

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended March 31, 2003

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 of Incorporation)

75-2837058  
-----

(I.R.S. Employer I.D. No.)

500 NORTH CENTRAL EXPRESSWAY, PLANO, TEXAS  
-----

75074  
-----

(Address of principal executive offices)

(Zip Code)

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

At May 7, 2003 there were 18,428,871 shares of registrant's common stock outstanding, excluding 86,300 shares of common stock in treasury.

PFSWEB, INC. AND SUBSIDIARIES  
 FORM 10-Q  
 MARCH 31, 2003

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

PFSWEB, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

March 31, 2003	December 31, 2002	(Unaudited)	
ASSETS CURRENT ASSETS: Cash and cash equivalents			
		\$ 8,858	\$ 8,595
Restricted cash			
			1,387
1,016 Accounts receivable, net of allowance for doubtful accounts of \$531 and \$411 at March 31, 2003 and December 31, 2002, respectively			
		32,158	29,961
Inventories, net			
			39,531
46,291 Other receivables			
			3,544
3,417 Prepaid expenses and other current assets			
		2,776	2,888
----- Total current assets			
		88,254	92,168
-- PROPERTY AND EQUIPMENT, net			
		10,947	11,695
RESTRICTED CASH			
2,889 2,878 OTHER ASSETS			
----- Total assets			
		211	285
			\$ 102,301
			\$ 107,026
===== LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES: Current portion of long-term debt and capital lease obligations			
		\$ 58,706	\$ 60,863
Trade accounts payable			
		7,006	7,317
Accrued expenses			
			7,570
7,862 ----- Total current liabilities			
			73,282
			76,042
----- LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion			
2,761 3,094 OTHER LIABILITIES			
1,246 1,420 COMMITMENTS AND CONTINGENCIES SHAREHOLDERS' EQUITY:			
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued and outstanding			
		--	--
Common stock, \$0.001 par value; 40,000,000 shares authorized; 18,503,377 and 18,397,983 shares issued at March 31, 2003 and December 31, 2002, respectively; and 18,417,077 and 18,311,683 outstanding at March 31, 2003 and December 31, 2002, respectively			
		18	18
Additional paid-in capital			
		52,122	52,094
Accumulated deficit			
			(27,331)
(25,557) Accumulated other comprehensive income			
		288	--
Treasury stock at cost, 86,300 shares at March 31, 2003 and December 31, 2002			
		(85)	(85)
----- Total shareholders' equity			
		25,012	26,470
----- Total liabilities and shareholders' equity			
		\$ 102,301	\$ 107,026
			=====

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

Three Months Ended March 31, -----	2003	2002	-----
REVENUES: Product revenue, net .....	\$		
59,719 \$ -- -----			Gross
service fee revenue			
.....	7,248	7,826	
Gross service fee revenue, affiliate .....	--	1,565	-----
----- Total gross service fee revenue .....	7,248		
9,391 Less pass-through charges .....	640	1,073	---
----- Net service fee revenues .....	6,608		
8,318 ----- Total net revenues .....	66,327	8,318	-----
COSTS OF REVENUES: Cost of product revenue .....			
56,407 -- Cost of net service fee revenue .....	4,913	5,304	
----- Total costs of revenues .....	61,320	5,304	-----
Gross profit			
.....	5,007	3,014	SELLING, GENERAL AND ADMINISTRATIVE EXPENSES .....
6,112 7,018 -----			Loss
from operations			
.....	(1,105)		
(4,004) EQUITY IN EARNINGS OF AFFILIATE .....	--		
512 INTEREST EXPENSE			
.....	638	83	INTEREST INCOME
(30) (348) -----			Loss
before income taxes			
.....	(1,713)		
(3,227) INCOME TAX EXPENSE			
.....	61		
-- -----			NET LOSS
.....	\$ (1,774)	\$ (3,227)	=====
===== NET LOSS PER SHARE: Basic and diluted			
.....	\$		
(0.10) \$ (0.18) =====			=====
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING: Basic and diluted			
.....	18,416	18,149	=====
18,416 18,149 =====			=====

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

Three Months Ended March 31,	-----	2003	2002	-----
----- CASH FLOWS FROM OPERATING ACTIVITIES: Net loss				
\$ (1,774)	\$ (3,227)			
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Depreciation and amortization		1,189		
Provision for doubtful accounts		151	21	
Equity in earnings of affiliate		(512)		
Non-cash compensation expense				
			24	
Changes in operating assets and liabilities:				
Accounts receivables		(2,030)	(1,008)	
Inventories, net		7,237		
Prepaid expenses, other receivables and other current assets		134	713	
Accounts payable, accrued expenses and deferred income		(885)	1,555	
Net cash provided by (used in) operating activities		4,022		
(786)				
----- CASH FLOWS FROM INVESTING ACTIVITIES: Purchases of property and equipment				
		(267)	(338)	
Increase in restricted cash				
			(154)	
Payments of loans to affiliate, net				
			(145)	
-----				
- Net cash used in investing activities				
(267)	(637)			
----- CASH FLOWS FROM FINANCING ACTIVITIES: Payments on capital lease obligations				
		(272)	(259)	
Increase in restricted cash				
		(342)		
Proceeds from issuance of common stock				
		28	54	
Proceeds from (payments on) debt, net				
(2,821)	172			
Net cash used in financing activities				
		(3,407)	(33)	
----- EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS				
		(85)	(8)	
----- NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS				
		263	(1,464)	
CASH AND CASH EQUIVALENTS, beginning of period				
		8,595	10,786	
----- CASH AND CASH EQUIVALENTS, end of period				
		\$ 8,858	\$ 9,322	=====
===== SUPPLEMENTAL CASH FLOW INFORMATION Non-cash investing and financing activities: Fixed assets acquired under capital leases				
		\$ 64	\$ 186	=====

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

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. OVERVIEW AND BASIS OF PRESENTATION

PFSWEB OVERVIEW

PFSweb, Inc. and its subsidiaries (the "Company" or "PFSweb") is an international provider of integrated business process outsourcing services to major brand name companies seeking to maximize their supply chain efficiencies and to extend their traditional and e-commerce initiatives in the United States, Canada, and Europe. The Company offers such services as professional consulting, technology collaboration, managed hosting and internet application development, order management, web-enabled customer contact centers, customer relationship management, financial services including billing and collection services and working capital solutions, information management, option kitting and assembly services, and international fulfillment and distribution services.

SUPPLIES DISTRIBUTORS OVERVIEW

Business Supplies Distributors Holdings, LLC ("Holdings") and its subsidiaries (collectively "Supplies Distributors") are master distributors of various products, primarily International Business Machines ("IBM") products. Pursuant to transaction management services agreement between the Company and Supplies Distributors, the Company provides to Supplies Distributors such services 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. Additionally, IBM and Supplies Distributors have outsourced the product demand generation to Global Marketing Services, Inc. ("GMS"). Supplies Distributors, via its arrangements with GMS and the Company, sells its products in the United States, Canada and Europe.

All of the agreements between the Company and Supplies Distributors were made in the context of a related party relationship and were negotiated in the overall context of the Company's and Supplies Distributors' prior arrangement with IBM. Although management generally believes that the terms of these agreements are 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.

BASIS OF PRESENTATION

For the period from July 2001 to September 2002, the Company owned 49% of Supplies Distributors and as such the results of Supplies Distributors were not consolidated into the Company's results. The Company's equity interest in Supplies Distributors was presented in the consolidated balance sheet as investment in affiliate prior to October 2002 and the Company's allocation of Supplies Distributors' net income was presented in the consolidated statement of operations as equity in earnings of affiliate for the period from inception (July 2001) to September 2002, including the three months ended March 31, 2002. Effective October 1, 2002, the Company purchased the remaining 51% interest in Supplies Distributors from Inventory Financing Partners, LLC ("IFP"). As a result of the purchase, effective October 1, 2002, the Company began consolidating 100% of Supplies Distributors' financial position and results of operations into the Company's consolidated financial statements. The following table presents selected pro forma information, for comparative purposes, assuming the acquisition had occurred on January 1, 2002, for the three months ended March 31, 2002:

Net revenues.....	\$ 59,879 =====
Net loss.....	\$ 2,927 =====
Loss per share.....	\$ 0.16 =====

The pro forma data includes a \$0.2 million extraordinary gain on the purchase from IFP, primarily as a result of the purchase price being less than IFP's capital account. The unaudited pro forma net revenue and pro forma net loss are not necessarily indicative of the consolidated results of operations for future



PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

or the results of operations that would have been realized had we consolidated Supplies Distributors during the period noted.

The unaudited interim condensed consolidated financial statements as of March 31, 2003, and for the three months ended March 31, 2003 and 2002, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's financial position as of March 31, 2003, its results of operations for the three months ended March 31, 2003 and 2002 and its results of cash flows for the three months ended March 31, 2003 and 2002. Results of the Company's operations for interim periods may not be indicative of results for the full fiscal year.

Certain prior period data has been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income or shareholders' equity.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

All intercompany accounts and transactions have been eliminated in consolidation. Accounts and transactions between the Company and Supplies Distributors have been eliminated as of December 31, 2002 and as of and for the three months ended March 31, 2003.

INVESTMENT IN AFFILIATE

In July 2001, the Company made a 49% investment in Supplies Distributors. Effective October 1, 2002, the Company purchased the remaining 51% ownership interest of Supplies Distributors. Prior to consolidating Supplies Distributors' financial position and results of operations, the Company recorded its interest in Supplies Distributors' net income, which was allocated and distributed to the owners pursuant to the terms of Supplies Distributors' operating agreement, under the modified equity method, which resulted in the Company recording its allocated earnings of Supplies Distributors or 100% of Supplies Distributors' losses.

In addition to the equity investment, the Company loaned Supplies Distributors monies in the form of a Subordinated Demand Note (the "Subordinated Demand Note"). Under certain new and amended terms of its senior debt facilities, the outstanding balance of the Subordinated Demand Note cannot be increased or decreased without prior approval of the Company's lenders. As of March 31, 2003 and December 31, 2002, the outstanding balance of the Subordinated Demand Note was \$8.0 million.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses, including allowances for the collectibility of accounts and other receivable and the recoverability of inventory. The recognition and allocation of certain operating expenses, restructuring costs and the determination of costs applicable to client terminations in these consolidated financial statements also required management estimates and assumptions.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

REVENUE AND COST RECOGNITION

The Company recognizes product revenue and product cost upon shipment of product to customers. The Company permits its customers to return defective products (that the Company then returns to the manufacturer) and incorrect shipments for credit against other purchases and provides a reserve for estimated returns and allowances. The Company offers terms to its customers that it believes are standard for its industry.

Freight costs billed to customers are reflected as components of product revenues. Freight costs incurred by the Company are recorded as a component of cost of goods sold.

Under the Master Distributor Agreements, the Company bills IBM 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 IBM 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. The Company records a receivable for these reimbursable amounts as they are incurred with a corresponding reduction in either inventory or cost of product revenue. The Company also reflects pass through customer marketing programs as a reduction of product revenue.

The Company's service fee revenues primarily relate to its (1) distribution services, (2) order management/customer care services and (3) the reimbursement of out-of-pocket and third party expenses.

Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping). 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 client's 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, or (ii) 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, such as travel, and certain third-party vendor expenses such as shipping and handling costs and telecommunication charges are included in gross service fee revenue. The related reimbursable costs are reflected as pass-through charges and reduce total gross service fee revenue in computing net service fee 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 costs associated with technology collaboration and ongoing technology support that consist of creative internet application development and maintenance, web hosting, technology interfacing, 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 also performs billing services and information management services for certain of its clients. Billing services and information management services are typically not billed separately to clients because the activities are continually performed, and the costs are insignificant and are generally covered by other fees described above. Therefore, any revenue attributable to these services is often included in the distribution or order management fees that are recognized as services are performed. The service fee revenue associated with these activities are currently not significant and are incidental to the above-mentioned services.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company recognizes revenue, and records trade accounts receivables, pursuant to the methods described above, when collectibility is reasonably assured. Collectibility is evaluated on an individual customer basis taking into consideration historical payment trends, current financial position, results of independent credit evaluations and payment terms.

The Company primarily performs its services under one to three year contracts that can be terminated by either party. In conjunction with these long-term contracts the Company generally 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 costs is included as a cost of service fee revenue. To the extent implementation costs, excluding certain technology infrastructure and development costs, exceed the fees received, excess costs are expensed as incurred.

Current and non-current deferred implementation costs are a component of prepaid expenses and other assets, respectively. Implementation costs associated with technology infrastructure and development costs are a component of property and equipment. Current and non-current deferred implementation revenues are a component of deferred revenue and other liabilities, respectively.

CONCENTRATION OF BUSINESS AND CREDIT RISK

The Company's product revenue was primarily generated by sales of product purchased under master distributor agreements with one supplier. Sales to three customers accounted for approximately 13% 11% and 11% of the Company's total product revenues for the three months ended March 31, 2003. Service fee revenue from two clients accounted for approximately 30% and 22% of net service fee revenue for the three months ended March 31, 2003. On a consolidated basis, three clients accounted for approximately 15%, 10% and 10% of the Company's total revenues for the three months ended March 31, 2003. As of March 31, 2003, three customers/clients accounted for approximately 41% of accounts receivable. As of December 31, 2002, three customers/clients accounted for approximately 39% of accounts receivable.

In conjunction with Supplies Distributors' financing, the Company has provided certain collateralized guarantees on behalf of Supplies Distributors. Supplies Distributors' ability to obtain financing on similar terms would be significantly impacted without these guarantees. Additionally, since Supplies Distributors has limited personnel and physical resources, its ability to conduct business could be materially impacted by contract terminations by GMS.

The Company has multiple arrangements with IBM and is dependent upon the continuation of such arrangements. These arrangements, which are critical to the Company's ongoing operations, include Supplies Distributors' master distributor agreements, Supplies Distributors' working capital financing agreements, product sales to IBM business units, a general contractor relationship through the Company's largest client, and a term master lease agreement.

CASH AND CASH EQUIVALENTS

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

INVENTORIES

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of weighted average cost or market. Supplies Distributors assumes responsibility for slow-moving inventory under the Master Distributor Agreements. 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. As of March 31, 2003 and December

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

31, 2002, the Company's allowance for slow-moving inventory was approximately \$0.2 million and \$0.1 million, respectively. Supplies Distributors is able to return product rendered obsolete by IBM engineering changes after customer demand for the product ceases. In the event the Company, Supplies Distributors and IBM do not renew the Master Distributor Agreements, the parties shall mutually agree on a plan of disposition of Supplies Distributors' then existing inventory.

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 debt in the accompanying consolidated financial statements.

PROPERTY AND EQUIPMENT

The Company's property held under capital leases amounted to approximately \$4.1 million and \$4.3 million, net of accumulated amortization of approximately \$3.8 million and \$3.5 million, at March 31, 2003 and December 31, 2002, respectively.

STOCK BASED COMPENSATION

The Company accounts for stock options using the intrinsic-value method as outlined under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB No. 25") and related interpretations, including FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation and Interpretation of APB No. 25, issued in March 2000. Under this method, compensation expense is recorded on the date of the grant only if the current market price of the underlying stock exceeds the exercise price. The exercise prices of all options granted during the three months ended March 31, 2003 and 2002 were equal to the market price of the Company's common stock at the date of grant. As such, no compensation cost was recognized during those periods for stock options granted to employees. The following table shows the pro forma effect on the Company's net loss and loss per share as if compensation cost had been recognized for stock options based on their fair value at the date of the grant. The pro forma effect of stock options on the Company's net loss for those years may not be representative of the pro forma effect for future years due to the impact of vesting and potential future awards.

THREE MONTHS ENDED MARCH 31, 2003	THREE MONTHS ENDED MARCH 31, 2002	-----
--- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
Net loss as reported		
.....	\$	
(1,774)	\$ (3,227)	Add: Stock-based non-employee compensation expense included in reported net loss .....
-- 24		Deduct: Total stock-based employee and non-employee compensation expense determined under fair value based method .....
(108)	(613)	----- Pro forma net loss, applicable to common stock for basic and diluted computations .....
.....	\$ (1,882)	\$
(3,816)	=====	===== Loss per common share - basic and diluted As reported .....
\$ (0.10)	\$ (0.18)	=====
	Pro forma	=====
.....		
\$ (0.10)	\$ (0.21)	=====

On April 14, 2003, the Company issued an aggregate of 750,000 options to purchase shares of common stock at \$0.44 to officers and employees of PFSweb.

3. RECENTLY ISSUED ACCOUNTING PRINCIPLES

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting and reporting for

obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of this standard did not have a material impact on the consolidated financial statements.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses the financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The adoption of this standard did not have a material impact on the consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS 148 amends SFAS 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the provisions of SFAS 123 to require more prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results of operations. The Company adopted the disclosure requirements of SFAS 148 as of December 31, 2002.

In January 2003, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others." FIN No. 45 requires a company to recognize a liability for the obligations it has undertaken in issuing a guarantee. This liability would be recorded at the inception of a guarantee and would be measured at fair value. The measurement provisions of this statement apply prospectively to guarantees issued or modified after December 31, 2002. The disclosure provisions of the statement apply to financial statements for periods ending after December 15, 2002. The Company adopted the disclosure provisions of the statement as of December 31, 2002 and the measurement provisions of this statement during the three months ended March 31, 2003. The adoption of this statement did not have a material effect on the consolidated financial statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities." FIN 46 requires a company to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the company does not have a majority of voting interests. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception for any entity created after January 31, 2003. For an entity created before February 1, 2003, the provisions of this interpretation must be applied at the beginning of the first interim or annual period beginning after June 15, 2003. The Company adopted the provisions of FIN No. 46 during the three months ended March 31, 2003. The adoption of the statement did not have a material effect on the consolidated financial statements.

The FASB Emerging Issues Task Force issued EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," to address certain revenue recognition issues. The guidance provided from EITF 00-21 addresses both the timing and classification in accounting for different earnings processes. The Company does not expect that the adoption of EITF 00-21 will have a material impact on our consolidated financial condition or operations.

4. COMPREHENSIVE LOSS (IN THOUSANDS)

THREE MONTHS ENDED MARCH 31, -	
----- 2003	
2002 -----	Net
	loss
.....	
\$ (1,774)	\$ (3,227) Other
	comprehensive income (loss):
	Foreign currency translation
	adjustment
.....	288
(447) -----	
	Comprehensive loss
.....	\$
(1,486)	\$ (3,674) =====
	=====



PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. NET LOSS PER COMMON SHARE AND COMMON SHARE EQUIVALENT

Basic and diluted net loss per common share attributable to PFSweb common stock were determined based on dividing the net loss available to common stockholders by the weighted-average number of common shares outstanding. During the three months ended March 31, 2003 and 2002, all outstanding options to purchase common shares were anti-dilutive and have been excluded from the weighted diluted average share computation. As of March 31, 2003 and 2002 there were 4,724,835 and 5,982,391 options outstanding, respectively. There are no other potentially dilutive securities outstanding.

6. DEBT AND CAPITAL LEASE OBLIGATIONS:

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

MARCH 31, 2003	DECEMBER 31, 2002	
-----	-----	----
Term master lease agreement		
.....	\$ 4,338	\$ 4,627
Inventory and working capital financing agreements: United States		
.....	27,299	
28,147	Europe	
.....		
10,441	15,219	Loan and security agreements: Supplies Distributors
.....	15,552	12,552
	PFSweb	
.....		
- Factoring agreement, Europe		
.....	3,621	3,202
Other		
.....		
216	210	Total
.....		
61,467	63,957	Less current portion of long-term debt
.....	58,706	60,863
-----		
Long-term debt, less current portion		
.....	\$ 2,761	\$ 3,094
	=====	=====

INVENTORY AND WORKING CAPITAL FINANCING AGREEMENT, UNITED STATES - SUPPLIES DISTRIBUTORS

On September 27, 2001, Supplies Distributors entered into a short-term credit facility with IBM Credit LLC (formerly IBM Credit Corporation) to finance its distribution of IBM products in the United States, which has subsequently been amended. The amended asset based credit facility provides financing for purchasing IBM inventory and for certain other receivables up to \$27.5 million (\$30.5 million at December 31, 2002) through its expiration on March 29, 2004. 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, 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, cash flow from operations, and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, PFSweb is required to maintain a minimum subordinated note receivable balance from Supplies Distributors of \$8.0 million and a minimum shareholders' equity, as modified, of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 1%. The facility accrues a quarterly commitment fee of 0.375% on the unused portion of the commitment, and a monthly service fee.

INVENTORY AND WORKING CAPITAL FINANCING AGREEMENT, EUROPE - SUPPLIES DISTRIBUTORS

On September 27, 2001, Supplies Distributors S.A. ("SDSA"), a Belgium corporation and wholly-owned subsidiary of Supplies Distributors, entered into a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance its distribution of IBM products in Europe, which has subsequently been amended. The amended asset based credit facility with IBM

Belgium provides up to 12.5 million Euros (approximately \$13.5 million) (19.0 million euros, or approximately \$20.5 million at December 31, 2002) in financing for purchasing IBM inventory and for certain other receivables. The IBM Belgium facility remains in force until not less than 60 days written notice by any party, but no sooner than March 29, 2004. 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

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

payments to related parties, 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, cash flow from operations and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, PFSweb is required to maintain a minimum subordinated note receivable balance from Supplies Distributors of \$8.0 million and a minimum shareholders' equity, as modified, of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at Euribor plus 4%. SDSA pays a monthly service fee on the commitment.

LOAN AND SECURITY AGREEMENT - SUPPLIES DISTRIBUTORS

On March 29, 2002, Supplies Distributors entered into a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to \$25 million of eligible accounts receivable in the U.S. and Canada. The Congress facility expires on the earlier of three years or the date on which the parties to the IBM Master Distributor Agreement shall no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. Borrowings under the Congress facility accrue interest at prime rate plus 0.25% or Eurodollar rate plus 3.0% or on an adjusted basis, as defined. 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, 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 collateralized guaranties of Holdings and PFSweb. Additionally, PFSweb is required to maintain a subordinated loan to Supplies Distributors of no less than \$6.5 million and restricted cash of less than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors entered into Blocked Account Agreements with its banks and Congress whereby a security interest was granted to Congress for all customer remittances received in specified bank accounts.

LOAN AND SECURITY AGREEMENT - PFSWEB

On March 28, 2003, Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc., (both wholly-owned subsidiaries of PFSweb and collectively the "Borrowers") entered into a two year Loan and Security Agreement with Comerica Bank ("Comerica") to provide financing for up to \$7.5 million of eligible accounts receivable in the U.S. and Canada. Borrowings under the Comerica facility will accrue interest at prime rate plus 1%. The agreement contains cross default provisions, various restrictions upon the Borrowers' ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth, as defined, and a minimum liquidity ratio, as defined. The agreement restricts the amount of the Subordinated Demand Note to a maximum of \$8.0 million. The agreement is secured by all of the assets of the Borrowers, as well as a guarantee of PFSweb. There were no amounts outstanding under this facility as of March 31, 2003.

FACTORING AGREEMENT - SUPPLIES DISTRIBUTORS

On March 29, 2002, SDSA entered into a two year factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 7.5 million euros (approximately \$8.1 million) (originally 10 million euros, amended in October 2002) of eligible accounts receivables. Borrowings under this agreement can be either cash advances or straight loans, as defined. Cash advances accrue interest at 8.5%, or on an adjusted basis as defined, and straight loans accrue interest at Euribor plus 1.4% for the agreement's first year and Euribor plus 1.3% for the agreement's second year. This agreement contains various restrictions upon the ability of SDSA to, among other things, merge, consolidate, incur indebtedness, as well as financial covenants, such as minimum net worth. This agreement is secured by a guarantee of Supplies Distributors, up to a maximum of 200,000 euros.



PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DEBT COVENANTS

To the extent the Company or Supplies Distributors fail to comply with its covenants, including the monthly financial covenant requirements and required level of consolidated stockholders' equity (\$18.0 million), and the lenders accelerate the repayment of the credit facility obligations, the Company would be required to repay all amounts outstanding thereunder. Any acceleration of the repayment of the credit facilities would 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 March 31, 2003, the Company and Supplies Distributors were in compliance with all debt covenants.

PFSweb has also provided a guarantee of the obligations of Supplies Distributors and SDSA to IBM, excluding the trade payables that are financed by IBM credit.

7. SUPPLIES DISTRIBUTORS AND OTHER RELATED PARTIES

SUPPLIES DISTRIBUTORS

In September 2001, the Company made an equity investment of \$0.75 million in Supplies Distributors, for a 49% voting interest, and IFP made an equity investment of \$0.25 million in Supplies Distributors for a 51% voting interest. Certain officers and directors of the Company owned, individually, a 9.8% non-voting interest, and, collectively, a 49% non-voting interest, in IFP. Effective October 1, 2002, the Company purchased the remaining 51% interest in Supplies Distributors from IFP for \$0.3 million.

