PFSWEB INC
Form 10-Q
November 16, 2009

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2009

OR

o **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	**75-2837058**
(State of Incorporation)	(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**

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 þ No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company þ

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

At November 16, 2009 there were 9,933,803 shares of registrant s common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES
Form 10-Q
September 30, 2009
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements

PFSWEB, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)

	September 30, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 15,824	$ 16,050
Restricted cash	2,021	2,008
Accounts receivable, net of allowance for doubtful accounts of $629 and $980 at September 30, 2009 and December 31, 2008, respectively	34,790	44,546
Inventories, net of reserves of $2,016 and $2,124 at September 30, 2009 and December 31, 2008, respectively	36,461	47,186
Other receivables	14,076	13,072
Prepaid expenses and other current assets	4,532	3,802
Total current assets	107,704	126,664
PROPERTY AND EQUIPMENT, net	10,988	12,106
IDENTIFIABLE INTANGIBLES	843	961
GOODWILL	3,602	3,602
OTHER ASSETS	1,524	1,188
Total assets	$ 124,661	$ 144,521
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	$ 20,191	$ 22,251
Trade accounts payable	50,481	61,988
Accrued expenses	20,123	21,054
Total current liabilities	90,795	105,293
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	1,910	4,951
OTHER LIABILITIES	1,621	1,192
Total liabilities	94,326	111,436

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; 35,000,000 shares authorized; 9,949,551 and 9,935,095 shares issued at September 30, 2009 and December 31, 2008, respectively; and 9,931,190 and 9,916,734 outstanding at September 30, 2009 and December 31, 2008, respectively	10	10
Additional paid-in capital	93,050	92,728
Accumulated deficit	(65,016)	(61,393)
Accumulated other comprehensive income	2,376	1,825
Treasury stock at cost, 18,361 shares	(85)	(85)
Total shareholders equity	30,335	33,085
Total liabilities and shareholders equity	$ 124,661	$ 144,521

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

3

Table of Contents

PFSWEB, INC. AND SUBSIDIARIES
UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
REVENUES:				
Product revenue, net	$ 65,713	$ 79,157	$ 197,522	$ 252,496
Service fee revenue	13,118	22,900	42,604	64,966
Pass-through revenue	6,776	7,852	16,748	21,600
Total net revenues	85,607	109,909	256,874	339,062
COSTS OF REVENUES:				
Cost of product revenue	59,611	73,128	180,746	233,475
Cost of service fee revenue	9,674	15,588	30,406	44,537
Pass-through cost of revenue	6,776	7,852	16,748	21,600
Total costs of revenues	76,061	96,568	227,900	299,612
Gross profit	9,546	13,341	28,974	39,450
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, including stock based compensation expense of $97 and $109 in the three months ended September 30, 2009 and 2008, respectively, and $309 and $438 in the nine months ended September 30, 2009 and 2008, respectively	9,972	12,454	31,283	36,397
AMORTIZATION OF IDENTIFIABLE INTANGIBLES	26	202	79	605
Total operating expenses	9,998	12,656	31,362	37,002
Income (loss) from operations	(452)	685	(2,388)	2,448
INTEREST EXPENSE, NET	288	426	967	1,123
Income (loss) before income taxes	(740)	259	(3,355)	1,325
INCOME TAX EXPENSE (BENEFIT), NET	106	216	268	806
NET INCOME (LOSS)	$ (846)	$ 43	$ (3,623)	$ 519
NET INCOME (LOSS) PER SHARE:				
Basic	$ (0.09)	$ 0.00	$ (0.36)	$ 0.05

Diluted	$ (0.09)	$ 0.00	$ (0.36)	$ 0.05
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	9,931	9,913	9,927	9,902
Diluted	9,931	9,972	9,927	9,991

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

Table of Contents

PFSWEB, INC. AND SUBSIDIARIES
UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (3,623)	$ 519
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	5,191	4,819
Loss on sale of assets		17
Provision for doubtful accounts	(170)	
Provision for excess and obsolete inventory	752	950
Deferred income taxes	(41)	42
Stock-based compensation	309	438
Changes in operating assets and liabilities:		
Restricted cash	(6)	227
Accounts receivable	10,339	7,106
Inventories, net	10,676	(5,252)
Prepaid expenses, other receivables and other assets	(1,461)	(3,143)
Accounts payable, accrued expenses and other liabilities	(13,479)	5,585
Net cash provided by operating activities	8,487	11,308
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3,523)	(4,738)
Proceeds from sale of assets		117
Net cash used in investing activities	(3,523)	(4,621)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	(1,261)	(1,354)
Increase in restricted cash	(7)	(986)
Proceeds from issuance of common stock	13	50
Payments on debt, net	(4,508)	(3,953)
Net cash used in financing activities	(5,763)	(6,243)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	573	(15)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(226)	429

CASH AND CASH EQUIVALENTS, beginning of period	16,050	14,272
CASH AND CASH EQUIVALENTS, end of period	$ 15,824	$ 14,701
SUPPLEMENTAL CASH FLOW INFORMATION		
Non-cash investing and financing activities:		
Property and equipment acquired under capital leases	$ 364	$ 240

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

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

1. OVERVIEW AND BASIS OF PRESENTATION

PFSweb, Inc. and its subsidiaries, including Supplies Distributors, Inc., and eCOST.com, Inc., are collectively referred to as the Company; Supplies Distributors refers to Supplies Distributors, Inc. and its subsidiaries; eCOST refers to eCOST.com, Inc.; and PFSweb refers to PFSweb, Inc. and its subsidiaries excluding Supplies Distributors and eCOST.

PFSweb Overview

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. PFSweb offers a broad range of services such as professional consulting, technology collaboration, managed web 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, facilities and operations management, kitting and assembly services, and international fulfillment and distribution services.

Supplies Distributors Overview

Supplies Distributors, PFSweb and InfoPrint Solutions Company (IPS), a joint venture company owned by Ricoh and International Business Machines Corporation (IBM), have entered into master distributor agreements under which Supplies Distributors acts as a master distributor of various products, primarily IPS product.

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

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

eCOST Overview

eCOST is a multi-category online discount retailer of new, close-out and recertified brand-name merchandise, selling products primarily to customers in the United States. eCOST offers products in several merchandise categories, including computers, networking, electronics and entertainment, TV s, plasmas and monitors, cameras and camcorders, memory and storage, For the Home and sports and leisure. eCOST carries products from leading manufacturers such as Sony, JVC, Canon, Hewlett-Packard, Denon, Dyson, Sennheiser, Garmin, Panasonic, Toshiba and Microsoft.

The Company s liquidity has been negatively impacted as a result of the merger with eCOST. Since the merger, eCOST has experienced a net use of cash primarily due to operating losses. As a result, the Company has had to support eCOST s cash needs with the goal of reducing losses. The amount of additional cash needed to support eCOST operations will depend upon working capital requirements, bank

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

financing availability as well as eCOST s continued ability to improve its financial results. Further advances to eCOST may be limited by the Company s current cash and future cash flow and may be restricted by the Company s credit facility obligations.

