

PFSWEB INC  
Form 10-Q  
November 14, 2013

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2013

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-28275

PFSweb, Inc.

(Exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

75-2837058  
(I.R.S. Employer)

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I.D. No.)

505 Millennium Drive, Allen, Texas 75013  
(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 ☒ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller Reporting Company ☒

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

At November 11, 2013 there were 16,307,901 shares of registrant's common stock outstanding.

PFSweb, Inc. and Subsidiaries

Form 10-Q

September 30, 2013

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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## PFSweb, Inc. and Subsidiaries

## UNAUDITED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

|                                                                                                                                          | September 30,<br>2013 | December 31,<br>2012 |
|------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>ASSETS</b>                                                                                                                            |                       |                      |
| <b>CURRENT ASSETS:</b>                                                                                                                   |                       |                      |
| Cash and cash equivalents                                                                                                                | \$ 21,293             | \$ 19,626            |
| Restricted cash                                                                                                                          | 466                   | 283                  |
| Accounts receivable, net of allowance for doubtful accounts of \$367 and \$450 at September 30, 2013 and December 31, 2012, respectively | 37,715                | 45,684               |
| Inventories, net of reserves of \$1,688 and \$1,789 at September 30, 2013 and December 31, 2012, respectively                            | 17,326                | 24,654               |
| Other receivables                                                                                                                        | 7,645                 | 7,675                |
| Prepaid expenses and other current assets                                                                                                | 4,590                 | 4,346                |
| Total current assets                                                                                                                     | 89,035                | 102,268              |
| PROPERTY AND EQUIPMENT, net                                                                                                              | 26,667                | 27,917               |
| OTHER ASSETS                                                                                                                             | 2,880                 | 3,286                |
| Total assets                                                                                                                             | \$ 118,582            | \$ 133,471           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                              |                       |                      |
| <b>CURRENT LIABILITIES:</b>                                                                                                              |                       |                      |
| Current portion of long-term debt and capital lease obligations                                                                          | \$ 8,820              | \$ 16,660            |
| Trade accounts payable                                                                                                                   | 26,153                | 40,493               |
| Deferred revenue                                                                                                                         | 9,166                 | 6,648                |
| Accrued expenses                                                                                                                         | 21,299                | 23,097               |
| Total current liabilities                                                                                                                | 65,438                | 86,898               |
| LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion                                                                       | 3,473                 | 5,400                |
| DEFERRED REVENUE                                                                                                                         | 6,177                 | 7,562                |
| DEFERRED RENT                                                                                                                            | 5,142                 | 5,560                |
| Total liabilities                                                                                                                        | 80,230                | 105,420              |

## COMMITMENTS AND CONTINGENCIES

## SHAREHOLDERS' EQUITY:

Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued or outstanding

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Common stock, \$0.001 par value; 35,000,000 shares authorized; 16,199,431 and 12,812,386 shares issued at September 30, 2013 and December 31, 2012, respectively; and 16,165,964 and 12,778,919 outstanding at September 30, 2013 and December 31, 2012, respectively

|                                            |            |            |
|--------------------------------------------|------------|------------|
| Additional paid-in capital                 | 121,663    | 106,018    |
| Accumulated deficit                        | (84,891)   | (79,409)   |
| Accumulated other comprehensive income     | 1,689      | 1,554      |
| Treasury stock at cost, 33,467 shares      | (125)      | (125)      |
| Total shareholders' equity                 | 38,352     | 28,051     |
| Total liabilities and shareholders' equity | \$ 118,582 | \$ 133,471 |

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

## PFSWEB, INC. AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

|                                                                                                                                                                                                                                                                                          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                                                                                                                                                                                                                                                                          | 2013                                | 2012      | 2013                               | 2012       |
| REVENUES:                                                                                                                                                                                                                                                                                |                                     |           |                                    |            |
| Product revenue, net                                                                                                                                                                                                                                                                     | \$ 21,495                           | \$ 27,476 | \$ 69,660                          | \$ 91,450  |
| Service fee revenue                                                                                                                                                                                                                                                                      | 23,908                              | 28,260    | 78,708                             | 85,022     |
| Pass-through revenue                                                                                                                                                                                                                                                                     | 8,150                               | 9,018     | 26,511                             | 28,121     |
| Total revenues                                                                                                                                                                                                                                                                           | 53,553                              | 64,754    | 174,879                            | 204,593    |
| COSTS OF REVENUES:                                                                                                                                                                                                                                                                       |                                     |           |                                    |            |
| Cost of product revenue                                                                                                                                                                                                                                                                  | 20,221                              | 25,538    | 65,215                             | 84,483     |
| Cost of service fee revenue                                                                                                                                                                                                                                                              | 16,196                              | 20,777    | 53,265                             | 63,130     |
| Cost of pass-through revenue                                                                                                                                                                                                                                                             | 8,150                               | 9,018     | 26,511                             | 28,121     |
| Total costs of revenues                                                                                                                                                                                                                                                                  | 44,567                              | 55,333    | 144,991                            | 175,734    |
| Gross profit                                                                                                                                                                                                                                                                             | 8,986                               | 9,421     | 29,888                             | 28,859     |
| SELLING, GENERAL AND ADMINISTRATIVE<br>EXPENSES, including stock based compensation expense of<br>\$610 and \$308 in the three months ended September 30, 2013<br>and 2012, respectively, and \$1,195 and \$1,014 in the nine<br>months ended September 30, 2013 and 2012, respectively. | 10,656                              | 9,401     | 34,395                             | 29,807     |
| Income (loss) from operations                                                                                                                                                                                                                                                            | (1,670)                             | 20        | (4,507)                            | (948)      |
| INTEREST EXPENSE, net                                                                                                                                                                                                                                                                    | 162                                 | 236       | 564                                | 758        |
| Loss from operations before income taxes                                                                                                                                                                                                                                                 | (1,832)                             | (216)     | (5,071)                            | (1,706)    |
| INCOME TAX EXPENSE                                                                                                                                                                                                                                                                       | 120                                 | 154       | 411                                | 457        |
| NET LOSS                                                                                                                                                                                                                                                                                 | \$ (1,952)                          | \$ (370)  | \$ (5,482)                         | \$ (2,163) |
| NET LOSS PER SHARE:                                                                                                                                                                                                                                                                      |                                     |           |                                    |            |
| Basic                                                                                                                                                                                                                                                                                    | \$ (0.12)                           | \$ (0.03) | \$ (0.38)                          | \$ (0.17)  |
| Diluted                                                                                                                                                                                                                                                                                  | \$ (0.12)                           | \$ (0.03) | \$ (0.38)                          | \$ (0.17)  |
| WEIGHTED AVERAGE NUMBER OF SHARES<br>OUTSTANDING:                                                                                                                                                                                                                                        |                                     |           |                                    |            |
| Basic                                                                                                                                                                                                                                                                                    | 16,121                              | 12,783    | 14,490                             | 12,777     |
| Diluted                                                                                                                                                                                                                                                                                  | 16,121                              | 12,783    | 14,490                             | 12,777     |
| COMPREHENSIVE INCOME (LOSS):                                                                                                                                                                                                                                                             |                                     |           |                                    |            |
| Net loss                                                                                                                                                                                                                                                                                 | \$ (1,952)                          | \$ (370)  | \$ (5,482)                         | \$ (2,163) |
| Foreign currency translation adjustment                                                                                                                                                                                                                                                  | 275                                 | 235       | 135                                | 14         |
| TOTAL COMPREHENSIVE INCOME (LOSS)                                                                                                                                                                                                                                                        | \$ (1,677)                          | \$ (135)  | \$ (5,347)                         | \$ (2,149) |

