taxes	(10,545,605)	311,073	(23,207,673)	(25
(Benefit) provision for income taxes ...	(260,731)	100,069	1,202,282	(8
Net (loss) income	(10,284,874)	211,004	(24,409,955)	(17
Less: Preferred stock dividends	--	--	--	3
Net (loss) income to common shareholders	$(10,284,874)	$ 211,004	$(24,409,955)	$ (20
Basic (loss) earnings per share	$ (0.56)	$ 0.01	$ (1.34)	$
Diluted (loss) earnings per share	$ (0.56)	$ 0.01	$ (1.34)	$
Weighted average number of common shares outstanding:				
Basic	18,241,045	18,112,802	18,220,731	17,03
Diluted	18,241,045	18,269,005	18,220,731	17,03

See accompanying notes to consolidated financial statements.

TAG-IT PACIFIC, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2005	2004
	(as restated, see Note 2)	
Increase (decrease) in cash and cash equivalents		
Cash flows from operating activities:		
Net loss	$(24,409,955)	$ (170,706)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		

Depreciation and amortization	1,441,090	1,100,886
Increase in allowance for doubtful accounts	6,195,691	421,943
Increase in deferred tax asset valuation allowance	1,000,000	--
Increase in inventory valuation reserve	3,918,189	--
Asset impairment due to restructuring	2,036,091	--
Impairment of goodwill	450,000	--
Common stock issued for services	--	74,825
Warrants issued for services	--	10,906
Changes in operating assets and liabilities:		
Receivables, including related party	6,589,814	(9,110,564)
Inventories	(4,450,771)	613,526
Other assets	337,541	(504,946)
Prepaid expenses and other current assets	1,013,803	(1,720,684)
Accounts payable and accrued expenses	6,576,800	377,567
Income taxes payable	(116,319)	(413,212)
Net cash provided by (used in) operating activities	581,974	(9,320,459)
Cash flows from investing activities:		
Acquisition of property and equipment	(1,634,024)	(1,261,795)
Cash flows from financing activities:		
Repayment of bank line of credit, net	(555,013)	(2,498,034)
Proceeds from exercise of stock options and warrants	254,541	478,814
Repayment of capital leases	(683,876)	(325,268)
Proceeds from capital lease	--	950,000
Repayment of notes payable	(1,531,887)	(900,000)
Net cash used in financing activities	(2,516,235)	(2,294,488)
Net decrease in cash	(3,568,285)	(12,876,742)
Cash at beginning of period	5,460,662	14,442,769
Cash at end of period	$ 1,892,377	$ 1,566,027
Supplemental disclosures of cash flow information:		
Cash received (paid) during the period for:		
Interest paid	$ (923,839)	$ (474,619)
Income taxes paid	(47,720)	(340,119)
Income taxes received	29,734	2,585
Non-cash financing activities:		
Preferred Series D stock converted to common stock	--	22,918,693
Preferred Series C stock converted to common stock	--	2,895,001
Accrued dividends converted to common stock	--	458,707
Capital lease obligation	270,597	249,418
Mortgage note payable	--	765,000

See accompanying notes to consolidated financial statements.

TAG-IT PACIFIC, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. PRESENTATION OF INTERIM INFORMATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying unaudited consolidated financial statements reflect all adjustments that, in the opinion of the management of Tag-It Pacific, Inc. and Subsidiaries (collectively, the "Company"), are considered necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of the Company included in the Company's Form 10-K for the year ended December 31, 2004. The balance sheet as of December 31, 2004 has been derived from the audited financial statements as of that date but omits certain information and footnotes required for complete financial statements.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. This assumption is based on the Company being successful in restructuring its operations in accordance with the restructuring plan adopted by the Company's board of directors in August 2005. The Company's independent registered public accounting firm has informed the Company that it may include in its report on the Company's financial statements for the year ended December 31, 2005 an explanatory paragraph expressing substantial doubt about the Company's ability to continue as a going concern if the Company fails to successfully implement its restructuring initiative.

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2. RESTATEMENT OF FINANCIAL STATEMENTS

During the year-end financial closing and preparation of the Company's consolidated financial statements for the year ended December 31, 2005, management determined that the Company had incorrectly recognized revenue on a sale and inventory storage agreement that was effective at the end of the second quarter. In accordance with United States generally accepted accounting principles the revenue from this transaction should not have been recognized at the time of the agreement, but rather should have been, and will be, 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.

Following is a summary of the effects of these changes on the Company's consolidated balance sheets as of June 30, 2005 and September 30, 2005, as well as the effects of these changes on the Company's consolidated statements of operations and cash flows for the quarterly and year to date periods ending June 30, 2005 and September 30, 2005:

AS OF AND FOR THE THREE MONTHS ENDED JUNE 30, 2005

	As previously reported	Adjustments	As restated
CONSOLIDATED BALANCE SHEET			
Accounts Receivable	$ 13,352,574	$ (2,833,590)	$ 10,518,984
Inventories	11,948,779	1,617,138	13,565,917
Total current assets	33,703,385	(1,216,452)	32,486,933
Total Assets	50,042,958	(1,216,452)	48,826,506
Accumulated (deficit) earnings	(33,804,959)	(1,216,452)	(35,021,411)
Total Stockholders' Equity	17,541,157	(1,216,452)	16,324,705
Total Liabilities & Stockholders' Equity	50,042,958	(1,216,452)	48,826,506
CONSOLIDATED STATEMENT OF OPERATIONS			
Net sales	18,473,236	(2,833,590)	15,639,646
Cost of goods sold	16,500,664	(1,617,138)	14,883,526
Gross (loss) profit	1,972,572	(1,216,452)	756,120
(Loss) income from operations	(9,691,169)	(1,216,452)	(10,907,621)
(Loss) income before income taxes	(9,959,190)	(1,216,452)	(11,175,642)
Net (loss) income	(11,260,186)	(1,216,452)	(12,476,638)
Net (loss) income to common shareholders	(11,260,186)	(1,216,452)	(12,476,638)

FOR THE SIX MONTHS ENDED JUNE 30, 2005

	As previously reported	Adjustments	As restated
CONSOLIDATED STATEMENT OF OPERATIONS			
Net sales	$ 31,528,513	$ (2,833,590)	$ 28,694,923
Cost of goods sold	26,304,118	(1,617,138)	24,686,980
Gross (loss) profit	5,224,395	(1,216,452)	4,007,943
(Loss) income from operations	(10,908,940)	(1,216,452)	(12,125,392)
(Loss) income before income taxes	(11,445,616)	(1,216,452)	(12,662,068)
Net (loss) income	(12,908,629)	(1,216,452)	(14,125,081)
Net (loss) income to common shareholders	(12,908,629)	(1,216,452)	(14,125,081)
CONSOLIDATED STATEMENT OF CASH FLOWS			
Net loss	(12,908,629)	(1,216,452)	(14,125,081)
Receivables, including related parties .	(458,222)	2,833,590	2,375,368
Inventory	(4,192,959)	(1,617,138)	(5,810,097)

AS OF AND FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005

	As previously reported	Adjustments	As restated

CONSOLIDATED BALANCE SHEET			
Accounts Receivable	$ 9,470,783	$ (1,266,244)	$ 8,204,539
Inventories	8,615,953	1,222,448	9,838,401
Total current assets	22,691,555	(43,796)	22,647,759
Total Assets	36,353,680	(43,796)	36,309,884
Accounts payable and accrued expenses ..	12,849,511	1,105,085	13,954,596
Total current liabilities	14,468,970	1,105,085	15,574,055
Total Liabilities	29,164,968	1,105,085	30,270,053
Accumulated (deficit) earnings	(44,157,404)	(1,148,881)	(45,306,285)
Total Stockholders' Equity	7,188,712	(1,148,881)	6,039,831
Total Liabilities & Stockholders' Equity	36,353,680	(43,796)	36,309,884