In the event eCOST is unable to increase its revenue and/or gross profit from its present levels, it may fail to comply with one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and demand for payment under the Company parent guaranty. 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.

Management currently believes eCOST will meet the Company s expectations related to improved overall profitability. The Company has reported improvement in eCOST s financial results beginning in 2007, excluding the impact of any non-cash impairment charges, and currently expects improvement as a result of efforts to increase sales, improve product mix and control operating costs, although there can be no assurance that these future improvements will be achieved. If eCOST does not meet expectations, the Company currently anticipates that it would be able to terminate or sublease eCOST s facilities, liquidate remaining inventory through the eCOST website and reduce certain personnel related costs as needed so as to minimize any material impact upon the Company s other segments.

Basis of Presentation

The unaudited interim condensed consolidated financial statements as of September 30, 2009, and for the three and nine months ended September 30, 2009 and 2008, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and are unaudited. Certain information and note 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 September 30, 2009, its results of operations for the three and nine months ended September 30, 2009 and 2008 and its cash flows for the nine months ended September 30, 2009 and 2008. Results of the Company s operations for interim periods may not be indicative of results for the full fiscal year.

2. *SIGNIFICANT ACCOUNTING POLICIES*

Principles of Consolidation

All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The recognition and allocation of certain revenues and operating expenses in these consolidated financial statements also require management estimates and assumptions.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in this report and in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 in the section entitled Risk Factors. Based on a critical assessment of accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that the Company s consolidated financial statements are fairly stated in accordance with generally accepted accounting principles in the United States of America, and provide a fair presentation of the Company s financial position and results of operations.

Investment in Affiliates

Priority Fulfillment Services, Inc. (PFS), a wholly-owned subsidiary of PFSweb, has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the Subordinated Note). Under the terms of certain of the Company s debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than $6.5 million or decreased to less than $5.0 million without prior approval of the Company s lenders. As of September 30, 2009 and December 31, 2008, the outstanding balance of the Subordinated Note was $5.0 million and $5.5 million, respectively. The Subordinated Note is eliminated in the Company s consolidated financial statements.

PFS has also made advances to eCOST, which aggregated $10.9 million as of September 30, 2009 and $10.6 million as of December 31, 2008. Certain of the Company s debt facilities provide that the total advances to eCOST may not be less than $2.0 million without prior approval of eCOST s lender. PFS has received the approval of its lender to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of its subsidiaries and/or affiliates, including eCOST, if needed. PFSweb has also advanced to eCOST $5.0 million and $4.7 million as of September 30, 2009 and December 31, 2008, respectively.

Concentration of Business and Credit Risk

The Company s service fee revenue is generated under contractual service fee relationships with multiple client relationships. No service fee clients or product revenue customers exceeded 10% of consolidated total net revenue or accounts receivable during the nine months ended September 30, 2009. A summary of the nonaffiliated customer and client concentrations is as follows:

	Nine Months Ended	
	September 30, 2009	September 30, 2008
Product Revenue (as a percentage of Product Revenue):		
Customer 1	12%	11%
Customer 2	9%	10%
Service Fee Revenue (as a percentage of Service Fee Revenue):		
Client 1	9%	40%
Client 2	16%	10%
Client 3	11%	6%
Client 4	10%	7%

Client 1 did not renew its contract with PFS effective January 2009, though certain project work continued to occur through the quarter ended June 30, 2009.

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

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

The Company has multiple arrangements with IBM and IPS 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, certain of Supplies Distributors working capital financing agreements, product sales to IBM and IPS business units and an IBM term master lease agreement. Substantially all of the Supplies Distributors revenue is generated by its sale of product purchased from IPS. Supplies Distributors also relies upon IPS sales force and product demand generation activities and the discontinuance of such services would have a material impact upon Supplies Distributors business.

eCOST s arrangements with its vendors are terminable by either party at will. Loss of any vendors could have a material adverse effect on eCOST s financial position, results of operations and cash flows. Sales of HP and HP-related products represented 45% of eCOST s net revenues (11% of the Company s consolidated total net revenues) in the nine months ended September 30, 2009 and 48% of eCOST s net revenues (11% of the Company s consolidated total net revenues) in the comparable 2008 period.

Inventories

The Company establishes inventory reserves based upon estimates of declines in values due to inventories that are slow moving or obsolete, excess levels of inventory or values assessed at lower than cost. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory.

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

Property and Equipment

The Company s property held under capital leases amounted to approximately $2.5 million and $3.4 million, net of accumulated amortization of approximately $9.8 million and $8.4 million, at September 30, 2009 and December 31, 2008, respectively.

Stock-Based Compensation

During the nine months ended September 30, 2009, the Company issued an aggregate of 352,767 options to purchase shares of common stock to officers, directors, employees and consultants of the Company.

Long-Lived Assets

The Company reviews long-lived assets for impairment periodically, but at a minimum annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets include property, intangible assets, goodwill and certain other assets. Recoverability of assets is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value would be determined using appraisals, discounted cash flow analysis or similar valuation techniques. The Company makes judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. The Company records impairment losses in the period in which it determines that the carrying amount is not recoverable. This may require the Company to make judgments regarding long-term forecasts of their future revenues and costs related to the assets subject to review.

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

Cash Paid for Interest and Taxes

The Company made payments for interest of approximately $1.0 million and $1.2 million during the nine months ended September 30, 2009 and 2008, respectively. Income taxes of approximately $0.6 million and $1.5 million were paid by the Company during the nine months ended September 30, 2009 and 2008, respectively.

Subsequent Events

The Company has evaluated its subsequent events through November 16, 2009. There were no events or transactions that occurred after September 30, 2009 that required disclosure in the financial statements.

Impact of Recently Issued Accounting Standards

On January 1, 2009, the Company adopted the Financial Accounting Standards Board s, or FASB, new accounting guidance for the fair value measurement of all non-financial assets and liabilities. The guidance delayed the effective date for the treatment of certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis, at least annually, until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements.

On January 1, 2009, the Company adopted new FASB guidance contained in FASB Accounting Standards Codification (ASC) 805, which changes the method of accounting for business combinations. Under ASC 805, an acquiring entity is required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. ASC 805 requires that transaction costs such as legal, accounting and advisory fees be expensed and requires a substantial number of new disclosures. The Company applied the provisions of the new standard in the first quarter of 2009, which did not have a material impact on the Company s consolidated financial statements.

On January 1, 2009, the Company adopted new FASB guidance contained in ASC 810, which establishes new accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. The Company applied the provisions of the new standard in the first quarter of 2009. The adoption of the statement did not have a material impact on the Company s consolidated financial statements.

On January 1, 2009, the Company adopted the applicable sections of ASC 350-30, which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. ASC 350-30 applies prospectively to all intangible assets acquired after January 1, 2009, whether acquired in a business combination or otherwise. The adoption of the applicable sections of ASC 350-30 will impact the Company s accounting for new intangible assets acquired in business combinations that occur after January 1, 2009. The adoption of this guidance did not have any impact on the Company s consolidated financial statements.