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

## PFSweb, Inc. and Subsidiaries

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

|                                                                                 | Nine Months Ended<br>September 30, |                  |
|---------------------------------------------------------------------------------|------------------------------------|------------------|
|                                                                                 | 2013                               | 2012             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                    |                                    |                  |
| Net loss                                                                        | \$ (5,482)                         | \$ (2,163)       |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                    |                  |
| Depreciation and amortization                                                   | 7,533                              | 6,834            |
| Provision for doubtful accounts                                                 | 18                                 | (131)            |
| Provision for excess and obsolete inventory                                     | 56                                 | 249              |
| Deferred income taxes                                                           | 47                                 | (6)              |
| Stock-based compensation expense                                                | 1,195                              | 1,014            |
| Changes in operating assets and liabilities:                                    |                                    |                  |
| Restricted cash                                                                 | 2                                  | (30)             |
| Accounts receivable                                                             | 8,087                              | 14,806           |
| Inventories                                                                     | 7,307                              | 4,821            |
| Prepaid expenses, other receivables and other assets                            | 152                                | 3,693            |
| Deferred rent                                                                   | (344)                              | 5,420            |
| Accounts payable, deferred revenue, accrued expenses and other liabilities      | (15,203)                           | (14,803)         |
| Net cash provided by operating activities                                       | 3,368                              | 19,704           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                    |                                    |                  |
| Purchases of property and equipment                                             | (5,245)                            | (11,048)         |
| Net cash used in investing activities                                           | (5,245)                            | (11,048)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                                    |                  |
| Net proceeds from issuance of common stock                                      | 14,453                             | 48               |
| Purchase of treasury stock                                                      |                                    | (36)             |
| Decrease (increase) in restricted cash                                          | (185)                              | 386              |
| Payments on capital lease obligations                                           | (1,991)                            | (1,508)          |
| Payments on long-term debt, net                                                 | (8,768)                            | (7,427)          |
| Net cash provided by (used in) financing activities                             | 3,509                              | (8,537)          |
| <b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>                    | <b>35</b>                          | <b>(21)</b>      |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                | <b>1,667</b>                       | <b>98</b>        |
| <b>CASH AND CASH EQUIVALENTS, beginning of period</b>                           | <b>19,626</b>                      | <b>17,695</b>    |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>                                 | <b>\$ 21,293</b>                   | <b>\$ 17,793</b> |

SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash investing and financing activities:

|                                                                         |    |       |    |       |
|-------------------------------------------------------------------------|----|-------|----|-------|
| Property and equipment acquired under long-term debt and capital leases | \$ | 1,338 | \$ | 6,229 |
|-------------------------------------------------------------------------|----|-------|----|-------|

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

Notes to Unaudited Consolidated Financial Statements

## 1. OVERVIEW AND BASIS OF PRESENTATION

PFSweb, Inc. and its subsidiaries are collectively referred to as the Company; Supplies Distributors refers to Supplies Distributors, Inc. and its subsidiaries; Retail Connect refers to PFSweb Retail Connect, Inc.; and PFSweb refers to PFSweb, Inc. and its subsidiaries and affiliates, excluding Supplies Distributors and Retail Connect.

### PFSweb Overview

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

### Supplies Distributors Overview

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

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

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

### Basis of Presentation

The unaudited interim consolidated financial statements as of September 30, 2013, and for the three and nine months ended September 30, 2013 and 2012, 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 ( U.S. GAAP ) 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 consolidated financial statements of

the Company include all adjustments necessary for a fair presentation of the Company's financial position as of September 30, 2013, its results of operations for the three and nine months ended September 30, 2013 and 2012 and its cash flows for the nine months ended September 30, 2013 and 2012. Results of the Company's operations for interim periods may not be indicative of results for the full fiscal year.

Certain prior period data on the income statement has been reclassified to conform to the current year presentation of a) product and pass-through revenues, b) cost of product, service fee and pass-through revenues and c) selling, general and administrative expenses, each of which was previously classified as a different component on the income statement. These reclassifications decreased gross profit and selling, general and administrative expenses by \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2012, respectively, but had no effect on previously reported net loss, total shareholders' equity or net cash provided by operating activities.

Notes to Unaudited Consolidated Financial Statements

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

All intercompany balances and transactions have been eliminated in consolidation.

### Use of Estimates

The preparation of consolidated financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The recognition and allocation of certain revenues and selling, general and administrative expenses in these consolidated financial statements also require management estimates and assumptions.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and 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 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, 2012 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 the Company's consolidated financial statements are fairly stated in accordance with U.S. GAAP, 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, Inc., has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the "Subordinated Note"). Under the terms of certain of the Company's debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than \$5.0 million or decreased to less than \$3.5 million without prior approval of certain of the Company's lenders. As of both September 30, 2013 and December 31, 2012, the outstanding balance of the Subordinated Note was \$3.5 million. The Subordinated Note is eliminated in the Company's consolidated financial statements.

