

---

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

---

**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2012**

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 000-28275**

---

**PFSWEB, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**75-2837058**  
*(I.R.S. Employer  
Identification Number)*

**505 Millennium Drive, Allen, Texas**  
*(Address of principal executive offices)*

**75013**  
*(Zip code)*

**Registrant's telephone number, including area code:**  
**972-881-2900**

**Securities registered pursuant to Section 12(b) of the Act:**  
**None**

**Securities registered pursuant to Section 12(g) of the Act:**  
**Common Stock, par value \$.001 per share**

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

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

|                         |  |                           |                                     |
|-------------------------|--|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/>   | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a Smaller reporting company) | Smaller reporting company | <input checked="" type="checkbox"/> |

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2012 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was \$35,696,590.

At March 28, 2013, there were 12,812,386 shares of the registrant's Common Stock issued, \$.001 par value.

---

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this Annual Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of shareholders, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report relates.

---

## Table of Contents

### INDEX

|  | <u>Page</u> |
|--|-------------|
| <b><u>PART I</u></b>   |             |
| Item 1. <a href="#">Business</a>   | 1           |
| Item 1A. <a href="#">Risk Factors</a>  | 14          |
| Item 1B. <a href="#">Unresolved Staff Comments</a>   | 23          |
| Item 2. <a href="#">Properties</a>   | 23          |
| Item 3. <a href="#">Legal Proceedings</a>  | 24          |
| Item 4. <a href="#">Mine Safety Disclosure</a>   | 24          |
| <b><u>PART II</u></b>  |             |
| Item 5. <a href="#">Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</a> | 25          |
| Item 6. <a href="#">Selected Consolidated Financial Data</a>   | 26          |
| Item 7. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>                        | 26          |
| Item 7A. <a href="#">Quantitative and Qualitative Disclosure About Market Risk</a>   | 36          |
| Item 8. <a href="#">Financial Statements and Supplementary Data</a>  | 37          |
| Item 9. <a href="#">Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</a>                         | 60          |
| Item 9A. <a href="#">Controls and Procedures</a>   | 60          |
| Item 9B. <a href="#">Other Information</a>   | 61          |
| <b><u>PART III</u></b>   |             |
| Item 10. <a href="#">Directors and Executive Officers and Corporate Governance</a>   | 61          |
| Item 11. <a href="#">Executive Compensation</a>  | 61          |
| Item 12. <a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</a>              | 61          |
| Item 13. <a href="#">Certain Relationships and Related Transactions and Director Independence</a>                                    | 61          |
| Item 14. <a href="#">Principal Accountant Fees and Services</a>  | 61          |
| <b><u>PART IV</u></b>  |             |
| Item 15. <a href="#">Exhibits, Financial Statement Schedules</a>   | 62          |
| <a href="#">Signatures</a>   | 72          |

*Unless otherwise indicated, all references to “PFSweb,” “the Company,” “we,” “us” and “our” refer to PFSweb, Inc., a Delaware corporation, and its subsidiaries; references to “PFS” refer to our wholly-owned subsidiaries, Priority Fulfillment Services, Inc., PFS Canada and PFS Europe; references to “Supplies Distributors” refer to our wholly-owned subsidiary Supplies Distributors, Inc. and its subsidiaries; and references to “Retail Connect” refers to our wholly-owned subsidiary PFSweb Retail Connect, Inc.*

## PART I

### Item 1. *Business*

#### General

PFSweb is an international business process outsourcing provider of end-to-end eCommerce solutions and other services. PFSweb provides these solutions and services to major brand names and other companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives. We derive our revenues by providing a broad range of services as we facilitate and process individual business transactions on our clients' behalf. Marketed as *PFSweb's End2End eCommerce*<sup>®</sup> solution and PFSweb Infinite Commerce, or iCommerce, the services we offer are organized into the following categories:

- Digital Marketing
- eCommerce Technology
- Order Management & Omni-Channel Solutions
- Customer Care
- Logistics and Fulfillment
- Financial Management
- Professional Consulting

Our solutions support both direct-to-consumer ("DTC") and business-to-business ("B2B") sales channels. The majority of our clients are the merchants of record for the orders we process through our infrastructure on their behalf. For these clients, we do not own the inventory or the resulting accounts receivable, but provide eCommerce solutions and other services for these client-owned assets.

For some of our clients, we are the merchant of record for the orders we process through our infrastructure. Under these arrangements, we either record product revenue or a net sale, own the accounts receivable and inventory and we may be compensated for all or a portion of our services through the resulting profit margin. In some cases, we purchase the inventory as the product is delivered to our facility. In other situations, the client retains ownership of inventory in our facility and we purchase the inventory immediately prior to each individual customer sales transaction. In all cases, we seek inventory financing from our clients in the form of extended terms, working capital programs or marketing funds to help offset the working capital requirements that follow accounts receivable and inventory ownership.

We are headquartered in Allen, Texas where our executive and administrative offices and our primary technology operations and hosting facilities are located. We operate state-of-the-art call centers from our U.S. facilities located in Dallas, Texas, and Memphis, Tennessee, and from our international facilities located in Richmond Hill, Ontario, Canada, Liège, Belgium and Manila, Philippines. We lease or manage warehouse facilities of approximately 1.4 million square feet, many containing highly automated and state of the art material handling and communications equipment, in Memphis, Tennessee, Southaven, Mississippi, Grapevine, Texas, Richmond Hill, Ontario, Canada and Liège, Belgium, allowing us to provide global distribution solutions.

#### Recent Events

In 2012, we relocated our corporate headquarters to Allen, Texas and our North Texas customer care center to downtown Dallas, Texas. We believe the relocation of both operations provides us with greater flexibility to support organic and new business growth, seasonal staffing fluctuations and provides an improved working environment for our employees

#### ***PFSWEB'S END2END ECOMMERCE<sup>®</sup> SOLUTIONS***

PFSweb serves as the "brand behind the brand"<sup>®</sup> for companies seeking to increase efficiencies, enter new markets or launch optimized sales channels. As an eCommerce and business process outsourcer, we offer scalable and cost-effective solutions for brand manufacturers, online retailers, and distributors across a wide range of industry segments. We provide our clients with seamless and transparent solutions to support their business strategies, allowing them to focus on their core competencies. Leveraging PFSweb's technology, expertise and

## [Table of Contents](#)

proven methodologies, we enable clients to develop and deploy new products and implement new business strategies or address new distribution channels rapidly and efficiently through our optimized solutions. Our clients engage us both as a consulting partner to assist them in the design of a business solution as well as a virtual and physical infrastructure partner to provide the mission critical operations required to build and manage their business solution. Together, we not only help our clients define new ways of doing business, but also provide them the technology, physical infrastructure and professional resources necessary to quickly implement their business model. We allow our clients to quickly and dramatically change how they “go-to-market.”

Each client has a unique business model and unique strategic objectives that often require highly customized solutions. PFSweb supports clients in a wide array of industries, including fashion apparel and accessories, fragrance and beauty products, consumer packaged goods, home furnishings and housewares, consumer electronics, office technology and network connectivity products and aviation spare parts. These clients turn to PFSweb for help in addressing a variety of business issues that include eCommerce, customer satisfaction and retention, time-definite logistics, vendor managed inventory and integration, supply chain compression, cost model realignments, transportation management and international expansion, among others. We also act as a constructive agent of change, providing clients the ability to alter their current distribution model, establish direct relationships with end-customers, and reduce the overall time and costs associated with existing distribution channel strategies. Our clients are seeking solutions that will provide them with dynamic supply chain and multi-channel marketing efficiencies, while ultimately delivering a world-class customer service experience.

Our value proposition is to become a seamless, well integrated extension of our clients’ enterprises by delivering superior solutions that drive optimal customer experiences. On behalf of the brands we serve, we strive to increase and enhance sales and market growth, bolster customer satisfaction and customer retention, and drive costs out of the business through operations and technology related efficiencies. As both a virtual and a physical infrastructure for our clients’ businesses, we embrace their brand values and strategic objectives. By utilizing our services, our clients are able to:

*Quickly Capitalize on Market Opportunities.* Our solutions empower clients to rapidly implement their supply chain and eCommerce strategies and take advantage of opportunities without lengthy integration and implementation efforts. We have readily available advanced technology and physical infrastructure that is flexible in its design, which facilitates quick integration and implementation. The PFSweb solution is designed to allow our clients to deliver consistent quality service as transaction volumes grow and also to handle daily and seasonal peak periods. Through our international locations, our clients can sell their products throughout the world.

*Improve the Customer Experience.* We enable our clients to provide their customers with a high-touch, positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with online ordering and product information. We believe we offer our clients a “world-class” level of service, including 24-hour, seven-days-a-week, Web-enabled customer care service centers, detailed Customer Relationship Management (“CRM”) reporting and exceptional order accuracy. We have significant experience in the development of eCommerce storefronts that allows us to recommend features and functions easily navigated and understood by our clients’ customers. Our technology platform is designed to ensure high levels of reliability and fast response times for our clients’ customers. Because of our technology, our clients benefit from being able to offer the latest in customer communication and response conveniences to their customers.

*Minimize Investment and Improve Operating Efficiencies.* One of the most significant benefits outsourcing provides is the ability to transform fixed costs into variable costs. By eliminating the need to invest in a fixed capital infrastructure, our clients’ costs typically become more directly correlated with volume increases or declines. Further, as volume increases drive the demand for greater infrastructure or capacity, we are able to quickly deploy additional resources. We provide services to multiple clients, which enables us to offer our clients economies of scale, and resulting cost efficiency, that they may not have been able to obtain on their own. Additionally, because of the large number of daily transactions we process, we have been able to justify investments in levels of automation, security surveillance, quality control processes and transportation carrier interfaces that are typically outside the scale of investment that our clients might be able to cost justify on their own. These additional capabilities can provide our clients the benefits of enhanced operating performance and efficiency, reduced inventory shrinkage, and expanded customer service options.

## [Table of Contents](#)

*Access a Sophisticated Technology Infrastructure.* We provide our clients with ready access to a sophisticated technology infrastructure that is designed to interface seamlessly with their systems. We provide our clients with vital product and customer information that can be immediately available to them on their own systems or through web based graphic user interfaces for use in data mining, analyzing sales and marketing trends, monitoring inventory levels and performing other management functions.

We believe our highest value proposition is achieved when our clients engage our full suite of services from all of the categories included in *PFSweb's End2End eCommerce®* solutions. However, we provide our clients with the opportunity to customize their solution by selecting only certain services from our offering in à la carte fashion if they prefer. We believe this flexibility and willingness to create a customized solution for each client differentiates us from our competition.

### **Digital Marketing Services**

Our team has extensive experience partnering with our clients to help grow their business. We have expertise in developing strategies to attract new customers, converting website visitors into actual buyers, and nurturing the relationships with current customers to increase their lifetime value. We achieve this through the following services:

*Search Engine Optimization (SEO).* We combine knowledge of SEO best practices with a detailed knowledge of the technology platform to maximize the programs' performance. Our subject matter experts achieve measurable results by using best-of-breed on-site page optimization tactics, internal-linking strategies, back-linking strategies, and back-link building. We provide both the strategies and the implementation to achieve top rankings in the search engines, increase visibility of the brand and drive sales results.

*Pay-Per-Click.* We go beyond buying keywords. In addition to bid management, we provide effective copywriting as well as landing page recommendations, optimization, and creation to increase conversion. Our strategic search engine marketing approach is designed to drive incremental traffic, increase conversion, and lower ad spend.

*Affiliate Marketing.* We seek the best affiliate partners that fit the brands, implement the program, and manage the ongoing relationships. We develop strategies for the programs and nurture the affiliate partnerships to ensure relevant traffic is driven to the website to convert into sales.

*Comparison Shopping Engines.* We have experience creating and managing comparison shopping feeds that will increase brand visibility in a competitive landscape while driving sales. We use the comparison shopping engine channel to enhance the search engine marketing initiatives and power mobile applications.

*Conversion Optimization.* We combine industry expertise with best-in-breed technology to increase conversion and increase average order size. Our team of experts offers services in on-site merchandising, recommendations, personalization, on-site search, and promotion management and support.

*Web Analytics.* All of our interactive marketing services are data driven; we look at how the various channels are performing and determine where investments need to be made. We turn data into knowledge and offer insight into the customers' behavior and create strategies to provide actionable results.

*Customer Experience.* We determine how to optimize the website to engage the customers with the brand, drive sales conversion, and offer an ideal customer shopping experience. Our team makes it their focus to understand the customer's needs and offer site usability assessments that will improve the customer experience, enhance the brand and support revenue goals.

*Email Marketing.* We provide a world class email platform to create and send dynamic 1-to-1 emails designed to achieve exceptional business results. We provide email delivery services to ensure email is reaching the inbox and have established methodologies to test content, design, and subject lines, as well as drive email strategy to engage customers and increase revenue.

*Social Media.* We engineer social media strategies across multiple platforms to encourage interaction and build relationships, and raise overall brand awareness. Our strategists leverage innovative technologies to engage the customers through relevant content and connect the customer with the brand.

## [Table of Contents](#)

*Creative Services.* With a unique understanding of usability and user experience we can convey our clients' creative needs from concept to execution. Our creative solutions are in tune with our client's brand and effectively translate the clients' voice in the digital market while engaging customers at every digital touchpoint.

### **eCommerce Technology Services**

*Direct-to-Consumer eCommerce ("DTC").* PFSweb's End2End eCommerce® solution for the DTC online channel features Demandware eCommerce, a leading third party Software-as-a-Service ("SaaS") eCommerce platform. We have fully integrated Demandware with the rest of our world-class technology platform including other best-of-breed technology partners to create a PFSweb reference application that provides our clients with a very high-function DTC online store out-of-the-box. We are able to use the PFSweb reference application as a starting point to quickly create a completely customized online store for our DTC clients. Designed specifically for DTC brands, our comprehensive offering redefines end-to-end eCommerce by enabling retailers and branded consumer goods manufacturers with the ability to employ a total outsourcing solution customized to their particular eCommerce strategy, without the loss of site or brand control associated with earlier end-to-end outsourcing solutions.

*Business-to-Business eCommerce ("B2B").* PFSweb's End2End eCommerce® solution for the B2B online channel features our GlobalMerchant Commerceware® service that provides a complete eCommerce website solution for our B2B clients. We engage collaboratively with our clients to design, build, host, and manage fully branded, fully customized and fully integrated eCommerce web applications for B2B channels. We offer a broad range of hosting and support plans that can be tailored to fit the needs of each client. Utilizing Microsoft's .NET Technologies and our proprietary GlobalMerchant Commerceware® platform, we maintain a robust hosting environment for our hosted client B2B web sites.

### **Order Management Services**

*Order Management Interfaces.* Our order management technology solutions provide interfaces that allow for real-time information retrieval, including information on inventory, sales orders, shipments, delivery, purchase orders, warehouse receipts, customer history, accounts receivable and credit lines. These solutions are seamlessly integrated with our web-enabled customer contact centers, allowing for the processing of orders through shopping cart, phone, fax, mail, email, web chat, and other order receipt methods. As the information backbone for our total supply chain solution, order management services can be used on a stand-alone basis or in conjunction with our other business infrastructure offerings, including customer contact, financial or distribution services. In addition, for the B2B market, our technology platform provides a variety of order receipt methods that facilitate commerce within various stages of the supply chain. Our systems provide the ability for both our clients and their customers to track the status of orders at any time. Our services are transparent to our clients' customers and are seamlessly integrated with our clients' internal system platforms and web sites. By synchronizing these activities, we can capture and provide critical customer information, including:

- Statistical measurements critical to creating a quality customer experience, containing real-time order status, order exceptions, back order tracking, allocation of product based on timing of online purchase and business rules, the ratio of customer inquiries to purchases, average order sizes and order response time;
- B2B supply chain management information critical to evaluating inventory positioning, for the purpose of improving inventory turns, and assessing product flow-through and end-user demand;
- Reverse logistics information, including customer response and reason for the return or rotation of product and desired customer action;
- Detailed marketing information about what was sold and to whom it was sold, by location and preference; and
- Web traffic reporting showing the number of visits ("hits") received, areas visited, and products and information requested.

## [Table of Contents](#)

*Technology Collaboration.* We have created a suite of technology services that enable buyers and suppliers to fully automate their business transactions within their supply chain using the order management interfaces. Our collaboration technologies operate in an open systems environment and feature the use of industry-standard XML and SOA web services, enabling customized eCommerce solutions with minimal changes to a client's systems or our Enterprise Resource Planning ("ERP") systems. The result is a faster implementation process. We also support information exchange methods such as FTP, EDI, MQ Series, ALE, HTTP, and HTTPS.

*Information Management.* We have the ability to communicate with and transfer information to and from our clients through a wide variety of technology services, including real-time web service enabled data interfaces, file transfer methods and electronic data interchange. Our systems are designed to capture, store and electronically forward to our clients critical information regarding customer inquiries and orders, product shipments, inventory status (for example, levels of inventory on hand, on backorder, on purchase order and inventory due dates to our warehouse), product returns and other information. Our systems are capable of providing our clients with customer inventory and order information for use in analyzing sales and marketing trends and introducing new products. We also offer customized reports and data analyses based upon specific client needs to assist them in their budgeting and business decision process.

### **Customer Care Services**

*Customer Relationship Management.* We offer a completely customized web enabled CRM solution for clients. Our CRM solution encompasses a full-scale customer contact management service offering, as well as a fully integrated customer analysis program. All customer contacts are captured and customer purchases are documented. Full-scale reporting on all customer transactions is available for evaluation purposes. Through each of our customer touch-points, information can be analyzed and processed for current or future use in business evaluation, product effectiveness and positioning, and supply chain planning.

*Customer Order Assistance.* An important feature of evolving commerce is the ability for the customer to speak with a live customer service representative. Our experience has been that many consumers tell us they visited the web location for information, but not all of those consumers chose to place their order online. Our customer care services utilize features that integrate voice, e-mail, standard mail, fax, data and Internet chat communications to respond to and handle customer inquiries. Our customer care representatives answer various questions, acting as virtual representatives of our clients' organization, regarding order status, shipping, billing, returns and product information and availability as well as a variety of other questions. Our web-enabled customer care technology identifies each customer contact automatically and routes it to the appropriate customer care representative who is individually trained in the clients' business and products.

Our web-enabled customer care centers are flexibly designed so that our customer care representatives can handle either several different clients and products in a shared agent environment, thereby creating economy of scale benefits for our clients, or through a highly customized dedicated agent support model that provides the ultimate customer experience and brand reinforcement. Our advanced technology also enables our representatives to up-sell, cross-sell and inform customers of other products and sales opportunities. The web-enabled customer care center is fully integrated into the data management and order processing system, allowing full visibility into customer history and customer trends. Through this fully integrated system, we are able to provide a complete customer care solution.

*Quality Monitoring.* Quality is essential in our client solutions. As representatives of our clients, our customer care representatives must adhere to the unique quality standards of each client. We continually monitor the quality of our customer care representatives against each client quality standard and use the results to provide agent-level feedback to continually improve the customer care experience. Clients may participate in the quality process by remotely listening to calls, assisting in the grading of recorded calls, and providing ongoing direction to improve quality standards.

*Customer Self-Help.* With the need for efficiency and cost optimization for many of our clients, we have integrated interactive voice response ("IVR") as another option for customer contacts. IVR creates an "electronic workforce" with virtual agents that can assist customers with vital information at any time of the day or night. IVR



## [Table of Contents](#)

allows for our clients' customers to deal interactively with our system to handle basic customer inquiries, such as account balance, order status, shipment status, catalog requests, product and price inquiries, and routine order entry for established customers. The inclusion of IVR in our service offering allows us to offer a cost effective way to handle high volume, low complexity calls.

### **Logistics and Fulfillment Services**

*Advanced Distribution Facilities and Infrastructure.* An integral part of our solution is the warehousing and distribution of inventory either owned by our clients or owned by us. We currently have approximately 1.4 million square feet of leased or managed warehouse space domestically and internationally to store and process our own and our clients' inventory. We receive inventory in our distribution centers, verify shipment accuracy, unpack and audit packages (a process that includes spot-checking a percentage of the inventory to validate piece counts and check for damages that may have occurred during shipping, loading and unloading). Upon request, we inspect for other damages or defects, which may include checking fabric, stitching and zippers for soft goods, or 'testing' power-up capabilities for electronic items as well as product specifications. We generally stock for sale within one business day of unloading. We pick, pack and ship customer orders and can provide customized packaging, customized monogramming, capabilities of high volume shrink packaging, inserts and promotional literature for distribution with customer orders. For many clients, we provide gift-wrapping services including line level gifting, customized gift-wrapping paper, ribbon, gift-box and gift-messaging.

Our distribution facilities contain computerized sortation equipment, highly mobile pick-to-light carts, powered material handling equipment, scanning and bar-coding systems and automated conveyors and in-line scales. Our distribution complexes include several advanced technology enhancements, such as radio frequency technology in product receiving processing to ensure accuracy, as well as an automated package routing and a pick-to-light paperless order fulfillment system. Our advanced distribution systems provide us with the capability to warehouse an extensive number of stock keeping units (SKUs), ranging from large high-end laser printers to small cosmetic compacts. Our facilities are flexibly configured to process B2B and single pick DTC orders from the same central location.

In addition to our advanced distribution systems, our pick-to-light carts, stationary pick-to-light areas and conveyor system controls provide real time productivity reporting, thereby providing our management team with the tools to implement productivity standards. This combination of computer-controlled equipment provides the seamless integration of our pick-to-light systems and mass sortation capabilities. This unique combination of technologies ensures high order accuracy for each and every customer order.

We are able to take advantage of a variety of shipping and delivery options, which range from next day service to zone skipping to optimize transportation costs. Our facilities and systems are equipped with multi-carrier functionality, allowing us to integrate with all leading package carriers and provide a comprehensive freight and transportation management offering. We offer reverse logistics management services, including issuing return authorizations, return carrier shipping labels, receipt of product, crediting customer accounts and disposition of returned product.

Our domestic facilities provide security trained law enforcement professionals from our security headquarters in Memphis, Tennessee and Southaven, Mississippi. Continual validation ensures that we employ the latest in security processes and procedures to further enhance our surveillance and detection capabilities.

*Facility Operations and Management.* Our facilities management service offering includes distribution facility design and optimization, business process reengineering and ongoing staffing and management. Along with our operations in Mississippi and Tennessee, we also manage an aircraft parts distribution center in Grapevine, Texas on behalf of one of our clients. Our expertise in supply chain management, logistics and customer-centric fulfillment operations extends through our management of client-owned facilities, resulting in cost reductions, process improvements and technology-driven efficiencies.

*Kitting and Assembly Services.* Our expanded kitting and assembly services enable our clients to reduce the time and costs associated with managing multiple suppliers, warehousing hubs, and light manufacturing partners. As a single source provider, we provide the advantage of convenience, accountability and speed. Our kitting and assembly services include light assembly, specialized kitting and supplier-consigned inventory hub either in our distribution facilities or co-located elsewhere. We also offer customized light manufacturing and supplier relationship management ("SRM").



## [Table of Contents](#)

We will work with clients to re-sequence certain supply chain activities to aid in an inventory postponement strategy. We can provide kitting and assembly services and build-to-stock thousands of units daily to stock in a Just-in-Time (“JIT”) environment. This service, for example, can entail the procurement of packaging materials including retail boxes, foam inserts and anti-static bags. These raw material components may be shipped to us from domestic or overseas manufacturers, and we will build the finished SKUs to stock for the client. Also included is the custom configuration of high-end printers and servers. This strategy allows manufacturers to make a smaller investment in base unit inventory while meeting changing customer demand for highly customizable products.