In May 2009, the FASB updated, and we adopted, the *Subsequent Events* Topic of the FASB ASC to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This topic requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. This topic is effective in the first interim period ending after June 15, 2009. The adoption of this update did not have a material impact on the Company s financial statements.

In June 2009, the FASB issued ASU 2009-01, *Generally Accepted Accounting Principles* and approved the FASB Accounting Standards Codification (Codification) as the single source of authoritative nongovernmental US GAAP. The Codification does not change previous US GAAP, but is intended to

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

simplify user access to all authoritative US GAAP by providing all the authoritative literature related to a particular topic in one place. All prior accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered non-authoritative. ASU 2009-01 is effective for interim and annual periods ending after September 15, 2009. The implementation of this update did not have an impact on the Company s consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* to amend certain guidance in *FASB Accounting Standards Codification*™ (ASC) 605, *Revenue Recognition*, 25, Multiple-Element Arrangements . The amended guidance in ASC 605-25 (1) modifies the separation criteria by eliminating the criterion that requires objective and reliable evidence of fair value for the undelivered item(s), and (2) eliminates the use of the residual method of allocation and instead requires that arrangement consideration be allocated, at the inception of the arrangement, to all deliverables based on their relative selling price.

The FASB also issued ASU 2009-14, *Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issues Task Force*, to amend the scope of arrangements under ASC 985, *Software*, 605, Revenue Recognition to exclude tangible products containing software components and non-software components that function together to deliver a product s essential functionality.

The amended guidance in ASC 605-25 and ASC 985-605 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early application and retrospective application permitted. The Company is in the process of evaluating the impact the amendments to ASC 605-25 and ASC 985-605 will have on its consolidated financial statements.

3. *COMPREHENSIVE INCOME (LOSS) (in thousands)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net income (loss)	$ (846)	$ 43	$ (3,623)	$ 519
Other comprehensive income (loss):				
Foreign currency translation adjustment	435	(1,041)	551	(381)
Comprehensive income (loss)	$ (411)	$ (998)	$ (3,072)	$ 138

4. *NET INCOME (LOSS) PER COMMON SHARE*

Basic and diluted net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the reporting period. For both the three and nine months ended September 30, 2009, 1.8 million outstanding options to purchase common shares were anti-dilutive and have been excluded from the diluted weighted average share computation. For the three and nine months ended September 30, 2008, common stock equivalents of 0.1 million and 0.8 million, respectively, are included in the diluted weighted average number of shares outstanding. For both the three and nine months ended September 30, 2008, 1.3 million and 0.6 million, respectively, of outstanding options to purchase common shares were anti-dilutive and have been excluded from the diluted weighted average share computation.

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

5. *VENDOR FINANCING:*

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

	September 30, 2009	December 31, 2008
Inventory and working capital financing agreements:		
United States	$ 15,083	$ 23,885
Europe	13,687	16,422
Total	$ 28,770	$ 40,307

Inventory and Working Capital Financing Agreement, United States

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of IPS products in the United States, providing financing for eligible IPS inventory and certain receivables up to $30.5 million through its expiration in March 2010. As of September 30, 2009, Supplies Distributors had $3.5 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $5.0 million and a minimum shareholders equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of September 30, 2009). The facility also includes a monthly service fee. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets.

Inventory and Working Capital Financing Agreement, Europe

Supplies Distributors European subsidiary has a short-term credit facility with IBM Belgium Financial Services S.A. (IBM Belgium) to finance its distribution of IPS products in Europe. The asset based credit facility with IBM Belgium provides up to 16.0 million euros (approximately $23.4 million) in inventory financing and cash advances based on eligible inventory and accounts receivable through its expiration in March 2010. As of September 30, 2009, Supplies Distributors European subsidiaries had 0.8 million euros ($1.2 million) of available credit. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors and its European subsidiaries to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors European subsidiary, as well as collateralized guaranties of Supplies Distributors and PFSweb. Additionally, PFSweb is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $5.0 million and a minimum shareholders equity of $18.0 million. Borrowings under the credit facility accrue interest at Euribor plus 1.94% for cash advances, and, after a defined free financing period, at Euribor plus 4.25% for inventory financings. As of September 30, 2009, the interest rate was 2.4% on the $3.1 million of outstanding cash advances (see Note 6) and 4.7% on the $13.7 million of outstanding inventory financings. Supplies Distributors European subsidiary pays a monthly service fee on the commitment. Given the structure of this facility and as outstanding inventory

12

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

financing balances are repaid within twelve months, the Company has classified the outstanding inventory financing amounts under this facility as accounts payable in the consolidated balance sheets.

6. *DEBT AND CAPITAL LEASE OBLIGATIONS;*

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

	September 30, 2009	December 31, 2008
Loan and security agreements, United States		
Supplies Distributors	$ 6,814	$ 9,649
PFS	3,400	6,000
Inventory and Working Capital Financing Agreement, Europe (see Note 5)	3,064	599
Credit facility eCOST		
Factoring agreement, Europe	1,738	2,577
Taxable revenue bonds	2,400	3,200
Master lease agreements	4,003	4,657
Other	682	520
Total	22,101	27,202
Less current portion of long-term debt	20,191	22,251
Long-term debt, less current portion	$ 1,910	$ 4,951

Loan and Security Agreement Supplies Distributors

Supplies Distributors has a loan and security agreement with Wachovia Bank, N.A. (Wachovia) to provide financing for up to $25 million of eligible accounts receivable in the United States and Canada. As of September 30, 2009, Supplies Distributors had $2.9 million of available credit under this agreement. The Wachovia facility expires on the earlier of March 2011 or the date on which the parties to the IPS master distributor agreement no longer operate under the terms of such agreement and/or IPS no longer supplies products pursuant to such agreement. Borrowings under the Wachovia facility accrue interest at prime rate plus 0.25% to 0.75% (3.75% as of September 30, 2009) or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability, 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 (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than $5.0 million and may not maintain restricted cash of more than $5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wachovia pursuant to which a security interest was granted to Wachovia for all U.S. and Canadian customer remittances received in specified bank accounts. At September 30, 2009 and December 31, 2008, these bank accounts held $0.2 million and $0.1 million, respectively, which was restricted for payment to Wachovia.

Loan and Security Agreement PFS

PFS has a Loan and Security Agreement (Comerica Agreement) with Comerica Bank (Comerica). The Comerica Agreement provides for up to $10.0 million of eligible accounts receivable financing through March 2010. Borrowings under the Comerica Agreement accrue interest at a defined rate, which will generally be prime rate plus

2%, with a minimum of 4.5% (5.25% at September 30, 2009). As of September 30, 2009, PFS had $3.8 million of available credit under this facility. The Comerica Agreement contains cross default provisions, various restrictions upon PFS ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of $20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the subordinated note receivable from Supplies Distributors to a maximum of $6.5 million. Comerica has provided approval for PFS to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of its subsidiaries and/or affiliates, including eCOST, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

Credit Facility eCOST

eCOST has an asset-based line of credit facility of up to $7.5 million from Wachovia, through May 2011, which is collateralized by substantially all of eCOST s assets. Borrowings under the facility are limited to a percentage of eligible accounts receivable and inventory. Outstanding borrowings under the facility bear interest at rates ranging prime rate plus 0.75% to 1.25% or Eurodollar rate plus 3.0% to 4.0%, depending on eCOST s financial results. There were no outstanding borrowings as of September 30, 2009. As of September 30, 2009, eCOST had $1.0 million of letters of credit outstanding and $1.3 million of available credit under this facility. In connection with the line of credit, eCOST entered into a cash management arrangement whereby eCOST s operating amounts are considered restricted and swept and used to repay outstanding amounts under the line of credit. As of September 30, 2009 and December 31, 2008, the restricted cash amount was $0.2 million in each period. The credit facility restricts eCOST s ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb, Inc.), make investments and loans, pledge assets, make changes to capital stock ownership structure, and requires a minimum tangible net worth of $0 million, as defined. PFSweb has guaranteed all current and future obligations of eCOST under this line of credit.