PFS has also made advances to Retail Connect, which aggregated \$11.1 million at both September 30, 2013 and December 31, 2012. Certain terms of the Company's debt facilities provide that the total advances to Retail Connect may not be less than \$2.0 million without prior approval of Retail Connect's lender, if needed. PFS has received the approval of its lender to advance incremental amounts to certain of its subsidiaries and/or affiliates, including Retail Connect, if needed, subject to certain financial covenants, as defined. PFSweb, Inc. has also advanced to Retail Connect an additional \$8.5 million and \$8.2 million as of September 30, 2013 and December 31, 2012, respectively.

All of these advances are eliminated upon consolidation. As of September 30, 2013, PFSweb, Inc. has approximately \$12.6 million available to be advanced to Retail Connect and/or other affiliates.

Concentration of Business and Credit Risk

No service fee client or product revenue customer represented more than 10% of the Company's consolidated total net revenues during the nine months ended September 30, 2013 or the Company's consolidated accounts receivable as of September 30, 2013.

## Notes to Unaudited Consolidated Financial Statements

A summary of the nonaffiliated customer and client concentrations is as follows:

|                                                                     | Nine Months Ended<br>September 30, |      |
|---------------------------------------------------------------------|------------------------------------|------|
|                                                                     | 2013                               | 2012 |
| Product Revenue (as a percentage of total Product Revenue):         |                                    |      |
| Customer 1                                                          | 15 %                               | 14 % |
| Customer 2                                                          | 12 %                               | 11 % |
| Service Fee Revenue (as a percentage of total Service Fee Revenue): |                                    |      |
| Client 1                                                            | 10 %                               | 14 % |
| Client 2                                                            | 8 %                                | 16 % |

The Company currently anticipates that its product revenue and service fee revenue from the customers and clients identified above will decline during the next twelve months and the contractual relationship with Client 1 ended during the quarter ended September 30, 2013.

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

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

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

#### Inventories

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

Supplies Distributors assumes responsibility for slow-moving inventory under its Ricoh distributor agreements, subject to certain termination rights, but has the right to return product rendered obsolete by engineering changes, as

defined. In the event PFS, Supplies Distributors and Ricoh terminate the distributor agreements, the agreements provide for the parties to mutually agree on a plan of disposition of Supplies Distributors' then existing inventory.

#### Operating Leases

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

#### Property and Equipment

The Company's property held under capital leases amounts to approximately \$4.2 million and \$5.1 million, net of accumulated amortization of approximately \$4.5 million and \$2.6 million, at September 30, 2013 and December 31, 2012, respectively. Depreciation and amortization expense related to capital leases during the nine months ended September 30, 2013 and 2012 was \$2.0 million and \$1.5 million, respectively. In addition, during 2012, the Company incurred approximately \$6.0 million of

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

leasehold improvements at certain of its leased facilities that are being amortized over the shorter of the asset's useful lives or the lease terms and were primarily financed via tenant allowances that are also being amortized over the lease terms.

Income Taxes

The Company records a tax provision primarily associated with state income taxes and its Supplies Distributors subsidiary's international operations. The Company has recorded a valuation allowance for the majority of its net deferred tax assets.

Cash Paid for Interest and Taxes

The Company made payments for interest of approximately \$0.6 million and \$0.8 million in the nine months ended September 30, 2013 and 2012, respectively. Income taxes of approximately \$0.1 and \$0.4 million were paid by the Company during the nine month periods ended September 30, 2013 and 2012, respectively.

3. NET LOSS PER COMMON SHARE

Basic and diluted net loss per share are computed by dividing net loss by the weighted-average number of common shares outstanding for the reporting period. Stock options not included in the calculation of diluted net loss per share for the nine months ended September 30, 2013, and 2012 were 2.2 million and 2.1 million, respectively, as the effect would be anti-dilutive.

4. STOCK AND STOCK OPTIONS

In May 2013, the Company completed an equity offering pursuant to which the Company sold an aggregate of 3.2 million shares of common stock, par value \$0.001 per share, at \$4.57 per share, resulting in net proceeds, after deducting offering expenses, of approximately \$14.1 million.

On May 22, 2013, pursuant to the Company's 2005 Employee Stock and Incentive Plan, as amended and restated (the "Plan"), the Company issued Performance-Based Share Awards ("Performance Shares", as defined in the Plan) to certain of the Company's executives. The number of Performance Shares that each such individual may receive is subject to, and calculated by reference to, the achievement by the Company of certain 2013 financial targets. Based on the financial targets, the aggregate maximum number of Performance Shares that may be issued for 2013 is 0.7 million. The Performance Shares are subject to four year vesting based upon continued employment and the comparative performance (on an annual and cumulative basis) of the Company's common stock on NASDAQ compared to the Russell Micro Cap Index. Stock compensation charged against income related to the Performance Shares was \$0.3 million in the nine months ended September 30, 2013.

During the nine months ended September 30, 2013 and 2012, the Company issued an aggregate of 306,000 and 73,000 options, respectively, to purchase shares of common stock to officers, directors, employees and consultants of the Company.

## 5. VENDOR FINANCING

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of Ricoh products in the United States, providing financing for eligible Ricoh inventory and certain receivables up to \$20.0 million. The agreement has no stated maturity date and provides either party the ability to exit the facility following a 90-day notice. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility, which were \$12.1 million and \$11.9 million as of September 30, 2013 and December 31, 2012, respectively, as accounts payable in the consolidated balance sheets. As of September 30, 2013, Supplies Distributors had \$1.4 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among 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. The credit facility also contains 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 is secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of \$3.5 million and the Company is required to maintain a minimum shareholders' equity of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of September 30, 2013). The facility also includes a monthly service fee.