Our standard capabilities include: build-to-order, build-to-stock, expedited orders, passive and active electrostatic discharge (“ESD”) controls, product labeling, serial number generation, marking and/or capture, lot number generation, asset tagging, bill of materials (“BOM”) or computer automated design (“CAD”) engineering change processing, SKU-level pricing and billing, manufacturing and metrics reporting, first article approval processes, and comprehensive quality controls.

Kitting and inventory hub services enable clients to collapse supply chains into the minimal steps necessary to prepare product for distribution to any channel, including wholesale, mass merchant retail, or direct to consumer. Clients no longer have to employ multiple providers or require suppliers to consign multiple inventory caches for each channel. We offer our clients the opportunity to consolidate operations from a channel standpoint, as well as from a geographic perspective. Our integrated, global information systems and international locations support business needs worldwide.

*Product Management and Inspection Services.* We also operate a coupon management system and product management program. Coupons are managed and activated by a unique serial number, thus significantly reducing fraudulent activity. Our capabilities also extend into salvage operations, allowing our clients to reclaim valuable raw materials and components from discontinued or obsolete inventory.

We operate a test and repair center where we visually inspect items for cosmetic defects. These items are put through rigorous testing that includes: functionality, durability, accessory inspection and packaging. Items that pass the testing are repackaged and resold with a noted exception of “open-box” merchandise. Items that fail the inspection are disassembled and working spare parts are saved for future use in repairs.

*High Compliance Distribution Related to Food and Cosmetic Products.* We also operate an American Institute of Bakers and the Food and Drug Administration compliant facility, which adheres to the Consolidated Standards for Inspection along with regulatory developments required by the F.D.A. Food Safety Modernization Act and other industry best practices. Adherence to these standards resulted in the facility scoring a “Superior” rating from the AIB audit and inspection in 2012.

### **Financial Management Services**

Our financial services are divided into two major areas: 1) billing, credit, collection and cash application services for B2B clients and 2) fraud review, chargeback management and processing and settlement credit card services for DTC clients.

*Business-to-Business Financial Management.* For B2B clients, we offer full-service accounts receivable management and collection capabilities, including the ability to generate customized computer-generated invoices in our clients’ names. We assist clients in reducing accounts receivable and days sales outstanding, while minimizing costs associated with maintaining an in-house collections staff. We offer electronic credit services in the format of EDI and XML communications direct from our clients to their vendors, suppliers and retailers.

*Direct-to-Consumer Financial Management.* For DTC clients, we offer secure credit card processing related services for orders made via a client web site or through our customer contact center. We offer manual credit card order review as an additional level of fraud protection. We also calculate sales taxes, goods and services taxes or

## [Table of Contents](#)

value added taxes, if applicable, for numerous taxing authorities and on a variety of products. Using third-party leading-edge fraud protection services and risk management systems, we can offer high levels of security and reduce the level of risk for client transactions.

### **Professional Consulting Services**

As part of the tailored solution for our clients, we offer a full team of experts specifically designated to focus on our clients' businesses. Team members play a consultative role, providing constructive evaluation, analysis and recommendations for the client's business. This team creates customized solutions and devises plans that will increase efficiencies and produce benefits for the client when implemented.

Comprised of industry experts from top-tier consulting firms and industry market leaders, our team of professional consultants provides client service focus and eCommerce, customer care, logistics and distribution expertise. They have built solutions for Fortune 1000 and Global 2000 market leaders in a wide range of industries, including multi-channel retailers, apparel, technology, telecommunications, cosmetics, aviation, housewares, high-value collectibles, sporting goods, pharmaceuticals and several more. Focusing on the evolving infrastructure needs of major corporations and their business initiatives, our team has a solid track record providing consulting services in the areas of interactive marketing eCommerce, supply chain management, distribution and fulfillment, technology interfacing, logistics and customer support.

### **SELLER SERVICES FINANCIAL MODELS**

#### **Enablement Financial Model**

We refer to the standard PFS seller services financial model as the "Enablement" model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various business outsourcing services in support of their business operations. We provide eCommerce website services, inventory and order management, customer service, payment processing, and operations reports such as product sales, sales tax, and inventory management reports. In this model, we provide infrastructure and services and the clients are responsible for all financial operations and reporting related to the sales transactions.

The Enablement model is designed to generate margins for our clients consistent with other retailers in our clients' product category and provide bottom line financial results for our clients similar to other retailers in their space. Service fee revenues in this model are reported in our traditional PFSweb service fee segment.

#### **Agent (Flash) Financial Model**

As an additional service, we offer an "Agent" model, or "Flash" model, in which our clients maintain ownership of the product inventory stored at our locations. When a customer orders the product from our clients, a "flash" sale transaction passes product ownership to us for each order and we in turn immediately re-sell the product to the customer. The "flash" ownership exchange establishes us as the merchant of record, which enables us to use our existing merchant infrastructure to process sales to end customers, removing the need for clients to establish these business processes internally, but permitting them to control the sales process to end customers. In this model, based on the terms of our current client arrangements, we record product revenue net of cost of product revenue.

#### **Retail Financial Model**

In addition to the Enablement and the Agent models, we also offer a "Retail" model. Under the Retail model, a PFSweb subsidiary purchases inventory from the client just as any other client reseller partner. In the Retail model, we place the initial and replenishment purchase orders with the client and take ownership of the product upon delivery to our facility.

Because we are the product owner as well as the merchant of record, we work closely with the client to plan sales and promotional activities. Under the Retail model, depending upon the product category and sales characteristics, we may require the client to provide product price protection as well as product purchase payment terms, right of return, and obsolescence protection appropriate to the product sales profile. Since we purchase and

## [Table of Contents](#)

own the inventory and accounts receivable, this business model generally requires significant working capital requirements for which we have credit available either through credit terms provided by our clients or under senior credit facilities.

The costs of all standard PFSweb services normally billed on a transaction basis under the Enablement model, as well as certain credit risks, may be covered by the selling margin under the Retail model arrangement. The bottom line financial results for our client should be similar to the financial benefits from the retail channel, although unlike the traditional retail channel, our clients generally control the presentation and branding of the web site and own all the customer data from the eCommerce activities.

We currently provide the Retail model for a portion of our Procter & Gamble engagement for DTC sales through the P&G eStore. In addition, we use our Retail model to enable our Supplies Distributors subsidiary to serve as a global distributor of printer supplies for Ricoh Infoprint Solutions Company (“IPS”), a wholly-owned subsidiary of Ricoh Company Ltd. (hereafter referred to collectively as “RicoH”). In this model, the product revenues are reported in our Business and Retail Connect segment.

## **INDUSTRY INFORMATION AND COMPETITIVE LANDSCAPE**

### **Industry Overview**

Business activities in the public and private sectors continue to operate in an environment of rapid technological advancement, increasing competition and continuous pressure to improve operating and supply chain efficiency while decreasing costs. We currently see the following trends within the industry:

- Manufacturers strive to restructure their supply chains to maximize efficiency and reduce costs in both B2B and DTC markets, and to create a variable-cost supply chain able to support the multiple, unique needs of each of their initiatives, including traditional and electronic commerce.
- Companies in a variety of industries seek outsourcing as a method to address one or more business functions that are not within their core business competencies, to reduce operating costs or to improve the speed or cost of implementation.

### **Supply Chain Management Trend**

As companies maintain focus on improving their businesses and balance sheet financial ratios, significant efforts and investments continue to be made identifying ways to maximize supply chain efficiency and extend supply chain processes. Working capital financing, vendor managed inventory, supply chain visibility software solutions, distribution channel skipping, direct to consumer eCommerce sales initiatives, and complex upstream supply chain collaborative technology are products that manufacturers seek to help them achieve greater supply chain efficiency.

A key business challenge facing many manufacturers and retailers as they evaluate their supply chain efficiency is in determining how the trend toward increased direct-to-customer business activity will impact their traditional B2B and DTC commerce business models. Order management and small package fulfillment and distribution capabilities are becoming increasingly important processes as this trend evolves. We believe manufacturers will look to outsource their non-core competency functions to support this modified business model. We believe companies will continue to strategically plan for the impact that eCommerce and other new technology advancements will have on their traditional commerce business models and their existing technology and infrastructure capabilities.

Manufacturers, as buyers of materials, are also imposing new business practices and policies on their supplier partners to shift the normal supply chain costs and risks associated with inventory ownership away from their own balance sheets. Through techniques like Vendor Managed Inventory or Consigned Inventory Programs (“CIP”), manufacturers are asking their suppliers, as a part of the supplier selection process, to provide capabilities where the manufacturer need not own, or even possess, inventory prior to the exact moment that unit of inventory is required as a raw material component or for shipping to a customer. To be successful for all parties, business models such as these often require a sophisticated collection of technological capabilities that allow for complete integration and collaboration of the information technology environments of both the buyer and supplier. For example, for an

## [Table of Contents](#)

inventory unit to arrive at the precise required moment in the manufacturing facility, it is necessary for the Manufacturing Resource Planning systems of the manufacturer to integrate with the CRM systems of the supplier. When hundreds of supplier partners are involved, this process can become quite complex and technologically challenging. Buyers and suppliers are seeking solutions that utilize XML based protocols and traditional EDI standards to ensure an open systems platform that promote easier technology integration in these collaborative solutions.

### **Outsourcing Trend**

In response to growing competitive pressures and technological innovations, we believe many companies, both large and small, are focusing their critical resources on the core competencies of their business and utilizing eCommerce and business process outsourcing to accelerate their business plans in a cost-effective manner and perform non-core business functions. Outsourcing can provide many key benefits, including the ability to:

- Enter new business markets or geographic areas rapidly;
- Increase flexibility to meet changing business conditions and demand for products and services;
- Enhance customer satisfaction and gain competitive advantage;
- Reduce capital and personnel investments and convert fixed investments to variable costs;
- Improve operating performance and efficiency; and
- Capitalize on skills, expertise and technology infrastructure that would otherwise be unavailable or expensive given the scale of the business.

Typically, many outsourcing service providers are focused on a single function, such as information technology, call center management, credit card processing, warehousing or package delivery. This focus creates several challenges for companies looking to outsource more than one of these functions, including the need to manage multiple outsourcing service providers, to share information with service providers and to integrate that information into their internal systems. Additionally, the delivery of these multiple services must be transparent to the customer and enable the client to maintain brand recognition and customer loyalty. Furthermore, traditional commerce outsourcers are frequently providers of domestic-only services versus international solutions. As a result, companies requiring global solutions must establish additional relationships with other outsourcing parties.

Another vital point for major brand name companies seeking to outsource is the protection of their brand. When looking for an outsourcing partner to provide infrastructure solutions, brand name companies must find a company that can ensure the same quality performance and superior experience their customers expect from their brands. Working with an outsourcing partner requires finding a partner that can maintain the consistency of their brand image, which is one of the most valuable intangible assets that recognized brand name companies possess.

### **Competition**

We face competition from many different sources depending upon the type and range of services requested by a potential client. Many other companies offer one or more of the same services we provide on an individual basis. Our competitors include vertical outsourcers, which are companies that offer a single function solution, such as call centers, public warehouses or credit card processors. We occasionally compete with transportation logistics providers, known in the industry as 3PL's and 4PL's (third or fourth party logistics providers), who offer product management functions as an ancillary service to their primary transportation services. We also compete against other eCommerce and business process outsourcing providers, who perform various services similar to our solution offerings.

In many instances, we compete with the in-house operations of our potential clients themselves. Occasionally, the operations departments of potential clients believe they can perform the same services we do, at similar quality levels and costs, while others are reluctant to outsource business functions that involve direct customer contact. We cannot be certain we will be able to compete successfully against these or other competitors in the future.

Although many of our competitors offer one or more of our services, we believe our primary competitive advantage is our ability to offer a full array of customized services marketed as *PFSweb's End2End eCommerce®* solutions, thereby eliminating any need for our clients to coordinate these services from many different providers. We believe we can differentiate ourselves by offering our clients a very broad range of eCommerce and business process services that address, in many cases, the entire value chain, from demand to delivery.

## [Table of Contents](#)

We also compete on the basis of many other important additional factors, including:

- operating performance and reliability;
- ease of implementation and integration;
- experience of the people required to successfully and efficiently design and implement solutions;
- experience operating similar solutions dynamically;
- leading edge technology capabilities;
- global reach; and
- price.

We believe we can compete favorably with respect to many of these factors. However, the market for our services is competitive and continually evolving, and we may not be able to compete successfully against current and future competitors.

## **COMPANY INFORMATION**

### **Clients and Marketing**

Our target clients include online retailers as well as leading technology and consumer goods brands looking to quickly and efficiently implement or enhance business initiatives, adapt their go-to-market strategies, or introduce new products, programs or geographies, without the burden of modifying or expanding their technology, customer care, supply chain and logistics infrastructure. Our solutions are applicable to a multitude of industries and company types and we have provided solutions for such companies as:

IPS (printer supplies in several geographic areas), Xerox (printers and printer supplies), Roots Canada Ltd. (apparel), Hawker Beechcraft Corp. (facilities management and time-definite logistics supporting parts distribution), Riverbed Technologies (technology products), LEGO Brand Retail (toys), Procter & Gamble (consumer packaged goods), AAFES (military exchange service), L'Oréal (health & beauty), Sorel (active outdoor apparel) among many others.

We target potential clients through an extensive integrated marketing program comprised of a variety of direct marketing techniques, email marketing initiatives, trade event participation, search engine marketing, public relations, social media and a sophisticated outbound tele-sales lead generation model. We have also developed an intricate messaging matrix that defines our various eCommerce and business process outsourcing solutions and products, the vehicles we utilize to deliver marketing communication on these solutions/products and the target audience segments that display a demand for these solutions/products. This messaging matrix allows us to deploy highly targeted solution messages to selected key vertical industry segments where we feel we are able to provide significant service differentiation and value. We also pursue strategic marketing alliances with consulting firms, software manufacturers and other logistics providers to increase market awareness and generate referrals and customer leads.

Because of the highly complex nature of the solutions we provide, our clients demand significant competence and experience from a variety of different business disciplines during the sales cycle. As such, we utilize a selected member of our senior executive team to lead the design and proposal development of each potential new client we choose to pursue. The senior executive is supported by a select group of highly experienced individuals from our professional services group with specific industry knowledge of, or experience with, the solutions development process. We employ a team of highly trained implementation managers whose responsibilities include the oversight and supervision of client projects and maintaining high levels of client satisfaction during the transition process between the various stages of the sales cycle and steady state operations.

### **Technology**

We maintain advanced management information systems and have automated key business functions using online, real-time or batch systems. These systems enable us to provide information concerning sales, inventory

## [Table of Contents](#)

status, customer payments and other operations essential for us and our clients to efficiently manage electronic commerce and supply chain business programs. Our systems are designed to scale rapidly to handle the transaction processing demands of our clients and our growth.

We employ technology from a select group of vendors. For example, we deploy IBM e-servers and network printers in appropriate models to run web site functions as well as order management and distribution functions. Our network backbone is powered by Cisco, who provides network connectivity and network security solutions for our worldwide locations. We utilize Avaya Communication for telephone switch and call center management functions, and to interact with customers via voice, e-mail or chat. Avaya Communication technology also allows us to share web pages between customers and our service representatives. We have the ability to transmit and receive voice, data and video simultaneously on a single network connection to a customer to more effectively serve that customer for our client. Clients' interest in using this technology stems from its ability to allow shoppers to consult with known experts in a way the customer chooses prior to purchasing. Our sophisticated computer-telephony integration has been accomplished by combining systems software from IBM and Avaya Communication together with our own application development. We use Verizon Business for our private enterprise network and AT&T as our long distance carrier. We use Oracle's J.D. Edwards as the software provider for the primary ERP applications used in our operational areas and financial areas. We use Dematic/Rapistan Materials Handling Automation for our automated order selection, automated conveyor and "pick-to-light" (inventory retrieval) systems, and Symbol Technologies/Telxon for our warehouse radio frequency applications. Our Warehouse Management System ("WMS") and Distribution Requirements Planning ("DRP") system have been developed in-house to meet the varied unique requirements of our vertical markets. Both the WMS and DRP are tightly integrated to both the North American and European deployments of our J.D. Edwards' system.

Many internal infrastructures are not sufficient to support the explosive growth in e-business, e-marketplaces, supply chain compression, distribution channel realignment and the corresponding demand for real-time information necessary for strategic decision-making and product fulfillment. To address this need, we have created *PFSweb's End2End eCommerce*<sup>®</sup> platform to enable companies with little or no eCommerce infrastructure to speed their time to market and minimize resource investment and risk, and to allow all companies involved to improve the efficiency of their supply chain.

Using the various components of our collaboration technology suite, we can assist our clients in easily integrating their web sites or ERP systems to our systems for real-time web service enabled transaction processing without regard for their hardware platform or operating system. This high-level of systems integration allows our clients to automatically process orders, customer data and other eCommerce information. We also can track information sent to us by the client as it moves through our systems in the same manner a carrier would track a package throughout the delivery process. Our systems enable us to track, at a detailed level, information received, transmission timing, any errors or special processing required and information sent back to the client.

We provide technology interfaces to our back-office applications including our customized Oracle J.D. Edwards order management and fulfillment application. We utilize Gentran Integration Suite<sup>™</sup> ("GIS") as our technology platform for Enterprise Application Integration with our clients and clients' trading partners. With GIS, we have greatly increased our ability to quickly design and deploy customized B2B and DTC eCommerce solutions for our clients by utilizing a robust business process modeling tool and a highly scalable operating infrastructure. This platform facilitates the efficient and secure exchange of electronic business transactions/documents in a wide variety of formats (i.e. XML, X.12 EDI, delimited text, IDOCS) and communication protocols (i.e. FTP/SFTP, AS2/HTTP/HTTPS, AS1 SMTP, MQ Series and SOA Web Services).

We have invested in advanced telecommunications, computer telephony, electronic mail and messaging, automated fax technology, IVR technology, barcode scanning, wireless technology, fiber optic network communications and automated inventory management systems. We have also developed and utilize telecommunications technology that provides for automatic customer call recognition and customer profile recall for inbound customer service representatives.

The primary responsibility of our systems development team of IT professionals is directed at implementing custom solutions for new clients and maintaining existing client relationships. Our development team can also produce proprietary systems infrastructure to expand our capabilities in circumstances where we cannot purchase standard solutions from commercial providers. We also utilize temporary and/or contract resources when needed for additional capacity.

## [Table of Contents](#)

Our information technology operations and infrastructure are built on the premise of reliability and scalability. We maintain diesel generators and uninterruptible power supply equipment to provide constant availability to computer rooms, call centers and warehouses. Multiple internet service providers and redundant web servers provide for a high degree of availability to web sites that interface with our systems. Capacity planning and upgrading is performed regularly to allow for quick implementation of new clients and avoid time-consuming infrastructure upgrades that could slow growth rates. In the event of a disastrous situation, we also have a disaster recovery plan that provides geographically separated and comparably equipped data centers that are able to recover stored data in a reasonable and effective manner.

### **Strategy**

We continue to maintain our simple but effective strategy statement to drive our actions, QGP. This acronym stands for Quality, Growth and Profit. We believe if we can achieve outstanding performance on these three basic elements, they will provide for a stable foundation for our future. As the evolution of our business model continues, we will remain focused on these three fundamentals:

*Quality:* To exceed our client's service level requirements and enhance the value of their brand while providing their customers a positive, memorable and efficient experience.

*Growth:* To increase our revenue and gross profit from its current levels. To aggressively market simplified product messages to drive new clients and revenue and profit growth. To become a larger company and create career and additional employment opportunities. To embrace strategic partnering to accentuate strengths and minimize weaknesses.

*Profit:* To generate positive cash flow and continue to strive for consistent profitable results. To increase the value of our company for all of its stakeholders while rewarding our team members with challenging, fun and memorable life experiences.

The successful balance of the execution of these fundamental strategies is targeted to result in the formation of a solid strategic and financial foundation and provide us a sustainable and profitable business model for the future.

See "Risk Factors" for a complete discussion of risk factors related to our ability to achieve our objectives and fulfill our business strategies.

### **Employees**

As of December 31, 2012, we had approximately 1,550 employees, of which approximately 1,260 were located in the United States. We have never suffered an interruption of business as a result of a labor dispute. We consider our relationship with our employees to be good. In the U.S., Canada and Philippines, we are not a party to any collective bargaining agreements and while our European subsidiaries are not a party to a collective-bargaining agreement, they are required to comply with certain rules mentioned in collective bargaining agreements, agreed upon by representatives of their industry (logistics) and unions.

Our success in recruiting, hiring and training large numbers of skilled employees and obtaining large numbers of hourly employees and temporary staff during peak periods for distribution and call center operations is critical to our ability to provide high quality distribution and support services. Call center representatives and distribution personnel receive feedback on their performance on a regular basis and, as appropriate, are recognized for superior performance or given additional training. Generally, our clients provide specific product training for our customer service representatives and, in certain instances, on-site client personnel to provide specific technical support. To maintain good employee relations and to minimize employee turnover, we strive to offer competitive pay, hire primarily full-time employees who are eligible to receive a full range of employee benefits, and provide employees with clear, visible career paths.



## [Table of Contents](#)

### **Internet Access to Reports**

We maintain an Internet website, [www.pfsweb.com](http://www.pfsweb.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K (and amendments, if any, to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934) are made available, free of charge, through the investor relations section of this website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. The information on this website is not incorporated in this report.

### **Government Regulation**

We are subject to federal, state, local and foreign consumer protection laws, including laws protecting the privacy of our customers' personally identifiable information and other non-public information and regulations prohibiting unfair and deceptive trade practices. Furthermore, the growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens and greater penalties on online companies. Moreover, there is a trend toward regulations requiring companies to provide consumers with greater information regarding, and greater control over, how their personal data is used, and requiring notification when unauthorized access to such data occurs. For example, many states currently require us to notify each of our customers who are affected by any data security breach in which an unauthorized person, such as a computer hacker, obtains such customer's name and one or more of the customer's social security number, driver's license number, credit or debit card number or other similar personal information. In addition, several jurisdictions, including foreign countries, have adopted privacy-related laws that restrict or prohibit unsolicited email promotions, commonly known as "spam," and that impose significant monetary and other penalties for violations. One such law, the CAN-SPAM Act of 2003 imposes complex, burdensome and often ambiguous requirements in connection with our sending commercial email to our customers and potential customers. Moreover, in an effort to comply with these laws, Internet service providers may increasingly block legitimate marketing emails. These consumer protection laws may become more stringent in the future and could result in substantial compliance costs and could interfere with the conduct of our business.

We collect sales or other similar taxes for shipments of goods in certain states. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. If sales tax obligations are successfully imposed upon us by a state or other jurisdiction, we could be exposed to substantial tax liabilities for past sales and fines and penalties for failure to collect sales taxes and we could suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from us increases for those residing in that state or jurisdiction. In addition, new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes or regulatory restrictions on our business. These taxes could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

### **Item 1A. RISK FACTORS**

*Our business, financial condition and operating results could be adversely affected by any or all of the following factors, in which event the trading price of our common stock could decline, and you could lose part or all of your investment.*

#### **General Risks Related to Our Business**

***Our business and future growth depend on our continued access to bank and commercial financing. An uncertain or recessed economy may negatively impact our business, results of operations, financial condition or liquidity.***

Our business and future growth currently depend on our ability to access bank, vendor and commercial lines of credit. We currently depend on line of credit facilities provided by various banks and commercial lenders that provided for an aggregate of up to approximately \$74 million in available financing as of December 31, 2012. These

## [Table of Contents](#)

lines of credit currently mature at various dates through April 2015 and are secured by substantially all our assets. Our ability to renew our lines of credit depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current maturities on reasonable terms or at all. Our inability to renew or replace our credit facilities or find alternative financing would materially adversely affect our business, financial condition, operating results and cash flow. An uncertain or recessed economy could also adversely impact our customers' operations or ability to maintain liquidity, which may negatively impact our business and results of operations.