AS OF AND FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005

	As previously reported	Adjustments	As restated
CONSOLIDATED STATEMENT OF OPERATIONS			
Net sales	$ 9,039,507	433,391	9,472,898
Cost of goods sold	11,201,308	365,820	11,567,128
Gross (loss) profit	(2,161,801)	67,571	(2,094,230)
(Loss) income from operations	(10,348,625)	67,571	(10,281,054)
(Loss) income before income taxes	(10,613,176)	67,571	(10,545,605)
Net (loss) income	(10,352,445)	67,571	(10,284,874)
Net (loss) income to common shareholders	(10,352,445)	67,571	(10,284,874)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005

	As previously reported	Adjustments	As restated
CONSOLIDATED STATEMENT OF OPERATIONS			
Net sales	$ 40,568,020	(2,400,199)	38,167,821
Cost of goods sold	37,505,426	(1,251,318)	36,254,108
Gross (loss) profit	3,062,594	(1,148,881)	1,913,713
(Loss) income from operations	(21,256,392)	(1,148,881)	(22,405,273)
(Loss) income before income taxes	(22,058,792)	(1,148,881)	(23,207,673)
Net (loss) income	(23,261,074)	(1,148,881)	(24,409,955)
Net (loss) income to common shareholders	(23,261,074)	(1,148,881)	(24,409,955)
CONSOLIDATED STATEMENT OF CASH FLOWS			
Net loss	(23,261,074)	(1,148,881)	(24,409,955)
Receivables, including related parties .	5,323,570	1,266,244	6,589,814
Inventory	(3,228,323)	(1,222,448)	(4,450,771)
Accounts payable and accrued expenses ..	5,471,715	1,105,085	6,576,800

3. EARNINGS PER SHARE

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

THREE MONTHS ENDED SEPTEMBER 30, 2005	(LOSS) INCOME	SHARES	PER SHARE
	(As restated, see Note 2)		(As restated, see Note 2)
Basic loss per share:			
Loss available to common stockholders ..	$(10,284,874)	18,241,045	$ (0.56)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders ..	$(10,284,874)	18,241,045	$ (0.56)
THREE MONTHS ENDED SEPTEMBER 30, 2004			
Basic earnings per share:			
Income available to common stockholders	$ 211,004	18,112,802	$ 0.01
Effect of Dilutive Securities:			
Options	--	156,203	--
Warrants	--	--	--
Income available to common stockholders	$ 211,004	18,269,005	$ 0.01

NINE MONTHS ENDED SEPTEMBER 30, 2005	LOSS (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
	(As restated see Note 2)		(As restated see Note 2)
Basic loss per share:			
Loss available to common stockholders ..	$(24,409,955)	18,220,731	$ (1.34)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders ..	$(24,409,955)	18,220,731	$ (1.34)

NINE MONTHS ENDED SEPTEMBER 30, 2004			
Basic loss per share:			
Loss available to common stockholders ..	$ (201,211)	17,036,001	$ (0.01)
Effect of Dilutive Securities:			
Options	--	--	--
Warrants	--	--	--
Loss available to common stockholders ..	$ (201,211)	17,036,001	$ (0.01)

Warrants to purchase 1,510,479 shares of common stock at between $3.50 and $5.06, options to purchase 1,812,000 shares of common stock at between $1.30 and $5.23, convertible debt of $500,000 convertible at $4.50 per share and convertible debt of $12.5 million convertible at $3.65 per share were outstanding for the three and nine months ended September 30, 2005, but were not included in the computation of diluted earnings per share because exercise or conversion would have an antidilutive effect on earnings per share.

Warrants to purchase 1,191,984 shares of common stock at between $4.29 and $5.06, options to purchase 1,270,200 shares of common stock at between $3.63 and $4.63, and convertible debt of $500,000 convertible at $4.50 per share, were outstanding for the three months ended September 30, 2004, but were not included in the computation of diluted earnings per share because exercise or conversion would have an antidilutive effect on earnings per share.

Warrants to purchase 1,191,984 shares of common stock at between $4.29 and $5.06, options to purchase 1,790,200 shares of common stock at between $1.30 and $4.63, and convertible debt of $500,000 convertible at $4.50 per share, were outstanding for the nine months ended September 30, 2004, but were not included in the computation of diluted earnings per share because exercise or conversion would have an antidilutive effect on earnings per share.

4. STOCK BASED COMPENSATION

All stock options issued to employees had an exercise price not less than the fair market value of the Company's Common Stock on the date of grant, and in accounting for such options utilizing the intrinsic value method there is no related compensation expense recorded in the Company's financial statements for the three and nine months ended September 30, 2005 and 2004. If compensation cost for stock-based compensation had been determined based on the fair value of the stock options on their dates of grant in accordance with Statement of Financial Accounting Standards No. 123 the Company's net (loss) income

and (loss) earnings per share for the three and nine months ended September 30, 2005 and 2004 would have amounted to the pro forma amounts presented below:

	Three Months Ended September 30,	Nine m Ended Sept

	2005 (As restated, see Note 2)	2004	2005 (As restated, see Note 2)
Net (loss) income, as reported	$(10,284,874)	$ 211,004	$(24,409,955)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	--	--	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(65,332)	(5,224)	(142,393)
Pro forma net (loss) income	$(10,350,206)	$ 205,780	$(24,552,348)
(Loss) earnings per share:			
Basic - as reported	$ (0.56)	$ 0.01	$ (1.34)
Basic - pro forma	$ (0.56)	$ 0.01	$ (1.34)
Diluted - as reported	$ (0.56)	$ 0.01	$ (1.34)
Diluted - pro forma	$ (0.56)	$ 0.01	$ (1.34)

5. 2005 RESTRUCTURING PLAN

In an effort to better align the Company's organizational and cost structures with its future growth opportunities, in August 2005 the Company's Board of Directors adopted a restructuring plan for the Company that it expects will be completed by December 2005. The plan includes restructuring the Company's global operations by eliminating redundancies in its Hong Kong operation, closing its Mexican facilities, converting its Guatemala facility from a manufacturing site to a distributor, and closing its North Carolina manufacturing facility. The Company also intends to focus its sales efforts on higher margin products, which may result in lower net sales over the next twelve months. Upon completion of this restructuring, the Company will operate with fewer employees and reduced associated operating and manufacturing expenses.

The Company has recorded charges in connection with its restructuring plan in accordance with SFAS No. 146 (As Amended), "Accounting for Costs Associated with Exit or Disposal Activities." In addition, the Company's restructuring plan has resulted in the carrying value of certain long-lived assets, primarily equipment, being impaired. Accordingly, the Company has recorded a charge to recognize the impairment of these assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." It is possible that, upon completion of its restructuring plan by December 2005, the Company's recorded charges might need to be adjusted to reflect changes in the disposition of these assets. The Company will continue to monitor its progress during this restructuring period and adjust its business strategies and plans to achieve its planned operating efficiencies and costs reductions.