PFSweb, Inc. and Subsidiaries

## Notes to Unaudited Consolidated Financial Statements

## 6. DEBT AND CAPITAL LEASE OBLIGATIONS;

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

|                                                   | September 30,<br>2013 | December 31,<br>2012 |
|---------------------------------------------------|-----------------------|----------------------|
| Loan and security agreements                      |                       |                      |
| Supplies Distributors                             | \$ 4,691              | \$ 3,264             |
| PFS                                               | 1,749                 | 11,077               |
| Credit facility Retail Connect                    |                       |                      |
| Master lease agreements                           | 5,404                 | 6,648                |
| Other                                             | 449                   | 1,071                |
| Total                                             | 12,293                | 22,060               |
| Less current portion of long-term debt            | 8,820                 | 16,660               |
| Long-term debt, less current portion              | \$ 3,473              | \$ 5,400             |
| Loan and Security Agreement Supplies Distributors |                       |                      |

Supplies Distributors has a loan and security agreement with Wells Fargo Bank, National Association ( Wells Fargo ) to provide financing for up to \$25 million of eligible accounts receivable in the United States and Canada. As of September 30, 2013, Supplies Distributors had \$0.8 million of available credit under this agreement. The Wells Fargo facility expires on the earlier of March 2014 or the date on which the parties to the Ricoh distributor agreement no longer operate under the terms of such agreement and/or Ricoh no longer supplies products pursuant to such agreement. Borrowings under the Wells Fargo facility accrue interest at prime rate plus 0.25% to 0.75% (3.75% as of September 30, 2013) or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability and subject to a minimum of 3.0%, as defined. The interest rate as of September 30, 2013 was 3.75% for \$3.7 million of outstanding borrowings and 3.0% for \$1.0 million of outstanding borrowings. As of December 31, 2012, the interest rate was 3.75% for \$1.3 million of outstanding borrowings and 3.0% for \$2.0 million of outstanding borrowings. This agreement contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends. This agreement also contains 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 \$3.5 million, may not maintain restricted cash of more than \$5.0 million and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wells Fargo pursuant to which a security interest was granted to Wells Fargo for all U.S. and Canadian customer remittances received in specified bank

accounts. At September 30, 2013 and December 31, 2012, these bank accounts held \$0.4 million and \$0.2 million, respectively, which were restricted for payment to Wells Fargo.

#### 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 \$12.5 million (\$10.0 million during certain non-seasonal peak months) of eligible accounts receivable financing ( Working Capital Advances ) through March 2014. The Comerica Agreement also provided for up to \$3.0 million of eligible equipment advances ( Equipment Advances ) through January 2013, with principal payments due through April 2015. As of September 30, 2013, PFS had \$9.9 million of available credit under the Working Capital Advance portion of this facility and no remaining availability for Equipment Advances.

Borrowings under the Working Capital Advance portion of the Comerica Agreement accrue interest at prime rate plus 2% (5.25% at September 30, 2013) while the Equipment Advances accrue interest at prime rate plus 2.25% (5.5% at September 30, 2013). The Comerica Agreement contains cross default provisions and various restrictions upon PFS ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the Subordinated Note receivable from Supplies Distributors to a maximum of \$5.0 million. Comerica has provided approval for PFS to

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

advance incremental amounts subject to certain financial covenants, as defined, to certain of its subsidiaries and/or affiliates, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

Credit Facility    Retail Connect

Retail Connect has an asset-based line of credit facility of up to \$2.0 million from Wells Fargo, through May 2014, which is collateralized by substantially all of Retail Connect's assets. Borrowings under the facility are limited to a percentage of eligible accounts receivable and inventory, up to a specified amount. Outstanding borrowings under the facility bear interest at prime rate plus 1% or Eurodollar rate plus 3.5%. There were no outstanding borrowings as of September 30, 2013. As of September 30, 2013, Retail Connect had \$33,000 of available credit under this facility. In connection with the line of credit, Retail Connect entered into a cash management arrangement whereby Retail Connect's operating accounts are considered restricted and swept and used to repay outstanding amounts under the line of credit, if any. The credit facility restricts Retail Connect's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb, Inc.), make investments and loans, pledge assets, make changes to capital stock ownership structure, and requires a minimum tangible net worth for Retail Connect of \$0 million, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

Factoring Agreement

Supplies Distributors    European subsidiary has a factoring agreement with BNP Paribas Fortis Factor that provides factoring for up to 7.5 million euros (approximately \$10.1 million as of September 30, 2013) of eligible accounts receivable through March 2014. This factoring agreement is accounted for as a secured borrowing. As of September 30, 2013, Supplies Distributors    European subsidiary had approximately 0.9 million euros (approximately \$1.2 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.7% (0.8% at September 30, 2013).

Debt Covenants

To the extent the Company or any of its subsidiaries fail to comply with its covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements, such as profitability and cash flow, and required level of shareholders' equity or net worth (as defined), the Company would be required to obtain a waiver from the lender or the lender would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under the Company parent guarantee. Any acceleration of the repayment of the credit facilities may have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations. As of September 30, 2013, the Company was in compliance with all debt covenants.

Master Lease Agreements

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

## PFSweb, Inc. and Subsidiaries

## Notes to Unaudited Consolidated Financial Statements

## 7. SEGMENT INFORMATION

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

|                                               | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|-----------------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                               | 2013                                | 2012      | 2013                               | 2012       |
| Revenues (in thousands):                      |                                     |           |                                    |            |
| PFSweb                                        | \$ 32,471                           | \$ 38,312 | \$ 106,846                         | \$ 116,763 |
| Business and Retail Connect                   | 23,592                              | 27,619    | 75,610                             | 91,901     |
| Eliminations                                  | (2,510)                             | (1,177)   | (7,577)                            | (4,071)    |
|                                               | \$ 53,553                           | \$ 64,754 | \$ 174,879                         | \$ 204,593 |
| Income (loss) from operations (in thousands): |                                     |           |                                    |            |
| PFSweb                                        | \$ (1,823)                          | \$ (568)  | \$ (5,153)                         | \$ (2,896) |
| Business and Retail Connect                   | 153                                 | 588       | 646                                | 1,948      |
|                                               | \$ (1,670)                          | \$ 20     | \$ (4,507)                         | \$ (948)   |
| Depreciation and amortization (in thousands): |                                     |           |                                    |            |
| PFSweb                                        | \$ 2,399                            | \$ 2,476  | \$ 7,417                           | \$ 6,768   |
| Business and Retail Connect                   | 38                                  | 26        | 116                                | 66         |
|                                               | \$ 2,437                            | \$ 2,502  | \$ 7,533                           | \$ 6,834   |
| Capital expenditures (in thousands):          |                                     |           |                                    |            |
| PFSweb                                        | \$ 2,028                            | \$ 1,575  | \$ 5,174                           | \$ 10,857  |
| Business and Retail Connect                   | 55                                  | 102       | 71                                 | 191        |
|                                               | \$ 2,083                            | \$ 1,677  | \$ 5,245                           | \$ 11,048  |

|                             | September 30,<br>2013 | December 31,<br>2012 |
|-----------------------------|-----------------------|----------------------|
| Assets (in thousands):      |                       |                      |
| PFSweb                      | \$ 88,074             | \$ 94,940            |
| Business and Retail Connect | 45,225                | 52,648               |
| Eliminations                | (14,717)              | (14,117)             |
|                             | \$ 118,582            | \$ 133,471           |