***We anticipate incurring significant expenses in the foreseeable future, which may reduce our ability to achieve or maintain profitability.***

To reach our business growth objectives, we may increase our operating and marketing expenses, as well as capital expenditures. To offset these expenses, we will need to generate additional profitable business. If our revenue grows slower than either we anticipate or our clients' projections indicate, or declines, or if our operating and marketing expenses exceed our expectations or cannot be reduced to an appropriate level, we may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or annual basis in the future. Additionally, if our revenue grows slower than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

***We have a large investment in fulfillment and computer technology equipment as well as long term building leases. A reduction in our clients' ecommerce business or our inability to increase service fee revenue from new or existing clients could negatively impact our operating results.***

We seek to maintain sufficient capacity in our fulfillment operations and computer technology systems to support growth in our clients' business and service those clients during seasonal volume increases. A reduction in our clients' business or our inability to increase service fee revenue from new or existing clients could result in an underutilization in our invested assets. Furthermore, we recently entered into two building leases with lease terms long enough to secure competitive lease rates, but which require early termination payments in the event we elect to terminate the leases prior to their scheduled expiration, thus limiting our flexibility to reduce fixed capacity in response to reduced revenue.

***We operate with significant levels of indebtedness and are required to comply with certain financial and non-financial covenants; we are required to maintain a minimum level of subordinated loans to our subsidiary Supplies Distributors; and we have guaranteed certain indebtedness and obligations of our subsidiaries.***

As of December 31, 2012, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of Ricoh product inventory, was approximately \$34 million. Certain of the credit facilities have maturity dates in calendar year 2014 or beyond, but are classified as current liabilities in our consolidated financial statements given the underlying nature of the credit facility. We cannot provide assurance that our credit facilities will be renewed by the lending parties. Additionally, these credit facilities include both financial and non-financial covenants, many of which also include cross default provisions applicable to other agreements. These covenants also restrict our ability to transfer funds among our various subsidiaries, which may adversely affect the ability of our subsidiaries to operate their businesses or comply with their respective loan covenants. We cannot provide assurance that we will be able to maintain compliance with these covenants. A non-renewal, default under or acceleration of any of our credit facilities could have a material adverse impact upon our business and financial condition. In addition we have provided \$3.5 million of subordinated indebtedness to Supplies Distributors as of December 31, 2012. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from our lenders is \$5.0 million. The restrictions on increasing this amount without lender approval may limit our ability to comply with certain loan covenants or further grow and develop Supplies Distributors' business. We have guaranteed most of the indebtedness of Supplies Distributors. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so. We have also guaranteed Retail Connect's \$3.0 million credit line, as well as certain of its vendor trade payables.

## [Table of Contents](#)

### ***We are dependent on our key personnel, and we need to hire and retain skilled personnel to sustain our business.***

Our performance is highly dependent on the continued services of our executive officers and other key personnel, the loss of any of whom could materially adversely affect our business. In addition, we need to attract and retain other highly-skilled, technical and managerial personnel for whom there is intense competition. We cannot assure you we will be able to attract and retain the personnel necessary for the continuing growth of our business. Our inability to attract and retain qualified technical and managerial personnel could materially adversely affect our ability to maintain and grow our business significantly.

### ***We are subject to risks associated with our international operations.***

We currently operate a distribution complex in Liège, Belgium with approximately 200,000 square feet, and a distribution center in Richmond Hill, Ontario, Canada with approximately 34,000 square feet. We also operate a facility in the Philippines with approximately 7,000 square feet to provide technology development and administrative support. We cannot assure you we will be successful in expanding in these or any additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are risks inherent in doing business internationally, including:

- changing regulatory requirements;
- legal uncertainty regarding foreign laws, tariffs and other trade barriers;
- political instability;
- potentially adverse tax consequences;
- foreign currency fluctuations; and
- cultural differences.

Any one or more of these factors could materially adversely affect our business in a number of ways, such as increased costs, operational difficulties and reductions in revenue.

### ***We are uncertain about our need for and the availability of additional funds.***

Our future capital needs are difficult to predict. We may require additional capital to take advantage of unanticipated opportunities, including strategic alliances and acquisitions, and to fund capital expenditures, or to respond to changing business conditions and unanticipated competitive pressures. We may also require additional funds to finance operating losses. Should these circumstances arise, our existing cash balance and credit facilities may be insufficient and we may need to raise additional funds either by borrowing money or issuing additional equity. We cannot assure you that such resources will be adequate or available for all of our future financing needs. Our inability to finance our growth, either internally or externally, may limit our growth potential and our ability to execute our business strategy. If we are successful in completing an additional equity financing, this could result in further dilution to our shareholders' ownership or reduce the market value of our common stock.

### ***We may engage in future strategic alliances or acquisitions that could dilute our existing shareholders' ownership, cause us to incur significant expenses or harm our business.***

We may review strategic alliance or acquisition opportunities that would complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses, technologies or services may be expensive and time-consuming. To finance any acquisitions, it may be necessary for us to raise additional funds through borrowing money or completing public or private financings. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our shareholders' ownership. We may not be able to operate any acquired businesses profitably or otherwise implement our growth strategy successfully. If we are unable to integrate any newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions could also result in incremental expenses and the incurrence of debt and contingent liabilities, any of which could harm our operating results. We may also incur costs in connection with potential strategic opportunities that are not consummated. Although we require potential strategic partners to agree to confidentiality and nondisclosure provisions, the use or disclosure of our confidential or proprietary information by such parties in violation of their confidentiality and nondisclosure obligations could harm our business.

## [Table of Contents](#)

***If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our common stock.***

Based on the current requirements and our public float, we are not required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act to obtain a report by our independent auditors opining on the effectiveness of our internal controls over financial reporting. If we fail to correct any issues in the design or operating effectiveness of internal controls over financial reporting or fail to prevent fraud, current and potential shareholders, customers and clients could lose confidence in our financial reporting, which could harm our business and the trading price of our common stock.

***Delivery of our and our clients' products could be delayed or disrupted by factors beyond our control, and we could lose customers and clients as a result.***

We rely upon third party carriers for timely delivery of our and our clients' product shipments. As a result, we are subject to carrier disruptions and increased costs due to factors that are beyond our control, including employee strikes, inclement weather and increased fuel costs. Any failure to deliver products to our and our clients' customers in a timely and accurate manner may damage our reputation and brand, and could cause us to lose customers and clients. We cannot be sure that our relationships with third party carriers will continue on terms favorable to us, if at all. If our relationship with any of these third party carriers is terminated or impaired, or if any of these third parties is unable to deliver products, we would be required to use alternative carriers for the shipment of our and our clients' products to customers. We may be unable to engage alternative carriers on a timely basis or on favorable terms, if at all. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in order processing and product delivery;
- increased cost of delivery, resulting in reduced margins; and
- reduced shipment quality, which may result in damaged products and customer dissatisfaction.

***Our profitability could be adversely affected if the operation of our facilities were interrupted or shut down as the result of a natural disaster.***

We operate a majority of our distribution facilities in and around the Memphis, Tennessee area and our headquarters and call center operations are centered in the Dallas, Texas area. We also maintain facilities in Canada, Europe and the Philippines. Any natural disaster or other serious disruption to our facilities due to fire, tornado, flood or any other cause would substantially disrupt our operations and would impair our ability to adequately service our customers. In addition, we could incur significantly higher costs during the time it takes for us to reopen or replace any one or more of our facilities, which may or may not be reimbursed by insurance. As a result, disruption at one or more of our facilities could adversely affect our profitability.

***A breach of our eCommerce security measures could reduce demand for our services. Credit card fraud and other fraud could adversely affect our business.***

A requirement of the continued growth of eCommerce is the secure transmission of confidential information over public networks. A party who is able to circumvent our security measures could misappropriate proprietary information or interrupt our operations. Any compromise or elimination of our security could reduce demand for our services.

We may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage our reputation, cause us to lose clients, impact our ability to attract new clients and we could be exposed to litigation and possible liability. Our security measures may not prevent security breaches, and failure to prevent security breaches may disrupt our operations. In certain circumstances, we do not carry insurance against the risk of credit card fraud and other fraud, so the failure to adequately control fraudulent transactions on either our behalf or our client's behalf could increase our expenses.

## [Table of Contents](#)

### ***We may be liable for misappropriation of our customers' and our clients' customers' personal information.***

Data security laws are becoming more stringent in the United States and abroad. Third parties are engaging in increased cyber-attacks against companies doing business on the Internet and individuals are increasingly subjected to identity and credit card theft on the Internet. If third parties or unauthorized employees are able to penetrate our network security or otherwise misappropriate our customers' or our clients' customers' personal information or credit card information, or if we give third parties or our employees improper access to customers' personal information or credit card information, we could be subject to liability. This liability could include claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims. This liability could also include claims for other misuses of personal information, including unauthorized marketing purposes. Liability for misappropriation of this information could decrease our profitability. In such circumstances, we also could be liable for failing to provide timely notice of a data security breach affecting certain types of personal information. In addition, the Federal Trade Commission and state agencies have brought numerous enforcement actions against Internet companies for alleged deficiencies in those companies' privacy and data security practices, and they may continue to bring such actions. We could incur additional expenses if new regulations regarding the collection, use or storage of personal information are introduced or if government agencies investigate our privacy or security practices.

We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of sensitive customer information such as customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments may result in a compromise or breach of the algorithms that we use to protect customer transaction data. If any such compromise of security were to occur, it could subject us to liability, damage our reputation and diminish the value of our brand-name. A party who is able to circumvent the security measures could misappropriate proprietary information or cause interruptions in operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. Our security measures are designed to prevent security breaches, but our failure to prevent such security breaches could subject us to liability, damage our reputation and diminish the value of our brand-name.

We also may provide non-secured channels for customers to communicate. Despite the increased security risks, customers may use such channels to send personal information and other sensitive data. In addition, "phishing" incidents are on the rise. Phishing involves an online company's customers being tricked into providing their credit card numbers or account information to someone pretending to be the online company's representative. Such incidents have recently given rise to litigation against online companies for failing to take sufficient steps to police against such activities by third parties, and may discourage customers from using online services.

### **Specific Risks Related to Our Business Process Outsourcing Business**

***Our service fee revenue and gross margin is dependent upon our clients' business and transaction volumes and our costs; many of our client service agreements are terminable by the client at will; we may incur financial penalties if we fail to meet contractual service levels under certain client service agreements.***

Our service fee revenue is primarily transaction based and fluctuates with the volume of transactions or level of sales of the products by our clients for whom we provide transaction management services. If we are unable to retain existing clients or attract new clients, or if we dedicate significant resources to clients whose business does not generate sufficient revenue or whose products do not generate substantial customer sales, our business may be materially adversely affected. Moreover, our ability to estimate service fee revenue for future periods is substantially dependent upon our clients' and our own projections, the accuracy of which has been, and will continue to be, unpredictable. Therefore, our planning for client activity and targeted goals for service fee revenue and gross margin may be materially adversely affected by incomplete, delayed or inaccurate projections. In addition, many of our service agreements with our clients are terminable by the client at will. Therefore, we cannot assure you any of our clients will continue to use our services for any period of time. The loss of a significant amount of service fee revenue due to client terminations could have a material adverse effect on our ability to cover our costs and thus on our profitability. Many of our client service agreements contain minimum service level requirements and impose financial penalties if we fail to meet such requirements. The imposition of a substantial amount of such penalties could have a material adverse effect on our business and operations.

## [Table of Contents](#)

***We may be a party to litigation involving our eCommerce intellectual property rights. If third parties claim we are infringing their intellectual property rights, we could incur significant litigation costs, be required to pay damages, or change our business or incur licensing expenses.***

Third parties have asserted, and may in the future assert, that our business or the technologies we use infringe on their intellectual property rights. As a result, we may be subject to intellectual property legal proceedings and claims in the ordinary course of business. We cannot predict whether third parties will assert claims of infringement in the future or whether any future claims will prevent us from offering popular products or services. If we are found to infringe, we may be required to pay monetary damages, which could include treble damages and attorneys' fees for any infringement that is found to be willful, and either be enjoined or required to pay ongoing royalties with respect to any technologies found to infringe. Further, as a result of infringement claims either against us or against those who license technology to us, we may be required, or deem it advisable, to develop non-infringing technology, which could be costly and time consuming, or enter into costly royalty or licensing agreements. Such royalty or licensing agreements, if required, may be unavailable on terms that are acceptable, or at all. If a third party successfully asserts an infringement claim against us and we are enjoined or required to pay monetary damages or royalties or we are unable to develop suitable non-infringing alternatives or license the infringed or similar technology on reasonable terms on a timely basis, our business, results of operations and financial condition could be materially harmed.

***We rely on third party providers for a portion of our client services, and we are subject to various risks and liabilities if we are unable to continue our relationship with such providers, such providers do not provide the third party services or provide them in a manner that does not meet required service levels.***

We currently, and may in the future, rely on third party providers to provide a portion of our end-to-end solution service offering. Although our end-to-end solution service clients generally approve in advance the designation of the third party provider and its provision of the third party services, under the terms of our contracts with our end-to-end solution service clients, we remain liable to provide such third party services and may be liable for the actions and omissions of such third party providers. In certain instances, our end-to-end solution service clients prepay in advance a portion of the service fees payable in respect of the third party services, and, under certain circumstances, including our breach or the breach by our third party provider of our or their respective obligations, we are liable to refund all or a portion of such prepaid fees. Consequently, in the event our third party provider fails to provide the third party services in compliance with required services levels, or otherwise breaches its obligations, or discontinues its business, whether as the result of bankruptcy, insolvency or otherwise, we may be required to provide such services at a higher cost to us and may otherwise be liable for various costs and expenses related to such event. In addition, any such failure may damage our reputation and otherwise result in a material adverse affect upon our business and financial condition.

***We may incur liability for indemnification obligations under our contracts with our clients and business partners which may have a material adverse effect upon our business, results of operations and financial condition.***

We include indemnification provisions in the contracts we enter into with our clients and business partners. Generally, the provisions require us to defend claims arising out of our infringement of third-party intellectual property rights, breach of contractual obligations and/or unlawful or otherwise culpable conduct, including breach of data security. The indemnity obligations generally cover damages, costs and attorneys' fees arising out of such claims. In many instances, our indemnification obligations to our clients include the actions or omissions of our third-party service providers. Although we seek to limit our total liability under such provisions to either a portion of the value of the contract or a specified, agreed-upon amount, in some cases our total liability under such provisions is unlimited. Although in most cases our third party service providers indemnify us for their actions and omissions, such providers may dispute or be unable to satisfy their indemnification obligation to us. In addition, our indemnification obligation to our clients may be broader in scope, or may be subject to larger limitations of liability, than the indemnification obligation of our third party service providers to us. In most cases, the term of the indemnity provision is perpetual. If we are required to indemnify a claim in a material amount, or if a series of indemnification claims are in the aggregate a material amount, we may be required to expend significant resources to defend the claims, which may have a material adverse effect upon our business, results of operations and financial condition.

***Our business is subject to the risk of customer and supplier concentration.***

For 2012, two clients represented approximately 29% of our service fee revenue (excluding pass-through revenue) and 18% of consolidated revenue. We currently anticipate that both of these clients and other clients will reduce the level of services or terminate their relationship with us so that, unless we are able to increase our service fee revenue from other existing or new clients or adjust our operating costs, such reduction or termination of services will have a material adverse effect upon our business, results of operation and financial condition.

The majority of our Supplies Distributors product revenue is generated by sales of product purchased under distributor agreements with Ricoh. These agreements are terminable at will and no assurance can be given that Ricoh will continue the distributor agreements with Supplies Distributors. Supplies Distributors does not have its own sales force and relies upon Ricoh's sales force and product demand generation activities for its sale of Ricoh product. As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability for Supplies Distributors in 2012 and 2013. Further reduction in the Ricoh business may have a material adverse effect on Supplies Distributors' business and our overall financial condition.

Sales by Supplies Distributors to two customers in the aggregate accounted for approximately 27% of Supplies Distributors' total product revenue for the year ended December 31, 2012 and 11% of consolidated net revenue. The loss of one or both of such customers, or non-payment of any material amount by these or any other customer, would have a material adverse effect upon Supplies Distributors' business, results of operations and financial condition.

***Our operating results are materially impacted by our client mix and the seasonality of their business.***

Our business is materially impacted by our client mix and the seasonality of their business. Based upon our current client mix and their current projected business volumes, we anticipate our run rate service fee revenue business activity will be at its highest in the fourth quarter of our fiscal year. We are unable to predict how the seasonality of future clients' business may affect our quarterly revenue and whether the seasonality may change due to modifications to a client's business. As such, we believe results of operations for a quarterly period may not be indicative of the results for any other quarter or for the full year.

***Our systems may not accommodate significant growth in our number of clients.***

Our success depends on our ability to handle a large number of transactions for many different clients in various product categories. We expect the volume of transactions will increase significantly as we expand our operations. In addition, client marketing programs, such as "secret sales" or "flash sales" often result in significant short-term spikes in transaction volumes. When this occurs, additional stress is placed upon our network hardware and software and our ability to efficiently manage our operations, and we cannot assure you of our ability to efficiently manage a large number of transactions. If we are not able to maintain an appropriate level of operating performance, we may be in breach of our client contractual obligations, develop a negative reputation, and impair existing and prospective client relationships and our business would be materially adversely affected.

***We may not be able to recover all or a portion of our start-up costs associated with one or more of our clients.***

We generally incur start-up costs in connection with the planning and implementation of business process solutions for our clients. Although we generally attempt to recover these costs from the client in the early stages of the client relationship, or upon contract termination if the client terminates without cause prior to full amortization of these costs, there is a risk that the client contract may not fully cover the start-up costs or that the client will terminate the contract for cause and withhold payment of any unamortized start-up costs. To the extent start-up costs exceed the start-up fees received, certain excess costs will be expensed as incurred. Additionally, in connection with new client contracts we generally incur capital expenditures associated with assets whose primary use is related to the client solution. There is a risk that the contract may end before expected and we may not recover the full amount of our capital costs.



***Our revenue and margins may be materially impacted by client transaction volumes that differ from client projections and business assumptions.***

Our pricing for client transaction services, such as call center and fulfillment, is often based upon volume projections and business assumptions provided by the client and our anticipated costs to perform such work. In the event the actual level of activity or cost is substantially different from the projections or assumptions, we may have insufficient or excess staffing, incremental costs or other assets dedicated for such client that may negatively impact our margins and business relationship with such client. In the event we are unable to meet the service levels expected by the client, our relationship with the client will suffer and may result in financial penalties and/or the termination of the client contract.

***We face competition from many sources that could adversely affect our business; growth in our clients' ecommerce business may make it more efficient for the client to perform our services themselves.***

Many companies offer, on an individual basis, one or more of the same services we do, and we face competition from many different sources depending upon the type and range of services requested by a potential client. Our competitors include vertical outsourcers, which are companies that offer a single function, such as call centers, public warehouses or credit card processors. We compete against transportation logistics providers who offer product management functions as an ancillary service to their primary transportation services. We also compete against other business process outsourcing providers, who perform many similar services as us. Many of these companies have greater capabilities than we do for the single or multiple functions they provide. In many instances, our competition is the in-house operations of potential clients themselves. The in-house operations of potential clients often believe they can perform the same services we do, while others are reluctant to outsource business functions that involve direct customer contact. We cannot be certain we will be able to compete successfully against these or other competitors in the future.

In addition, growth in our clients' ecommerce businesses may cause a client to consider making the necessary investments to process their ecommerce operations in-house. In such event, unless we can provide a more cost-effective solution to the client, the client may choose to terminate our services. There is no assurance that we will be able to provide a more cost-effective solution, or that any such solution will not reduce our profitability or be accepted by the client.

***Our sales and implementation cycles are highly variable and our ability to finalize pending contracts may cause our operating results to vary widely.***

The sales cycle for our services is variable, typically ranging between several months to up to a year or longer from initial contact with the potential client to the signing of a contract. Occasionally the sales cycle requires substantially more time. Delays in signing and executing client contracts may affect our revenue and cause our operating results to vary widely. A potential client's decision to purchase our services is discretionary, involves a significant commitment of the client's resources and is influenced by intense internal and external pricing and operating comparisons. To successfully sell our services, we generally must educate our potential clients regarding the use and benefit of our services, which can require significant time and resources. Consequently, the period between initial contact and the purchase of our services is often long and subject to delays associated with the lengthy approval and competitive evaluation processes that typically accompany significant operational decisions. Additionally, the time required to finalize pending contracts and to implement our systems and integrate a new client can range from several weeks to many months. Delays in signing and integrating new clients may affect our revenue and cause our operating results to vary widely.

***Our business could be adversely affected by a systems or equipment failure, whether ours or our clients.***

Our operations are dependent upon our ability to protect our distribution facilities, customer service centers, computer and telecommunications equipment and software systems against damage and failures. Damage or failures could result from fire, power loss, equipment malfunctions, system failures, natural disasters and other causes. If our business is interrupted either from accidents or the intentional acts of others, our business could be materially adversely affected. In addition, in the event of widespread damage or failures at our facilities, our short-term disaster recovery and contingency plans and insurance coverage may not be sufficient.

## [Table of Contents](#)

Our clients' businesses may also be harmed from any system or equipment failures we experience. In that event, our relationship with these clients may be adversely affected, we may lose these clients, our ability to attract new clients may be adversely affected and we could be exposed to liability.

Interruptions could also result from the intentional acts of others, like hackers. If our systems are penetrated by computer hackers, or if computer viruses infect our systems, our computers could fail or proprietary information could be misappropriated.

If our clients suffer similar interruptions in their operations, for any of the reasons discussed above or for others, our business could also be adversely affected. Many of our clients' computer systems interface with our systems. If our clients suffer interruptions in their systems, the link to our systems could be severed and sales of the client's products could be slowed or stopped.

### **Risks Related to the Business Process Outsourcing Industry**

*If the trend toward outsourcing does not continue, our business could be adversely affected.*

Our business could be materially adversely affected if the trend toward outsourcing declines or reverses, or if corporations bring previously outsourced functions back in-house. Particularly during general economic downturns, businesses may bring in-house previously outsourced functions to avoid or delay layoffs.

*Our market is subject to rapid technological change and to compete we must continually enhance our systems to comply with evolving standards.*

To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our services and the underlying network infrastructure. If we are unable to adapt to changing market conditions, client requirements or emerging industry standards, our business could be adversely affected. The internet and eCommerce environments are characterized by rapid technological change, changes in user requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our technology and systems obsolete. Our success will depend, in part, on our ability to both internally develop and license leading technologies to enhance our existing services and develop new services. We must continue to address the increasingly sophisticated and varied needs of our clients and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. The development of proprietary technology involves significant technical and business risks. We may fail to develop new technologies effectively or to adapt our proprietary technology and systems to client requirements or emerging industry standards.

### **Risks Related to Our Stock**

*The market price of our common stock may be volatile. You may not be able to sell your shares at or above the price at which you purchased such shares.*

The trading price of our common stock may be subject to wide fluctuations in response to quarter-to-quarter fluctuations in operating results, announcements of material adverse events, general conditions in our industry or the public marketplace and other events or factors, including the thin trading of our common stock. In addition, stock markets have experienced extreme price and trading volume volatility in recent years. This volatility has had a substantial effect on the market prices of securities of many technology related companies for reasons frequently unrelated to the operating performance of the specific companies. These broad market fluctuations may adversely affect the market price of our common stock. In addition, if our operating results differ from our announced guidance or the expectations of equity research analysts or investors, the price of our common stock could decrease significantly.