Factoring Agreement

Supplies Distributors European subsidiary has a factoring agreement with Fortis Commercial Finance N.V. (Fortis) to provide factoring for up to 7.5 million euros (approximately $11.0 million) of eligible accounts receivables through March 2010. As of September 30, 2009, Supplies Distributors European subsidiary had approximately 0.9 million euros ($1.3 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 1.2% (1.6% at September 30, 2009). This agreement contains various restrictions upon the ability of Supplies Distributors European subsidiary to, among other things, merge, consolidate and 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.

Taxable Revenue Bonds

PFS has a Loan Agreement with the Mississippi Business Finance Corporation (the MBFC) in connection with the issuance by the MBFC of $5 million MBFC Taxable Variable Rate Demand Limited Obligation Revenue Bonds, Series 2004 (Priority Fulfillment Services, Inc. Project) (the Bonds). The MBFC loaned the proceeds of the Bonds to PFS for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in one of the Company s Southaven, Mississippi distribution facilities. The Bonds bear interest at a variable rate (0.8% as of September 30, 2009), as determined by Comerica Securities, as Remarketing Agent. PFS, at its option, may convert the Bonds to a fixed rate, to be determined by the Remarketing Agent at the time of conversion.

The primary source of repayment of the Bonds is a letter of credit (the Letter of Credit) in the initial face amount of $5.1 million issued by Comerica pursuant to a Reimbursement Agreement between PFS and Comerica under which PFS is obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has a maturity date of April 2010 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof. If the Letter of Credit is renewed or replaced,

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

the Bonds require future annual principal repayments of $800,000 in January of each year through 2012. PFS obligations under the Reimbursement Agreement are secured by substantially all of the assets of PFS, including restricted cash of $1.5 million and a Company parent guarantee.

Debt Covenants

To the extent the Company or any of its subsidiaries fail to comply with covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements and required level of shareholders equity or net worth, and one or all of the lenders accelerate the repayment of the credit facility obligations, the Company would be required to repay all amounts outstanding thereunder. In particular, in the event eCOST is unable to increase its revenue and/or gross profit from its present levels, or if PFS service fee revenue declines from expected levels and it is unable to reduce costs to correspond to such reduced revenue levels or if Supplies Distributors revenue or gross profit declines from expected levels, such events may result in a breach of one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and demand for payment under the Company parent guaranty. 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. As of September 30, 2009, the Company was in compliance with all debt covenants.

Master Lease Agreements

The Company has a Term Lease Master Agreement with IBM Credit Corporation (Master Lease Agreement) that provides for leasing or financing transactions of equipment and other assets, which generally have terms of three years. The amounts outstanding under this Master Lease Agreement ($1.9 million as of September 30, 2009 and $1.7 million as of December 31, 2008) are secured by the related equipment.

The Company has two other master agreements with financing companies that provide for leasing or financing transactions of certain equipment. The amounts outstanding under these agreements were $1.1 million and $1.5 million as of September 30, 2009 and December 31, 2008, respectively, and are secured by the related equipment.

The Company has other leasing and financing agreements and will continue to enter into those arrangements as needed to finance the purchasing or leasing of certain equipment or other assets. Borrowings under these agreements are generally secured by the related equipment.

7. *SEGMENT INFORMATION*

The Company is organized into three operating segments: PFSweb is an international provider of integrated eCommerce and business process outsourcing solutions and operates as a service fee business; Supplies Distributors is a master distributor primarily of IPS products; and eCOST is a multi-category online discount retailer of new, close-out and recertified brand-name merchandise.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Revenues (in thousands):				
PFSweb	$ 21,494	$ 32,645	$ 64,812	$ 92,637
Supplies Distributors	45,120	55,448	135,720	177,795
eCOST	20,593	23,709	61,802	74,701
Eliminations	(1,600)	(1,893)	(5,460)	(6,071)
	$ 85,607	$ 109,909	$ 256,874	$ 339,062

Table of Contents

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Income (loss) from operations (in thousands):				
PFSweb	$ (2,375)	$ 6	$ (5,760)	$ (289)
Supplies Distributors	2,162	1,427	4,559	5,136
eCOST	(239)	(748)	(1,187)	(2,399)
Eliminations				
	$ (452)	$ 685	$ (2,388)	$ 2,448
Depreciation and amortization (in thousands):				
PFSweb	$ 1,445	$ 1,426	$ 4,910	$ 4,074
Supplies Distributors	8	2	26	12
eCOST	87	248	255	733
Eliminations				
	$ 1,540	$ 1,676	$ 5,191	$ 4,819
Capital expenditures (in thousands):				
PFSweb	$ 1,563	$ 2,987	$ 3,408	$ 4,467
Supplies Distributors			2	77
eCOST	11	96	113	194
Eliminations				
	$ 1,574	$ 3,083	$ 3,523	$ 4,738

	September 30, 2009	December 31, 2008
Assets (in thousands):		
PFSweb	$ 62,405	$ 108,436
Supplies Distributors	69,245	82,280
eCOST	13,585	13,489
Eliminations	(20,574)	(59,684)
	$ 124,661	$ 144,521

8. *COMMITMENTS AND CONTINGENCIES*

The Company receives municipal tax abatements in certain locations. During 2004 the Company received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements. In December 2006, the Company received notice that the municipal authority planned to make an adjustment to the Company s tax abatement. The Company has disputed the adjustment, but if the dispute is not resolved favorably, additional taxes of approximately $1.7 million could be assessed against the Company.

The Company is subject to claims in the ordinary course of business, including claims of alleged infringement by the Company or its subsidiaries of the patents, trademarks and other intellectual property rights of third parties. If the party asserting such claims commences litigation, the Company could be required to defend itself or its customers. The Company is not aware of any such litigation.

Table of Contents

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 si 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, 2008, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

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

potential litigation;

potential delisting;

our dependency on key personnel;

the impact of new accounting standards, and changes in existing accounting rules or the interpretations of those rules;

our ability to raise additional capital or obtain additional financing;

our ability and the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants;

relationship with and our guarantees of certain of the liabilities and indebtedness of our subsidiaries;

taxation on the sale of our products;

eCOST s ability to maintain existing and build new relationships with manufacturers and vendors and the success of its advertising and marketing efforts;

eCOST s ability to increase its sales revenue and sales margin and improve operating efficiencies; and

eCOST s ability to generate projected cash flows sufficient to cover the values of its intangible assets.