Pursuant to the terms of the Company's transaction management services agreement with Supplies Distributors, the Company earned service fees, which, prior to the consolidation effective October 1, 2002 are reported as service fee revenue, affiliate in the accompanying consolidated financial statements, of approximately \$1.5 million for the three months ended March 31, 2002.

Pursuant to Supplies Distributors' operating agreement, prior to the October 1, 2002 acquisition date, Supplies Distributors allocated its earning and distributed its cash flow, as defined, in the following order of priority: first, to IFP until it received a one-time amount equal to its capital contribution of \$0.25 million; second, to IFP until it received an amount equal to a 35% cumulative annual return on its capital contribution; third, to PFSweb until it received a one-time amount equal to its capital contribution of \$0.75 million; fourth, to PFSweb until it received an amount equal to a 35% cumulative annual return on its capital contribution; and fifth, to PFSweb and IFP, pro rata, in accordance with their respective capital accounts. The Company recorded \$0.5 million of equity in the earnings of Supplies Distributors, prior to the October 1, 2002 acquisition, for the three months ended March 31, 2002. As a result of the Company's 100% ownership of Supplies Distributors, future earnings and dividends will be allocated and paid 100% to the Company. Under the terms of its amended credit agreements, Supplies Distributors is currently restricted from paying annual cash dividends without the prior approval of its lenders. In March 2003, Supplies Distributors received lender approval for a distribution to PFSweb of up to \$600,000, none of which has been declared.

OTHER RELATED PARTIES

In August 2001, Supplies Distributors entered into an Agreement for Sales Forces Services ("ASFS") with IBM, whereby Supplies Distributors is to actively generate demand for and promote brand loyalty for IBM products. The ASFS expires on the earlier of December 31, 2003 or the termination of the Master Distributor Agreements. The ASFS automatically renews for successive one-year periods unless either party provides prior written notice. Pursuant to the ASFS, IBM pays to Supplies Distributors a quarterly service fee as agreed to by both parties. Supplies Distributors has subcontracted with GMS to provide the sales force activities required under the ASFS for an amount equal to the fees received by Supplies Distributors from IBM under the ASFS. The principal officer of GMS owned 46% of IFP, prior to PFSweb's purchase of IFP's interest in Supplies Distributors.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. RESTRUCTURING

In September 2002, the Company implemented a restructuring plan that resulted in the termination of approximately 60 employees, of which 20 were hourly employees. The Company recorded \$1.2 million for severance and other termination costs, of which \$0.8 million was paid during the year ended December 31, 2002, and \$0.2 million was paid during the three months ended March 31, 2003. The remaining \$0.2 million at March 31, 2003 is included in accrued expenses and is expected to be paid by March 2004. The Company did not finalize all restructuring activities as of December 31, 2002, and expects to incur an additional amount totaling \$0.5 million to \$1.0 million of restructuring charges during calendar year 2003.

9. COMMITMENTS AND CONTINGENCIES

In June 2002, the NASDAQ approved our transition from the NASDAQ National Market System to the NASDAQ SmallCap Market. Our securities began trading on the NASDAQ SmallCap Market on June 10, 2002.

This transition occurred in response to NASDAQ Marketplace Rule 4450(a)(5), which requires a minimum bid price of \$1.00 for continued listing on the NASDAQ National Market. The SmallCap Market also has a minimum bid price of \$1.00 per share. However, as compared to the 90 day grace period provided by the NASDAQ National Market, the SmallCap Market currently has a longer minimum bid price grace period of 180 days from receipt of NASDAQ Delisting Notification (February 14, 2002 for the Company). This grace period extended us through August 13, 2002.

Due to the Company's compliance with the initial listing requirements for the NASDAQ SmallCap Market, on August 14, 2002 PFSweb was provided an additional 180 day grace period, or until February 10, 2003 to regain compliance. In March 2003, the Company was provided an additional 90 day grace period, or until May 12, 2003, to regain compliance. On May 14, 2003, we received a NASDAQ Staff Determination letter, indicating that the Company no longer complies with the \$1 minimum bid price requirement for continued listing and that the Company's common stock is, therefore, subject to delisting from the NASDAQ SmallCap Market at the opening of business on May 23, 2003. The Company will request a hearing to appeal this notice. The Company's hearing request will defer delisting until the NASDAQ Listing Qualifications Panel reaches a decision. Until then, the Company's common stock will remain listed and will continue to trade on the NASDAQ SmallCap Market. There can be no assurance as to when the Panel will reach a decision or that such a decision will be favorable to the Company. If the Company subsequently decides not to appeal the delisting notice, or if the Panel denies the appeal, the Company's securities may be immediately eligible for quotation on the OTC Bulletin Board. The delisting of the Company's common stock could have a material adverse effect on the market price of, and the efficiency of the trading market for, PFSweb's common stock.

The Company is involved in certain litigation arising in the ordinary course of business. Management believes that such litigation will be resolved without material effect on the Company's financial position or results of operations.

10. SEGMENT INFORMATION

The Company is organized into two operating segments: PFSweb is an international provider of integrated business process outsourcing solutions and operates as a service fee business; Supplies Distributors is a master distributor of primarily IBM products, and recognizes revenues and costs when product is shipped.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS THREE MONTHS ENDED  
 ENDED MARCH 31, MARCH 31, 2003  
 2002 -----  
 Revenues (in thousands): PFS  
 .....  
 \$ 8,528 \$ 8,318 Supplies  
 Distributors .....  
 59,719 -- Eliminations  
 ..... (1,920)  
 ----- \$  
 66,327 \$ 8,318 =====  
 =====

MARCH 31, DECEMBER 31, 2003 2002  
 ----- Long-  
 lived assets (in thousands): PFS  
 .....  
 \$ 10,949 \$ 11,710 Supplies  
 Distributors ..... 28  
 35 ----- \$  
 10,977 \$ 11,745 =====  
 =====

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

The following discussion and analysis of our results of operations and financial condition should be read in conjunction with the unaudited interim condensed consolidated financial statements and related notes appearing elsewhere in this Form 10-Q.

### FORWARD-LOOKING INFORMATION

We have made forward-looking statements in this Report on Form 10-Q. 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 those set forth above or elsewhere in this Report on Form 10-Q and our Form 10-K for the year ended December 31, 2002, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- o our ability to retain and expand relationships with existing clients and attract new clients;
- o our reliance on the fees generated by the transaction volume or product sales of our clients;
- o our reliance on our clients' projections or transaction volume or product sales;
- o our dependence upon our agreements with IBM;
- o our client mix and the seasonality of their business;
- o our ability to finalize pending contracts;
- o the impact of strategic alliances and acquisitions;
- o trends in the market for our services;
- o trends in e-commerce;
- o whether we can continue and manage growth;
- o changes in the trend toward outsourcing;
- o increased competition;
- o our ability to generate more revenue and achieve sustainable profitability;
- o effects of changes in profit margins;
- o the customer concentration of our business;
- o the unknown effects of possible system failures and rapid changes in technology;
- o trends in government regulation both foreign and domestic;
- o foreign currency risks and other risks of operating in foreign countries;
- o potential litigation involving our e-commerce intellectual property rights;
- o our dependency on key personnel;
- o our ability to raise additional capital or obtain additional financing;
- o our relationship with and our guarantees of the working capital indebtedness of our subsidiary, Supplies Distributors;
- o our ability or the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants;

and

- o the continued listing of our common stock on the NASDAQ SmallCap Market.

We have based these statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations actually will 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 that we do not currently view as material or that are not presently known.

## OVERVIEW

We are an international outsourcing provider of integrated business process outsourcing solutions to major brand name companies seeking to maximize their supply chain efficiencies and to extend their e-commerce initiatives. We derive our revenues from a broad range of services, including professional consulting, technology collaboration, order management, managed web hosting and web development, customer relationship management, financial services including billing and collection services and working capital solutions, options kitting and assembly services, information management and international fulfillment and distribution services. 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 our warehouses and include real-time inventory management and customized picking, packing and shipping of our clients' customer orders. We currently provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, printers, cosmetics, fragile goods, high security collectibles, pharmaceuticals, housewares, apparel, telecommunications and consumer electronics, among others.

Our service fee revenue is typically charged on a percent of shipped revenue basis or a per-transaction basis, such as a per-minute 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 contracts with our clients 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 passed on to our clients (and, in many cases, our clients' customers). Our billings for reimbursements of these and other 'out-of-pocket' expenses, such as travel, shipping and handling costs and telecommunication charges are included in gross service fee revenue. The related reimbursable costs are reflected as pass-through charges and reduce total gross service fee revenue in computing net service fee revenue.

For the periods subsequent to October 1, 2002 and currently, our services include purchasing and reselling client product inventory under our master distributor agreements with IBM and certain other clients. In these arrangements, our product revenue is recognized at the time product is shipped. Product revenue includes freight costs billed to customers and is reduced for pass through customer marketing programs. For the period from January 1, 2002, to September 30, 2002, these IBM and other agreements were structured to provide transaction management services only on a service fee basis based on a percentage of shipped revenue.

Our expenses are comprised of:

- o subsequent to October 1, 2002 and currently, cost of product revenue, which consists of the price of product sold and freight costs and is reduced by certain reimbursable expenses such as pass through customer marketing programs, direct costs incurred in passing on any price decreases offered by IBM to Supplies Distributors 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 under the master distributor agreements;
- o cost of service fee revenue, which 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; and
- o selling, general and administrative expenses, which consist primarily of compensation and related expenses for sales and marketing staff, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses. In addition, for the periods subsequent to October 1, 2002 and currently, certain direct contract costs related to our IBM and other master distributor agreements are reflected as selling and administrative expenses.

RESULTS OF OPERATIONS

The following table sets forth certain historical financial information from our unaudited interim condensed consolidated statements of operations expressed as a percent of revenue.

Three Months Ended March 31, -----		----- 2003 2002 -----	
(Unaudited)	(Unaudited)	Product revenue	
90.0%	--%	Gross service fee revenue	10.9
94.1		Gross service fee revenue, affiliate	18.8
		- Total gross service fee revenue	10.9 112.9
		Pass-through charges	(0.9) (12.9)
		Net service fee revenue	10.0 100.0
		Total net revenues	100.0 100.0
		Cost of product revenue (as % of product revenue)	94.5
		Cost of service fee revenue (as % of net service fee revenue)	74.3 63.8
		Total costs of revenues	92.5 63.8
		Gross profit	7.5
		Selling, general and administrative expenses	9.2 84.4
		Loss from operations	(1.7) (48.2)
		Equity in earnings of affiliate	6.2
		Interest expense	1.0
		Interest income	(0.1) (4.2)
		Loss before income taxes	(2.6)
		Income tax expense (benefit)	0.1
		Net loss	(2.7)% (38.8)%

RESULTS OF OPERATIONS FOR THE INTERIM PERIODS ENDED MARCH 31, 2003 AND 2002

Product Revenue. Product revenue was \$59.7 million for the three months ended March 31, 2003, which reflects product sales for Supplies Distributors subsequent to its consolidation effective October 1, 2002 (see "Supplies Distributors"). Supplies Distributors had \$53.1 million of product revenue for the three months ended March 31, 2002 prior to consolidation. Based on Supplies Distributors' current business plan, we expect to report future product revenue of approximately \$60 million per quarter in calendar year 2003.

Net Service Fee Revenue (including service fee revenue, affiliate). Net service fee revenue was \$6.6 million for the three months ended March 31, 2003 as compared to \$8.3 million for the three months ended March 31, 2002, a decrease of \$1.7 million or 20.6%. We earned \$1.2 million of service fee revenues in the three months ended March 31, 2003, applicable to new service contract relationships. However, this increase was more than offset primarily by (i) \$1.5 million applicable to the elimination of service fee revenue, affiliate earned from our arrangements with Supplies Distributors, subsequent to its consolidation effective October 1, 2002, (ii) the prior year period including service fees of \$0.9 million applicable to an incremental project for a certain client which did not recur this year, and (iii) the impact of certain client terminations in calendar year 2002, which had generated \$0.5 million of net service fee revenue in the prior year period. Net service fee revenue during the March quarter is seasonably lower than other quarters due to the seasonality of our largest client, which is expected to be followed by a higher second quarter.

Cost of Product Revenue. Cost of product revenue was \$56.4 million for the three months ended March 31, 2003, which reflects cost of product sales for

Supplies Distributors subsequent to its consolidation effective October 1, 2002. Cost of product revenue as a percent of product revenue was 94.5% during the three months ended March 31, 2003. The resulting gross profit margin was 5.5% for the three months ended March 31, 2003. Supplies Distributors had \$50.1 million of cost of product revenue, prior to

consolidation, for the three months ended March 31, 2002. Based on Supplies Distributors' current business plan, we expect to report future cost of product revenue of approximately \$57 million per quarter in calendar year 2003.

Cost of Net Service Fee Revenue. Cost of net service fee revenue was \$4.9 million for the three months ended March 31, 2003, as compared to \$5.3 million during the three months ended March 31, 2002, a decrease of \$0.4 million or 7.4%. The resulting service fee gross profit was \$1.7 million or 25.7% of net service fee revenue, during the three months ended March 31, 2003 as compared to \$3.0 million, or 36.2% of net service fee revenue for the three months ended March 31, 2002. Our gross profit as a percent of net service fee revenue decreased in the current period primarily as a result of the elimination of the service fee revenue affiliate and resulting gross profit, from services provided under our arrangements with Supplies Distributors and due to the seasonality of our largest client. As we add new service fee revenue in the future, we currently intend to target the underlying contracts to earn an average gross profit percentage of 35-40%.

Selling, General and Administrative Expenses. SG&A expenses were \$6.1 million for the three months ended March 31, 2003, or 9.2% of total net revenues, as compared to \$7.0 million, or 84.4% of total net revenues, for the three months ended March 31, 2002. SG&A expenses as a percentage of total net revenues decreased from the prior year due to the increase in total net revenues, resulting from the inclusion of product sales subsequent to the consolidation of Supplies Distributors effective October 1, 2002. SG&A expenses decreased from the prior year due to the restructuring actions, including personnel reductions, which occurred in September 2002. In addition, the prior year SG&A expense included certain incremental sales and marketing costs. These items were partially offset as due to the consolidation of Supplies Distributors, we reclassify certain costs previously characterized as cost of service fee revenue to SG&A. We are targeting our future consolidated SG&A expenses to be between approximately \$6.0 million to \$7.0 million on a quarterly basis for calendar year 2003.

Equity in Earnings of Affiliate. For the three months ended March 31, 2002, we recorded \$0.5 million of equity in earnings of affiliate that represents our allocation of Supplies Distributors' earnings prior to October 1, 2002. Due to the consolidation of Supplies Distributors, effective October 1, 2002, we no longer report equity in earnings of affiliate, on a consolidated basis, for our ownership of Supplies Distributors in the future.

Interest Expense. Interest expense was \$0.6 million for the three months ended March 31, 2003 as compared to \$0.1 million for the three months ended March 31, 2002. The increase in interest expense is due to the consolidation of Supplies Distributors. Based on current estimates of interest rates and borrowing levels, we expect interest expense to be approximately \$0.6 million to \$0.8 million on a quarterly basis for calendar year 2003.

Interest Income. Interest income was \$0.03 million and \$0.3 million for the three months ended March 31, 2003 and 2002, respectively. Effective October 1, 2002 we now report lower consolidated interest income resulting from the elimination of interest income from the Subordinated Note due to PFS from Supplies Distributors upon consolidating Supplies Distributors. Interest income, prior to the consolidation of Supplies Distributors, would have been \$0.2 million for the three months ended March 31, 2003. Interest income decreased as compared to the three months ended March 31, 2003, attributable to lower interest rates earned by our cash and cash equivalents and lower balances of cash and cash equivalents.

Income Taxes. For the three months ended March 31, 2003, we recorded a tax provision of \$0.1 million primarily associated with Supplies Distributors' Canadian and European operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations. A valuation allowance has been provided for our net deferred tax assets as of December 31, 2002, which are primarily related to our net operating loss carryforwards. For the three months ended March 31, 2002, we did not record an income tax benefit. We did not record an income tax benefit for our European pre-tax losses in the current or prior period. Due to the consolidation of Supplies Distributors, in the future we anticipate that we will continue to record an income tax provision associated with Supplies Distributors' Canadian and European results of operations.

## SUPPLIES DISTRIBUTORS

In July 2001, we and Inventory Financing Partners, LLC ("IFP") formed Business Supplies Distributors Holdings, LLC ("Holdings"), and Holdings formed a wholly-owned subsidiary, Supplies Distributors ("SD"). Concurrently, SD formed its wholly-owned subsidiaries Supplies Distributors of Canada, Inc. ("SDC") and Supplies Distributors S.A. ("SDSA"), a Belgium corporation (collectively with Holdings, SD, SDC and SDSA, "Supplies Distributors"). Supplies Distributors acts as master distributors of various IBM and other products and, pursuant to a transaction management services agreement between us and Supplies Distributors, we provide transaction management and fulfillment services to Supplies Distributors. We made an initial equity investment in Holdings for a 49% voting interest, and IFP made an equity investment for a 51% voting interest. Certain officers and directors of PFSweb owned, individually, a 9.8% non-voting interest, and, collectively, a 49% non-voting interest, in IFP. In addition to our equity investment in Holdings, we have also provided Supplies Distributors with a subordinated loan that, as of March 31, 2003, had an outstanding balance of \$8.0 million and accrued interest at a rate of approximately 10%.

On September 27, 2001, Supplies Distributors entered into short-term credit facilities with IBM Credit Corporation ("IBM Credit") and IBM Belgium Financial Services S.A. ("IBM Belgium") to finance its distribution of IBM products. We provided a collateralized guaranty to secure the repayment of these credit facilities. As of March 31, 2003, the subsequently amended asset-based credit facilities provided financing for up to \$27.5 million and up to 12.5 million Euros (approximately \$13.5 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2004.

In March 2002, Supplies Distributors also entered into a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to \$25 million of eligible accounts receivables in the U.S. and Canada. The Congress facility expires on the earlier of three years or the date on which the parties to the IBM Master Distributor Agreement shall no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. In March 2002, SDSA entered into a two year factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 7.5 million Euros (approximately \$8.1 million) of eligible accounts receivables. Borrowings under this agreement can be either cash advances or straight loans, as defined.

These credit facilities contain cross default provisions, various restrictions upon the ability of Holdings, SD and SDSA to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, 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 collateralized guaranties of Holdings and PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than \$8.0 million, maintain restricted cash of less 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 SDSA under these facilities if SD, SDC or SDSA is unable to do so. We have also provided a guarantee of the obligations of SD and SDSA to IBM, excluding the trade payables that are financed by IBM credit.

Effective October 1, 2002, we purchased the remaining 51% interest in Holdings from IFP.

Pursuant to the terms of our transaction management services agreement with Supplies Distributors, we earned service fees, which are reported as service fee revenue, affiliate in the accompanying unaudited interim condensed consolidated financial statements (prior to the consolidation of Supplies Distributors' results of operations effective October 1, 2002), of approximately \$1.5 million for the three months ended March 31, 2002.

Prior to the consolidation of Supplies Distributors' operating results effective October 1, 2002, we recorded our interest in Supplies Distributors' net income, which was allocated and distributed to the owners pursuant to the terms of Supplies Distributors' operating agreement, under the modified equity method, which resulted in us recording our allocated earnings of Supplies Distributors or 100% of Supplies Distributors' losses and our proportionate share of Supplies Distributors' cumulative foreign currency



translation adjustments. Pursuant to Supplies Distributors' operating agreement, Supplies Distributors allocated its earning and distributed its cash flow, as defined, in the following order of priority: first, to IFP until it received a one-time amount equal to its capital contribution of \$0.25 million; second, to IFP until it received an amount equal to a 35% cumulative annual return on its capital contribution; third, to PFSweb until it received a one-time amount equal to its capital contribution of \$0.75 million; fourth, to PFSweb until it received an amount equal to a 35% cumulative annual return on its capital contribution; and fifth, to PFSweb and IFP, pro rata, in accordance with their respective capital accounts. We recorded \$0.5 million of equity in the earnings of Supplies Distributors for the three months ended March 31, 2002. As a result of our 100% ownership of Supplies Distributors, future earnings and dividends will be allocated and paid 100% to PFSweb. Notwithstanding the foregoing, no distribution could be made if, after giving effect thereto, the net worth of Supplies Distributors would be less than \$1.0 million. Under terms of the credit agreements described above, Supplies Distributors is currently limited to annual cash dividends of \$0.6 million.

In the future, as a result of the purchase, we will consolidate 100% of Supplies Distributors financial position and results of operations into our consolidated financial statements. Pro forma net revenues and pro forma net loss for the three months ended March 31, 2002, assuming our purchase of the remaining 51% interest in Supplies Distributors from IFP had occurred in January 2002, would have been \$59.9 million and \$2.9 million, respectively. The pro forma data includes a \$0.2 million extraordinary gain on the purchase from IFP, primarily as a result of the purchase price being less than IFP's capital account. The unaudited pro forma net revenue and pro forma net loss are not necessarily indicative of the consolidated results of operations for future periods or the results of operations that would have been realized had we consolidated Supplies Distributors during the period noted.

#### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was \$4.0 million for the three months ended March 31, 2003, and primarily resulted from a \$7.2 million decrease in inventory, partially offset by cash used to fund operating losses and an increase in accounts receivable of \$2.0 million and decrease in accounts payable and accrued expenses of \$0.9 million. Net cash used in operating activities was \$0.8 million for the three months ended March 31, 2002, and primarily resulted from cash used to fund operating losses and an increase in accounts receivable, partially offset by a decrease in prepaid expenses and other current assets and a decrease in accounts payable, accrued expenses, and deferred income.

Net cash used in investing activities for the three months ended March 31, 2003 totaled \$0.3 million, representing capital expenditures. Net cash used by investing activities totaled \$0.6 million for the three months ended March 31, 2002, which primarily included \$0.3 million of capital expenditures. Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, including our Internet-based customer tools, other methods of e-commerce and general expansion of and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures in order to support new contracts and anticipated future growth opportunities. We anticipate that our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months will be approximately \$2 to \$4 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. A portion of these expenditures may be financed through operating or capital leases. We may elect to modify or defer a portion of such anticipated investments in the event that we do not achieve the revenue necessary to support such investments.

Net cash used in financing activities was approximately \$3.4 million for the three months ended March 31, 2003, primarily representing \$0.3 million of payments on our long-term debt and capital lease obligations and \$2.8 million of payments on debt.

During the three months ended March 31, 2003, our working capital decreased to \$15.0 million from \$16.1 million at December 31, 2002 primarily as a result of our operating losses. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including utilizing capital or operating leases, borrowing under our own credit facility, or transferring a portion of our subordinated loan balances, due from Supplies Distributors, to third-parties. In conjunction with certain of these alternatives, we may be required to provide certain letters of credit to secure these arrangements. No assurances can be given that we will be successful in obtaining any



additional financing or the terms thereof. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including our anticipated revenue growth and/or cost reductions to offset lower than anticipated revenue growth) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our lease obligations, and additional subordinated loans to Supplies Distributors, if necessary, for at least the next twelve months.

The following is a schedule of our total contractual cash and other obligations, which is comprised of operating leases, other obligations, which represents \$0.1 million of contingent obligations we believe will be paid in the next twelve months, long-term debt and capital leases, including interest (in millions):

TOTAL CONTRACTUAL DEBT AND CONTRACTUAL CASH AND OPERATING CAPITAL OTHER LEASES LEASES OBLIGATIONS -----			
----- Twelve Months Ended March 31, 2003			
.....	\$ 63,609	\$ 1,385	\$ 64,994 2004
.....	3,840	763	4,603 2005
.....	3,150	501	3,651 2006
.....	2,717	441	3,158 2007
.....	1,172	425	1,597 Thereafter
.....	71	803	----- 732
Total contractual cash obligations .... \$			
	75,220	\$ 3,586	\$ 78,806 =====
	=====	=====	=====

In support of certain debt instruments and leases, as of March 31, 2003, we had \$2.9 million of cash restricted as collateral for letters of credit. The letters of credit currently expire at various dates through July 2004, but require renewal through the related debt and lease obligations termination dates. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain Supplies Distributors' credit facilities. As of March 31, 2003, the outstanding balance of our senior credit facilities was approximately \$58.4 million. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of stockholders' equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. Any requirement to accelerate the repayment of the credit facility obligations would have a material adverse impact on our financial condition and results of operations. We can provide no assurance that we will have the financial ability to repay all of such obligations. As of March 31, 2003, we were in compliance with all debt covenants and we believe that we will maintain such compliance throughout calendar year 2003. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries by its lenders, in the event that Supplies Distributors or its subsidiaries are unable to do so. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined. We are also required to maintain a minimum subordinated loan to Supplies Distributors of \$8.0 million. We have to seek lender approval to increase or decrease this amount. We do not have any other material financial commitments.

In September 2002, we implemented a restructuring plan and terminated approximately 10% of our workforce. As a result of the terminations and certain asset write-offs recorded during the three months ended September 30, 2002, we believe we have reduced our annual operating expenses by approximately \$5 million to \$6 million. We also continue to seek out other non-payroll related operating expense reductions that could impact this amount further.