The North Carolina manufacturing facility is a long lived asset that is classified as "held for sale" because it meets the criteria listed in Paragraph 30 of SFAS 144. Management has the authority and has committed to sell the asset; the asset is listed for sale with a commercial real estate agent who is actively marketing the property; the sale of the asset is probable and the sale is expected to be completed within one year and it is unlikely that this plan will be changed. The major pieces of equipment used to manufacture zippers are not classified as held for sale because they do not meet the criteria listed in Paragraph 30 of SFAS 144 and will therefore be recorded in the balance sheet as property and equipment.

Total restructuring charges recorded in the third quarter of 2005 were $6,176,000. The restructuring charges included approximately $3,447,000 of inventory write-downs, restructuring charges of approximately $2,279,000 consisting of $2,036,000 for the impairment of long-lived assets, primarily machinery and equipment, $170,000 of one time employee termination benefits and other costs of $73,000. In addition, an impairment charge to goodwill in the amount of $450,000 was recorded. This goodwill was associated with an acquisition made to benefit the Central and South American operations. Since these operations are being exited, management concluded that this goodwill was impaired and should be written off. These restructuring charges were recorded on our Consolidated Statements of Operations for the three month and nine month periods ended September 30, 2005 in the following line items and amounts:

Cost of goods sold	$3,447,000
Goodwill impairment	450,000
Restructuring costs	2,279,000
Total	$6,176,000

6. GUARANTEES AND CONTINGENCIES

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

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

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

The Company enters into indemnification provisions under its agreements with investors and its agreements with other parties in the normal course of business, typically with suppliers, customers and landlords. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification

provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has not recorded any related liabilities.

The Company has 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) - based on various contractual and tort claims relating to the Company's exclusive license and intellectual property agreement, seeking declaratory relief, injunctive relief and damages. The agreement with Pro-Fit gives the Company exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. Pro-Fit filed an answer denying the material allegations of the complaint and filed a counterclaim alleging various contractual and tort claims seeking injunctive relief and damages. The Company filed a reply denying the material allegations of Pro-Fit's pleading. Pro-Fit has since purported to terminate the exclusive license and intellectual property agreement based on the same alleged breaches of the agreement that are the subject of the parties' existing litigation, as well as on an additional basis unsupported by fact. In February 2005, the Company amended its pleadings in the litigation to assert additional breaches by Pro-Fit of its obligations to the Company under the agreement and under certain additional letter agreements, and for a declaratory judgment that Pro-Fit's patent No. 5,987,721 is invalid and not infringed by the Company. Thereafter, Pro-Fit filed an amended answer and counterclaim denying the material allegations of the amended complaint and alleging various contractual and tort claims seeking injunctive relief and damages. Pro-Fit further asserted that the Company infringed its United States Patent Nos. 5,987,721 and 6,566,285. The Company filed a reply denying the substantive allegations of the reply. At the Company's request, the Court bifurcated the contract issues for trial to commence on January 10, 2006. The parties have filed summary judgment motions which may dispose of some of the issues in this case prior to trial. The remaining issues will be tried at a later date. As the Company derives a significant amount of revenue from the sale of products incorporating the stretch waistband technology, its business, results of operations and financial condition could be materially adversely affected if the dispute with Pro-Fit is not resolved in a manner favorable to the Company. Additionally, the Company has incurred significant legal fees in this litigation, and unless the case is settled, the Company will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

The Company is subject to certain other legal proceedings and claims arising in connection with its business. In the opinion of management, there are currently no claims that will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

7. NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 123R "Share Based Payment." This statement is a revision of SFAS Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest. This statement is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The Company has evaluated the effects of the adoption of this pronouncement and has determined it will not have a material impact on the Company's financial statements.

In December 2004, the FASB issued Statement Accounting Standard ("SFAS") No. 153 "Exchanges of Nonmonetary Assets". This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after December 16, 2004. The provisions of this Statement should be applied prospectively. The adoption of this pronouncement did not have material effect on the Company's financial statements.

In March, 2005, the Securities and Exchange Commission's ("SEC") Office of the Chief Accountant and its Division of Corporation Finance released Financial Accounting Bulletin No. 107, "Share-Based Payment" (SAB 107). SAB 107 provides interpretive guidance related to the interaction between Statement of Financial Accounting Standard No. 123R "Shared Based Payment" (SFAS 123R) and certain SEC rules and regulations. SAB 107 provides the staff's views regarding the valuation of shared-based payment arrangements for public companies and stresses the importance of including appropriate disclosures within SEC filings, particularly during the transition to SFAS 123R.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes" ("APB 20") and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements for voluntary changes in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The impact of SFAS 154 will depend on the accounting change, if any, in a future period.

8. SIGNIFICANT ADJUSTMENTS

The Company evaluated its accounts receivable, inventory, accounts payable, certain other assets and its net deferred tax asset and recorded the following significant adjustments during the three months ended June 30, 2005:

- o Increased allowance for doubtful accounts by $6,381,000 based upon management's estimate of the collectibility of accounts receivable related to two customers;

- o Increased inventory obsolescence reserve by $1,550,000 based upon management's estimate of the net realizable value of certain inventories;

- o Recorded additional reserves of $1,523,000 to primarily reflect an increase in legal accruals, charges related to the Company's Pro-Fit litigation and a reduction in certain assets; and

- o Reduced the carrying value of the Company's net deferred tax asset to zero from $1,000,000 at December 31, 2004.

9. ACCOUNTS RECEIVABLE

As of September 30, 2005, the Company had accounts receivable from Azteca Productions International of approximately $10,654,000 less a reserve of $7,007,000, for a net balance of $3,647,000 recorded on the Company's balance sheet. The Company is pursuing several payment alternatives with Azteca, one of which would involve the Company granting to Azteca warrants to purchase shares of its common stock at a significant premium to market to induce Azteca to borrow funds, the proceeds of which would be paid to the Company in full settlement of the outstanding accounts receivable due from Azteca within the next 60 days. The Company anticipates that the value of the warrants, using the Black-Scholes valuation method, would be approximately $100,000, and that the amount paid to the Company, less the cost of the warrants, would be at least equal to the net amount the Company has recorded in accounts receivable as of September 30, 2005. If the Company is unable to reach a settlement with Azteca, it will consider all available alternatives, including bringing suit to collect the amounts due the Company.

10. SUBSEQUENT EVENT

On October 12, 2005, a purported shareholder class action lawsuit was filed against the Company and certain officers and directors of the Company in the United States District Court for the Central District of California alleging claims under Section 10(b) and Section 20 of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. The case is entitled HUBERMAN V. TAG-IT PACIFIC, INC., ET AL., Case No. CV05-7352 R(Ex). The action is purportedly brought on behalf of all purchasers of the Company's publicly-traded securities during the period from November 14, 2003 to August 12, 2005. The Company has accepted service of the complaint and has entered into a stipulation with plaintiff's counsel to formally respond following the appointment of lead plaintiff and lead counsel and the anticipated filing of the consolidated amended complaint. The Company believes the lawsuit to be without merit and intends to vigorously defend against the lawsuit. At this stage of the litigation, the Company is not able to reasonably estimate potential losses, if any, related to the lawsuit.

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

The following discussion and analysis should be read together with the Consolidated Financial Statements of Tag-It Pacific, Inc. and the notes to the Consolidated Financial Statements included elsewhere in this Form 10-Q/A.