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

Table of Contents

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.

Overview

We are an international provider of integrated eCommerce and business process outsourcing solutions to major brand name companies seeking to optimize their supply chain efficiencies and to extend their traditional business and e-commerce initiatives. Through our eCOST.com business unit, we are a leading multi-category online discount retailer of new, close-out and recertified brand-name merchandise. We derive our revenues from three business segments: as an eCommerce and business process outsourcer, a master distributor and an online discount retailer.

First, in our eCommerce and business process outsourcing segment we derive our revenues from a broad range of services, including professional consulting, technology collaboration, order management, managed web hosting and web development, the development of an eCommerce technology platform, customer relationship management, financial services including billing and collection services and working capital solutions, 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 warehouses that we lease or manage and include real-time inventory management and customized picking, packing and shipping of our clients customer orders. We currently offer the ability to provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, cosmetics, fragile goods, contemporary home furnishings, apparel, aviation, telecommunications and consumer electronics, among others.

In this eCommerce and business process outsourcing segment, we do not own the underlying inventory or the resulting accounts receivable, but provide management services for these client-owned assets. We typically charge our service fee revenue on a cost-plus basis, 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 service fee contracts involve third-party vendors who provide additional services such as package delivery. The costs we are charged by these third-party vendors for these services are often passed on to our clients. Our billings for reimbursements of these and other out-of-pocket expenses include travel, shipping and handling costs and telecommunication charges are included in pass-through revenue.

Our second business segment is a product revenue model. In this segment, we are a master distributor of product for IPS and certain other clients. In this capacity, we purchase, and thus own, inventory and recognize the corresponding product revenue. As a result, upon the sale of inventory, we own the accounts receivable. Freight costs billed to customers are reflected as components of product revenue. This business segment requires significant working capital requirements, for which we have senior credit facilities to provide for approximately $91 million of available financing.

Our third business segment is a web-commerce product revenue model focused on the sale of products to a broad range of consumer and small business customers. In this segment we operate as a multi-category online discount retailer of new, close-out and recertified brand-name merchandise. Our product line currently offers approximately 350,000 products in several primary merchandise categories, primarily including computers, networking, electronics and entertainment, TV s, plasmas and monitors, cameras and camcorders, memory and storage, For the Home and sports and leisure.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our eCommerce and business process outsourcing segment is driven by two main elements: new client relationships and organic growth from existing clients. We focus our sales efforts on

Table of Contents

larger contracts with brand-name companies within two primary target markets, online brands and retailers and technology manufacturers, which, by nature, require a longer duration to close but also have the potential to be higher-quality and longer duration engagements.

Growth within our product revenue business is primarily driven by our ability to attract new master distributor arrangements with IPS or other manufacturers and the sales and marketing efforts of the manufacturers and third party sales partners.

Growth within our web-commerce product revenue model is primarily driven by eCOST s ability to increase sales by generating organic growth, new customers and expand its product line.

We continue to monitor and control our costs to focus on profitability. While we are targeting our new service fee contracts to yield increased gross profit, we also expect to incur incremental investments to implement new contracts, investments in infrastructure and sales and marketing to support our targeted growth and increased public company professional fees.

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

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

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

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

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

Operating expenses consist primarily of selling, general and administrative (SG&A) expenses such as compensation and related expenses for sales and marketing staff, advertising, online marketing and catalog production, distribution costs (excluding freight) applicable to the Supplies Distributors and eCOST businesses, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses.

Table of Contents

Results of Operations
For the Interim Periods Ended September 30, 2009 and 2008

The following table sets forth certain historical financial information from our unaudited interim condensed consolidated statements of operations expressed as a percent of net revenues (in millions):

	Three Months Ended September 30,			% of Net Revenues		Nine Months Ended September 30,			% of Net Revenues	
	2009	2008	Change	2009	2008	2009	2008	Change	2009	2008
Revenues:										
Product revenue, net	$ 65.7	$ 79.1	$ (13.4)	76.8%	72.0%	$ 197.5	$ 252.5	$ (55.0)	76.9%	74.4%
Service fee revenue	13.1	22.9	(9.8)	15.3%	20.9%	42.6	65.0	(22.4)	16.6%	19.2%
Pass-through revenue	6.8	7.9	(1.1)	7.9%	7.1%	16.8	21.6	(4.8)	6.5%	6.4%
Total net revenues	85.6	109.9	(24.3)	100.0%	100.0%	256.9	339.1	(82.2)	100.0%	100.0%
Cost of Revenues										
Cost of product revenue (1)	59.6	73.1	(13.5)	90.7%	92.4%	180.7	233.5	(52.8)	91.5%	92.5%
Cost of service fee revenue (2)	9.7	15.6	(5.9)	73.7%	68.1%	30.4	44.5	(14.1)	71.4%	68.6%
Pass-through cost of revenue (3)	6.8	7.9	(1.1)	100.0%	100.0%	16.8	21.6	(4.8)	100.0%	100.0%
Total cost of revenues	76.1	96.6	(20.5)	88.8%	87.9%	227.9	299.6	(71.7)	88.7%	88.4%
Product revenue gross profit	6.1	6.0	0.1	9.3%	7.6%	16.8	19.0	(2.2)	8.5%	7.5%
Service fee gross profit	3.4	7.3	(3.9)	26.3%	31.9%	12.2	20.5	(8.3)	28.6%	31.4%
Pass-through gross profit				%	%				%	%
Total gross profit	9.5	13.3	(3.8)	11.2%	12.1%	29.0	39.5	(10.5)	11.3%	11.6%
Operating Expenses	10.0	12.7	(2.7)	11.7%	11.5%	31.4	37.0	(5.6)	12.2%	10.9%
Income from operations	(0.5)	0.6	(1.1)	(0.4)%	0.6%	(2.4)	2.5	(4.9)	(0.9)%	0.7%
	0.2	0.4	0.2	0.3%	0.4%	1.0	1.2	0.2	0.4%	0.3%

Interest expense, net										
Income before income taxes	(0.7)	0.2	(0.9)	(0.7)%	0.2%	(3.4)	1.3	(4.7)	(1.3)%	0.4%
Income tax expense, net	0.1	0.2	0.1	0.1%	0.2%	0.2	0.8	0.6	0.1%	0.2%
Net income (loss)	$ (0.8)	$ 0.0	$ (0.8)	(0.8)%	%	$ (3.6)	$ 0.5	$ (4.1)	(1.4)%	0.2%

(1) % of net revenues represents the percent of Product revenue, net.

(2) % of net revenues represents the percent of Service fee revenue.

(3) % of net revenues represents the percent of Pass-through revenue.