We currently believe that we are still operating with and incurring costs applicable to excess physical capacity in our North American and European operations. We believe that based on our current cost structure, as we add revenue, we will be able to cover our reduced infrastructure costs and reach profitability. We currently estimate that the net service fee revenue needed to leverage our existing infrastructure and cost structure and reach profitability is approximately between \$12 million to \$13 million per quarter. No assurance can be given that we can achieve such operating levels, or that, if achieved, we

will be profitable in any particular fiscal period. We will reevaluate the carrying value of certain of the excess long-lived warehouse operation and information technology infrastructure assets for impairment in

2003, in conjunction with our future operating plans, and determine if additional asset impairment costs should be recognized.

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.

On March 28, 2003, Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc., (both wholly-owned subsidiaries of PFSweb and collectively the "Borrowers") entered into a two year Loan and Security Agreement with Comerica Bank ("Comerica") to provide financing for up to \$7.5 million of eligible accounts receivable in the U.S. and Canada. We entered this agreement to supplement our existing cash position, and provide funding for our future operations, including our targeted growth. Borrowings under the Comerica facility will accrue interest at prime rate plus 1%. The agreement contains cross default provisions, various restrictions upon the Borrowers' ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth, as defined, and a minimum liquidity ratio, as defined. The agreement also limits our ability to increase the subordinated loan to Supplies Distributors without the lender's approval. The agreement is secured by all of the assets of the Borrowers, as well as a guarantee of PFSweb.

#### CONTINUED LISTING ON NASDAQ SMALLCAP MARKET

In June 2002, the NASDAQ approved our transition from the NASDAQ National Market System to the NASDAQ SmallCap Market. Our securities began trading on the NASDAQ SmallCap Market on June 10, 2002.

This transition occurred in response to NASDAQ Marketplace Rule 4450(a)(5), which requires a minimum bid price of \$1.00 for continued listing on the NASDAQ National Market. The SmallCap Market also has a minimum bid price of \$1.00 per share. However, as compared to the 90 day grace period provided by the NASDAQ National Market, the SmallCap Market currently has a longer minimum bid price grace period of 180 days from receipt of NASDAQ Delisting Notification (February 14, 2002 for the Company). This grace period extended us through August 13, 2002.

Due to our compliance with the initial listing requirements for the NASDAQ SmallCap Market, on August 14, 2002 we were provided an additional 180 day grace period, or until February 10, 2003 to regain compliance. In March 2003, we were provided an additional 90 day grace period, or until May 12, 2003, to regain compliance. On May 14, 2003, we received a NASDAQ Staff Determination letter, indicating that we no longer comply with the \$1 minimum bid price requirement for continued listing and that our common stock is, therefore, subject to delisting from the NASDAQ SmallCap Market at the opening of business on May 23, 2003. We will request a hearing to appeal this notice. Our hearing request will defer delisting until the NASDAQ Listing Qualifications Panel reaches a decision. Until then, our common stock will remain listed and will continue to trade on the NASDAQ SmallCap Market. There can be no assurance as to when the Panel will reach a decision or that such a decision will be favorable to us. If we subsequently decide not to appeal the delisting notice, or if the Panel denies the appeal, our securities may be immediately eligible for quotation on the OTC Bulletin Board. The delisting of our common stock could have a material adverse effect on the market price of, and the efficiency of the trading market for, our common stock.

#### SEASONALITY

The seasonality of our business is dependent upon the seasonality of our clients' business and their sale of their products. Accordingly, our management must rely upon the projections of our clients in assessing quarterly variability. We believe that with our current client mix, our service fee business activity will be at its lowest in the quarter ended March 31 and at its highest in the quarter ended June 30. We expect our Supplies Distributors business to be seasonally strong in the December quarter of each year.

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 that inflation has not had a material effect on our operations.

#### IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of this standard did not have a material impact on the consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses the financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The adoption of this standard did not have a material impact on the consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS 148 amends SFAS 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the provisions of SFAS 123 to require more prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results of operations. We adopted the disclosure requirements of SFAS 148 as of December 31, 2002.

In January 2003, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others." FIN No. 45 requires a company to recognize a liability for the obligations it has undertaken in issuing a guarantee. This liability would be recorded at the inception of a guarantee and would be measured at fair value. The measurement provisions of this statement apply prospectively to guarantees issued or modified after December 31, 2002. The disclosure provisions of the statement apply to financial statements for periods ending after December 15, 2002. We adopted the disclosure provisions of the statement as of December 31, 2002 and the measurement provisions of this statement during the three months ended March 31, 2003. The adoption of this statement did not have a material effect on the consolidated financial statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities." FIN 46 requires a company to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the company does not have a majority of voting interests. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception for any entity created after January 31, 2003. For an entity created before February 1, 2003, the provisions of this interpretation must be applied at the beginning of the first interim or annual period beginning after June 15, 2003. We adopted the provisions of FIN No. 46 during the three months ended March 31, 2003. The adoption of the statement did not have a material effect on the consolidated financial statements.

The FASB Emerging Issues Task Force issued EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," to address certain revenue recognition issues. The guidance provided from EITF 00-21 addresses both the timing and classification in accounting for different earnings processes. We do not expect that the adoption of EITF 00-21 will have a material impact on our consolidated financial condition or operations.

## CRITICAL ACCOUNTING POLICIES

A description of critical accounting policies is included in Note 2 to the accompanying unaudited interim condensed consolidated financial statements. For other significant accounting policies, see Note 2 to the consolidated financial statements in our December 31, 2002 Annual Report on Form 10-K.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to various market risks including interest rates on its financial instruments and foreign exchange rates.

### Interest Rate Risk

Our interest rate risk is limited to our outstanding balances on our inventory and working capital financing agreements, loan and security agreement and factoring agreement for the financing of inventory, accounts receivable and certain other receivables, which amounted to \$57.1 million at March 31, 2003. A 100 basis point movement in interest rates would result in approximately \$0.2 million annualized increase or decrease in interest expense based on the outstanding balance of these agreements at March 31, 2003.

### Foreign Exchange Risk

Currently, our foreign currency exchange rate risk is primarily limited to the Canadian Dollar and the Euro. In the future, our foreign currency exchange risk may also include other currencies applicable to certain of our international operations. We may, from time to time, employ derivative financial instruments to manage our exposure to fluctuations in foreign currency rates. To hedge our net investment and intercompany payable or receivable balances in foreign operations, we may enter into forward currency exchange contracts. We do not hold or issue derivative financial instruments for trading purposes or for speculative purposes.

## ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of management, including our Chief Executive Officer and Principal Financial and Accounting Officer, within 90 days prior to the filing date of this report. Based upon the evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings. No significant changes were made to our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits:

EXHIBIT NO.  
DESCRIPTION  
OF EXHIBITS

-----

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----- 3.1\*

Amended and

Restated

Certificate

of

Incorporation

3.2\* Amended

and Restated

Bylaws

10.1\*\* Loan

and Security

Agreement by

and between

Comerica

Bank -

California

("Bank") and

Priority

Fulfillment

Services,

Inc.

("Priority")

and Priority

Fulfillment

Services of

Canada, Inc.

("Priority

Canada")

10.2\*\*

Unconditional

Guaranty of

PFSweb, Inc.

to Comerica

Bank-

California

10.3\*\*

Security

Agreement of

PFSweb, Inc.

to Comerica

Bank-

California

10.4\*\*

Intellectual

Property

Security Agreement between Priority Fulfillment Services, Inc. and Comerica Bank-California 10.5\*\*

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. 10.6\*\*

Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplied Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., and IBM Credit LLC 99.1\*\*

Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 99.2\*\*

Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906



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\* Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657).

\*\* Filed herewith

b) Reports on Form 8-K:

Form 8-K/A filed on January 8, 2003 reporting Item 2, Acquisition or Disposition of Assets, that on October 25, 2002, Priority Fulfillment Services, Inc. (the "Company") acquired the remaining 51% ownership interest in Business Supplies Distributors Holdings, LLC ("Holdings") for \$331,758. Also reporting Item 7, Financial Statements of Holdings and the Pro Forma Financial Information of the Company.

SIGNATURES

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

Date: May 15, 2003

PFSweb, Inc.

By: /s/ Thomas J. Madden

-----  
Thomas J. Madden  
Chief Financial Officer,  
Chief Accounting Officer,  
Executive Vice President

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

I, Mark Layton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PFSweb, Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this quarterly 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-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize, and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003  
-----

By: /s/ Mark C. Layton  
-----  
Chief Executive Officer

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

I, Tom Madden, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PFSweb, Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this quarterly 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-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize, and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003  
-----

By: /s/ Thomas J. Madden  
-----  
Chief Financial Officer and  
Chief Accounting Officer

INDEX TO EXHIBITS

EXHIBIT NO.  
DESCRIPTION  
OF EXHIBITS

- - - - -  
-----

3.1\* Amended  
and Restated  
Certificate  
of

Incorporation

3.2\* Amended  
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10.1\*\* Loan  
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("Bank") and

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("Priority")  
and Priority

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Amendment 2  
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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. 10.6\*\*  
Amendment to  
Agreement  
for  
Inventory  
Financing by  
and among  
Business  
Supplies  
Distributors  
Holdings,  
LLC,  
Supplied  
Distributors,  
Inc.,  
Priority  
Fulfillment  
Services,  
Inc.,  
PFSweb,  
Inc., and  
IBM Credit  
LLC 99.1\*\*  
Certification  
of Chief  
Executive  
Officer  
Pursuant to  
18 U.S.C.  
Section  
1350, as  
Adopted  
Pursuant to  
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of the  
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\* Incorporated by reference from PFSweb, Inc. Registration Statement on Form  
S-1 (Commission File No. 333-87657).

\*\* Filed herewith

-----  
PRIORITY FULFILLMENT SERVICES, INC.

AND

PRIORITY FULFILLMENT SERVICES OF CANADA, INC.

LOAN AND SECURITY AGREEMENT  
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This LOAN AND SECURITY AGREEMENT is entered into as of March 28, 2003, by and between Comerica Bank - California ("Bank") and Priority Fulfillment Services, Inc. ("Priority") and Priority Fulfillment Services of Canada, Inc. ("Priority Canada"; Priority and Priority Canada are sometimes collectively referred to in this Agreement as "Borrower" and each individually as "Borrower").

#### RECITALS

Borrowers wish to obtain credit from time to time from Bank, and Bank desires to extend credit to Borrowers. This Agreement sets forth the terms on which Bank will advance credit to Borrowers, and Borrowers will repay the amounts owing to Bank.

#### AGREEMENT

The parties agree as follows:

##### 1. DEFINITIONS AND CONSTRUCTION.

1.1 Definitions. As used in this Agreement, all capitalized terms shall have the definitions set forth on Exhibit A. Any term used in the Code and not defined herein shall have the meaning given to the term in the Code.

1.2 Accounting Terms. Any accounting term not specifically defined on Exhibit A shall be construed in accordance with GAAP and all calculations shall be made in accordance with GAAP. The term "financial statements" shall include the accompanying notes and schedules.

##### 2. LOAN AND TERMS OF PAYMENT.

###### 2.1 Credit Extensions.

(a) Promise to Pay. Each Borrower jointly and severally promises to pay to Bank, in lawful money of the United States of America, the aggregate unpaid principal amount of all Credit Extensions made by Bank to Borrowers, together with interest on the unpaid principal amount of such Credit Extensions at rates in accordance with the terms hereof.

###### (b) Revolving Advances.

(i) Amount. Subject to and upon the terms and conditions of this Agreement (1) Borrowers may request Advances in an aggregate outstanding amount not to exceed the lesser of (A) the Committed Revolving Line or (B) the Borrowing Base, less any amounts outstanding under the Letter of Credit Sublimit, and (2) amounts borrowed pursuant to this Section 2.1(b) may be repaid and reborrowed at any time prior to the Revolving Maturity Date, at which time all Advances under this Section 2.1(b) shall be immediately due and payable. Borrowers may prepay any Advances without penalty or premium.

(ii) Form of Request. Whenever Borrowers desire an Advance, Borrowers will notify Bank by facsimile transmission or telephone no later than 3:00 p.m. Pacific time, on the Business Day that the Advance is to be made. Each such notification shall be promptly confirmed by a Payment/Advance Form in substantially the form of Exhibit C. Bank is authorized to make Advances under this Agreement, based upon instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions, but upon prior notice to Borrower, if in Bank's discretion such Advances are necessary to meet Obligations which have become due and remain unpaid. Bank shall be entitled to rely on any telephonic notice given by a person who Bank reasonably believes to be a Responsible Officer or a designee thereof, and Borrowers shall indemnify and hold Bank harmless for any damages or loss suffered by Bank as a result of such reliance. Bank will credit the amount of Advances made under this Section 2.1(b) to Borrowers' deposit account.

(iii) Letter of Credit Sublimit. Subject to the availability under the Committed Revolving Line, and in reliance on the representations and warranties of Borrowers set forth herein, at any time and from time to time from the date hereof through the Business Day immediately prior to the Revolving Maturity Date, Bank shall issue for the account of Borrowers such Letters of Credit as Borrowers may request by delivering to Bank a duly executed letter of credit application on Bank's standard form; provided, however, that the outstanding and undrawn amounts under all such Letters of Credit (i) shall not at any time exceed the Letter of Credit Sublimit, and (ii) shall be deemed to constitute Advances for the purpose of calculating availability under the Committed Revolving Line. Any drawn but unreimbursed amounts under any Letters of Credit shall be charged as Advances against the Committed Revolving Line. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's form application and letter of credit agreement. Borrowers will pay any standard issuance and other fees that Bank notifies Borrowers will be charged for issuing and processing Letters of Credit. Unless Borrowers shall have deposited with Bank cash collateral in an amount sufficient to cover all undrawn amounts under each such Letter of Credit and Bank shall have agreed in writing, no Letter of Credit shall have an expiration date that is later than the Revolving Maturity Date. If Borrowers have not secured to Bank's satisfaction its obligations with respect to any Letters of Credit by the Revolving Maturity Date, then, effective as of such date, the balance in any deposit accounts held by Bank and the certificates of deposit issued by Bank in either Borrower's name (and any interest paid thereon or proceeds thereof, including any amounts payable upon the maturity or liquidation of such certificates), shall automatically secure such obligations to the extent of the then outstanding and undrawn Letters of Credit. Borrowers authorize Bank to hold such balances in pledge and to decline to honor any drafts thereon or any requests by Borrowers or any other Person to pay or otherwise transfer any part of such balances for so long as the Letters of Credit are outstanding.

2.2 Overadvances. If the aggregate amount of the outstanding Advances exceeds the lesser of the Committed Revolving Line or the Borrowing Base at any time, Borrowers shall immediately pay to Bank, in cash, the amount of such excess.

### 2.3 Interest Rates, Payments, and Calculations.

(a) Interest Rates. Except as set forth in Section 2.3(b), the Advances shall bear interest, on the outstanding daily balance thereof, at a variable rate equal to 1% above the Prime Rate.

(b) Late Fee; Default Rate. If any payment is not made within 10 days after the date such payment is due, Borrower shall pay Bank a late fee equal to the lesser of (i) 5% of the amount of such unpaid amount or (ii) the maximum amount permitted to be charged under applicable law. All Obligations shall bear interest, from and after the occurrence and during the continuance of an Event of Default, at a rate equal to 5 percentage points above the interest rate applicable immediately prior to the occurrence of the Event of Default.

(c) Payments. Interest hereunder shall be due and payable on the 15th calendar day of each month during the term hereof. Bank shall, at its option, charge such interest, all Bank Expenses, and all Periodic Payments against any of Borrower's deposit accounts or against the Committed Revolving Line, in which case those amounts shall thereafter accrue interest at the rate then applicable hereunder. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder.

(d) Computation. In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased, effective as of the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate. All interest chargeable under the Loan Documents shall be computed on the basis of a 360 day year for the actual number of days elapsed.

(e) Limitation on Interest. Borrowers and Bank intend to contract in strict compliance with applicable usury law from time to time in effect. In furtherance thereof such persons stipulate and agree that none of the terms and provisions contained in the Loan Documents shall ever be construed to provide for interest in excess of the maximum amount of interest permitted to be charged by applicable usury law from time to time in



effect. If, notwithstanding the foregoing, any amount constituting interest is nonetheless charged or collected in excess of the maximum amount of interest permitted to be charged by applicable usury law from time to time in effect, then such excess shall, at the option of the payee thereof, be credited on the amount of the obligations owed to such payee or refunded by such payee to the payor thereof.

2.4 Crediting Payments. Prior to the occurrence of an Event of Default, Bank shall credit a wire transfer of funds, check or other item of payment to such deposit account or Obligation as Borrowers specify. After the occurrence of an Event of Default, the receipt by Bank of any wire transfer of funds, check, or other item of payment shall be immediately applied to conditionally reduce Obligations, but shall not be considered a payment on account unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Bank after 12:00 noon Pacific time shall be deemed to have been received by Bank as of the opening of business on the immediately following Business Day. Whenever any payment to Bank under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

2.5 Fees. Borrowers shall pay to Bank the following:

(a) Unused Fee. An unused commitment fee in an amount equal to the product of (a) .5% multiplied by (b) the difference between (i) the Committed Revolving Line and (ii) the sum of the aggregate outstanding principal balance of all Advances and the undrawn amount of all outstanding Letters of Credit. Such fee shall be computed on a daily basis and shall be payable quarterly in arrears as of the end of each of Borrowers' fiscal quarters. Bank shall invoice Borrowers for such fees, which invoice shall be due and payable within 15 days after receipt;

(b) Bank Expenses. On the Closing Date, all Bank Expenses incurred through the Closing Date, and, after the Closing Date, all Bank Expenses, as and when they become due.

2.6 Term. This Agreement shall become effective on the Closing Date and, subject to Section 12.7, shall continue in full force and effect for so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions under this Agreement. Notwithstanding the foregoing, Bank shall have the right to terminate its obligation to make Credit Extensions under this Agreement immediately and without notice upon the occurrence and during the continuance of an Event of Default.

### 3. CONDITIONS OF LOANS.

3.1 Conditions Precedent to Initial Credit Extension. The obligation of Bank to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, the following:

(a) this Agreement;

(b) an officer's certificate of each Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Agreement;

(c) a financing statement (Form UCC-1);

(d) an intellectual property security agreement from each Borrower;

(e) agreement to provide insurance;

(f) payment of the fees and Bank Expenses then due specified in Section 2.5;

(g) current SOS Reports indicating that except for Permitted Liens, there are no other security interests or Liens of record in the Collateral;

(h) an audit of the Collateral, the results of which shall be satisfactory to Bank;

(i) current financial statements, including audited statements for Borrowers' fiscal year 2001, together with an unqualified opinion, in accordance with Section 6.2;

(j) a guarantee executed and delivered by Guarantor;

(k) a pledge agreement executed and delivered by Guarantor pursuant to which Guarantor pledges all of its ownership interest in Borrowers;

(l) an officer's certificate of Guarantor with respect to incumbency and resolutions authorizing the execution and delivery of the Loan Documents to which Guarantor is a party;

(m) subordination agreements duly executed and delivered by each of IBM Credit Corporation, IBM Belgium Financial Services S.A., and Congress Financial Corporation (Southwest);

(n) within ninety (90) days of the date hereof, a lockbox agreement with Bank establishing a post office box (the "Lockbox") in Bank's name; and

(o) such other documents or certificates, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. The obligation of Bank to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

(a) timely receipt by Bank of the Payment/Advance Form as provided in Section 2.1; and

(b) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and be continuing, or would exist after giving effect to such Credit Extension (provided, however, that those representations and warranties expressly referring to another date shall be true, correct and complete in all material respects as of such date). The making of each Credit Extension shall be deemed to be a representation and warranty by Borrowers on the date of such Credit Extension as to the accuracy of the facts referred to in this Section 3.2.

#### 4. CREATION OF SECURITY INTEREST.

4.1 Grant of Security Interest. Each Borrower grants and pledges to Bank a continuing security interest in the Collateral to secure prompt repayment of any and all Obligations and to secure prompt performance by such Borrower of each of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the presently existing Collateral, and will constitute a valid, first priority security interest in later-acquired Collateral. Notwithstanding any termination, Bank's Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding.

4.2 Perfection of Security Interest. Each Borrower authorizes Bank to file at any time financing statements, continuation statements, and amendments thereto that describe the Collateral and to describe the Collateral as all assets of such Borrower of the kind pledged hereunder and which contain any other information required by the Code for the sufficiency of filing office acceptance of any financing statement, continuation statement, or amendment, including whether such Borrower is an organization, the type of organization and any organizational identification number issued to such Borrower, if applicable. Each Borrower shall from time to time execute and deliver to Bank, at the request of Bank, all Negotiable Collateral and other documents that Bank may reasonably request, in form satisfactory to Bank, to perfect and continue perfected Bank's security interests in the Collateral and in order to fully consummate all of the transactions contemplated under the Loan Documents. Borrower shall have possession of the Collateral, except where expressly otherwise provided in this Agreement or



where Bank chooses to perfect its security interest by possession in addition to the filing of a financing statement. Where Collateral is in possession of a third party bailee, each Borrower shall take such steps as Bank reasonably requests for Bank to (i) obtain an acknowledgment, in form and substance satisfactory to Bank, of the bailee that the bailee holds such Collateral for the benefit of Bank, (ii) obtain "control" of any Collateral consisting of investment property, deposit accounts, letter-of-credit rights or electronic chattel paper (as such items and the term "control" are defined in Revised Article 9 of the Code) by causing the securities intermediary or depository institution or issuing bank to execute a control agreement in form and substance satisfactory to Bank. No Borrower will create any chattel paper without placing a legend on the chattel paper acceptable to Bank indicating that Bank has a security interest in the chattel paper.

4.3 Right to Inspect. Bank (through any of its officers, employees, or agents) shall have the right, upon reasonable prior notice, from time to time during Borrowers' usual business hours but no more than twice a year (unless an Event of Default has occurred and is continuing), to inspect Borrowers' Books and to make copies thereof and to check, test, and appraise the Collateral in order to verify Borrowers' financial condition or the amount, condition of, or any other matter relating to, the Collateral.

4.4 Lockbox. Within ninety (90) days of the date of this Agreement, each Borrower shall notify all account debtors (other than account debtors of Priority Canada which have their principal place of business in Canada) to make payments with respect to its Accounts directly to the Lockbox. Any payments received by a Borrower with respect to its Accounts by wire transfer shall be deposited directly in Borrowers' primary deposit accounts held with Bank. Bank shall have exclusive and unrestricted access to the Lockbox. So long as no Event of Default has occurred and is continuing, Bank shall transfer all funds received in the Lockbox in accordance with Borrowers' instructions. During the continuation of an Event of Default, all funds received in the Lockbox shall be applied to reduce the Obligations, subject to the terms of Section 2.4. Within ninety (90) days of the date of this Agreement, Priority Canada shall establish a lockbox in Canada with Bank or one of its Affiliates for deposit of payments made by account debtors of Priority Canada which have their principal place of business in Canada.

## 5. REPRESENTATIONS AND WARRANTIES.

Each Borrower represents and warrants as follows except as set forth in the Schedule:

5.1 Due Organization and Qualification. Each Borrower and each Subsidiary is a corporation (or limited liability company) duly existing under the laws of its respective Organizational Jurisdiction and qualified and licensed to do business in any state in which the conduct of its business or its ownership of property requires that it be so qualified, except where the failure to do so would not reasonably be expected to cause a Material Adverse Effect.

5.2 Due Authorization; No Conflict. The execution, delivery, and performance of the Loan Documents are within Borrowers' powers, have been duly authorized, and are not in conflict with nor constitute a breach of any provision contained in Borrowers' organizational documents, nor will they constitute an event of default under any material agreement by which either Borrower is bound. Borrowers are not in default under any agreement by which it is bound, except to the extent such default would not reasonably be expected to cause a Material Adverse Effect.

5.3 Collateral. Each Borrower has rights in or the power to transfer the Collateral, and its title to the Collateral is free and clear of Liens, adverse claims, and restrictions on transfer or pledge except for Permitted Liens. All Collateral is located solely in the Collateral States. The Eligible Accounts are bona fide existing obligations. The property or services giving rise to such Eligible Accounts has been delivered or rendered to the account debtor or its agent for immediate shipment to and unconditional acceptance by the account debtor subject to the audit, disputes and other rights of the account debtor arising in the ordinary course of business of Borrowers. Borrowers have not received notice of actual or imminent Insolvency Proceeding of any account debtor whose accounts are included in any Borrowing Base Certificate as an Eligible Account. All Inventory is in all material respects of good and merchantable quality, free from all material defects, except for Inventory for which adequate reserves have been made. Except as set forth in the Schedule, no securities account or deposit account of either Borrower (excluding the Third Party Deposit Accounts) is maintained or invested with a Person other than Bank or Bank's affiliates.