## [Table of Contents](#)

### ***Our stock price could decline if a significant number of shares become available for sale.***

As of December 31, 2012, we have an aggregate of 2.1 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$4.55 per share. The shares of common stock that may be issued upon exercise of these options may be resold into the public market. Sales of substantial amounts of common stock in the public market as a result of the exercise of these options, or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

### ***Our certificate of incorporation, our bylaws, our shareholder rights plan and Delaware law make it difficult for a third party to acquire us, despite the possible benefit to our shareholders.***

Provisions of our certificate of incorporation, our bylaws, our shareholder rights plan and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. For example, our certificate of incorporation provides for a classified board of directors, meaning that only approximately one-third of our directors may be subject to re-election at each annual shareholder meeting. Our certificate of incorporation also permits our Board of Directors to issue one or more series of preferred stock, which may have rights and preferences superior to those of the common stock. The ability to issue preferred stock could have the effect of delaying or preventing a third party from acquiring us. We have also adopted a shareholder rights plan. These provisions could discourage takeover attempts and could materially adversely affect the price of our stock. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit large shareholders from consummating a merger with, or acquisition of us. These provisions may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

### ***There are limitations on the liabilities of our directors and executive officers.***

Pursuant to our bylaws and under Delaware law, our directors are not liable to us or our shareholders for monetary damages for breach of fiduciary duty, except for liability for breach of a director's duty of loyalty, acts or omissions by a director not in good faith or which involve intentional misconduct or a knowing violation of law, or any transaction in which a director has derived an improper personal benefit.

### **Item 1B. *Unresolved Staff Comments***

None.

### **Item 2. *Properties***

Our headquarters are located in Allen, Texas, a Dallas suburb.

In the U.S., we operate a distribution facility in Memphis, Tennessee, with aggregate space of more than 440,000 square feet. We also operate approximately 490,000 square feet of distribution facilities in Southaven, Mississippi. These facilities are located approximately ten miles from the Memphis International Airport. We also manage a distribution facility in Grapevine, Texas with approximately 200,000 square feet.

Internationally, we operate a distribution complex in Liège, Belgium with approximately 200,000 square feet, which contains advanced distribution systems and equipment. We operate a distribution center in Richmond Hill, Ontario, Canada with approximately 34,000 square feet. We also operate a facility in the Philippines with approximately 7,000 square feet to provide primarily technology development and administrative support.

Except for the Grapevine, Texas facility, which we manage on our client's behalf, all of our facilities are leased and the material lease agreements generally contain one or more renewal options.

We operate customer service centers in our facilities in Tennessee, Texas, Belgium, Canada and the Philippines. Our call center technology permits the automatic routing of calls to available customer service representatives in several of our call centers.

---

[Table of Contents](#)

**Item 3.      *Legal Proceedings***

We are not party to any legal proceedings other than routine claims and lawsuits arising in the ordinary course of our business. We do not believe such claims and lawsuits, individually or in the aggregate, will have a material adverse effect on our business.

**Item 4.      *Mine Safety Disclosures***

Not Applicable

**PART II**

**Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

Our common stock is listed, and currently trades, on the NASDAQ Capital Market under the symbol “PFSW.” The following table sets forth for the period indicated the high and low sale price for the common stock as reported by NASDAQ:

|                                     | Price  |        |
|-------------------------------------|--------|--------|
|                                     | High   | Low    |
| <b>Year Ended December 31, 2011</b> |        |        |
| First Quarter                       | \$5.22 | \$2.89 |
| Second Quarter                      | \$6.72 | \$4.15 |
| Third Quarter                       | \$5.50 | \$3.70 |
| Fourth Quarter                      | \$4.55 | \$2.15 |
| <b>Year Ended December 31, 2012</b> |        |        |
| First Quarter                       | \$4.37 | \$2.46 |
| Second Quarter                      | \$4.40 | \$2.31 |
| Third Quarter                       | \$3.20 | \$2.30 |
| Fourth Quarter                      | \$3.27 | \$2.14 |

As of March 11, 2013, there were approximately 3,500 shareholders, of which 128 were record holders of the common stock.

We have never declared or paid cash dividends on our common stock and do not anticipate the payment of cash dividends on our common stock in the foreseeable future. We are also restricted from paying dividends under our debt agreements without the prior approval of our lenders. The payment of any future cash dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, the general financial condition of the Company and general business conditions and the approval of our lenders. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources.”

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2012:

| <u>Plan category (1)</u>                               | <u>Number of securities to be issued upon exercise of outstanding options and warrants</u> | <u>Weighted-average exercise price of outstanding options and warrants</u> | <u>Number of securities remaining available for future issuance</u> |
|--|--|--|---|
| Equity compensation plans approved by security holders | 2,100,184  | \$ 4.55  | 1,407,231   |

(1) See Note 5 to the Consolidated Financial Statements for more detailed information regarding the Company’s equity compensation plans.

The following table presents information with respect to purchases of our common stock made during the three months ended December 31, 2012:

| <u>Period</u> | <u>Total Number of Shares Purchased</u> | <u>Average Price Paid per Share</u> | <u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u> | <u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)</u> |
|---------------|---|-------------------------------------|---|---|
| October 1-31  | 1,306                                   | 2.67                                | 15,106  | 960,383   |
| November 1-30 | —                                       | —                                   | 15,106  | 960,383   |
| December 1-31 | —                                       | —                                   | 15,106  | 960,383   |
| <b>Total</b>  | <b>1,306</b>                            | <b>\$ 2.67</b>                      | <b>15,106</b>   | <b>\$ 960,383</b>   |

## [Table of Contents](#)

- (1) On December 16, 2011, our Board of Directors authorized a stock repurchase program to acquire up to \$1.0 million of our outstanding common stock, subject to any restrictions pursuant to the terms of our credit agreements or otherwise.

### **Item 6. Selected Consolidated Financial Data**

None

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*We believe the following discussion and analysis provides information that is relevant to an assessment and understanding of our consolidated results of operations and financial condition. The discussion and analysis should be read in conjunction with the consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-K. This Management's Discussion and Analysis will help you understand:*

- The impact of forward looking statements;
- Our financial structure, including our historical financial presentation;
- Our results of operations for the previous two years;
- Certain of our relationships with our subsidiaries;
- Our liquidity and capital resources;
- The impact of seasonality, inflation and recently issued accounting standards on our financial statements; and
- Our critical accounting policies and estimates.

### **Forward-Looking Information**

We have made forward-looking statements in this Report on Form 10-K. These statements are subject to risks and uncertainties, and there can be no guarantee that these statements will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like "seek," "strive," "believe," "expect," "anticipate," "predict," "potential," "continue," "will," "may," "could," "intend," "plan," "target" and "estimate" or similar expressions, we are making forward-looking statements. You should understand that the following important factors, in addition to the Risk Factors set forth above or elsewhere in this Report on Form 10-K, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients' projections, transaction volume or product sales;
- our dependence upon our agreements with International Business Machines Corporation ("IBM") and Ricoh;
- our dependence upon our agreements with our major clients;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in eCommerce, outsourcing, government regulation, both foreign and domestic, and the market for our services;
- whether we can continue and manage growth;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer and supplier concentration of our business;
- the reliance on third-party subcontracted services;
- the unknown effects of possible system failures and rapid changes in technology;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;
- our dependence upon key personnel;
- the impact of new accounting standards and changes in existing accounting rules or the interpretations of those rules;

## [Table of Contents](#)

- our ability to raise additional capital or obtain additional financing;
- our ability, and the ability of our subsidiaries, to borrow under current financing arrangements and maintain compliance with debt covenants;
- relationships with, and our guarantees of, certain liabilities and indebtedness of our subsidiaries; and
- taxation on the sale of our products.

We have based these statements on our current expectations about future events. Although we believe the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee these expectations will actually be achieved. In addition, some forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Therefore, actual outcomes and results may differ materially from what is expected or forecasted in such forward-looking statements. We undertake no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available or other events occur in the future. There may be additional risks we do not currently view as material or that are not presently known. In evaluating these statements, you should consider various factors, including the risks set forth in the section entitled “Risk Factors.”

## **Overview**

We are an international business process outsourcing provider of end-to-end eCommerce solutions. We provide these solutions to major brand name companies and others seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives. We derive our revenues by providing a broad range of services as we process individual business transactions on our clients’ behalf using three different seller services financial models: 1) the Enablement model, 2) the Agent (or Flash) model and 3) the Retail model.

We refer to the standard PFSweb seller services financial model as the Enablement model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various business outsourcing services in support of their business operations. We derive our service fee revenues by providing a broad range of service offerings that include digital marketing, eCommerce technologies, order management, customer care, logistics and fulfillment, financial management and professional consulting. We offer our services as an integrated solution, which enables our clients to outsource their complete infrastructure needs to a single source and to focus on their core competencies. Our distribution services are conducted at warehouses we lease or manage. We currently provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, cosmetics, fragile goods, contemporary home furnishings, apparel, aviation, telecommunications, consumer electronics and consumer packaged goods, among others.

In this model, we typically charge for our services on a cost-plus basis, a percent of shipped revenue basis or a per-transaction basis, such as a per-labor hour basis for web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services. We price our services based on a variety of factors, including the depth and complexity of the services provided, the amount of capital expenditures or systems customization required, the length of contract and other factors.

Many of our service fee contracts involve third-party vendors who provide additional services, such as package delivery. The costs we are charged by these third-party vendors for these services are often passed on to our clients. Our billings for reimbursements of these costs and other ‘out-of-pocket’ expenses include travel, shipping and handling costs and telecommunication charges and are included in pass-through revenue.

As an additional service, we offer our second model, the Agent, or Flash, financial model, in which our clients maintain ownership of the product inventory stored at our locations. When a customer orders the product from our clients, a “flash” sale transaction passes product ownership to us for each order and we in turn immediately re-sell the product to the customer. The “flash” ownership exchange establishes us as the merchant of record, which enables us to use our existing merchant infrastructure to process sales to end customers, removing the need for the clients to establish these business processes internally, but permitting them to control the sales process to end customers. In this model, based on the terms of our current client arrangements, we record product revenue net of cost of product revenue.



## [Table of Contents](#)

Finally, our Retail model allows us to purchase inventory from the client just as any other client reseller partner. In this model, we place the initial and replenishment purchase orders with the client and take ownership of the product upon delivery to our facility. Consequently, in this model, we generate product revenue, as we own the inventory and the accounts receivable arising from our product sales. Under the Retail model, depending upon the product category and sales characteristics, we may require the client to provide product price protection as well as product purchase payment terms, right of return, and obsolescence protection appropriate to the product sales profile. In this model we recognize product revenue for customer sales. Freight costs billed to customers are reflected as components of product revenue. This business model generally requires significant working capital requirements, for which we have credit available either through credit terms provided by our clients or under senior credit facilities.

In general, we provide the Enablement and Agent (or Flash) models through our PFS and Supplies Distributors subsidiaries and the Retail model through our Supplies Distributors and PFSweb Retail Connect subsidiaries.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our Enablement and Agent models is driven by two main elements: new client relationships and organic growth from existing clients. We focus our sales efforts on larger contracts with brand-name companies within two primary target markets, online brands and retailers and technology manufacturers, which, by nature, require a longer duration to close but also have the potential to be higher quality and longer duration engagements.

Currently, any growth within our Retail model would primarily be driven by our ability to attract new distributor arrangements with Ricoh or other manufacturers, and the sales and marketing efforts of the manufacturers and third party sales partners. As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability under our Retail model in 2013.

We continue to monitor and control our costs to focus on profitability. While we are targeting our new service fee contracts to yield incremental gross profit, we also expect to incur incremental investments in technology development, operational and support management and sales and marketing expenses.

Our expenses comprise primarily four categories: 1) cost of product revenue, 2) cost of service fee revenue, 3) cost of pass-through revenue and 4) selling, general and administrative expenses.

*Cost of product revenue* – consists of the purchase price of product sold and freight costs, which are reduced by certain reimbursable expenses. These reimbursable expenses include pass-through customer marketing programs, direct costs incurred in passing on any price decreases offered by vendors to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and certain other expenses as defined under the distributor agreements.

*Cost of service fee revenue* – consists primarily of compensation and related expenses for our web-enabled customer contact center services, international fulfillment and distribution services and professional consulting services, and other fixed and variable expenses directly related to providing services under the terms of fee based contracts, including certain occupancy and information technology costs and depreciation and amortization expenses.

*Cost of pass-through revenue* – the related reimbursable costs for pass-through expenditures are reflected as cost of pass-through revenue.

*Selling, General and Administrative expenses* – consist of expenses such as compensation and related expenses for sales and marketing staff, distribution costs (excluding freight) applicable to the Supplies Distributors business and the Retail model, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses.

Monitoring and controlling our available cash balances and our expenses continues to be a primary focus. Our cash and liquidity positions are important components of our financing of both current operations and our targeted growth.

[Table of Contents](#)

**Results of Operations**

**Year Ended December 31, 2012 Compared to Year Ended December 31, 2011**

The results of operations related to the eCOST.com business unit that was sold in February 2011 have been reported as discontinued operations in 2011. The following table discloses certain financial information for the periods presented, expressed in terms of dollars, dollar change, percentage change and as a percentage of total revenue (in millions).

|  |                 |                 | Change        |               | % of Total Revenue |               |
|--|-----------------|-----------------|---------------|---------------|--------------------|---------------|
|  | 2012            | 2011            | \$            | %             | 2012               | 2011          |
| <b>Revenues:</b>                                       |                 |                 |               |               |                    |               |
| Product revenue, net                                   | \$ 119.7        | \$ 162.4        | \$ (42.7)     | (26.3)%       | 42.5%              | 54.4%         |
| Service fee revenue                                    | 120.4           | 95.4            | 25.0          | 26.3%         | 42.8%              | 31.9%         |
| Pass-through revenue                                   | 41.4            | 41.0            | 0.4           | 1.0%          | 14.7%              | 13.7%         |
| Total net revenues                                     | <u>281.5</u>    | <u>298.8</u>    | <u>(17.3)</u> | <u>(5.8)%</u> | <u>100.0%</u>      | <u>100.0%</u> |
| <b>Cost of Revenues</b>                                |                 |                 |               |               |                    |               |
| Cost of product revenue                                | 110.2           | 150.7           | (40.5)        | (26.9)%       | 92.0%(1)           | 92.8%         |
| Cost of service fee revenue                            | 89.2            | 71.8            | 17.4          | 24.4%         | 74.1%(2)           | 75.3%         |
| Pass-through cost of revenue                           | 41.4            | 41.0            | 0.4           | 1.0%          | 100.0%(3)          | 100.0%        |
| Total cost of revenues                                 | <u>240.8</u>    | <u>263.5</u>    | <u>(22.7)</u> | <u>(8.6)%</u> | <u>85.5%</u>       | <u>88.2%</u>  |
| Product revenue gross profit                           | 9.5             | 11.7            | (2.2)         | (18.4)%       | 8.0%(1)            | 7.2%          |
| Service fee gross profit                               | 31.2            | 23.6            | 7.6           | 32.2%         | 25.9%(2)           | 24.7%         |
| Pass-through gross profit                              | —               | —               | —             | —             | —                  | —             |
| Total gross profit                                     | <u>40.7</u>     | <u>35.3</u>     | <u>5.4</u>    | <u>15.4%</u>  | <u>14.5%</u>       | <u>11.8%</u>  |
| <b>Selling, General and Administrative Expenses</b>    |                 |                 |               |               |                    |               |
|  | <u>40.6</u>     | <u>37.5</u>     | <u>3.1</u>    | <u>8.3%</u>   | <u>14.4%</u>       | <u>12.6%</u>  |
| Income (loss) from operations                          | 0.1             | (2.2)           | 2.3           | 105.5%        | 0.1%               | (0.8)%        |
| <b>Interest expense, net</b>                           |                 |                 |               |               |                    |               |
|  | <u>1.0</u>      | <u>1.1</u>      | <u>(0.1)</u>  | <u>(8.9)%</u> | <u>0.4%</u>        | <u>0.3%</u>   |
| Loss from continuing operations before income taxes    | (0.9)           | (3.3)           | 2.4           | 73.7%         | (0.3)%             | (1.1)%        |
| <b>Income tax expense, net</b>                         |                 |                 |               |               |                    |               |
|  | <u>0.6</u>      | <u>0.4</u>      | <u>0.2</u>    | <u>69.5%</u>  | <u>0.2%</u>        | <u>0.1%</u>   |
| Loss from continuing operations                        | (1.5)           | (3.7)           | 2.2           | 58.9%         | (0.5)%             | (1.2)%        |
| Income (loss) from discontinued operations, net of tax | —               | (0.9)           | 0.9           | 100.0%        | — %                | (0.3)%        |
| Net loss   | <u>\$ (1.5)</u> | <u>\$ (4.6)</u> | <u>\$ 3.1</u> | <u>66.9%</u>  | <u>(0.5)%</u>      | <u>(1.5)%</u> |

- (1) Represents the percent of Product revenue, net.
- (2) Represents the percent of Service fee revenue.
- (3) Represents the percent of Pass-through revenue.

*Product revenue, net.* Product revenue decreased \$42.7 million, or 26.3%, in 2012 as compared to the prior year. As a result of an operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues for Supplies Distributors in 2012 and 2013. We currently expect product revenue to be approximately \$90 million to \$95 million in 2013.

*Service fee revenue.* The increase in service fee revenue for the year ended December 31, 2012 as compared to the prior year was primarily due to increased service fees from both existing client relationships and new client relationships that began in 2012, partially offset by the impact of terminated clients. The change in service fee revenue, excluding pass-through revenue, is shown below (\$ millions):

|   |                 |
|---|-----------------|
| Year ended December 31, 2011  | \$ 95.4         |
| New service contract relationships  | 4.0             |
| Change in existing client service fees, including clients implemented during 2011 | 22.8            |
| Terminated clients not included in 2012 revenue                                   | (1.8)           |
| Year ended December 31, 2012  | <u>\$ 120.4</u> |

## [Table of Contents](#)

We currently expect our service fee revenue to be negatively impacted in 2013 by the conclusion or anticipated reduction of operations of several client programs. Based on current client projections, we currently expect the reduction in revenue derived from these client programs to be offset in part, but not in whole, by new or expanded client opportunities.

*Cost of Product Revenue.* Cost of product revenue decreased by \$40.5 million, or 26.9%, to \$110.2 million in 2012 as compared to the prior year. The resulting gross profit margin was \$9.5 million or 8.0% of product revenue for the year ended December 31, 2012 and \$11.7 million or 7.2% of product revenue for 2011. The gross profit was negatively impacted by reduced product revenue primarily attributable to the Ricoh restructuring activities, and we expect this to continue in 2013. The gross profit margin for 2012 and 2011 includes the impact of incremental gross margin earned on product sales resulting from certain product price increases and the impact of certain incremental inventory cost reductions.

*Cost of Service Fee Revenue.* Gross profit as a percentage of service fees was 25.9% in 2012 and 24.7% in 2011. The gross profit percentage increase is primarily due to a change in the client mix, improved operating efficiencies, including benefits of leveraging our infrastructure across increased service fee revenues, and an increased level of higher margin client project activity.

We target to earn an overall average gross profit of 25-30% on existing and new service fee contracts, but we have accepted, and may continue to accept, lower gross margin percentages on certain contracts depending on contract scope and other factors, including projected volumes. We expect that our service fee business gross profit will be negatively impacted in 2013 by the conclusion or anticipated reduction of operations of several client programs.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$40.6 million, or 14.4% of total net revenues in the 2012 period and \$37.5 million, or 12.6% of total net revenues in the prior year. The increase in expenses is primarily attributable to approximately \$0.5 million of lease termination costs incurred in 2012 and approximately \$0.9 million of relocation related costs relating to our facility relocations and expansions due to investments to support growth in our service fee business. In addition, our personnel related costs and professional fees increased as compared to 2011. In 2011 we incurred approximately \$0.5 million of incremental relocation related costs necessary to support our growth.

*Income Taxes.* We recorded a tax provision associated primarily with state income taxes, our subsidiary Supplies Distributors' Canadian and European operations, and our Philippines operations. A valuation allowance has been provided for the majority of our net deferred tax assets, which are primarily related to our net operating loss carryforwards and certain foreign deferred tax assets. We expect we will continue to record an income tax provision associated with state income taxes, Supplies Distributors' Canadian and European results of operations and our Philippines operations.

*Loss from Discontinued Operations, Net of Tax.* Discontinued operations generated a loss of approximately \$0.9 million in 2011. In February 2011, we sold substantially all of the inventory and certain intangible assets applicable to our eCOST business unit for a total aggregate cash purchase price of approximately \$2.3 million. For 2011, we classified the operating results of this business unit, excluding costs expected to continue to occur in the future, as discontinued operations.

### **Supplies Distributors and its Subsidiaries**

We conduct a portion of our Retail business model operations through Supplies Distributors and its subsidiaries, which act as distributors of various Ricoh and other products. We conduct these services through transaction management services agreements under which PFS provides transaction management and fulfillment services to Supplies Distributors and its subsidiaries. In addition to our equity investment in Supplies Distributors, we have also provided Supplies Distributors with a subordinated loan that, as of December 31, 2012, had an outstanding balance of \$3.5 million.

## [Table of Contents](#)

Supplies Distributors paid us dividends of \$1.0 million and \$0.6 million in 2012 and 2011, respectively. Supplies Distributors has received lender approval to pay dividends of approximately \$2.5 million in 2013, but pursuant to the terms of its amended credit agreements, is restricted from paying further cash dividends without the prior approval of its lenders. In addition, no distribution may be made if, after giving effect thereto, Supplies Distributors or its subsidiaries are in noncompliance with its financial covenants under its current facilities.

### **Liquidity and Capital Resources**

During the year ended December 31, 2012, we generated \$28.6 million of cash from operating activities primarily due to: a \$7.3 million decrease in accounts receivable primarily related to reduced product revenue activity related to the change in sale and distribution of Ricoh products through our Supplies Distributors business; a \$5.7 million reduction in inventories related to reduced product revenue; a \$5.3 million increase in deferred rent related to tenant improvement allowances at certain new facilities; a \$4.4 million decrease in prepaid expenses, and other receivables and other assets primarily related to a timing of receipts and a reduction of value-added tax receivable at our European subsidiary. Included in our cash flows from operating activities was also \$9.3 million of cash income from continuing operations before working capital changes. These sources of cash were partially offset by a \$3.3 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities following the timing of payments we make for products and services, payment processing and related transactions costs. At December 31, 2012, our accounts payable and accrued expense were approximately \$5.0 million higher than normally expected due to the timing of various vendor and client reimbursement payments.

During the year ended December 31, 2011, we generated \$4.3 million of cash income from continuing operations before working capital changes, \$2.3 million in proceeds from the February 2011 sale of our eCOST business plus \$1.3 million applicable to a reduction of eCOST inventory prior to the sale. In addition, we generated \$3.4 million in proceeds due to a reduction in net inventories based on the timing of product sell-through and reduced inventory purchasing as a result of reduced Ricoh product revenue volumes. We also received proceeds from the issuance of common stock of \$2.0 million from the exercise of stock options. These cash inflows were offset by an \$11.5 million increase in accounts receivable resulting from the growth and holiday seasonal peak period billing activity of our services business, partially offset by a reduction in accounts receivable from eCOST customer collections in conjunction with the February 2011 sale of that business.