Product Revenue, net. eCOST product revenue was $20.6 million in the three months ended September 30, 2009, a 13.1% decrease as compared to $23.7 million in the comparable quarter of the prior year. The decrease is primarily due to a decline in sales in the business to consumer sales channel during the three month period compared to prior year primarily resulting from the impact of the global economic environment. eCOST product revenue was $61.8 million in the nine months ended September 30, 2009, a 17.3% decrease as compared to $74.7 million in the comparable quarter of the prior year. The decrease in the nine month period is primarily due to a decline in sales in the business to business channel resulting from the impact of the global economic environment as well as eCOST s reduced emphasis on this lower margin channel.

Supplies Distributors product revenue of $45.1 million decreased $10.3 million, or 18.6%, in the three months ended September 30, 2009 as compared to the same quarter of the prior year. Product revenue of $135.7 million decreased $42.1 million, or 23.7%, in the nine months ended September 30, 2009 as compared to the same period of the prior year. The decreases are primarily due to decreased sales volume resulting from the impact of the overall global economic pressures, inventory rationalization by customers, reduced IBM and IPS printer installations in certain categories as well as the negative impact of foreign exchange rates compared to the same three and nine month periods in the prior year. In addition, product revenue in the nine months ended September 30, 2009 was negatively impacted by a $1.4 million reduction of revenue resulting from a customer bankruptcy.

Table of Contents

Service Fee Revenue. Service fee revenue of $13.1 million decreased $9.8 million, or 42.7%, in the three months ended September 30, 2009 as compared to the same quarter of the prior year. Service fee revenue of $42.6 million decreased $22.4 million, or 34.4%, in the nine months ended September 30, 2009 as compared to the same period of the prior year. The decrease in service fee revenue for the three and nine months ended September 30, 2009 is primarily due to the non-renewal of a certain U.S. government agency client relationship partially offset by increased service fees generated from the impact of new service contract relationships. The change in service fee revenue is shown below ($ millions):

	Three Months	Nine Months
Period ended September 30, 2008	$ 22.9	$ 65.0
New service contract relationships, including certain incremental projects under new contracts	2.6	5.2
Change in existing client service fees	(0.1)	(25.8)
Terminated clients	(12.3)	(1.8)
Period ended September 30, 2009	$ 13.1	$ 42.6

The $22.7 million reduction of service fee revenue which resulted from the non-renewal of the U.S. government agency client is included in the existing client line item above for the nine month period as there was activity with this client in each of the nine month periods. For the three month period, the $10.3 million reduction of service fee revenue which resulted from the non-renewal is included in the terminated client line item.

Cost of Product Revenue. The gross margin for eCOST was $1.8 million or 9.0% of product revenue in the three months ended September 30, 2009 and $2.2 million or 9.2% of product revenue during the comparable period of 2008. The decline in gross margin is primarily due to the customer mix, which included a larger percentage of sales to the lower margin business-to-business segment during the three months ended September 30, 2009 compared to the same period last year.

The gross margin for eCOST was $5.9 million or 9.5% of product revenue in the nine months ended September 30, 2009 and $6.2 million or 8.5% of product revenue during the comparable period of 2008. The increase in gross margin percentage in the nine month period is primarily due to the customer mix, which included a larger percentage of sales to the higher margin business-to-consumer channel compared to the same period last year. We are targeting an increasing percentage of eCOST revenues to be generated from the business-to-consumer channel, yet we continue to strive to improve our product sales and gross margin in our business-to-business channel. We expect overall gross margin for eCOST in 2009 will continue to be higher than the prior year.

Supplies Distributors cost of product revenue decreased by $10.7 million, or 20.8%, to $40.9 million in the three months ended September 30, 2009 primarily as a result of decreased product sales. The resulting gross profit margin was $4.2 million, or 9.4% of product revenue, for the three months ended September 30, 2009 and $3.8 million, or 6.9% of product revenue, for the comparable 2008 period. The three month period ending September 30, 2009 includes the impact of certain incremental inventory cost related adjustments which are not expected to continue at the same rate in future periods.

Supplies Distributors cost of product revenue decreased by $40.3 million, or 23.7%, to $124.8 million in the nine months ended September 30, 2009 primarily as a result of decreased product sales. The resulting gross profit margin was $10.9 million, or 8.0% of product revenue, for the nine months ended September 30, 2009 and $12.7 million, or 7.1% of product revenue, for the comparable 2008 period. The 2008 and 2009 nine month periods include the impact of certain incremental inventory cost adjustments. The 2009 margin percentage reflects an increase due to incremental gross margin earned on product sales resulting from certain product price increases, which is partially offset by a reduction in revenue resulting from a customer bankruptcy during the first quarter of 2009.

Cost of Service Fee Revenue. Gross profit as a percentage of service fees was 26.3% in the three months ended September 30, 2009, compared to 31.9% in the same period of the prior year. Gross profit as a percentage of service fees was 28.6% in the nine months ended September 30, 2009, compared to 31.4% in the same period of the prior year. The margins in the prior year periods included the benefit of nine months of higher margin incremental project work associated with the U.S. government contract relationship that was not renewed and was completed in the second quarter of 2009.

Table of Contents

We target to earn an overall average gross profit of 25-30% on existing and new service fee contracts, but we have and may continue to accept lower gross margin percentages on certain contracts depending on contract scope and other factors.

Operating Expenses. Operating expenses for the three months ended September 30, 2009 decreased $2.7 million to $10.0 million from $12.7 million in the same 2008 period. As a percentage of total net revenue, operating expenses were 11.7% in the three months ended September 30, 2009 and 11.5% in the comparable period.

Operating expenses for the nine months ended September 30, 2009 decreased $5.6 million to $31.4 million from $37.0 million in the same 2008 period. As a percentage of total net revenue, operating expenses were 12.2% in the nine months ended September 30, 2009 and 10.9% in the comparable period. The increase in percentage of total net revenue is primarily due to the reduction in total net revenues which decreased at a higher rate than the reduction in operating expenses. During the three and nine months ended September 30, 2009, we implemented certain cost reductions, primarily including personnel related adjustments, as a result of the lower service fee revenue and product revenue.

Income Taxes. We recorded a tax provision associated primarily with state income taxes and our subsidiary Supplies Distributors Canadian and European operations. During the nine months ended September 30, 2009, we recognized a tax benefit relating to our adoption of a new transfer pricing policy between certain international subsidiaries. This policy adoption resulted from the completion of a transfer pricing study and its approval by appropriate tax regulators. A valuation allowance has been provided for the majority of our net deferred tax assets as of September 30, 2009 and December 31, 2008, which are primarily related to our net operating loss carryforwards, and certain foreign deferred tax assets. We expect that we will continue to record an income tax provision associated with state income taxes and Supplies Distributors Canadian and European results of operations.

Liquidity and Capital Resources

Net cash provided by operating activities was $8.5 million for the nine months ended September 30, 2009, and primarily resulted from a $10.3 million decrease in accounts receivable, a decrease in inventories of $10.7 million and cash income before working capital changes of $2.4 million partially offset by a $13.5 million decrease in accounts payable, accrued expenses and other liabilities and a $1.5 million increase in prepaid expenses, other receivables and other assets.