5.4 Intellectual Property Collateral. Each Borrower is the sole owner of its Intellectual Property Collateral, except for Permitted Liens and licenses granted by such Borrower to its customers in the ordinary course of business. To the best of Borrowers' knowledge, each of the Copyrights, Trademarks and Patents is valid and enforceable, and no part of the Intellectual Property Collateral has been judged invalid or unenforceable, in whole or in part, and no claim has been made to Borrowers that any part of the Intellectual Property Collateral violates the rights of any third party except to the extent such claim would not reasonably be expected to cause a Material Adverse Effect. Except as set forth in the Schedule, sublicensing fees received or to be received by Borrower with respect to intellectual property do not give rise to more than 5% of its gross revenue in any given month.

5.5 Name; Location of Chief Executive Office. Except as disclosed in the Schedule, neither Borrower has done business under any name other than that specified on the signature page hereof, and its exact legal name is as set forth in the first paragraph of this Agreement. The chief executive office of each Borrower is located in its respective Chief Executive Office.

5.6 Litigation. Except as set forth in the Schedule, there are no actions or proceedings pending by or against either Borrower or any Subsidiary before any court or administrative agency in which a likely adverse decision would reasonably be expected to have a Material Adverse Effect, or a material adverse effect on either Borrower's interest or Bank's security interest in the Collateral.

5.7 No Material Adverse Change in Financial Statements. All consolidating and consolidated financial statements related to Guarantor, Borrowers and any Subsidiary that are delivered by Borrowers to Bank fairly present in all material respects Guarantor's and Borrowers' consolidating and consolidated financial condition as of the date thereof and Guarantor's and Borrowers' consolidating and consolidated results of operations for the period then ended. There has not been a material adverse change in the consolidated financial condition of Guarantor or the financial condition of Borrowers since the date of the most recent of such financial statements submitted to Bank, except for ordinary seasonal fluctuations in the ordinary course of business.

5.8 Solvency, Payment of Debts. Each Borrower is able to pay its debts (including trade debts) as they mature; the fair saleable value of such Borrower's assets (including goodwill minus disposition costs) exceeds the fair value of its liabilities; and such Borrower is not left with unreasonably small capital after the transactions contemplated by this Agreement.

5.9 Compliance with Laws and Regulations. Each Borrower and each of their Subsidiaries have met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. No event has occurred resulting from either Borrower's failure to comply with ERISA that is reasonably likely to result in such Borrower's incurring any liability that could have a Material Adverse Effect. Neither Borrower is an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Neither Borrower is engaged principally, or as one of the important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations T and U of the Board of Governors of the Federal Reserve System). Each Borrower has complied in all material respects with all the provisions of the Federal Fair Labor Standards Act. Each Borrower is in compliance with all environmental laws, regulations and ordinances except where the failure to comply is not reasonably likely to have a Material Adverse Effect. Neither Borrower has violated any statutes, laws, ordinances or rules applicable to it, violation of which could have a Material Adverse Effect. Each Borrower and each of its Subsidiaries have filed or caused to be filed all tax returns required to be filed, and have paid, or have made adequate provision for the payment of, all taxes reflected therein except those being contested in good faith with adequate reserves under GAAP or where the failure to file such returns or pay such taxes would not reasonably be expected to have a Material Adverse Effect.

5.10 Subsidiaries. Borrowers do not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.11 Government Consents. Borrowers and each Subsidiary have obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental

authorities that are necessary for the continued operation of each Borrower's business as currently conducted, except where the failure to do so would not reasonably be expected to cause a Material Adverse Effect.

#### 5.12 Intentionally Omitted.

5.13 Full Disclosure. No representation, warranty or other statement made by either Borrower in any certificate or written statement furnished to Bank taken together with all such certificates and written statements furnished to Bank contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained in such certificates or statements not misleading, it being recognized by Bank that the projections and forecasts provided by Borrowers in good faith and based upon reasonable assumptions are not to be viewed as facts and that actual results during the period or periods covered by any such projections and forecasts may differ from the projected or forecasted results.

### 6. AFFIRMATIVE COVENANTS.

Each Borrower covenants that, until payment in full of all outstanding Obligations, and for so long as Bank may have any commitment to make a Credit Extension hereunder, Borrowers shall do all of the following:

6.1 Good Standing and Government Compliance. Each Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in its respective Organizational Jurisdiction, shall maintain qualification and good standing in each jurisdiction in which the failure to so qualify could have a Material Adverse Effect, and shall furnish to Bank the organizational identification number issued to such Borrower by the authorities of the state in which such Borrower is organized, if applicable. Each Borrower shall meet, and shall cause each Subsidiary to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA, except where the failure to meet such requirements would not reasonably be expected to have a Material Adverse Effect. Each Borrower shall comply in all material respects with all applicable Environmental Laws, and maintain all material permits, licenses and approvals required thereunder where the failure to do so could have a Material Adverse Effect. Each Borrower shall comply, and shall cause each of its Subsidiaries to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, and shall maintain, and shall cause each of its Subsidiaries to maintain, in force all licenses, approvals and agreements, the loss of which or failure to comply with which would reasonably be expected to have a Material Adverse Effect, or a material adverse effect on the Collateral or the priority of Bank's Lien on the Collateral.

6.2 Financial Statements, Reports, Certificates. Borrowers shall deliver to Bank:

(a) as soon as available, but in any event within 35 days after the end of each calendar month, a company prepared consolidated and consolidating balance sheet and income statement of Guarantor covering Borrowers' operations during such period, in a form reasonably acceptable to Bank and certified by a Responsible Officer;

(b) as soon as available, but in any event within 90 days after the end of Guarantor's fiscal year, audited consolidated and unaudited consolidating financial statements of Guarantor prepared in accordance with GAAP, consistently applied, together with an opinion which is unqualified or otherwise consented to in writing by Bank on such consolidated financial statements of an independent certified public accounting firm reasonably acceptable to Bank

(c) as soon as available, but in any event within 90 days after the end of BSD's fiscal year, audited consolidated and unaudited consolidating financial statements of BSD prepared in accordance with GAAP, consistently applied, together with an opinion which is unqualified or otherwise consented to in writing by Bank on such consolidated financial statements of an independent certified public accounting firm reasonably acceptable to Bank;

(d) as soon as available, but in any event within 45 days after the end of Guarantor's fiscal quarter, all reports on Form 10-Q filed by Guarantor with the Securities and Exchange Commission;

(e) as soon as available, but in any event within 90 days after the end of Guarantor's fiscal year, all reports on Form 10-K filed by Guarantor with the Securities and Exchange Commission;

(f) if applicable, copies of all other statements, reports and notices sent or made available generally by Borrowers or Guarantor to its security holders or to any holders of Subordinated Debt;

(g) promptly upon receipt of notice thereof, a report of any legal actions pending or threatened against either Borrower or any Subsidiary that could result in damages or costs to such Borrower or any Subsidiary of \$250,000 or more;

(h) such budgets, sales projections, operating plans or other financial information generally prepared by Borrowers in the ordinary course of business as Bank may reasonably request from time to time;

(i) within 30 days of the last day of each fiscal quarter, a report signed by Borrowers, in form reasonably acceptable to Bank, listing any applications or registrations that either Borrower has made or filed in respect of any Patents, Copyrights or Trademarks and the status of any outstanding applications or registrations, as well as any material change in Borrowers' Intellectual Property Collateral, including but not limited to any subsequent ownership right of Borrower in or to any Trademark, Patent or Copyright not specified in Exhibits A, B, and C of the Intellectual Property Security Agreement delivered to Bank by Borrowers in connection with this Agreement;

(j) within 30 days after the last day of each month, Borrowers shall deliver to Bank a Borrowing Base Certificate signed by a Responsible Officer in substantially the form of Exhibit D hereto, together with aged listings by invoice date of accounts receivable and accounts payable;

(k) within 35 days after the last day of each month, Borrowers shall deliver to Bank with the monthly financial statements a Compliance Certificate signed by a Responsible Officer in substantially the form of Exhibit E hereto; and

(l) as soon as possible and in any event within 3 calendar days after becoming aware of the occurrence or existence of an Event of Default hereunder, a written statement of a Responsible Officer setting forth details of the Event of Default, and the action which Borrower has taken or proposes to take with respect thereto.

Bank shall have a right from time to time, upon reasonable prior notice, hereafter to audit Borrowers' Accounts and appraise Collateral at Borrowers' expense, provided that such audits will be conducted no more often than every 6 months unless an Event of Default has occurred and is continuing.

6.3 Inventory; Returns. Borrowers shall keep all Inventory in good and merchantable condition, free from all material defects except for Inventory for which adequate reserves have been made. Returns and allowances, if any, as between each Borrower and its account debtors shall be on the same basis and in accordance with the usual customary practices of such Borrower, as they exist on the Closing Date. Borrowers shall promptly notify Bank of all returns and recoveries and of all disputes and claims involving more than \$100,000.

6.4 Taxes. Borrowers shall make, and cause each Subsidiary to make, due and timely payment or deposit of all material federal, state, and local taxes, assessments, or contributions required of it by law, including, but not limited to, those laws concerning income taxes, F.I.C.A., F.U.T.A. and state disability, and will execute and deliver to Bank, on demand, proof satisfactory to Bank indicating that Borrower or a Subsidiary has made such payments or deposits and any appropriate certificates attesting to the payment or deposit thereof; provided that Borrowers or a Subsidiary need not make any payment if the amount or validity of such payment is contested in good faith by appropriate proceedings and is reserved against (to the extent required by GAAP) by Borrowers.

## 6.5 Insurance.

(a) Each Borrower, at its expense, shall keep the Collateral insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where such Borrower's business is conducted on the date hereof. Each Borrower shall also maintain liability and other insurance in amounts and of a type that are customary to businesses similar to such Borrower's.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as reasonably satisfactory to Bank. All policies of property insurance shall contain a lender's loss payable endorsement, in a form satisfactory to Bank, showing Bank as an additional loss payee, and all liability insurance policies shall show Bank as an additional insured and specify that the insurer must give at least 20 days notice to Bank before canceling its policy for any reason. Upon Bank's request, each Borrower shall deliver to Bank certified copies of the policies of insurance and evidence of all premium payments. If no Event of Default has occurred and is continuing, proceeds payable under any casualty policy will, at Borrower's option, be payable to such Borrower to replace the property subject to the claim, provided that any such replacement property shall be deemed Collateral in which Bank has been granted a first priority security interest. If an Event of Default has occurred and is continuing, all proceeds payable under any such policy shall, at Bank's option, be payable to Bank to be applied on account of the Obligations.

6.6 Primary Depository. Except for those accounts specified on the Schedule that support existing letters of credit issued at the application of Borrowers and the Third Party Deposit Accounts, within ninety (90) days of the date of this Agreement, all primary depository, operating and investment accounts of each Borrower (including without limitation, all primary depository, operating and investment accounts maintained in Canada) shall be maintained with Bank or Bank's Affiliates.

6.7 Financial Covenants. Borrowers shall at all times maintain the following financial ratios and covenants, measured as of the last day of each calendar month unless stated otherwise:

(a) Tangible Net Worth. A consolidated Tangible Net Worth of Guarantor of not less than \$19,000,000.

(b) Liquidity Ratio. A ratio of (i) consolidated Cash of Guarantor (excluding Business Supplies Distributors Holdings LLC and its Subsidiaries) plus the Eligible Accounts to (ii) all Obligations of not less than 1.50 to 1.00.

## 6.8 Registration of Intellectual Property Rights.

(a) Each Borrower shall register or cause to be registered on an expedited basis (to the extent not already registered) with the United States Patent and Trademark Office or the United States Copyright Office, as the case may be, those registerable intellectual property rights now owned or hereafter developed or acquired by such Borrower, to the extent that such Borrower, in its reasonable business judgment, deems it appropriate to so protect such intellectual property rights.

(b) Each Borrower shall promptly give Bank written notice of any applications or registrations of intellectual property rights filed with the United States Patent and Trademark Office, including the date of such filing and the registration or application numbers, if any.

(c) Each Borrower shall (i) give Bank not less than 30 days prior written notice of the filing of any applications or registrations with the United States Copyright Office, including the title of such intellectual property rights to be registered, as such title will appear on such applications or registrations, and the date such applications or registrations will be filed, and (ii) prior to the filing of any such applications or registrations, shall execute such documents as Bank may reasonably request for Bank to maintain its perfection in such intellectual property rights to be registered by such Borrower, and upon the request of Bank, shall file such documents simultaneously with the filing of any such applications or registrations. Upon filing any such

applications or registrations with the United States Copyright Office, each Borrower shall promptly provide Bank with (i) a copy of such applications or registrations, without the exhibits, if any, thereto, (ii) evidence of the filing of any documents requested by Bank to be filed for Bank to maintain the perfection and priority of its security interest in such intellectual property rights, and (iii) the date of such filing.

(d) Each Borrower shall execute and deliver such additional instruments and documents from time to time as Bank shall reasonably request to perfect and maintain the priority of Bank's security interest in the Intellectual Property Collateral.

(e) Each Borrower shall (i) protect, defend and maintain the validity and enforceability of the trade secrets, Trademarks, Patents and Copyrights, (ii) use commercially reasonable efforts to detect infringements of the Trademarks, Patents and Copyrights and promptly advise Bank in writing of material infringements detected and (iii) not allow any material Trademarks, Patents or Copyrights to be abandoned, forfeited or dedicated to the public without the written consent of Bank, which shall not be unreasonably withheld.

(f) Bank may audit Borrowers' Intellectual Property Collateral to confirm compliance with this Section 6.8, provided such audit may not occur more often than twice per year, unless an Event of Default has occurred and is continuing. Bank shall have the right, but not the obligation, to take, at Borrowers' sole expense, any actions that Borrowers are required under this Section 6.8 to take but which Borrowers fail to take, after 15 days' notice to Borrowers.

(g) Borrowers shall reimburse and indemnify Bank for all reasonable costs and reasonable expenses incurred in the reasonable exercise of its rights under this Section 6.8.

#### 6.9 Intentionally Omitted.

6.10 Further Assurances. At any time and from time to time each Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

6.11 Weekly Reporting. During any period of time that Adjusted Tangible Net Worth is less than \$21,000,000, Borrowers shall deliver the information described in Section 6.2(j) on the second Business Day of each calendar week for the immediately preceding calendar week.

### 7. NEGATIVE COVENANTS.

Each Borrower covenants and agrees that, so long as any credit hereunder shall be available and until the outstanding Obligations are paid in full or for so long as Bank may have any commitment to make any Credit Extensions, Borrowers will not do any of the following without Bank's prior written consent, which shall not be unreasonably withheld:

7.1 Dispositions. Convey, sell, lease, license, transfer or otherwise dispose of (collectively, to "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, other than Permitted Transfers.

7.2 Change in Name, Location or Executive Office, Change in Business; Change in Fiscal Year; Change in Control. Change its name, the Organizational Jurisdiction, or relocate its chief executive office without 30 days prior written notification to Bank; engage in any business, or permit any of its Subsidiaries to engage in any business, other than or reasonably related or incidental to the businesses currently engaged in by Borrowers; change its fiscal year end; have a Change in Control.

7.3 Mergers or Acquisitions. Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization (other than mergers or consolidations of a Subsidiary into another Subsidiary or into a Borrower or Guarantor), or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person (other than acquisitions by

Borrower, Guarantor or a Subsidiary of an existing Subsidiary's capital stock or property) except where (i) such transactions do not in the aggregate exceed \$250,000 and (ii) no Event of Default has occurred, is continuing or would exist after giving effect to the transactions.

7.4 Indebtedness. Create, incur, assume, guarantee or be or remain liable with respect to any Indebtedness, or permit any Subsidiary so to do, other than Permitted Indebtedness, or prepay any Indebtedness or take any actions which impose on Borrowers an obligation to prepay any Indebtedness, except Indebtedness to Bank, if either before or after giving effect to such prepayment, an Event of Default has occurred and is continuing.

7.5 Encumbrances. Create, incur, assume or allow any Lien with respect to any of its property, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens, or covenant to any other Person that Borrowers in the future will refrain from creating, incurring, assuming or allowing any Lien with respect to any of Borrowers' property.

7.6 Distributions. Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock, except that Subsidiaries may pay dividends and make such distributions or payments to Borrowers and Borrowers may (i) repurchase the stock of former employees pursuant to stock repurchase agreements as long as an Event of Default does not exist prior to such repurchase or would not exist after giving effect to such repurchase, and (ii) repurchase the stock of former employees pursuant to stock repurchase agreements by the cancellation of indebtedness owed by such former employees to Borrowers regardless of whether an Event of Default exists.

7.7 Investments. Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries so to do, other than Permitted Investments, or maintain or invest any of its securities accounts or deposit accounts with a Person other than Bank or Bank's affiliates (excluding those existing accounts specified in the Schedule and the Third Party Deposit Accounts) unless such Person has entered into a control agreement with Bank, in form and substance satisfactory to Bank, or suffer or permit any Subsidiary (other than Business Supplies Distributors Holdings, LLC and its Subsidiaries with respect to their existing Indebtedness owed to IBM Credit Corporation, IBM Belgium Financial Services S.A. and Congress Financial Corporation (Southwest)) to be a party to, or be bound by, an agreement that restricts such Subsidiary from paying dividends or otherwise distributing property to Borrowers.

7.8 Transactions with Affiliates. Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrowers except for (a) the transaction management fees charged to Supplies Distributors, Inc. and its Subsidiaries by Priority and its Subsidiaries, (b) interest expenses on intercompany Indebtedness owed to Borrowers or Guarantor, (c) intercompany tax payments, (d) Permitted Investments, (e) Permitted Indebtedness, and (f) transactions that are in the ordinary course of Borrowers' business, upon fair and reasonable terms that are no less favorable to Borrowers than would be obtained in an arm's length transaction with a non-affiliated Person.

7.9 Subordinated Debt. Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except in compliance with the terms of such Subordinated Debt, or amend any material provision affecting Bank's rights contained in any documentation relating to the Subordinated Debt without Bank's prior written consent which shall not be unreasonably withheld or delayed.

7.10 Inventory and Equipment. Store the Inventory or the Equipment with a bailee, warehouseman, or similar third party unless the third party has been notified of Bank's security interest and Bank (a) has received an acknowledgment from the third party that it is holding or will hold the Inventory or Equipment for Bank's benefit or (b) is in possession of the warehouse receipt, where negotiable, covering such Inventory or Equipment. Except for Inventory sold in the ordinary course of business and except for such other locations as Bank may approve in writing, Borrowers shall keep the Inventory and Equipment only at the location set forth in Section 10, the Schedule and such other locations of which Borrowers give Bank prior written notice and as to which Bank files a financing statement where needed to perfect its security interest.

7.11 No Investment Company. Become or be controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Credit Extension for such purpose.

7.12 Capital Expenditures. Make capital expenditures in an aggregate amount (including all capital expenditures made by Borrower's Subsidiaries) greater than \$3,000,000 in any fiscal year.

## 8. EVENTS OF DEFAULT.

Any one or more of the following events shall constitute an Event of Default by Borrowers under this Agreement:

8.1 Payment Default. If Borrowers fail to pay any of the Obligations when due;

8.2 Covenant Default.

(a) If Borrowers fail to perform any obligation under Section 6.2(j), 6.2(l) or 6.7 or violates any of the covenants contained in Article 7 of this Agreement; or

(b) If Borrowers fail or neglect to perform or observe any other material term, provision, condition, covenant contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between Borrowers and Bank and as to any default under such other term, provision, condition or covenant that can be cured, has failed to cure such default within 10 days after Borrowers receive notice thereof or any officer of Borrowers becomes aware thereof; provided, however, that if the default cannot by its nature be cured within the 10 day period or cannot after diligent attempts by Borrowers be cured within such 10 day period, and such default is likely to be cured within a reasonable time, then Borrowers shall have an additional reasonable period (which shall not in any case exceed 30 days) to attempt to cure such default, and within such reasonable time period the failure to have cured such default shall not be deemed an Event of Default but no Credit Extensions will be made;

8.3 Defective Perfection. If Bank shall receive at any time following the Closing Date an SOS Report indicating that except for Permitted Liens, Bank's security interest in the Collateral is not prior to all other security interests or Liens of record reflected in the report;

8.4 Material Adverse Change. If there occurs a material adverse change in Borrowers' business or financial condition, or if there is a material impairment of the prospect of repayment of any portion of the Obligations or a material impairment of the value or priority of Bank's security interests in the Collateral;

8.5 Attachment. If any material portion of either Borrower's assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within 10 days, or if either Borrower is enjoined, restrained, or in any way prevented by court order from continuing to conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of either Borrower's assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of either Borrower's assets by the United States Government, or any department, agency, or instrumentality thereof, or by any state, county, municipal, or governmental agency, and the same is not paid within ten days after such Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by the applicable Borrower (provided that no Credit Extensions will be made during such cure period);

8.6 Insolvency. If either Borrower becomes insolvent, or if an Insolvency Proceeding is commenced by either Borrower, or if an Insolvency Proceeding is commenced against either Borrower and is not

dismissed or stayed within 45 days (provided that no Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding);

8.7 Other Agreements. If there is a default or other failure to perform by Borrowers in any agreement to which either Borrower is a party with a third party or parties resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness of Borrowers in an amount in excess of \$250,000 or that could have a Material Adverse Effect;

8.8 Subordinated Debt. If either Borrower makes any payment on account of Subordinated Debt, except to the extent the payment is allowed under any subordination agreement entered into with Bank;

8.9 Judgments. If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least \$500,000 shall be rendered against either Borrower and shall remain unsatisfied and unstayed for a period of 10 days (provided that no Credit Extensions will be made prior to the satisfaction or stay of the judgment); or

8.10 Misrepresentations. If any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth herein or in any certificate delivered to Bank by any Responsible Officer pursuant to this Agreement or to induce Bank to enter into this Agreement or any other Loan Document.

8.11 Guaranty. If any guaranty of all or a portion of the Obligations (a "Guaranty") ceases for any reason to be in full force and effect, or any guarantor fails to perform any obligation under any Guaranty or a security agreement securing any Guaranty (collectively, the "Guaranty Documents"), or any event of default occurs under any Guaranty Document or any guarantor revokes or purports to revoke a Guaranty, or any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth in any Guaranty Document or in any certificate delivered to Bank in connection with any Guaranty Document, or if any of the circumstances described in Sections 8.3 through 8.9 occur with respect to Guarantor or any other guarantor.

#### 9. BANK'S RIGHTS AND REMEDIES.

9.1 Rights and Remedies. Upon the occurrence and during the continuance of an Event of Default, Bank may, at its election, without notice of its election and without demand, do any one or more of the following, all of which are authorized by Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.6, all Obligations shall become immediately due and payable without any action by Bank);

(b) Demand that Borrowers (i) deposit cash with Bank in an amount equal to the amount of any Letters of Credit remaining undrawn, as collateral security for the repayment of any future drawings under such Letters of Credit, and (ii) pay in advance all Letter of Credit fees scheduled to be paid or payable over the remaining term of the Letters of Credit, and Borrowers shall promptly deposit and pay such amounts.

(c) Cease advancing money or extending credit to or for the benefit of Borrowers under this Agreement or under any other agreement between Borrowers and Bank;

(d) Settle or adjust disputes and claims directly with account debtors for amounts, upon terms and in whatever order that Bank reasonably considers advisable;

(e) Make such payments and do such acts as Bank considers necessary or reasonable to protect its security interest in the Collateral. Borrowers agree to assemble the Collateral if Bank so requires, and to make the Collateral available to Bank as Bank may designate. Borrowers authorize Bank to enter the premises where the Collateral is located, to take and maintain possession of the Collateral, or any part of it, and to pay,

purchase, contest, or compromise any encumbrance, charge, or lien which in Bank's determination appears to be prior or superior to its security interest and to pay all expenses incurred in connection therewith. With respect to any of Borrowers' owned premises, Borrowers hereby grant Bank a license to enter into possession of such premises and to occupy the same, without charge, in order to exercise any of Bank's rights or remedies provided herein, at law, in equity, or otherwise;

(f) Set off and apply to the Obligations any and all (i) balances and deposits of Borrowers held by Bank, and (ii) indebtedness at any time owing to or for the credit or the account of Borrowers held by Bank;

(g) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell (in the manner provided for herein) the Collateral. Bank is hereby granted a license or other right, solely pursuant to the provisions of this Section 9.1, to use, without charge, each Borrower's labels, patents, copyrights, rights of use of any name, trade secrets, trade names, trademarks, service marks, and advertising matter, or any property of a similar nature, as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section 9.1, each Borrower's rights under all licenses and all franchise agreements shall inure to Bank's benefit;

(h) Sell the Collateral at either a public or private sale, or both, by way of one or more contracts or transactions, for cash or on terms, in such manner and at such places (including Borrower's premises) as Bank determines is commercially reasonable, and apply any proceeds to the Obligations in whatever manner or order Bank deems appropriate. Bank may sell the Collateral without giving any warranties as to the Collateral. Bank may specifically disclaim any warranties of title or the like. This procedure will not be considered adversely to affect the commercial reasonableness of any sale of the Collateral. If Bank sells any of the Collateral upon credit, Borrowers will be credited only with payments actually made by the purchaser, received by Bank, and applied to the indebtedness of the purchaser. If the purchaser fails to pay for the Collateral, Bank may resell the Collateral and Borrowers shall be credited with the proceeds of the sale;

(i) Bank may credit bid and purchase at any public sale;

(j) Apply for the appointment of a receiver, trustee, liquidator or conservator of the Collateral, without notice and without regard to the adequacy of the security for the Obligations and without regard to the solvency of Borrowers, any guarantor or any other Person liable for any of the Obligations; and

(k) Any deficiency that exists after disposition of the Collateral as provided above will be paid immediately by Borrowers.