This discussion summarizes the significant factors affecting the consolidated operating results, financial condition and liquidity and cash flows of Tag-It Pacific, Inc. for the three months and nine months ended September 30, 2005 and 2004. Except for historical information, the matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations are forward looking statements that involve risks and uncertainties and are based upon judgments concerning various factors that are beyond our control.

OVERVIEW

Tag-It Pacific, Inc. is an apparel company that specializes in the distribution of trim items to manufacturers of fashion apparel, specialty retailers and mass merchandisers.

As part of our restructuring plan which was approved by our Board of Directors in August 2005, we have developed a new strategic direction for our trim division and Talon zipper division.

TRIM DIVISION.

We have restructured our trim business to become an outsourced product development, sourcing and sampling department for the most demanding brands and retailers. We believe that trim design differentiation among brands and retailers has become a critical marketing tool for our customers. By assisting our customers in the development, design and sourcing of trim, we expect to achieve higher margins for our trim products, create long-term relationships with our customers, grow our sales to a particular a customer by supplying trim for a larger proportion of their brands, and better differentiate our trim sales and services from those of our competitors. We expect our trim kits to have less of a material contribution to our trim business. We will continue to supply trim to customers who do not engage us to serve as an outsourced development, sourcing and sampling department; however, we will not provide this trim in a preassembled "trim kit."

TALON ZIPPER DIVISION.

We intend to continue to focus on the global expansion of our Talon zipper division by developing a network of distribution relationships worldwide. Several of our distribution partners have experienced delays in their acquisition of necessary zipper equipment, which has delayed the distribution of Talon zippers in their respective territories. These delays, coupled with other performance deficiencies, have caused us to terminate several distribution partners and modify our global expansion plans. We are significantly streamlining our distribution process, and adopting more flexible procedures for certifying our distributor's existing equipment to meet our high manufacturing standards, supplementing this existing equipment only where necessary. In addition, we are approaching more existing zipper factories to serve as our distributors in order to reduce the time to market by eliminating the setup and build-out phase of new factory development.

2005 RESTRUCTURING PLAN

In an effort to better align the Company's organizational and cost structures with its future growth opportunities, in August 2005 the Company's Board of Directors adopted a restructuring plan for the

Company that it expects will be completed by December 2005. The plan includes restructuring the Company's global operations by eliminating redundancies in its Hong Kong operation, closing its Mexican facilities, converting its Guatemala facility from a manufacturing site to a distributor, and closing its North Carolina manufacturing facility. The Company also intends to focus its sales efforts on higher margin products, which may result in lower net sales over the next twelve months. Upon completion of this restructuring, the Company will operate with fewer employees and reduced associated operating and manufacturing expenses.

The Company has recorded charges in connection with its restructuring plan in accordance with SFAS No. 146 (As Amended), "Accounting for Costs Associated with Exit or Disposal Activities." In addition, the Company's restructuring plan has resulted in the carrying value of certain long-lived assets, primarily equipment, being impaired. Accordingly, the Company has recorded a charge to recognize the impairment of these assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." It is possible that, upon completion of its restructuring plan by December 2005, the Company's recorded charges might need to be adjusted to reflect changes in the disposition of these assets. The Company will continue to monitor its progress during this restructuring period and adjust its business strategies and plans to achieve its planned operating efficiencies and costs reductions.

The North Carolina manufacturing facility is a long lived asset that is classified as "held for sale" because it meets the criteria listed in Paragraph 30 of SFAS 144. Management has the authority and has committed to sell the asset; the asset is listed for sale with a commercial real estate agent who is actively marketing the property; the sale of the asset is probable and the sale is expected to be completed within one year and it is unlikely that this plan will be changed. The major pieces of equipment used to manufacture zippers are not classified as held for sale because they do not meet the criteria listed in Paragraph 30 of SFAS 144 and will therefore be recorded in the balance sheet as property and equipment.

Total restructuring charges recorded in the third quarter of 2005 were $6,176,000. The restructuring charges included approximately $3,447,000 of inventory write-downs, restructuring charges of approximately $2,279,000 consisting of $2,036,000 for the impairment of long-lived assets, primarily machinery and equipment, $170,000 of one time employee termination benefits and other costs of $73,000. In addition, an impairment charge to goodwill in the amount of $450,000 was recorded. This goodwill was associated with an acquisition made to benefit the Central and South American operations. Since these operations are being exited, management concluded that this goodwill was impaired and should be written off. These restructuring charges were recorded on our Consolidated Statements of Operations for the three month and nine month periods ended September 30, 2005 in the following line items and amounts:

Cost of goods sold	$3,447,000
Goodwill	450,000
Restructuring costs	2,279,000
Total	$6,176,000

SHAREHOLDER LAWSUIT

On October 12, 2005, a purported shareholder class action lawsuit was filed against us and certain of our officers and directors in the United States District Court for the Central District of California alleging claims under Section 10(b) and Section 20 of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. The case is entitled HUBERMAN V. TAG-IT PACIFIC, INC., ET AL., Case No. CV05-7352 R(Ex). The action is purportedly brought on behalf of all purchasers of our publicly-traded securities during the period from November 14, 2003 to August 12, 2005. We have accepted service of the complaint and have entered into a stipulation with plaintiff's counsel to formally respond following the

appointment of lead plaintiff and lead counsel and the anticipated filing of the consolidated amended complaint. Although we believe that we and the other defendants have meritorious defenses to the class action complaint and intend to contest the lawsuit vigorously, an adverse resolution of any of the lawsuit could have a material adverse effect on our financial position and results of operations. At this stage of the litigation, we are not able to reasonably estimate potential losses, if any, related to the lawsuit.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to our valuation of inventory and our allowance for uncollectible accounts receivable. 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. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

o 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. 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 the adjustments become known. A portion of our total inventories is subject to buyback arrangements with our customers. The buyback arrangements contain provisions related to the inventory we purchase and warehouse on behalf of our customers, and require that these customers purchase the inventories from us in accordance with the applicable buyback arrangements. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to purchase inventories, an additional adjustment may be required. These buyback arrangements are considered in management's estimate of future market value of inventories. See further discussion below of reserve for inventory obsolescence recorded in the third quarter of 2005.

- 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.

- We record valuation allowances to reduce our deferred tax assets to an amount that we believe is more likely than not to be realized. We consider estimated future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. If we determine that we may not realize all or part 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. At September 30, 2005, the carrying value of our net deferred tax asset was zero because we could not determine that it was more likely than not that the deferred tax asset would be realized.

- Intangible assets are evaluated on a continual basis and impairment adjustments are made based on management's valuation of identified reporting units related to goodwill, the valuation of intangible assets with indefinite lives and the reassessment of the useful lives related to other intangible assets with definite useful lives. Impairment adjustments are made for the difference between the carrying value of the intangible asset and the estimated valuation and charged to operations in the period in which the facts that give rise to the adjustments become known.

- Long-lived assets are evaluated on a continual basis and impairment adjustments are made based upon management's valuations. As part of the 2005 Restructuring Plan, certain long-lived assets, primarily machinery and equipment, were impaired and their values adjusted accordingly.

o Sales are recorded at the time of shipment, at which point title transfers to the customer, and when collection is reasonably assured.