We incurred capital expenditures of \$14.7 million, net of \$7.3 million of property and equipment acquired under debt and capital lease financing, in 2012 and \$7.6 million, net of \$4.8 million of property and equipment acquired under debt and capital lease financing, in 2011, which primarily consisted of payments for internally developed software, technology, call center and distribution equipment, leasehold improvements, primarily related to our new corporate headquarters and call center facility, and furniture and fixtures. The leasehold improvements were primarily financed by the landlords through tenant allowances. Payments on capital leases and net payments on debt were \$12.7 million and \$2.4 million, respectively, in the aggregate during 2012 and 2011.

Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, development of customized technology solutions to support and integrate with our service fee clients and general expansion and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures to support new contracts and anticipated future growth opportunities. Based on our current client business activity and our targeted growth plans, we anticipate our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months, including costs to implement new clients, will be approximately \$9 million to \$11 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. To maintain our current operating cash position, a portion of these expenditures may be financed through client reimbursements, debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event that we do not obtain the financing or achieve the financial results necessary to support such investments.

During 2012, our working capital decreased to \$15.4 million from \$20.4 million at December 31, 2011, primarily due to the funding of capital expenditures. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including the sale of equity, utilizing capital or operating leases, borrowing under our credit facilities, expanding our current credit facilities or entering into new debt agreements. No assurances can be given we will be successful in obtaining any additional financing or the terms thereof. We currently believe our cash position, financing available

## Table of Contents

under our credit facilities and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries, if necessary, for at least the next twelve months.

In support of certain debt instruments and leases, as of December 31, 2012, we had \$0.2 million of cash restricted for repayment to lenders. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain of our subsidiaries' credit facilities. Many of these facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other credit facilities and agreements. These covenants include, among others, minimum levels of net worth, profitability and cash flow (as defined) and the restrictions on the ability of the borrower subsidiaries to advance funds to other borrower subsidiaries. As a result, it is possible for one or more of these borrower subsidiaries to fail to meet their respective covenants even if another borrower subsidiary otherwise has available excess funds which, if not restricted, could be used to cure the default. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders' equity and we are not able to obtain a waiver, the lenders would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under our parent guarantee. A requirement to accelerate the repayment of the credit facility obligations may have a material adverse impact on our financial condition and results of operations. We can provide no assurance we will have the financial ability to repay all of such obligations. As of December 31, 2012, we were in compliance with all debt covenants. Further, any non-renewal of any of our credit facilities may have a material adverse impact on our business and financial condition. We do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

In the future, we may attempt to acquire other businesses or seek an equity or strategic partner to generate capital or expand our services or capabilities in connection with our efforts to grow our business. Acquisitions involve certain risks and uncertainties and may require additional financing. Therefore, we can give no assurance with respect to whether we will be successful in identifying businesses to acquire or an equity or strategic partner, whether we or they will be able to obtain financing to complete a transaction, or whether we or they will be successful in operating the acquired business.

We receive municipal tax abatements in certain locations. In prior years we received notice from a municipality that we did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to our tax abatement. We disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against us and the timing of the related payments has not been finalized. As of December 31, 2012, we believe we have adequately accrued for the expected assessment.

In April 2010, a sales employee of our former subsidiary eCOST.com, was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. We received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and have responded to such subpoenas and are fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and we intend to seek the recovery or reimbursement of the funds, that are currently classified as other receivables in the December 31, 2012 financial statements. Based on the information available to date, we are unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or our inability to recover such funds or any significant portion thereof, or any costs and expenses we may incur in connection with such matter will not have a material adverse effect upon our financial condition or results of operations.

On December 16, 2011, the Company announced a board approved stock repurchase program of up to \$1 million of the outstanding shares of its common stock. As of the date of this report, we have purchased 15,106 shares under this program for a total of approximately \$40,000. In considering whether to purchase shares under this program, the Company will consider, among other factors, the market price of the shares, the Company's available cash balance and the Company's anticipated cash needs.

### ***Supplies Distributors Financing***

To finance its distribution of Ricoh products in the U.S., Supplies Distributors has a short-term credit facility with IBM Credit LLC (“IBM Credit”) that provides financing for up to \$20.0 million. We have provided a collateralized guarantee to secure the repayment of this credit facility. The IBM Credit facility does not have a stated maturity and both parties have the ability to exit the facility following a 90-day notice. The Company has direct vendor credit terms with Ricoh to finance Supplies Distributors European subsidiary’s inventory purchases.

Supplies Distributors also has a loan and security agreement with Wells Fargo Bank, National Association (“Wells Fargo”) to provide financing for up to \$25.0 million of eligible accounts receivables in the United States and Canada. The Wells Fargo facility expires on the earlier of March 2014 or the date on which the parties to the Ricoh distributor agreement no longer operate under the terms of such agreement and/or Ricoh no longer supplies products pursuant to such agreement.

Supplies Distributors’ European subsidiary has a factoring agreement with BNP Paribas Fortis Factor (“BNP Paribas”) to provide factoring for up to 7.5 million Euros (approximately \$9.9 million at December 31, 2012) of eligible accounts receivables through March 2014.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as cash flow from operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than \$3.5 million, not maintain restricted cash of more than \$5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders’ equity of at least \$18.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of substantially all of the obligations of Supplies Distributors and its subsidiaries to IBM and Ricoh.

### ***PFS Financing***

Our PFS subsidiary has a Loan and Security Agreement (“Comerica Agreement”) with Comerica Bank (“Comerica”), which provides for up to \$12.5 million (\$10.0 million during certain non-seasonal peak months) of eligible accounts receivable financing through March 2014. The Comerica Agreement also provided for up to \$3.0 million of eligible equipment financing (“Equipment Advances”). Outstanding Equipment Advances have a final maturity date of April 15, 2015. We entered into this Comerica Agreement to supplement our existing cash position, and provide funding for our current and future operations, including our targeted growth. The Comerica Agreement contains cross default provisions, various restrictions upon our ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20.0 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement also limits PFS’ ability to increase the subordinated loan to Supplies Distributors to more than \$5.0 million and permits PFS to advance incremental amounts to certain of its subsidiaries and/or affiliates subject to certain financial covenants, as defined. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb.

## [Table of Contents](#)

### ***Retail Connect Financing***

Retail Connect has an asset-based line of credit facility of up to \$3.0 million with Wells Fargo, which is collateralized by substantially all of Retail Connect's assets and expires in May 2013. The facility is expected to be renewed prior to its maturity. Borrowings under the facility and letter of credit availability are limited to a percentage of accounts receivable and inventory, up to specified amounts. As of December 31, 2012, Retail Connect had no borrowings or letters of credit outstanding and \$0.3 million available credit under this facility. The credit facility restricts Retail Connect's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as a minimum tangible net worth for Retail Connect of \$0, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

### ***Restricted Net Assets***

Certain of our credit facilities contain various financial covenants and include covenants that restrict our ability to incur additional indebtedness, create or permit liens on assets, engage in mergers or consolidations, and place restrictions on the transfer of assets or the payment of dividends between us and our subsidiaries. At December 31, 2012 and 2011, we had restricted net assets of approximately \$20.7 million and \$20.1 million, respectively.

### **Off-Balance Sheet Arrangements**

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### **Inventory Management**

In our Retail model, we manage our inventories held for sale by maintaining sufficient quantities of product to achieve high order fill rates while at the same time maximizing inventory turnover rates. Inventory balances will fluctuate as we add new product lines. To reduce the risk of loss due to supplier price reductions, Supplies Distributors' distributor agreement provides for price protection under which it receives credits if the supplier lowers prices on previously purchased inventory.

### **Seasonality**

The seasonality of our service fee business is dependent upon the seasonality of our clients' business and sales of their products. Accordingly, we must rely upon the projections of our clients in assessing quarterly variability. We believe that with our current client mix and their current business volumes, our run rate service fee business activity, which is dependent upon the business volume of our clients, will be generally highest during the quarter ended December 31. We anticipate our product revenue will be highest during the quarter ended December 31. We believe our historical revenue pattern makes it difficult to predict the effect of seasonality on our future revenues and results of operations.

We believe that results of operations for a quarterly period may not be indicative of the results for any other quarter or for the full year.

### **Inflation**

Management believes inflation has not had a material effect on our operations.

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. These accounting principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe the reported amounts would



## [Table of Contents](#)

be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. If there is a significant unfavorable change to current conditions, it would likely result in a material adverse impact to our business, operating results and financial condition. We evaluate our estimates and assumptions on an ongoing basis. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements.

We have defined a critical accounting estimate as one that is both important to the portrayal of our financial condition and results of operations and requires us to make difficult, subjective or complex judgments or estimates about matters that are uncertain. During the past three fiscal years, we have not made any material changes in accounting methodology used to establish the critical accounting estimates discussed below. The following represent certain critical accounting policies that require us to exercise our business judgment or make significant estimates. In addition, there are other items within our consolidated financial statements that require estimation but are not deemed critical as defined above.

### ***Product Revenue Recognition***

Sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for the sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectability is reasonably assured.

Sales are reported net of estimated returns and allowances which are estimated based upon historical return information. Management also considers any other current information and trends in making estimates. If actual sales returns, allowances and discounts are greater than estimated by management, additional expense may be incurred.

### ***Cost of Service Fee Revenue***

Our service fee revenue primarily relates to our distribution services and order management/customer care services. Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping product on our clients' behalf). Order management/customer care services relate primarily to taking customer orders for our clients' products via various channels such as telephone call-center, electronic or facsimile. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities.

Our cost of service fee revenue represents the cost to provide the services described above, primarily compensation and related expenses and other fixed and variable expenses directly related to providing the services. These include certain occupancy and information technology costs and depreciation and amortization expenses. Certain of these costs are allocated from general and administrative expenses. For these allocations, we estimate the amount of direct expenses based on client-specific information, such as the number of transactions processed. We believe our allocation methodology is reasonable, however a change in assumptions would result in a different gross profit in our statement of operations, yet no change to the resulting net income or loss.

### ***Allowance for Doubtful Accounts***

The determination of the collectability of amounts due from our customers requires us to use estimates and make judgments regarding future events and trends, including monitoring our customers' payment history and current credit worthiness to determine that collectability is reasonably assured, as well as consideration of the overall business climate in which our clients and customers operate. Inherently, these uncertainties require us to make frequent judgments and estimates regarding our clients and customers' ability to pay amounts due us to determine the appropriate amount of valuation allowances required for doubtful accounts. Provisions for doubtful accounts are recorded when it becomes evident the client or customer will not make the required payments at either contractual due dates or in the future.

In our Retail model, we also maintain an allowance for uncollectible vendor receivables, which arise from



## [Table of Contents](#)

inventory returns to vendors, vendor rebates, price protections and other promotions. We determine the sufficiency of the vendor receivable allowance based upon various factors, including payment history. Amounts received from vendors may vary from amounts recorded because of potential non-compliance with certain elements of vendor programs. If our estimated allowances for uncollectible accounts or vendor receivables subsequently prove insufficient, additional allowance may be required.

Allowances for doubtful accounts totaled \$0.5 million and \$0.7 million at December 31, 2012 and 2011, respectively. We believe our allowances for doubtful accounts are adequate to cover anticipated losses under current conditions; however, uncertainties regarding changes in the financial condition of our clients and customers, either adverse or positive, could impact the amount and timing of any additional provisions for doubtful accounts that may be required.

### ***Inventory Reserves***

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of weighted average cost or market. Supplies Distributors and its subsidiaries assume responsibility for slow-moving inventory under certain distributor agreements, subject to certain termination rights, but have the right to return product rendered obsolete by engineering changes, as defined. We review inventories for impairment on a periodic basis, but at a minimum, annually. Recoverability of the inventory on hand is measured by comparisons of the carrying value to the fair value of the inventory. This requires us to record provisions and maintain reserves for excess or obsolete inventory. If write-downs of inventories are necessary, the cost basis of that inventory is adjusted. To determine these reserve amounts, we regularly review inventory quantities on hand and compare them to estimates of future product demand and market conditions. These estimates and forecasts inherently include uncertainties and require us to make judgments regarding potential outcomes. At December 31, 2012 and 2011, our allowance for slow moving inventory was \$1.8 million and \$1.6 million at each year-end, respectively. We believe our reserves are adequate to cover anticipated losses under current conditions. Significant or unanticipated changes to our estimates and forecasts, either adverse or positive, could impact the amount and timing of any additional provisions for excess or obsolete inventory that may be required.

### ***Income Taxes***

The liability method is used for determining our income taxes, under which current and deferred tax liabilities and assets are recorded in accordance with enacted tax laws and rates. Under this method, the amounts of deferred tax liabilities and assets at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered. Valuation allowances are established to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining the need for valuation allowances, we have considered and made judgments and estimates regarding estimated future taxable income. These estimates and judgments include some degree of uncertainty and changes in these estimates and assumptions could require us to adjust the valuation allowances for our deferred tax assets. The ultimate realization of our deferred tax assets depends on the generation of sufficient taxable income in the applicable taxing jurisdictions. Although we believe our estimates and judgments are reasonable, actual results may differ, which could be material.

Because we operate in multiple countries, we are subject to the jurisdiction of multiple domestic and foreign tax authorities. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws and regulations and the use of estimates and assumptions regarding significant future events such as the amount, timing and character of deductions, permissible revenue recognition methods under the tax law and the sources and character of income and tax credits. Changes in tax laws, regulations, foreign currency exchange restrictions or our level of operations or profitability in each taxing jurisdiction could have an impact on the amount of income taxes that we provide during any given year.

### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Not Applicable.

[Table of Contents](#)

**Item 8. Financial Statements and Supplementary Data**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND  
FINANCIAL STATEMENT SCHEDULES**

|  | <u>Page</u> |
|--|-------------|
| <b>PFSweb, Inc. and Subsidiaries</b>   |             |
| <a href="#">Report of Independent Registered Public Accounting Firm</a>      | 38          |
| <a href="#">Consolidated Balance Sheets</a>                                  | 39          |
| <a href="#">Consolidated Statements of Operations and Comprehensive Loss</a> | 40          |
| <a href="#">Consolidated Statements of Shareholders' Equity</a>              | 41          |
| <a href="#">Consolidated Statements of Cash Flows</a>                        | 42          |
| <a href="#">Notes to Consolidated Financial Statements</a>                   | 43          |
| <b>Supplementary Data</b>  |             |
| <a href="#">Schedule I – Condensed Financial Information of Registrant</a>   | 68          |
| <a href="#">Schedule II – Valuation and Qualifying Accounts</a>              | 71          |

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
PFSweb, Inc.:

We have audited the accompanying consolidated balance sheets of PFSweb, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive loss, shareholders' equity, and cash flows for each of the years then ended. Our audits of the basic consolidated financial statements included the financial statement schedules listed in the index appearing under Item 15(a) (1). These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PFSweb, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedules, when considered in relation to the consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ GRANT THORNTON LLP

Dallas, Texas  
April 1, 2013

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except share data)**

|   | December 31,<br>2012 | December 31,<br>2011 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| <b>CURRENT ASSETS:</b>  |                      |                      |
| Cash and cash equivalents   | \$ 19,626            | \$ 17,695            |
| Restricted cash   | 283                  | 827                  |
| Accounts receivable, net of allowance for doubtful accounts of \$450 and \$663 at December 31, 2012 and 2011, respectively  | 45,684               | 52,679               |
| Inventories, net of reserves of \$1,789 and \$1,555 at December 31, 2012 and 2011, respectively   | 24,654               | 30,487               |
| Other receivables   | 7,675                | 11,915               |
| Prepaid expenses and other current assets   | 4,346                | 4,697                |
| Total current assets  | <u>102,268</u>       | <u>118,300</u>       |
| PROPERTY AND EQUIPMENT, net   | 27,917               | 14,945               |
| OTHER ASSETS  | 3,286                | 3,127                |
| Total assets  | <u>\$ 133,471</u>    | <u>\$ 136,372</u>    |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                      |                      |
| <b>CURRENT LIABILITIES:</b>   |                      |                      |
| Current portion of long-term debt and capital lease obligations   | \$ 16,660            | \$ 23,939            |
| Trade accounts payable  | 40,493               | 48,544               |
| Deferred revenue  | 6,648                | 6,766                |
| Accrued expenses  | 23,097               | 18,657               |
| Total current liabilities   | <u>86,898</u>        | <u>97,906</u>        |
| LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion  | 5,400                | 3,583                |
| DEFERRED REVENUE  | 7,562                | 5,908                |
| DEFERRED RENT   | 5,560                | 901                  |
| Total liabilities   | <u>105,420</u>       | <u>108,298</u>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                      |                      |
| <b>SHAREHOLDERS' EQUITY:</b>  |                      |                      |
| Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued and outstanding   | —                    | —                    |
| Common stock, \$0.001 par value; 35,000,000 shares authorized; 12,812,386 and 12,782,907 shares issued at December 31, 2012 and 2011, respectively; and 12,778,919 and 12,764,546 outstanding at December 31, 2012 and 2011, respectively | 13                   | 13                   |
| Additional paid-in capital  | 106,018              | 104,645              |
| Accumulated deficit   | (79,409)             | (77,898)             |
| Accumulated other comprehensive income  | 1,554                | 1,399                |
| Treasury stock at cost, 33,467 and 18,361 shares at December 31, 2012 and 2011, respectively  | (125)                | (85)                 |
| Total shareholders' equity  | <u>28,051</u>        | <u>28,074</u>        |
| Total liabilities and shareholders' equity  | <u>\$ 133,471</u>    | <u>\$ 136,372</u>    |

The accompanying notes are an integral part of these consolidated financial statements.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**FOR THE YEARS ENDED DECEMBER 31**  
(In thousands, except per share data)

|  | 2012              | 2011              |
|--|-------------------|-------------------|
| <b>REVENUES:</b>   |                   |                   |
| Product revenue, net   | \$ 119,740        | \$ 162,447        |
| Service fee revenue  | 120,433           | 95,345            |
| Pass-through revenue   | 41,390            | 40,974            |
| Total revenues   | <u>281,563</u>    | <u>298,766</u>    |
| <b>COSTS OF REVENUES:</b>  |                   |                   |
| Cost of product revenue  | 110,183           | 150,738           |
| Cost of service fee revenue  | 89,249            | 71,751            |
| Cost of pass-through revenue   | 41,390            | 40,974            |
| Total costs of revenues  | <u>240,822</u>    | <u>263,463</u>    |
| Gross profit   | 40,741            | 35,303            |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, including stock based compensation expense of \$1,325 and \$1,402<br>in the years ended December 31, 2012 and 2011, respectively |                   |                   |
|  | 40,620            | 37,512            |
| Income (loss) from operations  | 121               | (2,209)           |
| INTEREST EXPENSE, net  |                   |                   |
|  | 988               | 1,085             |
| Loss from continuing operations before income taxes  | (867)             | (3,294)           |
| INCOME TAX EXPENSE   |                   |                   |
|  | 644               | 380               |
| NET LOSS FROM CONTINUING OPERATIONS  | (1,511)           | (3,674)           |
| NET LOSS FROM DISCONTINUED OPERATIONS, NET OF TAX  | —                 | (892)             |
| NET LOSS   | <u>\$ (1,511)</u> | <u>\$ (4,566)</u> |
| LOSS PER SHARE FROM CONTINUING OPERATIONS:   |                   |                   |
| Basic  | <u>\$ (0.12)</u>  | <u>\$ (0.29)</u>  |
| Diluted  | <u>\$ (0.12)</u>  | <u>\$ (0.29)</u>  |
| LOSS PER SHARE FROM DISCONTINUED OPERATIONS:   |                   |                   |
| Basic  | <u>\$ 0.00</u>    | <u>\$ (0.07)</u>  |
| Diluted  | <u>\$ 0.00</u>    | <u>\$ (0.07)</u>  |
| NET LOSS PER SHARE:  |                   |                   |
| Basic  | <u>\$ (0.12)</u>  | <u>\$ (0.36)</u>  |
| Diluted  | <u>\$ (0.12)</u>  | <u>\$ (0.36)</u>  |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:   |                   |                   |
| Basic  | <u>12,777</u>     | <u>12,574</u>     |
| Diluted  | <u>12,777</u>     | <u>12,574</u>     |
| COMPREHENSIVE LOSS:  |                   |                   |
| Net Loss   | \$ (1,511)        | \$ (4,566)        |
| Foreign currency translation adjustment  | 155               | (127)             |
| TOTAL COMPREHENSIVE LOSS   | <u>\$ (1,356)</u> | <u>\$ (4,693)</u> |

The accompanying notes are an integral part of these consolidated financial statements.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(In thousands, except share data)

|   | Common Stock      |              | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury Stock |                 | Total<br>Shareholders'<br>Equity |
|---|-------------------|--------------|----------------------------------|------------------------|--|----------------|-----------------|----------------------------------|
|   | Shares            | Amount       |                                  |                        |  | Shares         | Amount          |                                  |
| Balance, December 31, 2010  | 12,255,064        | \$ 12        | \$ 101,229                       | \$ (73,332)            | \$ 1,526   | 18,361         | \$ (85)         | \$ 29,350                        |
| Net loss  | —                 | —            | —                                | (4,566)                | —  | —              | —               | (4,566)                          |
| Stock-based compensation expense                                  | —                 | —            | 1,402                            | —                      | —  | —              | —               | 1,402                            |
| Issuance of common stock  | 527,843           | 1            | 2,014                            | —                      | —  | —              | —               | 2,015                            |
| Other comprehensive loss— foreign currency translation adjustment | —                 | —            | —                                | —                      | (127)  | —              | —               | (127)                            |
| Balance, December 31, 2011  | 12,782,907        | 13           | 104,645                          | (77,898)               | 1,399  | 18,361         | (85)            | 28,074                           |
| Net loss  | —                 | —            | —                                | (1,511)                | —  | —              | —               | (1,511)                          |
| Stock-based compensation expense                                  | —                 | —            | 1,325                            | —                      | —  | —              | —               | 1,325                            |
| Purchase of treasury stock  | —                 | —            | —                                | —                      | —  | 15,106         | (40)            | (40)                             |
| Issuance of common stock  | 29,479            | —            | 48                               | —                      | —  | —              | —               | 48                               |
| Other comprehensive loss— foreign currency translation adjustment | —                 | —            | —                                | —                      | 155  | —              | —               | 155                              |
| Balance, December 31, 2012  | <u>12,812,386</u> | <u>\$ 13</u> | <u>\$ 106,018</u>                | <u>\$ (79,409)</u>     | <u>\$ 1,554</u>  | <u>33,467</u>  | <u>\$ (125)</u> | <u>\$ 28,051</u>                 |

The accompanying notes are an integral part of these consolidated financial statements.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31**  
(In thousands)

|   | <u>2012</u>      | <u>2011</u>      |
|---|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                  |                  |
| Net loss  | \$ (1,511)       | \$ (4,566)       |
| Loss from discontinued operations   | —                | (892)            |
| Loss from continuing operations   | (1,511)          | (3,674)          |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                  |                  |
| Depreciation and amortization   | 9,248            | 6,344            |
| Provision for doubtful accounts   | (130)            | (11)             |
| Provision for excess and obsolete inventory   | 353              | 187              |
| Deferred income taxes   | (18)             | 70               |
| Stock-based compensation expense  | 1,325            | 1,402            |
| Changes in operating assets and liabilities:  |                  |                  |
| Restricted cash   | (76)             | 185              |
| Accounts receivable   | 7,315            | (11,500)         |
| Inventories, net  | 5,650            | 3,394            |
| Prepaid expenses, other receivables and other assets                                      | 4,420            | 989              |
| Deferred rent   | 5,273            | 1,040            |
| Accounts payable, deferred revenue, accrued expenses and other liabilities                | (3,264)          | (1,146)          |
| Net cash provided by (used in) continuing operating activities                            | 28,585           | (2,720)          |
| Net cash provided by discontinued operating activities                                    | —                | 1,875            |
| Net cash provided by (used in) operating activities                                       | 28,585           | (845)            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                  |                  |
| Purchases of property and equipment   | (14,712)         | (7,550)          |
| Proceeds from sale of eCOST subsidiary  | —                | 2,327            |
| Net cash used in investing activities   | (14,712)         | (5,223)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                  |                  |
| Net proceeds from issuance of common stock  | 48               | 2,015            |
| Purchase of treasury stock  | (40)             | —                |
| Decrease in restricted cash   | 620              | 841              |
| Payments on capital lease obligations   | (2,125)          | (1,110)          |
| Proceeds from (payments on) debt, net   | (10,582)         | 3,535            |
| Net cash provided by (used in) financing activities                                       | (12,079)         | 5,281            |
| EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS                                     | 137              | 52               |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                      | 1,931            | (735)            |
| CASH AND CASH EQUIVALENTS, beginning of year  | 17,695           | 18,430           |
| CASH AND CASH EQUIVALENTS, end of year  | <u>\$ 19,626</u> | <u>\$ 17,695</u> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>   |                  |                  |
| Non-cash investing and financing activities:  |                  |                  |
| Property and equipment acquired under debt and capital leases                             | <u>\$ 7,310</u>  | <u>\$ 4,801</u>  |

The accompanying notes are an integral part of these consolidated financial statements.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Overview**

PFSweb, Inc. and its subsidiaries are collectively referred to as the “Company;” “Supplies Distributors” refers to Supplies Distributors, Inc. and its subsidiaries; “Retail Connect” refers to PFSweb Retail Connect, Inc.; and “PFSweb” refers to PFSweb, Inc. and its subsidiaries excluding Supplies Distributors and Retail Connect. In connection with the sale of certain of the assets of eCOST.com, Inc. (“eCOST”) described below, the name of eCOST was changed to PFSweb Retail Connect, Inc. in March 2011.