Bank may comply with any applicable state or federal law requirements in connection with a disposition of the Collateral and compliance will not be considered adversely to affect the commercial reasonableness of any sale of the Collateral.

9.2 Power of Attorney. Effective only upon the occurrence and during the continuance of an Event of Default, each Borrower hereby irrevocably appoints Bank (and any of Bank's designated officers, or employees) as such Borrower's true and lawful attorney to: (a) send requests for verification of Accounts or notify account debtors of Bank's security interest in the Accounts; (b) endorse such Borrower's name on any checks or other forms of payment or security that may come into Bank's possession; (c) sign such Borrower's name on any invoice or bill of lading relating to any Account, drafts against account debtors, schedules and assignments of Accounts, verifications of Accounts, and notices to account debtors; (d) dispose of any Collateral; (e) make, settle, and adjust all claims under and decisions with respect to such Borrower's policies of insurance; (f) settle and adjust disputes and claims respecting the accounts directly with account debtors, for amounts and upon terms which Bank determines to be reasonable; (g) to modify, in its sole discretion, any intellectual property security agreement entered into between Borrower and Bank without first obtaining such Borrower's approval of or signature to such modification by amending Exhibits A, B, and C, thereof, as appropriate, to include reference to any right, title or interest in any Copyrights, Patents or Trademarks acquired by such Borrower after the execution hereof or to delete any reference to any right, title or interest in any Copyrights, Patents or Trademarks in which Borrower no longer has or claims to have any right, title or interest; (h) to file, in its sole discretion, one or more financing or



continuation statements and amendments thereto, relative to any of the Collateral without the signature of such Borrower where permitted by law; and (i) to transfer the Intellectual Property Collateral into the name of Bank or a third party to the extent permitted under the California Uniform Commercial Code; provided Bank may exercise such power of attorney to sign the name of Borrower on any of the documents described in clauses (g) and (h) above regardless of whether an Event of Default has occurred. The appointment of Bank as each Borrower's attorney in fact, and each and every one of Bank's rights and powers, being coupled with an interest, is irrevocable until all of the Obligations have been fully repaid and performed and Bank's obligation to provide advances hereunder is terminated.

9.3 Accounts Collection. At any time after the occurrence and during the continuation of an Event of Default, Bank may notify any Person owing funds to either Borrower of Bank's security interest in such funds and verify the amount of such Account. Each Borrower shall collect all amounts owing to Borrower for Bank, receive in trust all payments as Bank's trustee, and immediately deliver such payments to Bank in their original form as received from the account debtor, with proper endorsements for deposit.

9.4 Bank Expenses. If Borrowers fail to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Bank may do any or all of the following after reasonable notice to Borrowers: (a) make payment of the same or any part thereof; (b) set up such reserves under the Revolving Facility as Bank deems necessary to protect Bank from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.5 of this Agreement, and take any action with respect to such policies as Bank deems prudent. Any amounts so paid or deposited by Bank shall constitute Bank Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided, and shall be secured by the Collateral. Any payments made by Bank shall not constitute an agreement by Bank to make similar payments in the future or a waiver by Bank of any Event of Default under this Agreement.

9.5 Bank's Liability for Collateral. Bank has no obligation to clean up or otherwise prepare the Collateral for sale. All risk of loss, damage or destruction of the Collateral shall be borne by Borrowers.

9.6 No Obligation to Pursue Others. Bank has no obligation to attempt to satisfy the Obligations by collecting them from any other person liable for them and Bank may release, modify or waive any collateral provided by any other Person to secure any of the Obligations, all without affecting Bank's rights against Borrowers. Borrowers waive any right they may have to require Bank to pursue any other Person for any of the Obligations.

9.7 Remedies Cumulative. Bank's rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Bank shall have all other rights and remedies not inconsistent herewith as provided under the Code, by law, or in equity. No exercise by Bank of one right or remedy shall be deemed an election, and no waiver by Bank of any Event of Default on Borrowers' part shall be deemed a continuing waiver. No delay by Bank shall constitute a waiver, election, or acquiescence by it. No waiver by Bank shall be effective unless made in a written document signed on behalf of Bank and then shall be effective only in the specific instance and for the specific purpose for which it was given. Borrower expressly agrees that this Section 9.7 may not be waived or modified by Bank by course of performance, conduct, estoppel or otherwise.

9.8 Demand; Protest. Each Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees at any time held by Bank on which such Borrower may in any way be liable.

## 10. NOTICES.

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery service, certified mail, postage prepaid, return receipt requested, or by telefacsimile to Borrowers or to Bank, as the case may be, at its addresses set forth below:



If to Priority: Priority Fulfillment Services, Inc.  
500 N. Central Expressway, 5th Floor  
Plano, Texas 75074  
Attn: Thomas J. Madden  
FAX: (972) 633-3952

If to Priority Canada: Priority Fulfillment Services, of Canada, Inc.  
500 N. Central Expressway, 5th Floor  
Plano, Texas 75074  
Attn: Thomas J. Madden  
FAX: (972) 633-3952

If to Bank: Comerica Bank-California  
Technology & Life Sciences  
800 E. Campbell Road, Suite 254  
Richardson, Texas 75081  
Attn: Steven Moiles  
FAX: (214) 570-7979

with a copy to: Comerica Bank-California  
9920 S. LaCienega Blvd., Suite 1401  
Inglewood, California 90301  
Attn: Manager  
FAX: (310) 338-6110

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other.

11. CHOICE OF LAW AND VENUE; JURY TRIAL WAIVER. This Agreement shall be governed by, and construed in accordance with, the internal laws of the State of California, without regard to principles of conflicts of law. Each of Borrowers and Bank hereby submits to the exclusive jurisdiction of the state and Federal courts located in the County of Santa Clara, State of California. BANK AND BORROWERS EACH ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL ONE, BUT THAT IT MAY BE WAIVED. EACH OF THEM, AFTER CONSULTING OR HAVING HAD THE OPPORTUNITY TO CONSULT, WITH COUNSEL OF THEIR CHOICE, KNOWINGLY, VOLUNTARILY AND INTENTIONALLY WAIVES ANY RIGHT ANY OF THEM MAY HAVE TO A TRIAL BY JURY IN ANY LITIGATION BASED UPON OR ARISING OUT OF THIS AGREEMENT OR ANY RELATED INSTRUMENT OR LOAN DOCUMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT OR ANY COURSE OF CONDUCT, DEALING, STATEMENTS (WHETHER ORAL OR WRITTEN), OR ACTION OF ANY OF THEM. THESE PROVISIONS SHALL NOT BE DEEMED TO HAVE BEEN MODIFIED IN ANY RESPECT OR RELINQUISHED BY BANK OR BORROWER, EXCEPT BY A WRITTEN INSTRUMENT EXECUTED BY EACH OF THEM.

#### 12. GENERAL PROVISIONS.

12.1 Successors and Assigns. This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties and shall bind all persons who become bound as a debtor to this Agreement; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrowers without Bank's prior written consent, which consent may be granted or withheld in Bank's sole discretion. Bank shall have the right without the consent of or notice to Borrowers to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights and benefits hereunder.

12.2 Indemnification. Each Borrower shall defend, indemnify and hold harmless Bank and its officers, employees, and agents against: (a) all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with the transactions contemplated by this Agreement, except for obligations, demands, claims and liabilities caused by Bank's gross negligence or willful misconduct; and (b) all losses or Bank Expenses in any way suffered, incurred, or paid by Bank, its officers, employees and agents as a result of or in any way arising out of, following, or consequential to transactions between Bank and Borrowers whether under this Agreement, or otherwise (including without limitation reasonable attorneys fees and expenses), INCLUDING ANY OBLIGATIONS, DEMANDS, CLAIMS, LIABILITIES AND LOSSES RESULTING FROM BANK'S OWN NEGLIGENCE OR ARISING OUT OF ANY CLAIM OR THEORY OF STRICT LIABILITY, except for losses caused by Bank's gross negligence or willful misconduct.

12.3 Time of Essence. Time is of the essence for the performance of all obligations set forth in this Agreement.

12.4 Severability of Provisions. Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision.

12.5 Amendments in Writing, Integration. All amendments to or terminations of this Agreement must be in writing. All prior agreements, understandings, representations, warranties, and negotiations between the parties hereto with respect to the subject matter of this Agreement, if any, are merged into this Agreement and the Loan Documents.

12.6 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

12.7 Survival. All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding. The obligations of Borrowers to indemnify Bank with respect to the expenses, damages, losses, costs and liabilities described in Section 12.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Bank have run.

12.8 Confidentiality. In handling any confidential information, Bank and all employees and agents of Bank shall exercise the same degree of care that Bank exercises with respect to its own proprietary information of the same types to maintain the confidentiality of any non-public information thereby received or received pursuant to this Agreement except that disclosure of such information may be made (i) to the subsidiaries or affiliates of Bank in connection with their present or prospective business relations with Borrower, (ii) to prospective transferees or purchasers of any interest in the Loans, provided that they have entered into a comparable confidentiality agreement in favor of Borrowers and have delivered a copy to Borrowers, (iii) as required by law, regulations, rule or order, subpoena, judicial order or similar order, (iv) as may be required in connection with the examination, audit or similar investigation of Bank and (v) as Bank may determine in connection with the enforcement of any remedies hereunder. Confidential information hereunder shall not include information that either: (a) is in the public domain or in the knowledge or possession of Bank when disclosed to Bank, or becomes part of the public domain after disclosure to Bank through no fault of Bank; or (b) is disclosed to Bank by a third party, provided Bank does not have actual knowledge that such third party is prohibited from disclosing such information.

THIS WRITTEN AGREEMENT AND THE OTHER LOAN DOCUMENTS REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

PRIORITY FULFILLMENT SERVICES, INC.

By: \_\_\_\_\_  
Title: \_\_\_\_\_

PRIORITY FULFILLMENT SERVICES OF CANADA,  
INC.

By: \_\_\_\_\_  
Title: \_\_\_\_\_

COMERICA BANK-CALIFORNIA

By: \_\_\_\_\_  
Steven Moiles  
Vice President

## EXHIBIT A

### DEFINITIONS

"Accounts" means all presently existing and hereafter arising accounts, contract rights, and all other forms of obligations owing to a Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by such Borrower and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by such Borrower and such Borrower's Books relating to any of the foregoing.

"Adjusted Tangible Net Worth" means at any date as of which the amount thereof shall be determined, (a) the consolidated shareholder equity of Guarantor (excluding foreign currency translation accounts), minus (b) goodwill plus (c) the Restructuring Charges for the period in which incurred.

"Advance" or "Advances" means a cash advance or cash advances under the Revolving Facility.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, any Person that controls or is controlled by or is under common control with such Person, and each of such Person's senior executive officers, directors, and partners.

"Bank Expenses" means all reasonable costs or expenses (including reasonable attorneys' fees and expenses, whether generated in-house or by outside counsel) incurred in connection with the preparation, negotiation, administration, and enforcement of the Loan Documents; reasonable Collateral audit fees; and Bank's reasonable attorneys' fees and expenses (whether generated in-house or by outside counsel) incurred in amending, enforcing or defending the Loan Documents (including fees and expenses of appeal), incurred before, during and after an Insolvency Proceeding, whether or not suit is brought. The initial Bank audit fee shall not exceed \$4,000.

"Borrower's Books" means all of a Borrower's books and records including: ledgers; records concerning such Borrower's assets or liabilities, the Collateral, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

"Borrowing Base" means an amount equal to 80% of Eligible Accounts, as determined by Bank with reference to the most recent Borrowing Base Certificate delivered by Borrowers.

"BSD" means Business Supplies Distributors Holdings, LLC, a Delaware limited liability company.

"Business Day" means any day that is not a Saturday, Sunday, or other day on which banks in the State of California are authorized or required to close.

"Cash" means unrestricted cash and cash equivalents.

"Change in Control" shall mean a transaction in which any "person" or "group" (within the meaning of Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) becomes the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, of a sufficient number of shares of all classes of stock then outstanding of Borrower ordinarily entitled to vote in the election of directors, empowering such "person" or "group" to elect a majority of the Board of Directors of Borrower, who did not have such power before such transaction.

"Chief Executive Office" means (a) with respect to Priority, 500 North Central Expressway, 5th Floor, Plano, Texas 75074, where Priority's chief executive office is located, and (b) with respect to Priority Canada, 9133 Leslie Street Unit 120, Richmond Hill Ontario L4B N41, where Priority Canada's chief executive office is located.

"Closing Date" means the date of this Agreement.

"Code" means the California Uniform Commercial Code as amended or supplemented from time to time.



"Collateral" means the property described on Exhibit B attached hereto and all Negotiable Collateral and Intellectual Property Collateral to the extent not described on Exhibit B, except to the extent any such property (i) is nonassignable by its terms without the consent of the licensor thereof or another party (but only to the extent such prohibition on transfer is enforceable under applicable law, including, without limitation, Sections 9406 and 9408 of the Code), or (ii) the granting of a security interest therein is contrary to applicable law, provided that upon the cessation of any such restriction or prohibition, such property shall automatically become part of the Collateral.

"Collateral State" means the state or states where the Collateral is located, which are Texas, Tennessee and Ontario, Canada.

"Committed Revolving Line" means a Credit Extension of up to \$7,500,000 (inclusive of any amounts outstanding under the Letter of Credit Sublimit).

"Contingent Obligation" means, as applied to any Person (other than as between Borrowers, Guarantor or any Subsidiary), any direct or indirect liability, contingent or otherwise, of that Person with respect to (i) any indebtedness, lease, dividend, letter of credit or other obligation of another, including, without limitation, any such obligation directly or indirectly guaranteed, endorsed, co-made or discounted or sold with recourse by that Person, or in respect of which that Person is otherwise directly or indirectly liable; (ii) any obligations with respect to undrawn letters of credit issued for the account of that Person; and (iii) all obligations arising under any interest rate, currency or commodity swap agreement, interest rate cap agreement, interest rate collar agreement, or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; provided, however, that the term "Contingent Obligation" shall not include endorsements for collection or deposit in the ordinary course of business. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by such Person in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

"Copyrights" means any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret, now or hereafter existing, created, acquired or held.

"Credit Extension" means each Advance or any other extension of credit by Bank to or for the benefit of Borrowers hereunder.

"Eligible Accounts" means those Accounts that arise in the ordinary course of Borrowers' business that comply with all of Borrowers' representations and warranties to Bank set forth in Section 5.3; provided, that Bank may change the standards of eligibility by giving Borrowers 30 days prior written notice. Unless otherwise agreed to by Bank, Eligible Accounts shall not include the following (all references to percentages shall mean in dollar amount):

- (a) Accounts that the account debtor has failed to pay in full within 90 days of invoice date;
- (b) Accounts with respect to an account debtor, 25% of whose Accounts the account debtor has failed to pay within 90 days of invoice date;
- (c) Accounts with respect to which the account debtor is an officer, employee, or agent of Borrowers;
- (d) Accounts arising from the sale of goods by Borrowers and with respect to which such goods are placed on consignment, guaranteed sale, sale or return, sale on approval, bill and hold, demo or promotional, or other terms by reason of which the payment by the account debtor may be conditional;
- (e) Accounts with respect to which the account debtor is an Affiliate of Borrowers;
- (f) Accounts with respect to which the account debtor does not have its principal place of business in the United States, except for Eligible Foreign Accounts;



- (g) Accounts with respect to which the account debtor is the United States or any department, agency, or instrumentality of the United States, except for Accounts of the United States if the payee has assigned its payment rights to Bank and the assignment has been acknowledged under the Assignment of Claims Act of 1940 (31 U.S.C. 3727);
- (h) Accounts with respect to which either Borrower is liable to the account debtor for goods sold or services rendered by the account debtor to such Borrower, but only to the extent of any amounts owing to the account debtor against amounts owed to such Borrower (excluding amounts owed to account debtors for money received in Third Party Deposit Accounts and money received or to be received in settlement of credit card account receivables of Borrowers' account debtors);
- (i) Accounts with respect to an account debtor (other than IBM), including Subsidiaries and Affiliates, whose total obligations to Borrowers exceed 25% of all Accounts, to the extent such obligations exceed the aforementioned percentage, except as approved in writing by Bank;
- (j) Accounts with respect to which IBM is the account debtor, to the extent that its total obligations to Borrowers exceed the 40% of all Accounts, except as approved in writing by Bank;
- (k) Accounts with respect to which the account debtor disputes liability or makes any claim with respect thereto as to which Bank believes, in its sole discretion, that there may be a basis for dispute (but only to the extent of the amount subject to such dispute or claim), or is subject to any Insolvency Proceeding, or becomes insolvent, or goes out of business
- (l) Credit card Accounts; and
- (m) Accounts the collection of which Bank reasonably determines after inquiry and consultation with Borrowers to be doubtful.

"Eligible Foreign Accounts" means Accounts with respect to which the account debtor does not have its principal place of business in the United States and that are (i) supported by one or more letters of credit in an amount and of a tenor, and issued by a financial institution, acceptable to Bank, (ii) insured by EXIM Bank, (iii) generated by an account debtor with its principal place of business in Canada, provided that the Bank has perfected its security interest in the appropriate Canadian province, or (iv) approved by Bank on a case-by-case basis.

"Environmental Laws" means all laws, rules, regulations, orders and the like issued by any federal state, local foreign or other governmental or quasi-governmental authority or any agency pertaining to the environment or to any hazardous materials or wastes, toxic substances, flammable, explosive or radioactive materials, asbestos or other similar materials.

"Equipment" means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder.

"Event of Default" has the meaning assigned in Article 8.

"GAAP" means generally accepted accounting principles, consistently applied, as in effect from time to time.

"Guarantor" means PFSweb, Inc., a Delaware corporation.

"Indebtedness" means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including without limitation reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations, and (d) all Contingent Obligations.

"Insolvency Proceeding" means any proceeding commenced by or against any Person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extension generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

"Intellectual Property Collateral" means all of each Borrower's right, title, and interest, if any, in and to the following to the extent freely assignable or transferable:

- (a) Copyrights, Trademarks and Patents;
- (b) Any and all trade secrets, and any and all intellectual property rights in computer software and computer software products now or hereafter existing, created, acquired or held;
- (c) Any and all design rights which may be available to such Borrower now or hereafter existing, created, acquired or held;
- (d) Any and all claims for damages by way of past, present and future infringement of any of the rights included above, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the intellectual property rights identified above;
- (e) All licenses or other rights to use any of the Copyrights, Patents or Trademarks, and all license fees and royalties arising from such use to the extent permitted by such license or rights;
- (f) All amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents; and
- (g) All proceeds and products of the foregoing, including without limitation all payments under insurance or any indemnity or warranty payable in respect of any of the foregoing.

"Inventory" means all present and future inventory in which a Borrower has any interest, including merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products intended for sale or lease or to be furnished under a contract of service, of every kind and description now or at any time hereafter owned by or in the custody or possession, actual or constructive, of such Borrower, including such inventory as is temporarily out of its custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and such Borrower's Books relating to any of the foregoing. Inventory does not include any of the foregoing which is now or hereafter held by, or in the possession of, a Borrower for or on behalf of its customers.

"Investment" means any beneficial ownership of (including stock, partnership or limited liability company interest or other securities) any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Letter of Credit" means a commercial or standby letter of credit or similar undertaking issued by Bank at Borrower's request in accordance with Section 2.1(b)(iii).

"Letter of Credit Sublimit" means a sublimit for Letters of Credit under the Committed Revolving Line not to exceed \$2,500,000.

"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance.

"Loan Documents" means, collectively, this Agreement, any note or notes executed by Borrowers, and any other document, instrument or agreement entered into between Borrowers and Bank in connection with this Agreement, all as amended or extended from time to time.

"Material Adverse Effect" means a material adverse effect on (i) the business operations or condition (financial or otherwise) of Borrowers and their Subsidiaries taken as a whole or (ii) the ability of Borrowers to repay the Obligations or otherwise perform their obligations under the Loan Documents.

"Negotiable Collateral" means all of each Borrower's present and future letters of credit of which it is a beneficiary, drafts, instruments (including promissory notes), securities, documents of title, and chattel paper, and such Borrower's Books relating to any of the foregoing.

"Obligations" means all debt, principal, interest, Bank Expenses and other amounts owed to Bank by Borrowers pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding and including any debt, liability, or obligation owing from Borrowers to others that Bank may have obtained by assignment or otherwise.

"Organizational Jurisdiction" means (a) with respect to Priority, Delaware, the state under whose laws Priority is organized, (b) with respect to Priority Canada, Ontario, the province under whose laws Priority Canada is organized, and (c) with respect to each Subsidiary, the jurisdiction indicated opposite such Subsidiary's name on the Schedule.

"Patents" means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same.

"Periodic Payments" means all installments or similar recurring payments that either Borrower may now or hereafter become obligated to pay to Bank pursuant to the terms and provisions of any instrument, or agreement now or hereafter in existence between Borrowers and Bank.

"Permitted Indebtedness" means (without duplication):

- (a) Indebtedness of Borrowers in favor of Bank arising under this Agreement or any other Loan Document;
- (b) Indebtedness existing on the Closing Date and disclosed in the Schedule;
- (c) Indebtedness not to exceed \$3,000,000 in the aggregate in any fiscal year of Borrowers secured by a lien described in clause (c) of the defined term "Permitted Liens," provided such Indebtedness does not exceed the lesser of the cost or fair market value of the equipment financed with such Indebtedness;
- (d) Subordinated Debt and the Indebtedness described in clause (h) of Permitted Investments (but without duplication thereof);
- (e) Indebtedness to, or for the benefit of, trade creditors incurred in the ordinary course of business;
- (f) Indebtedness arising under any interest rate, currency or commodity swap agreement, interest rate cap agreement, interest rate collar agreement or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices, provided that such agreements and arrangements are with counterparties and on terms reasonably satisfactory to Bank;
- (g) Indebtedness of a Borrower owing to the other Borrower;
- (h) Indebtedness evidenced by the Subordinated Demand Note;
- (i) Indebtedness of PFSM, LLC owing to Priority for the acquisition of equipment by PFSM, LLC, provided (i) such Indebtedness does not exceed the lesser of the cost or fair market value of the equipment financed with such Indebtedness, (ii) the aggregate principal amount of Indebtedness incurred by PFSM, LLC pursuant to this clause when added to the aggregate amount of Investments made by Priority pursuant to clause (g) of the definition of Permitted Investments does not exceed \$450,000 in any fiscal year, and (iii) at the time of incurrence of such Indebtedness and after giving effect thereto, no Event of Default has occurred and is continuing;

- (j) Indebtedness described in clause (f) of Permitted Investments (but without duplication thereof);
- (k) Intercompany Indebtedness incurred in connection with the allocation of certain expenses (such as expenses incurred for reports filed with the Securities and Exchange Commission) to PFSweb, Inc., provided that the aggregate amount of such allocated expenses does not exceed \$100,000 in any fiscal year; and
- (l) Extensions, refinancings and renewals of any items of Permitted Indebtedness, provided that with respect to such Permitted Indebtedness (other than trade payables), the principal amount is not increased or the terms modified to impose materially more burdensome terms upon Borrowers or their Subsidiary, as the case may be.