RESULTS OF OPERATIONS

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2005 (as restated, see Note 2)	2004	2005 (as restated, see Note 2)	2004
Net sales	100.0 %	100.0 %	100.0 %	100.0%
Cost of goods sold	122.1	74.4	95.0	73.3
Gross (loss) profit	(22.1)	25.6	5.0	26.7
Selling expenses	5.8	3.8	5.1	5.0
General and administrative expenses	51.8	19.0	51.5	21.1
Impairment of goodwill	4.7	0.0	1.2	0.0
Restructuring costs	24.1	0.0	6.0	0.0
Operating (loss) income	(108.5)%	2.8 %	(58.8)%	0.6 %

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The following table sets forth for the periods indicated revenues attributed to geographical regions based on the location of the customer as a percentage of net sales:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2005 (as restated, see Note 2)	2004	2005 (as restated, see Note 2)	2004
United States	17.7%	9.7%	12.5%	8.7%
Asia	43.2	19.3	37.8	22.2
Mexico	8.7	44.9	25.8	40.2
Dominican Republic	15.7	15.8	14.1	18.2
Central and South America ...	9.4	7.4	7.4	9.3

Other	5.3	2.9	2.4	1.4
	100.0%	100.0%	100.0%	100.0%

Net sales for the three months ended September 30, 2005 were $9,473,000, a decrease of $7,532,000 or 44.3% compared to the net sales of $17,005,000 for the three months ended September 30, 2004. This decrease was primarily due to a decrease in sales to our Mexican customers of trim and, to a lesser extent, Talon zippers due to an industry shift of apparel production from Latin America to Asia. As reported elsewhere, we are responding to these market changes by reducing our Mexican operation and focusing our efforts on the Asian market. Asian sales of our Talon zippers and trim products increased 23%. Sales of our Tekfit waistband decreased because of lower demand from the single customer for this product.

Net sales for the nine months ended September 30, 2005 were $38,168,000, a decrease of $3,920,000 or 9.3% compared to net sales of $42,088,000 for the nine months ended September 30, 2004. This decrease in net sales occurred in our Mexican operation in the third quarter as the market for trim and zipper products moved from Latin America to Asia. For the period, sales of Talon zippers and trim products by our Asian operation increased approximately 38% over the same period in the prior year. During this period sales of our Tekfit waistband decreased because of lower demand from the single customer for this product.

Gross loss was $2,094,000 for the three months ended September 30, 2005 compared to a gross profit of $4,346,000, or 25.6% of sales, for the three months ended September 30, 2004. The gross loss included an inventory write down associated with the restructuring plan of $3,447,000. Excluding the inventory restructuring write down, gross profit would have been $1,353,000, or 14.3% of net sales. This amount was adversely affected by the low sales volume resulting in certain fixed costs being absorbed by lower sales and inventory adjustments unrelated to the restructuring plan.

Gross profit decreased approximately $9,316,000, or 83.0% to $1,914,000 for the nine months ended September 30, 2005 from $11,230,000 for the nine months ended September 30, 2004. Gross profit as a percentage of net sales decreased to approximately 5.0% for the nine months ended September 30, 2005 as compared to 26.7% for the nine months ended September 30, 2004. The decrease in gross profit was due to the inventory write down of $3,447,000 associated with the restructuring plan, an increase in our inventory obsolescence reserve of $1,550,000 recorded in the second quarter of 2005, unabsorbed overhead costs incurred in our North Carolina manufacturing facility, additional charges associated with unrealized charge backs to vendors and customers recorded in the second quarter and credits issued to a customer during the first quarter for defective products received from Pro-Fit Holdings.

Selling expenses decreased approximately $97,000 or 15.0% to $549,000 for the three months ended September 30, 2005 compared to $646,000 for the prior year period. A portion of this decrease

resulted from the restructuring plan implemented during the third quarter. As a percentage of sales, selling expenses were 5.7% of sales compared to 3.8% of sales because we were unable to reduce expenses in direct proportion to the sales decrease.

Selling expenses for the nine month period ended September 30, 2005 were $1,940,000 or 5.1% of sales compared to $2,121,000 or 5.0% of sales for the nine month period ended September 30, 2004. Selling expenses decreased approximately $181,000 because of cost containment efforts.

General and administrative expenses increased $1,682,000 or 52.1% to $4,909,000 for the three months ended September 30, 2005 compared to $3,227,000 for the three months ended September 30, 2004. This increase in general and administrative expense is primarily due to higher legal expenses associated with our litigation with Pro-Fit Holdings Limited. Unless this case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial. This increase in general and administrative expenses was partially offset by a reduction in employee costs in September as a result of the implementation of our restructuring plan.

General and administrative expenses increased approximately $10,775,000 to $19,650,000 for the nine months ended September 30, 2005 from $8,875,000 for the nine months ended September 30, 2004. This increase in general and administrative expenses was due primarily to an increase of $6,381,000 in the reserve for doubtful accounts recorded in the second quarter of 2005, higher legal expenses of approximately $2,351,000 related primarily to the Pro-Fit litigation, and generally higher employment levels through the first eight months of the period.

During the third quarter of 2005 we recorded a restructuring charge of $6,176,000. These restructuring charges were recorded on our Consolidated Statements of Operations for the three month and nine month periods ended September 30, 2005 in the following line items and amounts:

Cost of goods sold	$3,447,000
Goodwill impairment	450,000
Restructuring costs	2,279,000
Total	$6,176,000

Net interest expense increased approximately $103,000, or 63.6%, to $265,000 for the three months ended September 30, 2005 from $162,000 for the three months ended September 30, 2004. Net interest expense increased approximately $309,000, or 62.7%, to $802,000 for the nine months ended September 30, 2005 from $493,000 for the nine months ended September 30, 2004. The interest expense increases for both the three month and nine month periods were primarily due to higher debt levels associated with the $12.5 million secured convertible notes partially offset by a reduction in other indebtedness.

The benefit for income taxes for the three months ended September 30, 2005 resulted from adjustments between our US and Hong Kong operations to better align expenses with revenues. These adjustments resulted in a tax benefit of $261,000. For the three months ended September 30, 2004 we recorded a tax provision of $100,000.

The provision for income taxes for the nine months ended September 30, 2005 amounted to approximately $1,202,000 compared to an income tax benefit of $88,000 for the nine months ended September 30, 2004. The provision for income taxes increased due to an increase in our deferred tax asset valuation allowance. Based on our net operating losses, there is not sufficient evidence to determine that it is more likely than not that we will be able to utilize our net operating loss carry forwards to offset future taxable income.

Net loss was approximately $10,285,000 for the three months ended September 30, 2005 as compared to net income of $211,000 for the three months ended September 30, 2004. Net loss was approximately $24,410,000 for the nine months ended September 30, 2005 as compared to a net loss of $201,000 for the nine months ended September 30, 2004.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased to $1,892,000 at September 30, 2005 from $5,460,000 at December 31, 2004. The decrease resulted from approximately $582,000 of cash provided by operating activities, $1,634,000 of cash used in investing activities and $2,516,000 of cash used in financing activities.

Net cash provided by operating activities was approximately $582,000 for the nine months ended September 30, 2005 and cash used by operations was approximately $9,320,000 for the nine months ended September 30, 2004. Cash provided by operating activities for the nine months ended September resulted primarily from a decrease in accounts receivables because of lower sales during the third quarter of 2005, a decrease in related party accounts receivables, an increase in accounts payable and accrued expenses which were partially offset by an increase in inventories.

Net cash used in operating activities was approximately $9,320,000 for the nine months ended September 30, 2004. Cash used in operating activities for the nine months ended September 30, 2004 resulted primarily from increased accounts receivable and prepaid and other current assets. The increase in accounts receivable during the period was due primarily to slower customer collections of non-related party receivables during the nine-month period. Non-related party trade receivables increased by an additional $5.4 million due to the inclusion of receivables that were previously classified as related party trade receivables.