Net cash provided by operating activities was $11.3 million for the nine months ended September 30, 2008, and primarily resulted from cash income before working capital changes of $6.8 million, a $5.6 million of increase in accounts payable, accrued expenses and other liabilities and a $7.1 million decrease in accounts receivable. These benefits were offset by a $3.1 million increase in prepaid expenses, other receivables and other assets and a $5.3 million increase in inventories.

Net cash used in investing activities for the nine months ended September 30, 2009 and 2008 totaled $3.5 million and $4.6 million, respectively, resulting primarily from capital expenditures.

Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, development of customized technology solutions to support and integrate with our service fee clients, and general expansion and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures to support new contracts and anticipated future growth opportunities. Based on our current client business activity and our targeted growth plans, we anticipate our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months will be approximately $3 to $5 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. To maintain our current operating cash position, a portion of these expenditures may be financed through client reimbursements, debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event we do not obtain the financing or achieve the financial results necessary to support such investments.

Net cash used in financing activities was approximately $5.8 million for the nine months ended September 30, 2009, primarily representing payments on debt and capital lease obligations.

Net cash used in financing activities was approximately $6.2 million for the nine months ended September 30, 2008, primarily representing payments on debt and capital lease obligations, partially offset by an increase in restricted cash.

Our liquidity has been negatively impacted as a result of the merger with eCOST. Since the merger, eCOST has experienced a net use of cash primarily due to operating losses. As a result, PFSweb has had to support eCOST s cash needs with the goal of reducing operating losses. The amount of further cash needed to support eCOST operations will depend upon the financing available as well as eCOST s ability to improve its financial results. eCOST s results, excluding the impact of any non-cash impairment charges, have improved beginning in 2007, and we currently expect improvement as a result of efforts to increase sales, improve product mix and further improve operational efficiencies.

Our liquidity has also been negatively impacted by a decline in service fee revenue due to the current general economic decline as well as the nonrenewal of a U.S. government agency contract and certain other client contracts. To help minimize the impact of lower service fee revenue, we have implemented certain measures that reduced variable costs and expenses and redeployed existing infrastructure to other client activities. No assurance can be given that a further decline in service fee revenue, will not have a material adverse effect upon our business, financial condition or results of operations.

During the nine months ended September 30, 2009, our working capital decreased to $16.9 million from $21.4 million at December 31, 2008, partially due to the reclassification of our taxable revenue bonds to short-term debt due to the April 2010 maturing of the related letters of credit securing the taxable revenue bonds and the paydown of debt facilities. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including the sale of equity, utilizing capital or operating leases, borrowing under our credit facilities, expanding our current credit facilities, entering into new debt agreements or transferring to third parties a portion of our subordinated loan balance due from Supplies Distributors. In conjunction with certain of these alternatives, we may be required to provide certain letters of credit to secure these arrangements. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including cost reductions related to the nonrenewal of our U.S. government contract) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries Supplies Distributors and eCOST, if necessary, for at least the next twelve months.

Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States and foreign governments. While the ultimate outcome of these events cannot be predicted, they may have a material adverse effect on our liquidity, financial condition, results of operations and our ability to renew our credit facilities.

The following is a schedule of our total contractual cash obligations which is comprised of operating leases, debt, vendor financing and capital leases (including interest) as of September 30, 2009, (in millions):

		Payments Due By Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Debt and vendor financing	$ 48,883	$ 47,748	$ 958	$ 177	$
Capital lease obligations	2,464	1,573	888	3	
Operating leases	15,827	7,568	6,740	1,519	
Total	$ 67,174	$ 56,889	$ 8,586	$ 1,699	$

In support of certain debt instruments and leases, as of September 30, 2009, we had $2.0 million of cash restricted for repayment to lenders. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain of our subsidiaries credit facilities. Many of these facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other credit facilities and agreements. These covenants include minimum levels of net worth for the individual borrower subsidiaries and restrictions on the ability of the borrower subsidiaries to advance funds to other borrower subsidiaries. As a result, it is possible for one or more of these borrower subsidiaries to fail to meet their respective covenants even if another borrower subsidiary otherwise has available excess funds, which, if not restricted, could be used to cure the default. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. In particular, in the event eCOST is unable to increase its revenue and/or gross profit from its present levels, or if PFS service fee revenue declines from expected levels and it is unable to reduce costs to correspond to such reduced revenue levels or if Supplies Distributors revenue or gross profit declines from expected levels, such events may result in a breach of one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and payment under our parent guaranty. A 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 September 30, 2009, we were in compliance with all debt covenants. Further, any non-renewal of any of our credit facilities would have a material adverse impact on our business and financial condition. We do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

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

To finance their distribution of IPS products, Supplies Distributors and its subsidiaries have short-term credit facilities with IBM Credit LLC (IBM Credit) and IBM Belgium Financial Services S.A. (IBM Belgium). We have provided a collateralized guaranty to secure the repayment of these credit facilities. These asset-based credit facilities provided financing for up to $30.5 million and up to 16 million euros (approximately $23.4 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2010.

Supplies Distributors also has a loan and security agreement with Wachovia Bank, N.A. (Wachovia) to provide financing for up to $25 million of eligible accounts receivables in the United States and Canada. The Wachovia facility expires on the earlier of March 2011 or the date on which the parties to the IPS master distributor agreement no longer operate under the terms of such agreement and/or IPS no longer supplies products pursuant to such agreement.

Supplies Distributors European subsidiary has a factoring agreement with Fortis Commercial Finance N.V. (Fortis) to provide factoring for up to 7.5 million euros (approximately $11.0 million) of eligible accounts receivables through March 2010.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as cash flow from operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than $5.0 million, not maintain restricted cash of more than $5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes

to capital stock ownership structure and a minimum shareholders equity of at least $18.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of the obligations of Supplies Distributors and its subsidiaries to IBM and IPS, excluding the trade payables that are financed by IBM credit.

Our subsidiary, Priority Fulfillment Services, Inc. (PFS), has a Loan and Security Agreement (Agreement) with Comerica Bank (Comerica), which provides for up to $10 million of eligible accounts receivable financing through March 2010. We entered this Agreement to supplement our existing cash position, and provide funding for our current and future operations, including our targeted growth. The Agreement contains cross default provisions, various restrictions upon our ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of $20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The agreement also limits PFS ability to increase the subordinated loan to Supplies Distributors to more than $6.5 million and permits PFS to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of its subsidiaries and/or affiliates, including eCOST. The Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb.

eCOST currently has an asset-based line of credit facility of up to $7.5 million with Wachovia, which is collateralized by substantially all of eCOST s assets and expires in May 2011. Borrowings under the facility are limited to a percentage of eligible accounts receivable and letter of credit availability is limited to a percentage of accounts receivable and inventory. As of September 30, 2009, eCOST had $1 million of letters of credit outstanding and $1.3 million of available credit under this facility. The credit facility restricts eCOST s ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as a minimum tangible net worth of $0 million, as defined. PFSweb has guaranteed all current and future obligations of eCOST under this line of credit.