"Permitted Investment" means:

- (a) Investments existing on the Closing Date disclosed in the Schedule;
- (b) (i) Marketable direct obligations issued or unconditionally guaranteed by the United States of America or any agency or any State thereof maturing within one year from the date of acquisition thereof, (ii) commercial paper maturing no more than one year from the date of creation thereof and currently having rating of at least A-2 or P-2 from either Standard & Poor's Corporation or Moody's Investors Service, (iii) certificates of deposit maturing no more than one year from the date of investment therein, and (iv) money market accounts;
- (c) Repurchases of stock from former employees or directors of Borrowers under the terms of applicable repurchase agreements (i) in an aggregate amount not to exceed \$100,000 in any fiscal year, provided that no Event of Default has occurred, is continuing or would exist after giving effect to the repurchases, or (ii) in any amount where the consideration for the repurchase is the cancellation of indebtedness owed by such former employees to Borrowers regardless of whether an Event of Default exists;
- (d) Investments accepted in connection with Permitted Transfers;
- (e) Advances by Priority to Supplies Distributors, Inc. pursuant to the Subordinated Demand Note, so long as (1) the aggregate outstanding principal amount of such Indebtedness does not exceed \$8,005,000 (excluding accrued and unpaid interest) at any time, and (2) before and after giving effect to such advances no Event of Default has occurred and is continuing;
- (f) Investments in or advances to PFSweb B.V. by Priority after the date hereof not to exceed \$1,000,000 in the aggregate in any fiscal year (excluding accrued interest), so long as before and after giving effect to such Investments or advances, no Event of Default has occurred and is continuing;
- (g) Investments by Priority in PFSM, LLC for the acquisition of equipment by PFSM, LLC, provided (i) each such Investment does not exceed the lesser of the cost or fair market value of the equipment acquired with such Investment, (ii) the aggregate amount of Investments made by Priority pursuant to this clause when added to the Indebtedness incurred by PFSM, LLC pursuant to clause (i) of the definition of Permitted Indebtedness does not exceed \$450,000 in any fiscal year, and (iii) at the time of each such Investment and after giving effect thereto, no Event of Default has occurred and is continuing;
- (h) Investments by Priority in Supplies Distributors, Inc. in an amount not to exceed the aggregate cash dividends paid to Priority by Supplies Distributors, Inc. after the date hereof, so long as at the time of and after giving effect to each such Investment, no Event of Default has occurred and is continuing;

- (i) Investments of Subsidiaries in or to other Subsidiaries or Borrower and Investments by Borrowers in Subsidiaries (not described in clauses (a), (d), (e), (f), (g) and (h) above), not to exceed \$100,000 in the aggregate in any fiscal year (excluding increases in either Borrower's Investment in existing Subsidiaries that arise solely as a result of earnings by such Subsidiaries that are not distributed to Borrowers);
- (j) Investments not to exceed \$100,000 outstanding at any time in the aggregate consisting of (i) travel advances and employee relocation loans and other employee loans and advances in the ordinary course of business, and (ii) loans to employees, officers or directors relating to the purchase of equity securities of Borrowers or its Subsidiaries pursuant to employee stock purchase plan agreements approved by each Borrower's Board of Directors;
- (k) Investments (including debt obligations) received in connection with the bankruptcy or reorganization of customers or suppliers and in settlement of delinquent obligations of, and other disputes with, customers or suppliers arising in the ordinary course of Borrowers' business;
- (l) Investments consisting of notes receivable of, or prepaid royalties and other credit extensions, to customers and suppliers who are not Affiliates, in the ordinary course of business, provided that this subparagraph (l) shall not apply to Investments of Borrowers in any Subsidiary;
- (m) (Capitalization of intercompany Indebtedness that is outstanding on the date of this Agreement; and
- (n) Joint ventures or strategic alliances in the ordinary course of Borrowers' business consisting of the non-exclusive licensing of technology, the development of technology or the providing of technical support, provided that any cash Investments by Borrowers do not exceed \$100,000 in the aggregate in any fiscal year.

"Permitted Liens" means the following:

- (a) Any Liens existing on the Closing Date and disclosed in the Schedule (excluding Liens to be satisfied with the proceeds of the Advances) or arising under this Agreement or the other Loan Documents;
- (b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings and for which Borrowers maintain adequate reserves, provided the same have no priority over any of Bank's security interests;
- (c) Liens not to exceed \$3,000,000 in the aggregate in any fiscal year (i) upon or in any Equipment acquired or held by Borrowers or any of their Subsidiaries to secure the purchase price of such Equipment or indebtedness incurred solely for the purpose of financing the acquisition or lease of such Equipment, or (ii) existing on such Equipment at the time of its acquisition, provided that the Lien is confined solely to the property so acquired and improvements thereon, and the proceeds of such Equipment;
- (d) Liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by Liens of the type described in clauses (a) through (c) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase;
- (e) Liens arising from judgments, decrees or attachments in circumstances not constituting an Event of Default under Sections 8.5 or 8.9;
- (f) Liens in favor of other financial institutions arising in connection with Borrowers' deposit accounts held at such institutions, provided that Bank has a perfected security interest in the amounts held in such deposit accounts other than the deposit accounts listed in the Schedule and any Third Party Deposit Account; and
- (g) Other Liens not described above arising in the ordinary course of business and not having or not reasonably likely to have a Material Adverse Effect on Borrower and its Subsidiaries taken as a whole.



"Permitted Transfer" means the conveyance, sale, lease, transfer or disposition by Borrowers or any Subsidiary of:

- (a) Inventory in the ordinary course of business;
- (b) licenses and similar arrangements for the use of the property of Borrowers or its Subsidiaries in the ordinary course of business;
- (c) worn-out or obsolete Equipment;
- (d) any Equipment under a sale-leaseback transaction approved by Bank;
- (e) any transfer of assets made by Borrower to PFSweb B.V. in connection with the reincorporation of PFSweb B.V. under the laws of Belgium, provided that such assets were originally transferred to such Borrower by PFSweb B.V. in connection with its reincorporation; or
- (f) other assets of Borrowers or their Subsidiaries the gross sales proceeds of which do not in the aggregate exceed \$250,000 during any fiscal year.

"Person" means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

"Prime Rate" means the variable rate of interest, per annum, most recently announced by Bank, as its "prime rate," whether or not such announced rate is the lowest rate available from Bank.

"Responsible Officer" means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer and the Corporate Controller of Borrowers.

"Restructuring Charges" means restructuring charges which may be incurred by Priority Canada, not to exceed \$750,000 in the aggregate, in connection with the restructuring activities of Priority Canada. The incurrence of Restructuring Charges shall not by itself be deemed a material adverse change in the financial conditions of Borrowers.

"Revolving Facility" means the facility under which Borrowers may request Bank to issue Advances, as specified in Section 2.1(b) hereof.

"Revolving Maturity Date" means March 28, 2005.

"Schedule" means the schedule of exceptions attached hereto and approved by Bank, if any.

"SOS Reports" means the official reports from the Secretaries of State or other applicable governmental official of each Collateral State, Chief Executive Office and Organizational Jurisdiction and other applicable federal, state or local government offices identifying all current security interests filed in the Collateral and Liens of record as of the date of such report.

"Subordinated Debt" means any debt incurred by either Borrower that is subordinated in writing to the debt owing by Borrower to Bank on terms reasonably acceptable to Bank (and identified as being such by Borrower and Bank), including all obligations owing by Borrower to IBM Belgium Financial Services S.A., Congress Financial Corporation (Southwest) or IBM Credit Corporation that is expressly subordinated by the Subordination Agreements of even date herewith, as from time to time amended, modified or restated.

"Subordinated Demand Note" means the promissory note dated November 12, 2002, in the stated principal amount of \$8,000,000, from Supplies Distributor, Inc. to Priority, which has been subordinated to all obligations of Supplies Distributors, Inc. owed to IBM Credit Corporation, Congress Financial Corporation (Southwest) and IBM Belgium Financial Services S.A.

"Subsidiary" means any corporation, partnership or limited liability company or joint venture in which (i) any general partnership interest or (ii) more than 50% of the stock, limited liability company interest or joint venture of which by the terms thereof ordinary voting power to elect the Board of Directors, managers or trustees of the entity, at the time as of which any determination is being made, is owned by either Borrower, either directly or through an Affiliate.

"Tangible Net Worth" means at any date as of which the amount thereof shall be determined, (a) the consolidated shareholder equity of Guarantor, minus (b) goodwill.

"Third Party Deposit Accounts" means those deposit accounts now existing or hereafter established by a Borrower for deposits of funds received by such Borrower on behalf of its account debtors in payment of such account debtors' receivables, provided that such deposit accounts are titled to clearly indicate that Borrower maintains such deposit accounts on behalf of its account debtors.

"Trademarks" means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of a Borrower connected with and symbolized by such trademarks.

DEBTORS: PRIORITY FULFILLMENT SERVICES, INC.  
PRIORITY FULFILLMENT SERVICES, OF CANADA, INC.

SECURED PARTY: COMERICA BANK-CALIFORNIA

EXHIBIT B

COLLATERAL DESCRIPTION ATTACHMENT  
TO LOAN AND SECURITY AGREEMENT

All personal property of each Borrower (herein referred to as "Borrower" or "Debtor") whether presently existing or hereafter created or acquired, and wherever located, including, but not limited to:

- (a) all accounts (including health-care-insurance receivables), chattel paper (including tangible and electronic chattel paper), deposit accounts (other than the Third Party Deposit Accounts), documents (including negotiable documents), equipment (including all accessions and additions thereto), general intangibles (including payment intangibles and software), goods (including fixtures), instruments (including promissory notes), inventory (including all goods held for sale or lease or to be furnished under a contract of service, and including returns and repossessions), investment property (including securities and securities entitlements), letter of credit rights, money, Personal Property of Priority Fulfillment Services of Canada, Inc. (as the term "Personal Property" is defined in the Personal Property Security Act, R.S.O. 1990 c. P.10, or similar Canadian provincial legislation) and all of Debtor's books and records with respect to any of the foregoing, and the computers and equipment containing said books and records;
- (b) all common law and statutory copyrights and copyright registrations, applications for registration, now existing or hereafter arising, in the United States of America or in any foreign jurisdiction, obtained or to be obtained on or in connection with any of the foregoing, or any parts thereof or any underlying or component elements of any of the foregoing, together with the right to copyright and all rights to renew or extend such copyrights and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of copyright;
- (c) all trademarks, service marks, trade names and service names and the goodwill associated therewith, together with the right to trademark and all rights to renew or extend such trademarks and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of trademark;
- (d) all (i) patents and patent applications filed in the United States Patent and Trademark Office or any similar office of any foreign jurisdiction, and interests under patent license agreements, including, without limitation, the inventions and improvements described and claimed therein, (ii) licenses pertaining to any patent whether Debtor is licensor or licensee, (iii) income, royalties, damages, payments, accounts and accounts receivable now or hereafter due and/or payable under and with respect thereto, including, without limitation, damages and payments for past, present or future infringements thereof, (iv) right (but not the obligation) to sue in the name of Debtor and/or in the name of Secured Party for past, present and future infringements thereof, (v) rights corresponding thereto throughout the world in all jurisdictions in which such patents have been issued or applied for, and (vi) reissues, divisions, continuations, renewals, extensions and continuations-in-part with respect to any of the foregoing;
- (e) all ownership interests of Debtor in Supplies Distributors Holdings, LLC and PFSM, LLC, together with all dividends and other distributions at any time made with respect to such ownership interests. and
- (f) any and all cash proceeds and/or noncash proceeds of any of the foregoing, including, without limitation, insurance proceeds, and all supporting obligations and the security therefor or for any right to payment. All terms above have the meanings given to them in the California Uniform Commercial Code, as amended or supplemented from time to time, including revised Division 9 of the Uniform Commercial Code-Secured Transactions, added by Stats. 1999, c.991 (S.B. 45), Section 35, operative July 1, 2001.



## UNCONDITIONAL GUARANTY

For and in consideration of the loan by COMERICA BANK-CALIFORNIA ("Bank") to Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc. (collectively, "Borrower"), which loan is made pursuant to a Loan and Security Agreement between Borrower and Bank dated as of March 28, 2003, as amended, modified or restated from time to time (the "Agreement"), and acknowledging that Bank would not enter into the Agreement without the benefit of this Guaranty, the undersigned guarantor ("Guarantor") hereby unconditionally and irrevocably guarantees the prompt and complete payment of all amounts that Borrower owes to Bank and performance by Borrower of the Agreement and any other agreements between Borrower and Bank, as amended from time to time (collectively referred to as the "Agreements"), in strict accordance with their respective terms.

1. If Borrower does not perform its obligations in strict accordance with the Agreements, Guarantor shall immediately pay all amounts due thereunder (including, without limitation, all principal, interest, and fees) and otherwise to proceed to complete the same and satisfy all of Borrower's obligations under the Agreements. Without limiting the generality of the foregoing, Guarantor agrees that its obligations hereunder include all obligations and liabilities for which Borrower would otherwise be liable to Bank were it not for the invalidity or unenforceability of them by reason of any proceeding involving Borrower under any bankruptcy, insolvency or other similar law.

2. If there is more than one guarantor, the obligations hereunder are joint and several, and whether or not there is more than one Guarantor, the obligations hereunder are independent of the obligations of Borrower, and a separate action or actions may be brought and prosecuted against Guarantor whether action is brought against Borrower or whether Borrower be joined in any such action or actions. Guarantor waives the benefit of any statute of limitations affecting its liability hereunder or the enforcement thereof, to the extent permitted by law. Guarantor's liability under this Guaranty is not conditioned or contingent upon the genuineness, validity, regularity or enforceability of the Agreements.

3. Guarantor authorizes Bank, without notice or demand and without affecting its liability hereunder, from time to time to (a) renew, extend, or otherwise change the terms of the Agreements or any part thereof; (b) take and hold security for the payment of this Guaranty or the Agreements, and exchange, enforce, waive and release any such security; and (c) apply such security and direct the order or manner of sale thereof as Bank in its sole discretion may determine.

4. Guarantor waives any right to require Bank to (a) proceed against Borrower or any other person; (b) proceed against or exhaust any security held from Borrower; or (c) pursue any other remedy in Bank's power whatsoever. Bank may, at its election, exercise or decline or fail to exercise any right or remedy it may have against Borrower or any security held by Bank, including without limitation the right to foreclose upon any such security by judicial or nonjudicial sale, without affecting or impairing in any way the liability of Guarantor hereunder. Guarantor waives any defense arising by reason of any disability or other defense of Borrower or by reason of the cessation from any cause whatsoever of the liability of Borrower. Guarantor waives any setoff, defense or counterclaim that Borrower may have against Bank. Guarantor waives any defense arising out of the absence, impairment or loss of any right of reimbursement or subrogation or any other rights against Borrower. Until all of the amounts that Borrower owes to Bank have been paid in full, Guarantor shall have no right of subrogation or reimbursement for claims arising out of or in connection with this Guaranty, contribution or other rights against Borrower, and Guarantor waives any right to enforce any remedy that Bank now has or may hereafter have against Borrower. Guarantor waives all rights to participate in any security now or hereafter held by Bank. Guarantor waives all presentments, demands for performance, notices of nonperformance, protests, notices of protest, notices of dishonor, and notices of acceptance of this Guaranty and of the existence, creation, or incurring of new or additional indebtedness. Guarantor assumes the responsibility for being and keeping itself informed of the financial condition of Borrower and of all other circumstances bearing upon the risk of nonpayment of any indebtedness or nonperformance of any obligation of Borrower, warrants to Bank that it will keep so informed, and agrees that absent a request for particular information by Guarantor, Bank shall have no duty to advise Guarantor of information known to Bank regarding such condition or any such circumstances. Guarantor waives the benefits of California Civil Code sections 2809, 2810, 2819, 2845, 2847, 2848, 2849, 2850, 2899 and 3433.

5. Guarantor acknowledges that, to the extent Guarantor has or may have certain rights of subrogation or reimbursement against Borrower for claims

arising out of this Guaranty, those rights may be

impaired or destroyed if Bank elects to proceed against any real property security of Borrower by non-judicial foreclosure. That impairment or destruction could, under certain judicial cases and based on equitable principles of estoppel, give rise to a defense by Guarantor against its obligations under this Guaranty. Guarantor waives that defense and any others arising from Bank's election to pursue non-judicial foreclosure. Without limiting the generality of the foregoing, Guarantor waives any and all benefits and defenses under California Code of Civil Procedure Sections 580a, 580b, 580d and 726, to the extent they are applicable.

6. If Borrower becomes insolvent or is adjudicated bankrupt or files a petition for reorganization, arrangement, composition or similar relief under any present or future provision of the United States Bankruptcy Code, or if such a petition is filed against Borrower, and in any such proceeding some or all of any indebtedness or obligations under the Agreements are terminated or rejected or any obligation of Borrower is modified or abrogated, or if Borrower's obligations are otherwise avoided for any reason, Guarantor agrees that Guarantor's liability hereunder shall not thereby be affected or modified and such liability shall continue in full force and effect as if no such action or proceeding had occurred. This Guaranty shall continue to be effective or be reinstated, as the case may be, if any payment must be returned by Bank upon the insolvency, bankruptcy or reorganization of Borrower, Guarantor, any other guarantor, or otherwise, as though such payment had not been made.

7. Any indebtedness of Borrower now or hereafter held by Guarantor is hereby subordinated to any indebtedness of Borrower to Bank; and such indebtedness of Borrower to Guarantor shall be collected, enforced and received by Guarantor as trustee for Bank and be paid over to Bank on account of the indebtedness of Borrower to Bank but without reducing or affecting in any manner the liability of Guarantor under the other provisions of this Guaranty.

8. Guarantor agrees to pay a reasonable attorneys' fee and all other costs and expenses which may be incurred by Bank in the enforcement of this Guaranty. No terms or provisions of this Guaranty may be changed, waived, revoked or amended without Bank's prior written consent. Should any provision of this Guaranty be determined by a court of competent jurisdiction to be unenforceable, all of the other provisions shall remain effective. This Guaranty, together with any agreements (including without limitation any security agreements or any pledge agreements) executed in connection with this Guaranty, embodies the entire agreement among the parties hereto with respect to the matters set forth herein, and supersedes all prior agreements among the parties with respect to the matters set forth herein. No course of prior dealing among the parties, no usage of trade, and no parol or extrinsic evidence of any nature shall be used to supplement, modify or vary any of the terms hereof. There are no conditions to the full effectiveness of this Guaranty. Bank may assign this Guaranty without in any way affecting Guarantor's liability under it. This Guaranty shall inure to the benefit of Bank and its successors and assigns. This Guaranty is in addition to the guaranties of any other guarantors and any and all other guaranties of Borrower's indebtedness or liabilities to Bank.

9. Guarantor represents and warrants to Bank that (i) Guarantor has taken all necessary and appropriate action to authorize the execution, delivery and performance of this Guaranty, (ii) execution, delivery and performance of this Guaranty do not conflict with or result in a breach of or constitute a default under Guarantor's Certificate of Incorporation or Bylaws or other organizational documents or agreements to which it is party or by which it is bound, and (iii) this Guaranty constitutes a valid and binding obligation, enforceable against Guarantor in accordance with its terms.

10. Guarantor covenants and agrees that Guarantor shall do all of the following:

10.1. Guarantor shall maintain its corporate existence, remain in good standing in Delaware, and continue to qualify in each jurisdiction in which the failure to so qualify could have a material adverse effect on the financial condition, operations or business of Guarantor. Guarantor shall maintain in force all licenses, approvals and agreements, the loss of which could have a material adverse effect on its financial condition, operations or business.

10.2. Guarantor shall comply with all statutes, laws, ordinances, directives, orders, and government rules and regulations to which it is subject if non-compliance with such laws could adversely affect the financial condition, operations or business of Guarantor.

10.3. At any time and from time to time Guarantor shall execute and

deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

10.4. Guarantor shall not transfer, assign, encumber or otherwise dispose of any shares of capital stock or other equity interest Guarantor may now have or hereafter acquire in Borrower.

11. This Guaranty shall be governed by the laws of the State of California, without regard to conflicts of laws principles. GUARANTOR WAIVES ANY RIGHT TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS GUARANTY OR ANY OF THE TRANSACTIONS CONTEMPLATED THEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. Guarantor submits to the exclusive jurisdiction of the state and federal courts located in Santa Clara County, California.

IN WITNESS WHEREOF, the undersigned Guarantor has executed this Guaranty as of this 28th day of March, 2003.

PSFWEB, INC.

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By:  
Title:

As of March 28, 2003, for value received, the undersigned ("Debtor") pledges, assigns and grants to Comerica Bank-California, a California banking association ("Bank"), whose address is 800 E. Campbell Road, Suite 254, Richardson, Texas 75081, a continuing security interest and lien (any pledge, assignment, security interest or other lien arising hereunder is sometimes referred to herein as a "security interest") in the Collateral (as defined below) to secure payment when due, whether by stated maturity, demand, acceleration or otherwise, of all existing and future indebtedness ("Indebtedness") to the Bank of Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc. (both individually and collectively referred to as "Borrower") and/or Debtor. Indebtedness includes without limit any and all obligations or liabilities of the Borrower and/or Debtor to the Bank, whether absolute or contingent, direct or indirect, voluntary or involuntary, liquidated or unliquidated, joint or several, known or unknown, originally payable to the Bank or to a third party and subsequently acquired by the Bank including, without limitation, any late charges, loan fees or charges, and overdraft indebtedness, any and all obligations or liabilities for which the Borrower and/or Debtor would otherwise be liable to the Bank were it not for the invalidity or unenforceability of them by reason of any bankruptcy, insolvency or other law, or for any other reason; any and all amendments, modifications, renewals and/or extensions of any of the above; all costs incurred by Bank in establishing, determining, continuing, or defending the validity or priority of any security interest, or in pursuing its rights and remedies under this Agreement or under any other agreement between Bank and Borrower and/or Debtor or in connection with any proceeding involving Bank as a result of any financial accommodation to Borrower and/or Debtor; and all other costs of collecting Indebtedness, including without limit attorneys' fees. Debtor agrees to pay Bank all such costs incurred by the Bank, immediately upon demand, and until paid all costs shall bear interest at the highest per annum rate applicable to any of the Indebtedness, but not in excess of the maximum rate permitted by law. Any reference in this Agreement to attorneys' fees shall be deemed a reference to reasonable fees, costs, and expenses of counsel and paralegals, whether inside or outside counsel is used, whether or not a suit or action is instituted, and to court costs if a suit or action is instituted, and whether attorneys' fees or court costs are incurred at the trial court level, on appeal, in a bankruptcy, administrative or probate proceeding or otherwise.

Debtor further covenants, agrees, represents and warrants as follows:

1. COLLATERAL shall mean all of the following property the undersigned now or later owns or has an interest in, wherever located:
  - (a) All of the following, whether now or hereafter existing, which are owned by Debtor or in which Debtor otherwise has any rights: all shares of stock of Priority Fulfillment Services, Inc., sixty-five percent (65%) of the ownership interest of Debtor in each of Priority Fulfillment Services of Canada, Inc. and PFSweb B.V., all certificates representing any such shares, all options and other rights, contractual or otherwise, at any time existing with respect to such shares, and all dividends, cash, instruments and other property now or hereafter received, receivable or otherwise distributed in respect of or in exchange for any or all of such shares.
  - (b) All additions, attachments, accessions, parts, replacements, substitutions, renewals, interest, dividends, distributions, rights of any kind (including but not limited to stock splits, stock rights, voting and preferential rights), products, and proceeds of or pertaining to the above including, without limit, cash or other property which were proceeds and are recovered by a bankruptcy trustee or otherwise as a preferential transfer by the undersigned.

In the definition of Collateral, a reference to a type of collateral shall not be limited by a separate reference to a more specific or narrower type of that collateral.

2. WARRANTIES, COVENANTS AND AGREEMENTS. The undersigned warrants, covenants and agrees as follows:
  - 2.1 The undersigned shall furnish to Bank, in form and at intervals as Bank may request, any information Bank may reasonably request and allow Bank to examine, inspect, and copy any of the undersigned's

books and records. The undersigned shall, at the request of Bank, mark its records and the Collateral to clearly indicate the security interest of Bank under this Agreement.

- 2.2 At the time any Collateral becomes, or is represented to be, subject to a security interest in favor of Bank, the undersigned shall be deemed to have warranted that (a) the undersigned is the lawful owner of the Collateral and has the right and authority to subject it to a security interest granted to Bank; (b) none of the Collateral is subject to any security interest other than that in favor of Bank, (c) there are no financing statements on file, other than in favor of Bank; (d) no person, other than Bank, has possession or control (as defined in the Uniform Commercial Code) of any Collateral of such nature that perfection of a security interest may be accomplished by control; and (e) Debtor acquired its rights in the Collateral in the ordinary course of its business; provided that Debtor makes no representation as to the creation, perfection or priority of Bank's security interest in Debtor's ownership interest in PFSweb B.V.
- 2.3 The undersigned will keep the Collateral free at all times from all claims, liens, security interests and encumbrances other than those in favor of Bank. The undersigned will not, without the prior written consent of Bank, sell, transfer or lease, or permit to be sold, transferred or leased, any or all of the Collateral. Bank or its representatives may at all reasonable times inspect the Collateral and may enter upon all premises where the Collateral is kept or might be located.
- 2.4 The undersigned will do all acts and will execute or cause to be executed all writings requested by Bank to establish, maintain and continue an exclusive, perfected and first security interest of Bank in the Collateral (excluding Debtor's ownership interest in PFSweb B.V. and all proceeds thereof). The undersigned agrees that Bank has no obligation to acquire or perfect any lien on or security interest in any asset(s), whether realty or personalty, to secure payment of the Indebtedness, and the undersigned is not relying upon assets in which the Bank may have a lien or security interest for payment of the Indebtedness.
- 2.5 The undersigned will pay within the time that they can be paid without interest or penalty all taxes, assessments and similar charges which at any time are or may become a lien, charge, or encumbrance upon any Collateral, except to the extent contested in good faith and bonded in a manner satisfactory to Bank. If the undersigned fails to pay any of these taxes, assessments, or other charges in the time provided above, Bank has the option (but not the obligation) to do so, and the undersigned agrees to repay all amounts so expended by Bank immediately upon demand, together with interest at the highest lawful default rate which could be charged by Bank to Borrower on any Indebtedness.
- 2.6 Intentionally omitted.
- 2.7 The undersigned at all times shall be in strict compliance with all applicable laws, including without limit any laws, ordinances, directives, orders, statutes, or regulations an object of which is to regulate or improve health, safety, or the environment ("Environmental Laws").
- 2.8 Intentionally omitted.
- 2.9 If Bank, acting in its sole discretion, redelivers Collateral to the undersigned or the undersigned's designee for the purpose of (a) the ultimate sale or exchange thereof; or (b) presentation, collection, renewal, or registration of transfer thereof; or (c) loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with it preliminary to sale or exchange; such redelivery shall be in trust for the benefit of Bank and shall not constitute a release of Bank's security interest in it or in the proceeds or products of it unless Bank specifically so agrees in writing. Any proceeds of Collateral coming into the undersigned's possession as a result of any such redelivery shall be held in trust for Bank and immediately delivered to Bank for application on the Indebtedness. Bank may (in its sole discretion) deliver any or all of the Collateral to the undersigned, and such delivery by Bank shall discharge Bank from all liability or responsibility for such

Collateral. Bank, at its option, may require delivery of any Collateral to Bank at any time with such endorsements or assignments of the Collateral as Bank may request.