Net cash used in investing activities was approximately $1,634,000 and $1,262,000 for the nine months ended September 30, 2005 and 2004, respectively. Net cash used in investing activities for the nine months ended September 30, 2005 consisted primarily of capital expenditures for purchases of equipment. Net cash used in investing activities for the nine months ended September 30, 2004 consisted primarily of capital equipment related to the exclusive supply agreement we entered into with Levi Strauss & Co. and the purchase of additional TALON zipper equipment.

Net cash used in financing activities was approximately $2,516,000 and $2,294,000 for the nine months ended September 30, 2005 and 2004, respectively. Net cash used in financing activities for the nine months ended September 30, 2005 primarily reflects the repayment of borrowings under our bank line of credit facility, repayment of notes payable and capital leases, partially offset by funds raised from the exercise of stock options and warrants. Net cash used in financing activities for the nine months ended September 30, 2004 primarily reflects the repayment of borrowings under our credit facility and notes payable, offset by funds raised from the exercise of stock options and warrants and the proceeds from a capital lease obligation.

We currently satisfy our working capital requirements primarily through cash flows generated from operations, sales of equity securities and borrowings from institutional investors and individual accredited investors. On November 10, 2004, we refinanced our working capital credit facility with UPS Capital Global Trade Finance Corporation with a portion of the proceeds received from a private placement of $12.5 million of Secured Convertible Promissory Notes. The

Secured Convertible Promissory Notes are

convertible into common stock at a price of $3.65 per share, bear interest at 6% payable quarterly, are due November 9, 2007 and are secured by the TALON trademarks. The Notes are convertible at the option of the holder at any time after closing. We may repay the Notes at any time after one year from the closing date with a 15% prepayment penalty. At maturity, we may repay the Notes in cash or require conversion if certain conditions are met. In connection with the issuance of the Notes, we issued to the Note holders warrants to purchase up to 171,235 shares of common stock. The warrants have a term of five years, an exercise price of $3.65 per share and vested 30 days after closing. We have registered with the SEC, the resale by the holders of the shares issuable upon conversion of the Notes and exercise of the warrants.

Amounts borrowed under our foreign factoring agreement as of September 30, 2005 amounted to approximately $59,000. At September 30, 2004, outstanding borrowings under our UPS Capital credit facility, including amounts borrowed under our foreign factoring agreement, amounted to approximately $4,597,000.

In 2005, we entered into a letter of credit facility with Wells Fargo Bank. This facility provides for letters of credit up to a maximum of $1.5 million, expires in November 2005 and is secured by cash on hand managed by Wells Fargo Bank. At September 30, 2005, outstanding letters of credit under the Wells Fargo facility amounted to $50,000.

Pursuant to the terms of a factoring agreement for our Hong Kong subsidiary, Tag-It Pacific Limited, the factor purchases our eligible accounts receivable and assumes the credit risk with respect to those accounts for which the factor has given its prior approval. If the factor does not assume the credit risk for a receivable, the collection risk associated with the receivable remains with us. We pay a fixed commission rate and may borrow up to 80% of eligible accounts receivable. Interest is charged at 1.5% over the Hong Kong Dollar prime rate. As of September 30, 2005 and 2004, the amount factored with recourse and included in trade accounts receivable was approximately $1,401,000 and $872,000. Outstanding advances as of September 30, 2005 and 2004 amounted to approximately $59,000 and $512,000 and are included in the line of credit balance.

As we continue to respond to the current industry trend of large retail brands to outsource apparel manufacturing to offshore locations, our foreign customers, though backed by U.S. brands and retailers, are increasing. This makes receivables based financing with traditional U.S. banks more difficult. Our current borrowings may not provide the level of financing we may need to expand into additional foreign markets. As a result, we are continuing to evaluate non-traditional financing of our foreign assets.

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

As of September 30, 2005, we had accounts receivable from Azteca Productions International of approximately $10,654,000 less a reserve of $7,007,000, for a net balance of $3,647,000 recorded on our balance sheet. We are pursuing several payment alternatives with Azteca, one of which would involve us granting to Azteca warrants to purchase shares of our common stock at a significant premium to market to induce Azteca to borrow funds, the proceeds of which would be paid to us in full settlement of the outstanding accounts receivable due from Azteca within the next 60 days. We anticipate that the value of the warrants, using the Black-Scholes valuation method, would be approximately $100,000, and that the amount paid to us, less the cost of the warrants, would be at least equal to the net amount we have recorded in accounts receivable as of September 30, 2005. If we are unable to reach a settlement with Azteca, we will consider all available alternatives, including bringing suit to collect the amounts due us.

We believe that our existing cash and cash equivalents and anticipated cash flows from our operating activities and available financing will be sufficient to fund our minimum working capital and capital expenditure needs for at least the next twelve months. This conclusion is based on the assumption that we will be successful in restructuring our operations in accordance with the restructuring plan adopted by our board of directors in August 2005, and that we will collect at least $4 million in cash from Azteca Productions International in payment of outstanding accounts receivable within the next 60 days. If we are unable to successfully fully implement our restructuring initiative or collect the receivable, or experience greater than anticipated reductions in sales, we may need to raise additional capital or further reduce the scope of our business in order to fully satisfy our future short-term liquidity requirements. If we cannot raise additional capital or reduce the scope of our business in response to our failure to implement our restructuring initiative in accordance with our plan, there may be substantial doubt about our ability to continue as a going concern. Our auditors have informed us that they may include in their report on our financial statements for the year ended December 31, 2005 an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern if we fail to successfully implement our restructuring initiative.

The extent of our future long-term capital requirements will depend on many factors, including our results of operations, future demand for our products, the size and timing of future acquisitions, our borrowing base availability limitations related to eligible accounts receivable and inventories and our expansion into foreign markets. Our need for additional long-term financing includes the integration and expansion of our operations to exploit our rights under our Talon trade name, the expansion of our operations in the Asian, Central and South American and Caribbean markets and the further development of our waistband technology. If our cash from operations is less than anticipated or our working capital requirements and capital expenditures are greater than we expect, we may need to raise additional debt or equity financing in order to provide for our operations. We are continually evaluating various financing strategies to be used to expand our business and fund future growth or acquisitions. There can be no assurance that additional debt or equity financing will be available on acceptable terms or at all. If we are unable to secure additional financing, we may not be able to execute our plans for expansion, including expansion into foreign markets to promote our Talon brand tradename, and we may need to implement additional cost savings initiatives.

RELATED PARTY TRANSACTIONS

Gerard Guez and Todd Kay, executive officers and significant shareholders of Tarrant Apparel Group, are significant stockholders of ours. Total sales to Tarrant Apparel Group and its affiliate, United Apparel Ventures, amounted to approximately $165,000 and $698,000 for the nine months ended September 30, 2005 and 2004, respectively. As of September 30, 2005, accounts receivable, related party included $1,400,000 due from Tarrant's affiliate, United Apparel Ventures. United Apparel Ventures agreed to pay its remaining balance over an eight-month period beginning May 2005.

As of September 30, 2005 and 2004, we had outstanding related-party debt of approximately $665,000 and $850,000, at interest rates ranging from 7% to 11%, and additional non-related-party debt of $25,200 at an interest rate of 10%. The majority of related-party debt is due on demand, with the remainder due and payable on the fifteenth day following the date of delivery of written demand for payment.

NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 123R "Share Based Payment." This statement is a revision of SFAS Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R addresses all forms of share based

payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest. This statement is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The Company has evaluated the effects of the adoption of this pronouncement and has determined it will not have a material impact on the Company's financial statements.

In December 2004, the FASB issued Statement Accounting Standard ("SFAS") No. 153 "Exchanges of Nonmonetary Assets". This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after December 16, 2004. The provisions of this Statement should be applied prospectively. The adoption of this pronouncement did not have material effect on our financial statements.

In March, 2005, the Securities and Exchange Commission's ("SEC") Office of the Chief Accountant and its Division of Corporation Finance released Financial Accounting Bulletin No. 107, "Share-Based Payment" (SAB 107). SAB 107 provides interpretive guidance related to the interaction between Statement of Financial Accounting Standard No. 123R "Shared Based Payment" (SFAS 123R) and certain SEC rules and regulations. SAB 107 provides the staff's views regarding the valuation of shared-based payment arrangements for public companies and stresses the importance of including appropriate disclosures within SEC filings, particularly during the transition to SFAS 123R.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes" ("APB 20") and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements for voluntary changes in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The impact of SFAS 154 will depend on the accounting change, if any, in a future period.

CAUTIONARY STATEMENTS AND RISK FACTORS

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

OUR GROWTH AND OPERATING RESULTS COULD BE MATERIALLY, ADVERSELY EFFECTED IF WE ARE UNSUCCESSFUL IN RESOLVING A DISPUTE THAT NOW EXISTS REGARDING OUR RIGHTS UNDER OUR EXCLUSIVE LICENSE AND INTELLECTUAL PROPERTY AGREEMENT ("AGREEMENT") WITH PRO-FIT HOLDINGS. Pursuant to our Agreement with Pro-Fit Holdings Limited, we have exclusive rights in certain geographic areas to Pro-Fit's stretch and rigid waistband technology. By letter dated April 6, 2004, Pro-Fit alleged various breaches of the Agreement which we dispute. To prevent Pro-Fit in the future from terminating the Agreement based on alleged

breaches that we do not regard as meritorious, we filed a lawsuit against Pro-Fit in the U.S. District Court for the Central District of California, based on various contractual and tort claims seeking declaratory relief, injunctive relief and damages. Pro-Fit filed an answer denying the material allegations of the complaint and filed a counterclaim alleging various contractual and tort claims seeking injunctive relief and damages. We filed a reply denying the material allegations of Pro-Fit's pleading. Pro-Fit has since purported to terminate our exclusive license and intellectual property agreement based on the same alleged breaches of the agreement that are the subject of our existing litigation, as well as on an additional basis unsupported by fact. In February 2005, we amended our pleadings in the litigation to assert additional breaches by Pro-Fit of its obligations to us under our agreement and under certain additional letter agreements, and for a declaratory judgment that Pro-Fit's patent No. 5,987,721 is invalid and not infringed by us. Thereafter, Pro-Fit filed an amended answer and counterclaim denying the material allegations of the amended complaint and alleging various contractual and tort claims seeking injunctive relief and damages. Pro-Fit further asserted that we infringed its United States Patent Nos. 5,987,721 and 6,566,285. We filed a reply denying the substantive allegations of the reply. At our request, the Court bifurcated the contract issues for trial to commence on January 10, 2006. The parties have filed summary judgment motions which may dispose of some of the issues in this case prior to trial. The remaining issues will be tried at a later date.

We derive a significant amount of revenues from the sale of products incorporating the stretch waistband technology. Our business, results of operations and financial condition could be materially adversely affected if we are unable to conclude our present negotiations in a manner acceptable to us and ensuing litigation is not resolved in a manner favorable to us. Additionally, we have incurred significant legal fees in this litigation, and unless the case is settled, we will continue to incur additional legal fees in increasing amounts as the case accelerates to trial.

FAILURE TO MANAGE OUR CORPORATE RESTRUCTURING COULD IMPAIR OUR BUSINESS. In an effort to better align our organizational and cost structures with our future growth opportunities, in August 2005 our Board of Directors adopted a restructuring plan for our company that we expect will be completed in December 2005. The plan includes reorganizing our global operations by eliminating redundancies in our Hong Kong operation, reducing the functions performed at our Mexico facilities, converting our Guatemala facility from a manufacturing site to a distributor, and closing our North Carolina manufacturing facility. While we expect that the restructuring will result in reduced operating costs and improved operating results and cash flows, there can be no assurance that these results will be achieved. We recorded a restructuring charge during the third quarter of 2005 of approximately $6.2 million. We face many challenges related to our decision implement this restructuring plan, including that we may not execute the restructuring effectively, and our expectation that we will benefit from greater efficiencies may not be realized. Any failure on our part to successfully manage these challenges or other unanticipated consequences may result in loss of customers and sales, which could cause our results to differ materially from management's current expectations. The challenges we face include:

- Our ability to execute successfully through business cycles while we continue to implement the restructuring plan and cost reductions;

- Our ability to meet and achieve the benefits of our cost-reduction goals and otherwise successfully adapt our cost structures to continuing changes in business conditions;

- The risk that our cost-cutting initiatives will impair our ability to develop products and remain competitive and to operate effectively;

- We may experience delays in implementing our restructuring plan and incur additional costs;

- We may experience decreases in employee morale; and

- We may experience unanticipated expenses in winding down manufacturing operations, including labor costs, which may adversely affect our results of operations in the short term.

If we are unable to successfully fully implement our restructuring initiative, or experience greater than anticipated reductions in sales, we may need to raise additional capital or further reduce the scope of our business in order to fully satisfy our future short-term liquidity requirements. If we cannot raise additional capital or reduce the scope of our business in response to our failure to implement our restructuring initiative in accordance with our plan, there may be substantial doubt about our ability to continue as a going concern. Our auditors have informed us that they may include in their audit report on our financial statements for the year ending December 31, 2005 an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern if we fail to successfully implement our restructuring initiative.

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

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

CONCENTRATION OF RECEIVABLES FROM OUR LARGER CUSTOMERS MAKES RECEIVABLE BASED FINANCING DIFFICULT AND INCREASES THE RISK THAT IF OUR LARGER CUSTOMERS FAIL TO PAY US, OUR CASH FLOW WOULD BE SEVERELY AFFECTED. Our business relies heavily on a relatively small number of customers. This concentration of our business reduces the amount we can borrow from our lenders under receivables based financing agreements. Under a borrowing base credit agreement, for instance, if accounts receivable due us from a particular customer exceed a specified percentage of the total eligible accounts receivable against which we can borrower, the lender will not lend against the receivables that exceed the specified percentage. If we are unable to collect any large receivables due us, our cash flow would be severely impacted.

IF CUSTOMERS DEFAULT ON BUYBACK AGREEMENTS WITH US, WE WILL BE LEFT HOLDING NON-SALABLE INVENTORY. Inventories include goods that are subject to buyback agreements with our customers. Under these buyback agreements, some of our customers are required to purchase inventories from us under normal invoice and selling terms, if any inventory which we purchase on their behalf remains in our hands longer than agreed by the customer from the time we received the goods from our vendors. If any customer defaults on these buyback provisions or insists on markdowns, we may incur a charge in connection with our holding significant amounts of non-salable inventory and this would have a negative impact on our income.