In 2004, PFS incurred more than $5 million in capital expenditures to support incremental business from a distribution facility in Southaven, MS. PFS financed a significant portion of these expenditures through a Loan Agreement with the Mississippi Business Finance Corporation (the MBFC) pursuant to which the MBFC issued $5 million MBFC Taxable Variable Rate Demand Limited Obligation Revenue Bonds, Series 2004 (Priority Fulfillment Services, Inc. Project) (the Bonds). The MBFC loaned PFS the proceeds of the Bonds for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in the Southaven, Mississippi distribution facility. The primary source of repayment of the Bonds is a letter of credit (the Letter of Credit) in the initial face amount of $5.1 million issued by Comerica pursuant to a Reimbursement Agreement between us and Comerica under which PFS is obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has a maturity date of April 2010 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof. The amount outstanding on this Loan Agreement as of September 30, 2009 was $2.4 million. PFS obligations under the Reimbursement Agreement are secured by substantially all of its assets, including restricted cash of $1.5 million and a Company parent guarantee.

eCOST has historically incurred significant operating losses and used cash to fund its operations. As a result, we have been required to invest cash to fund eCOST s operations, which we may not be able to continue to do without approval from our lenders. The amount of further cash needed to support eCOST operations depends upon the financing available under its credit line as well as eCOST s ability to improve its financial results. Through September 30, 2009, we have advanced $15.8 million to eCOST to fund eCOST s cash flow requirements and have lender approval to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of our subsidiaries and/or affiliates, including eCOST. In the event we need to invest further cash to eCOST, we may be required to seek approval from our lenders to provide such funds. We can provide no assurance that we will receive such approval from our

lenders or any terms or conditions required by our lenders in order to obtain such approval. In addition, PFSweb has provided a guaranty of eCOST s bank line of credit and certain eCOST vendor trade payables.

We receive municipal tax abatements in certain locations. During 2004 we received notice from a municipality that we did not satisfy certain criteria necessary to maintain the abatements. In December 2006, we received notice that the municipal authority planned to make an adjustment to our tax abatement. We have disputed the adjustment, but if the dispute is not resolved favorably, additional taxes of $1.7 million could be assessed against us.

Seasonality

The seasonality of our service fee business is dependent upon the seasonality of our clients business and sales of their products. Accordingly, our management must rely upon the projections of our clients in assessing quarterly variability. We believe with our current client mix and their current business volumes, our run rate service fee business activity will be at its lowest in the quarter ended March 31. We anticipate our Supplies Distributors product revenue will be highest during the quarter ended December 31. Our eCOST business is moderately seasonal, reflecting the general pattern of peak sales for the retail industry during the holiday shopping season. Typically, a larger portion of our eCOST revenues occur during the fourth fiscal quarter. We believe our historical revenue growth makes it difficult to predict the effect of seasonality on our future revenues and results of operations.

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

Inflation

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

Critical Accounting Policies

A description of our critical accounting policies, including goodwill and long-lived assets, is included in Note 2 of the consolidated financial statements in our December 31, 2008 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 financial instruments and foreign exchange rates.

Interest Rate Risk

Our interest rate risk exists from our outstanding balances on our inventory and working capital financing agreements, taxable revenue bonds, factoring agreement, and loan and security agreements for the financing of inventory, accounts receivable and certain other receivables and certain equipment, which amounted to $46.9 million at September 30, 2009. 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 September 30, 2009.

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 have and may continue, from time to time, to 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.

ITEM 4. Controls and Procedures

Disclosure 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. 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.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting (as defined in Rule 13(a)-15(f) or Rule 15-d-15(f) of the Exchange Act) during the three and nine months ended September 30, 2009 that have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

None.

ITEM 1A. Risk Factors

There have been no material changes with regard to the risk factors set forth in Part I, Item 1A of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008 filed with the Securities and Exchange Commissions on March 31, 2009 other than those as set forth below.

Risks Related to All Our Business Segments

Our business and future growth depend on our continued access to bank and commercial financing. The current economic crisis may negatively impact our business, results of operations, financial condition or liquidity.

Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States and foreign governments. The current economic crisis could also adversely impact our customers operations or ability to maintain liquidity which may negatively impact our business and results of operations.

Our business and future growth currently depend on our ability to access bank and commercial lines of credit. We currently depend on an aggregate of approximately $111 million in credit facilities provided by various banks and commercial lenders. These facilities currently mature at various dates through May 2011 and are secured by substantially all our assets. Our ability to renew our credit facilities depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current maturity on reasonable terms or at all. Our inability to renew or replace our credit facilities or find alternative financing would materially adversely affect our business, financial condition, operating results and cash flow.

Risks Related to Our PFS and Supplies Distributors Operating Segments

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

For the nine months ended September 30, 2009 and 2008, a U.S. government agency, Xerox Corporation and a consumer products company represented the source of approximately 9%, 16% and 11%, respectively, and approximately 40%, 10% and 6%, respectively, of our total service fee revenue, excluding pass-through revenue. The loss of, or non-payment of invoices by, any or all such clients would have a material adverse effect upon our business. In particular, the agreements under which we provide services to such clients are terminable at will upon notice by such clients. Our activity under our contract with the U.S. government agency concluded in the second quarter of 2009 and the nonrenewal of that contract, as well as the loss of, or non-payment of invoices by, any or all of such other clients are likely to have a material adverse effect upon our business.

A substantial portion of our Supplies Distributors product revenue is generated by sales of product purchased under master distributor agreements with IPS. These agreements are terminable at will and no assurance can be given that IPS will continue the master distributor agreements with Supplies Distributors. Supplies Distributors does not have its own sales force and relies upon IPS sales force and product demand generation activities. Discontinuance of such activities would have a material adverse effect on Supplies Distributors business and the Company s financial condition.

Sales by Supplies Distributors to two customers accounted for approximately 31% and 29% of Supplies Distributors total product revenue for the nine months ended September 30, 2009 and 2008, respectively (20% and 15% of our consolidated net revenues in each nine month period, respectively). The loss of any one or both of such customers, or non-payment of any material amount by these or any other customer, are likely to have a material adverse effect upon Supplies Distributors business.

Table of Contents

We subcontract a portion of our client services to third parties, and we are subject to various risks and liabilities if such subcontractors do not provide the subcontracted services or provide them in a manner which does not meet required service levels.

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

Risks Related to eCOST, our Online Discount Retailer Segment

Our business is subject to the risk of supplier concentration.

Our business is dependent on sales of Hewlett Packard (HP) and HP-related products, which represented approximately 45% of eCOST s net revenues (11% of our consolidated net revenues) in the nine months ended September 30, 2009 and 48% of eCOST s net revenues (11% of our consolidated net revenues) in the comparable period of 2008. If our ability to purchase direct from HP is terminated or restricted, or if the demand for HP and HP-related products declines, our business will be materially adversely affected.

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

Table of Contents

ITEM 6. Exhibits

a) Exhibits:

Exhibit No.	Description of Exhibits
3.1(1)	Amended and Restated Certificate of Incorporation
3.1.1	Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
3.2(1)	Amended and Restated Bylaws
31.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657) and Annual Report on Form 10-K for the Fiscal Year ended December 31, 2005 filed on March 31, 2006.

* Filed Herewith

Table of Contents

SIGNATURE

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: November 16, 2009

PFSweb, Inc.

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

31