## 8. COMMITMENTS AND CONTINGENCIES

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

The Company received municipal tax abatements in certain locations. In prior years, the Company received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to the Company's tax abatement. The Company disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against the Company and the timing of the related payments has not been finalized. As of September 30, 2013, the Company believes it has adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST (the former name of Retail Connect) was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. The Company received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and the Company

PFSweb, Inc. and Subsidiaries

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responded to the subpoenas and is fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and the Company is seeking the recovery of the funds that are currently classified as other receivables on the September 30, 2013 financial statements. Based on the information available to date, the Company is unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or the inability of the Company to recover such funds or any significant portion thereof, or any costs and expenses incurred by the Company in connection with this matter will not have a material adverse effect upon the Company's financial condition or results of operations.

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

## ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

### Forward-Looking Information

We have made forward-looking statements in this Report on Form 10-Q. These statements are subject to risks and uncertainties, and there can be no guarantee that these statements will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like seek, strive, believe, expect, anticipate, predict, potential, continue, will, may, could, intend, plan, target and estimate or similar words, we are making forward-looking statements. You should understand that the following important factors, in addition to those set forth above or elsewhere in this Report on Form 10-Q and our Form 10-K for the year ended December 31, 2012, 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 Ricoh Company Limited and Ricoh Production Print Solutions, a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as Ricoh );
- 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 client and customer 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;
- our reliance on third-party subcontracted services;
- the unknown effects of possible system failures and rapid changes in technology;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;
- our dependency upon 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;
- our relationship with, and our guarantees of, certain of the liabilities and indebtedness of our subsidiaries; and
- taxation on the sale of our products and provision of our services.

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 these expectations actually will be achieved. In addition, some forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Therefore, actual outcomes and results may differ materially from what is expected or forecasted in such forward-looking statements. We undertake no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available or other events occur in the future.

## Overview

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

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

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

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

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

Finally, our Retail model allows us to purchase inventory from the client just as any other client reseller partner. In this model, we place the initial and replenishment purchase orders with the client and take ownership of the product

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

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

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

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

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

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

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

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

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

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

Monitoring and controlling our available cash balances and our expenses continues to be a primary focus. Our cash and liquidity positions are important components of our financing of both current operations and our targeted growth. To improve our cash and liquidity position, in May 2013, we sold an aggregate of 3.2 million shares of our Common Stock at \$4.57 per share, resulting in net proceeds of \$14.1 million.

## Results of Operations For the Interim Periods Ended September 30, 2013 and 2012

The following table discloses certain financial information for the periods presented, expressed in terms of dollars, dollar change, percentage change and as a percentage of total revenue (in millions):

|                                            | Three Months Ended September 30, |         |          |                   |        | Nine Months Ended September 30, |         |           |                   |        |
|--------------------------------------------|----------------------------------|---------|----------|-------------------|--------|---------------------------------|---------|-----------|-------------------|--------|
|                                            |                                  |         | Change   | % of Net Revenues |        |                                 |         | Change    | % of Net Revenues |        |
|                                            | 2013                             | 2012    |          | 2013              | 2012   | 2013                            | 2012    |           | 2013              | 2012   |
| Revenues                                   |                                  |         |          |                   |        |                                 |         |           |                   |        |
| Product revenue, net                       | \$ 21.5                          | \$ 27.5 | \$ (6.0) | 40.1%             | 42.5%  | \$ 69.7                         | \$ 91.5 | \$ (21.8) | 39.8%             | 44.7%  |
| Service fee revenue                        | 23.9                             | 28.3    | (4.4)    | 44.7%             | 43.6%  | 78.7                            | 85.0    | (6.3)     | 45.0%             | 41.6%  |
| Pass-through revenue                       | 8.2                              | 9.0     | (0.8)    | 15.2%             | 13.9%  | 26.5                            | 28.1    | (1.6)     | 15.2%             | 13.7%  |
| Total net revenues                         | 53.6                             | 64.8    | (11.2)   | 100.0%            | 100.0% | 174.9                           | 204.6   | (29.7)    | 100.0%            | 100.0% |
| Cost of Revenues                           |                                  |         |          |                   |        |                                 |         |           |                   |        |
| Cost of product revenue (1)                | 20.2                             | 25.6    | (5.4)    | 95.4%             | 92.9%  | 65.2                            | 84.5    | (19.3)    | 93.6%             | 92.4%  |
| Cost of service fee revenue (2)            | 16.2                             | 20.8    | (4.6)    | 66.9%             | 73.5%  | 53.3                            | 63.1    | (9.8)     | 67.7%             | 74.3%  |
| Pass-through cost of revenue (3)           | 8.2                              | 9.0     | (0.8)    | 100.0%            | 100.0% | 26.5                            | 28.1    | (1.6)     | 100.0%            | 100.0% |
| Total cost of revenues                     | 44.6                             | 55.4    | (10.8)   | 83.2%             | 85.5%  | 145.0                           | 175.7   | (30.7)    | 82.9%             | 85.9%  |
| Product revenue gross profit               | 1.3                              | 1.9     | (0.6)    | 5.9%              | 7.1%   | 4.5                             | 7.0     | (2.5)     | 6.4%              | 7.6%   |
| Service fee gross profit                   | 7.7                              | 7.5     | 0.2      | 32.2%             | 26.5%  | 25.4                            | 21.9    | 3.5       | 32.3%             | 25.7%  |
| Pass-through gross profit                  |                                  |         |          | %                 | %      |                                 |         |           | %                 | %      |
| Total gross profit                         | 9.0                              | 9.4     | (0.4)    | 16.8%             | 14.5%  | 29.9                            | 28.9    | 1.0       | 17.1%             | 14.1%  |
| Selling General and Administrative expense | 10.7                             | 9.4     | 1.3      | 19.9%             | 14.5%  | 34.4                            | 29.8    | 4.6       | 19.7%             | 14.6%  |
| Loss from operations                       | (1.7)                            |         | (1.7)    | (3.1)%            | %      | (4.5)                           | (0.9)   | (3.6)     | (2.6)%            | (0.5)% |
|                                            | 0.1                              | 0.2     | (0.1)    | 0.3%              | 0.4%   | 0.6                             | 0.8     | (0.2)     | 0.3%              | 0.4%   |