OUR REVENUES MAY BE HARMED IF GENERAL ECONOMIC CONDITIONS WORSEN. Our revenues depend on the health of the economy and the growth of our customers and potential future customers. When economic conditions weaken, certain apparel manufacturers and retailers, including some of our customers, have experienced in the past, and may experience in the future, financial difficulties which increase the risk of extending credit to such customers. Customers adversely affected by economic conditions have also

attempted to improve their own operating efficiencies by concentrating their purchasing power among a narrowing group of vendors. There can be no assurance that we will remain a preferred vendor to our existing customers. A decrease in business from or loss of a major customer could have a material adverse effect on our results of operations. Further, if the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, we may experience a material adverse impact on our business, operating results, and financial condition.

BECAUSE WE DEPEND ON A LIMITED NUMBER OF SUPPLIERS, WE MAY NOT BE ABLE TO ALWAYS OBTAIN MATERIALS WHEN WE NEED THEM AND WE MAY LOSE SALES AND CUSTOMERS. Lead times for materials we order can vary significantly and depend on many factors, including the specific supplier, the contract terms and the demand for particular materials at a given time. From time to time, we may experience fluctuations in the prices, and disruptions in the supply, of materials. Shortages or disruptions in the supply of materials, or our inability to procure materials from alternate sources at acceptable prices in a timely manner, could lead us to miss deadlines for orders and lose sales and customers.

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

- o The volume and timing of customer orders received during the quarter;
- o The timing and magnitude of customers' marketing campaigns;
- o The loss or addition of a major customer;
- o The availability and pricing of materials for our products;
- o The increased expenses incurred in connection with the introduction of new products;
- o Currency fluctuations;
- o Delays caused by third parties; and
- o Changes in our product mix or in the relative contribution to sales of our subsidiaries.

Due to these factors, it is possible that in some quarters our operating results may be below our stockholders' expectations and those of public market analysts. If this occurs, the price of our common stock would likely be adversely affected. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such a company. For instance, in October 2005, a purported securities class action lawsuit was filed against us.

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

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

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

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

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

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

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

INTERNET-BASED SYSTEMS THAT HOST OUR MANAGED TRIM SOLUTION MAY EXPERIENCE DISRUPTIONS AND AS A RESULT WE MAY LOSE REVENUES AND CUSTOMERS. Our

MANAGED TRIM SOLUTION is an Internet-based business-to-business e-commerce system. To the extent that we fail to adequately continue to update and maintain the hardware and software implementing the MANAGED TRIM SOLUTION, our customers may experience interruptions in service due to defects in our hardware or our source code. In addition, since our MANAGED TRIM SOLUTION is Internet-based, interruptions in Internet service generally can negatively impact our customers' ability to use the MANAGED TRIM SOLUTION to monitor and manage various aspects of their trim needs. Such defects or interruptions could result in lost revenues and lost customers.

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

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

IF OUR PRODUCTS INFRINGE ANY OTHER PERSON'S PROPRIETARY RIGHTS, WE MAY BE SUED AND HAVE TO PAY LARGE 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.

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

- The failure of our quarterly operating results to meet expectations of investors or securities analysts;

- Adverse developments in the financial markets, the apparel industry and the worldwide or regional economies;

- Interest rates;

- Changes in accounting principles;

- 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' stock ownership. We may also assume additional debt and incur impairment losses related to goodwill and other tangible assets if we acquire another company and this could negatively impact our results of operations.

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

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

INSIDERS OWN A SIGNIFICANT PORTION OF OUR COMMON STOCK, WHICH COULD LIMIT OUR STOCKHOLDERS' ABILITY TO INFLUENCE THE OUTCOME OF KEY TRANSACTIONS. As of November 21, 2005, our officers and directors and their affiliates beneficially owned approximately 22.6% of the outstanding shares of our common stock. The Dyne family, which includes Mark Dyne, Colin Dyne, Larry Dyne, Jonathan Burstein and the estate of Harold Dyne, beneficially owned approximately 25.3% of the outstanding shares of our common stock at November 21, 2005. As a result, our officers and directors and the Dyne family are able to exert considerable influence over the outcome of any matters submitted to a vote of the holders of our common stock, including the election of our Board of

Directors. The voting power of these stockholders could also discourage others from seeking to acquire control of us through the purchase of our common stock, which might depress the price of our common stock.

WE MAY FACE INTERRUPTION OF PRODUCTION AND SERVICES DUE TO INCREASED SECURITY MEASURES IN RESPONSE TO TERRORISM. Our business depends on the free flow of products and services through the channels of commerce. Recently, in response to terrorists' activities and threats aimed at the United States, transportation, mail, financial and other services have been slowed or stopped altogether. Further 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 activities. We may also experience delays in receiving payments from payers that have been affected by the terrorist activities and potential activities. The United States economy in general is being adversely affected by the terrorist activities and potential 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 4. CONTROLS AND PROCEDURES

EVALUATION OF CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, which we have designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and

that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding disclosure. In response to recent legislation and proposed regulations, we reviewed our internal control structure and our disclosure controls and procedures.

In the course of conducting its review of our financial statements for the fiscal quarters ended June 30, 2005 and September 30, 2005, our independent registered public accounting firm, BDO Seidman, LLP informed members of our senior management and the Audit Committee of our Board of Directors that they had discovered significant deficiencies in our internal control over financial reporting that alone and in the aggregate constituted a "material weakness," which is defined under standards established by the Public Company Accounting Oversight Board as a deficiency that could result in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

The deficiencies identified consisted of our recording significant post-closing adjustments in our financial statements for the quarters ended June 30, 2005 and September 30, 2005, which were identified by BDO Seidman, LLP in connection with its review of the financial statements, indicating a material weakness in our quarterly financial statement closing process. BDO Seidman, LLP identified the same material weakness in our annual financial statement closing process in connection with its audit of our financial statements for the fiscal year ended December 31, 2004. In order to address this material weakness identified in the annual financial statement closing process, we implemented additional review procedures over the selection and monitoring of appropriate assumptions and estimates affecting these accounting practices. There were no post-closing adjustments as of March 31, 2005, the first quarterly period following implementation of additional review procedures. The deficiencies, however, were again present in the closing process for our financial statements for the second and third quarters of 2005.

Members of the Company's management, including the Company's Chief Executive Officer, Stephen Forte, and then-serving Chief Financial Officer, August DeLuca, evaluated the effectiveness of our disclosure controls and procedures, as defined by paragraph (e) of Exchange Act Rules 13a-15 or 15d-15, as of September 30, 2005, the end of the period covered by this Quarterly Report. Based upon that evaluation, Mr. Forte and Mr. DeLuca concluded that the Company's disclosure controls and procedures were not effective.

Subsequently, in the course of preparing and reviewing our annual financial statements for the year ended December 31, 2005, members of current management, including Stephen Forte, Chief Executive Officer, and Lonnie Schnell, Chief Financial Officer, determined that material weaknesses in our internal control over financial reporting continued to exist. These material weaknesses included an error in the second and third quarters of 2005 in the application of generally accepted accounting principles in the recording of revenues during the periods. As a result, we determined to restate our financial statements for the second and third quarters of 2005 to correct the recording of revenues and corresponding net loss figures for those periods as a result of a sale and inventory storage agreement that was effective in the second quarter.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There were no significant changes in our internal controls over financial reporting that occurred during the third quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 6. EXHIBITS

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

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

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

SIGNATURES

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

Dated: April 17, 2006

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TAG-IT PACIFIC, INC.

/S/ LONNIE D. SCHNELL

By: Lonnie D. Schnell
Its: Chief Financial Officer

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