***PFSweb Overview***

PFSweb is an international business process outsourcing provider of end-to-end eCommerce solutions to major brand name companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives in the United States, Canada, and Europe. PFSweb offers a broad range of service offerings that include digital marketing, eCommerce technologies, order management, customer care, logistics and fulfillment, financial management and professional consulting.

***Supplies Distributors Overview***

Supplies Distributors and PFSweb operate under distributor agreements with Ricoh Company Limited and Ricoh Production Print Solutions, a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as “Ricoh”) under which Supplies Distributors acts as a distributor of various Ricoh products. Substantially all of Supplies Distributors’ revenue is generated by its sale of product purchased from Ricoh.

Supplies Distributors has obtained financing (see Notes 3 and 4) that allows it to fund the working capital requirements for the sale of primarily Ricoh products. Pursuant to the transaction management services agreements between PFSweb and Supplies Distributors, PFSweb provides to Supplies Distributors transaction management and fulfillment services, such as managed web hosting and maintenance, procurement support, web-enabled customer contact center services, customer relationship management, financial services including billing and collection services, information management, and international distribution services. Supplies Distributors does not have its own sales force and relies upon Ricoh’s sales force and product demand generation activities for its sale of Ricoh products. Supplies Distributors sells its products in the United States, Canada and Europe.

All of the agreements between PFSweb and Supplies Distributors were made in the context of a related party relationship and were negotiated in the overall context of PFSweb’s and Supplies Distributors’ arrangement with Ricoh. Although management believes the terms of these agreements are generally consistent with fair market values, there can be no assurance that the prices charged to or by each company under these arrangements are not higher or lower than the prices that may be charged by, or to, unaffiliated third parties for similar services. All of these transactions are eliminated upon consolidation.

***eCOST Overview***

Until February 2011, the Company operated eCOST primarily as a multi-category online discount retailer of new, “close-out” and recertified brand-name merchandise, which sold products primarily to customers in the United States. In February 2011 the Company sold substantially all of the inventory and certain intangible assets of the eCOST discount retailer business unit for a cash purchase price of \$2.3 million (before expenses of approximately \$0.2 million) and the assumption by the purchaser of certain limited liabilities of eCOST. The purchase price represented approximately \$1 million for inventory and the balance for the intangible assets. In connection with the closing of this business unit, the Company incurred exit costs of approximately \$0.4 million related to employee termination costs, excess property and equipment and certain contract termination costs. The Company also recorded approximately \$0.3 million in early exist costs associated with an eCOST facility. In 2011, the Company reported the operating results of the eCOST discount retailer business unit, excluding costs expected to continue to



**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

occur in the future, as discontinued operations (see Note 12). The remaining assets and business operations of eCOST are conducted under the name PFSweb Retail Connect, which provides certain services, primarily under a product ownership based model, to certain of the Company's client relationships.

Certain prior period data on the balance sheet and statement of cash flows has been reclassified to conform to the current year presentation of long-term deferred rent and deferred revenue, each of which was previously classified as other liabilities. These reclassifications had no effect on previously reported net income (loss) or total shareholders equity.

**2. Significant Accounting Policies**

***Principles of Consolidation***

All intercompany accounts and transactions have been eliminated in consolidation.

***Investment in Affiliates***

Priority Fulfillment Services, Inc. ("PFS"), a wholly-owned subsidiary of PFSweb, has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the "Subordinated Note"). Under the terms of certain of the Company's debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than \$5.0 million or decreased to less than \$3.5 million without prior approval of certain of the Company's lenders (see Notes 3 and 4). As of both December 31, 2012 and 2011, the outstanding balance of the Subordinated Note was \$3.5 million. The Subordinate Note is eliminated in the Company's consolidated financial statements.

PFS has also made advances to Retail Connect, which aggregated \$11.1 million as of both December 31, 2012 and 2011. Certain terms of the Company's debt facilities provide that the total advances to Retail Connect may not be less than \$2.0 million without prior approval of Retail Connect's lender, if needed. PFS has received the approval of its lender to advance incremental amounts to certain of its subsidiaries and/or affiliates, including Retail Connect, if needed, subject to certain financial covenants, as defined. PFSweb, Inc. has also advanced to Retail Connect an additional \$8.2 million and \$7.9 million as of December 31, 2012 and 2011, respectively. As of December 31, 2012, PFSweb, Inc. has approximately \$5.4 million available to be advanced to Retail Connect and/or other affiliates. All of these advances are eliminated upon consolidation.

***Use of Estimates***

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("US GAAP") requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The recognition and allocation of certain revenues and selling, general and administrative expenses in these consolidated financial statements also require management estimates and assumptions.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. Based on a critical assessment of accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes the Company's consolidated financial statements are fairly stated in accordance with US GAAP, and provide a fair presentation of the Company's financial position and results of operations.

***Revenue and Cost Recognition***

Depending on the terms of the customer arrangement, Supplies Distributors recognizes product revenue and product cost either upon the shipment of product to customers or when the customer receives the product. Supplies Distributors permits its customers to return product for credit against other purchases, which include returns for defective products (that Supplies Distributors then returns to the manufacturer) and incorrect shipments. Supplies Distributors provides a reserve for estimated returns and allowances and offers terms to its customers that it believes are standard for its industry.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Freight costs billed to customers are reflected as components of product revenue. Freight costs incurred are recorded as a component of cost of goods sold.

Under its distributor agreements (see Note 6), Supplies Distributors bills Ricoh for reimbursements of certain expenses, including: pass-through customer marketing programs, including rebates and coop funds; certain freight costs; direct costs incurred in passing on any price decreases offered by Ricoh to Supplies Distributors or its customers to cover price protection and certain special bids; the cost of products provided to replace defective product returned by customers; and certain other expenses as defined. Supplies Distributors includes these reimbursable amounts as they are incurred with a corresponding reduction in either inventory or cost of product revenue. Supplies Distributors also reflects pass-through customer marketing programs as a reduction of both product revenue and cost of product revenue.

The Company's service fee revenue primarily relates to its (1) distribution services, (2) order management/customer care services and (3) the reimbursement of out-of-pocket and third-party expenses. The Company typically charges its service fee revenue on a cost-plus basis, a percent of shipped revenue basis or a per transaction basis, such as a per item basis for fulfillment services or a per labor hour basis for web-enabled customer contact center services. Additional fees are billed for other services.

Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping) and facilities and operations management. Service fee revenue for these activities is recognized as earned, which is either (i) on a per transaction basis or (ii) at the time of product fulfillment, which occurs at the completion of the distribution services.

Order management/customer care services relate primarily to taking customer orders for the Company's clients' products via various channels such as telephone call-center, electronic or facsimile. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities. Service fee revenue for this activity is recognized as the services are rendered. Fees charged to the client are on a per transaction basis based on either (i) a pre-determined fee per order or fee per telephone minutes incurred, (ii) a per dedicated agent fee, or (iii) are included in the product fulfillment service fees that are recognized on product shipment.

The Company's billings for reimbursement of out-of-pocket expenses, including travel and certain third-party vendor expenses such as shipping and handling costs and telecommunication charges are included in pass-through revenue. The related reimbursable costs are reflected as cost of pass-through revenue.

The Company's cost of service fee revenue, representing the cost to provide the services described above, is recognized as incurred. Cost of service fee revenue also includes certain costs associated with technology collaboration and ongoing technology support that include maintenance, web hosting and other ongoing programming activities. These activities are primarily performed to support the distribution and order management/customer care services and are recognized as incurred.

The Company recognizes revenue and records trade accounts receivable, pursuant to the methods described above, when collectability is reasonably assured. Collectability is evaluated in the aggregate and on an individual customer basis taking into consideration payment due date, historical payment trends, current financial position, results of independent credit evaluations and payment terms. Related reserves are determined by either using percentages applied to certain aged receivable categories based on historical results and are reevaluated and adjusted as additional information is received or a specific identification method. After all attempts to collect a receivable have failed, the receivable is written off against the allowance for doubtful accounts.

The Company primarily performs its services under one- to three-year contracts that can generally be terminated by either party. In conjunction with these long-term contracts, the Company sometimes receives start-up fees to cover its implementation costs, including certain technology infrastructure and development costs. The Company defers the fees received, and the related costs, and amortizes them over the life of the contract. The amortization of deferred revenue is included as a component of service fee revenue. The amortization of deferred implementation

**PFSWEB, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

costs is included as a cost of service fee revenue. To the extent implementation costs for non-technology infrastructure and development exceed the corresponding fees received, the excess costs are expensed as incurred. The following summarizes the deferred implementation revenues and costs, excluding technology and development costs that are included in property and equipment (in thousands):

|   | <u>December 31,</u><br><u>2012</u> | <u>December 31,</u><br><u>2011</u> |
|---|------------------------------------|------------------------------------|
| <b>Deferred implementation revenues</b> |                                    |                                    |
| Current                                 | \$ 6,573                           | \$ 6,749                           |
| Non-current                             | 7,562                              | 5,907                              |
|   | <u>\$ 14,135</u>                   | <u>\$ 12,656</u>                   |
| <b>Deferred implementation costs</b>    |                                    |                                    |
| Current                                 | \$ 1,833                           | \$ 1,969                           |
| Non-current                             | 1,834                              | 1,904                              |
|   | <u>\$ 3,667</u>                    | <u>\$ 3,873</u>                    |

Current and non-current deferred implementation costs, excluding technology and development costs, are a component of prepaid expenses and other current assets and other assets, respectively. Current and non-current deferred implementation revenues may precede the timing of when the related implementation costs are incurred, and thus deferred.

***Concentration of Business and Credit Risk***

No product revenue customer or service fee client relationship represented over 10% of the Company's consolidated total net revenue during the years ended December 31, 2012 or 2011 nor more than 10% of the Company's accounts receivable at either December 31, 2012 or 2011. A summary of the customer and client concentrations is as follows:

|  | <u>December 31,</u><br><u>2012</u> | <u>December 31,</u><br><u>2011</u> |
|--|------------------------------------|------------------------------------|
| <b>Product Revenue (as a percentage of Total Product Revenue):</b>         |                                    |                                    |
| Customer 1   | 15%                                | 16%                                |
| Customer 2   | 12%                                | 9%                                 |
| <b>Service Fee Revenue (as a percentage of Total Service Fee Revenue):</b> |                                    |                                    |
| Client 1   | 15%                                | 15%                                |
| Client 2   | 14%                                | 16%                                |

The Company currently anticipates that its product revenue and service fee revenue from the customers and clients identified above will decline during the next twelve months.

The Company has provided certain collateralized guarantees of its subsidiaries' financings and credit arrangements. These subsidiaries' ability to obtain financing on similar terms would be significantly impacted without these guarantees.

The Company has multiple arrangements with International Business Machines Corporation ("IBM") and Ricoh, and is dependent upon the continuation of such arrangements. These arrangements, which are critical to the Company's ongoing operations, include Supplies Distributors' distributor agreements and certain of Supplies Distributors' working capital financing agreements. Substantially all of Supplies Distributors' revenue is generated by its sale of product purchased from Ricoh. Supplies Distributors also relies upon Ricoh's sales force and product demand generation activities and the discontinuance of such services would have a material impact upon Supplies Distributors' business. In addition, Supplies Distributors has product sales to IBM and Ricoh business affiliates.

As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability for Supplies Distributors in 2012 and 2013.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

**Cash and Cash Equivalents**

Cash equivalents are defined as short-term highly liquid investments with original maturities, when acquired, of three months or less.

**Restricted Cash**

Restricted cash includes the following items (in thousands):

|                       | December 31,<br>2012 | December 31,<br>2011 |
|-----------------------|----------------------|----------------------|
| Customer remittances  | \$ 283               | \$ 689               |
| Other                 | —                    | 138                  |
| Total restricted cash | <u>\$ 283</u>        | <u>\$ 827</u>        |

In conjunction with certain of its financing agreements, Supplies Distributors has granted to its lenders a security interest in certain customer remittances received in specified bank accounts (see Note 4). At December 31, 2012 and 2011, these bank accounts held \$0.2 million and \$0.6 million, respectively, which was restricted and can only be used to reduce the outstanding debt.

**Other Receivables**

Other receivables include \$6.5 million and \$9.7 million as of December 31, 2012 and 2011, respectively, primarily for amounts due from Ricoh and IBM for costs incurred by the Company under the distributor agreements (see Note 6). In addition, other receivables include \$0.6 million and \$1.6 million as of December 31, 2012 and 2011, respectively, applicable to value added tax receivables.

**Inventories**

Inventories (all of which are finished goods) are stated at the lower of weighted average cost or market. The Company establishes inventory reserves based upon estimates of declines in values due to inventories that are slow moving or obsolete, excess levels of inventory or values assessed at lower than cost.

Supplies Distributors assumes responsibility for slow-moving inventory under its Ricoh distributor agreements, subject to certain termination rights, but has the right to return product rendered obsolete by engineering changes, as defined (see Note 6). In the event PFSweb, Supplies Distributors and Ricoh terminate the distributor agreements, the agreements provide for the parties to mutually agree on a plan of disposition of Supplies Distributors' then existing inventory.

Supplies Distributors' inventories include merchandise in-transit that has not been received by the Company but that has been shipped and invoiced by Supplies Distributors' vendors. The corresponding payable for inventories in-transit is included in accounts payable in the accompanying consolidated financial statements.

The Company reviews inventory for impairment on a periodic basis, but at a minimum annually. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory. The allowance for slow moving inventory was \$1.8 million and \$1.6 million as of December 31, 2012 and 2011, respectively.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

**Property and Equipment**

The components of property and equipment as of December 31, 2012 and 2011 are as follows (in thousands):

|  | December 31,<br>2012 | December 31,<br>2011 | Depreciable<br>Life |
|--|----------------------|----------------------|---------------------|
| Purchased and capitalized software costs       | \$ 35,024            | \$ 26,875            | 3-5 years           |
| Furniture and fixtures                         | 22,378               | 20,473               | 2-10 years          |
| Computer equipment                             | 14,035               | 11,114               | 3-5 years           |
| Leasehold improvements                         | 13,229               | 8,926                | 3-10 years          |
| Other  | 2,953                | 1,732                | 3-5 years           |
|  | 87,619               | 69,120               |                     |
| Less-accumulated depreciation and amortization | (59,702)             | (54,175)             |                     |
| Property and equipment, net                    | <u>\$ 27,917</u>     | <u>\$ 14,945</u>     |                     |

The Company makes judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The Company records impairment losses, if any, in the period in which the Company determines the carrying amount is not recoverable. Recoverability of any assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. This may require the Company to make judgments regarding long-term forecasts of future revenues and costs related to the assets subject to review. During 2012 and 2011, no impairment of property and equipment was identified or recorded.

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Capitalized implementation costs are depreciated over the respective client contract periods. Leasehold improvements are amortized over the shorter of the useful life of the related asset or the remaining lease term. Depreciation and amortization expense related to property and equipment, excluding capital leases and amounts included in discontinued operations, during 2012 and 2011 was \$7.0 million and \$5.2 million, respectively.

The Company's property held under capital leases amount to approximately \$5.1 million and \$3.4 million, net of accumulated amortization of approximately \$2.6 million and \$1.6 million, at December 31, 2012 and 2011, respectively. Depreciation and amortization expense related to capital leases during 2012 and 2011 was \$2.2 million and \$1.1 million, respectively. In addition, during 2012, PFS incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that will be amortized over the shorter of the asset's useful lives or the lease terms and were primarily financed via tenant allowances that will also be amortized over the lease terms.

**Operating Leases**

The Company leases certain real estate for its warehouse, call center and corporate offices, as well as certain equipment under non-cancelable operating leases that expire at various dates through 2022. Management expects that, in the normal course of business, leases that expire will be renewed or replaced by other similar leases. The Company recognizes escalating lease payments on a straight-line basis over the term of each respective lease, with the difference between cash payments and rent expense recognized being recorded as deferred rent in the accompanying consolidated balance sheets.

**Foreign Currency Translation and Transactions**

For the Company's Canadian and European operations, the local currency is the functional currency. All assets and liabilities are translated at exchange rates in effect at the end of the period, and income and expense items are translated at the average exchange rates on a monthly basis.

The Company includes currency gains and losses on short-term intercompany advances in the determination of net income and loss. The Company reports gains and losses on intercompany foreign currency transactions that are of a long-term investment nature as a separate component of shareholders' equity.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

***Income Taxes***

For federal income tax purposes, tax years that remain subject to examination include years 2009 through 2012. However, the utilization of net operating loss (“NOL”) carryforwards that arose prior to 2009 remain subject to examination through the years such carryforwards are utilized. For Europe, tax years that remain subject to examination include years 2010 to 2012. However, the utilization of NOL carryforwards that arose prior to 2009 remain subject to examination through the years such carryforwards are utilized. For Canada, tax years that remain subject to examination include years 2004 to 2012, depending on the subsidiary. For state income tax purposes, the tax years that remain subject to examination include years 2006 to 2012, depending upon the jurisdiction in which the Company files tax returns. The Company and its subsidiaries have various income tax returns in the process of examination or administrative appeals. The Company does not expect these examinations will result in unrecognized tax benefits.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

The Company recognizes interest and penalties related to certain tax positions in income tax expense.

***Self Insurance***

The Company is self-insured for medical insurance benefits up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred, but not reported (“IBNR”) claims. IBNR claims are estimated using historical lag information and other data provided by claims administrators.

***Fair Value of Financial Instruments***

The carrying value of the Company’s financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable, debt and capital lease obligations, approximate their fair values based on short terms to maturity or current market prices and interest rates.

***Comprehensive Income (Loss)***

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) consists of net income (loss) and foreign currency translation adjustments.

***Net Loss Per Common Share***

Basic and diluted net loss per share are computed by dividing net loss by the weighted-average number of common shares outstanding for the reporting period. Stock options not included in the calculation of diluted net loss per share for the years ended December 31, 2012 and 2011, were 2.1 million and 2.2 million, respectively, as the effect would be anti-dilutive.

***Cash Paid For Interest and Taxes During Year***

The Company made payments for interest of approximately \$1.0 million in each of the years ended December 31, 2012 and 2011 (see Notes 3 and 4). Income tax payments of approximately \$0.6 million and \$0.4 million were made during each of the years ended December 31, 2012 and 2011, respectively (see Note 8).

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

**3. Vendor Financing**

Outstanding obligations under vendor financing arrangements consist of the following (in thousands):

|   | December 31,<br>2012 | December 31,<br>2011 |
|---|----------------------|----------------------|
| Inventory and working capital financing agreements: |                      |                      |
| United States                                       | \$ 11,890            | \$ 18,119            |
| Europe  | —                    | 9,143                |
| Total   | <u>\$ 11,890</u>     | <u>\$ 27,262</u>     |

***Inventory and Working Capital Financing Agreement, United States***

Supplies Distributors has a short-term credit facility with IBM Credit LLC (“IBM Credit”) to finance its distribution of Ricoh products in the United States, providing financing for eligible Ricoh inventory and certain receivables up to \$20.0 million. The agreement has no stated maturity date and provides either party the ability to exit the facility following a 90-day notice. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets. As of December 31, 2012, Supplies Distributors had \$2.4 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of \$3.5 million and the Company is required to maintain a minimum shareholders’ equity of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of both December 31, 2012 and 2011). The facility also includes a monthly service fee.

***Inventory and Working Capital Financing Agreement, Europe***

Supplies Distributors’ European subsidiary had a short-term credit facility with IBM Belgium Financial Services S.A. (“IBM Belgium”) to finance its distribution of Ricoh products in Europe that expired in June 2012. The asset-based credit facility with IBM Belgium provided up to 10.0 million Euros in inventory financing and cash advances through its expiration. Given the structure of the facility with IBM Belgium, and as outstanding inventory financing balances were repaid within twelve months, the Company has classified the outstanding inventory financing amounts under this facility as accounts payable in the consolidated balance sheets. Beginning in 2012, the Company replaced this credit facility with direct vendor credit terms from Ricoh to finance Supplies Distributors’ European subsidiary’s inventory purchases.

**4. Debt and Capital Lease Obligations:**

Outstanding debt and capital lease obligations consist of the following (in thousands):

|  | December 31,<br>2012 | December 31,<br>2011 |
|--|----------------------|----------------------|
| Loan and security agreements, United States: |                      |                      |
| Supplies Distributors                        | \$ 3,264             | \$ 7,245             |
| PFS  | 11,077               | 12,044               |
| Credit facility—Retail Connect               | —                    | —                    |
| Factoring agreement, Europe                  | —                    | 2,373                |
| Master lease agreements                      | 6,648                | 3,886                |
| Other  | 1,071                | 1,974                |
| Total  | <u>22,060</u>        | <u>27,522</u>        |
| Less current portion of long-term debt       | <u>16,660</u>        | <u>23,939</u>        |
| Long-term debt, less current portion         | <u>\$ 5,400</u>      | <u>\$ 3,583</u>      |

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

***Loan and Security Agreement – Supplies Distributors***

Supplies Distributors has a loan and security agreement with Wells Fargo Bank, National Association (“Wells Fargo”) to provide financing for up to \$25 million of eligible accounts receivable in the United States and Canada. As of December 31, 2012, Supplies Distributors had \$2.9 million of available credit under this agreement. The Wells Fargo facility expires on the earlier of March 2014 or the date on which the parties to the Ricoh distributor agreement (see Note 6) no longer operate under the terms of such agreement and/or Ricoh no longer supplies products pursuant to such agreement. Borrowings under the Wells Fargo facility accrue interest at prime rate plus 0.25% to 0.75% (3.75% as of December 31, 2012) or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability and subject to a minimum of 3.0%, as defined. The interest rate as of December 31, 2012 was 3.75% for \$1.26 million and 3.0% for \$2.0 million of outstanding borrowings. As of December 31, 2011, the interest rate was 3.75% for \$5.2 million and 3.02% for \$2.0 million of outstanding borrowings. This agreement contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guarantee of PFSweb. Additionally, PFS is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than \$3.5 million and may not maintain restricted cash of more than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wells Fargo pursuant to which a security interest was granted to Wells Fargo for all U.S. and Canadian customer remittances received in specified bank accounts. At December 31, 2012 and 2011, these bank accounts held \$0.2 million and \$0.6 million, respectively, which was restricted for payment to Wells Fargo.