|                          |          |          |          |        |        |          |          |          |        |        |
|--------------------------|----------|----------|----------|--------|--------|----------|----------|----------|--------|--------|
| Interest expense, net    |          |          |          |        |        |          |          |          |        |        |
| Loss before income taxes | (1.8)    | (0.2)    | (1.6)    | (3.4)% | (0.4)% | (5.1)    | (1.7)    | (3.4)    | (2.9)% | (0.9)% |
| Income tax expense, net  | 0.2      | 0.2      |          | 0.2%   | 0.2%   | 0.4      | 0.5      | (0.1)    | 0.2%   | 0.2%   |
| Net loss                 | \$ (2.0) | \$ (0.4) | \$ (1.6) | (3.6)% | (0.6)% | \$ (5.5) | \$ (2.2) | \$ (3.3) | (3.1)% | (1.1)% |

(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. Product revenue was \$21.5 million for the three months ended September 30, 2013, which represents a decrease of \$6.0 million or 21.8% as compared to the same quarter of the prior year. In the nine months ended September 30, 2013, product revenue was \$69.7 million, which represented a decrease of \$21.8 million or 23.8% compared to the same period of the prior year. This reduction in revenue is primarily due to the operational restructuring by Ricoh of its business, which has resulted, and will continue to result, in changes in the sale and distribution of Ricoh products and lower product revenue. We currently expect product revenue to be approximately \$90 million to \$95 million in 2013.

Service Fee Revenue. The decrease in service fee revenue for the three and nine months ended September 30, 2013 as compared to the same periods of the prior year was primarily due to decreased service fees from both existing and terminated client relationships, partially offset by the impact of new client relationships that began in 2012 and early 2013.

The change in service fee revenue, excluding pass-through revenue, is shown below (\$ millions):

|                                                 | Three<br>Months | Nine<br>Months |
|-------------------------------------------------|-----------------|----------------|
| Period ended September 30, 2012                 | \$ 28.3         | \$ 85.0        |
| New service contract relationships              | 3.4             | 7.9            |
| Change in existing client service fees          | (3.9)           | (13.7)         |
| Terminated clients not included in 2013 revenue | (3.9)           | (0.5)          |
| Period ended September 30, 2013                 | \$ 23.9         | \$ 78.7        |

Our service fee revenue has been negatively impacted, and will continue to be negatively impacted through the first half of 2014, by the conclusion or anticipated reduction of operations of certain client programs. Based on current client projections for 2013, we currently expect the reduction in revenue derived from these client programs to be offset in part, but not in whole, by new service fee revenue generated by new or expanded client opportunities.

Cost of Product Revenue. The cost of product revenue decreased by \$5.4 million, or 20.8%, to \$20.2 million in the three months ended September 30, 2013. The resulting gross profit margin was \$1.3 million, or 5.9% of product revenue, for the three months ended September 30, 2013 and \$1.9 million, or 7.1% of product revenue, for the comparable 2012 period. The decrease in gross profit percentage for the three months ended September 30, 2013 was primarily due to the operational restructuring of Ricoh, resulting in a higher percentage of our product revenue generated from lower gross margin product categories and other inventory adjustments. The cost of product revenue decreased by \$19.3 million, or 22.8%, to \$65.2 million in the nine months ended September 30, 2013. The resulting gross profit margin was \$4.5 million, or 6.4% of product revenue, for the nine months ended September 30, 2013 and \$7.0 million, or 7.6% of product revenue, for the comparable 2012 period. The gross profit has been negatively impacted by reduced product revenue primarily attributable to the Ricoh restructuring activities, which we expect to continue in 2013 and beyond, and the gross profit margin declined due to a higher percentage of our product revenue generated from lower gross margin product categories and other inventory adjustments. The gross profit margin for 2013 and 2012 includes the impact of incremental gross margin earned on product sales resulting from certain product price increases and the impact of certain incremental inventory cost reductions.

Cost of Service Fee Revenue. Gross profit as a percentage of service fees improved to 32.2% in three month period ended September 30, 2013 from 26.5% in the same period of 2012. In the nine month period ended September 30, 2013, gross profit, as a percentage of service fees improved to 32.3% as compared to 25.7% in the comparable 2012 period. The gross profit percentage increase resulted from a change in the client mix, improved operating efficiencies and an increased level of higher margin client project activity. Additionally, the three and nine months ended September 30, 2013 included an incremental benefit of \$0.2 million and \$1.2 million, respectively, applicable to certain client transition related agreements.

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

**Selling, General and Administrative Expenses.** Selling, General and Administrative expenses for the three months ended September 30, 2013 and 2012 were \$10.7 million and \$9.4 million, respectively. As a percentage of total net revenue, selling, general and administrative expenses were 19.9% in the three months ended September 30, 2013 and 14.5% in the prior year period. In the nine months ended September 30, 2013, selling, general and administrative expenses were \$34.4 million, or 19.7% of total net revenue, as compared to \$29.8 million, or 14.6% of total net revenue in the comparable period of 2012. The increase in costs in the three months ended September 30, 2013 is primarily related to an increase in personnel related costs, non-cash stock based compensation expense and certain facility related expenses. The increase in costs in the nine months ended September 30, 2013 is primarily related to an increase in depreciation and amortization expense, certain facility related expenses and certain restructuring related charges of approximately \$2.5 million in 2013. The nine month period ended September 30, 2012 included \$0.5 million of lease termination costs and \$0.9 million of relocation related costs relating to our 2012 facility relocations and expansions. Excluding the restructuring related charges, lease termination costs and relocation related costs in both 2013 and 2012, as a percent of total net revenue, selling, general and administrative expenses were 19.9% and 18.7% in the three and nine months ended September 30, 2013, respectively, and 14.5% and 13.9% in the comparable three and nine months of the prior year period, respectively. These increased percentages for the three and nine month periods in 2013 are primarily due to a significant reduction in product revenue between years which did not result in a corresponding level of selling, general and administrative expense decreases and due to increased costs to support our service fee business, including depreciation and amortization expense, as well as facility related costs.