- 2.10 At any time after and during the continuation of an Event of Default and without notice, Bank may (a) cause any or all of the Collateral to be transferred to its name or to the name of its nominees; (b) receive or collect by legal proceedings or otherwise all dividends, interest, principal payments and other sums and all other distributions at any time payable or receivable on account of the Collateral, and hold the same as Collateral, or apply the same to the Indebtedness, the manner and distribution of the application to be in the sole discretion of Bank; (c) enter into any extension, subordination, reorganization, deposit, merger or consolidation agreement or any other agreement relating to or affecting the Collateral, and deposit or surrender control of the Collateral, and accept other property in exchange for the Collateral and hold or apply the property or money so received pursuant to this Agreement; and (d) take such actions in its own name or in Debtor's name as Bank, in its sole discretion, deems necessary or appropriate to establish exclusive control (as defined in the Uniform Commercial Code) over any Collateral (other than Debtor's ownership interest in PFSweb B.V.) of such nature that perfection of the Bank's security interest may be accomplished by control.
- 2.11 Bank may assign any of the Indebtedness and deliver any or all of the Collateral to its assignee, who then shall have with respect to Collateral so delivered all the rights and powers of Bank under this Agreement, and after that Bank shall be fully discharged from all liability and responsibility with respect to Collateral so delivered.
- 2.12 The undersigned delivers this Agreement based solely on the undersigned's independent investigation of (or decision not to investigate) the financial condition of Borrower and is not relying on any information furnished by Bank. The undersigned assumes full responsibility for obtaining any further information concerning the Borrower's financial condition, the status of the Indebtedness or any other matter which the undersigned may deem necessary or appropriate now or later. The undersigned waives any duty on the part of Bank, and agrees that the undersigned is not relying upon nor expecting Bank to disclose to the undersigned any fact now or later known by Bank, whether relating to the operations or condition of Borrower, the existence, liabilities or financial condition of any guarantor of the Indebtedness, the occurrence of any default with respect to the Indebtedness, or otherwise, notwithstanding any effect such fact may have upon the undersigned's risk or the undersigned's rights against Borrower. The undersigned knowingly accepts the full range of risk encompassed in this Agreement, which risk includes without limit the possibility that Borrower may incur Indebtedness to Bank after the financial condition of Borrower, or Borrower's ability to pay debts as they mature, has deteriorated.
- 2.13 The undersigned agrees that no security or guarantee now or later held by Bank for the payment of any Indebtedness, whether from Borrower, any guarantor, or otherwise, and whether in the nature of a security interest, pledge, lien, assignment, setoff, suretyship, guaranty, indemnity, insurance or otherwise, shall affect in any manner the unconditional pledge of the undersigned under this Agreement, and Bank, in its sole discretion, without notice to the undersigned, may release, exchange, modify, enforce and otherwise deal with any security or guaranty without affecting in any manner the unconditional pledge of the undersigned under this Agreement. The undersigned acknowledges and agrees that Bank has no obligation to acquire or perfect any lien on or security interest in any assets, whether realty or personalty, or to obtain any guaranty to secure payment of the Indebtedness, and the undersigned is not relying upon any guaranty which Bank has or may have or assets in which Bank has or may have a lien or security interest for payment of the Indebtedness.
- 2.14 Intentionally omitted.
- 2.15 The undersigned agrees to reimburse Bank upon demand for all costs and expenses (including, without limit, attorneys' fees) incurred in enforcing any of the duties or obligations of the undersigned under this Agreement or in establishing, determining, continuing or defending the validity or priority of Bank's security interest under this Agreement (other than with respect to PFSweb B.V.).
- 2.16 The undersigned shall defend, indemnify and hold harmless Bank, its employees, agents, shareholders, affiliates, officers, and directors from and against any and all claims, damages, fines, expenses,



or causes of action of whatever kind, including without limit consultant fees, legal expenses, and attorneys' fees, suffered by any of them as a direct or indirect result of any actual or asserted violation of any law, including, without limit, Environmental Laws, or of any remediation relating to any property required by any law, including without limit Environmental Laws, INCLUDING ANY CLAIMS, DAMAGES, FINES, EXPENSES, LIABILITIES OR CAUSES OF ACTION OF WHATEVER KIND RESULTING FROM BANK'S OWN NEGLIGENCE, except to the extent (but only to the extent) caused by Bank's gross negligence or willful misconduct.

3. COLLECTION OF PROCEEDS. The undersigned agrees to collect and enforce payment of all Collateral until Bank shall direct the undersigned to the contrary. Immediately upon notice to the undersigned by Bank and at all times after that, the undersigned agrees to fully and promptly cooperate and assist Bank in the collection and enforcement of all Collateral and to hold in trust for Bank all payments received in connection with Collateral and from the sale, lease or other disposition of any Collateral, all rights by way of suretyship or guaranty and all rights in the nature of a lien or security interest which the undersigned now or later has regarding Collateral. Immediately upon and after such notice, the undersigned agrees to (a) endorse to Bank and immediately deliver to Bank all payments received on Collateral or from the sale, lease or other disposition of any Collateral or arising from any other rights or interests of the undersigned in the Collateral, in the form received by the undersigned without commingling with any other funds, and (b) immediately deliver to Bank all property in the undersigned's possession or later coming into the undersigned's possession through enforcement of the undersigned's rights or interests in the Collateral. The undersigned irrevocably authorizes Bank or any Bank employee or agent to endorse the name of the undersigned upon any checks or other items which are received in payment for any Collateral, and to do any and all things necessary in order to reduce these items to money. Bank shall have no duty as to the collection or protection of Collateral or the proceeds of it, nor as to the preservation of any related rights, beyond the use of reasonable care in the custody and preservation of Collateral in the possession of Bank. The undersigned agrees to take all steps necessary to preserve rights against prior parties with respect to the Collateral. Nothing in this Section 3 shall be deemed a consent by Bank to any sale, lease or other disposition of any Collateral.

4. DEFAULTS, ENFORCEMENT AND APPLICATION OF PROCEEDS.

4.1 The occurrence of any "Event of Default" as defined in the Loan and Security Agreement of even date herewith between Borrowers and Bank, as from time to time amended, modified or restated, shall be an "Event of Default" under this Agreement.

4.2 Upon the occurrence of any Event of Default, Bank may at its discretion and without prior notice to the undersigned declare any or all of the Indebtedness to be immediately due and payable, and shall have and may exercise any right or remedy available to it including, without limitation, any one or more of the following rights and remedies:

(a) Exercise all the rights and remedies upon default, in foreclosure and otherwise, available to secured parties under the provisions of the Uniform Commercial Code and other applicable law;

(b) Institute legal proceedings to foreclose upon the lien and security interest granted by this Agreement, to recover judgment against Borrower or any Guarantor for all amounts then due and owing as Indebtedness, and to collect the same out of any Collateral or the proceeds of any sale of it;

(c) Institute legal proceedings for the sale, under the judgment or decree of any court of competent jurisdiction, of any or all Collateral; and/or

(d) Personally or by agents, attorneys, or appointment of a receiver, enter upon any premises where Collateral may then be located, and take possession of all or any of it and/or render it unusable; and without being responsible for loss or damage to such Collateral, hold, operate, sell, lease, or dispose of all or any Collateral at one or more public or private sales, leaseings or other dispositions at places and times and on terms and conditions as Bank may deem fit, without any previous



demand or advertisement; and except as provided in this Agreement, all notice of sale, lease or other disposition, and advertisement, and other notice or demand, any right or equity of redemption, and any obligation of a prospective purchaser or lessee to inquire as to the power and authority of Bank to sell, lease, or otherwise dispose of the Collateral or as to the application by Bank of the proceeds of sale or otherwise, which would otherwise be required by, or available to the undersigned under, applicable law are expressly waived by the undersigned to the fullest extent permitted.

At any sale pursuant to this Section 4.2, whether under the power of sale, by virtue of judicial proceedings or otherwise, it shall not be necessary for Bank or a public officer under order of a court to have present physical or constructive possession of Collateral to be sold. The recitals contained in any conveyances and receipts made and given by Bank or the public officer to any purchaser at any sale made pursuant to this Agreement shall, to the extent permitted by applicable law, conclusively establish the truth and accuracy of the matters stated (including, without limit, as to the amounts of the principal of and interest on the Indebtedness, the accrual and nonpayment of it and advertisement and conduct of the sale); and all prerequisites to the sale shall be presumed to have been satisfied and performed. Upon any sale of any Collateral, the receipt of the officer making the sale under judicial proceedings or of Bank shall be sufficient discharge to the purchaser for the purchase money, and the purchaser shall not be obligated to see to the application of the money. Any sale of any Collateral under this Agreement shall be a perpetual bar against the undersigned with respect to that Collateral. At any sale or other disposition of the Collateral pursuant to this Section 4.2, Bank disclaims all warranties which would otherwise be given under the Uniform Commercial Code, including without limit a disclaimer of any warranty relating to title, possession, quiet enjoyment or the like, and Bank may communicate these disclaimers to a purchaser at such disposition. This disclaimer of warranties will not render the sale commercially unreasonable.

- 4.3 The undersigned shall at the request of Bank after the occurrence of an Event of Default, notify the account debtors or obligors of Bank's security interest in any Collateral and direct payment of it to Bank. Bank may, itself, upon the occurrence of any Event of Default so notify and direct any account debtor or obligor. At the request of Bank, whether or not an Event of Default shall have occurred, Debtor shall immediately take such actions as the Bank shall request to establish exclusive control (as defined in the Uniform Commercial Code) by Bank over any Collateral which is of such a nature that perfection of a security interest may be accomplished by control.
- 4.4 The proceeds of any sale or other disposition of Collateral authorized by this Agreement shall be applied by Bank in such order as the Bank, in its discretion, deems appropriate including, without limitation, the following order: first upon all expenses authorized by the Uniform Commercial Code and all reasonable attorneys' fees and legal expenses incurred by Bank; second to all amounts, if any, owing by the undersigned to Bank under this Agreement, and the balance of the proceeds of the sale or other disposition shall be applied in the payment of the Indebtedness, first to interest, then to principal, then to remaining Indebtedness and the surplus, if any, shall be paid over to the undersigned or to such other person(s) as may be entitled to it under applicable law. Debtor shall remain liable for any deficiency, which it shall pay to Bank immediately upon demand. Debtor agrees that Bank shall be under no obligation to accept any noncash proceeds in connection with any sale or disposition of Collateral unless failure to do so would be commercially unreasonable. If Bank agrees in its sole discretion to accept noncash proceeds (unless the failure to do so would be commercially unreasonable), Bank may ascribe any commercially reasonable value to such proceeds. Without limiting the foregoing, Bank may apply any discount factor in determining the present value of proceeds to be received in the future or may elect to apply proceeds to be received in the future only as and when such proceeds are actually received in cash by Bank.
- 4.5 Nothing in this Agreement is intended, nor shall it be construed, to preclude Bank from pursuing any other remedy provided by law or in equity for the collection of the Indebtedness or for the recovery of any other sum to which Bank may be entitled for the breach of this

Agreement by the undersigned. Nothing in this Agreement shall reduce or release in any way any rights or security interests of Bank contained in any existing agreement between Borrower, the undersigned or any Guarantor and Bank.

- 4.6 No waiver of default or consent to any act by the undersigned shall be effective unless in writing and signed by an authorized officer of Bank. No waiver of any default or forbearance on the part of Bank in enforcing any of its rights under this Agreement shall operate as a waiver of any other default or of the same default on a future occasion or of any rights.
- 4.7 The undersigned (a) irrevocably appoints Bank or any agent of Bank (which appointment is coupled with an interest) the true and lawful attorney of the undersigned (with full power of substitution) in the name, place and stead of, and at the expense of, the undersigned and (b) authorizes Bank or any agent of Bank, in its own name, at Debtor's expense, to do any of the following, as Bank, in its sole discretion, deems appropriate:
- (i) to demand, receive, sue for, and give receipts or acquittances for any moneys due or to become due with respect to any Collateral and to endorse any item representing any payment on or proceeds of the Collateral;
  - (ii) to execute and file in the name of and on behalf of the undersigned all U. S. financing statements or other U.S. or Canadian filings deemed necessary or desirable by Bank to evidence, perfect, or continue the security interests granted in this Agreement; and
  - (iii) to do and perform any act on behalf of the undersigned permitted or required under this Agreement.
- 4.8 Upon the occurrence of an Event of Default, the undersigned also agrees, upon request of Bank, to assemble the Collateral and make it available to Bank at any place designated by Bank which is reasonably convenient to Bank and the undersigned.
- 4.9 The following shall be the basis for any finder of fact's determination of the value of any Collateral which is the subject matter of a disposition giving rise to a calculation of any surplus or deficiency under Section 9.615 (f) of the Uniform Commercial Code (as in effect on or after July 1, 2001): (a) the Collateral which is the subject matter of the disposition shall be valued in an "as is" condition as of the date of the disposition, without any assumption or expectation that such Collateral will be repaired or improved in any manner; (b) the valuation shall be based upon an assumption that the transferee of such Collateral desires a resale of the Collateral for cash promptly (but no later than 30 days) following the disposition; (c) all reasonable closing costs customarily borne by the seller in commercial sales transactions relating to property similar to such Collateral shall be deducted including, without limitation, brokerage commissions, tax prorations, attorneys' fees, whether inside or outside counsel is used, and marketing costs; (d) the value of the Collateral which is the subject matter of the disposition shall be further discounted to account for any estimated holding costs associated with maintaining such Collateral pending sale (to the extent not accounted for in (c) above), and other maintenance, operational and ownership expenses; and (e) any expert opinion testimony given or considered in connection with a determination of the value of such Collateral must be given by persons having at least 5 years experience in appraising property similar to the Collateral and who have conducted and prepared a complete written appraisal of such Collateral taking into consideration the factors set forth above. The "value" of any such Collateral shall be a factor in determining the amount of proceeds which would have been realized in a disposition to a transferee other than a Bank, a person related to a Bank or a secondary obligor under Section 9-615(f) of the Uniform Commercial Code.

## 5. MISCELLANEOUS.

- 5.1 Until Bank is advised in writing by the undersigned to the contrary, all notices, requests and demands required under this Agreement or by law shall be given to, or made upon, the undersigned at the following address: PFSweb, -- Inc., 500 N. Central Expressway, 5th Floor, Plano, Texas 75074.



- 5.2 The undersigned will give Bank not less than 30 days prior written notice of all contemplated changes in the undersigned's name, chief executive office, principal place of business, and/or location of any Collateral, but the giving of this notice shall not cure any Event of Default caused by this change.
- 5.3 Bank assumes no duty of performance or other responsibility under any contracts contained within the Collateral.
- 5.4 Bank has the right to sell, assign, transfer, negotiate or grant participations or any interest in, any or all of the Indebtedness and any related obligations, including without limit this Agreement. In connection with the above, but without limiting its ability to make other disclosures to the full extent allowable, Bank may disclose all documents and information which Bank now or later has relating to the undersigned, the Indebtedness or this Agreement, however obtained. The undersigned further agrees that Bank may provide information relating to this Agreement or relating to the undersigned or the Indebtedness to the Bank's parent, affiliates, subsidiaries, and service providers.
- 5.5 The undersigned, to the extent not expressly prohibited by applicable law, waives any right to require the Bank to: (a) proceed against any person or property; (b) give notice of the terms, time and place of any public or private sale of personal property security held from Borrower or any other person, or otherwise comply with the provisions of Sections 9.611 or 9.621 of the Uniform Commercial Code; or (c) pursue any other remedy in the Bank's power. The undersigned waives notice of acceptance of this Agreement and presentment, demand, protest, notice of protest, dishonor, notice of dishonor, notice of default, notice of intent to accelerate or demand payment of any Indebtedness, any and all other notices to which the undersigned might otherwise be entitled, and diligence in collecting any Indebtedness, and agree(s) that the Bank may, once or any number of times, modify the terms of any Indebtedness, compromise, extend, increase, accelerate, renew or forbear to enforce payment of any or all Indebtedness, or permit Borrower to incur additional Indebtedness, all without notice to the undersigned and without affecting in any manner the unconditional obligation of the undersigned under this Agreement. The undersigned unconditionally and irrevocably waives each and every defense and setoff of any nature which, under principles of guaranty or otherwise, would operate to impair or diminish in any way the obligation of the undersigned under this Agreement, and acknowledges that such waiver is by this reference incorporated into each security agreement, collateral assignment, pledge and/or other document from the undersigned now or later securing the Indebtedness, and acknowledges that as of the date of this Agreement no such defense or setoff exists.
- 5.6 The undersigned waives any and all rights (whether by subrogation, indemnity, reimbursement, or otherwise) to recover from Borrower any amounts paid or the value of any Collateral pledged by the undersigned pursuant to this Agreement.
- 5.7 In the event that applicable law shall obligate Bank to give prior notice to the undersigned of any action to be taken under this Agreement, the undersigned agrees that a written notice given to the undersigned at least ten days before the date of the act shall be reasonable notice of the act and, specifically, reasonable notification of the time and place of any public sale or of the time after which any private sale, lease, or other disposition is to be made, unless a shorter notice period is reasonable under the circumstances. A notice shall be deemed to be given under this Agreement when delivered to the undersigned or when placed in an envelope addressed to the undersigned and deposited, with postage prepaid, in a post office or official depository under the exclusive care and custody of the United States Postal Service or delivered to an overnight courier. The mailing shall be by overnight courier, certified, or first class mail.
- 5.8 Notwithstanding any prior revocation, termination, surrender, or discharge of this Agreement in whole or in part, the effectiveness of this Agreement shall automatically continue or be reinstated in the event that any payment received or credit given by Bank in respect of the Indebtedness is returned, disgorged, or rescinded under any applicable law, including, without limitation, bankruptcy or insolvency laws, in which case this Agreement, shall be enforceable

against the undersigned as if the returned, disgorged, or rescinded payment or credit had not been received or given by Bank, and whether or not Bank relied upon

this payment or credit or changed its position as a consequence of it. In the event of continuation or reinstatement of this Agreement, the undersigned agrees upon demand by Bank to execute and deliver to Bank those documents which Bank determines are appropriate to further evidence (in the public records or otherwise) this continuation or reinstatement, although the failure of the undersigned to do so shall not affect in any way the reinstatement or continuation.

- 5.9 This Agreement and all the rights and remedies of Bank under this Agreement shall inure to the benefit of Bank's successors and assigns and to any other holder who derives from Bank title to or an interest in the Indebtedness or any portion of it, and shall bind the undersigned and the heirs, legal representatives, successors, and assigns of the undersigned. Nothing in this Section 5.9 is deemed a consent by Bank to any assignment by the undersigned.
- 5.10 If there is more than one the undersigned, all undertakings, warranties and covenants made by the undersigned and all rights, powers and authorities given to or conferred upon Bank are made or given jointly and severally.
- 5.11 Except as otherwise provided in this Agreement, all terms in this Agreement have the meanings assigned to them in Article 9 (or, absent definition in Article 9, in any other Article) of the Uniform Commercial Code, as those meanings may be amended, revised or replaced from time to time. "Uniform Commercial Code" means the California Commercial Code, as amended, revised or replaced from time to time. Notwithstanding the foregoing, the parties intend that the terms used herein which are defined in the Uniform Commercial Code have, at all times, the broadest and most inclusive meanings possible. Accordingly, if the Uniform Commercial Code shall in the future be amended or held by a court to define any term used herein more broadly or inclusively than the Uniform Commercial Code in effect on the date of this Agreement, then such term, as used herein, shall be given such broadened meaning. If the Uniform Commercial Code shall in the future be amended or held by a court to define any term used herein more narrowly, or less inclusively, than the Uniform Commercial Code in effect on the date of this Agreement, such amendment or holding shall be disregarded in defining terms used in this Agreement.
- 5.12 No single or partial exercise, or delay in the exercise, of any right or power under this Agreement, shall preclude other or further exercise of the rights and powers under this Agreement. The unenforceability of any provision of this Agreement shall not affect the enforceability of the remainder of this Agreement. This Agreement constitutes the entire agreement of the undersigned and Bank with respect to the subject matter of this Agreement. No amendment or modification of this Agreement shall be effective unless the same shall be in writing and signed by the undersigned and an authorized officer of Bank. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS OF THE STATE OF CALIFORNIA, WITHOUT REGARD TO CONFLICT OF LAWS PRINCIPLES.
- 5.13 Debtor represents and warrants that Debtor's exact name is the name set forth in this Agreement. Debtor further represents and warrants the following and agrees that Debtor is, and at all times shall be, located in the following place:
- Debtor is a registered organization which is organized under the laws of one of the states comprising the United States (e.g. corporation, limited partnership, registered limited liability partnership or limited liability company), and Debtor is located (as determined pursuant to the Uniform Commercial Code) in the state under the laws of which it was organized, which is Delaware.
- 5.14 A carbon, photographic or other reproduction of this Agreement shall be sufficient as a financing statement under the Uniform Commercial Code and may be filed by Bank in any filing office.
- 5.15 This Agreement shall be terminated only by the filing of a termination statement in accordance with the applicable provisions of the Uniform Commercial Code, but the obligations contained in Section 2.16 of this Agreement shall survive termination.



5.16 Debtor agrees to reimburse the Bank upon demand for any and all costs and expenses (including, without limit, court costs, legal expenses and reasonable attorneys' fees, whether inside or outside counsel is used, whether or not suit instituted and, if suit it instituted, whether at the trial court level, appellate level, in a bankruptcy, probate or administrative proceeding or otherwise) incurred in enforcing or attempting to enforce this Agreement or in exercising or attempting to exercise any right or remedy under this Agreement or incurred in any other matter or proceeding relating to this Security Agreement

6. Intentionally omitted.

7. THE UNDERSIGNED AND BANK ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL ONE, BUT THAT IT MAY BE WAIVED. EACH PARTY, AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF THEIR CHOICE, KNOWINGLY AND VOLUNTARILY, AND FOR THEIR MUTUAL BENEFIT WAIVES ANY RIGHT TO TRIAL BY JURY IN THE EVENT OF LITIGATION REGARDING THE PERFORMANCE OR ENFORCEMENT OF, OR IN ANY WAY RELATED TO, THIS AGREEMENT OR THE INDEBTEDNESS.

8. THIS WRITTEN LOAN AGREEMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

REMAINDER OF PAGE INTENTIONALLY LEFT BLANK

DEBTOR:  
PFSWEB, INC., a Delaware corporation

BANK:  
COMERICA BANK-CALIFORNIA, a  
California banking corporation

By: \_\_\_\_\_  
Signature of: \_\_\_\_\_  
Its: \_\_\_\_\_  
Title

By: \_\_\_\_\_  
Steven Moiles  
Vice President

## INTELLECTUAL PROPERTY SECURITY AGREEMENT

This Intellectual Property Security Agreement is entered into as of March 28, 2003 by and between COMERICA BANK-CALIFORNIA ("Bank") and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation (collectively, "Grantor").

## RECITALS

A. Bank has agreed to make certain advances of money and to extend certain financial accommodation to Grantor (the "Loans") in the amounts and manner set forth in that certain Loan and Security Agreement by and between Bank, Grantor and Priority Fulfillment Services of Canada, Inc. dated of even date herewith (as the same may be amended, modified or supplemented from time to time, the "Loan Agreement"; capitalized terms used herein are used as defined in the Loan Agreement).

B. Bank is willing to make the Loans to Grantor, but only upon the condition, among others, that Grantor shall grant to Bank a security interest in certain Copyrights, Trademarks and Patents to secure the obligations of Grantor under the Loan Agreement.

C. Pursuant to the terms of the Loan Agreement, Grantor has granted to Bank a security interest in all of Grantor's right, title and interest, whether presently existing or hereafter acquired, in, to and under all of the Collateral.