***Loan and Security Agreement – PFSweb***

PFS has a Loan and Security Agreement (“Comerica Agreement”) with Comerica Bank (“Comerica”). The Comerica Agreement provides for up to \$12.5 million (\$10.0 million during certain non-seasonal peak months) of eligible accounts receivable financing (“Working Capital Advances”) through March 2014. The Comerica Agreement also provides for up to \$3.0 million of eligible equipment purchases (“Equipment Advances”) through January 2013, with principal payments due through April 2015. As of December 31, 2012, PFS had \$3.9 million of available credit under the Working Capital Advance portion of this facility and no remaining availability for Equipment Advances. Borrowings under the Working Capital Advance portion of this Comerica Agreement accrue interest at prime rate plus 2% (5.25% at both December, 31, 2012 and 2011), while the Equipment Advances accrue interest at prime rate plus 2.25% (5.5% at both December 31, 2012 and 2011). The Comerica Agreement contains cross default provisions, various restrictions upon PFS’s ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the Subordinated Note receivable from Supplies Distributors to a maximum of \$5.0 million. Comerica has provided approval for PFS to advance incremental amounts subject to certain financial covenants, as defined, to certain of its subsidiaries and/or affiliates, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

***Credit Facility – Retail Connect***

Retail Connect has an asset-based line of credit facility of up to \$3.0 million from Wells Fargo through May 2013, which is collateralized by substantially all of Retail Connect’s assets. Borrowings under the facility are limited to a percentage of eligible accounts receivable and inventory, up to a specified amount. Outstanding borrowings



**PFSWEB, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

under the facility bear interest at prime rate plus 1% or Eurodollar rate plus 3.5%. There were no outstanding borrowings as of December 31, 2012 or 2011. As of December 31, 2012, Retail Connect had \$0.3 million available credit under this facility. In connection with the line of credit, Retail Connect entered into a cash management arrangement whereby Retail Connect's operating accounts are considered restricted and swept and used to repay outstanding amounts under the line of credit, if any. The credit facility restricts Retail Connect's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb, Inc.), make investments and loans, pledge assets, make changes to capital stock ownership structure, and requires a minimum tangible net worth for Retail Connect of \$0, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

**Factoring Agreement**

Supplies Distributors' European subsidiary has a factoring agreement with BNP Paribas Fortis Factor ("BNP Paribas") that provides factoring for up to 7.5 million Euros (approximately \$9.9 million at December 31, 2012) of eligible accounts receivables through March 2014. This factoring agreement is accounted for as a secured borrowing. As of December 31, 2012, Supplies Distributors' European subsidiary had approximately 1.4 million Euros (approximately \$1.8 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.7% (0.8% at December 31, 2012).

**Debt Covenants**

To the extent the Company or any of its subsidiaries fail to comply with its covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements, such as profitability and cash flow, and required level of shareholders' equity or net worth (as defined), the Company would be required to obtain a waiver from the lender or the lender would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under the Company parent guarantee. Any acceleration of the repayment of the credit facilities may have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations. At December 31, 2012 and 2011, the Company had restricted net assets of approximately \$20.7 million and \$20.1 million, respectively. As of December 31, 2012, the Company was in compliance with all debt covenants.

**Master Lease Agreements**

The Company has various agreements that provide for leasing or financing transactions of equipment and other assets and will continue to enter into such arrangements as needed to finance the purchasing or leasing of certain equipment or other assets. Borrowings under these agreements, which generally have terms of three to five years, are generally secured by the related equipment, and in certain cases, by a Company parent guarantee.

**Debt and Capital Lease Maturities**

The Company's aggregate maturities of debt subsequent to December 31, 2012 are as follows (in thousands):

|                                |                 |
|--------------------------------|-----------------|
| Fiscal year ended December 31, |                 |
| 2013                           | \$14,208        |
| 2014                           | 1,870           |
| 2015                           | 731             |
| 2016                           | 90              |
| Thereafter                     | —               |
| Total                          | <u>\$16,899</u> |

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

The following is a schedule of the Company's future minimum lease payments under the capital leases, together with the present value of the net minimum lease payments as of December 31, 2012 (in thousands):

|  |                 |
|--|-----------------|
| Fiscal year ended December 31,                                       |                 |
| 2013   | \$ 2,641        |
| 2014   | 1,866           |
| 2015   | 667             |
| 2016   | 252             |
| 2017   | 44              |
| Thereafter   | —               |
| Total minimum lease payments   | \$ 5,470        |
| Less amount representing interest at rates ranging from 4.5% to 9.3% | (309)           |
| Present value of net minimum lease payments                          | 5,161           |
| Less: Current portion  | (2,452)         |
| Long-term capital lease obligations                                  | <u>\$ 2,709</u> |

## 5. Stock and Stock Options

### *Preferred Stock Purchase Rights*

On June 8, 2000, and as amended, the Company's Board of Directors declared a dividend distribution of one preferred stock purchase right (a "Right") for each share of the Company's common stock outstanding on July 6, 2000 and each share of common stock issued thereafter. Each Right entitles the registered shareholders to purchase from the Company one one-thousandth of a share of preferred stock at an exercise price of \$314.90, subject to adjustment. The Rights are not currently exercisable, but would become exercisable if certain events occurred relating to a person or group acquiring or attempting to acquire 23 percent or more of the Company's outstanding shares of common stock. The Rights expire on July 6, 2015, unless redeemed, exchanged or extended by the Company.

### *Stock Options and Stock Option Plans*

The Company recognizes compensation cost for all share-based payments based on the grant date fair value. Compensation cost is recognized on a straight-line basis, net of estimated forfeitures, over the requisite service period of each award.

Stock-based compensation charged against income was \$1.3 million and \$1.4 million for the years ended December 31, 2012 and 2011, respectively. As of December 31, 2012, there was \$1.0 million of total unrecognized compensation costs related to unvested stock options, which is expected to be recognized over a weighted average period of approximately 1 year.

The Company has an Employee Stock and Incentive Plan and an Outside Director Stock Option and Retainer Plan, under which an aggregate of 4,142,341 shares of common stock have been authorized for issuance (the "Stock Options Plans") and an outstanding stock option agreement under which 7,446 shares were originally authorized for issuance. The Stock Option Plans provide for the granting of incentive awards in the form of stock options to directors, executive management, key employees, and outside consultants of the Company. The rights to purchase shares under the employee stock option agreements typically vest over a three-year period, one-twelfth each quarter. Stock options must be exercised within 10 years from the date of grant. Stock options are generally issued such that the exercise price is equal to the market value of the Company's common stock at the date of grant. The Company uses newly issued shares of common stock to satisfy option exercises.

As of December 31, 2012, there were 1,407,231 shares available for future grants under the Stock Option Plans.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

The following table summarizes stock option activity under the Stock Option Plans:

|   | Shares           | Price Per Share | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (in<br>years) | Aggregate<br>Intrinsic<br>Value (in<br>millions) |
|---|------------------|-----------------|--|---|--|
| Outstanding, December 31, 2011                      | 2,167,852        | \$ 1.01—\$13.91 | \$ 4.56                                  |   |  |
| Granted   | 76,000           | \$ 2.54—\$ 3.11 | \$ 2.63                                  |   |  |
| Exercised   | (29,479)         | \$ 1.01—\$1.83  | \$ 1.62                                  |   |  |
| Canceled  | (114,189)        | \$ 1.46—\$12.08 | \$ 4.57                                  |   |  |
| Outstanding, December 31, 2012                      | <u>2,100,184</u> | \$ 1.01—\$13.91 | \$ 4.55                                  |   |  |
| Exercisable, December 31, 2012                      | <u>1,719,108</u> | \$ 1.01—\$13.91 | \$ 4.56                                  | 6.0   | \$ 0.4   |
| Exercisable and expected to vest, December 31, 2012 | <u>2,039,979</u> | \$ 1.01—\$13.91 | \$ 4.56                                  | 5.5   | \$ 0.4   |

The weighted average fair value per share of options granted during the years ended December 31, 2012 and 2011 was \$1.84 and \$3.55, respectively. The total intrinsic value of options exercised under the Stock Option Plans was \$0.1 million during the year ended December 31, 2012.

*Fair Value*

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of options under the Stock Option Plans:

|   | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|---|------------------------------------|------------------------------------|
| Expected dividend yield                 | —                                  | —                                  |
| Expected stock price volatility         | 82% - 83%                          | 82% - 83%                          |
| Weighted average stock price volatility | 83%                                | 84%                                |
| Risk-free interest rate                 | 0.9% - 1.1%                        | 1.2% - 2.6%                        |
| Expected life of options (years)        | 6                                  | 6                                  |

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock-price volatility. The assumptions listed above represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Company's recorded and pro forma stock-based compensation expense could have been different. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Company's actual forfeiture rate is materially different from its estimate, the share-based compensation expense could be materially different. The expected life of options has been computed using the simplified method.

**6. Distributor Agreements**

Supplies Distributors, PFSweb and Ricoh have entered into distributor agreements under which Supplies Distributors acts as a distributor of various products, primarily Ricoh products, and PFSweb provides transaction management and fulfillment services to Supplies Distributors. The distributor agreements are subject to periodic renewals, the next of which is in December 2013. Under the distributor agreements, Ricoh sells product to Supplies Distributors and reimburses Supplies Distributors for certain freight costs, direct costs incurred in passing on any price decreases offered by Ricoh to Supplies Distributors or its customers to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and other certain expenses as defined. Supplies Distributors can return to Ricoh product rendered obsolete by Ricoh engineering changes after customer demand ends. Ricoh determines when a product is obsolete. Ricoh and Supplies Distributors also have agreements under which Ricoh reimburses or collects from Supplies Distributors amounts calculated in certain inventory cost adjustments.

**PFSWEB, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Supplies Distributors passes through to customers marketing programs specified by Ricoh and administers, along with a party performing product demand generation for the Ricoh products, such programs according to Ricoh guidelines.

**7. Supplies Distributors**

Pursuant to a credit agreement, Supplies Distributors is restricted from making any distributions to PFSweb if, after giving affect thereto, Supplies Distributors' would be in noncompliance with its financial covenants. Under the terms of its amended credit agreements, Supplies Distributors is restricted from paying annual cash dividends without the prior approval of its lenders (see Notes 3 and 4). Supplies Distributors has received lender approval to pay approximately \$2.5 million of dividends in 2013. Supplies Distributors paid dividends to PFSweb of \$1.0 million and \$0.6 million in 2012 and 2011, respectively.

**8. Income Taxes**

The consolidated income (loss) from continuing operations before income taxes, by domestic and foreign entities, is as follows (in thousands):

|          | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|----------|------------------------------------|------------------------------------|
| Domestic | \$ (492)                           | \$ (3,057)                         |
| Foreign  | (375)                              | (237)                              |
| Total    | <u>\$ (867)</u>                    | <u>\$ (3,294)</u>                  |

A reconciliation of the difference between the expected income tax expense from continuing operations at the U.S. federal statutory corporate tax rate of 34%, and the Company's effective tax rate is as follows (in thousands):

|   | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|---|------------------------------------|------------------------------------|
| Income tax benefit computed at statutory rate | \$ (295)                           | \$ (1,120)                         |
| Foreign dividends received                    | 171                                | 637                                |
| Items not deductible for tax purposes         | 780                                | 275                                |
| Change in valuation reserve                   | 1,976                              | (265)                              |
| State taxes                                   | 492                                | 168                                |
| Impact of foreign taxation                    | 96                                 | 119                                |
| Foreign exchange rate difference              | (76)                               | 104                                |
| Net operating loss adjustments                | (1,616)                            | 215                                |
| Prior year return to provision true-up        | (665)                              | (73)                               |
| Other   | (219)                              | 320                                |
| Provision for income taxes                    | <u>\$ 644</u>                      | <u>\$ 380</u>                      |

Current and deferred income tax expense (benefit) is summarized as follows (in thousands):

|                 | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|-----------------|------------------------------------|------------------------------------|
| <b>Current</b>  |                                    |                                    |
| Domestic        | \$ —                               | \$ —                               |
| State           | 537                                | 165                                |
| Foreign         | 125                                | 145                                |
| Total current   | <u>662</u>                         | <u>310</u>                         |
| <b>Deferred</b> |                                    |                                    |
| Domestic        | —                                  | —                                  |
| State           | —                                  | —                                  |
| Foreign         | (18)                               | 70                                 |
| Total deferred  | <u>(18)</u>                        | <u>70</u>                          |
| Total           | <u>\$ 644</u>                      | <u>\$ 380</u>                      |

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

The components of the deferred tax asset (liability) are as follows (in thousands):

|                                  | December 31,<br>2012 | December 31,<br>2011 |
|----------------------------------|----------------------|----------------------|
| <b>Deferred tax assets:</b>      |                      |                      |
| Allowance for doubtful accounts  | \$ 639               | \$ 723               |
| Inventory reserve                | 630                  | 556                  |
| Net operating loss carryforwards | 20,617               | 20,026               |
| Other                            | 4,676                | 2,420                |
|                                  | <u>26,562</u>        | <u>23,725</u>        |
| Less — Valuation allowance       | 24,914               | 22,938               |
| Total deferred tax asset         | <u>1,648</u>         | <u>787</u>           |
| <b>Deferred tax liabilities:</b> |                      |                      |
| Property and equipment           | (1,238)              | (446)                |
| Other                            | (46)                 | —                    |
| Total deferred tax liabilities   | <u>(1,284)</u>       | <u>(446)</u>         |
| Deferred tax assets, net         | <u>\$ 364</u>        | <u>\$ 341</u>        |

Management believes that PFSweb has not established a sufficient history of earnings, on a stand-alone basis, to support the more likely than not realization of certain deferred tax assets in excess of existing taxable temporary differences. A valuation allowance has been provided for the majority of these net deferred income tax assets as of December 31, 2012 and 2011. The remaining net deferred tax assets at both December 31, 2012 and 2011 primarily relate to the Company's European operations. At December 31, 2012, net operating loss carryforwards relate to taxable losses of PFSweb's European subsidiary totaling approximately \$1.6 million, PFSweb's Canadian subsidiary totaling approximately \$5.9 million and PFSweb's U.S. subsidiaries totaling approximately \$54.5 million that expire at various dates from 2014 through 2032. The U.S. NOL carryforward includes approximately \$4.7 million relating to tax benefits of stock option exercises and, if utilized, will be recorded against additional paid-in capital upon utilization rather than as an adjustment to income tax expense from continuing operations. The U.S. NOL also includes approximately \$20.5 million of NOL acquired in 2006, which is subject to annual limits of \$1.2 million under IRS Section 382.

The Company evaluates its tax positions for potential liabilities associated with unrecognized tax benefits. As of December 31, 2012 and 2011, no unrecognized tax benefits, penalties or interest were identified or recorded. The Company does not expect to record unrecognized tax benefits in the next twelve months.

**9. Commitments and Contingencies**

The Company leases facilities, warehouse and office space and transportation and other equipment under operating leases expiring in various years through December 31, 2022. In most cases, management expects that, in the normal course of business, leases will be renewed or replaced by other similar leases. The Company is also subleasing, to a third party, a facility in El Segundo, California through April 2014. The Company's facility leases generally contain one or more renewal options.

Minimum future annual rental payments and sublease receipts under non-cancelable operating leases having original terms in excess of one year are as follows (in thousands):

| Fiscal year ended December 31, | Operating<br>Lease<br>Payments | Sublease<br>Income |
|--------------------------------|--------------------------------|--------------------|
| 2013                           | \$ 6,302                       | \$ 127             |
| 2014                           | 5,007                          | 42                 |
| 2015                           | 3,842                          | —                  |
| 2016                           | 2,938                          | —                  |
| 2017                           | 2,266                          | —                  |
| Thereafter                     | 14,353                         | —                  |
| Total                          | <u>\$ 34,708</u>               | <u>\$ 169</u>      |

Minimum rental payments under operating leases are recognized on a straight-line basis over the term of the lease including any periods of free rent. Any differences between cash rental payments made and straight-line rent

**PFSWEB, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

expense is recorded as deferred rent on the accompanying consolidated balance sheets. Total rental expense under operating leases approximated \$7.8 million and \$7.5 million for the years ended December 31, 2012 and 2011, respectively. Certain landlord required deposits are secured by letters of credit.

In 2012, the Company incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that will be amortized over the shorter of the assets lives or the lease terms and were primarily financed via tenant allowances that will also be amortized over the lease terms.

The Company received municipal tax abatements in certain locations. In prior years, the Company received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to the Company's tax abatement. The Company disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against the Company and the timing of the related payments has not been finalized. As of December 31, 2012, the Company believes it has adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. The Company received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and the Company has responded to the subpoenas and is fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and the Company intends to seek the recovery or reimbursement of the funds which are currently classified as other receivables on the December 31, 2012 financial statements. Based on the information available to date, the Company is unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or the inability of the Company to recover such funds or any significant portion thereof, or any costs and expenses incurred by the Company in connection with this matter, will not have a material adverse effect upon the Company's financial condition or results of operations.

The Company is subject to claims in the ordinary course of business, including claims of alleged infringement by the Company or its subsidiaries of the patents, trademarks and other intellectual property rights of third parties. PFS is generally required to indemnify its service fee clients against any third party claims alleging infringement by PFS of the patents, trademarks and other intellectual property rights of third parties.

**10. Segment and Geographic Information**

The Company is currently organized into two primary operating segments, which generally align with the corporate organization structure. In the first segment, PFSweb is an international provider of various business process outsourcing solutions and operates as a service fee business. In the second operating segment, ("Business and Retail Connect"), subsidiaries of the Company purchase inventory from clients and resell the inventory to client customers. In this segment, the Company generally recognizes product revenue.

|   | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|---|------------------------------------|------------------------------------|
| Revenues (in thousands):                      |                                    |                                    |
| PFSweb  | \$ 167,220                         | \$ 142,822                         |
| Business and Retail Connect                   | 120,419                            | 162,447                            |
| Eliminations                                  | (6,076)                            | (6,503)                            |
|   | <u>\$ 281,563</u>                  | <u>\$ 298,766</u>                  |
| Income (loss) from operations (in thousands): |                                    |                                    |
| PFSweb  | \$ (2,030)                         | \$ (5,413)                         |
| Business and Retail Connect                   | 2,151                              | 3,204                              |
|   | <u>\$ 121</u>                      | <u>\$ (2,209)</u>                  |

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

|  | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|--|------------------------------------|------------------------------------|
| <b>Depreciation and amortization (in thousands):</b> |                                    |                                    |
| PFSweb   | \$ 9,147                           | \$ 6,318                           |
| Business and Retail Connect                          | 101                                | 26                                 |
|  | <u>\$ 9,248</u>                    | <u>\$ 6,344</u>                    |
| <b>Capital expenditures (in thousands):</b>          |                                    |                                    |
| PFSweb   | \$ 14,449                          | \$ 7,464                           |
| Business and Retail Connect                          | 263                                | 86                                 |
|  | <u>\$ 14,712</u>                   | <u>\$ 7,550</u>                    |
| <b>Assets (in thousands):</b>                        |                                    |                                    |
| PFSweb   | \$ 94,940                          | \$ 83,097                          |
| Business and Retail Connect                          | 52,648                             | 66,740                             |
| Eliminations   | (14,117)                           | (13,465)                           |
|  | <u>\$ 133,471</u>                  | <u>\$ 136,372</u>                  |

Geographic areas in which the Company operates include the United States, Europe (primarily Belgium), and Canada. The following is geographic information by area. Revenues are attributed based on the Company's domicile.

|  | Year Ended<br>December 31,<br>2012 | Year Ended<br>December 31,<br>2011 |
|--|------------------------------------|------------------------------------|
| <b>Revenues (in thousands):</b>                |                                    |                                    |
| United States                                  | \$ 225,591                         | \$ 215,027                         |
| Europe   | 51,582                             | 79,602                             |
| Canada   | 5,817                              | 5,787                              |
| Inter-segment eliminations                     | (1,427)                            | (1,650)                            |
|  | <u>\$ 281,563</u>                  | <u>\$ 298,766</u>                  |
| <b>Other long-lived assets (in thousands):</b> |                                    |                                    |
| United States                                  | \$ 25,826                          | \$ 15,480                          |
| Europe   | 4,929                              | 2,273                              |
| Canada   | 448                                | 319                                |
|  | <u>\$ 31,203</u>                   | <u>\$ 18,072</u>                   |

### 11. Employee Savings Plan

The Company has a defined contribution employee savings plan under Section 401(k) of the Internal Revenue Code. Substantially all full-time and part-time U.S. employees are eligible to participate in the plan. The Company, at its discretion, may match employee contributions to the plan and also make an additional matching contribution in the form of profit sharing in recognition of the Company's performance. The Company contributed approximately \$0.2 million and \$0.1 million during the years ended December 31, 2012 and 2011, respectively, to match an approved percentage of employee contributions.

### 12. Discontinued Operations

In February 2011, the Company sold certain assets of eCOST to a third party for a total aggregate cash purchase price of approximately \$2.3 million (before expenses of approximately \$0.2 million). Accordingly, the accompanying consolidated financial statements reflect the related operating results of the eCOST segment as discontinued operations for the year ended December 31, 2011.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Summarized financial information in the accompanying consolidated statement of operations for the discontinued eCOST operations is as follows (in thousands):

|  | Year Ended<br>December 31<br><u>2011</u> |
|--|--|
| Product revenue, net                         | \$ 6,909                                 |
| Expenses                                     | <u>7,792</u>                             |
| Loss before provision for income taxes       | (883)                                    |
| Provision (benefit) for income taxes         | <u>(9)</u>                               |
| Discontinued operations, net of income taxes | <u>\$ (892)</u>                          |



**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

We maintain a comprehensive set of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). As of December 31, 2012, an evaluation of the effectiveness of our disclosure controls and procedures was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, these disclosure controls and procedures were effective.

**Changes in Internal Control Over Financial Reporting**

During the year ended December 31, 2012, there was no change in internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Management’s Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) under the Exchange Act. Our internal control over financial reporting is designed, under the supervision of our principle executive and principle financial officers, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (GAAP). Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and Board of Directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2012. This evaluation was based on the framework in “Internal Control—Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our Chief Executive Officer and Chief Financial Officer concluded that internal control over financial reporting was effective as of December 31, 2012.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our independent registered public accounting firm pursuant to the exemption provided to issuers that are not “large accelerated filers” or “accelerated filers” under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

[Table of Contents](#)

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors and Executive Officers and Corporate Governance**

Reference is made to the information to be set forth in the section entitled “Board of Directors” and “Committees of the Board” in the definitive proxy statement in connection with our Annual Meeting of Shareholders (the “Proxy Statement”), which section is incorporated herein by reference. Our Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the last day of our fiscal year ended December 31, 2012.