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

#### Liquidity and Capital Resources

During the nine months ended September 30, 2013, we generated \$3.4 million of cash from operating activities primarily due to an \$8.1 million decrease in accounts receivable mostly applicable to our services business following the 2012 holiday seasonal peak period and a \$7.3 million reduction in inventories related to reduced product revenue. Included in our cash flows from operating activities is also \$3.4 million of cash income from operations before working capital changes. These cash inflows were partially offset by a \$15.2 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities related to reduced inventory purchases as a result of a reduction in product revenue, reduced service fee business payables and accrual levels and a reduction related to timing of various vendor and client reimbursable payments.

During the nine months ended September 30, 2012, we generated \$19.7 million of cash from operating activities primarily due to a \$14.8 million decrease in accounts receivable mostly applicable to our services business following the 2011 holiday seasonal peak period, a \$5.4 million increase in deferred rent related to tenant allowance improvements at certain new facilities, a \$3.7 million decrease in prepaid expenses, other receivables and other assets primarily related to a timing of receipts and a reduction of value-added tax receivable at our European subsidiary and a \$4.8 million reduction in inventories related to reduced product revenue. Included in our cash flows from operating activities is also \$5.8 million of cash income from operations before working capital changes. These inflows were partially offset by a \$14.8 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities following the timing of payments we make for products and services, payment processing and related transactions costs.

In the nine months ended September 30, 2013, we incurred capital expenditures of \$5.2 million, exclusive of \$1.3 million of property and equipment acquired under debt and capital lease financing, which consisted primarily of payments for internally developed software and capital leases on equipment. Net proceeds of \$14.5 million from the issuance of common stock, including an equity offering in May, were partially offset by net payments on debt and capital leases and an increase in restricted cash of \$10.9 million in the nine months ended September 30, 2013.

In the nine months ended September 30, 2012, we incurred capital expenditures of \$11.0 million, exclusive of \$6.2 million of property and equipment acquired under debt and capital lease financing. This included capital expenditures related to our new corporate headquarters and call center facility, which were primarily financed by the facility landlords through tenant allowances. Cash used for payments on debt and capital leases, net of any proceeds from debt and a decrease in restricted cash, was \$8.5 million in the nine months ended September 30, 2012.

Capital expenditures have historically consisted of additions to upgrade our management information systems, development of customized technology solutions to support and integrate with our service fee clients and general expansion and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures to support new contracts and anticipated future growth opportunities. Based on our current client business activity and our targeted growth plans, we anticipate our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months, including costs to implement new clients, will be approximately \$9 million to \$11 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. To maintain our current operating cash position, a portion of these expenditures may be

financed through client reimbursements, debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event we do not obtain the financing or achieve the financial results necessary to support such investments.

During the nine months ended September 30, 2013, our working capital increased to \$23.6 million from \$15.4 million at December 31, 2012 primarily due to net proceeds of \$14.1 million from an equity offering in May 2013 partially offset by the paydown of debt facilities, capital expenditures and the impact of certain restructuring related accruals. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including the sale of equity, utilizing capital or operating leases, borrowing under our credit facilities, expanding our current credit facilities or entering into new debt agreements. No assurances can be given we will be successful in obtaining any additional financing or the terms thereof. We currently believe our cash position, financing available under our credit facilities and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries, if necessary, for at least the next twelve months.

In support of certain debt instruments and leases, as of September 30, 2013, we had \$0.5 million of cash restricted for repayment to lenders. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain of our

subsidiaries' credit facilities. Many of these facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other credit facilities and agreements. These covenants include, among others, minimum levels of net worth, profitability and cash flow (as defined) and restrictions on the ability of the borrower subsidiaries to advance funds to other borrower subsidiaries. As a result, it is possible for one or more of these borrower subsidiaries to fail to meet their respective covenants even if another borrower subsidiary otherwise has available excess funds, which, if not restricted, could be used to cure the default. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders equity, and we are not able to obtain a waiver, the lenders would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under our parent guarantee. A requirement to accelerate the repayment of the credit facility obligations may have a material adverse impact on our financial condition and results of operations. We can provide no assurance we will have the financial ability to repay all such obligations. As of September 30, 2013, we were in compliance with all debt covenants. Further, non-renewal of any of our credit facilities may have a material adverse impact on our business and financial condition. We do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

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

We receive municipal tax abatements in certain locations. In prior years, we received notice from a municipality that we did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to our tax abatement. We disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against us and the timing of the related payments has not been finalized. As of September 30, 2013, we believe we have adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST (the former name of Retail Connect) was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. We received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and have responded to such subpoenas and are fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and we are seeking the recovery of such funds, that are currently classified as other receivables in the September 30, 2013 financial statements. Based on the information available to date, we are unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or our inability to recover such funds or any significant portion thereof, or any costs and expenses we may incur in connection with such matter will not have a material adverse effect upon our financial condition or results of operations.

#### Supplies Distributors Financing

To finance its distribution of Ricoh products in the U.S., Supplies Distributors has a short-term credit facility with IBM Credit LLC ( IBM Credit ) that provides financing for up to \$20.0 million. We have provided a collateralized guarantee to secure the repayment of this credit facility. The IBM Credit facility does not have a stated maturity and

both parties have the ability to exit the facility following a 90-day notice. The Company has direct vendor credit terms with Ricoh to finance Supplies Distributors European subsidiary's inventory purchases.