NOW, THEREFORE, for good and valuable consideration, receipt of which is hereby acknowledged, and intending to be legally bound, as collateral security for the prompt and complete payment when due of its obligations under the Loan Agreement and all other agreements now existing or hereafter arising between Grantor and Bank, Grantor hereby represents, warrants, covenants and agrees as follows:

## AGREEMENT

To secure its obligations under the Loan Agreement and under any other agreement now existing or hereafter arising between Bank and Grantor, Grantor grants and pledges to Bank a security interest in all of Grantor's right, title and interest in, to and under its Intellectual Property Collateral (including without limitation those Copyrights, Patents and Trademarks listed on Schedules A, B and C hereto), and including without limitation all proceeds thereof (such as, by way of example but not by way of limitation, license royalties and proceeds of infringement suits), the right to sue for past, present and future infringements, all rights corresponding thereto throughout the world and all re-issues, divisions continuations, renewals, extensions and continuations-in-part thereof.

This security interest is granted in conjunction with the security interest granted to Bank under the Loan Agreement. The rights and remedies of Bank with respect to the security interest granted hereby are in addition to those set forth in the Loan Agreement and the other Loan Documents, and those which are now or hereafter available to Bank as a matter of law or equity. Each right, power and remedy of Bank provided for herein or in the Loan Agreement or any of the Loan Documents, or now or hereafter existing at law or in equity shall be cumulative and concurrent and shall be in addition to every right, power or remedy provided for herein and the exercise by Bank of any one or more of the rights, powers or remedies provided for in this Intellectual Property Security Agreement, the Loan Agreement or any of the other Loan Documents, or now or hereafter existing at law or in equity, shall not preclude the simultaneous or later exercise by any person, including Bank, of any or all other rights, powers or remedies.

Grantor represents and warrants that Exhibits A, B, and C attached hereto set forth any and all intellectual property rights in connection to which Grantor has registered or filed an application with either the United States Patent and Trademark Office or the United States Copyright Office, as applicable.

IN WITNESS WHEREOF, the parties have caused this Intellectual Property Security Agreement to be duly executed by its officers thereunto duly authorized as of the first date written above.

GRANTOR:

Address of Grantor:

PRIORITY FULFILLMENT SERVICES, INC.

500 N. Central Expressway, 5th Floor  
Plano, Texas 75074  
Attn: Thomas J. Madden

By:

-----  
Title:

BANK:

-----  
COMERICA BANK-CALIFORNIA

Address of Bank:

Comerica Bank-California  
Commercial Loan Services Department  
9920 S. La Cienega Blvd., 14th Floor  
Inglewood, CA 90301

By:

-----  
Title:

Attn: Loan Documentation

EXHIBIT A  
Copyrights

Registration Number	Registration Date
-----	-----
-	-----
---	
Description	
-----	
-- NONE	

EXHIBIT B

Patents

Registration/  
Registration/  
Application/  
Application  
Description  
Number Date  
- - - - -  
- - - - -  
- - - - -  
---- NONE

EXHIBIT C

Trademarks

REGISTRATIONS

MARK

REGISTRATION

NUMBER DATE

REGISTERED -

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-----

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--- PFSWEB

2,345,487

4/25/00 FROM

THE CLICK

2,643,270

10/31/00 OF

THE MOUSE TO

THE KNOCK AT

THE HOUSE

ENTENTEWEB

2,656,989

12/3/02

PENDING

APPLICATIONS

MARK SERIAL

NUMBER DATE

FILED - ----

-----

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THE EVOLUTION

76/271,303

6/14/01 OF

OUTSOURCING

PFSWEB AND

DESIGN

76/271,304

6/14/01

ENTENTEREPORT

76/405,570

5/10/02

ENTENTE SUITE

76/079,094

6/28/00

ENTENTEDIRECT

76/079,092

6/28/00

ENTENTEMESSAGE

76/079,093

6/28/00

AMENDMENT 2  
TO  
AMENDED AND RESTATED PLATINUM PLAN AGREEMENT (WITH INVOICE DISCOUNTING)

This Amendment 2 ("Amendment") dated March 28, 2003 is made to the AMENDED AND RESTATED PLATINUM PLAN AGREEMENT (WITH INVOICE DISCOUNTING) by and among IBM BELGIUM FINANCIAL SERVICES COMPANY S.A., with a registered number of R.C. Brussels 451.673 with an address of Avenue du Bourget 42 Brussels 1130 VAT BE 424300467 ("IBM GF" or "US"), SUPPLIERS DISTRIBUTORS S.A. with a registered number of RC Liege 208795 with an address of Rue Louis Bleriot 5, B-4460 Grace-Hollogne, Belgium ("SDSA"), and BUSINESS SUPPLIES DISTRIBUTORS EUROPE BV a Netherlands company registered in Maastricht with a Netherlands trade registration number of HR Maastricht 14062763 with an address of Dalderhaag 13, 6136 Sittard, The Netherlands ("BSDE") (SDSA and BSDE collectively, "YOU"), PFS WEB B.V a Netherlands company registered in Maastricht under the number 17109541 with a Belgian trade registration number of R.C. Liege 204162 ("PFS WEB B.V.") (SDSA, BSDE and PFS Web B.V. collectively, the "LOAN PARTIES")

RECITALS:

A. The Loan Parties and IBM GF have entered into that certain AMENDED AND RESTATED PLATINUM PLAN AGREEMENT (WITH INVOICE DISCOUNTING) dated as of March 29, 2002 (as amended and modified from time to time, the "Agreement");

B. The Loan Parties have requested and IBM GF has agreed to extend the Agreement for twelve months;

C. The Loan Parties agree to certain financial covenants revisions by IBM GF; and

D. The parties have agreed to modify the Agreement as more specifically set forth below, upon and subject to the terms and conditions set forth herein.

AGREEMENT

NOW THEREFORE, in consideration of the premises and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, IBM GF and the Loan Parties hereby agree as follows:

SECTION 1. DEFINITIONS. All capitalized terms not otherwise defined herein shall have the respective meanings set forth in the Agreement.

SECTION 2. AMENDMENT. Subject to Section 4 hereof, the Agreement is hereby amended as follows:

A. The Agreement is hereby amended as follows:

(a) Section 1.1 is hereby amended by adding the following definition:

"TERMINATION DATE": means March 29, 2004 or such other date as to which IBM GF and the Loan Parties may agree from time to time.

(b) Section 8.2.7 is hereby amended by deleting it in its entirety and substituting, in lieu thereof, the following:

" FINANCIAL COVENANTS

You agree to comply with the Financial Covenants, if any, set out in the relevant supplements or the Schedule. You also agree that you will not, without our consent, make any of the following payments ("Restricted Payments") without our prior written consent (i) declare or pay any dividend

(other than dividends payable solely in common stock of BSDE and/or SDSA and the aggregate amount of such dividends under this Agreement and the AIF does not cause you or Holdings to violate such Financial Covenants or exceed Six Hundred Thousand Dollars (\$600,000), without duplication, to be paid in fiscal year 2003 for which consent is hereby given) on, or make any payment on account of, or set apart assets for a sinking or other analogous fund for, the purchase, redemption, defeasance, retirement or other acquisition of, any shares of any class of capital stock of BSDE and/or SDSA or any warrants, options or rights to purchase any such capital stock or Equity Interests, whether now or hereafter outstanding, or make any other distribution in respect thereof, either directly or indirectly, whether in cash or property or in obligations of BSDE and/or SDSA ; or (ii) make any optional payment or prepayment on or redemption (including, without limitation, by making payments to a sinking or analogous fund) or repurchase of any Indebtedness (other than the Obligations)), except as permitted by the Amended and Restated Notes Payable Subordination Agreement.

- (c) Section 10.1 is hereby amended by deleting it in its entirety and substituting, in lieu thereof, the following:

"This Agreement will remain in force until the Termination Date. However following the occurrence of an Event of Default that we have not waived in writing we may by notice with immediate effect terminate this Agreement. Upon any termination of this Agreement we shall have all the rights and remedies set out in Clause 9.2 until the complete discharge of all the Loan Parties' obligations to us. Any such termination shall not affect any right we have in relation to the IBM Reimbursables and IBM Receivables or the Receivables Rights and the Supplier Obligations and the Product Rights.

B. The Schedule to the Agreement is hereby amended by deleting such Schedule in its entirety and substituting, in lieu thereof, the Schedule attached hereto. Such new Schedule shall be effective as of the date specified in the new Schedule. The changes contained in the new Schedule include, without limitation, the following:

CREDIT LINE: E12,500,000

VAT RECEIVABLES: Deleted from Collateral Valuation

PREPAYMENT PERCENTAGE: (i) 80% of Eligible IBM Reimbursables (1) and (ii) 80% or Eligible IBM Receivables

COLLATERAL VALUE OF STOCK-IN-TRADE: (A) 100% of paid for IBM Printing Systems Division inventory (other than (a) machines which IBM Printing Systems Division has declared obsolete at least 60 days prior to the date of determination and (b) service parts) which (i) we have purchased the associated Supplier Invoice from the Authorised Supplier on or after the Closing Date (ii) purchased directly from IBM prior to the Closing Date and not subject to retention of title, provided, however, we have a first priority security interest in such inventory, (iii) is repurchasable under a repurchase agreement with the Authorized Supplier and (iv) is secured and managed through a pledge with Disposition, with coverage percentage acceptable to us (such acceptable percentage to be determined by us within 60 days of the date this Schedule is executed)The value to be assigned to such inventory shall be based upon the Supplier Invoice net of all applicable credit notes.

FINANCIAL COVENANT DEFINITIONS: Changed for net Profit After Tax, Revenue and Working Capital Turnover.

FINANCIAL COVENANTS

SDSA and BSDE will be required, on a consolidated basis, to maintain the following financial ratios, percentages and amounts on a year to date basis as of the last day of the fiscal period under review (monthly, quarterly and annually) by us and IBM Credit:

Covenant  
Covenant  
Requirement

-----  
-----  
-----  
-----  
-----

(i) Debt  
to  
Tangible  
Net Worth  
Greater  
than Zero  
and Less  
than

7.0:1.0

(ii) Net  
Profit  
after Tax  
to Revenue  
Greater  
than 0.10  
percent

(iii)  
Working  
Capital  
Turnover  
(WCTO)  
Greater  
than Zero  
and Less  
than  
43.0:1.0

PFSweb, Inc. will be required to maintain the following financial ratios, percentages and amounts as of the last day of the fiscal period under review (monthly, quarterly and annually) by IBM Credit:

Covenant  
Covenant  
Requirement

Date as of --  
-----  
-----

----- (i)  
Minimum  
Tangible Net  
Worth  
\$18,000,000.00  
03/31/03 and  
beyond

SECTION 3. CONDITIONS OF EFFECTIVENESS OF CONSENT AND AMENDMENT. This Amendment shall have been authorized, executed and delivered by each of the parties hereto and IBM GF shall have received a copy of a fully executed Amendment.

SECTION 4. REPRESENTATIONS AND WARRANTIES. Each Loan Party makes to IBM GF the following representations and warranties all of which are material and are made to induce IBM GF to enter into this Amendment.

SECTION 4.1 ACCURACY AND COMPLETENESS OF WARRANTIES AND REPRESENTATIONS. All representations made by the Loan Party in the Agreement were true and accurate

and complete in every respect as of the date made, and, as amended by this Amendment, all representations made by the Loan Party in the Agreement are true, accurate and complete in every material respect as of the date hereof, and do not fail to disclose any material fact necessary to make representations not misleading.

SECTION 4.2 VIOLATION OF OTHER AGREEMENTS. The execution and delivery of this Amendment and the performance and observance of the covenants to be performed and observed hereunder do not violate or cause any Loan Party not to be in compliance with the terms of any agreement to which such Loan Party is a party.

SECTION 4.3 LITIGATION. Except as has been disclosed by the Loan Party to IBM GF in writing, there is no litigation, proceeding, investigation or labor dispute pending or threatened against any Loan Party, which, if adversely determined, would materially adversely affect the Loan Party's ability to perform such Loan Party's obligations under the Agreement and the other documents, instruments and agreements executed in connection therewith or pursuant hereto.

SECTION 4.4 ENFORCEABILITY OF AMENDMENT. This Amendment has been duly authorized, executed and delivered by each Loan Party and is enforceable against each Loan Party in accordance with its terms.

SECTION 5. RATIFICATION OF AGREEMENT. Except as specifically amended hereby, all of the provisions of the Agreement shall remain unamended and in full force and effect. Each Loan Party

hereby ratifies, confirms and agrees that the Agreement, as amended hereby, represents a valid and enforceable obligation of such Loan Party, and is not subject to any claims, offsets or defenses.

SECTION 6. RATIFICATION OF GUARANTY. Each of Holdings, SDI, PFSweb and PFS hereby ratify and confirm their respective guaranties in favor of IBM GF and agree that such guaranties remain in full force and effect and that the term "Liabilities", as used therein include, without limitation the indebtedness liabilities and obligations of SDSA and BSDE under the Agreement as amended hereby. SDI hereby ratifies and confirms its Notes Payable Subordination Agreement executed by SDI on March 29, 2002 and confirms such Notes Payable Subordination Agreement remains in full force and effect.

SECTION 7. GOVERNING LAW. This Amendment shall be governed by and interpreted in accordance with the laws which govern the Agreement.

SECTION 8. COUNTERPARTS. This Amendment may be executed in any number of counterparts, each of which shall be an original and all of which shall constitute one agreement.

IN WITNESS WHEREOF, each Loan Party has read this entire Amendment, and has caused its authorized representatives to execute this Amendment and has caused its corporate seal, if any, to be affixed hereto as of the date first written above.

IBM BELGIUM FINANCIAL SERVICES S.A.

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

SUPPLIERS DISTRIBUTORS S.A.

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

BUSINESS SUPPLIES DISTRIBUTORS EUROPE BV

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

PFS WEB B.V.

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

THE FOLLOWING PARTIES AGREE TO SECTION 6 AS APPLICABLE TO THEM.

SUPPLIES DISTRIBUTORS, INC.

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

PRIORITY FULFILLMENT SERVICES, INC.

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

AMENDMENT  
TO  
AGREEMENT FOR INVENTORY FINANCING

This Amendment ("Amendment") to the Agreement for Inventory Financing is made as of March 28, 2003 by and among IBM CREDIT LLC, a Delaware limited liability company, formerly IBM Credit Corporation ("IBM Credit"), BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC, a limited liability company duly organized under the laws of the state of Delaware ("Holdings"), SUPPLIES DISTRIBUTORS, INC. (formerly known as BSD Acquisition Corp.), a corporation duly organized under the laws of the state of Delaware ("Borrower"), PRIORITY FULFILLMENT SERVICES, INC., a corporation duly organized under the laws of the state of Delaware ("PFS") and PFSWEB, INC., a corporation duly organized under the laws of the state of Delaware ("PFSweb") (Borrower, Holdings, IFP, PFS, PFSweb, and any other entity that executes this Agreement or any Other Document, including without limitation all Guarantors, are each individually referred to as a "Loan Party" and collectively referred to as "Loan Parties").

RECITALS:

- A. Borrower and IBM Credit have entered into that certain Agreement for Inventory Financing ("AIF") dated as of March 29, 2002 (the "Agreement");
- B. Borrower has requested and IBM Credit agrees to extend the Termination Date of the Agreement;
- C. Borrower agrees to certain financial covenants revisions by IBM Credit; and
- D. The parties have agreed to modify the Agreement as more specifically set forth below, upon and subject to the terms and conditions set forth herein.

AGREEMENT

NOW THEREFORE, in consideration of the premises and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Borrower and IBM Credit hereby agree as follows:

SECTION 1. DEFINITIONS. All capitalized terms not otherwise defined herein shall have the respective meanings set forth in the Agreement.

SECTION 2. AMENDMENT. Subject to Section 4 hereof, the Agreement is hereby amended as follows:

- A. The AIF is hereby amended as follows:

(a) The definition of "Termination Date" in Section 1.1 of the Agreement is hereby amended by deleting it in its entirety and substituting, in lieu thereof, the following definition:

"Termination Date": shall mean March 29, 2004 or such other date as IBM Credit and the Customer may agree to from time to time in writing."

- (b) Section 8.6 is hereby amended in its entirety to read as follows:

"8.6. RESTRICTED PAYMENTS. Borrower will not, directly or indirectly make any of the following payments ("Restricted Payments") without prior written consent from IBM Credit, which shall not be unreasonably withheld: (i) declare or pay any dividend (other than dividends payable solely in common

stock of Borrower and dividends not to exceed \$600,000 to be paid in fiscal year 2003 for which consent is hereby given) on, or make any payment on account of, or set apart assets for a sinking or other analogous fund for, the purchase, redemption, defeasance, retirement or other acquisition of, any shares of any class of capital stock of Borrower or any warrants, options or rights to purchase any such capital stock or Equity Interests, whether now or hereafter outstanding, or make any other distribution in respect thereof, either directly or indirectly, whether in cash or property or in obligations of Borrower; or (ii) make any optional payment or prepayment on or redemption (including, without limitation, by making payments to a sinking or analogous fund) or repurchase of any Indebtedness (other than the Obligations or payments of the revolving loans made by Congress made in the ordinary course administration thereof pursuant to the Congress Credit Agreement)), except as permitted by the Amended and Restated Notes Payable Subordination Agreement."

B. Attachment A to the AIF is hereby amended by deleting such Attachment A in its entirety and substituting, in lieu thereof, the Attachment A attached hereto. Such new Attachment A shall be effective as of the date specified in the new Attachment A. The changes contained in the new Attachment A include, without limitation, the following:

(a) The following definitions of "Total Assets" and "Total Net Worth" in Section IV of Attachment A are amended in their entirety to read as follows:

"Total Assets" shall mean the total of Current Assets and Long Term Assets. For the purpose of calculating Total Assets for Borrower, the accumulated earnings and foreign currency translation adjustments applicable to Borrower's Canadian and European subsidiaries should be excluded.

"Total Net Worth" (the amount of owner's or stockholder's ownership in an enterprise) is equal to Total Assets minus Total Liabilities. For the purpose of calculating Total Net Worth of Borrower, the following shall be excluded (i) accumulated earnings and foreign currency translation adjustments applicable to Borrower's Canadian and European subsidiaries and (ii) all income and losses applicable to foreign currency adjustments for each period but not excluding such foreign currency adjustments for annual periods that must comply with GAAP.

(b) Section IV of Attachment A is amended and restated by replacing the applicable subsections to read as follows:

1. Borrower will be required to maintain the following financial ratios, percentages and amounts as of the last day of the fiscal period under review (monthly, quarterly, annually) by IBM Credit:

Covenant  
Covenant  
Requirement  
-----

(ii) Net  
Profit  
after Tax  
to  
Revenue\*\*  
Equal to or  
Greater  
than

\*\*Excluding  
all income  
and losses  
applicable  
to 0.20  
percent (a)  
100%  
ownership  
in Canadian  
and  
European  
subsidiaries  
and (b)  
foreign  
currency  
adjustments

for each  
period but  
not  
excluding  
such  
foreign  
currency  
adjustments  
for annual  
periods  
that must  
comply with  
GAAP and  
excluding  
revenue  
from  
intercompany  
sales.

2. Business Supplies Distributors Holdings, LLC will be required to maintain the following financial ratios, percentages and amounts as of the last day of the fiscal period under review (monthly, quarterly, annually) by IBM Credit:

Covenant  
Covenant  
Requirement  
-----  
-----

(ii) Net  
Profit  
after Tax  
to Revenue\*  
Equal to or  
Greater  
than  
\*Excluding  
all (a)  
income and  
losses  
applicable  
0.15  
percent to  
foreign  
currency  
adjustments  
for each  
period but  
not  
excluding  
such  
foreign  
currency  
adjustments  
for annual  
periods  
that must  
comply with  
GAAP and  
(b) revenue  
from  
intercompany  
sales. (iv)  
Cash Flow  
from  
Operations  
per quarter  
Greater  
than \$0

C. Attachment C-1 to the AIF is hereby amended by deleting such Attachment C-1 in its entirety and substituting, in lieu thereof, the Attachment C-1 attached hereto. Such new Attachment C-1 shall be effective as of the date specified in the new Attachment C-1. The changes contained in the new Attachment C-1 include, without limitation, the following:

Section I of Attachment C-1 is amended and restated by replacing the applicable subsections to read as follows:

"I. FINANCIAL COVENANTS:

SUPPLIES DISTRIBUTORS, INC.

Covenant  
Covenant  
Requirement  
Covenant  
Actual ----  
-----  
-----  
-----

(ii) Net  
Profit  
after Tax  
to  
Revenue\*\*  
Equal to or

Greater than 0.20 percent  
\*\*Excluding all income and losses applicable to (a) 100% ownership in Canadian and European subsidiaries and (b) foreign currency adjustments for each period but not excluding such foreign currency adjustments for annual periods that must comply with GAAP and excluding revenue from intercompany sales.

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC

Covenant  
Covenant  
Requirement  
Covenant  
Actual ----  
-----  
-----  
-----  
-----  
(ii) Net Profit after Tax to Revenue\*  
Equal to or Greater  
\*Excluding all (a) income and losses than 0.15 percent applicable to foreign currency adjustments for each period but not excluding such foreign currency adjustments for annual periods that must comply with GAAP and (b) revenue from

intercompany  
sales. (iv)  
Cash Flow  
from  
Operations  
per Greater  
than \$0  
quarter

SECTION 3. CONDITIONS OF EFFECTIVENESS OF CONSENT AND AMENDMENT.

(a) This Amendment shall have been authorized, executed and delivered by each of the parties hereto and IBM Credit shall have received a copy of a fully executed Amendment.

SECTION 4. REPRESENTATIONS AND WARRANTIES. Each Loan Party makes to IBM Credit the following representations and warranties all of which are material and are made to induce IBM Credit to enter into this Amendment.

SECTION 4.1 ACCURACY AND COMPLETENESS OF WARRANTIES AND REPRESENTATIONS. All representations made by the Loan Party in the Agreement were true and accurate and complete in every respect as of the date made, and, as amended by this Amendment, all representations made by the Loan Party in the Agreement are true, accurate and complete in every material respect as of the date hereof, and do not fail to disclose any material fact necessary to make representations not misleading.

SECTION 4.2 VIOLATION OF OTHER AGREEMENTS. The execution and delivery of this Amendment and the performance and observance of the covenants to be performed and observed hereunder do not violate or cause any Loan Party not to be in compliance with the terms of any agreement to which such Loan Party is a party.

SECTION 4.3 LITIGATION. Except as has been disclosed by the Loan Party to IBM Credit in writing, there is no litigation, proceeding, investigation or labor dispute pending or threatened against any Loan Party, which, if adversely determined, would materially adversely affect the Loan Party's ability to perform such Loan Party's obligations under the Agreement and the other documents, instruments and agreements executed in connection therewith or pursuant hereto.

SECTION 4.4 ENFORCEABILITY OF AMENDMENT. This Amendment has been duly authorized, executed and delivered by each Loan Party and is enforceable against each Loan Party in accordance with its terms.

SECTION 5. RATIFICATION OF AGREEMENT. Except as specifically amended hereby, all of the provisions of the Agreement shall remain unamended and in full force and effect. Each Loan Party hereby ratifies, confirms and agrees that the Agreement, as amended hereby, represents a valid and enforceable obligation of such Loan Party, and is not subject to any claims, offsets or defenses.

SECTION 6. RATIFICATION OF GUARANTY AND NOTES PAYABLE SUBORDINATION AGREEMENT. Each of Holdings, PFSweb and PFS hereby ratify and confirm their respective guaranties in favor of IBM Credit and agree that such guaranties remain in full force and effect and that the term "Liabilities", as used therein include, without limitation the indebtedness liabilities and obligations of the Borrower under the Agreement as amended hereby. PFS hereby ratifies and confirms its Notes Payable Subordination Agreement executed by PFS on November 12, 2002 in favor of IBM Credit and confirms such agreement remains in full force and effect.

SECTION 7. GOVERNING LAW. This Amendment shall be governed by and interpreted in accordance with the laws which govern the Agreement.

SECTION 8. COUNTERPARTS. This Amendment may be executed in any number of counterparts, each of which shall be an original and all of which shall constitute one agreement.

IN WITNESS WHEREOF, each Loan Party has read this entire Amendment, and has caused its authorized representatives to execute this Amendment and has caused its corporate seal, if any, to be affixed hereto as of the date first written above.

IBM CREDIT LLC

SUPPLIES DISTRIBUTORS, INC.

By: \_\_\_\_\_

By: \_\_\_\_\_

Print Name: \_\_\_\_\_

Print Name: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC  
By: \_\_\_\_\_ as Managing Member

PRIORITY FULFILLMENT SERVICES, INC.

By: \_\_\_\_\_

By: \_\_\_\_\_

Print Name: \_\_\_\_\_

Print Name: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

PFSWEB, INC.

By: \_\_\_\_\_

Print Name: \_\_\_\_\_

Title: \_\_\_\_\_

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

In connection with the Quarterly Report of PFSweb, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark C. Layton, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Mark C. Layton

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Mark C. Layton  
Chief Executive Officer  
May 15, 2003

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.

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

In connection with the Quarterly Report of PFSweb, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas J. Madden, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas J. Madden  
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Thomas J. Madden  
Chief Financial Officer  
May 15, 2003

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.