**Item 11. Executive Compensation**

Information required by Part III, Item 11, will be included in the section entitled “Executive Compensation” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

Information required by Part III, Item 12, will be included in the Sections entitled “Election of Directors” and “Security Ownership of Certain Beneficial Owners and Management” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2012:

| <u>Plan category (1)</u>                               | <u>Number of securities to be issued upon exercise of outstanding options and warrants</u> | <u>Weighted-average exercise price of outstanding options and warrants</u> | <u>Number of securities remaining available for future issuance</u> |
|--|--|--|---|
| Equity compensation plans approved by security holders | 2,100,184  | \$ 4.55  | 1,407,231   |

(1) See Note 5 to the Consolidated Financial Statements for more detailed information regarding the Company’s equity compensation plans.

**Item 13. Certain Relationship and Related Transactions and Director Independence**

Information regarding certain of our relationships and related transactions will be included in the section entitled “Certain Relationship and Related Transactions” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Information required by Part III, Item 14, will be included in the section entitled “Ratification of Appointment of Independent Auditors” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) *The following documents are filed as part of this report:*

1. *Financial Statements*

PFSweb, Inc. and Subsidiaries

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Operations  
Consolidated Statements of Shareholders' Equity and Comprehensive Loss  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

*Financial Statement Schedules*

Schedule I – Condensed Financial Information of Registrant

Schedule II – Valuation and Qualifying Accounts

All other schedules are omitted because the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the financial statements or notes thereto.

2. *Exhibits*

| <u>Exhibit Number</u> | <u>Description of Exhibits</u>   |
|-----------------------|--|
| 3.1 (1)               | Amended and Restated Certificate of Incorporation of PFSweb, Inc.  |
| 3.1.1 (20)            | Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.  |
| 3.1.2 (32)            | Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.   |
| 3.1.3 (36)            | Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.  |
| 3.2 (1)               | Amended and Restated Bylaws  |
| 3.2.1 (26)            | Amendment to the Amended and Restated By-Laws of PFSweb, Inc.  |
| 2.2.2 (39)            | Amendment to the Amended and Restated By-Laws of PFSweb, Inc.  |
| 4.1 (30)              | Rights Agreement, dated as of June 8, 2000, between the Company and ChaseMellon Shareholder Services, LLC  |
| 4.1 (31)              | Amendment No. 1 to Rights Agreement, dated as of May 30, 2008 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent. |
| 4.1 (38)              | Amendment No. 2 to Rights Agreement, dated as of May 24, 2010 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent. |
| 4.1 (39)              | Amendment No. 3 to Rights Agreement, dated as of July 2, 2010 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent. |
| 10.1 (18)             | Amendment 3 to Loan and Security Agreement.  |
| 10.2 (18)             | Amendment 6 to Agreement for Inventory Financing.  |
| 10.3 (18)             | Amendment 1 to First Amended and Restated Loan and Security Agreement.   |
| 10.4 (16)             | Amendment 5 to Amended and Restated Platinum Plan Agreement.   |
| 10.5 (16)             | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.   |
| 10.6 (16)             | Amendment No. 5 to Agreement for Inventory Financing.  |
| 10.7 (1)              | Industrial Lease Agreement between Shelby Drive Corporation and Priority Fulfillment Services, Inc.  |
| 10.8 (1)              | Lease Contract between Transports Weerts and Priority Fulfillment Services Europe B.V.   |
| 10.9 (2)              | Form of Change of Control Agreement between the Company and each of its executive officers   |

## Table of Contents

|              |  |
|--------------|--|
| 10.11 (5)    | Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., Inventory Financing Partners, LLC and IBM Credit Corporation              |
| 10.12 (5)    | Amended and Restated Collateralized Guaranty by and between Priority Fulfillment Services, Inc. and IBM Credit Corporation   |
| 10.13 (5)    | Amended and Restated Guaranty to IBM Credit Corporation by PFSweb, Inc.  |
| 10.14 (5)    | Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors Europe B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.                                     |
| 10.15 (5)    | Amended and Restated Guaranty to IBM Belgium Financial Services S.A. by PFSweb, Inc.   |
| 10.16 (5)    | Subordinated Demand Note by and between Supplies Distributors, Inc. and Priority Fulfillment Services, Inc.  |
| 10.17 (5)    | Notes Payable Subordination Agreement between Congress Financial Corporation (Southwest) and Priority Fulfillment Services, Inc.   |
| 10.18 (5)    | Guarantee in favor of Congress Financial Corporation (Southwest) by Business Supplies Distributors Holdings, LLC, Priority Fulfillment Services, Inc. and PFSweb, Inc.   |
| 10.19 (5)    | General Security Agreement by Priority Fulfillment Services, Inc. in favor of Congress Financial Corporation (Southwest).  |
| 10.20 (5)    | Inducement Letter by Priority Fulfillment Services, Inc. and PFSweb, Inc. in favor of Congress Financial Corporation (Southwest).  |
| 10.21 (6)    | Form of Executive Severance Agreement between the Company and each of its executive officers.  |
| 10.21.1 (33) | Form of Amendment to Executive Severance Agreement.  |
| 10.21.2 (33) | Form of Amendment to Change in Control Severance Agreement.  |
| 10.21.3 (39) | Severance, Nondisclosure, Nonsolicitation and Noncompete Agreement dated July 2, 2010 between the Company and Cynthia Almond.  |
| 10.22 (7)    | Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., Inventory Financing Partners, LLC and IBM Credit Corporation |
| 10.23 (7)    | Amendment to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors Europe B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.                        |
| 10.24 (7)    | Amendment to Factoring agreement dated March 29, 2002 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.  |
| 10.25 (8)    | Unconditional Guaranty of PFSweb, Inc. to Comerica Bank – California   |
| 10.26 (8)    | Security Agreement of PFSweb, Inc. to Comerica Bank – California   |
| 10.27 (8)    | Intellectual Property Security Agreement between Priority Fulfillment Services, Inc. and Comerica Bank – California  |
| 10.28 (8)    | Amendment 2 to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.                             |
| 10.29 (8)    | Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., and IBM Credit LLC   |
| 10.30 (9)    | Amendment to factoring agreement dated April 30, 2003 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.  |
| 10.31 (9)    | Loan and Security Agreement by and between Congress Financial Corporation (Southwest), as Lender and Supplies Distributors, Inc., as Borrower dated March 29, 2002.  |

## Table of Contents

|            |  |
|------------|--|
| 10.32 (9)  | General Security Agreement – Business Supplies Distributors Holdings, LLC in favor of Congress Financial Corporation (Southwest)   |
| 10.33 (9)  | Stock Pledge Agreement between Supplies Distributors, Inc. and Congress Financial Corporation (Southwest)  |
| 10.34 (9)  | First Amendment to General Security Agreement by Priority Fulfillment Services, Inc. in favor of Congress Financial Corporation (Southwest)  |
| 10.35 (12) | Industrial Lease Agreement between New York Life Insurance Company and Daisytek, Inc.  |
| 10.36 (12) | First Amendment to Industrial Lease Agreement between New York Life Insurance Company, Daisytek, Inc. and Priority Fulfillment Services, Inc.  |
| 10.37 (12) | Second Amendment to Industrial Lease Agreement between ProLogis North Carolina Limited Partnership and Priority Fulfillment Services, Inc.   |
| 10.38 (12) | Modification, Ratification and Extension of Lease between Shelby Drive Corporation and Priority Fulfillment Services, Inc.   |
| 10.39 (13) | Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., and IBM Credit LLC               |
| 10.40 (13) | Amendment 4 to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors B.V., PFSweb B.V., and IBM Belgium Financial Services S.A. |
| 10.41 (13) | First Amendment to Loan and Security Agreement by and between Congress Financial Corporation (Southwest), as Lender and Supplies Distributors, Inc., as Borrower.  |
| 10.42 (13) | Form of Modification to Executive Severance Agreement.   |
| 10.43 (14) | Industrial Lease Agreement by and between Industrial Developments International, Inc. and Priority Fulfillment Services, Inc.  |
| 10.44 (14) | Guaranty by PFSweb, Inc. in favor of Industrial Developments International, Inc.   |
| 10.48 (15) | Loan Agreement between Mississippi Business Finance Corporation and Priority Fulfillment Services, Inc. dated as of November 1, 2004   |
| 10.49 (15) | Reimbursement Agreement between Priority Fulfillment Services, Inc. and Comerica Bank  |
| 10.50 (15) | First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.  |
| 10.51 (15) | Remarketing Agreement between Priority Fulfillment Services, Inc. and Comerica Securities  |
| 10.52 (20) | Amendment to factoring agreement dated December 12, 2005 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.   |
| 10.53 (21) | Amendment 7 to Agreement for Inventory Financing.  |
| 10.54 (21) | Amendment 6 to Amended and Restated Platinum Plan Agreement.   |
| 10.55 (21) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.   |
| 10.56 (21) | Second Amendment to Loan and Security Agreement by and between eCOST.com, Inc. and Wachovia Capital Finance Corporation (Western).   |
| 10.57 (21) | Amendment 4 to Loan and Security Agreement.  |
| 10.58 (21) | Guaranty by PFSweb, Inc., in favor of Wachovia Capital Finance Corporation (Western).  |
| 10.59 (21) | Second Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.  |
| 10.61 (24) | Amendment 8 to Agreement for Inventory Financing.  |
| 10.62 (24) | Fourth Amendment to the Loan and Security Agreement by and between eCOST.com, Inc. and Wachovia Capital Finance Corporation (Western).   |
| 10.63 (24) | Amendment 5 to Loan and Security Agreement.  |

## Table of Contents

|            |   |
|------------|---|
| 10.64 (24) | Amendment 7 to Amended and Restated Platinum Plan Agreement.  |
| 10.65 (24) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.  |
| 10.66 (25) | Fifth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.                                |
| 10.67 (27) | Second Amendment to Industrial Lease Agreement by and between Industrial Property Fund VI, LLC and Priority Fulfillment Services, Inc.  |
| 10.68 (29) | Amendment 9 to Agreement for Inventory Financing.   |
| 10.69 (29) | Amendment 8 to Amended and Restated Platinum Plan Agreement.  |
| 10.70 (29) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.  |
| 10.71 (29) | Sixth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.                                |
| 10.72 (34) | Sixth Amendment to Loan and Security Agreement dated January 6, 2009 between Wachovia Bank and Supplies Distributors, Inc.  |
| 10.73 (34) | Fifth Amendment to Loan and Security Agreement dated January 6, 2009 between Wachovia Bank and eCOST.com Inc.   |
| 10.74 (35) | Amendment 10 to Agreement for Inventory Financing.  |
| 10.75 (35) | Amendment 9 to Amended and Restated Platinum Plan Agreement.  |
| 10.76 (35) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.  |
| 10.77 (35) | Seventh Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.                              |
| 10.78 (36) | Amended and Restated 2005 Employee Stock and Incentive Plan of PFSweb, Inc.   |
| 10.79 (36) | Amended and Restated Non-Employee Director Stock Option and Retainer Plan of PFSweb, Inc.   |
| 10.80 (37) | Eighth Amended and Restated Notes Payable Subordination Agreement by and between Priority Fulfillment Services, Inc., Supplies Distributors, Inc. and IBM Credit Corporation. |
| 10.81 (37) | Amendment 11 to Agreement for Inventory Financing.  |
| 10.82 (37) | Amendment 10 to Amended and Restated Platinum Plan Agreement.   |
| 10.83 (37) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.  |
| 10.84 (37) | Eighth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.                               |
| 10.85 (40) | Asset Purchase Agreement by and between eCOST.com., PC Mall, Inc. and Mall Acquisition 3, Inc. dated as of February 17, 2011.   |
| 10.86 (41) | Consent and Lien release dated as of February 17, 2011, by and between Wells Fargo Bank, National Association and eCOST.com, Inc.   |
| 10.87 (42) | Factoring Agreement by and between BNP Paribas Fortis Factor and Supplies Distributors, S.A.  |
| 10.88 (42) | Amendment 12 to Agreement for Inventory Financing   |
| 10.89 (42) | Amendment 11 to Amended and Restated Platinum Plan Agreement  |
| 10.90 (42) | Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule   |
| 10.91 (42) | Ninth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment services, Inc.                                |
| 10.92 (42) | 2011 Management Bonus Plan  |
| 10.93 (42) | Seventh Amendment to Loan and Security Agreement dated January 6, 2009 between Wells Fargo Bank and Supplies Distributors, Inc.   |

## Table of Contents

- 10.94 (43) Seventh Amendment to Loan and Security Agreement dated January 6, 2009 by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, Inc.
- 10.95 (44) Tenth Amendment to First Amended and Restated Loan and Security Agreement dated November 10, 2011 by and between Priority Fulfillment Services, Inc., and Comerica Bank
- 10.96 (45) Lease agreement by and between Binyan Realty LP and Priority Fulfillment Services, Inc.
- 10.97 (45) Lease Guaranty by PFSweb, Inc. in favor of Binyan Realty LP
- 10.98 (45) Lease Agreement dated December 8, 2011, between CCI-Millennium, L.P. and Priority Fulfillment Services, Inc.
- 10.99 (45) Guaranty of PFSweb, Inc. to CCI-Millennium, L.P.
- 10.100 (45) Eleventh Amendment to First Amended and Restated Loan and Security Agreement by and between Priority Fulfillment Services, Inc., and Comerica Bank
- 10.101 (45) Amendment 13 to Agreement for Inventory Financing
- 10.102 (46) Twelfth Amendment to First Amended and Restated Loan and Security Agreement dated May 14, 2012 by and between Priority Fulfillment Services, Inc., and Comerica Bank.
- 10.103 (46) Eighth Amendment to Loan and Security Agreement dated January 6, 2009 by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, Inc.
- 10.104 (47) Fourteenth Amendment to First Amended and Restated Loan and Security Agreement between Priority Fulfillment Services, Inc. and Comerica Bank.
- 21 (48) Subsidiary Listing
- 23.1 (48) Consent of GRANT THORNTON, LLP, Independent Registered Public Accounting Firm
- 31.1 (48) Certifications of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350
- 31.2 (48) Certifications of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350
- 32.1 (48) Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- (1) Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657).
- (2) Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year ended March 31, 2001
- (3) Incorporated by reference from PFSweb, Inc. Form 10-Q/A for the quarterly period ended September 30, 2001
- (4) Incorporated by reference from PFSweb, Inc. Form 10-K for the transition period ended December 31, 2001
- (5) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2002
- (6) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2002
- (7) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2002
- (8) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2003
- (9) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2003
- (10) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2003
- (11) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 10, 2003
- (12) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2003
- (13) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2004
- (14) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2004
- (15) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2004.
- (16) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2005.

## Table of Contents

- (17) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 14, 2005.
- (18) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2005.
- (19) Incorporated by reference from PFSweb, Inc. Current Report on Form 8-K filed on November 30, 2005.
- (20) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2005.
- (21) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2006.
- (22) Incorporated by reference from PFSweb, Inc. Current Report on Form 8-K filed on June 2, 2006.
- (23) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2006.
- (24) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2006.
- (25) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2007.
- (26) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 13, 2007.
- (27) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2007.
- (28) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 2, 2008.
- (29) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2008.
- (30) Incorporated by reference from PFSweb, Inc. Registration Statement on Form 8-A filed on June 14, 2000.
- (31) Incorporated by reference from PFSweb, Inc. Report on Form 8K filed on May 30, 2008.
- (32) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 2, 2008.
- (33) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on January 6, 2009.
- (34) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on January 9, 2009.
- (35) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 15, 2009.
- (36) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2009.
- (37) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 17, 2010.
- (38) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 25, 2010.
- (39) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 2, 2010.
- (40) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on February 23, 2011.
- (41) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2010.
- (42) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 16, 2011
- (43) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 15, 2011.
- (44) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on November 14, 2011.
- (45) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2011.
- (46) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 15, 2012.
- (47) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on November 14, 2012.
- (48) Filed herewith.



**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**BALANCE SHEETS – PARENT COMPANY ONLY**  
**(In thousands)**

|   | December 31,<br>2012 | December 31,<br>2011 |
|---|----------------------|----------------------|
| <b>ASSETS:</b>                              |                      |                      |
| Cash and cash equivalents                   | \$ 5,408             | \$ 5,876             |
| Receivable from subsidiaries.               | 6,218                | 6,043                |
| Receivable from PFSweb Retail Connect, Inc. | 8,200                | 7,900                |
| Investment in subsidiaries                  | 8,225                | 8,255                |
| Total assets                                | <u>\$ 28,051</u>     | <u>\$ 28,074</u>     |
| <b>LIABILITIES:</b>                         |                      |                      |
| Total liabilities                           | <u>\$ —</u>          | <u>\$ —</u>          |
| <b>SHAREHOLDERS' EQUITY:</b>                |                      |                      |
| Preferred stock                             | —                    | —                    |
| Common stock                                | 13                   | 13                   |
| Additional paid-in capital                  | 106,018              | 104,645              |
| Accumulated deficit                         | (79,409)             | (77,898)             |
| Accumulated other comprehensive income      | 1,554                | 1,399                |
| Treasury stock                              | (125)                | (85)                 |
| Total shareholders' equity                  | <u>28,051</u>        | <u>28,074</u>        |
| Total liabilities and shareholders' equity  | <u>\$ 28,051</u>     | <u>\$ 28,074</u>     |

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**STATEMENTS OF OPERATIONS – PARENT COMPANY ONLY**  
**FOR THE YEARS ENDED DECEMBER 31**  
**(In thousands)**

|   | <u>2012</u>      | <u>2011</u>      |
|---|------------------|------------------|
| EQUITY IN NET LOSS OF CONSOLIDATED SUBSIDIARIES | <u>\$(1,511)</u> | <u>\$(4,566)</u> |
| NET LOSS  | <u>\$(1,511)</u> | <u>\$(4,566)</u> |

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**STATEMENTS OF CASH FLOWS – PARENT COMPANY ONLY**  
**FOR THE YEARS ENDED DECEMBER 31**  
**(In thousands)**

|   | <u>2012</u>     | <u>2011</u>     |
|---|-----------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                    |                 |                 |
| Net loss  | \$(1,511)       | \$(4,566)       |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                 |                 |
| Equity in net loss of consolidated subsidiaries                                 | 1,511           | 4,566           |
| Net cash provided by operating activities                                       | <u>—</u>        | <u>—</u>        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                 |                 |
| Proceeds from issuance of common stock  | 48              | 2,015           |
| Purchase of treasury stock  | (40)            | —               |
| Increase in receivable from PFSweb Retail Connect, Inc.                         | (300)           | (500)           |
| Increase in receivable from subsidiaries, net                                   | (176)           | (645)           |
| Net cash provided by (used in) financing activities                             | <u>(468)</u>    | <u>870</u>      |
| NET INCREASE (DECREASE) IN CASH   | (468)           | 870             |
| CASH AND CASH EQUIVALENTS, beginning of period                                  | 5,876           | 5,006           |
| CASH AND CASH EQUIVALENTS, end of period  | <u>\$ 5,408</u> | <u>\$ 5,876</u> |

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**FOR THE YEARS ENDED DECEMBER 31**  
**(Amounts in thousands)**

|                                 | <u>Balance at<br/>Beginning<br/>of Period</u> | <u>Additions</u>                                |  | <u>Deductions</u> | <u>Balance<br/>at End<br/>of<br/>Period</u> |
|---------------------------------|---|---|--|-------------------|---|
|                                 |   | <u>Charges<br/>to Cost<br/>and<br/>Expenses</u> | <u>Charges<br/>to Other<br/>Accounts</u> |                   |   |
| Year Ended December 31, 2011:   |   |   |  |                   |   |
| Allowance for doubtful accounts | \$ 754  | (11)  | —  | (80)              | \$ 663                                      |
| Year Ended December 31, 2012:   |   |   |  |                   |   |
| Allowance for doubtful accounts | \$ 663  | (131)   | —  | (82)              | \$ 450                                      |

**SIGNATURES**

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

By: /s/ Thomas J. Madden  
Thomas J. Madden,  
*Executive Vice President and  
Chief Financial and Accounting Officer*

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

| <u>Signature</u>                                    | <u>Title</u>   | <u>Date</u>   |
|---|--|---------------|
| <u>/s/ Michael Willoughby</u><br>Michael Willoughby | Chief Executive Officer (Principal Executive Officer)  | April 1, 2013 |
| <u>/s/ Thomas J. Madden</u><br>Thomas J. Madden     | Executive Vice President and Chief Financial and Accounting Officer (Principal Financial and Accounting Officer) | April 1, 2013 |
| <u>/s/ James F. Reilly</u><br>James F. Reilly       | Chairman of the Board  | April 1, 2013 |
| <u>/s/ Neil Jacobs</u><br>Dr. Neil Jacobs           | Director   | April 1, 2013 |
| <u>/s/ Timothy M. Murray</u><br>Timothy M. Murray   | Director   | April 1, 2013 |
| <u>/s/ David I. Beatson</u><br>David I. Beatson     | Director   | April 1, 2013 |

| <b>Name</b>   | <b>Jurisdiction</b> |
|---|---------------------|
| Priority Fulfillment Services, Inc.                               | Delaware            |
| Priority Fulfillment Services of Canada, Inc.                     | Ontario             |
| PFSweb BV SPRL (f/k/a Priority Fulfillment Services Europe, B.V.) | Belgium             |
| Business Supplies Distributors Holdings, LLC                      | Delaware            |
| Supplies Distributors, Inc.                                       | Delaware            |
| Supplies Distributors of Canada, Inc.                             | Ontario             |
| Supplies Distributors S.A.  | Belgium             |
| PFSweb Retail Connect, Inc.,                                      | Delaware            |
| PFSweb Philippines Services, LLC                                  | Philippines         |

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated April 1, 2013, with respect to the consolidated financial statements and schedules in the Annual Report of PFSweb, Inc. on Form 10-K for the year ended December 31, 2012. We hereby consent to the incorporation by reference of said report in the Registration Statements of PFSweb, Inc. on Forms S-8 (File Nos. 333-164973, effective February 18, 2010, 333-128486, effective September 21, 2005, 333-75764, effective December 21, 2001, 333-75772, effective December 21, 2001; 333-46096, effective September 19, 2000; 333-42186, effective July 25, 2000 and 333-40020, effective June 23, 2000) and on Forms S-3 (File Nos. 333-164971, effective March 17, 2010, 333-135794, effective July 17, 2006 and 333-110853, effective December 1, 2003).

/s/ GRANT THORNTON LLP

Dallas, Texas  
April 1, 2013

**CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350**

I, Michael Willoughby, certify that:

1. I have reviewed this annual report on Form 10-K of PFSweb, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 1, 2013

By: /s/ MICHAEL WILLOUGHBY  
Chief Executive Officer



**CERTIFICATIONS OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350**

I, Thomas Madden, certify that:

1. I have reviewed this annual report on Form 10-K of PFSweb, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 1, 2013

By: /s/ THOMAS J. MADDEN  
Chief Financial Officer

**CERTIFICATIONS PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION  
906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of PFSweb, Inc. (the "Company"), does hereby certify that:

The Annual Report on Form 10-K for the year ended December 31, 2012 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-K.

April 1, 2013

/s/ Michael Willoughby

---

Michael Willoughby  
Chief Executive Officer

April 1, 2013

/s/ Thomas J. Madden

---

Thomas J. Madden  
Chief Financial Officer

The foregoing certification is being furnished as an exhibit to the Form 10-K pursuant to Item 601(b)(32) of Regulation S-K and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-K for purposes of Section 18 of the Securities Exchange Act of 1934, as whether made before or after the date hereof, regardless of any general incorporation language in such filing.

A signed original of this written statement required by Section 906 has been provided to PFSweb, Inc. and will be retained by PFSweb, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.