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

Supplies Distributors European subsidiary has a factoring agreement with BNP Paribas Fortis Factor (BNP Paribas) to provide factoring for up to 7.5 million Euros (approximately \$10.1 million at September 30, 2013) of eligible accounts receivables through March 2014.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as cash flow from

operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than \$3.5 million, not maintain restricted cash of more than \$5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders' equity of at least \$18.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of substantially all of the obligations of Supplies Distributors and its subsidiaries to IBM and Ricoh.

#### PFS Financing

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

#### Retail Connect Financing

Retail Connect has an asset-based line of credit facility for up to \$2.0 million of eligible financing with Wells Fargo, which is collateralized by substantially all of Retail Connect's assets and expires in May 2014. Borrowings under the facility and letter of credit availability are limited to a percentage of accounts receivable and inventory, up to specified amounts. As of September 30, 2013, Retail Connect had \$33,000 of available credit under this facility. The credit facility restricts Retail Connect's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as a minimum tangible net worth for Retail Connect of \$0 million, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

#### Equity Offering

In May 2013, we sold 3.2 million shares of our common stock in a private transaction at \$4.57 per share, resulting in net proceeds of approximately \$14.1 million after deducting expenses.

#### Seasonality

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

We believe 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 is included in Note 2 of the consolidated financial statements in our December 31, 2012 Annual Report on Form 10-K.

## ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Not applicable.

## ITEM 4. Controls and Procedures

### Disclosure Controls and Procedures

We maintain a comprehensive set of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ( Exchange Act ). As of September 30, 2013, an evaluation of the effectiveness of our disclosure controls and procedures was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, these disclosure controls and procedures were effective.

### Changes in Internal Control over Financial Reporting

During the period that ended on September 30, 2013, there was no change in internal control over financial reporting (as defined in Rule 13a-15(f) or Rule 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

None

### ITEM 1A. Risk Factors

In addition 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, 2012 filed with the Securities and Exchange Commission on April 1, 2013, our business, financial condition and operating results could be adversely affected by any or all of the following factors.

#### General Risks Related to Our Business

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

As of September 30, 2013, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of Ricoh product inventory, was approximately \$24 million. We cannot provide assurance that our credit facilities will be renewed by the lending parties. Additionally, these credit facilities include both financial and non-financial covenants, many of which also include cross default provisions applicable to other agreements. These covenants also restrict our ability to transfer funds among our various subsidiaries, which may adversely affect the ability of our subsidiaries to operate their businesses or comply with their respective loan covenants. We cannot provide assurance that we will be able to maintain compliance with these covenants. Any non-renewal, default under or acceleration of any of our credit facilities may have a material adverse impact upon our business and financial condition. In addition we have provided \$3.5 million of subordinated indebtedness to Supplies Distributors as of September 30, 2013. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from our lenders is \$5.0 million. The restrictions on increasing this amount without lender approval may limit our ability to comply with certain loan covenants or grow and support Supplies Distributors' business. We have guaranteed most of the indebtedness of Supplies Distributors. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so. We have also guaranteed Retail Connect's \$2.0 million credit line, as well as certain of its vendor trade payables.

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

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

For the nine months ended September 30, 2013, two clients represented approximately 18% of service fee revenue (excluding pass-through revenue) and approximately 10% of consolidated revenue. We currently anticipate that both of these clients and other clients will reduce the level of services or terminate their relationship with us so that, unless we are able to increase our service fee revenue from other existing or new clients or adjust our operating costs, such reduction or termination of services would have a material adverse effect upon our business, results of operation and financial condition.

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

Sales by Supplies Distributors to two customers in the aggregate accounted for approximately 27% of Supplies Distributors' total product revenue and 11% of consolidated net revenues in the nine month period ended September 30, 2013. The loss of one or both of such customers, or non-payment of any material amount by these or any other customer would have a material adverse effect upon Supplies Distributors' business results of operations and financial condition.

### Risks Related to Our Stock

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

As of September 30, 2013, we have an aggregate of 2.2 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$4.81 per share. The shares of common stock that may be issued upon exercise of these options may be resold into the public market. Sales of substantial amounts of common stock in the public market as a result of the exercise of these options, or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

### ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

### ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. Mine Safety Disclosure

Not applicable

ITEM 5. Other Information

None

ITEM 6. Exhibits

a) Exhibits:

| Exhibit No. | Description of Exhibits                                                                                                                                                        |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1(1)      | Amended and Restated Certificate of Incorporation of PFSweb, Inc.                                                                                                              |
| 3.1.1(2)    | Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.                                                                                  |
| 3.1.2(4)    | Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.                                                                                                       |
| 3.1.3(5)    | Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.                                                                                  |
| 3.1.4(8)    | Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.                                                                                  |
| 3.2(1)      | Amended and Restated By-Laws                                                                                                                                                   |
| 3.2.1(3)    | Amendment to the Amended and Restated By-Laws of PFSweb, Inc.                                                                                                                  |
| 3.2.2(6)    | Amendment to the Amended and Restated By-Laws of PFSweb, Inc.                                                                                                                  |
| 3.2.3(8)    | Amendment to the Amended and Restated By-Laws of PFSweb, Inc.                                                                                                                  |
| 10.1**      | First Amendment to Industrial Lease Agreement dated May 7, 2013, by and between US Industrial Reit II and Priority Fulfillment Services, Inc.                                  |
| 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 |
| 101.INS*    | XBRL Instance Document.                                                                                                                                                        |
| 101.SCH*    | XBRL Taxonomy Extension Schema.                                                                                                                                                |
| 101.CAL*    | XBRL Taxonomy Extension Calculation Linkbase.                                                                                                                                  |
| 101.DEF*    | XBRL Taxonomy Extension Definition Linkbase.                                                                                                                                   |
| 101.LAB*    | XBRL Taxonomy Extension Label Linkbase.                                                                                                                                        |

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase.

- (1) Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657).
- (2) Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year ended December, 31, 2005 filed on March 31, 2006.
- (3) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 13, 2007.
- (4) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 2, 2008.
- (5) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2009.
- (6) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 2, 2010.
- (7) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 29, 2013.
- (8) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 18, 2013.

\*Filed Herewith

\*\*Furnished Herewith

SIGNATURES

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

Date: November 14, 2013

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